慶應義塾大学ビジネス・スクール

Nippon Steel's Competitive Strategy and Takeover Defense

Shockwaves of Arcelor Takeover by Mittal

At 10 o'clock on the morning of January 4, 2007, headquarters-based senior managers of Nippon Steel Corporation (hereafter "Nippon Steel") gathered in an auditorium located on the second floor of the company's headquarters building to attend a New Year's function. The New Year's message of President Akio Mimura — who, with his extensive overseas experience, including study at Harvard University Graduate School, assumed the presidency of Nippon Steel in April 2003 — was very sobering, reflecting the difficult situation the company faced.

"We have experienced that, once you become a takeover target, you can be swept away by a surging tide driven by the logic of financial capital rather than industrial capital, no matter how big a company you may be."

"If we were to be acquired by a business entity with a different set of ideas from ours in a hostile takeover, it could jeopardize the hard-earned competitive edge of not only us but also the Japanese manufacturing industry as a whole. Although there is no bulletproof takeover protection, management is determined to protect the corporate value of Nippon Steel that have been built over the years through hard work, by combining a number of measures."[1]

"Last year, the world steel industry witnessed a monumental event; the successful takeover of Arcelor by Mittal. The birth of ArcelorMittal, which boasts a crude steel production capacity of 120 million tons, approximately three times as large as ours, and a cash flow of over 1 trillion yen, sent shockwaves throughout the world steel industry. Until now, we've believed that the best thing we can do for the company and its employees is to improve our business performance, modernize our facilities and strengthen our financial structure, and have been working hard to achieve those goals. However, the successful takeover of Arcelor by Mittal shows that, the better a company performs, the more attractive it becomes for potential takeover bidders, thus elevating the risk of being taken over - unless it achieves a commensurate total market value as well."[2]

Kotaro Inoue (Associate Professor, Graduate School of Business Administration, Keio University) prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.
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[1] NHK Special Reporting Team, "Nippon Steel vs. Mittal", Diamond, Inc., p. 19 (hereafter "NHK").
[2] NHK, p. 23.

sample

For Nippon Steel, 2007 was a special year, the 150th anniversary of its founding. The company dates back to 1857 (still in Edo era), when pig iron was successfully tapped from Japan's first Western-style blast furnace in Kamaishi. In 1934, Japan Iron & Steel Co., Ltd. was founded through a merger of Yahata Steel Works with Wanishi Iron Works, Kamaishi Mines, Mitsubishi Iron, Fuji Steel, Kyushu Steel and Tokyo Steel. Although Japan Iron & Steel was split into Yahata Iron & Steel Co., Ltd. and Fuji Iron & Steel Co., Ltd. in 1950 under the Law to Eliminate Excessive Economic Concentration, the two companies merged again in 1970 and re-launched themselves as Nippon Steel Corporation. Since then, Nippon Steel has been a leading force in throughout Japanese manufacturing industry. Despite their important presence, the firm was now feeling the threat of a takeover by overseas players.

Winding back a year to January 27, 2006. Mittal Steel, an Indian-based steel company boasting the largest steel production output in the world, announced its plan to acquire Arcelor, a Luxembourg-based steel company with the second largest steel production output in the world. Two weeks earlier on January 13, Arcelor Chairman Guy Dolle was invited to the London residence of Mr. Lakshmi Mittal, Chairman of Mittal Steel, for dinner, and received — and rejected — a merger proposal at the dinner table. Mittal Steel's takeover offer was 28 euros per share with a total value of 18.6 billion euro (roughly 2.6 trillion yen)[3]. In concrete terms, it was based on a share swap at a ratio of four Mittal Steel shares plus 35.25 euros in cash for five Arcelor shares. Arcelor called a meeting of the Board of Directors, and formally rejected Mittal Steel's takeover proposal, thus turning it into a hostile takeover bid.

It was a bold takeover move by Mittal, which had just become the largest steel company in the world through the acquisition of ISG, the second largest steel company in the United States, in the spring of 2005. Chairman Mittal, who had turned around the operation of a string of developing countries' national steel companies struck by financial woes, stated in a press conference held on 27th of January of the same year: "We want to stabilize the operation of the steel industry. It will benefit employees, shareholders and society. To achieve that goal, industry consolidations are essential, and this takeover proposal is an important step towards a structural change of the steel industry[4]. The Arcelor takeover proposal sent the share prices of major steel companies soaring across the world. A successful merger would create a gigantic company having a combined crude steel production output of over 100 million tons, more than three times that of Nippon Steel, the third largest producer in the world, along with a total work force of 320,000 employees and annual sales of about 70 billion dollars.

[3] For details about Mittal Steel's takeover proposal to Arcelor and the subsequent tug-of-war, see the Keio University Business School case study entitled "Arcelor: Takeover Defense Strategy".

[4] Nihon Keizai Shimbun, "Proposing Arcelor Takeover, Chairman Mittal's Insatiable Appetite for Industry Consolidations", 2006/01/30.

Caught totally by surprise, Arcelor expressed its displeasure by branding the takeover proposal "hostile". Arcelor was Europe's largest steel company created in 2002 through a merger of three European steel companies: Arbed of Luxembourg, Usinor, a former French national enterprise, and Aceralia of Spain. For this reason, Mittal Steel's takeover proposal was greeted by statements of disapproval from top government officials of France, Luxembourg, and other countries. The Luxembourg Government was the largest shareholder of Arcelor with a 5.6% stake. In addition, TOB reviews by financial regulators in France, Spain and other countries where Arcelor's stock was listed dragged on, thus preventing Mittal from launching a formal TOB bid. In the meantime, Arcelor announced a set of defense measures, including a rise in dividend payout from 0.65 euros per share to 1.2 euros per share and an additional shareholder profit distribution measure worth 5 billion euros. Against a background of the increased dividend payout by Arcelor and anticipation of a rise in Mittal Steel's takeover price, Arcelor's share price hovered above Mittal's offer of 28 euros per share.

Although the top shareholder of Arcelor was the Luxembourg Government, its long-term shareholder base was only about 20% in terms of total shareholding[5]. With individual shareholders accounting for about 40%, Arcelor's shareholder structure was by no means favorable for defense against a hostile takeover. This stemmed from the fact that Usinor, a former French national enterprise which had been one of the participants in the creation of Arcelor, sold its shares mainly to individual investors at the time of its privatization. After the announcement of Mittal's takeover proposal, many of those individual shareholders rushed to sell their stakes as Arcelor's share price soared. At the same time, a number of hedge funds moved in to buy up Arcelor shares. In an M&A situation, hedge funds usually engage in an investment activity called "risk arbitrage" in anticipation of a rise in the takeover price. Namely, as individual shareholders tend to sell their stakes for fear of a plunge in the share price in the event of a collapse of the takeover bid, hedge funds buy up those stakes at prices below the potential takeover price to net the price differentials while betting on a further rise in the takeover price. In Arcelor's case, many hedge funds are believed to have acted in anticipation of an increase in Mittal Steel's takeover price, as the Arcelor's share price hovered above the company's initial offer of 28 euros per share. Other factors included Arcelor's appeal to its major shareholders to increase their stakes and support the current management team. Roman Zaleski was one of the investors who heeded this appeal to become a large shareholder, eventually increasing his stake to 8%.

Arcelor also asked for support from Nippon Steel, who they had a strategic alliance in terms of technology and manufacturing relating to products catering to European-based Japanese-affiliated car manufacturers. The firm hoped to build at least a significant cross-shareholding-based relationship similar to the one between Nissan and Renault, even though a full merger would have been difficult. However, Nippon Steel was not that interested, and the plan did not materialize[6].

On May 18, Mittal Steel launched its TOB. The prospective takeover price was raised, and a cash purchase offer priced at 37.74 euros per Arcelor share was included, in addition to the initial combination of share swap and cash payment, with shareholders given a choice. This latest proposal was at about a 85% premium over the Arcelor's share price just before the announcement of the initial

[5] NHK, p. 73.
[6] NHK, p. 58.

takeover proposal based on 20 euro share price. Mittal Steel set the size of cash payment at up to 7.6 billion euros or 30% of the total takeover price.

Nine days before the TOB, Arcelor had announced a counter-merger proposal involving Severstal, a Russian steelmaker ranked 12th in the world in crude steel production, as the white knight, an alternative takeover bidder supported by the current management team. The merger condition was 44 euros per Arcelor share, which was 15% more generous than Mittal's offer. Arcelor expressed strong opposition to Mittal's hostile takeover bid. Chairman Guy Dolle put it this way: "If you compare our company's products to high-class perfumes, Mittal's products are colognes." The statement emphasized the difference between Mittal, which pursued a production expansion of run-of-the-mill products, and Arcelor, which focused on high-quality steel for cars[7]. Arcelor had set its sights on BRICs nations, whose car markets were experiencing rapid growth, setting up a production base in Brazil and taking part in a three-way joint venture with Baoshan Iron & Steel and Nippon Steel in China. In Russia, its joint-venture plated steel plant with Severstal had just become operational, and Arcelor announced its strategy to dramatically enhance its presence in Russia through the newly proposed merger. However, Mittal Steel dismissed the proposal by issuing the following announcement on the 26th: "It is a second-rate merger. The Mittal-Arcelor combination is the best option in every way, and will really lead to important industry consolidations.

The proposed merger with Severstal also received a cool reception from Arcelor shareholders, and there was little prospect of securing their support for it. Mr. Zaleski, the major investor mentioned above, also opposed the proposal. As a result, Arcelor entered into negotiations with Mittal on June 8, 22 days after the TOB, at the Brussels Airport Sheraton Hotel[8]. At the negotiating table, Mittal was determined and persuasive: "Let's join forces and redraw the map of the world steel industry. This takeover will benefit both of us." The Mittal side was well-researched on what was going on inside Arcelor, and this enabled them to come up with an estimate of the synergistic effects between the two within two hours of negotiations.

On June 25, Arcelor's Board of Directors met again and approved the merger with Mittal. The final takeover offer was 40 euros per share, which translated to a total price of 26.9 billion euros (approx. 4 trillion yen).

Mr. Seki, who has become the Senior Corporate Auditor of Nippon Steel after a stint as an executive vice chairman, sums up the contributing factors to the successful takeover of Arcelor by Mittal Steel. First, Nippon Steel, which was similar in size to Arcelor, was valued at about 3 trillion yen at the time, whereas the market valuation of Arcelor prior to the takeover proposal was just 2.2 trillion yen, making it relatively cheap to acquire. Second, Mittal made full use of financial capital, including hedge funds. Namely, hedge funds bought up the stakes of individual shareholders, who accounted for 40% of all of Arcelor's shares, prior to the TOB, and Mittal bought those stakes from the hedge funds. Third, Mittal was able to minimize the use of cash through the utilization of a share swap. Fourth,

[7] Nihon Keizai Shimbun, "Arcelor Merger, Fight for Initiative in Global Steel Industry Consolidations — Size matters", 2006/05/27 (Morning Edition).
[8] NHK, p. 54.

Mittal was able to complete the acquisition without any negative impact on its financial position despite the 25.6 billion-euro (4 trillion-yen) price tag, thanks to ready access to a 12 billion-euro cash reserve Arcelor had built up prior to the takeover. Fifth, Arcelor had a small 20% or so long-term shareholder base, with individual shareholders eager to sell their stakes to lock into the acquisition premium over the Arcelor share price, so much so that by the time Arcelor brought the Russian would-be white knight into the stage, financial capital, including hedge funds, had already secured effective control of the company.

