

**Nippon Steel Corporation, FY2020 IR Briefing
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Summary of Q&A¹**

Presented by:

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◆ **Management environment**

Q The steel market is rapidly changing worldwide. There have been major changes such as China's call for production cuts and the reduction in the export VAT refund rate. Please share your views on the changes in the steel market.

A China, which marks the 100th anniversary of the Communist Party this year, is expected to grow at a certain level, and I think steel demand there is unlikely to fall back. According to estimates by the World Steel Association, world steel demand will increase by 5.8% in 2021. On the other hand, in China, which accounts for 60% of world steel production, the government has ordered a reduction in crude steel production, and if demand remains high and the supply is reduced, we need to see whether other regions can respond to robust demand in the world including China. Having said that, it is difficult for the world's steelmakers to go ahead and increase production in response to the robust demand. This is because there is the huge challenge of zero-carbon steel ahead of us, and no steelmaker in the world has any prospects for technology and process development. Without knowing the future production facility structure, it is impossible to make a large investment in production growth. Overall, I think that the supply/demand balance will remain tight for some time.

By the way, China's central government has significantly changed its steel industry policy in the last few months from a carbon neutral standpoint. Specifically, the government has substantially shifted to a strategy to domestically produce leading-edge products that contribute to carbon neutrality, and import commodities by moving their upstream processes overseas. I believe this has also led to the abolition of the export VAT refund to most of steel products.

Q How do you view the raw material market and the product market in your FY2021 forecasts?

A The price of fine iron ore is soaring above \$200 and extra prices of lump iron ore and pellets, which are of high quality and easy to process in blast furnaces, have surged to unprecedented levels. These prices are at higher levels than we assumed in our guidance. With regard to coking coal, Australian coal happens to be cheap in the midst of trade friction between Australia and China, but we have factored in the projection

¹ Based on information as of the date of the briefing.

that arbitrage pricing in relation to Canadian, American, and other coal will proceed. Taking into account the increase in other raw material prices, we don't know whether the cost of raw materials will stay within our assumed levels.

Looking at the product side, the price of hot coils is currently exceeding the price level that we assumed at the time of making our guidance.

◆ **Measures to be taken**

Q You said that the breakeven point would be improved through better long-term contract prices and a more sophisticated order mix. However, it seems that this may not be successful because the expected margin for 1H FY2021 is flat relative to the margin in 2H FY2020, for example. How do you explain this?

A We assumed the margin for 1H FY2021 would be flat as a whole, amid the large fluctuations in market prices for raw materials and steel products, but we will continue to improve long-term contract prices. With regard to the advanced order mix, a major increase in the supply of high-value-added products will start after we have completed strategic investment in measures to improve capacity and quality, and that will not be in FY2021. Rather, the full effects will emerge toward FY2025.

Q Please explain the factors that contributed to the profit improvement for FY2020 by dividing them into market factors and company-specific factors.

A Simply put, the reason for the profit improvement was a decline in the breakeven point. For 2H FY2020 and FY2021, I would like you to understand that our efforts to lower fixed costs have been producing significant effects in reducing the breakeven point.

Q Your crude steel production is recovering rapidly. What kind of efforts are you making to avoid production and equipment problems?

A Equipment problems, which tend to lead to a large reduction in production, are often caused by poor inspection. We have therefore been working to standardize equipment inspections and raise the completeness of inspections. Since there are an enormous number of inspection points, we have first focused on processes where those equipment troubles would lead to significant reduction in production. In addition, we have made use of smartphones and other IT tools in on-site inspections in order to enhance efficiency. As a result of these efforts, reduction in production due to equipment trouble has been steadily decreasing since 2H FY2019.

◆ **Financial results and other matters**

Q Your business profit for 4Q FY2020 was around ¥140 billion, which led me to think you could be more profitable in FY2021 than the forecast announced.

A As we mentioned in the past, the quarterly profit or loss does not necessarily represent a performance-based profit because it includes items such as a distorted fixed cost burden and the settlement of sales prices. I would like you to understand our FY2021 profit in comparison to the performance of 2H FY2020. In other words, please compare figures on a semi-annual basis, not on a quarterly basis. Please also note that, in addition to actual profit improvement, such as that resulting from increased production shipments and improved margins in the export market segment compared to 3Q, there were many one-off profit items in 4Q, including inventory valuation gains, foreign exchange gains, non-operating income, and additional deferred tax assets due to an upturn in business performance at equity-method affiliates. The 4Q profit therefore appears to be somewhat excessive compared to the actual performance.

