NSC Testimony

{show slide 4} Good afternoon. My name is Takeo Aoyama. In April 2009, I became Executive Vice President and General Manager of the Chicago Office of Nippon Steel USA. Prior to this position, I had been in various marketing positions during my almost 30 year career at Nippon Steel. My current responsibilities include all North and Central American marketing for all products from Nippon Steel, including tin mill products. This position also includes Nippon Steel activities in Mexico, a major market for Japanese exports.

My job is to expand our business in the United States. But those efforts take place in the broader context of the opportunities in many other markets around the world. We have not been able to compete for a large segment of the U.S. tin mill market for more than a decade. But business goes on, and we developed an overall strategy for our tin mill business that has been working. The U.S. market has not been and will not become a major part of that strategy. During the past decade, our business has refocused. We are now well positioned in those emerging markets that are growing and offering better prices than we could obtain in the U.S. market. There is simply no reason for us to change our strategy.

{show slide 5} Our strategy has three basic elements. First, we have focused on growing emerging markets, where there are both current and future opportunities. Second, we have focused on differentiating our products, leveraging the superior technical characteristics of our steel to better meet customer needs. Third, we have focused on long-term relationships in key markets, where we invest in technical support of our products. Let me discuss each of these points.

Our overall strategy starts with a simple premise: we should focus on those export markets that are growing, and thus present the greatest long-term opportunities. This growth has been to markets all over the world, but primarily in Asia and other emerging markets. **{show slide 6}** As you can see on the screen, during 2011, the Japanese industry exported tin mill steel to 45 different countries. Over the longer 2006-2011 period, the Japanese industry exported to 60 different countries. Japan's exports to these other markets have increased about 30 percent over the 2006 to 2011 period. Why would we shift our focus from these growing markets to a declining market like the United States? Why would we shift our focus from markets with few if any local producers, markets that must import tin mill steel, to a market like the United States with four local producers who have lots of excess capacity? It would make no sense.

{show slide 7} These markets are all over the world. Of the top ten export markets in 2011, five were in Asia (Philippines, Australia, Indonesia, Taiwan, Singapore) and five were in four other regions: Mexico in Central America; Peru in South America; the Netherlands in Europe; and finally Saudi Arabia and Iran in the Middle East. Besides better growth prospects, these diverse markets create geographic diversity that avoids too much exposure to the economic risks in any one market.

Beyond this focus on growing markets, we have also focused on providing technically superior products to these markets. We have succeeded because we have differentiated our products. Japanese tin mill steel is rarely the lowest price option, but we are often a lower cost option. The key issue for our customers is how they improve their productivity. How can they produce more cans faster using less steel? How fast and how error-free can they run their operations? Through a combination of more uniform thickness of the substrate and coating, , more consistent hardness, and other mechanical and technical properties of the steel, Japanese steel allows customers to achieve higher productivity.

{show slide 8} Let me give you a concrete example. We have been developing products that allow customers to "downgauge" – to use thinner steel for the same applications. I have provided an example on the screen. We can make thinner steel with higher tensile strength that can substitute for thicker steel. This allows the customer to use 20% less steel. Even if the steel price is 10 percent higher, the higher price steel is actually a much better value to the customers. Moreover, by providing steel with extremely consistent mechanical properties, we also allow customer to reduce errors and manufacturing interruptions.

This product differentiation has been a key to our market success. **{show slide 9}** Consider Mexico. In each year over the 2006-2011 period, Mexico has been the largest single export market for Japan. Let me spent a bit more time on Mexico, since it really illustrates all of the key elements of the Japanese industry thinking.

Mexico has grown. Japanese exports to Mexico increased more than 32 percent over the 2006-2011 period, by almost 53,000 tons. Moreover, Mexico grew even in 2009, a year in which many other markets shrank and in which total exports declined. So Mexico is both a story of growth and an illustration of the benefits of diversity.

But Mexico also illustrates the benefit of higher quality products. Nippon Steel sells tin mill steel to Mexico that better meets the specific needs of customers. For example, we supply a tin mill steel with special chemical composition that has excellent formability for use in three-piece welded cans. We also sell a tin mill steel with highly consistent mechanical properties and flatness that provides excellent drawability that is ideal for two-piece draw and redraw cans. We also export to Mexico a tin mill steel with a different chemical composition that has particularly good performance in easy-open can tops—consistent, easy opening and with deep drawability. These are not generic tin mill steels, but specialized high performance products. We also provide technical assistance to customers, and work with them to adapt their production processes to maximize the benefits of using technically superior steel that will improve their productivity and lower their costs. Japanese exports to Mexico continue to grow, even when faced with competition from other suppliers, because we can provide distinctive products that better meet customer needs.

Note that I have not mentioned China. Japan exports some tin mill steel to China, but it is not major export market for finished tin mill steel. Instead, Japanese mills have set up joint ventures in China that my colleague from JFE, Mr. Okamoto, will discuss shortly.

