JFE Group Investor Meeting

(FY2021 Financial Results)

Summary of Q&A Session on May 6, 2022

Moderator: We would like to move on to the Q&A session. We will now take questions from the first questioner. Please go ahead.

Participant: I would like to ask about two points.

First, I would like to ask about the reason for not disclosing your earnings forecast for FY2022. Iron ore prices for the first half and coking coal prices for the first quarter will soon be settled. If the price for hot rolled coils continues at the current level, I believe the profitability of exported hot rolled coils will fall. On the other hand, regarding domestic sales prices, I thought that the sales price was raised considerably more than the main raw material price in the second half of FY2021, including overhaul of the basic sales price. As a result, I believe the profitability of the Steel Business has returned in the fourth quarter.

In FY2022, although consumers are also feeling the strain of rising prices, I think it will likely be possible to raise prices commensurate with the main raw materials in the automotive and other sectors. However, given the sluggish export market, it is necessary to implement price increases exceeding the main raw materials in order to secure some profit. In addition, it is necessary to move forward with reflecting the price increases in the sales price as soon as possible.

I believe you mentioned that you still have a way to go in this regard, but I believe you have demonstrated success in the second half of FY2021. I wonder if the rising raw material prices were really the reason you did not disclose the earnings forecast for FY2022. Hasn't your confidence increased to an extent that a certain degree of rising raw material prices can be surely reflected in the selling prices? Or, do you still have to have selling price negotiations with domestic customers regarding rising raw material prices, resulting in uncertainty regarding the selling price of steel products to those customers?

Second, I would like to thank you for sharing us your detailed roadmap for achieving carbon neutrality. While the No. 6 blast furnace in Chiba is scheduled to be refit in FY2022, I believe the next refitting periods will come for the No. 2 blast furnace in Kurashiki, No. 5 blast furnace in Fukuyama, and No. 4 blast furnace in Fukuyama during the 10-year period through to 2030. In this way, there will be many refitting projects of blast furnaces around 2030, meaning that you will need to put considerable effort into developing the carbon-recycling blast furnace technology.

If you are unable to complete the technological development by that time, will you be refitting the furnaces once again with conventional technology? Or will you be making efforts to ensure that the technology can be implemented in one way or another by around 2030 at all costs?

JFE: First, we will answer your question regarding the reason we have not disclosed the earnings forecast. As you pointed out, the main reason is the high volatility in coking coal prices. But we believe that solid progress is being made in passing through higher raw material prices to selling prices. The biggest uncertainty, however, is whether further sales price increases linked to higher raw material prices can be accepted by customers.

In other words, it is possible for us to propose higher prices, but such a price increase may reduce demand. For example, small and mid-sized construction companies may not be able to sell their services to end consumers if prices were to be hiked beyond current levels. Doing so may lead to demand reduction. Hence, the uncertainty is in the volume of demand.

In that sense, if coking coal prices, which is already highly volatile, rise once again, we believe that automakers will likely accept these price increases linked to raw material prices to some extent. However, it is uncertain how much other sectors will accept such price increases in negotiations. Such price increases may lead to a reduction in demand, and it is uncertain how much of an impact it will have. In addition to this uncertainty, we believe there is a high probability that higher selling prices may reduce demand to some extent.

Regarding your second question, you have correctly pointed out that we decided to refit the No. 6 blast furnace in Chiba in FY2022. Refitting work will also be carried out at the No. 2 blast furnace in Kurashiki and No. 5 blast furnace in Fukuyama going forward. Due to the enormous costs that are incurred for the refitting of blast furnaces, we will make every effort possible to ensure that the technology is ready for implementation before the refitting of these blast furnaces.

For example, if a carbon-recycling blast furnace, which we expect as a transitional technology, can reduce the CO2 emissions by 30 % even under the current conditions, we are considering the implementation of part of its technologies in the upcoming blast furnace refitting. Furthermore, by combining the carbon-recycling blast furnace with CCU technology, we believe it is possible to achieve carbon neutrality. However, if we were to refit the existing blast furnaces, we would not be able to meet our targets, so we hope to accelerate the development of technologies such as carbon-recycling blast furnace technology.

Regarding your second question, we will be refitting the No. 6 blast furnace in Chiba in FY2022. For refitting projects of blast furnaces thereafter, we believe EAF is also an option in addition to carbon-recycling blast furnaces. However, we hope to make progress on developing carbon neutral technology as much as possible and to implement technology that can be used even as a transitional technology at an early stage. By doing so, we hope to quickly determine the decisions that need to be made regarding the next blast furnace refitting.

Participant: I understand. Thank you.

Moderator: Thank you. Next questioner, please.

Participant: Thank you.

