

**Nippon Steel Group Medium- to long-Term Management Plan IR Briefing
(Held on March 5, 2021)
Summary of Q&A**

Note: Based on information as of the date of the Briefing.

Presenters

Eiji Hashimoto, Representative Director and President

Katsuhiro Miyamoto, Representative Director and Executive Vice President

Akio Migita, Representative Director and Executive Vice President

● **Rebuilding our domestic steel business**

Q: What are your estimates regarding domestic demand and export volume for the domestic steel business environment in FY2025?

A Domestic steel demand is expected to decrease by approximately 10% in 2025 from the pre-COVID-19 pandemic level of around 60 million tons. This is a scenario where we feel “the decline will be at least this much.” Moreover, it does not mean that demand will stop declining after FY2025.

With regard to exports, we will not increase the export ratio because domestic demand has decreased as we did in the past. From the viewpoint of maintaining a certain facility size, we will increase the ratio of high-grade steel in exports but expect a lower overall export ratio in the future.

Q Is this going to be your last shutdown of facilities?

A No further shutdowns are expected at this stage. Unless there is significant downside from the expected business environment up to 2025, we believe that we will be able to generate a profit and restore our competitiveness. If there is a quantitative and margin movement that greatly changes this assumption, this would be a different story.

Q I understand that you are trying to shift to high-grade steel in order to lower the break-even point, but I think you may need some base competitiveness in commodity-grade steel. Will you be able to compete with foreign steel manufacturers after implementing the measures announced today?

A Although we need to produce a certain amount of commodity-grade steel to secure volume scale, our focus in general is to raise the ratio of high-grade products in Japan.

In the domestic steel business, we intend to lower the break-even point by realizing a higher-level order mix and raising long-term contract prices, and by curbing total fixed costs through fixed cost reduction

against the increase in depreciation expenses. In FY2019, we posted a significant operating loss on a non-consolidated basis with steel shipments of around 38.7 million tons. In comparison, in the second half (2H) of FY2020, we are expecting to be profitable even with steel shipments of around 33.6 million tons, although this is partly due to some emergency measures. I could say that we have lowered the break-even point to somewhere closer to the 30 million-ton mark. We plan to further reduce this break-even point.

Q Is there a possibility of impairment losses in the future?

A We believe there is no risk of impairment losses on our domestic steel mills. This is because we expect to generate a non-consolidated operating profit in 2H FY2020 and plan to further improve the product mix and implement structural reforms and cost reduction.

On the other hand, when the facilities are shut down in the future, a loss on retirement of facility book value will occur. The amount will not be large as we have already reduced the book value of some of these assets. Furthermore, the cost of dismantling will be reserved and booked to the extent possible. The actual dismantling and removal will be carried out after the facilities are shut down, based on the dismantling plan.

Q Will you elaborate on the next-generation hot strip mill to be newly built in the Nagoya Works?

A The need for vehicle weight reduction will increase because the weight of the battery is heavier for electric vehicles. Unlike gasoline vehicles, automakers do not have their own means of reducing weight and improving fuel consumption, so expectations for weight reduction by materials are set to increase. In response to these expectations, we intend to manufacture ultra-high-tensile steel sheets that are 30% lighter than the current sheet and 50% lighter in the future. Even when this product technology is established, leading-edge facilities are indispensable to ensure stable mass production with high productivity. I cannot give you details on the next-generation hot strip mill to be installed at the Nagoya Works, but simply put, it will be designed to meet the needs of customers by improving the control of rolling, especially finishing rolling.

● **Promoting a global strategy to deepen and expand overseas business**

Q How are you committed to the global production scale of 100 million tons? Does this mean that you need to expand the scale on top of improving the order mix, in order to compete in the global market?

A The shift to high-grade steel only refers to domestic production. Meanwhile, the world's demand for steel is not mainly for high-grade steel. In fact, steel products for automobiles represents less than 0.1 billion tons of the world's 1.8 billion tons of steel demand. The target area for our overseas operations is a growing emerging market, and the growing demand is mainly for commodity-grade steel, so local production will cover the local demand in order for us to secure the quantity. In other words, there is no contradiction

between shifting to high-value-added products in domestic production and growing globally. Rather, when we are expanding overseas production, it would be more strategically contradictory to make commodity products in Japan and export them as we have done so far.

