

**Nippon Steel Corporation, Second Quarter FY2021 IR Briefing
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Summary of Q&A¹**

Presented by:

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◆ **Negotiation of tied (long-term contract) sales prices**

Q You said that customers have gained a better understanding of Nippon Steel's request for the improvement of tied (long-term contract) sales prices. What level of prices are you ultimately aiming for?

A With regard to the tied sales prices, we aim to correct them to a level that secures a fair and appropriate margin internationally. I think we are getting quite close to this.

Q What are the merits of changing business practices for tied sales prices?

A As stated in today's briefing materials, the main objective is to make it easier for us to forecast the business outlook, but we believe that the change will result in the merit of reflecting the market situation in prices in a timely manner to both our customers and us. In the midst of great fluctuations in prices of raw materials and commodity materials at high levels, the scheme where price fluctuations are not reflected in product prices until six or twelve months later is no longer functioning. Anywhere you look, the basic business principle is to receive orders for products with fixed prices, and then produce and ship them. In a sense we are discussing obvious, natural things with customers. Of course, we are taking into account not only our circumstances but also the circumstances of each customer in order to reach an optimal choice. More customers are gaining a better understanding, and we are hoping to change the form of price contracts in this way from next fiscal year.

◆ **Profit/loss changes and dividends**

Q Your volume forecast for 2H FY2021 has not changed much since the previous announcement. Are you incorporating the impact of the semiconductor shortage and the accompanying reduction in automobile production in your volume forecasts for 3Q and 4Q?

A Automobile production has been affected by problems related to parts procurement due to the semiconductor shortage, etc. We are currently expecting that shipments to the automotive industry will decrease in 3Q but recover slightly from 4Q. However, even if our shipments for automobiles fall, the impact on volume and profits should not be significant because supply and demand conditions for steel

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

products are tight and we can divert products to other sectors, for example. When automakers start to see a recovery in the production of automobiles, we will have to make sure to reliably supply steel to them. Since the relining of a blast furnace is scheduled in 4Q in the Nagoya Works, a main base for supply related to automobiles, we intend to respond firmly to customers' needs, such as by managing our inventory.

Q You are expecting ¥90 billion in margin improvement in the upward revision to your full-year forecast. Please give us a breakdown of the improvement.

A Back in August, we were negotiating in areas with tied sales prices. As for commodity product areas, we were incorporating certain risks concerning the degree of penetration of price hikes in Japan and a decline in overseas markets. The results turned out to be better than expected in all areas, as these risks did not materialize.

Q Prices of energy, in particular natural gas, have surged, but you are not expecting much of a recovery in shipments of seamless steel pipes in 2H. What is your forecast for next fiscal year?

A The seamless steel pipe business takes time from order acceptance to shipment. In this sense, shipments have not yet increased significantly in 2H. However, in addition to the rise in crude oil prices, demand for natural gas is strong and driven notably by carbon-neutral movements. As a result, orders for high-end products are increasing and we are anticipating a recovery, although actual shipments will start in FY2022.

Q You are generating excellent financial results this year, but they include inventory valuation gains and carry-over. While you tend to pay dividends in accordance with profits, including inventory valuation gains, will you reduce dividends if the inventory valuation gains drop out next year and apparent profit decreases?

A We will maintain our basic policy of a 30% dividend payout ratio. Earnings for FY2021, will be at a high level and, as you pointed out, inventory valuation gains are also expected to be significant. In this situation, we have decided to pay an interim dividend of ¥70 per share, by incorporating not only the current level of profit, but also our desire to maintain a high level of dividends in the future.

◆ **Medium- to long-term strategy**

Q EBITDA for FY2021 is expected to exceed ¥1 trillion, amid tailwinds generated by rising steel prices and the worldwide tight supply and demand balance. In such a situation, you streamlined assets by ¥110 billion and issued convertible bonds of ¥300 billion. I think that your level of cash-in is significantly higher than initially expected in the medium-term management plan. How will you use the surplus cash? Will the surplus cash be actively used for prepayment of interest-bearing debt?

A Partly in response to the COVID-19 spread, our dependence on indirect financing has substantially risen.

We issued convertible bonds, based on the idea of increasing the ratio of direct financing and lowering the dependence on indirect financing while we have contracting repayments and new procurement, thereby securing more robust new procurement capacity in the future. It will also be possible to utilize more leverage if the convertible bonds are converted to equity. As for the use of funds, in addition to capital expenditures and business investments, we would like to respond firmly to funding needs related to carbon neutral initiatives in and after 2025.

Q There must be a lot of risks in operating an integrated steel mill overseas, but are you thinking about ways to limit the risks, which, I think, may also lead to an increase in the reliability of your overseas growth strategy?

A The operation of an integrated steel mill may entail risks but also provide the highest added-value. We thus intend to continue focusing on this operation. We are considering brownfield investment in order to reduce risks. In the case of brownfield investment, we do not need to build a sales network from scratch, and the impact on prices is low because excess capacity is not created in the market.

Q Is your sales strategy reflecting your plan of a more sophisticated order mix?

A A sophisticated order mix is a measure that will support Nippon Steel's future earnings, and without it, it will be impossible to further reduce the breakeven point. We are therefore firmly committed to achieving this.

Q Could you elaborate more on the possibility of a scenario that would allow you to grow profits over the medium to long term? Specifically, starting with the current fiscal year's business profit of ¥600 billion on an underlying basis, what kind of incremental profit can be added, including global expansion?

A Besides a global business expansion, there are two domestic factors that are expected to have a positive effect in terms of boosting earnings from the present underlying profit of ¥600 billion. The first one is the effect of the structural measures for production facilities. Although some effects have already been generated, full-scale effects in labor and other costs associated with the rationalization of facilities will be generated going forward. The second is the effect of a more advanced order mix. We are now investing in the sophistication of facilities and the effect will be generated after these facilities start operation. While there will be no further ¥200 billion in inventory valuation gains, our immediate target is to maintain the underlying profit of ¥600 billion. Beyond that, we will aim for further profit growth by moving up the marginal profit curve.

◆ **Other**

Q The financial market is concerned about whether the price-raising negotiations and the litigation concerning the electrical steel sheets with a certain automaker may lead to loss of your market share. Should these be considered risks?

A Let me respond to this question without limiting the issues to automobiles. We have been working on the correction of tied sales prices for more than a year, and I believe that our price level is approaching the margin where it should be. The level was close to an appropriate one in 1H and the level in 2H is roughly approaching the level to be settled sequentially. I cannot answer your question about the pending litigation case concerning the electrical steel sheets, but I understand that the issue of intellectual property is a separate matter from the usual negotiations.

Q What is your current shortcoming compared to your global competitors?

A POSCO and Baosteel are formidable rivals for us. We must raise our cost competitiveness relative to them. We would like to reestablish our competitiveness in this aspect.

End

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