According to Mr. Seki, Nippon Steel held 500 billion yen worth of financial assets in net terms at the beginning of 2006, and was also in a position to acquire Arcelor, given that its real acquisition cost was only 2 trillion yen (acquisition price 4 trillion yen — cash reserve of 2 trillion yen). Pointing out the need for Nippon Steel to broadly explore acquisition opportunities and look into collaboration with financial capital as a means to ensure successful acquisitions, in addition to strengthening its takeover defense measures, Mr. Seki expresses his disappointment over Nippon Steel's missed opportunity to take the lead in industry consolidation.

President Mimura of Nippon Steel, on the other hand, was very cautious about collaboration with financial capital. On October 2, 2006, the second day of the Annual Conference of the International Iron and Steel Institute, held in Buenos Aires, Argentina, Mr. Mimura as the Chair gave the following closing speech before senior delegates of major steelmakers from various countries: "A further consolidation of the steel industry will bring stability and is indeed necessary. However, it should be pursued by industry players themselves, rather than hedge funds and other financial capitalists[9].

Economic Background of the Steel Industry Consolidation

In the past, the steel industry underwent a series of consolidations to avoid over-competition. The launches of Nippon Steel in 1970, creation of the JFE Group, and establishment in 2002 of Arcelor through an international merger of three companies, including Usinor, were all aimed at avoiding over-competition. The Mittal-led consolidation was clearly different.

Senior Corporate Auditor Seki of Nippon Steel has identified the following contributing factors to industry's various consolidations: "Compared to other industries, the combined market share of the top five companies in the steel industry is low, only 20% vs. about 80% in the iron ore industry and about 70% in the automotive industry. Namely, the steel industry's market share concentration is low relative to its upstream and downstream industries, and this will drive further cross-border industry consolidation amid continued demand expansion in East Asia, including China and Russia"[10].

President Ouchi of Mizuho Research Institute Ltd. (position current at the time of the interview), who is well-versed in the steel industry, also points out that consolidations among major resource companies are behind Mittal's expansion strategy: "Resource giants kick-started international consolidations early on, and the user side followed suit, with reorganization into alliance groups well

[9] NHK, p. 72.
[10] Seki T. (2008), "M&A and Steel Industry", "Views & Views", No. 25, Chiba University of Commerce.

under way in the automobile and other industries. The steel industry has fallen behind, and even ArcelorMittal, by far the largest company in the world, only has a 10% market share. To regain negotiating clout in raw material procurement and product sales, steel industry players need to get bigger and bigger. … Among Western analysts, the supersizing of Mittal has been seen as largely advantageous in terms of the price stabilization of raw materials and products. There is no argument against gaining in size through consolidation."[11]

In the upstream iron ore industry, the development of a mine requires a huge capital investment in the order of several hundred million yen, especially due to a need for major infrastructure development, including a port and railway. For this reason, iron ore companies have been increasing their sizes through international mergers, including the creation in 2001 of BHP Billiton through the merger of Australia-based BHP and UK-based Billiton. As a result of market share concentration, the negotiating power of resource companies has increased[12]. Iron ore companies, which numbered more than 10 in the 1990s, have essentially consolidated into just three, Vale (formerly Companhia Vale do Rio Doce), BHP Billiton and Rio Tinto, with a combined market share of more than 70%[13]. Iron ore deposits are believed to account for 5–6% of the earth's crust, and are distributed fairly evenly throughout the world. However, accessible high-quality iron ore deposits are limited, and Australia and Brazil, together, account for about three-quarters of all iron ore exports.

As a consequence, steelmakers across the world were forced to accept four consecutive price rises starting in FY 2006, and the price of iron ore has more or less doubled since 2006. Faced with this situation, Mittal was hoping to be able to procure its raw materials more cheaply by increasing its negotiating power with the major resource firms on the basis of its 10% market share in terms of crude steel production. Chairman Lakshmi Mittal foresaw a chain reaction of industry consolidation: "Scale is the driving force of profit growth. Within the next decade, one or two steel companies with a crude steel production output of more than 150 million tons will emerge[14]". In a lecture given in June 2005, Mr. Mittal pointed out: "The iron ore industry enjoys a high profit margin of 35% because the top three companies have secured a 75% worldwide market share between them. In contrast, the profit margin of the steel industry is only about 10% because the combined share of the top 10 companies is no more than 25%." In this context, he foreshadowed his company's future acquisition path: "Worldwide consolidations can reduce cyclical fluctuations[15]". Mr. Mittal's ideal picture for the steel industry was as follow: a handful of steelmakers controlling worldwide steel production and wielding overwhelming negotiating power against iron ore and coal companies on the upstream side and automakers on the downstream side. Namely, the kind of steel industry consolidation being pursued by Mr. Mittal was aimed at acquiring the power of scale sufficient to match the negotiating power of industry players on both the upstream and downstream sides, where rapid market share concentration was under way, rather than alleviating industry over-competition. President Mimura of Nippon Steel

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[11] Nihon Keizai Shimbun, 2007/02/16, p. 15.
[12] Nihon Keizai Shimbun, "Reading 2006 Resource Situation (3), Iron Ore", 2006/02/16.
[13] NHK, p. 184.
[14] Nihon Keizai Shimbun, "High Resource Prices Forcing Industry Consolidations (3) Clear Sign of Oligopolistic Control over Resource Markets by Majors - An industry standoff with size and other international competitiveness as weapons", 2006/08/10 (Morning Edition).
[15] Nihon Keizai Shimbun, "Mr. Mittal - A Tycoon Bent on Oligopolistic Control", 2006/02/20 (Morning Edition).

agreed with this direction, describing "scale" as "an important factor in strengthening international competitiveness"[16]. Mr. Mimura also commented favorably on the merger of Arcelor and Mittal and subsequent industry trend in his "To Our Stakeholders" message in the company's Annual Report 2007: "the world steel industry is witnessing a proactive consolidation aimed at creating a more stable industry structure and capturing leadership in the industry".

Even after the merger of Arcelor and Mittal, the consolidation of the iron ore industry continued. In 2007, Anglo-Australian resource giant BHP Billiton proposed an acquisition of its rival Rio Tinto. With a price tag of 15 trillion yen, the proposal far exceeded Mittal's Arcelor acquisition in scale. In the face of a prospect of the emergence of a resource supergiant with a global market share of nearly 40%, leading steel companies across the world closed ranks and expressed unanimous opposition to the proposal. The International Iron and Steel Institute, a gathering of major steel companies and associations around the world, also issued a statement expressing its "strong opposition". If the merger was allowed to proceed, it would create a resource giant with a global market shares of 40% in the iron ore market, 30% in coking coal and 20% in uranium. As of the spring of 2008, how this takeover saga will conclude is still unclear, but it highlights how advanced market share concentration in the resource industry is compared to the steel industry. As far as iron ore is concerned, just three companies - BHP Billiton, Rio Tinto and Brazilian-based Vale, the largest iron ore company in the world - account for 80% of all global exports. These are the words of BHP Billiton CEO Kloppers: "Another consolidation step will give us overwhelming power in the global steel raw material markets."

Iron ore price negotiations for FY 2008 between Nippon Steel and BHP Billiton ended in a 65% increase from the previous fiscal year. This represents a 4.5 fold jump from FY 2002, when the high resource price trend was not yet clear. A combination of price pressures on the supply and demand sides, i.e. oligopolistic supply control by global resource companies achieved through industry consolidations and a demand explosion in developing countries, has led to unprecedented price rises. This trend looks set to continue, and there is deep concern for a prolonged period of high steel raw material prices[17].

Still not satisfied, BHP Billiton CEO Kloppers has begun proposing "the establishment of a global iron ore futures exchange" to other steel companies. In the steel industry, raw material prices have been set through once yearly negotiations between major steel companies and major resource companies in order to stabilize the prices of steel products used in various goods, such as cars and home electric appliances. Mr. Kloppers calls this "an opaque commercial practice." He calculates that, if speculative funds flow into the market, as is the case with crude oil, prices will rise further. This

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[16] Nihon Keizai Shimbun, "High Resource Prices Forcing Industry Consolidations (3) Clear Sign of Oligopolistic Control over Resource Markets by Majors — An industry standoff with size and other international competitiveness as weapons", 2006/08/10 (Morning Edition).

[17] Nihon Keizai Shimbun, "Nippon Steel Facing Threefold Rise in Coking Coal Procurement Price, High Steel Raw Material Prices May Be Prolonged — Caused by a rapid demand expansion and oligopolistic control of supplies", 2008/04/06 (Morning Edition).

bullish stance stems from the asymmetry of power between the upstream and downstream industries over resources[18].

The impact of this large negotiating power by the major resource firms is continuing to affect not only on the steel industry but also on its downstream industries. In 2008, Nippon Steel and Toyota Motor Corporation agreed on an approx. 30% rise in the price of automotive steel sheets. This rise translated into 20,000 to 25,000 yen per ton, which was a record hike, and the steel price topped 100,000 yen for the first time. What made Toyota accept such a large price rise despite its massive purchasing clout and against widespread expectations was the fact that ArcelorMittal had proposed to European automakers a price rise proposal on a range of major steel sheet products that would be effective from January 2008. Price rises would hit financially-constrained mid tier automakers particularly hard. President Carlos Ghosn of Nissan also commented: "Industry consolidations are a certainty". The situation of the shipbuilding industry would be even more serious, and industry players are fearful that accepting the price rises "would blow away all the profits across the industry[19]."

Senior Advisor Hiroshi Okuda of Toyota, who is also a member of Toyota's Board stated in a recent magazine interview: "The whole world has been thrown into a swirl wind of price instability, and the market may shift to a totally different equilibrium point in one or two years[20].

Nippon Steel's Growth Strategy

In the period ending in March 2006, Nippon Steel and three other major steel companies were enjoying record profits, thanks to booming sales for their specialty high-quality steel products destined for motor vehicles and home electronic appliances. The four companies' large profit growths were made possible by the widespread acceptance of higher prices for their products. In the case of Nippon Steel, the average price of steel products rose by 20% from the previous period, and the profit growth effect of price rises amounted to 310 billion yen. Since high-quality steel products destined for automotive, shipbuilding and other manufacturing industries, for which the supply-demand situation was tight, were Japanese steelmakers' forte, they were able to minimize the impact of the deteriorating market conditions for run-of-the-mill products. There was also a streamlining effect. Nippon Steel reduced its workforce from 60,000 in 1987, just before the collapse of the bubble economy, to 15,000 at the end of March 2006, thus dramatically improving its business efficiency. The number of blast furnaces, which used to be seen as a symbol of high costs, was cut from 13 in the mid-1980s to nine[21]. Saying "We can further reduce our workforce through technological innovations," a senior manager of Nippon Steel was enthusiastic about lowering the company's break-even point a few more notches[22].

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[18] Nihon Keizai Shimbun, "High Resource Prices as Unprecedented Challenge (2): Cost Blow Out by 250 Trillion Yen — There is mounting pressure for industry consolidations", 2008/04/28 (Morning Edition).

[19] Nihon Keizai Shimbun, "Price of Automotive Steel Sheets Rises above 100,000 Yen for First Time — The automotive and steel industries sharing the pain of high resource prices", 2008/05/16.

[20] Nihon Keizai Shimbun, "15 Trillion Yen Takeover Offer Sends Shockwaves — Approaching footsteps of resource supermajors", 2008/02/18 (Morning Edition).

[21] Nihon Keizai Shimbun, "Steelmakers' World-Class Business Performances - Four companies forecast record profits as they buttress their footholds in preparation for looming industry consolidations", 2006/03/03 (Morning Edition).

[22] Nihon Keizai Shimbun, "Chasing Bubble-Era High Share Prices (5) Nippon Steel - The company's global strategy being tested", 2007/07/11 (Morning Edition).

