

DAIDO STEEL CO., LTD. (5471 JP)

SOLID DEMAND FOR OPEN DIE FORGING AND LOWER SCRAP PRICE LED TO 1H REVISION. COST INCREASE BEING PASSED THROUGH.

FY22 Q1 RESULTS

Daido Steel (5471 JP) reported FY22 (March year-end) Q1 earnings with operating profit [OP] of ¥10,190mil (-3.0% YoY) on sales of ¥137,682mil (+4.9% YoY). Sales volumes of steel products fell 13.0% YoY to 280,000 tonnes due to reduced production from the auto sector – the largest customer for specialty steel products. On the other hand, sales to the semiconductor and the energy sectors for higher margin open die forging improved the overall sales mix. Consequently, OP matched FY21's 1H level despite higher raw material costs and energy prices.

The rapid surge in Q1 raw material prices and energy costs squeezed OP by approx. ¥17,600mil YoY, reflecting the rise in the cost of scrap (approx. +¥4,600mil YoY), and alloy materials, such as nickel, that added another ¥10,000mil to costs. In addition, energy prices were ¥3,000mil higher vs FY21 Q1. The rise in raw material and energy costs were passed onto customers, which boosted FY22 Q1 OP by ¥14,900mil and partially offset the impact.

Weaker sales of steel products reduced Q1 OP by ¥1,800mil, however, a change in the sales mix, with strong demand for high margin open die forging from the semiconductor and energy-related sectors, contributed ¥5,200mil to OP. As a result, while the Q1 OPM edged lower by 0.6ppt YoY to 7.4%, it is an improvement for the FY21 2H OPM of 6.5%.

Earnings Results and Guidance Summary						
(¥mil)	FY21				FY22	
	Q1	1H	2H	FY	Q1	YoY (%)
Steel Products Sales Volume (tonne)	322,000	634,000	619,000	1,253,000	280,000	-13.0
Sales	131,239	255,224	274,443	529,667	137,682	4.9
COGS	106,774	209,209	228,347	437,556	113,498	6.3
COGS / Sales (%)	81.4	82.0	83.2	82.6	82.4	+1.0pp
GP	24,464	46,015	46,096	92,111	24,183	-1.1
GPM (%)	18.6	18.0	16.8	17.4	17.6	-1.0pp
SG&A	13,958	26,858	28,270	55,128	13,993	0.3
SG&A / Sales (%)	10.6	10.5	10.3	10.4	10.2	-0.4pp
OP	10,505	19,156	17,826	36,982	10,190	-3.0
OPM (%)	8.0	7.5	6.5	7.0	7.4	-0.6pp
RP	11,824	20,556	18,644	39,200	11,339	-4.1
Extraordinary Profit / Loss	0	-424	1,970	1,546	0	n/a
Corporation Tax	-3,218	-5,643	-5,477	-11,120	-682	n/a
NP*	7,628	12,840	14,054	26,894	9,857	29.2

Source: Nippon-IBR based on Daido Steel's earnings results presentation materials
* NP attributed to the parent's shareholders

EXECUTIVE SUMMARY

- Daido Steel (5471 JP) reported FY22 Q1 earnings with operating profit [OP] of ¥10,190mil (-3.0% YoY) on sales of ¥137,682mil (+4.9% YoY). Despite the rapid surge in raw materials and energy prices, FY22 1H OP matched FY21 1H's level.
- Despite the surge in raw materials and energy prices, FY22 Q1 OP only fell 3.0% YoY as the rise in costs of ¥17,600mil was mostly offset by price hikes, which boosted OP by ¥14,900mil. Also, an improved sales mix, thanks to strong demand for open die forging, added a further ¥5,200mil to Q1 OP.
- The FY22 1H guidance from revised from OP of ¥11,500mil (-40.0% YoY) on sales of ¥280,000mil (+9.7% YoY) to OP of ¥19,500mil (+1.8% YoY) on sales of ¥280,000mil (+9.7% YoY). Thanks to price revisions that have been progressing as planned, the half-year sales will likely be in line with the initial expectation. OP is likely to exceed the current forecast thanks to 1) lower than expected steel scrap and nickel alloy prices, 2) an improved sales mix, and 3) further cost reductions.
- The full-year FY22 guidance for OP of ¥34,000mil (-8.1% YoY) on sales of ¥600,000mil (+13.3% YoY) are unchanged as (1) 2H energy costs are expected to rise further, (2) predicting orders and raw materials price trends remains a challenge, and (3) the prolonged cuts to auto production are also proving difficult for the firm to accurately forecast 2H demand levels. However, price rises to cover the higher costs of energy, and sales of alloy products that are not subject to surcharges have been progressing as planned, may provide a cushion.

