

JFE Group Investor Meeting

((FY2021 1Q Financial Results and FY2021 Earnings Forecasts)

Summary of Q&A Session on August 12, 2021

Moderator: Now, we would like to move on to the Q&A session. The first question, please.

Participant: The first question is about the earnings forecast for the second half. What are the price assumptions for iron ore, coking coal and hot coils? In the past few months, the price of iron ore and coking coal has been around USD200 per ton, and the price of hot coils in Asia has been in the mid-USD900 range. Are you generally assuming at that level?

In addition, equity in earnings of affiliates in the first quarter was very strong, and I assume that JSW Steel, California Steel, and others probably made a significant contribution. If we multiply the first quarter results by 4, we get about JPY100 billion. In your earlier explanation, I think you assumed that profits would be slightly lower in the second half than in the first half, but could you tell us about the trends at the major overseas group companies?

Secondly, please tell us more about the early reflection of raw material costs to sales prices on page 19.

JFE: Regarding the first point, the assumption for the second half of the fiscal year, we will not give specific figures, but we assume that the current level will continue in the second half of the fiscal year, as you have probably guessed. We assume that the profits of overseas group companies will continue to be at the level of the first quarter to some extent in the first half of the year, but for the second half of the year, there are some uncertainties, so we assume that profits will be lower than in the first half. For example, for JSW Steel, we also refer to analysts' consensus and other factors in preparing our forecasts.

Secondly, I would like to explain the early reflection of raw material costs in steel prices. For example, iron ore costs for April-June are fixed at the end of February, while coking coal costs are fixed at the end of May. In the past, it took about 2 quarters for the price of raw materials to be reflected in the price of steel in some cases. We are currently negotiating with our customers to see if we can change this up a quarter, or even earlier in some cases.

As pointed out by investors, we understand that the time lag in pass-on of raw material prices to steel prices leads to the high volatility of our profits, and our sales department is currently working to pass on the swift price transfer.

Participant: When the raw material is in an upward phase, I think you can push up profits earlier than ever before, but on the other hand, when the raw material is in a downward phase, will the steel price drop earlier?

JFE: We can't negotiate early only when the price is going up, so we will also have to accelerate when it is going down, but I think the most important thing is to eliminate the large volatility of profits.

Moderator: Thank you. Now, the next person, please.

Participant: First, the spread will be unchanged between the first half and the second half. Please tell us the background. Secondly, there is a view that the domestic price of long-term contracts is significantly lower than the overseas price. What is your company's policy on the difference between domestic and overseas prices?

JFE: Regarding the first point, it is true that the early reflection of raw material costs has been successful, but in reality, domestic prices in the first half have not increased at exactly the same pace as raw material costs have increased. In the second half of the year, we assume that price increases will be realized in line with main raw materials. The difference between the first half and the second is expected to be flat overall, coinciding with the rise in raw material prices and the total amount of price improvement in the second half of the year for the portion that was not reflected in selling prices in the first half. At some point in the second half of the fiscal year, we believe that domestic prices will be able to reflect the increase in the cost of key raw materials.

Regarding the second point, depending on the customer, we negotiate the price with reference to the market price as well. In light of the situation where overseas steel market prices have risen more than the cost of raw materials and the rising price of imported steel, we are also working to raise prices with the understanding of our customers. For products and fields that are highly linked to market conditions, we are making strong efforts to negotiate while monitoring overseas market conditions.

Moderator: Thank you. Now, the next person, please.

Participant: First, regarding the spread, will you be able to reliably achieve margin improvement in the second half of the year and the next fiscal year, when raw material prices will peak out? In the current fiscal year, the increase in the price of raw materials is largely reflected in the form of inventory valuation gains, but this is basically a time lag. Please tell us whether the increase in the price of steel will lead to an improvement in margins in the next fiscal year.

Second, the upward elasticity of production capacity in the steel industry is becoming limited, and the supply environment is changing in Asian markets, China and Russia, due to the burden of export tariffs. With the limited upward elasticity of production capacity, is there room for profit improvement through product mix improvement in the current or next fiscal year?

JFE: First, as I explained in the section on efforts to improve selling prices, we will promote early reflection of raw material costs and reflection of metal and scrap costs in steel prices, but this does not lead to an essential improvement in margins because it is only a reflection of cost increases. Therefore, it is the other areas that will be very important in improving the actual margins next year and beyond.

For example, if there are areas where domestic prices can be improved in line with overseas market conditions, margins will be higher than in the past, and the review of extra prices will be an important activity. In addition, and this may be somewhat related to the second point, we recognize that focusing on supplying products that are profitable is a very important issue for improving the total margin. By achieving this, we hope to improve our actual margins even as the market peaks out.

Regarding the second point, we would like to strongly focus on the structural reforms in the mid-term plan and the product mix after the shutdown of Keihin's upper process in 2023. Rather than improving the product mix in the short term, we need to focus on products that can generate sustainable profits after the structural reform.

As we discuss with our customers how to improve prices in this current environment, we would like to decide on prices while also explaining that we will not be able to manufacture products that do not generate profits as we narrow our production volume in the future. We recognize that we are currently in the process of building a post-structural reform product mix through this process.

Moderator: Thank you. The next person, please.

Participant: The first point is on page 22 of the presentation. Could you explain the background behind the high percentage of exports at 50% in the second quarter? I also have the impression that the shipment of steel was low in the first quarter and has been delayed to the second quarter.

Secondly, I felt that your company's stance on revenue price improvement is more aggressive than before. Please tell us your policy.

JFE: Regarding the first point, the increase in the export ratio, we expect export prices to improve from the first quarter to the second quarter and export volume to increase.