It was in this environment that Nippon Steel released its medium-term business plan at the end of 2005. It contained plans for major capital investments aimed at extending its technological lead, which far exceeded depreciation expenses in scale, and production increases for high-quality steel products, the demand for which was expanding in the automotive and other manufacturing industries. Given that Japanese steelmakers are said to be more technically advanced than overseas rivals by a margin of five to 10 years, the above emphasis on high-quality products seemed to be a logical choice to stabilize profits. However, some market sources found the numerical targets contained in the plan rather underwhelming. Nippon Steel's profit target for FY 2008 was 500 billion yen, which fell short of the FY 2006 figure. Even the crude steel production target only represented a 10% or so increase over FY 2006, when production cuts on run-of-the-mill steel products were in effect. The plan did not include any capital investment initiatives geared towards dramatically increasing the production capacity, such as the construction of a new blast furnace. Though it was a deliberate strategy to avoid taking excessive risks, a well-known analyst of a steel trading company could not help take a gibe at it: "They still haven't overcome the trauma from their tough restructuring process[23]."

However, President Mimura insisted that Nippon Steel has switched to a more scale-oriented expansion strategy in response to the Arcelor-Mittal merger:[24] "Steelmakers with a crude steel production output of 20–40 million tons per annum will face business instability for various reasons. In our case, the 40 million tons per annum, we have targeted to produce through the utilization of the excess capacities of our subsidiaries (by 2011) is not enough to ensure business stability. In the future, we will look into ways to top it up. Scale will remain a major factor in strengthening international competitiveness."

"Our goal to become the top overall steelmaker centering on high-quality products has not changed. Although we will not acquire companies with different corporate cultures in hostile takeovers or scavenge failed companies, M&A is definitely an option for companies to use to streamline. We will keep our door open on friendly M&A."

In fact, Nippon Steel upgraded its capital investment plan in 2007. In the Annual Report 2007, President Mimura summarizes the company's strategy as follows:

"Against the backdrop in the world steel industry, Nippon Steel is taking actions aimed at reinforcing its position in the industry. With that aim, we are working to simultaneously attain growth, stability and an enhanced financial position while building on our competitive edge in technology and manufacturing skills. One of the cornerstones of our strategy is to be the No. 1 global steelmaker focusing on medium-high grade steel. Once we finish upgrading the No. 1 blast furnace at the Oita Works in the first half of 2009, we will have an annual capacity for 40 million metric tons of crude steel output. But we will not stop here, and we are considering measures to further boost our annual capacity beyond 40 million metric tons in order to achieve more profit growth (note: Construction of a

[23] Nihon Keizai Shimbun, "Blind Spot of Major Steel Companies' Quality-Focused Growth Strategy – There is concern for an erosion in their pecking order amid global industry consolidations", 2006/03/14.
[24] Nihon Keizai Shimbun, "Our Response to Global Consolidations of Steel Industry: Nippon Steel President Akio Mimura", 2006/07/09 (Morning Edition).

steel plant in Brazil announced in 2008). The second initiative involves building more and stronger relationships with partners who share our values. All these activities demonstrate our policy of conducting operations in locations where there is demand for steel. We plan to continue forming and deepening these "soft alliances" on a global scale. The third initiative is to further refine our portfolio of leading-edge technologies. This breakthrough shows how we can use technology no competitor can match to create one-of-a-kind products that can drive profit growth. The fourth initiative calls for capturing synergies with our five non-steel business units and further improving the profitability of Group companies, both with the aim of raising the Group's corporate value. We are making large investments for capital expenditures and equity alliances that can underpin our future growth. During the three-year medium-term consolidated business plan ending in March 2009, we originally planned to make capital expenditures and investments totaling ¥850 billion (note: including long-term equity investments). We now expect this figure to rise to ¥1,200 billion."

President Mimura explains his "plus alpha", i.e. the production boost from the stated production target of 40 million tons p.a., centering on high-quality steel, as follows: "The birth of ArcelorMittal has been a critical factor. It boasts a crude steel production output of 110 million tons p.a., approximately three times as large as ours, and a cash flow of over 1 trillion yen, and has declared an aggressive acquisition strategy towards its rivals. The Chinese Government is also trying to create steelmakers with a crude steel production output of 30 to 50 million tons. Besides, Japanese automakers, who are also our important customers, are increasing their global production. In response to these circumstances, we will shift our focus onto growth. Rather than just being No. 1 in quality steel products, we will work to expand our scale. The expansion of our investment in Usiminas, the largest Brazilian steel company, is part of this strategy. In addition to licensing our state-of-the-art automotive steel sheet technology, we will assist them with the detailed feasibility study on the local construction of an integrated steel plant planned by them." President Mimura also indicates that Nippon Steel, too, had adopted M&A as a growth strategy option by stating: "There is nothing wrong with using M&A as a growth tool. Although we do not have a specific M&A project at the moment, friendly acquisitions are definitely an option. Having said this, since the share prices of steel makers' are currently high around the world, any acquisition needs to meet these three criteria: reasonable cost, technological advantage and management compatibility." The president went on to say: "Hostile takeover may be a technique to achieve growth. However, our approach is a soft alliance strategy." On that basis, he highlights the link between the company's growth strategy and its takeover defense measures by saying: "Once embroiled in a hostile takeover bid, management will be forced to spend most of its time working out how to respond to it. Rather than just defending ourselves by arming to the teeth, we will also pursue scale and profits. We want to kill two or even three birds with one stone[25]."

At the beginning of 2008, President Mimura made more specific remarks on Nippon Steel's growth strategy in the context of rivalry with Mittal: "Before the global industry consolidation began, it was a given for Japanese steel companies to build their plants on Japanese soil. However, as domestic demand stagnates, oversea demand has been growing at an annual rate of 5%, centering on developing

[25] Nihon Keizai Shimbun, "Nippon Steel President Akio Mimura — What are you going to do with global consolidations?", 2007/01/03 (Morning Edition).

countries. If you want profit growth, the most logical thing to do is go overseas. We must set up bases in areas where there is demand and trustworthy partners. The global consolidation that Mittal set in motion will continue for quite sometime. In several years, companies with a crude steel output of 30 to 40 million tons, like Nippon Steel now, will become minor players on the global scene. The goal of our medium-term business plan from FY 2009 is to become a global player. We will pursue scale expansion. To get there, we do not rule out M&A, as long as conditions are favorable and target companies are willing[26]."

Meanwhile, CFO Aditya Mittal, 33, of ArcelorMittal, who is in charge of the company's future M&A activities also has an ambitious expansion strategy. Mr. Mittal, the eldest son of Mr. Lakshmi Mittal and a graduate of the Wharton School of Business at the University of Pennsylvania, who, after engaging in M&A operations at Credit Suisse First Boston, joined Mittal Steel in 1997, says: "Looking at the global distribution of our production bases, we have more or less covered Europe and the Americas, but Asia is a blind spot. We must fill this gaping gap as soon as possible. Although I won't comment on our specific M&A projects in Japan or South Korea, one thing is clear. Asia is a growth area, and we intend to expand our investment there". Last year, our global market share was about 10%, but, without Asia, this jumps to 20%. Our near-term goal is to expand our steel production output from the current 110 million tons to 200 million tons, and Asia will be the focus of this. We want to increase our global share to 15%[27]."

According to the International Iron and Steel Institute, steel companies have various plans to increase their annual crude steel production outputs: ArcelorMittal to 150-200 million tons by 2010, Posco to 50 million tons as soon as possible, and Shanghai Baosteel to 80 million tons by 2012. Confronted by resource companies on the upstream side, where market share concentration is still in progress, on the one hand, and their own rivals, who are all keen to get bigger, while on the other side of the coin, steel companies' competition over scale advantage continues to intensify.

Legalization of Forward Triangular Merger

In 2006, President Mimura, looking back on the Arcelor takeover saga, made the following remarks: "I'm really glad that Mittal's first takeover target was not us. I'm sorry for Arcelor to say this, but luck was on our side on that occasion. We had been given a year's reprieve from the Heavens[28]."

By "a year's reprieve", President Mimura was referring to the year-long period left until the legalization of "forward triangular merger", an acquisition technique in which shares in foreign stocks can be used as acquisition compensation, which was to be passed into law by May 2007. It is essentially a share swap takeover by one company of another, but takes the form of an acquisition by a subsidiary of the former, hence the name "triangular". In concrete terms, the scheme works like this. In the first step, a foreign company transfers its shares to its Japanese subsidiary as compensation for the takeover of the target company. In the second step, the Japanese subsidiary transfers its parent's

[26] Nihon Keizai Shimbun, "Nippon Steel President Akio Mimura — Our battle strategy for global steel industry competition" 2008/01/11 (Morning Edition).
[27] Nihon Keizai Shimbun, 2007/11/16.
[28] NHK, p. 74.

shares to the shareholders of the target company and takes over the target company, upon which the latter becomes an expired corporation. In the third step, the shareholders of the target company, now an expired corporation, become shareholders of the parent company (foreign corporation).

This enables any foreign company to acquire a Japanese company through a share swap, as long as it has set up a business subsidiary in Japan, as it can transfer its own shares to the shareholders of the target company through the subsidiary. Although the Commercial Code traditionally called for the direct transfer of the acquiring company's shares to the shareholders of the company to be acquired in all acquisition scenarios, the "relaxation of M&A compensation" provisions of the Company Law (Article 749, etc.) has widened the scope of takeover/acquisition compensation to include cash, other companies' shares and other assets, not just shares of direct takeover/acquisition parties, thus paving the way for forward triangular mergers. In fact, forward triangular mergers would have become legal upon the taking effect of the Company Law in May 2006, had its introduction not been delayed by one year to allay the deep concerns of the Federation of Economic Organizations, particularly Mr. Mimura, then serving as Vice-Chairman of the forum. In this sense, the year's reprieve was a concession won from the Government, rather than a gift from the Gods. Mr. Mimura describes his concerns as follows: "The legalization of forward triangular mergers gives foreign companies one more degree of freedom in their M&A activities. In the United States, the use of shares in the stocks of companies not listed on a US stock market as M&A compensation is essentially banned. Even in Europe, there are a number of regulatory restrictions, such as a ban on two-step takeovers. In contrast, the Japanese legal system has lots of loopholes, and there should be some kinds of regulatory restrictions[29]."

The biggest advantage of a forward triangular merger is the ability given to a company to acquire another company through a share swap alone without involving any cash. In the past, it was virtually impossible for a foreign company to acquire a Japanese company using its own shares, whether or not it had a subsidiary in Japan. For this reason, the term "forward triangular merger" usually refers to a technique used by a foreign company to acquire a Japanese company through its subsidiary.

Against this background, the Federation of Economic Organizations again requested a review of forward triangular mergers in December 2006, just before the introduction of the provision, citing the facility it was likely to accord foreign companies when mounting hostile takeovers against Japanese companies. The statement of the Federation of Economic Organizations reads like this: "In the manufacturing industry, the international competitiveness of Japan as a whole may be lost, thus jeopardizing the country's national interest, due to the loss of the technological lead and R&D capacity built over the years to overseas competitors. ... In the future, as the relaxation of M&A compensation takes effect, it is expected to open up the way for foreign companies to acquire Japanese companies as their 100% subsidiaries without using any cash and become a trigger for an avalanche of hostile takeovers, thereby leading to unprecedented levels of M&A activities with unpredictable consequences. Article 9 of the Supplementary Provisions of the Company Law Enforcement Regulations provides that the relaxation of M&A compensation is 'subject to a review

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[29] Nihon Keizai Shimbun, "Strategy for This Year (2), Nippon Steel President Akio Mimura — How are you going to handle global consolidations?", 2007/01/03 (Morning Edition).

and any other necessary measures' in the lead up to its scheduled introduction in May next year. Taking this opportunity, therefore, it is necessary to conduct a wide review of Japan's M&A provisions, not just the Enforcement Regulations of the Company Law, and develop a comprehensive set of legal provisions as soon as possible. To ensure adequate regulatory oversight over the relaxation of M&A compensation, conditions for the shareholder approval of a merger involving assets other than cash and securities traded on a Japanese stock exchange (or securities that satisfy conditions for trading on a Japanese stock exchange) as compensation should be made stricter, in cases where the expired corporation is a listed company[30]."

