2Q 2019 POSCO Earnings Release
Q&A Transcript

July 23, 2019

Price Negotiation

Global mills in Japan, China and the U.S. have announced price hike in July reflecting the continuously increasing iron ore price. Japanese steelmakers announced JPY5,000 increase for domestic sales, Chinese mill at RMB100 and Nucor in the U.S. by U$40~50. POSCO is also planning to reflect the cost burden in the sales price. Price negotiation with automakers and shipbuilders are based on semi-annual or quarterly basis. We just started 2H negotiation with our customers. It seems that the negotiation will take a while to get settled, but we will consider 1H negotiation result and each sector's business performance to get fully reflected in determining the 2H pricing.

Impact of Raw Material Price & Earnings Outlook

Considering how much iron ore price increased in the past quarter, earnings level was relatively sound. The major contributors were positive sales trend of World Top Premium (WTP) products, which also indicates our strong product mix. For exporting products, we shipped to more highly profitable regions, and also gained more on strong dollar.

In terms of managing cost of raw material, we promoted various activities not to get heavily affected by additional cost increase in the downstream when we used low-priced raw materials. Such efforts were seen on our P/L as saving 50~60 billion KRW cost. This will give us even larger benefit in 2H when the iron ore input cost increase is maximized.

While iron ore price still moves at a high level, it is necessary to pass through our cost burden to customers to maintain our margin. However, our major end industries in domestic and overseas are still in the process of recovery to fully take the steel price increase.

At the beginning of this year, it was expected the earnings in 2H will be higher than 1H. However, the surged iron ore price and insufficient increase of selling price made the annual earnings outlook slightly lower than our expectations. To reach the targeted earnings, we will negotiate with our customers for higher sales price while making efforts to reduce costs internally.

The higher iron ore price level has been maintained more than expected. From the beginning of this year, we have been preparing for such unexpected external environment. Our efforts are being made mainly focused on company-wide cost competiveness activities, called CI 2020(Cost Innovation 2020).

The targeted cost reduction amount of this year is 230 billion KRW. In 1H, we already achieved 120 billion KRW worth reduction. In 2H19, it is expected that these activities will cover considerable amount of the increased costs. CI 2020 is not just a one-time cost reduction activity but the structural improvement. Therefore, our competence achieved from such initiative will remain as POSCO's sustainable competitiveness.

Raw Material Price Outlook

This year, we have expected the prices of iron ore and coal to be stabilized in 2H19. For the coal, even though there were not particular supply problems in 1H19, the price has been maintained strongly U$205 per ton from last year. Since the major coal producer's infrastructure issue was resolved, the supply-side circumstance is improved.

Demand is weakened because of the coal imports regulation at Tangshan city in China and the monsoon season from June to September in India. Therefore, the coal price is expected at ranging from U$170~180 per ton in 3Q19. In 4Q19 the coal price would go higher to U$190 per ton with build-up of coal stock preparing for the supply disruption in 2020. Overall, coal price will be stabilized in 2H19. In the midterm, price would move between U$150~170 per ton assuming there is not any supply issues.

Iron ore price has been surged and this is out of our price outlook range. The main reason is supply problem caused by the Vale's accident and cyclone in Australia. The amount of spot market supply is not sufficient to meet the demand.

Mainly, the port inventory in China usually maintained about 130~140 million tons. End of June, the level is reduced by 30 million tons. Demand side is still strong. With this situation even though the Vale is producing again, it will take about 2 months for the shipment to reach Asia. As a result, supply from Australia should meet the spot market demand.

To meet such demand, iron ore price will be maintained at U$100~110 per ton in 3Q19, and it might be under U$100 per ton in 4Q19 with stable supply from Brazil.

All in all, despite the restarted production in Brazil, iron ore price will remain strong in short-term period due to unstable supply condition in Australia and the lowest level of port inventory in China. In the longer term, at least 100 million ton supply shortage will affect the market, from the 2021 supply and demand will be balanced and the iron ore price will be down to U$70 per ton.

Overseas Subsidiaries

For overseas steel subsidiaries, 1H performance was not as positive as in the same period last year mainly due to iron ore price hike and worsened mill margin. For PT. Krakatau POSCO, plate is more profitable than slab, and domestic price is staying high as infrastructure investment continues in Indonesia. As this trend will remain firm, PT.KP will maintain its profitability this year.

POSCO SS VINA shows weaker performance than planned. In 2H, business structuring and other fundamental measures to secure competitiveness will be carried out. Once we have concrete plan, we will share with our investors.

As for POSCO Maharashtra, operating performance is weaker than last year. The main reason was India's election, which delayed many public investment projects. Also, auto production in 2H18 in India was 2.7 million units, but 1H this year it fell to 2.5 million units. As such demand for premium steel decreased, and this dragged down market price. In 2H, however, we expect improved profitability as we expand sales to new factories of Hyundai and Suzuki in India.

