Strategic Capital

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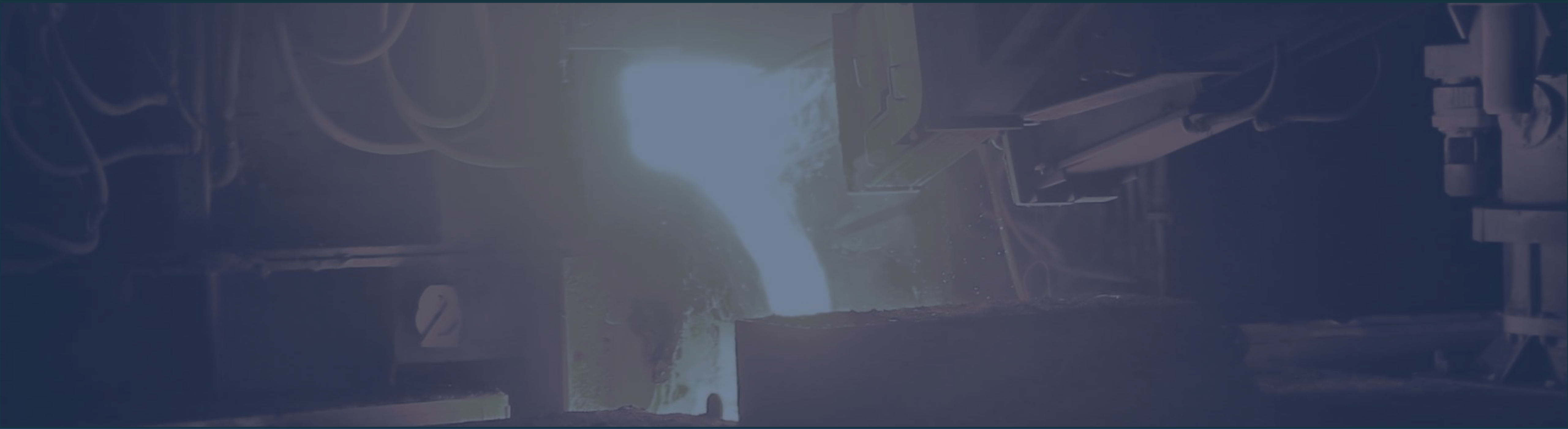

Proposal for Osaka Steel Co., Ltd (5449) to strengthen shareholder value

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Last updated May 10, 2024

Executive Summary

Strategic Capital, Inc.'s (SC) goal is to unlock enterprise and shareholder value through dialogue with the company management team and the exercise of shareholder rights.

SC and the funds managed by our company are shareholders of Osaka Steel Co., Ltd. ("Osaka Steel or the Company"). In order to increase shareholder value, we have submitted the following proposals to Osaka Steel by exercising our right to make a shareholder proposal

i. Prohibit provision of funds to Nippon Steel Corporation through deposit or loans
ii. Pay a special dividend
iii. Develop and disclose a plan to achieve a 1X PBR or greater
iv. Make the majority of Directors be outside Directors
v. Develop and disclose a plan to reduce GHG emissions

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Background of proposal

Both the Company and its parent, Nippon Steel Corp. ("Nippon Steel"), are both publicly listed and exist as a **parent-child listing***. The Company has **contributed to Nippon Steels profits by providing deposits and loans (hereinafter referred to as "CMS") and used as an *amakudari* destination for Nippon Steel executives**, and it is clear that a **conflict-of-interest risk exists between the controlling shareholder and ordinary shareholders**.

Therefore, we are making the following proposals to enhance shareholder value and improve its governance. As a listed company that is raising capital from a multitude of shareholders, they should focus on raising shareholder value through these proposals and **if they cannot, action should be taken to make the Company a wholly owned subsidiary of Nippon Steel and delisted.**

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Details of the proposals

Prolonged stock price slump and need for management reform → Develop and disclose a plan to achieve a 1X PBR or greater *(FSP 3)*

The stock price has not exceeded 1x PBR since 2008 and as of March 25, 2024, was extremely undervalued at only 0.56x.

In March 2023, the TSE requested listed companies to "take action to realize management that is conscious of cost of capital and stock price," and with particularly strong awareness of challenges facing companies with PBRs less than 1x. While the Company did respond on January 30, 2024, it only introduced existing measures with nothing new. As a result, there was no improvement in stock price.

The Company's disclosures, including MTBP are extremely limited and without an ROE target. Nippon Steel announced a 10% ROE target in its own MTBP, and as a consolidated subsidiary that is part of the plan, the Company should formulate and disclose a similar plan.