However, the Ministry of Economy, Trade and Industry has accommodated this request in the following manner[31]: "Regarding forward triangular mergers, we have put in place a two-step check mechanism consisting of a year's delay in its legalization and amendment of various legal provisions relating to takeover defense measures and the like. Whether to introduce such measures is entirely up to the decision of the shareholders, so we have been considering all aspects of this issue regarding forward triangular mergers very closely. A forward triangular merger is basically a friendly merger, not a hostile takeover. It is first put to management, and, if acceptable, submitted to the shareholders' meeting, where it is approved upon the passage of a special resolution with super majority. So, a forward triangular merger is just like any other friendly merger. ... Given that two-thirds of the shareholders have already agreed to it, the business community's excessive concern and obsession over takeover defense measures may be a little misplaced."

In fact, most M&A practitioners consider the use of a forward triangular merger for hostile takeover purposes impracticable. The only way for a company to carry out a hostile takeover is to secure the signature of the target company's board of directors on the merger agreement with majority support and put it to the shareholders' meeting. For this reason, the consensus opinion is against any move to block such a merger either by introducing regulatory restrictions or making approval conditions tougher.

Nippon Steel's Takeover Defense Measures

President Mimura describes the threat of hostile takeovers as[32]: "The steel industry as a whole is about to undergo a dramatic change. In the past, things like hostile takeovers were unheard of, and I still cannot believe what happened to Arcelor. In that sense, Mittal has opened up a new era. I don't know whether they'll strike at us. But, in this new era, aggressive M&A players can be anywhere, Russia, China, you name it. For this reason, top managers must manage their companies while being fully aware of the constant acquisition/takeover risk." Following Mittal's launch of a hostile takeover bid against Arcelor, Nippon Steel announced a series of takeover defense measures in quick succession.

[30] Federation of Economic Organizations, "Requesting Further Development of M&A Legislation" (December 12, 2006).
[31] Press Conference of Mr. Kitabatake, Vice-Minister of Economy, Trade and Industry (October 30, 2006).
[32] NHK, p. 33.

(1) Share buyback

On February 14, 2006, Nippon Steel passed a resolution on a buyback of 120 million of its own shares at a record cost of up to 50 billion yen. The media reacted to this maneuver in the following way: "The steel industry, which has never seen a hostile takeover, has entered a tumultuous period as events such as the serving by the proposal of Mittal Steel, the world's largest steelmaker, to take over the second ranked Arcelor has shown. With a view to preparing for any unforeseen events, Nippon Steel announced a buyback of its own shares to build up a treasury stock that could be used for a range of purposes, including the defense of its affiliated companies[33]." By June 28, 2006, Nippon Steel completed 95% of the share buyback program. On July 4, 2006, the company passed a resolution on another share buyback program, involving 250 million shares and costing up to 100 billion yen, with the program having been 90% completed by September 22nd of the same year. On March 1, 2007, Nippon Steel passed a resolution on yet another share buyback program, involving 150 million shares and costing up to 100 billion yen, with the program 80% completed by September 28th of 2007.

Nippon Steel was not the only company to actively engage in share buyback activities. The combined cost of share buyback programs executed and planned by five major steel companies in the period ending in March 2007 exceeded 440 billion yen, a record high[34]. Thanks to such aggressive share buyback efforts, Nippon Steel held 7.5% of its outstanding shares (treasury stock) as of the end of June 2007, and became its own top shareholder. Although those shares do not automatically give it 7.5% of votes, they are readily available for use in various situations, such as cross-shareholding with other companies and M&A. For this reason, they represent potential voting controlled by Nippon Steel management. If shares held by its subsidiaries are added, Nippon Steel directly controls 7.7% of its own shares.

(2) Introduction of advance warning-type takeover defense measure

On March 29, 2006, Nippon Steel announced the introduction of a mechanism whereby to demand the disclosure of the total purchase price, procurement methods and other information from any shareholder who wants to acquire 15% or more of the company's outstanding shares and put the appropriateness of the issuance of share warrants for takeover defense purposes to shareholders. Mindful of the risk of takeover defense measures being used for the self-preservation of current management if a proper safeguard is not in place, the company introduced strict application rules designed to increase the objectivity and transparency of the deployment of defensive measures.

Nippon Steel explained the intention of the above takeover defense measures were for in event that if someone targets a company and, all of a sudden, starts buying large numbers of its shares without adequate disclosure of information to shareholders, investors and others within the capital markets, it may harm the enterprise value of the company and common interest of its shareholders. Nippon Steel is no exception. If someone who wants to acquire Nippon Steel bursts onto the scene, the company will leave the ultimate decision of whether to accept such a move to the shareholders registered at the time. In this regard, to preserve/improve the corporate value of Nippon Steel and common interest of

[33] Nihon Keizai Shimbun, 2006/02/15.

[34] Nihon Keizai Shimbun, "Record Share Buybacks by Steel Companies — Over 400 billion yen spent by five major companies in this period", 2007/03/09 (Morning Edition).

its shareholders, the company considers it necessary to enable shareholders to make an appropriate judgment by supplying all the necessary information and allowing an ample amount of time for deliberation (informed judgment). To this end, Nippon Steel decided to introduce appropriate rules designed to show any person who wants to acquire the company and the procedure to follow before proceeding with share purchases in a clear and concrete manner. According to Nippon Steel, the appropriate rules aim was to enable shareholders to make an informed judgment and block ill-intentioned share purchases likely to damage the corporate value of the company and common interest of its shareholders by securing all the necessary information and a considerable amount of time to allow the board of directors to study the takeover proposal, including alternative offers. These appropriated rules were said to conform to the Guidelines on Takeover Defense Measures to Preserve/Improve Corporate Value and Common Shareholder Interest, formulated by the Ministry of Economy, Trade and Industry and the Ministry of Justice.

However, Nippon Steel's rules were actually stronger than the Guidelines on Takeover Defense Measure to Preserve/Improve Corporate Value and Common Shareholder Interest. Namely, the kind of takeover bidder described by Nippon Steel does not meet the definition of a greenmailer or any other predatory takeover bidder (a takeover bidder who goes against the common interest of shareholders). Moreover, even if such a takeover bidder conforms to "appropriate actions" set by Nippon Steel, the company will still move to issue share warrants by invoking the shareholder's intention in order to extract confirmation to proceed with a so called appropriate issuance of share warrants (based on votes cast by mail or at a meeting convened in a similar manner to an annual meeting) - unless the board of directors decides that the takeover proposal concerned contributes to the maximization of the enterprise value of the company and common interest of its shareholders. This contrasts with the fact that many Japanese companies require a takeover bidder to be a predatory takeover bidder as a condition for the invocation of takeover defense measures. Nippon Steel's rules appear to respect the intention of shareholders in that they obtain whether the invocation of takeover defenses is appropriate by intitating a decision at a shareholders' meeting. However, in addition to overlapping with the process in which shareholders express their intention regarding a TOB itself, it does not guarantee that the endorsement of current management by shareholders through majority vote maximizes shareholder interest, in cases where cross-shareholders hold the majority of votes, and even harms the interest of minority shareholders who are willing to accept the TOB to maximize their own interest. For these reasons, some market analysts were skeptical about Nippon Steel's. In fact, even some of Nippon Steel's industry rivals questioned them when the measures were introduced in 2006. Repudiating the introduction of takeover defense measures, President Fumio Sudo of JFE Holdings made the following remarks: "In the United States, for example, there are clear rules whereby the kinds of defense measures that lead to the self-preservation of management are illegal and those that contribute to an improvement in shareholder value are legal. Japan lacks such rules, and, because of that, companies are still at the trial and error stage. In the United States, 40 to 50% of companies have introduced takeover defense measures, while very few European companies have done so. In Japan, less than 3% of listed companies are said to be intending to introduce takeover defense measures at their shareholders' meetings in June 2006. Frankly, some companies' reaction to the recent argument about takeover defense measures is excessive. If a company goes public, it cannot avoid takeover risks. ... As the ultimate decision on whether a takeover bid is hostile or not rests with shareholders,

management should bite their collective tongue. The essence of takeover defense boils down to management running the company in a way that promotes the interest of shareholders. So, the best defense measure is to improve business performance, increase the corporate value of the company, and return profits to shareholders as much as possible. There are moves to strengthen cross-shareholding as part of a takeover defense strategy. However, by overusing cross-shareholding, management may run the risk of being sued by shareholders for impairing assets they are entrusted with[35]. For the record, JFE Holdings too announced the introduction of takeover defense measures in March 2007.

(3) Strengthening of cross-shareholding

On March 29, 2006, Nippon Steel signed a tripartite memorandum of understanding with Sumitomo Metal Industries, Ltd. and Kobe Steel, Ltd. on a consultation for joint defense measures to be mobilized upon receiving a hostile takeover proposal, as well as introducing an advance warning-type takeover defense measure. Under this joint defense arrangement, if any of the three companies receives a takeover proposal, it informs the other firms, and this is followed by the holding of a consultation by all three firms to discuss defense measures. Those three companies had previous history in the form of having a comprehensive agreement encompassing wide-ranging issues from joint research and business integration to cross shareholding in November 2002 in response to the establishment of JFE Holdings, and the above move was designed to strengthen this alliance in consideration of the immense impact that any hostile takeover bid for one of the partners would have on the remaining two. The memorandum of understanding also included a capital constraint clause whereby alliance partners were allowed to unilaterally terminate alliance arrangements in joint research, cross-licensing and other main areas in the event of the management of any other alliance partner falling under the control of a hostile camp[36].

Moreover, to ensure the smooth and reliable enforcement of the alliance, the partners increased their cross-shareholding, with the following cross-shareholding ratios announced: Nippon Steel holding 5.01% of the common shares in Sumitomo Metal Industries and Sumitomo Metal Industries holding 1.81% of common shares in Nippon Steel; Nippon Steel holding 2.05% in Kobe Steel and Kobe Steel holding 0.41% in Nippon Steel; and Sumitomo Metal Industries holding 2.05 % in Kobe Steel and Kobe Steel holding 1.71 % in Sumitomo Metal Industries.

On December 9, 2007, the three companies announced a further increase in their cross-shareholding. Under this new arrangement, Nippon Steel and Sumitomo Metal Industries would purchase an additional 100 billion yen or so worth of each other's shares, raising Nippon Steel's shareholding in Sumitomo Metal Industries from 5.01% (5.3%) to 9.4% (9.9%) and Sumitomo Metal Industries' shareholding in Nippon Steel from 1.81% (2.0%) to 4.1% (4.5%) (figures in brackets are based on a voting rights basis). This would likely make Sumitomo Metal Industries Nippon Steel's No. 2 shareholder. Similarly, Nippon Steel and Kobe Steel would purchase an additional 15 billion yen or so

[35] Nihon Keizai Shimbun, "Ready for Hostile Takeover Bids? — President Fumio Sudo of JFE Holdings", 2006/06/18 (Morning Edition).
[36] Nihon Keizai Shimbun, "Corporate Defense amid Global Steel Industry Consolidations — Nippon Steel, Sumitomo Metal Industries and Kobe Steel announce joint takeover defense measures", 2006/03/30 (Morning Edition).

