1Q 2019 POSCO Earnings Release
Q&A Transcript

April 24, 2019

Chinese Market

There are both positive and negative sides in the Chinese market at the moment. For the negative point, its major industry automobile sees 15% lower production and crude steel production picked up after winter cut ended in March. The good side is that the U.S.-China trade dispute is unlikely to go at worst scenario while not settled yet. Also, currently it is a peak season and accordingly, demand industries are on a recovery pace. In the last political gathering, the government announced to spend almost 700 trillion KRW in infra investment, reduce VAT and boost domestic economy. After the meeting, Chinese domestic indicators are showing improvement with PMI rebounded to over 50 and steel inventory down by 10% MoM at the end of March. While there are different views from those in the steel industry about the actual impact of the government measures, we think that visible results will start to be seen from 3Q.

Price Negotiation

As iron ore price continues to be strong, steelmakers are trying to hike steel prices. Chinese steel companies successfully passed through U$40-50/ton compared with the lowest price in 4Q. However, in the Korean market, we need to consider our clients' business conditions.

For auto sector, pricing would remain the same until 2Q. With auto parts companies, pricing is correlated with that of automakers. Price negotiation with shipbuilders has not finished for the 1H. Home appliances contract is on a quarterly basis, and we will try to raise 20-30 thousand KRW for 2Q. With distributors and re-rollers, pricing period is monthly, which we already raised 20-30 thousand KRW. Seeing March as the bottom, 2Q price on average will rebound.

In the export auto steel market, pricing terms are different depending on the global big 10 makers. If not spot purchase, for quarterly contracts, price was adjusted slightly lower considering the global market environment. Therefore, we are trying to increase auto steel price for export.

Raw Material Price: Iron Ore

Iron ore price is expected to surge by U$10 compared to the price U$69 of last year. The price has already reached U$83 and the two main issues have caused supply problems: the collapse of Vale dam in Brazil in January 2019 and the cyclone in West Australia in March 2019. For those supply disruptions, the iron ore price is currently staying as high as around U$94.

In Brazil, four ore mines have stopped producing after the collapse of the dam which have the production capacity of 93 million tons. This capacity is absolutely not a small-scale considering Vale's annual production plan of 380 million tons. However, the good news is that the Brazilian local court recently ordered to remove the production suspension of the ore mines that have a production capacity of 30 million tons.

Vale has ranged the short in supply from 20 to 80 million tons. POSCO has viewed more conservatively the short in supply from 40 to 50 million tons. For the underlying issues, POSCO has predicted the price of iron ore to be around mid-U$80, possibly hitting high-U$70 in 2H.

If the price hits too high, it is possible to see additional supplies of 20 million tons iron ore from Brazil’s iron mine currently at a ramp-up level that has a capacity of 90 million tons.

For other suppliers such as Rio Tinto and BHP, they are also expected to increase the supplies of iron ore if the price continues to surge. In conclusion, the supply is expected to improve in the future.

Raw Material Price: Coking Coal

We forecast coal price would be stabilized in a mid-term. The recent price surge was mainly caused by supply side, rather than demand side.

The cause of recent price surge was because of cyclone damage in Australia and Brazil where the major coal suppliers are located. However, annually, the coal price is usually increased in winter season from November to March because of the frequent unfavorable weather conditions such as cyclone and heavy rainfalls.

Also, most of steelmakers build up the coal stock to prevent the supply crunch during the winter season. In 2H 2019, the balance of supply and demand will be stable and there are no significant factors making the coal price higher even considering the steelmakers in India import larger amount of coals.

Overall, the forecast coal price range is $190~$195 in 2019, $180~$190 in 2020. Even though it is difficult to expect the mid-term price because of the wide fluctuation, most of the research firms forecast it as $150~$160 in a mid-term.

2Q Earnings Outlook

2Q outlook seems not so bright as raw material price stays strong and there is a time lag in price pass through. In 2Q, there will be a margin squeeze QoQ, but Chinese market will start to impact on the Korean market, which will have a full effect in 2Q to 3Q. 2Q earnings expected to be moderately weaker than 1Q, but mill margin will recover from 2Q, which will contribute to improving profitability from mid-2Q coupled with raw material price adjustment in 3Q. Annually, profit will be similar to that of last year.

Asset Impairment

Last year we had a large amount of asset impairments. Most of them were recognized last year, so we will only see ordinary ones this year and onwards. We stopped operation of CEM (Compact Endless Cast & Rolling Mill), which was recognized as impairment on the book in 1Q with the amount of 61 billion KRW. FINEX #1 was also recognized 12 billion KRW. For CEM, the impairment was reflected on the assets to be sold as well.

Overseas Steel

(POSCO SS VINA)
Normalization of this company is our urgent task. It is being delayed due to use of scrap and fierce competition in the Vietnamese rebar market. However, we do not have any plan to liquidate this company. Rather, we are discussing on how to stabilize the business. If it is

more specified, capital increase could be reviewed. We will try to give you better news that VINA has turned around by improving business structure.

