JFE Group Investor Meeting

((FY2022 Financial Results and FY2023 Earnings Forecasts)

Summary of Q&A Session on May 8, 2023

Moderator: Now I would like to move on to the question and answer session. First question, please.

Participant: I have three questions.

First, what is your approach to dividends? You mentioned that you expect to increase profits in FY2023, but, for example, if the price of raw materials declines significantly, resulting in inventory valuation loss and a downward swing in business profits, do you lower the dividend in conjunction with a 30% payout ratio?

I think that if actual profit without inventory valuation difference falls, the dividend will probably be lowered as well. My first question is what would you do if there is a large inventory valuation loss, for example, by continuous decline of coking coal prices?

Second, while I do not expect a major deterioration in the business environment such as a result of China’s increased exports caused by the China's economic slowdown in 2015, the most recent global steel market has been very bad, and steel raw materials have been dropping accordingly. What is your view of future steel market conditions and raw material prices?

For example, iron ore at present is about over USD90 under FOB terms and coking coal is about USD240, and I expect iron ore to be more than USD100 and coking coal to be in the USD200 range, close to USD300, this fiscal year. What is your company’s outlook?

Third, you mentioned that you will raise steel prices. I have a feeling that the environment may be changing a bit from the price increase phase, but will you be raising prices?

Or is it that you expect to maintain steel prices even though raw materials fall, and expect spreads to widen domestically with the effect of an improved product mix due to the suspension of blast furnaces and other facilities in Keihin? Please tell me about these three points. Thank you.

JFE: First, I would like to answer your first question regarding dividends. We are making various assumptions, but I think it is naturally possible that raw materials will go down in the future. Although it will depend on the extent to which raw materials prices decline, we are assuming that the domestic steel prices will be maintained, since there are various other cost-increasing factors.

Since our basic policy is to maintain a dividend payout ratio of around 30%, dividends depend on profit attributable to owners of the parent. But we currently believe that a slight drop in raw materials will not cause a significant drop in the dividends.

I think the big impact will be whether there will be any major market volatility like the big slowdown in the Chinese economy in 2015 that you mentioned earlier.

Although it is very difficult to make a clear view in this point, we believe that although Chinese steel exports are increasing significantly in the short term, in terms of fundamentals, domestic demand for steel products in China will gradually recover after the lifting of the zero-COVID-19 policy. In that sense, we do not expect a major slowdown as we saw in 2015.

JFE: I would like to answer your second question regarding how we view steel market conditions and raw material prices as a precondition of FY2023. As for raw materials, as you have pointed out, some recent raw material market figures show further weakness, but our assumptions for iron ore price is based on the current three-month average level rather than the current level.

As for coking coal price, we believe it will go up a little more than the current low level. We are not going to mention an absolute figure, but We think it would be the level of the figures you just pointed out.

On the other hand, steel market conditions, especially for exports, have been recovering from a very low period a while ago, and we think they are just now turning the corner a bit. Although linked to the state of demand or the price of raw materials, our view is that there will be a gradual recovery from the current situation.

Therefore, in terms of assumptions for profit and loss of FY2023, we expect export spreads to recover from the second half of FY2022, but we are looking at them at a certain level, which is roughly the same level as the annual average for FY2022.

Participant: I think there is a difference in pricing strategy with other companies, but taking the suspension of upstream operations in Keihin into consideration, can we assume that there is no need to reduce prices?

JFE: First of all, we are often asked if there is a significant price difference due to the difference in the pricing methods, but we believe that the total area of prices is the same.

Our current assumption is that we will be able to maintain our contract prices to a certain extent, since other various prices have also risen considerably without major fluctuations in raw materials.

Participant: I understand. Thank you very much.

Moderator: Next question, please.

Participant: Thank you for your explanation. I also have a question about the spread. The view for the first and second half of the current fiscal year was not explained compared to the second half of FY2022, but can you tell me what do you think of the first and second half of FY2023?

With regard to the chart of spread on page six, I thought you think the domestic spread will improve. Could you tell me, even qualitatively, for example, how much the shift from quantity to quality due to the suspension of upstream operations in Keihin is affecting on the spread?

In addition, I would like to know if there are any new areas of understanding with customers from the previous fiscal year, and what kind of areas you think will improve from now on. That is all.

