



**Nippon Steel & Sumitomo Metal Corporation FY2017 1st Quarter IR Briefing
July 28, 2017
Summary of Q&A**

Note: Based on information available as of the date of the IR Briefing

**Representative from NSSMC
Katsuhiro Miyamoto, Managing Executive Officer**

Q You mentioned your unwavering resolve to achieve prices and a margin for sustainable reproduction. How is the negotiation going? How much steel product margin improvement for both domestic sales and exports is incorporated in your ordinary income forecast of ¥300 billion for fiscal 2017?

A I mentioned that we will make unbending efforts in price negotiations to increase our margin by ¥5,000 per ton with the aim of “achieving a margin for sustainable reproduction,” in addition to a portion reflecting a change in the unit cost of raw materials. The domestic demand/supply balance is tight and steelmakers are running at full capacity. Meantime, we are enhancing global supply capacity to respond to needs of customers who are expanding overseas. We are explaining such background to customers, in an attempt to receive their understanding.

We understand that some overseas steelmakers tend to stop shipments if their customers don't agree with price rises. However, we fulfill our supply responsibilities, thoroughly discuss matters with customers, and try to receive customers' understanding on margin expansion. We also intend to negotiate firmly to “achieve a margin for sustainable reproduction” in the contract-based export area, as demand is firm and the market is improving.

We are incorporating some margin expansion based on the price increase target of ¥5,000 per ton in our ordinary income forecast of ¥300 billion for fiscal 2017.

Q You have changed the purchasing pricing method for hard coking coal. What is your thought on a method to determine steel prices?

A Concerning purchasing of iron ore and coal, contract prices are determined based on the three-month moving average. The index method has long been adopted for iron ore. As the same method has now been introduced for coal, replacing the previous

benchmark method, I think we have more transparency. The index price reference period is the three-month average of the last four months before the contract period for iron ore but is the three-month average of only the last one month for coal. Adopting a period nearer to the contract period is desirable in the case of coal as its price fluctuates more than that of iron ore.

I think we can ask for customers' understanding on changes in raw material prices, as use of the three-month average as a base remains unchanged. We will then ask to be allowed to "achieve a margin for sustainable reproduction" and reflect other contributions we make to customers.

Q You said that sales volume in the first half declined mainly due to production cut caused by suspension of lines due to some equipment trouble. Will you explain specific details and measures to take?

A Crude steel production in the first half is expected to decrease by about 1.1 million tons year-on-year. Some of this decrease was projected and some was not.

The former includes the large-scale repair and maintenance work of the blast furnaces in Wakayama and Kashima, and the concentrated schedule for thorough regular maintenance from upstream to downstream in May and June.

The latter, which involves a cut in production due to trouble, includes production cut of several hundred thousand tons, caused by the impact of the Oita Works fire accident in its steel plate plant. In addition, the upstream process in Kashima and the energy plant in Kimitsu had some equipment trouble.

In the first half, we allocated additional repair expenses. We will reduce such trouble going forward.

Q I see some changes in the ratio of domestic vs. export sales and in the pipes and tubes for the energy sector, which were stagnant for some time. How do you expect the product mix to change going forward?

A In the past several quarters, the product mix, in particular for pipes and tubes, has deteriorated. From the second half of fiscal 2016 to the first half of fiscal 2017, the product mix is expected to turn from a negative factor to a positive factor, albeit small. The export ratio is declining on an amount basis, as well as on a volume basis. We have reduced export orders, due to a reduction in our production caused mainly by construction projects and trouble.

In the energy sector, U.S. activities are recovering and the market is also slightly improving. Meanwhile, demand from oil majors in the Middle East, an area of strength for NSSMC, has reached bottom but when and how it will recover from here on is still

uncertain. If this demand recovers, our product mix should improve. In addition, if high-grade steel plate recovers in volume from its current depressed level, it should also help to improve the product mix.

In sum, the product mix has bottomed out but its recovery speed and timing are hard to project as the energy-related recovery is still uncertain. I must say that the recovery speed is unlikely to be as the same as the speed of recent deterioration.

Q Please explain your underlying ordinary profit forecasts for the first half and second half of fiscal 2017.