If you look at the global landscape, the world's largest steelmaker used to be ArcelorMittal at 100 million tons but China Baowu Steel Group is expected to have a 200 million-ton capacity in the near future. Against this backdrop, we believe that 100 million tons are the minimum production level required for a global major player and we intend to be strongly committed to this so that we can lead the world in the next 10 to 20 years.

Q Does the expansion of overseas capacity mainly cover regions such as China, ASEAN, and India? Are developed countries low in your priority list?

A India, where demand is definitely growing, comes at the top of the list for new capacity expansion. AM/NS India currently lacks capacity and we would like to raise its capacity to 14 million tons. In addition, we will consider establishing their second steel mill to be built most likely on the East Coast, according to the increase in demand. In China and ASEAN countries, however, we are not thinking of building a new integrated steel mill, and we would rather participate in existing projects or promote M&A.

In the United States, we assume that overall steel demand will not decrease but remain flat, and we will not aim to significantly increase production volume there. However, we have decided to build a new electric furnace for the upstream process at AM/NS Calvert and to produce high-grade steel for automobiles. Our direct objective is to strengthen the competitiveness of AM/NS Calvert but another objective for Nippon Steel is to establish technology to produce high-grade steel in electric furnaces. The accumulation of technology for making high-grade steel in electric furnaces will create another option for our overseas development, as the electric furnace business can be developed in a country where the steel market is not large enough to run a blast furnace business, and this option will be welcomed from the viewpoint of zero carbon steel.

Q As other steelmakers are also looking to expand overseas, what advantage can Nippon Steel promote as a buyer when pursuing overseas M&A opportunities?

A An M&A target company looks for a potential business partner who can help realize a greater outcome than doing business on its own. If the company can be profitable by itself, it would not need to bring in a partner. If it is a non-profitable business, it does not make sense for us to step in in the first place.

As an example, it is meaningless for ASEAN steelmakers to partner with Chinese steelmakers because they are competitors and produce similar types of products. In this regard, we are very strong in high-

grade steel, and have a range of steel products to meet various new needs while the world is heading toward carbon neutrality. If a potential partner is a blast furnace steelmaker, it can rely on us for the development of technology for zero carbon steel. From this point of view, I think we will be chosen unless the conditions we offer are unreasonable for the company concerned.

● **Nippon Steel Carbon Neutral Vision 2050**

Q With regard to carbon neutral initiatives, please explain your advantages compared to your peers, as well as challenges.

A In the zero carbon area, we are ahead of China in the development of a blast furnace hydrogen reduction technology in the COURSE50 project. We have conducted R&D and have achieved good prospects, at least on a lab basis. We are therefore an overwhelming leader up to the current phase. However, this means that we just had a good kick-off and we must make further progress and complete huge R&D themes in order to keep our lead up to the goal. The only concern here is that China Baowu Steel Group is a state-owned company and is financially supported by the government in its development funding from the start in promoting carbon neutrality. If we receive the understanding of the Japanese government and similar, comparative R&D support from it, we believe we can win the development competition all the way.

Q Carbon Neutral is a long-term vision and involves the development of challenging new technologies, so it may tend to become all words and no action. Will you tell us how we should think about the steps and milestones of a steady reduction in CO₂ emissions to the extent you can foresee specifically.

A In the near future of 2030, we believe that a 30% reduction can be achieved by improving production efficiency and by applying R&D outcomes to actual machines.

In order to achieve carbon neutrality by 2050, we must make good progress in developing hydrogen reduction technology, which is unprecedented and unproven. All steelmakers in the world are still at the starting stage in R&D aimed at carbon neutrality. At this point we cannot say what and by when in regard to specific milestones. One thing I can say for sure is that the game ends when you fall behind other countries in R&D.

Q: It appears that there is a significant political risk regarding Carbon Neutral initiatives. What do you think of external environment risks such as carbon pricing or hydrogen not becoming cheap?

A I am concerned that the introduction of the wrong policy will not only pose a risk to Nippon Steel or Japanese blast furnace steelmakers, but may also cause the Japanese economy to collapse. For example, there is now an unrealistic argument that carbon should be priced at ¥10,000 per carbon ton, but in this case, we would have to pay about ¥1 trillion a year in tax. This means our management resources for R&D

aimed at zero carbon steel would be wiped out. The wrong policy is a risk for Japanese steelmakers and should not be chosen for the interests of Japan. In Europe, carbon taxes were introduced some time ago but the steel industry has been almost exempt. "Industrial competitiveness" is indispensable for the country in its efforts to become carbon neutral. I have discussed this with various people concerned and I feel my argument is well understood when explained properly.