For my first question, I would like to ask about the profit per ton in the Steel business, which was explained by the President. When looking at the figure for the full year, profit per ton excluding inventory valuations etc. may have been around JPY6,000, but if we look at the fourth quarter alone, it was a little more than JPY10,000. Don't you think that profit per ton has reached a level that deserves a passing grade? Please tell us about your thoughts on how to think of profit per ton. Is it appropriate to look at this figure on a half-year basis?

In conjunction, I would like to ask about the improvement in selling price on page 26. Could you give us a more detailed explanation of what targets you could and you could not achieve during FY2021?

Second, I would like to know more about your plans to introduce a large-scale electric furnace from FY2027 through FY2030. Please give us a general idea, such as the type of furnace that will be implemented.

JFE: Sure.

First, I will explain the progress made in FY2021 toward the target of JPY10,000 profit per ton. One of the factors behind the profit per ton in FY2021 is the inventory valuation gain. In addition, compared with the final year of the medium-term plan, there has been a boost from the high profitability of overseas Group

companies and a significant rise in overseas steel prices. However, we do not necessarily think that the current situation will last until the final year of the medium-term plan.

Therefore, even though profit per ton excluding inventory valuations etc. in the fourth quarter was JPY10,000, that also includes contributions from such factors as the high profitability of overseas Group companies and higher steel prices at overseas market. We believe they were offset by a commensurate rise in selling price as a reflection of higher raw material prices. We stated earlier that a certain degree of progress has been made but we still have a way to go. Therefore, we will need to manage these factors to reach our initial target of JPY10,000 in profit per ton by FY2024.

Next, I will answer your second question regarding what we achieved or could not achieve in terms of improving selling prices in FY2021. Regarding our efforts to improve selling prices, we have had a certain degree of success in the initiatives taken so far, such as accelerating the pass-through of higher raw material costs to the steel sales price, charging extra, and adjusting the base price.

However, we do not believe that the various factors pushing up prices, such as metals and transportation costs, have been reflected in selling prices based on clearly defined rules during our negotiations. We hope to make efforts especially in passing through the various increases in prices to our selling prices. I believe this is something we have not yet achieved.

Regarding your second question about electric furnaces, the problem with operating a large-scale electric furnace in Japan is the extremely high electricity cost. The problem is whether the cost is proportionate to its productivity, and there would be a need to reduce the cost through higher melting efficiency.

Above all, the problem is that under current conditions it is not possible to manufacture high-quality products. We believe that we need to accelerate technology development to confirm the same ability to control impurity concentration at EAF as blast furnace under the Green Innovation Fund. As a result, we believe that we can produce the highly value-added steel products which can be used as automobile outer panels.

Therefore, broadly speaking, there are major hurdles that need to be cleared. First, we must work to reduce electricity costs by streamlining the melting process. Second, we need to raise the quality of steel sheets and make it possible to manufacture all kind of high-quality products with an electric furnace.

Participant: I understand. Thank you.

Moderator: Thank you. Next participant, please.

Participant: First, I would like to ask about what you referred to earlier regarding the reduction of demand arising as a result of higher prices. Earlier, you noted concerns regarding small and mid-sized construction companies among other sectors. What I would like to know is if you are already seeing such signs at present. In addition, are there any other sectors where you believe demand could be impacted by higher prices?

Second, I understand that crude steel production fell slightly in the fourth quarter of FY2021 due to rationalization measures. Was this decline in production volume merely the result of focusing on the metal spread?

Third, regarding the Keihin area site after shutting down upstream facilities, what is your business model as to how this site will be used in the future? More specifically, I would like to know how the land will be used and in what ways that would contribute to your profit. Could you provide us with a general idea of your plans? In addition, I would like to know why you chose to adopt this business scheme for the Keihin site, even though I am sure there must have been various other options that were being considered.

JFE: Sure.

First, regarding your question about the impact that rising prices are having on demand, based on what I have heard, large construction projects have generally proceeded according to schedule, but the timetables of small and mid-sized construction projects are starting to be pushed back in response to the rising official prices.

As for other sectors in which similar impacts are likely to be seen, it is difficult to name specific sectors at the moment. But the underlying point is that relatively smaller manufacturing companies or other companies will likely start to delay their orders if the current level of steel prices is to continue. Although it is difficult to name specific industries right now, I believe this is something that warrants concern.

Regarding your second question about the production volume of crude steel in the fourth quarter, you have correctly pointed out that we had rationalized production activities with an eye on improving the metal spread. Additionally, there were minor problems in connection with production facilities at a plant, but it's safe to say that the basic reason was because of placing our focus on the metal spread.

As for your third question about the usage of land in the Keihin area, there are three major options in how we use this land: we can either use the land to construct a new plant, lease the land, or sell the land. While the hydrogen and ammonia supply business is closely linked to many government initiatives, as an individual company, our aim is to develop the business while properly securing profitability.