A The first-half ordinary profit forecast of ¥150 billion includes a ¥50 billion inventory valuation gain, ¥18 billion in forex gains on stock and gains on group companies' one-off items (inventory valuation, forex, etc.), and a ¥10 billion loss caused by the impact of the Oita Works fire accident. Excluding the net gain of ¥58 billion in aggregate from these, underlying ordinary profit is estimated to be ¥92 billion, or ¥180 billion on an annualized basis.

We also expect second-half ordinary profit to reach ¥150 billion. Details regarding its breakdown cannot be disclosed yet. As for one-off items, some tens of billions of yen in inventory valuation losses are expected. Group companies are also likely to record inventory valuation losses. Although the Oita Works fire accident will no longer have an impact, we are assuming losses of some tens of billions of yen in total as the net impact of one-off items. Excluding these losses, underlying profit in the second half is expected to be roughly twice as high as the underlying profit of ¥92 billion in the first half.

Q In China, spot prices of steel products have risen to quite a high level in the past few years, along with favorable domestic demand. What is your view on the sustainability or upside potential of this?

A China's mills are curbing exports to some extent. Their price sensitivity is rising and they are changing from the previous attitude of exporting as long as money is circulating to a new mindset of not allowing losses. Partly due to strict guidance of the relevant authorities, it appears that financial institutions are also showing a severe attitude about making loans to companies and are forcing them to operate profitably. This is part of the reason why we believe that the market can be sustained for some time. I am confident about this until the Communist Party Congress in autumn. For the market to remain favorable, the disposal of excess capacity is important. China has already culled illegal induction furnaces. In addition, some operating facilities are in the process of permanently being closed down, according to the initial reduction plan.

There are some accelerating moves as well. If progress is made in the disposal of facilities, capacity will not increase at least. We therefore don't anticipate a crash in steel prices. We will keep watching the situation carefully.

Q At present, transport and material costs are rising significantly. How much are you incorporating in your ordinary income forecast of ¥300 billion for fiscal 2017?

A Partly due to the labor shortage, transport and material costs are increasing and they have some impacts on our transport cost within steelworks and product transport cost to customers. In our ordinary income forecast of ¥300 billion for fiscal 2017, an increase of several billions of yen in transport costs has been incorporated.

In particular, transport costs for imports of raw materials are large but they are unlikely to be affected as much in our view, as oil prices are stable and we tend to have long-term contracts. However, if vessel regulations regarding SOx and NOx are tightened in the future, shipping companies may need to make investments and we may also have to bear some of the related burden. This, however, is a common global challenge, not something that will affect only NSSMC.

Q Please explain the management environment, situation, and governance at Usiminas.

A Usiminas reported a net profit in the January-March quarter of 2017 for the first time in a long while. The Brazilian economy has bottomed out and is recovering, and steel prices are rising. In addition to operational improvements, a substantial reduction in cost has been implemented. The profit turnaround at Usiminas is one of the important factors behind the substantial improvement of our overseas business.

Concerning governance, Usiminas has changed its president several times. While NSSMC is fighting a legal battle concerning the president with another major shareholder who is our business partner, both parties, including NSSMC, are working together to do what needs to be done for Usiminas, at the same time. As you may know, we are operating Tenigal, a joint venture in Mexico, with the same partner. It is running smoothly without any problem. We hope to find a way to manage Usiminas cooperatively as soon as possible.

Q How do you foresee the income contribution of the overseas business, including Nisshin Steel's overseas group companies entering your overseas companies? What kind of contribution are you looking at by region?

A The biggest profit contributors in the overseas business are North and South America. In particular, Calvert in the U.S. substantially contributes to profit, partly due to their one-off inventory valuation gains. Usiminas in Brazil turned profitable while achieving a large amount of improvement. Our operations in Southeast Asia are generally favorable but their overall contribution is smaller, due to initial losses at some start-up operations, such as at KNSS in Indonesia. We expect a similar trend to continue for some time. We exclude inventory valuation gains which will be recorded at some companies this year when we consider the overall trend.

As you pointed out, Nisshin Steel's overseas companies, such as Wheeling Nissin and Acerinox, have been included from this fiscal year, contributing to profit growth.

Some overseas companies used to face challenges but we have established the Global Business Promotion Division to individually check all companies and draw up appropriate plans to respond to their issues.

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