Therefore, in order to get the stock out of its long-term slump, we propose the company develop and disclose a specific and highly feasible plan to achieve a 1x PBR or greater including the establishment of an ROE target and efforts to achieve it.

A system that continues to undermine shareholder value → Prohibit provision of funds to Nippon Steel Corporation through deposit or loans and pay a special dividend from surplus *(FSP 1,2)*

The Company's CMS to Nippon Steel totaled JPY 68.6B at the end of FY2022 which was more than 70% of the Company's market cap (JPY 93B as of Mar 25, 2024). The interest rate on the CMS was only 0.2% for FY2022, which was naturally much lower the cost-of-capital. The ROE has been stagnant and as a result PBR has remained low over the long term.

Therefore, we propose to prohibit the CMS program and pay a special dividend of 50% of surplus funds.

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Details cont'd

Improve ESG ①→ Make the majority of Directors be Outside Directors *(FSP 4)*

As of March 31, 2023, the Osaka Steel had eight directors (including three outside directors), but all five of full-time Directors were amakudari from Nippon Steel.

While contributing to the parent company's fund management through CMS and other means, the Company's directors continue to cause the shareholder value to decline. It is clear a conflict-of-interest risk exists between the controlling shareholder and ordinary shareholders, and we propose that the majority of the Directors be outside Directors in order to strengthen corporate governance.

Improve ESG ②→ Develop and disclose a plan to reduce GHG emissions *(FSP 5)*

The Company states that it aims to reduce total GHG emissions by 30% compared to 2013 levels by 2030 and to be carbon neutral by 2050. However, the measures to achieve this goal lack specificity and there is no disclosure of a time frame for achieving this goal nor the necessary financial plan. In addition, the electric furnace business, which recycles steel scrap and manufactures steel products, has a smaller environmental impact than the blast furnace business and is a tailwind toward the realization of a decarbonized society, yet disclosures are inadequate and as a result it is difficult to believe that the Company is being recognized by investors who are interested in environmental measures.

Therefore, we request that the Company formulate and disclose its short- and medium-term greenhouse gas reduction targets for Scope 1 through 3 and its financial plan for achieving them, with the aim of lowering its cost of capital.

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What's New

04.25.2024

Submitted Formal Shareholder Proposal to the Company

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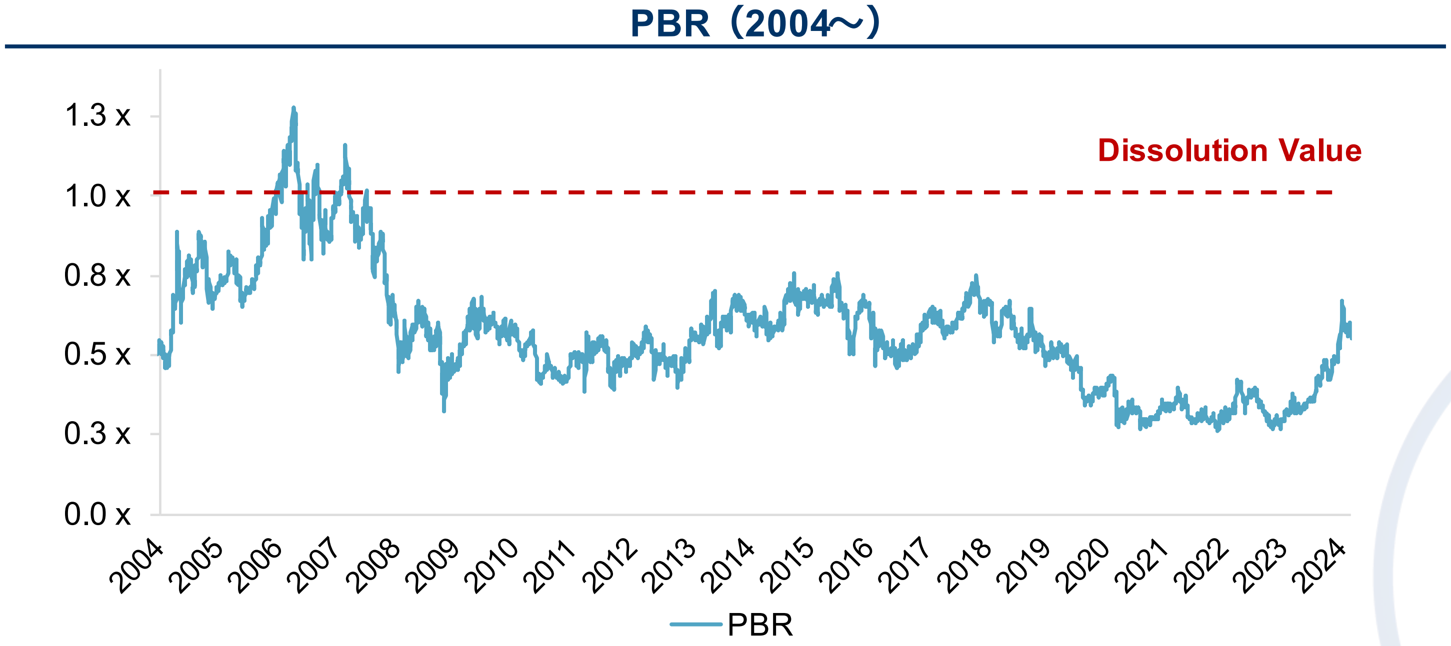
Market capitalization that can't exceed 1x PBR