FY22 Q1 EARNINGS BY SEGMENT

Sales, OP and OPM by Segment							
(¥mil)		FY21				FY22	
		Q1	1H	2H	FY	Q1	YoY (%)
Specialty Steel	Sales	46,558	93,168	104,635	197,803	50,591	8.7
	OP	1,013	1,441	2,386	3,827	135	-86.7
	OPM (%)	2.2	1.5	2.3	1.9	0.3	-1.9pp
High Performance Materials & Magnetic Materials	Sales	47,872	94,756	102,848	197,604	54,431	13.7
	OP	7,141	13,921	12,729	26,650	7,507	5.1
	OPM (%)	14.9	14.7	12.4	13.5	13.8	-1.1pp
Parts for Automobile and Industrial Equipment	Sales	24,900	46,521	45,983	92,504	23,828	-4.3
	OP	1,953	3,127	1,852	4,979	1,758	-10.0
	OPM (%)	7.8	6.7	4.0	5.4	7.4	-0.4pp
Engineering	Sales	3,724	8,732	9,482	18,214	3,778	1.5
	OP	-386	-709	-568	-1,277	-65	n/a
	OPM (%)	n/a	n/a	n/a	n/a	n/a	n/a
Trading & Service	Sales	8,182	12,047	11,493	23,540	5,051	-38.3
	OP	778	1,387	1,447	2,834	883	13.5
	OPM (%)	9.5	11.5	12.6	12.0	17.5	+8.0pp
Total	Sales	131,239	255,224	274,443	529,667	137,682	4.9
	OP	10,505	19,156	17,826	36,982	10,190	-3.0
	OPM (%)	8.0	7.5	6.5	7.0	7.4	-0.6pp

Source: Nippon-IBR based on FY21 & FY22 Q1 Earnings Results Materials published by Daido Steel

Daido Steel's business is largely divided into five segments:

1. Specialty Steel,
2. High Performance Materials & Magnetic Materials,
3. Automobile and Industrial Equipment Parts,
4. Engineering, and
5. Trading and Service.

FY22 Q1 segment earnings summary for the major three segments are discussed below:

Specialty Steel Segment

Special Steel generated FY22 Q1 segment OP of ¥135mil (-86.7% YoY) on sales of ¥50,591mil (+8.7% YoY). There were two negative factors that affected Q1 segment OP 1) ¥8,300mil from a surge in raw material and energy prices, 2) ¥1,400mil from decline in sales volume due to continued production reduction in the auto sector. However, those negative factors were partially offset by 1) price revision (¥7,800mil) which Daido Steel had planned to absorb rises in energy costs and prices of alloys, and 2) improved Slide Gap, the time lag to get the price rise agreed with customers. Scrap price remained lower than expected.

High Performance Materials & Magnetic Materials Segment

This segment is the most profitable of Daido Steel's divisions. The firm reported FY22 Q1 OP of ¥7,507mil (+5.1% YoY) on sales of ¥54,431mil (+13.8% YoY). Although the segment was also affected by higher raw materials prices and energy costs, Daido's Q1 OP was boosted by passing through part of the cost increase of ¥7,300mil to customers (+¥6,000mil) and a change in the sales mix (+¥1,600mil). Sales volumes of stainless steel and super alloys remained firm thanks to strong CAPEX momentum in the semiconductor sector. The segment Q1 OPM improved to 13.8% compared to 12.4% in FY21 2H. However, some distributors have started to delay their orders for stainless steel in anticipation of nickel prices peaking, which will lead to an adjustment in price of stainless steel in Q2.

Parts for Automobile and Industrial Equipment Segment

Parts for Automobile and Industrial Equipment Segment reported FY22 Q1 OP of ¥1,758mil (-10.0% YoY) on sales of ¥23,828mil (-4.3% YoY). Although die forging sales volumes declined along with the reduction in auto parts production, there was solid demand for open die forging from the semiconductor and the energy sectors. The weaker yen environment also was a tail wind for the open die forging business. As a result, the improvement in sales mix added ¥2,500mil to Q1 segment OP, offsetting negative impact from surge in raw materials and energy costs which gave a negative impact of ¥2,000mil.