JFE: It is difficult to explain since we have not provided a forecast for each the first and second half of FY2023, but we do not expect the spread improvement significantly from the second half of FY2022 to the first half of FY2023 in the domestic market.

Although there is an improvement in the spread from FY2022, this improvement includes the difference between the first and second half of FY2022. We do not anticipate a significant improvement in the spread as we experienced in FY2022 or FY2021.

However, as we mentioned earlier, we are aware that we need to add a little more to the spread in areas such as rising prices of various goods and services. We expect that we will have to improve the spread corresponding to various prices from the first half to the second half of FY2023.

JFE: Regarding the spread, the figure varies depending on the items included in the spread, such as energy and foreign exchange rates as well as raw material prices. In any case, it is true that various costs have risen in FY2023, including electricity. In this sense, we must continue to make strong efforts in FY2023 to obtain the understanding of our customers and promote improvements in the spread, as we believe that we still cannot fully transfer such various costs to our steel prices.

Regarding the question on the effects of the Keihin upstream facilities suspension, as for how the product mix will change as a result of the suspension of upstream operations in Keihin, there is no figure that I can give you right now to explain how we expect it to affect the product mix.

However, in the first half of FY2024, the first phase of the reinforcement of manufacturing facilities of electrical steel sheets will be completed and the number of electrical steel sheets will increase steadily, so the product mix will change slightly at that time. That is about all the information we have so far.

Participant: Okay, thank you very much. That is all.

Moderator: Thank you very much. Next question, please.

Participant: Thank you. I have two questions.

On page six, you mentioned that the spread had improved by JPY74 billion in FY2022 compared to the previous year, including energy and foreign exchange effects, et cetera. On the other hand, the profit and loss analysis for FY2021 versus FY2022 showed a metal spread of plus JPY220 billion. Similarly, there is a figure of a spread improvement of JPY83 billion in FY2023 compared to the previous year, and the profit and loss analysis for FY2022 versus FY2023 shows an increase of JPY75 billion. Please explain these transfers.

The suspension of the Keihin upstream facilities is a very big action for your company, and I think the impact will be much greater than the shutdown of downstream facilities. I feel that it will be necessary to use this as an opportunity to reorganize the customer base to some extent.

Compared to the current level of production decline, production may not change significantly due to the suspension. But at least you will give up your upward elasticity. So, I wonder if you can take proactive actions to increase the stable portion by changing the way of price negotiation, the concept of export ratio, and the relationship with customers in this way. I know this is a broad topic in relation to spreads, but please let me know.

The second point is your explanation on the green steel, JGreeX, which you said that about 200,000 tons can be supplied from the first half of FY2023. I believe that the President may have previously commented on a larger number regarding the scale of the total green steel business. Please explain at what stage we should be looking at the milestone of increasing the volume of JGreeX, including the changes in each of the processes based on your strategy for carbon neutrality. Thank you.

JFE: Let me first explain the relations of each figure. The JPY74 billion for FY2022 is the sum of JPY220 billion increase in the section "sales prices and raw materials" compared to the previous year and the difference in foreign exchange flows, the increase or decrease in unit energy costs, which is shown on page 22.

The JPY74 billion figure on page six is calculated by subtracting the JPY93 billion difference in foreign exchange flows from the JPY220 billion, and then subtracting the JPY53 billion in energy prices as noted in the others section.

Similarly, the JPY83 billion in FY2023 is related to the JPY75 billion in the section "sales prices and raw materials" on page 28. Offsetting the negative energy unit cost and the foreign exchange flow—this time the flow difference is positive because of the stronger yen—a positive JPY8 billion remains. the JPY83 billion is calculated by adding this JPY8 billion to the JPY75 billion.

JFE: Regarding the second half of your first question, the impact of the suspension of upstream operations in Keihin, we are currently studying the impact of the suspension on the product mix and customer mix. Prices fluctuate depending on each product, so we cannot say this is the case right now, but we think as follows;

The first is the ratio related to exports, which are generally very volatile. In particular, we think it is necessary to drop some of mill scale and semi-finished products for export, although revenue from them varies from time to time. Next, as I explained earlier, we plan to increase the ratio of highly value-added products, and we are considering how we will structure our product mix as we increase electrical steel sheets production when the first-round reinforcement of manufacturing facilities of electrical steel sheets is completed.

