

# Nippon Steel Corporation, Second Quarter FY2023 IR Briefing (November 1, 2023) Summary of Q&A<sup>1</sup>

Presented by:

Takahiro Mori, Representative Director and Executive Vice President, CFO

Takahiko Iwai, Managing Executive Officer

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## ◆ Business environment-related

Q Does the challenging environment make you feel the need to change your perspective on the medium- to long-term or structural business environment? What do you think about the risk of continued sluggish export margins in spot markets and weak domestic steel demand?

A One structural change we recognize is the coking coal market. India, a country with continuing growth, has to import coking coal because there are insufficient domestic coking coal resources there. On the other hand, given the lack of development on the supply side of coking coal, we believe that coking coal prices will gradually rise structurally. I hope you understand that we are making a quick move by considering investing in Elk Valley Resources, a high-quality coal mine in Canada\*.

\* On November 14, we announced our decision to indirectly acquire a 20% interest in Elk Valley Resources, in Canada.

Regarding the sluggish margins in spot exports, we do not expect much from this business area. The global strategy of the current medium- to long-term management plan is to abandon the idea of maintaining domestic production capacity by earning marginal profits from exports and to build a system that captures local demand through local production. In particular, we would like to promote local production and sales with a focus on India, ASEAN countries, especially Thailand, and the United States.

We are currently assessing medium- to long-term demand for steel products in Japan. In our medium- to long-term business plan, we had predicted that the scale of non-consolidated crude steel production would be about 38 million tons. However, at present, Japan's crude steel production scale is estimated to be about 88 million tons, and we estimate that Nippon Steel's crude steel production will be 35 million tons. We have to assess the extent of shrinking domestic steel demand and establish a medium- to long-term perspective.

<sup>&</sup>lt;sup>1</sup> Based on information as of the date of the briefing.



- Q Given the severe price environment in 2H FY2023, how do you see the risk of a decline in export volumes, and do you plan to increase prices for spot market sales in Japan?
- A There is a risk of a decline in exports obviously, but we are proud to have a strong export network, compared with other steelmakers, and we believe that we have various options and can secure a certain amount of export volume.

With regard to domestic spot market sales, domestic demand has been flat or shrinking, and the international market has been at low levels. Imports have therefore been stagnant, while costs for steelmakers are increasing, mainly due to rising prices of coking coal and other raw materials, and the weaker yen. These various factors are supporting the domestic market price. However, we will not emerge from the current difficulties unless we consider raising product prices sufficiently to offset the increase in raw material prices.

- Q You explained that you would make steady continual efforts to drastically lower the breakeven point in response to the unprecedentedly harsh environment. Is there room to accelerate efforts to improve costs and margins in light of the changing external environment?
- A We are not just standing idly by but are stepping up our efforts to improve costs. In FY2023, we are expecting to improve costs by ¥10 billion through the facility structural measures. In addition, we are working on improving variable costs and fixed costs in order to make cost improvements of ¥55 billion in total for FY2023. Since some fixed costs will naturally increase due to continued capital investment, the key point here is to improve variable costs and raise marginal profit per ton. Recently, capacity utilization has been stable and variable cost improvement is progressing considerably, and we are further accelerating our efforts.
- Q What is your view of the current situation regarding seamless pipes and what are your thoughts on the future? The graph at the bottom right of slide 18 of the briefing materials appears to show a decline in shipment volume of 13Cr high-alloy seamless pipes.
- A: Demand for super high-end seamless pipes, such as 13Cr high-alloy seamless pipes, is very firm, and full production is continuing. Please understand that the drop in shipments in 2Q FY2023 is merely attributable to the issues of the shipment timing of projects, many of which tend to have a long construction period. We are actually in a state of full production, which has led us to carry out internal discussions as to whether production capacity should be kept at the current level or not.

# Margins and sales prices

Q You said that the spread is expected to deteriorate by ¥130 billion from 1H to 2H FY2023. It also appears that the spread will deteriorate by about ¥40 billion in direct contract-based sales and by about ¥90 billion in spot market sales. Is it correct to



understand that the spread will recover to an appropriate level if raw material prices do not change from the assumptions made during the next price negotiation for contract-based sales in 4Q FY2023 or 1H FY2024, when the next prices will be determined?

In forecasting the underlying business profit for FY2024, the effect of direct contract-based sales prices returning to an appropriate level should be added to the underlying business profit of ¥341 billion for 2H FY2023, while assuming no improvements in spot market sales prices unless market conditions recover. Is it OK to see this as a starting point?

A Your understanding is correct in terms of both direct contract-based sales and spot market sales.

The pre-determined pricing means that the sales price is determined before external costs are fixed. So, if external costs change after the price is determined, the spread for that period will fluctuate and price negotiations will be conducted to secure an appropriate level of spread against the external cost level that is re-assumed in the negotiations in the next term.

In spot market sales, we have prepared the guidance for FY2023 based on the assumption that current prices will not improve. If the current relationship between market product prices and raw material prices continues, all steelmakers will be unable to operate in the long run. Therefore, we believe that some measures will be taken on the steel supply side, and the relationship will have to move in the direction of improvement eventually. We will have to keep an eye on when that will come.

- Q Under the contract-based pricing method, raw material prices are not fixed when product prices are determined, so there will always be a timing difference and adjustments will be made in the subsequent fiscal year. Is there any room to change this method to allow more flexible, simpler adjustment?
- A We are still working hard on this. For example, if circumstances of customers with semiannual contracts permit, we adjust the changes that occurred in the previous quarter in a later quarter effectively in a similar way as for quarterly contracts. These adjustments cannot be carried out without the customer's understanding of the complexity of the procedure. We are devising whatever we can and are evolving the price adjustment mechanism so that it benefits both us and our customers.
- Q Will you explain your assumption of a rise in sales prices from 1H to 2H FY2023.
- A Assuming that the yen weakens from 1H to 2H FY2023, we are expecting that yendenominated prices of exports will rise. In addition, the sophistication of the order mix will raise the average price.