- **Financial plan**

Q Please give us a breakdown of capital expenditures and business investment.

A We plan to increase capital expenditures by a further ¥10 billion per annum from the projected annual average of ¥470 billion in FY2018-2020. While maintenance and renewal investments will be limited to necessary equipment based on the production facility structural measures, we will also properly invest funds in innovative strategic investments, including the installation of a next-generation hot strip mill in the Nagoya Works and the measure for electrical steel sheet capacity. Roughly speaking, 30% of the capital expenditures of ¥2.4 trillion will be used for earnings improvement, 60% to strengthen business infrastructure, and 10% for other items. In addition, expected zero-carbon-related investments up to 2025 are also included.

Business investment of ¥600 billion is mainly for overseas expansion. In order to achieve a 100 million-ton crude steel capacity, we need to increase overseas capacity by 40 million tons or more. We plan to expand in India in two steps. As the first step, we are considering building a 14 million-ton structure, which is included in the ¥600 billion business investment. In addition, if an opportunity emerges to expand on the East Coast of India or for M&A in Asia, China, etc., the remaining portion of the ¥600 billion fund will be used.

Q Besides the ROS target of 10% for FY2025, what are your targets for consolidated business profit and non-consolidated operating profit for the same year?

A Sales will fluctuate significantly depending on the prices of iron ore and coking coal, but we plan to firmly secure the margin and achieve ROS of 10%. As for non-consolidated operating profit, we expect to return to profitability in 2H FY2020. We will further reduce the break-even point and raise profit to a more than sufficient level to secure consolidated ROS of 10%.

Q Do you expect a linear profit improvement toward meeting your FY2025 financial targets or a significant improvement in the latter half of the medium-term plan period?

A As we expect the current favorable business environment to continue until FY2021, we intend to make a linear improvement, rather than a significantly-tilted improvement in the latter half.

Q What is your cost reduction plan?

A Fixed costs will increase in the areas where they were urgently compressed, such as temporary leave, employment adjustment subsidies, and performance-based bonus payments, which stemmed from reductions in production and profits, but will be substantively reduced through structural measures.

Variable costs will improve mainly due to the effects of capital expenditures. The absence of demerits from the production cut has also been incorporated. Overall, the cost improvement effect we are looking at is slightly conservative compared to the ¥50 billion annual effect we generated in the past.

Q: What is the pricing strategy during the new management plan?

A I cannot comment specifically on how we will raise prices or in which field. Also, discussion over three or five years from now will not lead to the conclusion of price negotiations.

Since I became president in April 2019, I have held more than 110 conversations with 13 Heads of Marketing and have thoroughly identified the pricing policy as our biggest issue. First, we defined "strength in sales and marketing" as "receiving a fair price for a long-term contract from a customer." The two key points are "to reflect in sales prices the contributions we have made to our customers' business operations through steel products or various solution proposals" and "to share cost hike fairly in the supply chain." Since we are at the upstream of the supply chain, we are the first to be affected by any increase in costs of main raw materials, such as iron ore and coking coal, and alloys. However, not only cost increase of main raw materials, but also that of alloys which meet the quality needs of steel products that our customers demand should be fairly shared.. We are determined to realize a fair price policy for each contract, based on the keywords "contribution" and "fair share" with customers. Although it is not yet enough, we have achieved certain progress, and we will continue to ask customers for further understanding and agreement in the future.

Q Do you have any plan to lower the denominator, such as a reduction in equity, to improve ROE?

A You may have in mind a plan for the purchase of treasury stock. We will make a comprehensive management decision, taking into account the need for a flexible capital policy and the need to improve capital efficiency, as well as the stock price level and the impact on financial soundness.

Q What is your view of the medium- to long-term outlook for non-steel segments?

A The Engineering and Construction segment aims to expand its stable earnings base, such as in the environment energy-related O&M business. It also intends to expand the EPC business in areas with potential investment in renewable energy, and infrastructure development and renewal, among others.

The Chemicals & Materials segment will be affected by a decrease in raw materials due to the shutdown of our upstream facilities. However, we plan to adopt structural measures and absorb the negative impacts, and intend to grow business by applying the segment's related technologies, such as in the 5G and automotive areas.

Regarding the System Solutions segment, NS Solutions plans to further grow its DX business, not only by making a significant contribution to Nippon Steel's DX, but also by taking into account the potential progress of Japan's digitalized manufacturing industry.

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