Therefore, we are still considering the customer mix, including the export ratio, to maximize revenue, but we believe that it will be a major issue to determine how we can manage our operations with flexibility depending on the market conditions after the suspension of upstream operations in the Keihin area.

For your second question on the green steels, I firstly would like to mention the current global trend on green steels. There are various standards for defining green steel materials, and each country has its own definition.

This is not the way to go, and what was discussed at the recent G7 Climate, Energy, and Environment Ministers' Meeting was, first of all, to properly integrate the measurement methods and definitions of CO_2 reduction figures.

At the same time, there are already customers who want us to provide green steels, and we are selling green steel amidst the confusion I just mentioned. Then, why 200,000 tons this fiscal year? The amount of CO_2 emissions reductions we will achieve with our new technology in FY2022, which will be certified by a third-party certification organization, is expected to be approximately 500,000 tons.

If the 500,000 tons of CO_2 emissions reductions were to be certified, each ton of iron would emit about 2.3 tons of CO_2 if it were mill scale, so we have put the figure at 200,000 tons.

There may be major changes in this standard in the future, so we do not know what will happen, but at least we can supply 200,000 tons this fiscal year.

Participant: Thank you. Is it correct to understand that the CO_2 reduction target by 2030 is 17.4 million tons, of which 10 million tons, excluding 7.5 million tons due to the structural reforms, should be considered as the upside of the quantitative potential calculated by the mass balance method for green steels?

JFE: We believe that that is a guideline, but since it is not certified by a third-party organization, it is possible that this figure may change somewhat in the future as the method of measuring CO_2 emissions and the definition of green steels are established to some extent around the world.

Participant: Am I correct in understanding that the basic idea is in that direction as long as certification is obtained?

JFE: Yes.

Participant: Very well understood, thank you.

Moderator: Thank you very much. Next question, please.

Participant: Thank you. First of all, regarding dividends, I believe that in the past your company disclosed year-end dividends in the Q3 financial results, but why did you decide to disclose annual dividends at the beginning of the current fiscal year?

In particular, please tell me your thinking on the JPY100 disclosed this time, including whether it reflects your desire to maintain the dividend even if the dividend payout ratio changes somewhat, or even if P&L changes to some extent as the full year progresses.

Second, what is your company's perception of the TSE's efforts to correct P/B ratios below 1x? Please let me know if you have any feelings about this, including how to deal with it in the future. These two points.

JFE: Regarding dividends, in announcing our earnings forecast, we also disclosed our forecast on profit attributable to owners of parent.

We have not previously disclosed our dividends at this time, but many companies on the TSE have done so, and in our case, since our policy is to maintain a payout ratio of around 30%, we can calculate the dividend to some extent.

However, since this is only based on this forecast of profit attributable to owners of parent, it does not mean that the company will pay a minimum dividend of JPY100, depending on the actual amount of net profit attributable to owners of parent, though. In any case, I hope you will understand that we will do our utmost to maximize our revenue so that we can pay a dividend of JPY100.

Then, regarding the second question about the P/B ratio below 1x. We understand that this is a very serious issue regarding stock prices, and we take it very seriously. One reason is that the steel industry itself is an industry that emits a great deal of CO_2. I believe that investors do not have a clear understanding of the future growth potential of the Company, and that they may feel this uncertainty as to whether profitability will not reach the cost of capital, whether profitability will be sustained, and so on.

Therefore, the first important thing is to show the future potential of the steel industry by quickly developing a method to produce iron while reducing CO_2 emissions, as iron will continue to be needed in the future. This will not be possible immediately, but I believe it is very important for us to focus our efforts on this.

In addition, the steel industry is an extremely volatile industry, but through a series of sales price improvements, I believe that the range of earnings volatility has been reduced to some extent. In order for investors and shareholders to have such an understanding of the steel industry, I would like to ensure that we will complete the 7th mid-term plan and, after an upward swing, implement a growth strategy in the 8th mid-term plan that will lead to the next step, so that we will eventually get out from the P/B ratio below 1x.

Participant: I understand, thank you very much.

Moderator: Thank you very much. Next question, please.

Participant: Thank you very much for your explanation today. I have a question on page nine regarding the paths toward the 7th mid-term plan.