FY22 1H AND FULL YEAR OUTLOOK

Daido Steel revised its FY22 1H guidance from OP of ¥11,500mil (-40.0% YoY) on sales of ¥280,000mil (+9.7% YoY) to OP of ¥19,500mil (+1.8% YoY) on sales of ¥280,000mil (+9.7% YoY). Thanks to price revisions that have been progressing as planned, the half-year sales will likely be in line with the initial expectation. The OP forecast is likely to surpass the original target thanks to 1) lower than expected steel scrap and nickel alloy prices, 2) an improved sales mix, and 3) cost reductions.

The firm's 1H OP outlook is based on the following YoY assumptions:

- A ¥34,300mil hit from raw materials and energy prices, comprising approx. -¥7,000mil from steel scrap, -¥20,000mil from alloy prices such as nickel and -¥7,000mil from energy prices. This compares to the previous guidance which assumed a ¥38,500mil negative impact to FY22 1H OP, including a ¥3,000mil increase in steel scrap prices and approx. ¥1,000mil rise in the price of alloys.
- Surging raw materials and energy prices will be mostly offset by passing them on in the form of price hikes. This which will improve 1H OP by ¥33,400mil, vs ¥31,700mil expected in the previous guidance.
- A ¥10,100mil improvement from a change in sales mix as demand for high margin products such as open die forging expands. It is a significant improvement from the previous assumption of ¥5,200mil.
- A decline in sales volume of specialty steel products by 87,000 tonne will reduce 1H OP by ¥6,500mil, vs the previous estimate of ¥2,600mil.

Although the FY22 1H guidance was revised at the time of Q1 results in July, the full year guidance remains unchanged from the original forecast announced in April 2022 which calls for FY22 OP of ¥34,000mil (-8.1% YoY) on sales of ¥600,000mil (+13.3% YoY). Price rises to cover the cost increases in energy, and alloy products that are not subject to surcharges, have been progressing as planned. However, there are several factors behind management's decision to maintain the current guidance for the time being. They include:

- That energy costs will likely continue to rise in 2H [NB: there is around a 9-month time lag between changes in energy prices being reflected in earnings].
- Daido Steel assumes a FOREX rate of ¥120/\$ for 2H. However, the yen has weakened even further so could potentially worsen the impact of higher energy prices on profits,
- It remains a challenge to forecast order trends and raw materials prices, and
- Compared to management's initial assumption, auto production cuts have been prolonged, hence it is difficult to accurately forecast 2H estimates.

Earnings Forecast - Revised for 1H only							
(¥mil)	FY21			FY22			
	1H	2H	FY	1H (Old)	1H (New)	FY	YoY (%)
Steel Products Sales Volume (tonne)	634,000	619,000	1,253,000	584,000	547,000	1,227,000	-2.1
Sales	255,224	274,443	529,667	280,000	280,000	600,000	13.3
OP	19,156	17,826	36,982	11,500	19,500	34,000	-8.1
OPM (%)	7.5	6.5	7.0	4.1	7.0	5.7	-1.3pp
RP	20,556	18,644	39,200	12,000	20,000	35,000	-10.7
Extraordinary Profit / Loss	-424	1,970	1,546	0	0	0	n/a
Corporation Tax	-5,643	-5,477	-11,120	-3,000	-4,500	-10,000	n/a
NP*	12,840	14,054	26,894	9,000	15,500	25,000	-7.0

Source: Nippon-IBR based on Daido Steel's earnings results presentation materials
* NP attributed to the parent's shareholders

Raw Material Price Trends (Revised)							
Material	Classification	FY20	FY21	FY22			
		Result	Result	Assumption	Q1 Result	Q2 est	vs. assumption
Scrap (¥000/t)	H2	24.9	47.6	61.5	55.5	47.0	-14.0
	Factory Bundle	28.9	53.9	66.5	63.0	52.0	-15.0
Nickle (\$/Lb)	LME	6.8	9.3	14.0	13.2	10.0	-4.0
Crude Oil (US\$/bbl)	Dubai Brent	45.8	76.6	100.0	108.3	100.0	0.0
FOREX ¥/US\$)	TTM	107.1	113.4	120.0	129.6	135.0	+15.0

Source: Daido Steel FY22 Q1 Earnings Results Presentation

FY22 OUTLOOK BY SEGMENT

Specialty Steel Segment

Daido Steel revised segment 1H OP from an operating loss of ¥2,500mil (OP of ¥1,441mil in FY21 1H) to an operating profit of ¥1,300mil (-9.8% YoY). The firm assumes 1H segment sales will likely remain unchanged at ¥102,100mil (+9.5% YoY). Assumptions for Q2 steel scrap prices have been revised down by more than 20% compared to the previous forecast.

