

Nippon Steel Corporation, First Quarter FY2023 IR Briefing
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Summary of Q&A¹

Presented by:

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◆ **Spread and direct contract-based sales pricing**

Q The spread is expected to decline by ¥60 billion from 1H FY2023 to 2H FY2023. I understand that this is not a structural decline but an adjustment of the time lag toward spread optimization. Will you explain this?

A To come right to the point first, I would like you to understand that we are continuing to pursue an appropriate **level of** spread, and this time there is no structural decline in the spread, but it is caused by the process of optimizing spreads.

Since FY2022, we have shifted from retroactive basis to prefixed basis in price negotiation system for direct contract-based sales. As the sales price is determined before external costs are fixed, if the external costs change after the price is determined, the spread for that period will fluctuate. In negotiations in the next term, we will negotiate prices to secure an appropriate level of spread for the updated external costs. There will be an increase or decrease in the spread as long as the external costs do not meet expectations, but we operate this system based on the idea that the positive or negative effect of the external costs will be offset in the long run.

In 1H FY2023, raw material prices are turning lower than expected at the time the prices were determined, which is resulting in a temporarily higher spread than initially expected. In 2H, we will negotiate to secure an appropriate level of spread based on the outlook of the external costs in 2H. However, since the temporarily higher spread of 1H will be gone, the spread for 2H may appear to have decreased but this is caused by the process of optimizing spreads. This does not mean that we are lowering the price more than the decline in the external costs.

In general, people tend to focus on declining prices, but what we find important is not the price but the spread. If the external costs fall while the spread is maintained appropriately, the selling price should also fall. I would therefore like you to focus not only on price fluctuations, but also on spreads.

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

Q Your upward revision of ¥40 billion in underlying business profit for FY2023 is largely attributable to the additional ¥50 billion in the spread. Please explain this in more detail.

A At the time of the announcement of FY2022 financial results, we prepared the FY2023 forecasts on the assumption that the spreads in FY2022 and FY2023 would be unchanged, but various factors have subsequently changed, which resulted in an additional ¥50 billion in the spread.

In 1H FY2023, after the direct contract-based sales prices were determined, raw material prices are lower than expected and the spread is turning out to be temporarily higher. In addition, more sophisticated product mix based on investment in measures to improve electrical steel sheet capacity and quality, which are starting to be fully operational in order from 1H FY2023, also contribute to an improvement in the spread. On the other hand, amid the decline in domestic demand for steel from 2H FY2022 to 1H FY2023, the revision also incorporates the deterioration in the order mix, driven by an increase in exports to the relatively favorable markets.

Q You explained that the spread level in 2H FY2021 was roughly appropriate, but the expected spread level in FY2023 exceeds that level. Will this situation continue from FY2024 onward?

A We expect the spread, which reached a high level due to the decline in external costs after the price was fixed in 1H 2023, to return to an appropriate level from 2H. The average spread level for FY2023 will be high, as it includes the impact of the high spread acquired in 1H, but this level will not continue.

However, optimal spreads are not always fixed. We will continue to conduct discussions with customers in accordance with the sophistication of our products and services, and we are always aiming for higher spreads.

Concerning changes in external costs after the direct contract-based sales prices are determined, they should be adjusted over the long run and are unlikely to be biased one way or the other.

Q Concerning your current direct contract-based sales pricing, there remains a problem that external costs such as raw material prices change after the sales price is determined first, and a delayed impact on the sales price may occur. Will you think about modifying the pricing system, such as further shortening the contract period and, for example, changing to a monthly contract?

A In order to reflect changes in external costs, such as raw material unit prices, in a timely manner, we have asked our customers to create quarterly contracts or, in the case of semi-annual contracts, to make adjustments in the later quarter if the raw material assumptions

change significantly.

It has already been more than a year since we introduced the pre-determined method, and we would like to consolidate it into quarterly contracts as much as possible, but partly due to customer circumstances, it is hard to say whether the quarterly contracts or the semi-annual contracts are better. We are discussing this issue on an ongoing basis, but we do not expect it to change so dramatically in the future. I would say that the change to a monthly contract would require enormous procedures and costs and would not be worth pursuing.

◆ **Overseas business**

Q You said that the overseas business environment is severe, but you have kept your FY2023 earnings forecast unchanged at ¥120 billion and have actually raised your 1H forecast by ¥10 billion. What is the background to your strong outlook?

A In India, the average GDP growth rate has been more than 6% since 2010, and demand for steel products has continued to increase, while the market has also benefited from this growth. The earnings forecasts for AM/NS India in FY2023 include investment benefits and gains on sales of LNG under hedge contracts, and are very likely to be achieved. The increase in the earnings forecast for 1H FY2023 is due to the fact that the tax benefits associated with the integration of the acquiring entity AMIPL and AM/NS India at the time of the acquisition of former Essar were recorded in 1H FY2023, instead of the scheduled recording period of 2H FY2023. Although this positive impact is only for 1H, we expect the overseas business to be able to realize ¥120 billion yen for the full year.