This time, your company has revised upward its mid-term business plan target by JPY30 billion from the original JPY230 billion. The upward revision includes various factors such as improvement of fixed costs and increase in the ratio of highly value-added products. However, could you tell me again about the contribution of these factors?

Compared to the time when the mid-term plan was formulated, the business environment has become such that the production volume has not increased that much, and I wonder if you have no choice but to factor that into the downward revision factors. I would appreciate it if you could explain the positive and negative aspects of this as well. Thank you.

JFE: Let me answer this. First of all, the mid-term plan calls for a crude steel production of 26 million tons, but we have not factored in the increase in volume in this JPY30 billion.

Instead, although I cannot give you specific figures, we are aiming for an increase in profits through the first phase of the expansion of the electrical steel sheets, extra improvement in sales prices, and our overseas solutions business, which is our goal of quality instead of quantity. For example, the overseas solutions business has increased 1.5 times from the mid-term starting point in the current fiscal year. Although the amount is not that large yet, we are thinking of aiming for JPY30 billion by building on this kind of shift to quality.

JFE: As a supplementary note, in relation to the JPY230 billion in business profit that we had projected in the mid-term plan, the domestic spread has been improving more than we had projected in the mid-term plan, and the addition of this amount is a major contributing factor.

Cost reductions, et cetera, were originally factored into the mid-term forecast, so if you look at it from the perspective of the original mid-term forecast, I hope you will understand that the improvement in the domestic spread is a major contribution.

Participant: Yes, I understand. Other participants asked about the spread improvement, and you answered that although you have factored in spread improvement from the second half of FY2022, you have not factored in such a large improvement. Am I correct in my understanding that you will work hard in FY2023 to make a little improvement from the spread you were able to achieve in the second half of FY2022?

JFE: That is correct.

Participant: Okay, thank you very much.

Moderator: Thank you very much. Now that we are nearing the end of the closing time, we will let the next person ask the last question. Please go ahead.

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

First, the total profit of JFE steel in FY2022 was JPY146.8 billion. What was JFE steel's non-consolidated ordinary income?

The second question, which may be related to the earlier question about P/B ratio below 1x, is from the perspective of your company's stock price and the stock prices of your competitors. As of the end of last year, there was a difference of about JPY800, and I believe it has now opened up to about JPY1,300. What do you think is the reason for the gap in stock prices, especially since the beginning of the year, and what is the background behind this gap? Also, regarding the future, I believe that there are some points that you believe are superior to other companies, and there are some points that you feel that other companies are currently superior to you, but that you will be able to catch up with them in the future.

I know it is difficult to comment on other companies, but to the extent possible, please explain how their stock prices have changed since this past year, and how you plan to increase your revenue and stock prices to close the gap in the future. Thank you.

JFE: First of all, I am sorry, but I cannot give you information on non-consolidated ordinary income at this time. Please wait for the disclosure documents, et cetera, which will appear in due course.

Steel's non-consolidated ordinary income for FY2021 was JPY173.9 billion. As shown in the analysis chart, the effect of the decline in profits of group companies is approximately JPY70 billion, so it would be good if you could make an analogy with the change in consolidated segment profit of Steel from FY2021 to FY2022.

Participant: Yes, I understand.

JFE: I will answer to the second point about the difference between our competitors. We are also considering how to catch up on this difference. I think there are several reasons for the gap. For example, in addition to overseas raw material interests and overseas group companies, we believe there is also a profit disparity in the domestic steel business.

Although this is a matter for other companies, I think it can be said that they are ahead of us in what we are trying to do in our structural reforms, which is to lower fixed costs by consolidating and eliminating production facilities.

For our part, our first priority is to implement the Keihin restructuring in September as scheduled, to lower fixed costs as soon as possible, and to increase profits. In terms of technology, our electrical steel sheets, for example, are comparable to those of our competitors, and we intend to steadily expand sales of these products in the first and second periods to catch up in terms of revenue.

In addition, we have two consolidated and efficient steel works, one in the east and one in the west. The high productivity of the west mill, in particular, is an asset for us, and we intend to take advantage of this to improve our revenue in the future.

Participant: I understand. Thank you very much.

Moderator: That concludes the question and answer session.

Now, we will conclude today's investors meeting. Thank you very much for your participation today.

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