In general, people tend to focus on price fluctuations, but what is important for us is spread



rather than price. We believe that, if external costs change, sales prices should also change in order to maintain an appropriate spread. We would therefore like you to focus on the spread in addition to price fluctuations. In the price negotiations for contract-based sales in 4Q FY2023, we will discuss with customers price increases to enable the surging cost burden for raw material prices, after the pre-determined pricing, to be fairly allocated throughout the supply chain. Based on that scenario, we assume we will maintain an appropriate margin.

#### Overseas business

- Q You mentioned that the macro environment in India is strong. Will you talk about the management and business environment in India. I believe that India had exports to Europe, but are they still continuing?
- A Recently, statistics on demand in India were released, and they showed that demand for both flat and long steel products has been strong, and that double-digit growth has continued. In the past, India exported steel products to Europe, but in recent months, domestic demand has been high, so a negligible amount of steel products has been exported from Indian mills. The market is also at a high level, but imports have been restrained despite a considerable difference from the ASEAN market.

Since India is a very difficult market to enter, its supply capacity depends on how steelmakers currently in operation in India expand their capacity. AM/NS India, in which we have invested, is planning to start operating a new blast furnace in 2025-2026. Until the launch, there will be a shortage of pig iron and Nippon Steel in Japan will provide support by supplying hot coils and slabs from Japan.

- Q Your overseas businesses other than in India are experiencing an extremely severe business environment. Won't you need to find ways to improve them internally rather than relying on a recovery in the external environment? You have explained various improvement measures in the domestic business, but please tell us if there is room for implementing measures to improve the overseas business and what these measures are.
- A We are implementing the PDCA cycle for improvement measures in our overseas business as well as in Japan. In the past, the management of investment decisions and decision-making at overseas production and sales bases was different from that of domestic steelworks, but now, for example, steelworks in India are being managed in the same way as domestic steelworks. As overseas decision-making requires a much larger decision in a shorter period of time than domestic decision-making, there is also a positive effect, such as the fact that our operations are speeding up both in Japan and overseas. Of course, the time lag causes communication challenges, but we try to engage in dialogue fairly frequently. I, myself, attend a regular meeting every Monday and make sure to always share information.



We would like to make further improvements in whatever way we can.

# Dividends

- Your dividend forecast for FY2023, when announced in May 2023, was ¥140 or more per share with a dividend payout ratio of around 35% to maintain a high level of dividends. Then, the dividend forecast was raised from ¥140 or more to ¥150 or more in August, when the upward revision to earnings was announced. This time, the net profit forecast has been raised but the dividend forecast has been maintained, leading to a lower dividend payout ratio of 32.9%. Will you explain your approach to the payout ratio and what "or more" means in the case of "¥150 or more."
- A dividend payout ratio of around 30% is a rough guideline and, in principle, we intend to maintain it. However, given that net income, which is the source of dividends, fluctuates due to a one-time and huge inventory valuation difference, we are discussing how to set the dividend level and payout ratio within the scope of the principle. The dividend payout ratio, which we have set as our policy, is based on net income. If we take net income after excluding inventory valuation differences as the denominator, the payout ratios based on the dividend forecasts announced in May and August and at this time are all around 30%.

As for the question of what is meant by "or more," we want to promise a per-share dividend of at least ¥150 for FY2023. Even if earnings turn out to be lower in 2H, we will pay a dividend of ¥150, and if earnings are higher, we will consider paying a dividend of ¥150 or more.

- Q Will the inventory valuation difference included in the source of dividends be close to zero in FY2024 as the yen continues to weaken and raw material prices stay high? I find this important, as the portion other than consolidated underlying business profit is also a source of dividends.
- A: Coking coal prices are the most disruptive factor. Given the growing domestic demand for steel in India, coking coal prices are structurally expected to rise gradually. There should be no abnormal fluctuations like those that occurred in the past two years, but I have to answer that I do not know because the price of coking coal is going up and down so rapidly.
- Q If consolidated underlying business profit for FY2024 is at least double the level of 2H FY2023 profit, which is a little less than ¥700 billion, is it correct to assume that the dividend for FY2024 can be maintained at least at the level for FY2023?
- A We have not yet finalized the dividend for FY2023, so it is too early to say anything definite about the dividend for FY2024. Let us keep communicating on this matter.

### Carbon neutral

Q You said that you will accelerate 100% hydrogen use in the direct reduction process



and the implementation of the Super Course 50 technology by about 10 years. What kind of progress or results have led to the decision to accelerate? Also, how are you positioned relative to overseas steelmakers in developing decarbonization technologies?

A Without the expanded support from the Green Innovation Fund, we would have had to raise the funds ourselves. Since the government's support for our initiatives has become clear, we feel assured about making investments in R&D and human resources, and we will definitely be able to speed up the implementation period. Based on these expectations, we said that the implementation can be accelerated by about 10 years.

In terms of our positioning in decarbonization technology development, we believe we are leading in hydrogen reduction in blast furnaces. Having said that, there are strong companies involved in development using electric furnaces and shaft furnaces around the world. We are also starting with basic research, just like our competitors are.

# Other

- Q It was reported in the media that Nippon Steel and ArcelorMittal are working on acquiring US Steel. Are you actually interested in acquiring US Steel?
- A We would like to refrain from commenting on individual cases.
- Q When conducting M&A, will you raise funds through the issuance of corporate bonds or capital increases?
- A When conducting M&A, funds are secured in an optimal manner while taking into account the state of operating cash flow and financial market conditions at the time.

End

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