Q What was the background behind disclosing FY2021 forecasts starting at the beginning of the fiscal year? Please also explain your thoughts on dividend.

A Until a dozen years ago, we disclosed fiscal year forecasts at the time of the announcement of business results for the previous fiscal year. However, the change in the raw material contract method altered sales price negotiations for products, which made it difficult to forecast profit. We have since been announcing fiscal year forecasts at the time of the 1Q result announcement.

More recently we received opinions from investors and analysts that the company should publish forecasts from the beginning of the fiscal year. We had then considered doing so since FY2019. However, we could not release them in FY2019, as the COVID-19 pandemic had a significant impact and the financial outlook was not visible.

As a consequence, we decided to announce our full year forecasts at this time.

As for dividends, we have decided to determine the amount based on a payout ratio of around 30%, and by taking into account the outlook, etc. We plan to announce the interim dividend forecast at the time of the 1Q results announcement scheduled for August, in view of the forecast for the current fiscal year and other factors at the time.

◆ **Structural measures for production facilities**

Q I would like to ask if it is appropriate to implement the shutdown of the blast furnaces at Kure and Wakayama for FY2021 as planned, in the midst of an uptrend in the steel market in China and Asia.

A Until now, Nippon Steel have to be evaluated by the financial market at a cost of capital that incorporates risk because of the large fluctuation in our business performance, which is referred to as "king or beggar." To overcome this situation, it is necessary to create a structure that produces stable earnings, without relying on volume. To achieve this, we will thoroughly enforce two things: to have no excess capacity and to raise the ratio of high-end products that are not dependent on market conditions in the order mix. We intend to urgently implement measures to accomplish these two objectives in order to ensure that we can achieve a certain level of stable profit every year even if the business environment in 2025 becomes more severe just as currently expected.

In addition, from the viewpoint of cost competitiveness and products that can be manufactured, there is no economic rationality to keep running facilities scheduled to be shut down in FY2021, in order to export hot rolled coils just because their price is momentarily rising at present, since they face the risk of a worsening market. Even if the facilities are kept in operation, there will be losses if we shut them down when the market deteriorates.

Given these positives and negatives, we have no intention of keeping the facilities in operation just because the current market happens to be favorable.

◆ **Overseas business**

Q What is the current status of overseas group companies?

A AM/NS India and AM/NS Calvert have been performing strongly, and USIMINAS has also been profitable. It became more evident that the integrated steel mill was the one that could make a substantial profit. In India, as we have decided to expand the current steel mill and build a second steel mill on the East Coast, we will continue to work toward this. In other regions, we intend to undertake M&As from the viewpoint of avoiding start-up risks and the creation of any excess capacity. However, I cannot comment on individual strategies as other parties are involved. If we establish a technology that enables electric arc furnace (EAF) production of similar high-grade steel to that of blast furnace (BF) production, an integrated steelmaking becomes possible even in areas that do not have a large market, where the construction of a blast furnace is not economically justified. We thus want to develop such technology and make integrated production at an EAF another option for overseas operations.

Q Steel demand in India is decreasing due to the re-surge in COVID-19 cases. With no prospect of containing the spread of COVID-19, what are AM/NS India's FY2020 results and forecasts for FY2021?

A We are very concerned over India's serious situation caused by the re-emergence of the spread of COVID-19. Due to the lack of oxygen for medical use and the natural priority of providing oxygen for life, some of our customers' factories have started to suspend operation. I wouldn't say that this will have no impact, but I am not expecting that it will cause a significant drop in demand for steel in India as the majority of domestic steel demand there is related to infrastructure. In the medium to long term, India will have a shortage of domestic production capacity, while it is difficult to enter the market. Therefore, it will be different from China, where demand is growing but steel mills have been built with more production capacity than that required to satisfy demand. We have no intention of changing our policy, as the supply/demand balance is expected to be stable and the expansion of the steel business in India is highly feasible. Concerning AM/NS India's financial conditions, their actual income figures cannot be disclosed but the company contributed equity-method income of tens of billions of yen to Nippon Steel in FY2020 and is expected to do so again in FY2021.