(Indian Market)

In 1Q this year, Indian government officials and steel company representatives visited Korea to consult. There was not any concrete plan for cooperation outlined with any specific company. Discussions were underway on how to collaborate with POSCO in India in the future. POSCO has its subsidiary – POSCO Maharashtra already in India, which produces auto steel. As the country will see a growing auto market, we continuously review on how to cooperate with Indian steelmakers to secure materials from upstream and seek a growth opportunity within the Indian market.

(Brazil CSP)

CSP earned U$120 million in OP last year while net loss was heavy due to F/X impact. As the company is in complete capital erosion, Vale and Dongkuk Steel are discussing on capital increase. We are also talking with the counterparts. Among all the possible options, we will decide on the future plan sooner or later to improve the financial status of the company.

Dividend Policy

POSCO maintains its long-term stable dividend policy as the basic direction. Although 1Q earnings were lower on a year-on-year basis, it is expected that we will keep the same DPS from last year if we achieve stable performance similar to 2018. As of now, we are not reviewing treasury share buyback or cancellation in the near term.

Li-ion Battery Materials

POSCO currently has one lithium plant in operation in Gwangyang. Production volume from this plant will double to 1 thousand tons this year. Considering all the operating conditions, the volume is at a stable level. For revenue, per ton price will be around U$ 15,000.

Revenue from lithium business will greatly increase once the commercialized plan to be built in Gwangyang Yulchon Industrial Complex will start operation in 2021. This uses raw material from hard rock mine in Australia owned by Pilbara. The capacity will reach 30-40 thousand tons annually. We design 70% lithium hydroxide and 30% lithium carbonate as product mix. Depending on our customers' request, the ratio could vary. If necessary, the ratio of lithium hydroxide could go up to 90%.

After that, commercialization of plant to use material from Argentine brine will also be in full swing. Acquisition of mining right was fully transferred to us in February this year. The area spans 17,500 hectares with identified reserve of 2.25 million tons. Additional exploration is underway, and it seems highly possible additional reserve can be confirmed.

In 2H this year, demo plant will be constructed in the brine area, which will start to be operated from 1Q 2020. At early or end of 2021, 25 thousand ton capacity commercialized plant will be built in Argentina.

Lithium phosphate, intermediate product, will be produced on the region near the brine, and lithium hydroxide and lithium carbonate will be produced in an industrial complex located on the lower altitude. It means that all the final products will be produced locally. The mix between hydroxide and carbonate will also be 70 to 30.

Export Market: U.S. Tariff

POSCO exports a limited amount of steel products to the U.S. under Section 232 of the Trade Expansion Act. POSCO received 630 thousand tons annually, but exported only small amount due to high AD/CVD tariff rates. In the case of HR and CR, we hardly exported, but shipped around 150 thousand tons of plates and other products.

The result of AD/CVD annual review will be concluded in June. POSCO is trying to have the enhanced margin which will be enable to recover the amount of exports to the U.S. If POSCO can have a reasonable tariff rate, we expect to increase our sales to the U.S. by 190 thousand tons additionally. Our plan for this year will reach 400 thousand tons.

The United States is reviewing additional duty against the importing of automobiles. The way of duty is not yet determined between 25% of tariff or Quota. The Department of Commerce had reviewed and submitted the proposal to the President, and the review is ongoing in the White House.

The situation of the duty on the automobile products is different from that of steel products because the major U.S. automobile companies are against such duties while the major steel companies support it. Considering the internal opposition within the U.S and adverse effects of other industry caused by duty on automobile products, the final determination of the duty is hard to prospect. If any duty on the automobile products will be enacted, the steel industry would be adversely affected in some parts.

Stainless Steel Business

Although STS segment earnings went down significantly in 4Q, we managed to increase the price in 1Q in line with the Ni price hike. Profitability would not seem to reach 1H 2018 level, but we are recording profits on an average range. Moreover, it is least possible that STS profitability will decline as seen in 4Q.

E&C Business

1Q result was significantly down from 4Q. In 1Q, the issue was additional cost occurred right before completion of the construction on some of the overseas projects. In 2018, revenue was 7 trillion KRW, which we forecast to be higher this year. Operating profit marked 300 billion KRW last year, and this year will post a similar amount. All in all, POSCO E&C will achieve a slightly stronger performance in 2019.

Capex

In 2019, we view consolidated capex as 6.1 trillion KRW and 5.4 on parent level both including 1.3 trillion KRW of set aside reserve. Out of this total capex, 1Q execution was 450 billion KRW on a consolidated basis and 360 billion KRW on a parent basis.

By 2021, we plan 24 trillion KRW as consolidated capex, of which 8 trillion KRW is set aside without specific plans. We will cautiously deliver the investment procedures with our highest priority focusing on strengthening steel core competitiveness.