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worth of each other's shares, raising Nippon Steel's shareholding in Kobe Steel from 2.05% (2.2%) to 3.4% (3.6%) and Kobe Steel's shareholding in Nippon Steel from 0.41 (0.4%) to 0.8% (0.8%). Each company had also committed to make full share purchases on the stock market by the end of March 2008. According to market sources, the reason behind this further strengthening of cross-shareholding was sharp falls in Japanese major steelmakers' share prices. As of the November 2007, the market capitalization of ArcelorMittal was 11.8911 trillion yen compared to Nippon Steel's 4.5266 trillion yen, Sumitomo Metal Industries' 2.3453 trillion yen and Kobe Steel's 1.1307 trillion yen. Indeed, Japanese steelmakers had fallen far behind ArcelorMittal in terms of market value.

Nippon Steel also strengthened its cross-shareholding with other companies. Mitsubishi UFJ Financial Group increased its shareholding in Nippon Steel, raising its outstanding share stake from 1.5% to a little less than 2% by the end of March 2006. Mitsubishi UFJ had suggested the possibility of further purchasing in the upwards of an additional 5 billion yen of shares to support Nippon Steel's efforts to secure long-term shareholders. The media reported this latest round of share purchases as Mitsubishi UFJ granting a request by Nippon Steel, which placed emphasis on securing long-term shareholders[37]. On March 14, 2006, Mitsui & Co., Ltd. announced that it had purchased 10 billion yen worth of Nippon Steel's shares on the stock market, increasing its outstanding share stake from 0.31% to 0.65%. This move was also reported as reflecting the intention of Nippon Steel, which was in a haste to develop a long-term shareholder base[38]. Moreover, Nisshin Steel Co., Ltd., a major stainless steel manufacture in which Nippon Steel had already previously obtained 9.2% stake in terms of outstanding shares, made additional purchases of Nippon Steel's shares worth 5 billion yen in the second half of FY 2006, increasing its Nippon Steel stake to 0.5%. Apart from this, Nippon Steel expanded cross-share holding with Matsushita Electric Industrial Co., Ltd., Mitsubishi Heavy Industries, Ltd., JR East, JR Tokai, and other companies throughout the FY 2007 alone.

Cross-shareholding even spread across borders. On October 20, 2006, Nippon Steel and Posco announced that they would expand their alliance partnership by increasing their cross-shareholding and becoming each other's top business corporate shareholder — with a 5% Posco stake in the case of Nippon Steel and with a 3.5% Nippon Steel stake in the case of Posco — at a cost of approx. 55 billion yen each. Strange as it may seem, two one-time Asian rivals, who had once fiercely fought against each other, were being rapidly drawn into each other's arms. Asked about Nippon Steel's potential response to hostile takeover bids mounted against itself or Posco in a press conference held in Tokyo, Executive Vice Chairman Nobuyoshi Fujiwara declared resolutely: "We'll firmly deal with any hostile takeover bid[39]."

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[37] Nihon Keizai Shimbun, "Mitsubishi UFJ Buys More Nippon Steel Shares — Spending 15 billion yen in support of takeover defense efforts", 2006/05/11 (Evening Edition).
[38] Nihon Keizai Shimbun, "Mitsui & Co., Ltd. and Nisshin Steel Buy More Nippon Steel Shares — Are they helping Nippon Steel build a long-term shareholder base?" 2006/07/18.
[39] Nihon Keizai Shimbun, "Nippon Steel's 'Asian Alliance' Debuts after Eight Years in the Making — An expanded alliance with Posco", 2006/10/23.

Thanks to this long-term shareholder cultivation policy, Nippon Steel's stable shareholder base has reportedly grown from less than 40% of all stakes to nearly 50% (including potential stakes linked to bonds with share warrants to be discussed later)[40].

However, Mr. Yano, Senior Managing Director of the Pension Fund Association, Japan's largest institutional investor, expresses concern for such cross-shareholding strengthening moves: "Unlike capital investment, R&D, or M&A, cross-shareholding leaves funds just lying there. With a real risk of falling share prices, it adds another destabilizing factor to business management. Besides, widespread cross-shareholding will drive out independently-minded shareholders and investors, thus compromising the self-disciplining mechanism of the market. When engaging in cross-shareholding, companies need to at least clearly explain how it will contribute to an improvement in long-term shareholder value in a concrete manner. On that score, their current arguments do not cut the cake[41]." According to Nippon Steel, however, the kind of cross-shareholding it is currently pursing is measured and disciplined, unlike its past cross-shareholding with financial institutions.

President Mimura explained that: "We meet face-to-face with all our cross-shareholding partners at the top level at least once a year to check the effectiveness of the alliances." He insisted that, to demonstrate there is material substance in cross-shareholdings, the purpose and effectiveness of alliances are checked through top-level face-to-face meetings, while all cross-shareholding investments are subjected to a rigorous advance review against internal investment criteria. Executive Vice-President Kiichiro Masuda said regarding the issue: "Dividend income alone does not justify investment. So, cross-shareholding investments do not get a green light unless they clear internal return-on-capital criteria, with earnings expected from business cooperation taken into account." Although detailed figures are a company secret, "the return on capital must be at least 10%" (Mr. Masuda)[42].

President Mimura also added: "Though cross-shareholding is sometimes misunderstood, we've been engaging in it on the basis of careful studies conducted towards increasing the company's corporate value. Our alliance with Sumitomo Metal Industries and Kobe Steel has a profit boosting effect worth 25 billion yen per annum on an operating income basis due to an efficiency gain achieved in operations like procurement of steelmaking raw materials. The boosting of our equity stakes in Nakayama Steel Works and Sanyo Special Steel Co., Ltd. is also expected to yield returns greater than the capital invested. We are happy to pursue more cross-shareholding arrangements as long as they are mutually beneficial[43]."

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[40] Nihon Keizai Shimbun, "Dissecting Second Coming of Cross-Shareholding Practice (2) Companies Choosing Shareholders — There is a need to keep the markets happy too", 2007/09/28 (Morning Edition).

[41] NHK, p. 224.

[42] Nihon Keizai Shimbun, "Nippon Steel's 'Measured and Disciplined' Cross-Shareholding with Matsushita, Posco and Others", 2007/11/29.

[43] Nihon Keizai Shimbun, "Our Response to Global Consolidations of Steel Industry: Nippon Steel President Akio Mimura", 2006/07/09 (Morning Edition).

(4) Bonds with share warrants

On October 20, 2006, Nippon Steel announced the issuance of preferred securities worth 300 billion yen through its overseas subsidiaries. The company intends to use the funds raised for capital/financial investment and repayment of loans. With the whole allotment to be purchased by the three major banks in Japan, Mizuho Corporate Bank, Ltd., Bank of Tokyo-Mitsubishi UFJ, Ltd. and Mitsui Sumitomo Bank, the securities were accompanied by the right to swap them for Nippon Steel's bonds with share warrants (convertible bonds or CBs). These are therefore essentially the same instruments as CBs issued through subsidiaries and purchased by banks. While CBs can be converted into common equity when the share price reaches the strike price, the conversion price of the above bonds were set at a price of 740 yen, 50% higher than the market price of Nippon Steel shares at the time of their issuance to make the scheme less likely to cause dilution of the company's earnings per share unless there was a substantial surge in the share price. Now, if someone decided to take over the company, the bidder will likely be forced to attempt a TOB at 30 to 50% premium, and this will cause the company's share price to soar. At this point, the banks can convert the bonds into common shares en masse, thereby reducing the bidder's stake and undermining the takeover efforts. The combined stake to be potentially created by the issuance of those bonds is as high as 5.96% (calculated as the number of shares issued if all share warrants are converted divided by the number of outstanding shares, which is 6.807 billion). The interest on the bonds would yield an annual rate of 2.228%.

These bonds with share warrants contain a clause that gives Nippon Steel the right to convert them into perpetual subordinated debts on the redemption date, which is January 13, 2012, subject to an advance notice made within one to two months of that date (subordinated debt clause). The interest rate of those perpetual subordinated debts would be 1.70% above 6-month LIBOR. Because of this subordinated debt clause, the bonds have been recognized as more than 70% equity by major rating agencies, and are listed as minority interest on the balance sheet.

Some market sources expressed doubts about these bonds with share warrants. First, they thought their interest rate was too high. As the bonds are accompanied by an essentially American-style call option (can always be exercised within a set period) for conversion into shares, their interest should be lower than straight bonds. However, it is actually higher than those of straight bonds with the similar credit rating. Second, despite the subordinated debt clause, the procurement cost calculated on the basis of conversion into perpetual subordinated debts is substantially higher than normal borrowing costs, thus calling into question the need to resort to this form of fund issuance complete with a special clause, especially considering the recent improvement in the company's leveraging rate. According to market sources, the problem with takeover defense-type financing is the opacity of its true cost, as it aims to achieve two totally different objectives, fund raising as its primary objective and takeover defense, within the same framework.

On February 19, 2007, Nippon Steel's share price closed at 765 yen, the highest since 1990, and topped the conversion price of the above bonds with share warrants (740 yen). Although the share price stayed consistently above the conversion price from February to November 2007, the banks did not exercise their conversion right. It is widely believed that the banks intentionally let this profit-earning opportunity slip by out of consideration for Nippon Steel. President Saito of the Tokyo

Stock Exchange (TSE) has expressed concern over this kind of bonds with share warrants: "Depending on how issue conditions are set, they may be used exclusively for takeover defense purposes," and the TSE is currently looking into ways to deal with this kind of financing practices[44].

(5) Nippon Steel's individual shareholder relations measures

President Mimura intimately expressed his thoughts on the still-vivid Arcelor takeover by Mittal in the following statement: "Companies can no longer survive unless they make constant efforts to get their message across to institutional investors, the Government, individual shareholders and others regarding their corporate value[45];" "What is special about Nippon Steel's individual shareholders is their loyalty. For example, 60% of those currently holding 10,000 or more shares have held on to their stakes for years, including the period when our share price was low. If we manage to keep 5% of our individual shareholders on our side, it will give completely different dynamics to our battle against would-be takeover bidders[46]."

In the absence of bullet-proof takeover defense measures, Nippon Steel, which, until recently, engaged in hardly any individual shareholder relations activities, has begun making an effort to increase the number of individual shareholders who would not sell their stakes even if the company's share price surges for whatever reason. The IR Group of the company's Accounting & Finance Division has been hosting inspection tours of steel mills featuring a shareholder briefing session. By the first half of 2007, more than 15 such briefing sessions have been held with an cumulative attendance of 4000 shareholders. Shareholder feedback from questionnaire surveys conducted as part of those briefing sessions were mostly favorable for Nippon Steel, including "I have a much better understanding of the company now." and "I won't sell my shares. I'll buy more." Still, those 4000 participants account for just 1% of Nippon Steel 400,000 shareholders[47].

In March 2005, Nippon Steel changed its dividend payout policy from long-term stability-focused payment to performance-based payments. In concrete terms, it has adopted a consolidated dividend payout ratio of around 20% and a non-consolidated dividend payout ratio of around 30% as a yardstick, but, for the time being, will use a little lower levels (a consolidated dividend payout ratio of around 15–20% and a non-consolidated dividend payout ratio of around 20–30%) in view of the need to improve the company's financial structure as top priority.