{show slide 10} I understand that US Steel has argued increasing Chinese exports will displace Japanese exports, but this argument simply misunderstands the market. At the outset I note that in 2011, about 67 percent of total Japanese tin mill steel exports subject to this case went to markets <u>outside</u> of Europe and outside of Asia. The Japanese exports are extremely well diversified. During the past four years during which Japan exported about 900,000 tons to Mexico, China exported less than 20,000 tons. The world is a large place and our geographic focus is different than China.

Moreover, the Japanese mills are supplying fundamentally different products. We have growing joint ventures in China that succeed precisely because the products are different. Other than the Japanese joint ventures, Bao Steel is an integrated producer in China that qualifies as a tier #1 supplier of quality tin mill products. The other Chinese mills are using much lower grade substrate. Their substrate is not even really tin mill black plate – it is not clean enough and does not have consistent mechanical properties -- but is really just thin cold rolled steel – that are used mostly in lower end applications like paint cans. They cannot compete for food or beverage cans. Their steel is just too thick and too inconsistent. It would jam the machinery in a high speed food can operation.

The details are confidential, but I will submit with our post-hearing brief some test results that compare tin mill steel from the Japanese joint ventures in China with the tin mill steel from Chinese producers. The Japanese product is sufficiently different that it meets very different market needs.

{show slide 11} You can also see this difference between Japan and China in Australia. The local producer decided to stop production. China thus expanded its exports to Australia by about 29,000 tons. But over the same 2006-2011 period, Japan expanded its exports to Australia by about 54,000 tons. That is the point about growing markets and differentiated products – opportunities exist without being a zero sum game.

The final element of our strategy is long-term relationships. Again, Mexico provides a good example. Nippon Steel has been exporting tin mill steel to Mexico more than 40 years. Our largest customer in Mexico is a food can company that we have been supplying for more than 30 years. We grow with our customers. Our basic premise is that it makes more sense to have stable, long-term relationships with customers rather than switching around opportunistically. Making some extra money this quarter does not make sense when it undercuts the longer term strategy.

More importantly, in long term relationships we can invest in the technical support of our products that helps our customers use higher quality steels to improve their own productivity. I have engineers on my staff in Chicago who work with our customers in this region – including Mexico – to allow our customers to better leverage the benefits of our highly engineered steel products.

That is our basic strategy, and it does not depend on increasing exports to the United States. But there is another reason we cannot increase our exports to the United States: the disconnect between a U.S. market that demands annual contracts, and our unwillingness to enter into annual contracts.

One of the most serious challenges facing the steel industry has been the growing challenge of obtaining raw materials at a stable price. The Japanese mills are integrated producers – we run blast furnaces and melt steel – but we do not have access to key raw materials like iron ore and coking coal in Japan. We must import these raw materials. And although we have been investing to secure better access to key raw materials, this ongoing process has been challenging. **{show**

slide 12} This slide shows the problem. As China has consumed more and more of the global supply of these key steel making raw materials, world prices have spiked. Even more troubling, the old pattern of annual contracts – note the flat one year segments on this graph – has been replaced with rapidly changing prices on a quarterly or monthly basis. Raw material suppliers are unwilling to agree to annual contracts.

In most steel markets, this volatility is not a major issue. In most steel markets, pricing is set for transactions, or set quarterly. If the deal is for a longer term, there are mechanisms for price adjustments. The tin mill business in the United States is different. Customers in the United States have a strong preference for annual contracts. And these U.S. customers also strongly resist price adjustments within a contract year. They need to commit to pricing for their customers, and so they want to lock in their own material costs. That is just the reality in the U.S. market for tin mill steel.

And the U.S. market is different than our other markets. For example, in Mexico, although we previously had annual contracts, over the past few years we have moved all those customers to quarterly pricing. In fact, Nippon Steel now has a policy of not agreeing to annual contracts for steel.

But this reality puts Japanese mills in a box. The U.S. customers want to lock up a price for a year, but we have less ability to know our own costs with enough certainty to allow us to lock into a price for a year. Entering into an annual contract with a U.S. tin mill customer is thus a significant risk for a Japanese mill. It really does not make sense for us to take this risk, particularly given our ten-year effort to build customer relationship in other markets.

So where does that leave Japanese mills for the future? China is not going away. Indeed, rapidly growing Chinese consumption of key steel making raw materials will continue to be a major issue in the industry. Those integrated mills – like US Steel – with captive sources of key raw materials are at a significant advantage competing in the U.S. market. They can lock in annual contracts, and even longer term contracts, with less risk. Japanese mills, in contrast, face a disadvantage.

This is not just some abstract theory. We just don't sell steel to the U.S. market based on annual contracts that lock in price. Indeed, you can see this pattern in our shipments of excluded tin mill products. The quantities have been limited. Since we will not lock in prices longer term, customers have placed orders for only limited quantities. During the 2006 to 2011 period, all of our sales of excluded products have been quarterly contracts, not annual contracts.

Thank you. I will be happy to answer questions when our panel is finished.