Price increases from passing on cost increases will further progress in 2H, for which the firm estimates OP of ¥3,500mil (+46.7% YoY). However, the prolonged adjustments in auto production in 1H and a possible inventory adjustment by Tier 1 automakers might affect specialty steel sales volumes.

FY22 full year segment guidance remains unchanged OP of ¥1,000mil (-73.9% YoY) on sales of ¥222,000mil (+12.2% YoY). Previously, Daido Steel was forecasting the segment to return to profitability in 2H, earning OP of ¥3,500mil (+46.7% YoY).

High Performance and Magnetic Materials Segment

Daido Steel revised segment 1H forecast from OP of ¥12,000mil (-13.8% YoY) on sales of ¥110,000mil (+16.1% YoY) to OP of ¥13,000mil (-6.6% YoY) on sales of ¥108,100mil (+14.1% YoY) – the slight revision down in segment sales is due to falling stainless steel sales volumes. However, thanks to an improved sales mix, the 1H OPM will improve from the previous forecast of 10.9% to 12.0%. The original forecast of FY22 full-year segment OP forecast ¥25,500mil (-4.3% YoY) on sales of ¥237,000mil (+19.9% YoY) reflected the expected rise in fixed costs, such as a labour and travel / subsistence, along with a recovery in marketing activities, which would have lowered segment OPM by 2.7ppt YoY to 10.8% in FY22.

Parts for Automobile and Industrial Equipment Segment

1H guidance for the segment was substantially revised up from OP of ¥1,000mil (-68.0% YoY) on sales of ¥50,000mil (+7.5% YoY) to OP of ¥3,300mil (+5.5% YoY) on sales of ¥50,900mil (+9.4% YoY), thanks to a strong demand in open die forging. The firm assumes that sales volumes of auto parts will be affected by the low levels of auto production, but open die forging sales will benefit from strong demand from the semiconductor and energy sectors.

CAPITAL ALLOCATION POLICY

Daido Steel has two major allocations for its capital: growth investment including CAPEX and investment related to achieving a carbon neutral status, and dividend payments. The firm plans to finance CAPEX via cash flow, bank loans and the aforementioned proceeds from the unwinding some of its investment securities. Daido Steel does not currently have any shareholder return measure other than an annual cash dividend payout, at 30% of net profit. In FY21, the dividend pay-out ratio was 28.5% and will likely improve to 30.7% in FY22 – the level targeted under the ongoing Medium-term Plan.

Sales, OP and OPM by Segment									
(¥mil)		FY21			FY22				
		1H	2H	FY	1HCE (Old)	1HCE (New)	YoY (%)	FYCE	YoY (%)
Specialty Steel	Sales	93,168	104,635	197,803	102,000	102,100	9.6	222,000	12.2
	OP	1,441	2,386	3,827	-2,500	1,300	-9.8	1,000	-73.9
	OPM (%)	1.5	2.3	1.9	n/a	1.3	-0.2pp	0.5	-1.4pp
High Performance Materials & Magnetic Materials	Sales	94,756	102,848	197,604	110,000	108,100	14.1	237,000	19.9
	OP	13,921	12,729	26,650	12,000	13,000	-6.6	25,500	-4.3
	OPM (%)	14.7	12.4	13.5	10.8	12.0	-2.7pp	10.8	-2.7pp
Parts for Automobile and Industrial Equipment	Sales	46,521	45,983	92,504	50,000	50,900	9.4	103,000	11.3
	OP	3,127	1,852	4,979	1,000	3,300	5.5	4,500	-9.6
	OPM (%)	6.7	4.0	5.4	2.0	6.5	-0.2pp	4.4	-1.0pp
Engineering	Sales	8,732	9,482	18,214	9,500	8,700	-0.4	20,500	12.6
	OP	-709	-568	-1,277	0	200	n/a	500	n/a
	OPM (%)	n/a	n/a	n/a	n/a	2.3	n/a	2.4	n/a
Trading & Service	Sales	12,047	11,493	23,540	8,500	10,200	-15.3	17,500	-25.7
	OP	1,387	1,447	2,834	1,000	1,700	22.6	2,500	-11.8
	OPM (%)	11.5	12.6	12.0	11.8	16.7	+5.2pp	14.3	+2.3pp
Total	Sales	255,224	274,443	529,667	280,000	280,000	9.7	600,000	13.3
	OP	19,156	17,826	36,982	11,500	19,500	1.8	34,000	-8.1
	OPM (%)	7.5	6.5	7.0	4.1	7.0	-0.5pp	5.7	-1.3pp

Source: Nippon-IBR based on FY21 & FY22 Q1 Earnings Results Materials published by Daido Steel

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