Back when Mittal just launched its bid for Arcelor, Nippon Steel did not attract any particular attention. However, two pieces of news, the conclusion of a merger agreement between Arcelor and Severstal at the end of May 2006 and subsequent successful acquisition of Arcelor by Mittal in June changed all that. Namely, expectations for a global steel industry consolidation, particularly the possibility of Japanese major steelmakers becoming Mittal's next target, and those for M&As among Japanese major steelmakers set off a buying frenzy, and steel stocks outperformed the Tokyo Stock Exchange Stock Price Index (TOPIX) by a large margin.

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44 Nihon Keizai Shimbun, "Under the Knife: Takeover Defense-Type Financing", 2008/04/17 (Morning Edition).
45 NHK, p. 82.
46 NHK, p. 95.
47 NHK, p. 101 and 102.

In September 2006, Nippon Steel's share price recovered to the 500 yen mark for the first time in 15 years, and other steel stocks also boomed. Nevertheless, according to some market sources, major steel companies remained vulnerable to takeover bids as their share prices were still relatively cheap, given that their price to earnings ratio (PER) was in the low teens compared to the market average of approximately 20[48]. In the period ending March 2007, major steel companies, including Nippon Steel, resumed interim dividend payouts. Actually, it was the first ever interim dividend payout for JFE, which was founded in 2002, while it had been nearly 14 years for Nippon Steel and Kobe Steel, given that their last interim dividend payout was in 1992. However, citing the fact that steel companies also enjoyed record profits in the preceding fiscal year and that their struggle to improve their financial structure had been more or less over, some saw an ulterior motive behind it: "This exact timing in which they decided to resume interim dividend payouts betrays their true motive of building a long-term shareholder base in preparation for anticipated industry consolidation[49]."

Notwithstanding increased dividend payouts, however, many of Nippon Steel's individual shareholders moved to sell their stakes in July 2007 as the share price approached its highest level since listing (984 yen in 1989). By the end of March 2007, the combined stake of individual shareholders had fallen to a little less than 22%, down about 5% from a year earlier. Mr. Shinichi Taniguchi, then Managing Director of Nippon Steel, analyzes this as follows: "The number of shareholders who sold their stakes during the recent surge in our share price was 90,000, while many of the 50,000 shareholders who bought their stakes hoped to benefit from future consolidations[50]".

Nippon Steel's overall capital policy during this period was a combination of raising funds based on the issuance of bonds with share warrants and share buybacks. Namely, Nippon Steel raised 300 billion yen on the back of those bonds and bought 300 billion yen worth of its own shares, starting in 2006.

(6) Alliance with Mittal

While putting in place a series of defense measures, Nippon Steel decided to keep the alliance with ArcelorMittal. On July 16, 2006, President Mimura and Chairman Mittal met for the first time after Mittal's successful takeover of Arcelor. The face-to-face meeting lasted for about an hour without involving an interpreter. Following the confirmation of each other's management philosophy, Mr. Mittal pitched his plan to put funds into R&D, plant and equipment. "Then, let's work together as partners," replied Mr. Mimura. Although the agreement concluded by Nippon Steel and Arcelor contained a clause that allowed the dissolution of the partnership in the event of either party being taken over, Mr. Mimura made up his mind to keep the alliance, with Mittal as the new partner. However, Nippon Steel turned down Mittal's demand to review the licensing arrangement. Under the agreement with Arcelor, Nippon Steel limited Arcelor's access to its technologies to Arcelor's

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[48] Nihon Keizai Shimbun, "Steelmakers Announce Interim Dividend in Unison in Big Pitch to Shareholders — Their big cash reserves and advanced technologies increase their takeover risk", 2006/09/08 (Morning Edition).

[49] Nihon Keizai Shimbun, "Steelmakers' Comprehensive Takeover Defense Efforts - An interim dividend, international alliance partnerships, and strong business performance", 2006/09/08.

[50] Nihon Keizai Shimbun, "Part 2 Japanese Steelmakers' Offensive and Defensive Moves (5) Nippon Steel counting on individual shareholders as their ultimate saviors (Global Steel Industry Consolidations)", 2007/06/26.

European plants with the intention of making sure that local Japanese-affiliated automakers received its high-quality steel products through Arcelor. Mittal wanted this condition to be relaxed. However, given the clear technological gap between Nippon Steel and Mittal (over 20 times as many licenses held by Nippon Steel as Mittal), if Nippon Steel granted Mittal unlimited access to its technologies, its technological advantage would be fundamentally undermined. On March 25, 2007, the two top executives met again — this time in New Delhi, India — and alliance negotiations ended in broad agreement. Regarding the licensing issue, Nippon Steel's demand prevailed.

On July 12, 2007, President Mimura and Chairman Mittal again came face to face in a secret meeting held in a room at the Palace Hotel in New York City, U.S.A. The highest-level talks designed to conclude the difficult licensing negotiations lasted just 30 minutes. The two top executives signed a memorandum of understanding on an alliance partnership. The licensing arrangement agreed on by Nippon Steel and Mittal is summarized as follows:

1. The parties are to cross-license their technologies relating to automotive steel sheets in Europe and Asia
2. The parties are to boost their joint-venture production of automotive steel sheets in North America
3. The parties are to sign an agreement specifying the details of their partnership
4. The partnership is to be effective until 2011

"Cooperation and competition," these are words that Mr. Mimura has been using whenever asked about Mittal in recent years. As long as Nippon Steel wants to widen its global steel supply network, "not working with Mittal is outside the scope of realistic options[51]."

Basically, Nippon Steel gave priority to the development of a global steel supply network for automakers, its important customers, and chose an alliance with its powerful rival to advance this goal. Behind Nippon Steel's agonizing decision to partner with Mittal despite its vast technological superiority (though it is only one-third in size) were two factors.

The first factor is the maintenance/development of a global steel supply network for automakers. In Europe, Nippon Steel is currently supplying its steel sheets to local Japanese-affiliated automakers through Arcelor using a licensing arrangement. In North America, it is doing the same through a joint venture with Mittal. For Nippon Steel, which had been requested by a senior member of Toyota management to "steadily and reliably supply high-quality steel sheets", completely falling out with Mittal would have led directly to a big supply problem. Nippon Steel's main concern was how to prevent a technology drain. Thin and strong steel sheets and other high-quality steel products are not only difficult to make but also complicated as they use different ingredients from client to client and from model to model. Indeed, these are Japanese major steelmakers' exclusive territory. To put it the other way around, however, if this territory was taken, they would lose their competitiveness. For this reason, Mr. Mimura resisted Mittal's pressure to upgrade the partnership whereby the two companies

[51] Nihon Keizai Shimbun, "Nippon Steel and Mittal — A Year of Playing a Mutual Guessing Game (Global Steel Industry Consolidations), 2007/07/17.

would co-own each other's intellectual property rights and Mittal would be allowed to use Nippon Steel's technologies in and outside Europe, and pushed back the scope of cooperation to the original framework by threatening to end the partnership. He also turned down Mittal's proposal to increase its stakes in their North American and Chinese joint ventures.

The second factor is the risk of antagonizing Mittal. If Nippon Steel had broken off the alliance, Mittal would have certainly mounted an all-out assault on Asia using its considerable war chest. Nippon Steel decided it would be a better idea to appease Mittal with "amicable arrangements" and buy time to build up its strength and expand its partnerships, both domestically and internationally[52].

Meanwhile, Mr. Mimura expressed the following views in an interview held the day after the signing of the partnership: "The point is we decided to cooperate and compete at the same time. Both companies have operations in various regions. Mittal is trying to build integrated steelworks in India. Nippon Steel intends to strengthen its relationship with Tata Steel, another major Indian steelmaker, (through a joint venture, etc.) We will therefore be competing in that particular region. ... I don't think our takeover risk has receded. There are always takeover threats. It is generally correct to say that the steel industry will consolidate further in the near future[53]."

(7) Takeover defense — recap

President Mimura of Nippon Steel states: "As a mega merger like ArcelorMittal has now become a reality, companies that fail to put in place the best possible set of takeover defense measures should be reproached." In Mr. Mimura's opinion, the most effective takeover defense measure is to "increase the company's corporate value through profit growth". This means increasing the company's total market value to a point where acquisition is too costly to proceed with. Suppose Nippon Steel becomes a takeover target, if its total market value was 7 trillion yen, the would-be takeover bidder would need at least 10 trillion yen, taking into consideration a 40% or so takeover premium. Mr. Mimura considers this too high a price tag even with the help of investment funds[54].

President Mimura added that: "Although each individual measure may not be a decisive weapon by itself, the important thing is to combine different measures[55]."

Senior Managing Director Yano of the Pension Fund Association, which manages 13 trillion yen of funds, on the other hand, has a different view: "We do not reject foreign capital or foreign managers just because they are foreign. Japanese companies' business performances and share prices are poor compared to overseas counterparts. As the globalization of the economy continues to forge ahead, Japanese companies and the Japanese economy must go through reforms by introducing overseas

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[52] Nihon Keizai Shimbun, "Olive Branch, for Now As Nippon Steel Strengthens Alliance with Mittal in Automotive Steel Sheets — Giving priority to the global supply network", 2007/07/14 (Morning Edition).

[53] Nihon Keizai Shimbun, "Nippon Steel Signs MOU with Mittal, No Plans for Cross-Shareholding: President Mimura", 2007/07/14 (Morning Edition).

[54] Nihon Keizai Shimbun, "Chasing Bubble-Era High Share Prices (5) Nippon Steel — The company's global strategy being tested", 2007/07/11 (Morning Edition).

[55] Nihon Keizai Shimbun, "Japanese Steelmakers' Offensive and Defensive Moves (1) Three Company Alliance Bearing Fruit (Global Steel Industry Consolidations)", 2007/06/20.

capital and management know-how, if they are to grow. Nissan, for example, was only able to take a reform path after accepting capital from Renault and having Mr. Ghosn be placed as President. Even a hostile takeover needs to be judged on the basis of which side can put together a persuasive proposal in terms of increasing shareholder value and corporate value in the long run, the current management team or the takeover bidder[56]."

As the saying "Iron is the nation" illustrates, the steel industry has long been a key industry in various countries. However, amid ongoing global consolidations in both the upstream resource industry and the downstream manufacturing industry, it is increasingly difficult to keep the steel industry alone within the Japanese domestic framework. As Nippon Steel faces the question of how it should respond to the demands of the times, the collective gifts and talents of its management team have become increasingly important. In January 2008, Nippon Steel decided on a top management reshuffle, wherein President Mimura, who had confronted the threat of Mittal on the frontline would become Chairman with representative power and Executive Vice-President Shoji Muneoka becoming promoted to President. As Mr. Muneoka joined the company in 1970, when Yahata Iron & Steel and Fuji Iron & Steel merged, he would be the first president who was recruited as an employee of Nippon Steel. In an interview announcing the top management reshuffle, Mr. Muneoka declared: "Nippon Steel will transform itself into a global player[57]."

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[56] NHK, p. 229.

[57] Nihon Keizai Shimbun, "Mr. Muneoka Becomes New President of Nippon Steel, Mr. Mimura Appointed as Chairman", 2008/01/08, (Morning Edition).