Since 2008, Osaka Steel's stock valuation has **stagnated below 1x PBR**. As of March 25, 2024 the **PBR is 0.56x**. The stock price valuation clearly shows that the Company's management policy has been damaging the interests of its shareholders and a fundamental change in management and capital policy is necessary to increase shareholder value.



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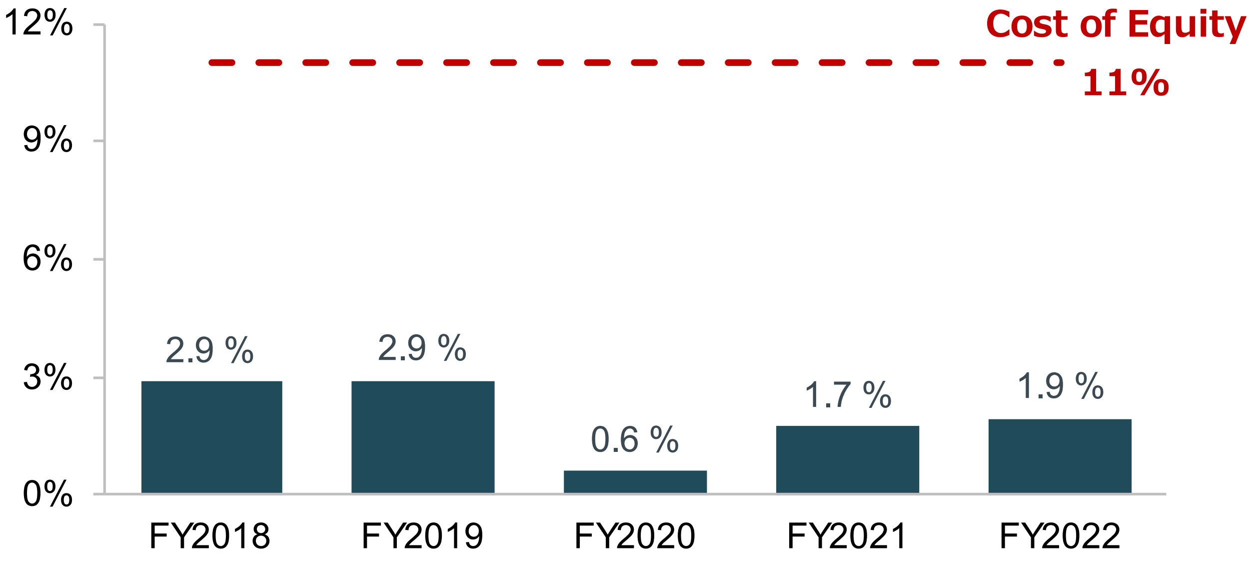
Capital efficiency below cost of capital

The main reason why the PBR has lagged below 1x is the ROE is less that the Cost of Equity (COE), which we estimate to be around 11%, (as of March 25,2024, Bloomberg and Quick put the cost of equity at around 11.2% and 10.7% respectively) and ROE continues to remain below the level. As **there is no ROE or other capital efficiency targets in the MTBP, and it must be said that management awareness of stock price, capital efficiency, etc. is low**. The Company should **set an ROE target that exceeds the COE and re-establish the MTBP to achieve it**.