Market conditions in Southeast Asia are worse than at the time of the FY2022 result announcement. Fortunately, we have not been affected much, as our downstream mills such as NS-SUS manufacture and sell high-end products. However, the integrated electric arc furnace (EAF) mills, G/GJ Steel, which we acquired in March 2022, manufacture and sell commodity-grades and have been affected by the decline in market prices. We are taking measures to improve profitability. Moreover, since we had not incorporated a significant contribution by G/GJ Steel to profit from the time of planning, the current severe market conditions in Southeast Asia will not have an impact on our achievement of the plan.

Q AM/NS India's capacity expansion and AM/NS Calvert's EAF investment are important projects to further increase earnings in the overseas business, but the timing and impact of any profit increase are still vague. Please explain the contribution from the investment in the EAF of AM/NS Calvert, which is scheduled to be launched in FY2024, and the timing of the launch.

A AM/NS India's expanded capacity will start operation in 2026. At this point I cannot provide any details of the impact on profit, but it would certainly not be small. We hope to launch AM/NS Calvert's EAF in 1H 2024. Currently, AM/NS Calvert purchases slabs and manufactures and sells sheet products. With the new EAF, AM/NS Calvert will be able to internally manufacture a portion of the slab requirements, which will contribute to strengthening its cost competitiveness and profitability.

◆ **Sophistication of product mix**

Q How will the introduction of aluminum giga-casting by Japanese automakers affect Nippon Steel?

A Aluminum giga-casting will not replace all steel products for automobiles. It is expected to shift roughly 10+% per target electric vehicle (EV) model. In addition, this will only be introduced to newly constructed battery electric vehicle (BEV) lines. So, we think the impact will be extremely limited at this time. However, we will closely monitor changes in the situation.

For many years, we have been making various proposals to Japanese automakers on the use of steel products in terms of weight, cost, development time, design, labor saving and other factors. Going forward, we will continue to strengthen our collaboration with our customers and focus even more on the development of new technologies.

Q Please explain how you are prepared in case Japanese automakers lose their global market shares in the future.

A We do not assume that current customers, not limited to the automotive sector, will continue to maintain strong and high market shares forever. As for steel demand as a whole, if one segment declines, we must always consider increasing demand in another segment. This is exactly what we do in our sales and marketing strategy. We are making ceaseless efforts to envision everything and think about strategies.

Q Looking at the Sophistication of Order Mix on slide 18 of the briefing materials, the shipment volumes of products other than seamless steel pipes do not seem to have increased recently. Will the contribution of profit from the sophistication of product mix really continue to work?

A Let's look at high-tensile GA, for example. The fluctuating trend is partly caused by the fluctuation in the production of automobiles. However, the ratio of the products to total products is truly expanding. We believe that the core of our measures to further lower the break-even point going forward is to raise the slope of the marginal profit curve by upgrading our product types. We want you to understand that there is no change in our strategy and that there is a temporary adjustment in the market that we are targeting.

Q The supply-demand balance for electrical steel sheets appears to be weakening. How do you view the supply-demand balance going forward?

A While the market for grain-oriented (GO) electrical steel sheet has remained tight, deterioration in the housing and construction sectors, mainly in Europe, has affected demand for transformers. Although it is basically tight, there has been a slight weakening in the supply-demand balance in some areas, and we have factored this into our performance forecast.

◆ **NSCarbolex™**

Q NSCarbolex's website has been revamped to make it easier to read. Has there been any change in inquiries? Two cases of NSCarbolex Solution were presented on slide 33 of the briefing materials, and I heard that another company has gained a price premium of 40%. I would like to ask about the price premiums in the case of your two examples.

A I don't know if the website renewal itself has had a significant impact on inquiries about NSCarbolex Solution, but customers have responded positively, and inquiries are not bad.

I would like to add something regarding the development of SUPERNICKEL™ for EV battery cases, one of the examples presented. It can be manufactured with a plate thickness of 0.3 mm, which greatly increases the difficulty of manufacturing, and can be supplied with a similar weight to aluminum with a thickness of about 0.8 mm. Steel has excellent performance in terms of heat resistance and workability, and especially in terms of heat resistance, while aluminum melts when the battery generates abnormal heat, steel has a high melting point and does not melt. This is extremely advantageous from the viewpoint of safety. Moreover, steel emits one-fifth of the carbon dioxide (CO₂) emissions of aluminum during the manufacturing process, so we would like to promote steel for environmentally friendly EVs.

As for the premium, I cannot clarify that at this point because it is still included in the product price, and it is hard to define and separate it. The example of the other company you have mentioned is so-called green steel products, which are equivalent to our brand NSCarbolex Neutral. Please make sure to differentiate NSCarbolex Solution, which is different in nature, and NSCarbolex Neutral. We plan to start supplying NSCarbolex Neutral within 1H FY2023, so we'd like to explain this at the appropriate point of time.

Q Will you give us some more quantitative hints about spread improvement and the direction of change in profit weight, driven by the production and shipment of NSCarbolex Solution?

A We want to quantitatively show the product mix, including NSCarbolex Solution, as we aim to sophisticate the product mix. However, we have to consider the relationship with

customers, which makes it difficult for us to disclose more. For this reason, while discussing matters with the sales department, we ascertained the information that we could disclose, and explained the progress in the sophistication of the order mix by using images instead of showing actual figures, as presented in the briefing materials at this time. As you pointed out, I think it would be more appropriate to quantitatively disclose the trend and show how far we are from the target. We would like to consider such a method of explanation in the future.

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