Chart 1. Nippon Steel Share Price

Chart 2. Price Trends of Nippon Steel and ArcelorMittal Shares (December 2005 = 1)

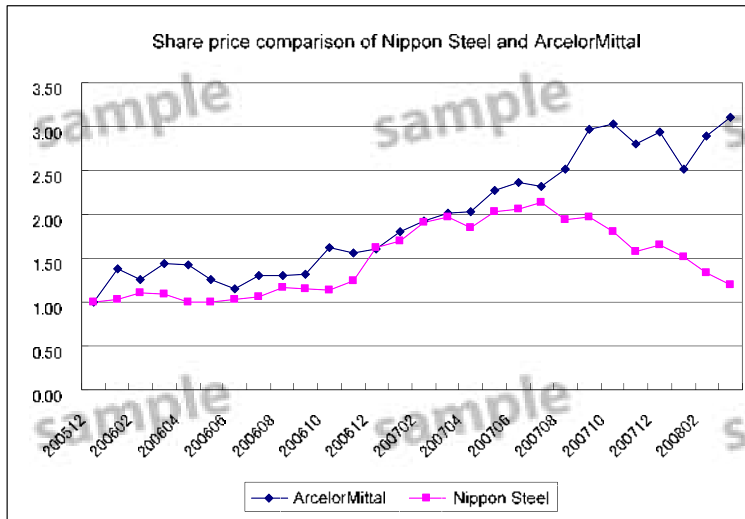

Chart 3. Price Trends of Nippon Steel Share and TOPIX (December 2005 = 1)

5

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15

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25

30

35

40

sample

Chart 4. Share Market Reaction to Major 2006 Events Described in Case Study

Date	Event	Cumulative abnormal return of Nippon Steel share price over three day period (-1d, +1d)	Cumulative abnormal return of Nippon Steel share price over five day period (-1d, +1d)
January 27, 2006	Mittal releases Arcelor takeover proposal	–1.41%	0.25%
February 19, 2006	Nippon Steel announces buyback of 1.20 million of its own shares	3.73%	4.90%
March 29, 2006	Nippon Steel announces advance warning-type takeover defense measure and signing of joint defense measures with two other steel companies	–2.13%	–3.57%
May 27, 2006	Arcelor announces merger with Severstal	1.10%	0.72%
June 25, 2006	Arcelor Board of Directors approves merger with Mittal	3.37%	3.01%
July 4, 2006	Nippon Steel announces buyback of 250 million of its own shares	1.43%	0.98%
October 20, 2006	Nippon Steel announces issuance of bonds with share warrants and cross-shareholding with Posco	–0.85%	–2.10%

Cumulative gain is adjusted to TOPIX price trend over same period

Chart 5. Nippon Steel Dividend Payout Ratio and Share Price — Trends

Period	2000	2001	2002	2003	2004	2005	2006	2007
Net assets per share (yen)	131	144	133	116	138	175	246	278
Earnings per share (yen)	1.64	3.89	–4.17	–7.69	6.15	32.73	51.07	54.28
Dividends (yen)	1.5	1.5	1.5	1.5	5	9	10	11
Dividend payout ratio (%)	91	39	n.a.	n.a.	81	27	20	20
Share price (high) (yen)	314	270	230	217	253	294	479	900
Share price (low) (yen)	215	165	145	119	127	203	242	370
Share price (average) (yen)	265	218	188	168	190	249	361	635
Ratio of earnings per share to share price (%)	0.6	1.8	–2.2	–4.6	3.2	13.2	14.2	8.5
Ratio of dividends to share price (%)	0.6	0.7	0.8	0.9	2.6	3.6	2.8	1.7
PBR	2.0	1.5	1.4	1.4	1.4	1.4	1.5	2.3
PER	161.3	55.9	–45.0	–21.8	30.9	7.6	7.1	11.7

Share price (average) is the average of the high and the low recorded over the period.
Ratio of earnings per share to share price: Earnings per share/Share price (average)
Ratio of dividends to share price: Dividends/Share price (average)

Chart 6. Nippon Steel's Shareholding Structure

	Number of outstanding shares (1000 shares)	Financial institutions	Brokerages	Foreign corporations	Individuals and others	Number of individual shareholders	Treasury stock
End of July 2005	6,806,981	40.18%	1.65%	23.96%	26.30%	402,738	0.80%
End of July 2006	6,806,981	38.41%	2.39%	21.29%	28.58%	415,226	2.29%
End of July 2007	6,806,981	36.82%	1.79%	20.67%	27.35%	364,383	7.72%

Chart 7. Nippon Steel's Main Shareholders

End of March 2005		End of March 2006	
Name	Stake (%)	Name	Stake (%)
Japan Trustee Services Bank	9.0	Japan Trustee Services Bank	7.1
Master Trust Bank of Japan	5.9	Master Trust Bank of Japan	5.4
State Street Trust & Banking	5.1	State Street Trust & Banking	4.9
Nippon Life Insurance	3.3	Nippon Life Insurance	3.0
Trust & Custody Services Bank	2.9	Trust & Custody Services Bank	2.9
Mizuho Corporate Bank	2.7	Mizuho Corporate Bank	2.7
Meiji Yasuda Life Insurance	2.1	Meiji Yasuda Life Insurance	2.1
Chase Manhattan Bank	1.8	Bank of Tokyo-Mitsubishi UFJ	2.0
Investors, Inc.	1.4	Sumitomo Metal Industries	1.8
Tokyo Marine & Nichido Fire Insurance	1.4	Investors, Inc.	1.6
Total	35.7	Total	33.5

End of March 2007		End of September 2007	
Name	Stake (%)	Name	Stake (%)
Japan Trustee Services Bank	6.5	Japan Trustee Services Bank	6.9
State Street Trust & Banking	6.2	Master Trust Bank of Japan	4.2
Master Trust Bank of Japan	4.0	CBHK Korea	3.5
Nippon Life Insurance	3.2	Nippon Life Insurance	3.3
Trust & Custody Services Bank	3.0	Mizuho Corporate Bank	2.7
Mizuho Corporate Bank	2.7	Trust & Custody Services Bank	2.7
Meiji Yasuda Life Insurance	2.1	State Street Trust & Banking	2.5
Bank of Tokyo-Mitsubishi UFJ	2.0	Meiji Yasuda Life Insurance	2.1
Sumitomo Metal Industries	1.8	Bank of Tokyo-Mitsubishi UFJ	2.0
Investors, Inc.	2.5	Sumitomo Metal Industries	1.8
Total	32.8	Total	31.7

sample

Chart 8. Directors of Nippon Steel (End of June 2007)

Executive title	Managerial title	Name	Career summary	Alma mater Faculty/major	Shareholding (1000 shares)	Stake (%)
Representative Director and President		Akio Mimura	Appointed as Member of the Board in June 1993 and Representative Director and President in April 2005 after serving in positions such as Manager of the Sales and Marketing Division	University of Tokyo Faculty of Economics	157	0.002
Representative Director and Executive Vice President		Hideaki Sekizawa	Appointed as Member of the Board in 1999 and Representative Director and Executive Vice-President in April 2005 after serving in such managerial positions as Manager of the General Administration Division	University of Tokyo College of Arts and Sciences	79	0.001
Representative Director and Executive Vice President		Shoji Muneoka	Appointed as Member of the Board in June 1999 and Representative Director and Executive Vice-President in April 2005 after serving in such managerial positions as Manager of the Secretarial Division	University of Tokyo Faculty of Agriculture	68	0.001
Representative Director and Executive Vice President		Hiroshi Shima	Appointed as Member of the Board in June 1999 and Representative Director and Executive Vice-President in April 2007 after serving in such managerial positions as Director of the Oita Works	Osaka University Graduate School of Engineering Majoring in Metallurgy	55	0.001
Representative Director and Executive Vice President		Kiichiro Masuda	Appointed as Member of the Board in June 2001 and Representative Director and Executive Vice-President in April 2007 after serving in such managerial positions as Manager of the Corporate Planning Division	Keio University Faculty of Economics	96	0.001
Representative Director and Executive Vice President	Director, Technical Development Bureau	Bunyu Futamura	Appointed as Member of the Board in June 2000 and Representative Director and Executive Vice-President in April 2007 after serving in such managerial positions as Deputy-Director of the Nagoya Works	Kyoto University Graduate School of Engineering Majoring in Resource Engineering	54	0.001
Managing Director/Member of Board		Tetsuo Imakubo	Appointed as Member of the Board in June 2000 and Managing Director/Member of the Board in April 2005 after serving in such managerial positions as Manager of the Pipe & Tube Sales Division, Pipe & Tube Division	Hitotsubashi University Faculty of Commerce	45	0.001
Managing Director/Member of Board		Junji Ota	Appointed as Member of the Board in June 2000 and Managing Director/Member of the Board in April 2005 after serving in such managerial positions as Director of the Stainless Steel Division	Hitotsubashi University Faculty of Commerce	55	0.001
Managing Director/Member of Board	Director, Flat Products Division Director, Bar & Wire Rod Division	Kozo Uchida	Appointed as Member of the Board in June 2003 and Managing Director/Member of the Board in June 2007 after serving in such managerial positions as Manager of the Flat Products Sales Division, Flat Products Division	University of Tokyo Faculty of Law	44	0.001
Managing Director/Member of Board		Shinichi Taniguchi	Appointed as Member of the Board in June 2003 and Managing Director/Member of the Board in June 2007 after serving in such managerial positions as Director of the Accounting & Financing Division	Keio University Faculty of Economics	46	0.001
Managing Director/Member of Board		Yasuo Hamamoto	Appointed as Member of the Board in June 2003 and Managing Director/Member of the Board in June 2007 after serving in such managerial positions as Deputy Director of the Kimitsu Works	University of Tokyo Faculty of Engineering	36	0.001
Total					735	0.011

Chart 9. Nippon Steel's Medium-Term Plan (Extract)

December 14, 2005

Nippon Steel's Medium-Term Consolidated Business Plan (FY 2006 through FY 2008)

— Striving for sustainable profit growth by reinforcing the competitiveness of its business segments through the enhancement of its technological edge and the reforming of its consolidated management system. —

● **Consolidated Business Plan Targets**

- With this medium-term plan, Nippon Steel shall aim to achieve both adequate investment for profit growth and further improvement of the overall financial structure.
- Nippon Steel shall maintain its dividend policy based on financial result (non-consolidated payout ratio: 20% to 30%, consolidated payout ratio: 15% to 20%).

Consolidated Financial Targets

	Target for FY 2008	Projection for second half of FY 2005 (annualized)
Net sales	Approx. ¥4200 billion	¥4000 billion
Operating income (ROS on operating income basis)	¥540 billion or more (13%)	¥460 billion (12%)
Ordinary income (ROS on ordinary income basis)	¥500 billion or more (12%)	¥440 billion (11%)
Net income (EPS)	¥300 billion or more (44 yen or more per share)	¥260 billion (38 yen per share)
ROA (return on assets)	approx. 12%	11%

Interest bearing debt	¥1000 billion or less	¥1110 billion
Shareholders' equity	¥2000 billion or less	¥1500 billion
Debt equity ratio	0.5 or less	0.74

	Target for FY 2006 through FY 2008	Estimate for FY 2003 through FY 2005
Cash flows from operating activities (before tax.)	Approx. ¥1700 billion	¥1470 billion including approx. ¥550 billion of depreciation expenses
Tax, etc.	Approx. –570 billion yen	–295 billion yen
Capital expenditures and investments	Approx. –850 billion yen	–635 billion yen
Dividends	Approx. –130 billion yen	–54 billion yen
Reduction of interest-bearing debt	Approx. –150 billion yen	–762 billion yen
Asset Write-offs	Approx. 0 billion yen	¥2760 billion

Note: The FY 2006–2008 targets for capital expenditures and investments have been increased to ¥1.2 trillion (1.5 times the original figure) in a subsequent forecast.