The assumption is that crude steel production was 6.25 million tons in the first quarter and will increase to about 6.7 million tons in the second quarter. Originally, the production volume has been a little low in the first quarter due to the concentration of maintenance work. In this context, domestic shipments have been stable on a quarterly basis, and export shipments were slightly lower in the first quarter. In the second quarter, crude steel production is expected to increase as well as exports to our partners and other customers.

As for the low shipment volume in the first quarter, shipments were rather accelerated in the fourth quarter of the previous fiscal year, as it was the end of the fiscal year. As a result, in terms of crude steel production and shipment volume in the first quarter, the shipment volume was slightly lower.

Regarding the second point, JFE Steel's goal in the mid-term plan is to make a profit of JPY10,000 per ton through structural reform. It is clear that we need to reduce production and concentrate and select varieties in the process. We will promote efforts to determine sustainable prices with the understanding of our customers, while also taking into account the responsibility of supply.

Moderator: Thank you. Now, the next person, please.

Participant: I would like to ask you 2 questions as well.

The first point is about profit by segment on page 8. Recently, I think the improvement of non-consolidated ordinary income has become an issue. In your latest guidance, you expect the steel business as a whole to generate JPY280 billion in segment profit for the year, but how much do you expect in terms of non-consolidated ordinary income?

The second point is the status of the restart of the No. 4 blast furnace in Kurashiki. In the chart on page 16, I think it was also explained that demand is also booming. I understand that your company has been selective in accepting orders, but are you planning to start operation of the No.4 blast furnace in Kurashiki in December as planned? Or, since demand is getting better, will you consider bringing forward the restart of the blast furnace, as was done in Fukuyama last year?

JFE: I would like to refrain from answering the question about non-consolidated profit and loss.

Regarding the renovation of the no. 4 blast furnace in Kurashiki, it will be difficult to move up the construction schedule since the renovation work involves the creation and manufacture of parts. After construction is complete, the blast furnaces will be heated up and coal, coke, and iron ore will be added to start up the blast furnaces in sequence.

Therefore, I believe that the only thing we can do is to speed up the time required for this start-up as much as possible by analyzing the start-up of the blast furnace in the Fukuyama district, which was recently restarted from banking, and the past start-up results.

Unfortunately, I believe that the possibility of upward elasticity in terms of production capacity is limited to this method.

Moderator: Thank you. As the scheduled end time has come, the next person will be the last one to ask a question. Please.

Participant: 2 questions, please.

The first point is about the price. In particular, with regard to prices between the first and second quarters of fiscal 2021, the average price of steel is expected to increase by JPY12,400, from JPY87,600 in the first quarter to JPY100,000 in the second quarter, but this appears to be somewhat low compared to the other companies in the industry.

In the briefing, you mentioned that the export ratio will increase in the second quarter, and you also made a very strong comment on price improvement this time. I would like to ask you to comment on how you expect the long-term-contract prices, which are still partially unsettled, for the second quarter.



Orders by Business Area

JFE Engineering

JFE

(billion yen)

Business Area	FY2020 Actual	FY2021 Forecast	Change	Main orders received in FY2021 ★: New projects received in FY2021 1Q
Waste to Resource	220.0	230.0	10.0	Improvement works of domestic waste treatment plant [★Kochi prefecture]
Carbon Neutral	36.0	82.0	46.0	★Renewal construction of Matsukawa geothermal power generation plant[Iwate prefecture] ★Construction work of Mori Binary power generation plant [Hokkaido]
Combined Utility Service	11.0	15.0	4.0	
Core Infrastructure	234.1	223.0	-11.1	Construction works of domestic bridge (★Ohno-Kobe Interchange in Tokai Kanjo Expressway [Gifu] etc.) Reconstruction works of domestic bridge (★Replacement of bridge decking: Ohigawa bridge in Tomei Express way [Shizuoka] etc.)
Total	501.1	550.0	48.9	

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Secondly, I would like to ask about the details of the order received by JFE Engineering on page 51. I believe that orders related to carbon neutrality have been increasing considerably.

I believe that investment in carbon neutrality is rapidly increasing at present. If you look at the time frame of the next 2 to 3 years, how much do you think this will continue to grow?

In this mid-term plan, you plan to achieve revenue of JPY80 billion in the carbon neutral field in FY2024, and I think you will be able to achieve this goal in FY2021. Please comment on whether or not orders are currently coming in at a higher pace than expected in the medium-term business plan.

These are my 2 questions. Thank you.

JFE: Regarding your first question, it is true that there are some prices that will be settled over the second quarter, and we are making certain assumptions about them, but I would like to refrain from commenting on whether they are higher or lower.

As for the somewhat smaller increase from the first quarter to the second quarter than the other companies in the industry, it depends on which you compare it with, but from the perspective of comparing it to the fourth quarter of fiscal 2020, we believe it is at a reasonable level.

It is difficult to make a general comment, but we believe that the range of increase from the fourth quarter to the first quarter is influenced by the timing of various things and, of course, the product mix.

I understand that there may be some in and out of the first and second quarters compared to the competitors.

JFE: Regarding JFE Engineering, this is due to the fact that we happened to get a geothermal power generation project and so on this fiscal year. For example, in the field of renewable energies such as biomass, solar, and geothermal, which we count as the carbon-neutral field, it is unclear whether similar projects will be received again next year.

On the other hand, once we start receiving orders for the foundation of offshore wind power, even though each project of offshore wind power is a one-time project, it will contribute to a certain degree of stable earnings in the carbon neutral field. In this way, I think it is important for JFE Engineering to achieve stable revenue of JPY80 billion in the carbon-neutral field, by receiving offshore power generation projects and creating a solid earnings foundation, and then receiving geothermal power generation and other projects.

Moderator: Thank you. This concludes the question and answer session.

This concludes today's Investor's Meeting. Thank you very much for joining us today.

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