Because the land is vast, it is of course important to consider collaboration in such ways, but it will also be important to generate cash flow by selling part of the land or using the land to raise funds for the development of other areas.

As the owner of the land, we also think it is important to consider leasing the land to those that we deem to be appropriate. It is in consideration of a combination of such options that we hope to use the land not only for the public benefit but also in a way that would generate profit for ourselves as an individual company. We will determine how to use the land in accordance with such basic principles.

Participant: I understand. Thank you.

Moderator: Thank you. Next questioner, please.

Participant: Thank you. I would like to ask two questions.

My question is related to the discussion from the previous questions. In the presentation material, it says that steel demand is expected to be tight again in the current fiscal year. However, I believe that the latest level of combined inventories of hot rolled, cold rolled and coated steel sheet products is high, partly due to the impact of production cuts by automakers.

Do you think it is possible for JFE to face a situation in the current fiscal year where it would need to actively curb supply, aside from its refitting plan for a blast furnace? Earlier, you mentioned that higher steel prices could have an impact on demand. Do you think it will be necessary to curb production in order to maintain the metal spread? That is my first question.

My second question is related to the Engineering business, where you mentioned that orders are being received in line with the plan. However, in view of the sales target of JPY650 billion in FY2024, I believe a further increase in orders, especially through initiatives related to renewable energy, will be necessary. I would like to know the profitability of such projects in conjunction with your current level of confidence in achieving the FY2024 target of receiving orders.

JFE: Sure. We will start by answering your first question.

Regarding your question of whether there will be a stage where we will need to curb supply in relation to steel demand, our honest answer is that the situation remains uncertain at this point. One of the reasons for this uncertainty is the conflict in Ukraine. The situation is still in its early stages, and it is hard to foresee what could happen going forward.

For the time being, we expect the purchasing prices of raw materials to rise. Furthermore, due to the stoppage of steel supplies from Ukraine and Russia, we expect steel prices to rise. However, if such conditions were to grow protracted, energy prices would begin to rise. If that happens, then there will likely be an impact on global economic growth, but it is unclear to what extent and in what ways this impact will manifest. Another factor that actually has great significance is the zero-COVID policy in China. The zero-COVID policy has caused existing plants to halt operations, and we believe that there will likely be a major change in the demand landscape of China in the future.

Therefore, under normal circumstances, a decline in demand would prompt us to curb supply, but due to the situations explained above, it is difficult to give a clear answer at this stage. Even though the outlook is uncertain at present, we will nonetheless need to determine how to control our operations while bearing in mind the situation in Ukraine, China's zero-COVID policy, and the global supply and demand for steel.

As for your second question about the Engineering business, we think that we still have so many things to achieve our revenue target of JPY650 billion by FY2024. We expect revenue contributions from a company that we acquired, and further growth can be expected particularly in the Waste to Resource field. Through these initiatives, we are taking active steps toward achieving the revenue target of JPY650 billion by FY2024.

One of our concerns is related to renewable energy. We have decided to produce monopiles for offshore wind power generation, and we plan to start the operation of the new plant in April 2024, expecting that there would be considerable Round One demand. However, the schedule of demand increase may possibly push back.

But this does not mean that we are sitting on our hands. We believe that we must further capture domestic demand for monopiles, as well as demand from Southeast Asia and beyond.

Participant: I understand. Thank you.

Moderator: Thank you. We are nearing the time to end the meeting, so the next person will be the last to ask a question. Please go ahead.

Participant: The President commented earlier that the selling price still needs to be increased in response to higher prices of major materials other than the main ones and rising fuel costs. Please explain if it is possible to implement a formula-based system to pass on the higher prices to selling prices.

I believe crude oil and raw material prices have already increased considerably in FY2021, but I would like to know the YoY impact of higher costs should current price levels continue. If possible, could you give us a quantitative answer with numbers?

JFE: Sure.

Regarding your question on whether we are considering adopting a formula-based system to reflect fuel and other costs to selling prices, we are not considering such a system at this point. I believe there are some of our contracts where such a formula-based system has been adopted for some products, but the current situation is one where not just fuel prices but all kinds of raw material prices are highly volatile, so adopting such a system in general is unlikely at this time.

As for your question about the YoY impact of higher costs as well as the quantitative impact should current levels of raw material prices continue, it is difficult to extrapolate the YoY impact based on current numbers.

One thing that we can say is that the difference in the first and second half of FY2021 was an increase of JPY50 billion for various costs. Strictly speaking, there may have been a slight difference in the third to fourth quarter, but the fact that there was a difference of JPY50 billion from the first to second half suggests that a continuation of the current levels would have a YoY impact that is greater than JPY50 billion.

Participant: Okay. That made very good sense. Thank you.

Moderator: Thank you. We would now like to end the Q&A session.

This concludes today's Investors Meeting. Thank you for joining us today. You may now leave the meeting.

[END]