(Source: Nippon Steel website)

Chart 10. Nippon Steel's Business Performance (Consolidated Basis) — Trend

(in million yen)

	Period ending in March 2007	Period ending in March 2006	Period ending in March 2005	Period ending in March 2004
Operating results				
Net sales	4,302,145	3,906,301	3,389,356	2,925,878
Operating income	580,097	576,319	429,948	224,475
Ordinary income	597,640	547,400	371,446	172,851
Net income	351,182	343,903	220,601	41,515
Financial position (at end of fiscal year)				
Total assets	5,344,924	4,542,766	3,872,110	3,705,917
Shareholders' equity	1,892,883	1,677,889	1,188,409	938,581
Interest-bearing debt	1,213,057	1,223,837	1,282,266	1,561,228
Per share data				
Net income (yen)	54.28	51.07	32.73	6.15
Cash dividends (yen)	10	9	5	1.5
Dividend payout ratio	18.4%	17.4%	15.3%	24.4%
Ratios				
Return on sales (ROS)	13.9%	14.0%	11.0%	5.9%
Return on assets (ROA)	12.1	13	9.8	4.8
Return on equity (ROE)	19.7	24	20.7	4.8
Ratio of net worth	35.4	36.9	30.7	25.3
Debt-to-equity ratio	0.64	0.73	1.08	1.66
Reference:				
Crude steel production (in 10 thousand tons)	3,452	3,395	3,279	3,273
Price of steel (non-consolidated, in thousand yen per ton)	75.3	74.3	61.6	52.2
Export ratio (non-consolidated, value basis; %)	32.3	30.9	31.6	31.3

Chart 11. Nippon Steel's Capital Investment Trends

(in 100 million yen)

Fiscal year	Steel industry Capital expenditures	Nippon Steel		
		a. Capital expenditures	b. Depreciation expenses	a–b
2000	3,620	1,573	2,070	–497
2001	3,823	1,958	1,973	–15
2002	3,056	1,633	1,967	–334
2003	3,734	1,496	1,835	–339
2004	3,978	1,952	1,806	146
2005	5,432	2,040	1,834	206
2006	7,205	2,734	1,925	809
2007	7,736	3,100	2,500	600

(This table was produced by the author using information available from the Nippon Steel website.)

Chart 12. Crude steel Production Outputs of Major Steelmakers in World

	Company	Country	Crude steel production output (10,000 tons)
2002			
1	Arcelor	Luxembourg	4,403
2	Nippon Steel	Japan	3,086
3	Posco	South Korea	2,886
4	LNM	Netherlands	2,750
5	Shanghai Baosteel	China	1,948
6	ThyssenKrupp		1,700
7	Corus Group	UK	1,684
8	NKK	Japan	1,654
9	Riva Group	Italy	1,520
10	US Steel	United States	1,445
11	Kawasaki Steel	Japan	1,372
12	Nucor	United States	1,236
13	Sumitomo Metal Industries	Japan	1,182
14	SAIL	India	1,145
15	Magnitogorsk	Russia	1,100
2004			
1	Arcelor	Luxembourg	4,690
2	LNM (taken over by Mittal)	Netherlands	4,284
3	Nippon Steel	Japan	3,141
4	JFE Steel	Japan	3,113
5	Posco	South Korea	3,105
6	Shanghai Baosteel	China	2,141
7	US Steel	United States	2,083
8	Corus Group	UK	1,994
9	Nucor	United States	1,791
10	ThyssenKrupp	Germany	1,758
11	Riva Group	Italy	1,670
12	ISG (taken over by Mittal)	United States	1,611
13	Gerdau Group	Brazil	1,340
14	Severstal	Russia	1,280
15	China Steel	China	1,253
2006			
1	Arcelor	Luxembourg	11,720
2	Nippon Steel	Japan	3,270
3	JFE Steel	Japan	3,200
4	Posco	South Korea	3,010
5	Shanghai Baosteel	China	2,250
6	US Steel	United States	2,120
7	Nucor	United States	2,030
8	Tangsteel	China	1,910
9	Corus Group	UK	1,830
10	Riva Group	Italy	1,820
11	Severstal	Russia	1,750
12	ThyssenKrupp	Germany	1,680
13	Evraz	Russia	1,610
14	Gerdau Group	Brazil	1,560
15	Anshan Steel	China	1,500

(Source: International Iron and Steel Institute)

Chart 13. Nippon Steel's Soft Alliances (as of July 2007)

Major overseas alliance partners

Region/country	Company	Equity stake	JV partner(s)
Europe			
Netherlands	ArcelorMittal	None	
Asia			
South Korea	Posco	5%	
China	Baoshan Iron & Steel	None	
	Baoshan-Nippon Steel (JV)	38%	Baoshan Iron & Steel, ArcelorMittal
India	Tata	None	
Thailand	Siam United Steel (JV)	45%	
North America			
United States	I/N Tek (JV)	40%	ArcelorMittal
	I/N Kote (JV)	50%	ArcelorMittal
South America			
Brazil	USIMINAS	23%	
	UNIGAL (jv)	21%	USIMINAS

Main Domestic Alliance/Equity Investment Partners

Company	Equity stake
Sumitomo Metal Industries	5%
Kobe Steel	2%
Nisshin Steel	9%
Sanyo Special Steel	15%
Daido Steel	10%
Godo Steel	15%
Nakayama Steel Works	10%
Aichi Steel	8%
Chubu Steel Plate	5%
Mitsubishi Steel Mfg.	1%

Chart 14. Nippon Steel's Bond Issues and Conditions

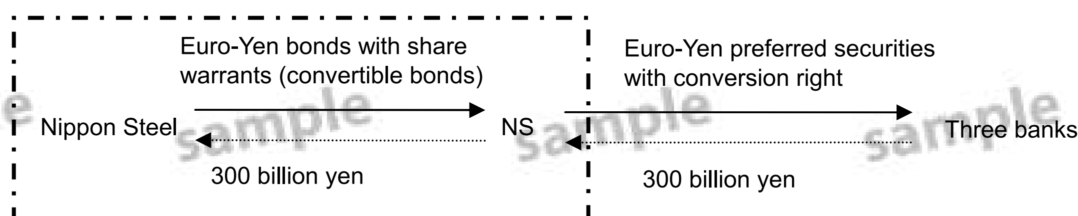
(in million yen)

Issue	Date of issuance	Total value	Interest rate (annual)	Date of redemption	Years to maturity
44th Issue of Unsecured Bonds	Nov. 20, 2002	30,000	0.54%	Nov. 20, 2007	5.0
45th Issue of Unsecured Bonds	Nov. 20, 2002	10,000	0.80%	Nov. 20, 2009	7.0
46th Issue of Unsecured Bonds	Nov. 20, 2002	10,000	1.36%	Nov. 20, 2012	10.0
47th Issue of Unsecured Bonds	Feb. 13, 2003	30,000	0.62%	Feb. 13, 2009	6.0
48th Issue of Unsecured Bonds	Feb. 13, 2003	15,000	1.18%	Feb. 13, 2013	10.0
1st Issue of Bonds with Advance Redemption Clause (limited subscribers)	Apr. 14, 2003	5,000	(at maturity) 2.30%	Apr. 14, 2023	20.0
49th Issue of Unsecured Bonds	June 4, 2003	20,000	0.80%	June 4, 2013	10.0
50th Issue of Unsecured Bonds with Advance Redemption Clause	June 4, 2003	15,000	(at maturity) 1.25%	June 4, 2015	12.0
51st Issue of Unsecured Bonds	May 28, 2004	20,000	0.78%	June 19, 2009	5.1
52nd Issue of Unsecured Bonds	May 28, 2004	15,000	1.67%	Mar. 20, 2014	9.8
Euro-Yen bonds with share warrants (convertible bonds)	Nov. 9, 2006	300,000	2.228%	Jan. 20, 2012	5.2

Chart 15. Japanese Government Bond Yields

Yield of 10 year JGB	
Year	Annual average
2002	1.28%
2003	0.99%
2004	1.50%
2005	1.36%
2006	1.75%
2007	1.70%
2008	1.45%

Chart 16. Schematic Diagram of Bonds with Share Warrants



NS: Preferred Capital Limited (a wholly-owned subsidiary of Nippon Steel set up in the Cayman Islands)

Chart 17. ArcelorMittal's Financial Statements

(Million Dollars)

ArcelorMittal condensed consolidated balance sheets

	2006	2007
ASSETS		
Current Assets		
- Cash and cash equivalents, restricted cash and short-term investments	$6,146	$8,105
- Trade accounts receivable – net	8,769	9,715
- Inventories	19,238	21,750
- Prepaid expenses and other current assets	5,209	5,940
Total Current Assets	39,362	45,510
- Goodwill and intangible assets	10,782	15,031
- Property, plant and equipment	54,696	61,994
- Investments in affiliates and joint ventures and other assets	7,326	11,113
Total Assets	$112,166	$133,648
LIABILITIES AND SHAREHOLDERS'		
Current Liabilities		
- Payable to banks and current portion of long-term debt	$4,922	$8,542
- Trade accounts payable	10,717	14,173
- Accrued expenses and other current liabilities	8,921	9,676
Total Current Liabilities	24,560	32,391
- Long-term debt, net of current portion	21,645	22,085
- Deferred tax liabilities Other long-term liabilities	7,274	7,927
Total Liabilities	61,975	72,272
Total Shareholders' Equity	42,127	56,526
Minority Interest	8,064	4,850
Total Equity	50,191	61,376
Total Liabilities and Shareholders' Equity	$112,166	$133,648

ArcelorMittal consolidated statements of income

	2006	2007
Sales	$88,576	$105,216
Depreciation and impairment	3,448	4,570
Operating Income	11,824	14,830
Operating Margin %	*13.30%*	*14.10%*
Income from equity method investments and Other Income	619	985
Financing costs - net	-1,328	-927
Income before taxes and minority interest	11,115	14,888
Income tax expense	1,654	3,038
Income before minority interest	9,461	11,850
Minority interest	-1,488	-1,482
Net income	$7,973	$10,368
Basic earnings per common share[3]	$5.76	$7.41
Diluted earnings per common share[3]	5.76	7.4
Weighted average common shares outstanding (in millions)[3]	1,383	1,399
Diluted weighted average common shares outstanding (in millions)[3]	1,385	1,401
EBITDA[4]	$15,272	$19,400
EBITDA Margin %	*17.20%*	*18.40%*

Chart 18. ArcelorMittal's Shareholder Structure

Shareholder Structure as of Beginning of 2008 (Shareholders with 5% or more holdings, Treasury Stock)

Shareholder	Shareholding	Stake (%)
Mittal family	623,620,000	43.04
Treasury stock	57,836,501	3.99
Other shareholders	767,369,846	52.97
Total	1,448,826,347	100

Chart 19. ArcelorMittal's Executives

Members of board of directors

Name	Position
Lakshmi N. Mittal	Chairman CEO
Vanisha Mittal Bhatia	
Naraynan Vaghul	Independent Director
Wibur L. Ross, Jr.	Independent Director
Lewis B. Kaden	Independent Director
François H. Pinault	Independent Director
José Ramón Álvarez Rendueles	Independent Director
Sergio Silva de Freitas	Independent Director
Georges Schmit	Shareholder Representative (Luxembourg Government)
Michel Marti	Employee Representative Independent Director
Jean-Pierre Hansen	Independent Director
John O. Castegnaro	Independent Director
Antoine spillmann	Employee Representative Independent Director
H.R.H.Prince Guillaume de Luxembourg	Independent Director
Ignacio Fernández Toxo	Union Representative
Malay Mukherjee	COO

Members of executive board

Name	Position
Lakshmi N. Mittal	Chairman CEO (formerly Mittal Steel)
Aditya Mittal	CFO (formerly Mittal Steel)
Michel Wurth	formerly Arcelor
Gonzalo Urquijo	formerly Arcelor
Sudhir Maheshwari	formerly Mittal Steel
Christophe Cormier	formerly Arcelor
Davinder Chugh	formerly Mittal Steel

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