Q Nippon Steel's long-term growth scenario must be in the overseas business, which mainly consists of equity-method affiliates in the form of JVs. While the JV format has high capital efficiency, some kind of mechanism in terms of fund collection needs to be devised. What do you think about this point?

A Some overseas operations are carried out by subsidiaries, but as you have pointed out, we also have JV companies as equity-method affiliates. For these JV companies, we make certain arrangements for the collection of funds through the JV agreement at the time of establishment. In the case of some companies with surplus funds, we have decided to collect funds as 100% dividends. Basically, if funds are needed for growth, they will be used for growth investment rather than for collection, and if surplus funds still remain, they will be collected. At present, AM/NS Calvert and AM/NS India, which highly contribute to Nippon Steel's profits, have a substantial need for growth investments, so their funds are used for growth investments rather than being collected. By considering the form of fund collection on a case-by-case basis, depending on the need for growth investment, the Nippon Steel Group is making effective use of funds and improving its financial efficiency.

◆ **Zero-carbon steel**

Q Since your announcement of a carbon neutral target, the Japanese government has raised its target for reducing CO₂ emissions to 46% in 2030. Are you thinking about responding to this change and revising your target?

A In March, we targeted a "30% reduction in CO₂ emissions by 2030", and said that this was a very significant technical challenge. Not only Nippon Steel but also the world's steelmakers are facing the same challenge. As someone in charge of on-site operations, I cannot say irresponsibly that the government changed the target to 46% so the steel industry will also change the target to 46%. Although we don't intend to change the 2030 target to 46%, we will make efforts to achieve our technology development target as soon as possible.

A common challenge for steelmakers worldwide is to technically establish zero-carbon steel and transfer it to production by means of actual machinery. This requires development capability. We are ahead of our peers in terms of development capabilities, and while zero-carbon steel is a technical challenge, it is also an opportunity for Nippon Steel's high competitiveness.

There are two other reasons why a carbon neutral society is an opportunity for us. First, we can profit from our technological capabilities in the rapid expansion of demand for advanced products required by the carbon neutral society, such as electrical steel sheets and ultra-high-tensile strength steel sheets. Second, providing zero-carbon steel to Japanese customers early will also enable them to gain an international competitive advantage, and our position in the relationships with our customers will be raised.

This is a very challenging theme, but we will take it as an opportunity and actively work on this since we firmly believe that such development capability will determine the competitiveness, profitability, and brand

strength of steelmakers around the world in the future.

Q Your scenario for zero-carbon steel is mainly to reduce CO₂ emissions in domestic production processes, but I think contributions to overseas invested companies should be included. For example, the use of CO₂ emission reduction technologies in emerging countries may also lead to opportunities for engineering business. Will you share your thoughts on this?

A Zero-carbon steel technology, which reduces CO₂ emissions in the steel industry, includes production of steel products with high quality via the EAF route on par with those produced via the BF route, and the use of hydrogen in reduction. All related technologies are unprecedented in the world and have to be developed from scratch. For instance, in the case of thermal power generation, there is the example of the development of Japan's ultra-supercritical power generation technology in emerging countries. Japan's steel industry is not yet at that stage, and there is no option like ultra-supercriticality in thermal power generation. Therefore, we must first develop technology in Japan and put it into actual production before applying it overseas.

The discussion on carbon pricing is similar. It may be possible for the electric power industry to introduce carbon pricing, among various options, in order to push forward renewable energy. However, the steel industry is at the stage of making options and needs to be pushed forward for development first. This is what we mentioned to Prime Minister Suga and Minister of the Environment Koizumi. To do this, carbon pricing will have the opposite effect.

Another challenge in the introduction of zero-carbon steel technology overseas is that in emerging countries there is no accumulation of steel scrap, so the use of the EAF route is limited.

We have been contributing to the development of technology overseas, and we will continue to think about it. To this end, it is also important that we have options through technology development. I hope you understand that we are now at that stage.

End

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