Brazil CSP demonstrates operating profits from last year. However, due to its large capex size, debt repayment starts this year in major scale. Shareholders decided to raise capital of U$500 million. Accordingly, the lenders have re-scheduled repayment so that the company will not face a cash flow issue. POSCO will also raise U$100 million, equivalent to its 20% shareholding, under the approval of the Board. In the current position, the participating companies will not only make efforts to improve financial position but will reinforce capabilities to create EBITDA and reduce costs. For this, POSCO will closely cooperate with other partners to share operation know-how and ultimately promote enterprise value.

Capex

In 2019, we view consolidated capex as 6.1 trillion KRW and 5.4 on parent level. In 1H, we planned 2.2 trillion KRW, of which 1.1 trillion KRW, 50% was actually executed. In terms of POSCO steel capex, 750 billion KRW was spent on rationalization and profitability enhancement, and for subsidiaries, 74 billion KRW was used in building cathode plants and 45 billion KRW in anode plants of POSCO Chemical. Overall 1.1 trillion KRW was executed by end of June, which is 18% of annual capex plan and 50% of 1H plan. This progress rate is explained by the fact that we strengthened the investment evaluation process to minimize risks. We expect this year capex will be less than 6.4 trillion KRW as roughly 70% of planned capex was actually spent historically.

Korean environmental regulations on SOx and NOx have become tighter since April. We expect that such policy will be continuously strengthened. POSCO is preemptively responding to the trend by setting up environment-related capex plan. For the next three years until 2021, 1 trillion and 250 billion KRW environment investment is planned. This year only, we are expecting 474 billion KRW on environment-related projects. We recently issued ESG bonds and will use this capital for environment capex budget.

Stainless Steel & Competition Landscape

In 1H, STS segment earnings went down compared to last year's. It was mainly caused by the low price products of Tsingshan Steel from Indonesia which were sold to Korea to avoid the trade barriers. Recently, Ni price was surged to U$15,000 per ton, and the fire accident in Tsingshan impacted on STS supply side. Overall, these factors will be positive on our STS business by boosting the sales price.

China's Tsingshan Group and Korea's Gilsan Group have submitted a LOl to invest 0.6 tons of STS cold-rolled plant in Busan, but we understand that no progress has been made so far.

Currently, STS cold-rolled market in South Korea is over-supplied, in which production capacity is 1.89 million tons while demand is 1 million tons, there is an oversupply of roughly 9 million tons. If a STS cold-rolled plant with capacity of 0.6 million tons is built in Korea, it is highly likely that domestic STS cold-rolled mills will face a crisis of survival.

If the joint venture company produces and exports a large volume of STS cold-rolled products to foreign countries, Korea could be misled as a bypass exporter of Indonesia and China. In that case, trade disputes could arise. To avoid such situation, the KOSA (Korea Steel Association) and domestic STS industry are filing a petition with the government. We have to wait and see, but we are concerned about the current situation.

Safety Policy

POSCO is highly emphasizing on safety today and putting maximum budget and efforts. This is why we are more regretful that there were several accidents at our sites recently. We have launched a Task Force on Safety Contingency Measures as of July 23. Through TF activities, we want to propose future direction for safety. Until today, our safety activities have been focused on equipment, systems or process. From 2018 to 2020, we spared 1.1 trillion KRW for various safety promoting investment. We pursue improving work environment, safety facilities and safety in partner companies. In addition to such investment in hardware, we will also focus on individual employee's mindset toward safety. Leaders will take the initiative to establish such mindset as culture of POSCO.

Lithium-ion Battery Materials Business

POSCO has been operating a demo plant that extracts lithium from ore since late 2018 and plans to start commercial investment in 2H this year. JV between POSCO and Pilbara is planning to build a plant in Korea with an annual production capacity of 40,000 tons of lithium carbonate.

Our second lithium project will be situated near salt lake in Argentina. POSCO signed a contract to take over the mining right in August last year and completed its registration in Argentina in February this year. Investment in the establishment of demo plant has been decided recently as environmental accreditation has progressed smoothly, including environmental impact assessment. Construction of demo plant will begin in August this year, and operation will be started next year. We will decide on investment building commercial plant with an annual capacity of 25,000 tons in 1H 2021. POSCO is currently discussing LOIs for long-term sales with multiple customers, and some of them have been signed up, as the company is able to supply 65,000 tons of lithium annually in the next few years.

As for cobalt, POSCO is building cathode material plant in Tongxiang, Zhejiang Province, in cooperation with China's Huayu, one of the top cobalt producers. A total of 107 billion KRW has been invested and construction has been carried out, scheduled to be completed in August this year. Usually, it takes about a year for the certification to take place to reach the customer after completion, but we are working to drastically reduce the period to within six months and expect to start selling the first batch from February next year.

Shareholder Return Policy

POSCO maintains its long-term stable dividend policy as the basic direction. As of now, we are not considering treasury share buyback or cancellation program.