ROE and Cost of Equity over time



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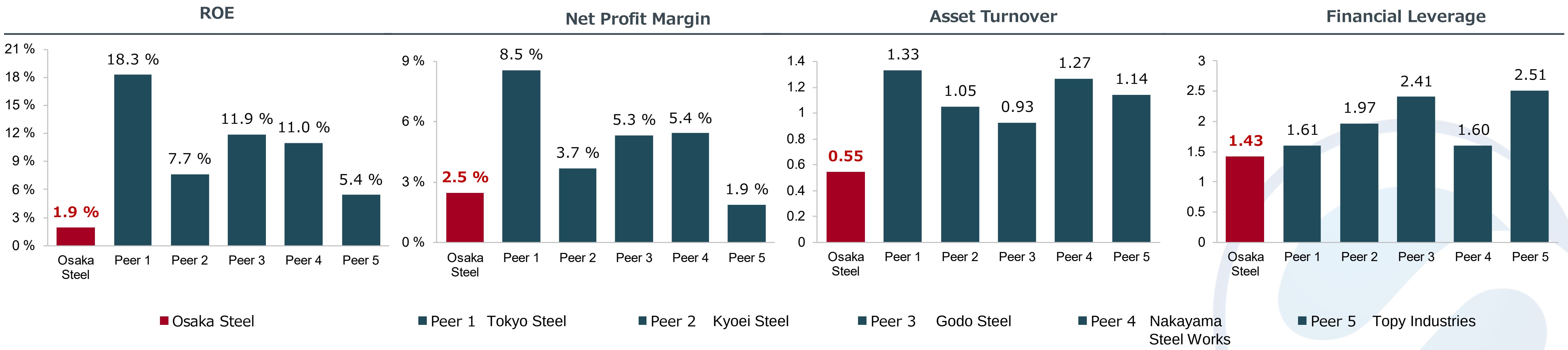
Capital efficiency far below peers due to CMS and other factors

Comparing ROE components (DuPont analysis) with industry peers, **Osaka Steel is among the lowest in all categories**. While it goes without saying that efforts should be made to increase profit margins, **asset turnover and financial leverage remain low compared to peers mainly due to the CMS which accounts for more than 30% of total assets**. If CMS, which only generates a 0.2% return, continues it will be impossible for ROE to exceed COC, and by extension, it will be difficult to end a PBR of less than 1x. By banning CMS, there will be JPY 68.6 B (as of March 31,2023) in cash of which 50% should be used for a special dividends, and the remainder for business investments that are expected to generate a return greater than the COC.



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Losses due to CMS

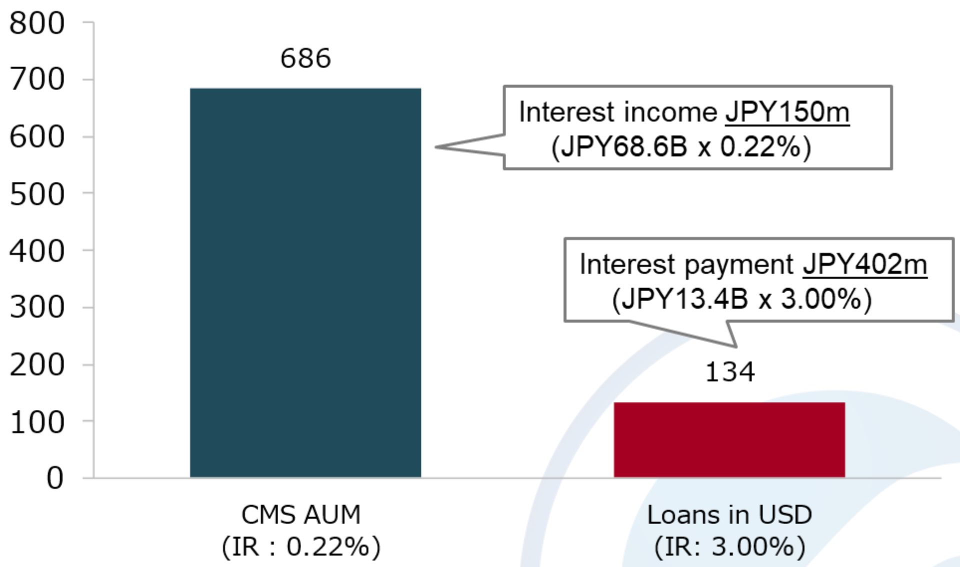
In addition, the Company made a loan to it's Indonesian subsidiary PT. KRAKATAU OSAKA STEEL ("KOS") **financed in USD resulting in an interest expense of approx. JPY400m for FY2022**. **An expense that would not have been incurred had CMS been reversed, converted to USD and then loaned to KOS**. Assuming JPY13.3B loan at the end of FY2022 and considering an interest rate expense of approx. 3.0% for the KOS loan and approx. 0.2% interest income from the CMS, **an annual loss of approx. JPY370m was incurred.**

This was easily foreseeable given interest rates differences but its apparent the Company Directors were more concerned with Nippon Steel that they continued CMS at the expense of the Company's economic interests.

Although the Company has recently repaid the above debt, CMS is a system that contributes to the parent company's cash management while detracts from shareholder value in its subsidiaries and the Company should promptly cease funding through CMS.

Loss due to CMS (JPY100m)

JPY373m/yr. [JPY402m – JPY29m (JPY13.4B x 0.22%)]



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Revisions

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