

DAIDO STEEL CO., LTD. (5471 JP)

MEDIUM-TERM OP TARGET WILL BE ACHIEVED ONE YEAR EARLIER THANKS TO IMPROVED PROFITABILITY AMID SALES MIX CHANGE

FY22 Q3 RESULTS

Daido Steel (5471 JP) reported FY22 (March year-end) Q3 results released on 30 January 2023 with cumulative Q1~Q3 operating profit [OP] of ¥37,654mil (+30.2% YoY) on sales of ¥434,726mil (+11.3% YoY). The earnings are largely in line with company guidance.

The progress rate for the 9-month period to the company's full-year guidance is 76.3% for sales and 83.7% for OP. Higher growth in OP was due to 1) price hikes which reflected higher energy and raw materials costs, 2) improved slide gap – i.e., the time lag to get the price adjustment agreed with customers, and 3) an improved sales mix, thanks to strong demand in open die forging and stainless steel products.

Due to declines in auto production, the cumulative 9-month sales volume of steel products fell 12.1% YoY to 836,000 tonnes. However, thanks to Daido Steel's efforts to adjust its prices – to compensate for the higher energy and raw materials costs – Q1~Q3 sales expanded 11.3% YoY. The negative impact to OP from the fall in sales volumes (-¥11,600mil) and the sharp increase in costs (-¥45,600mil) were almost totally offset by price hikes (+¥54,600mil).

In Q3 alone, however, amid a temporary recovery in auto production during the Oct~Dec quarter, sales volume recovered by +13.8% QoQ to 296,000 tonnes (parent basis). The QoQ recovery in sales volume had positive impact on 3Q OP (+¥2,500mil), which offset the higher costs – steel scrap (approx. +¥1,500mil) / alloys, e.g., nickel (-¥1,000mil) / energy costs (-¥2,000mil). The contraction in the slide gap of scrap metal also supported Q3 OP growth.

Furthermore, the improvement in sales mix also contributed to the profit performance throughout Q1~Q3. In 2016, Daido Steel had identified demand for open die forging would likely increase and invested accordingly. Benefits from this decision are now being realised. Increases in open die forging sales and an improved sales mix in stainless steel products added +¥15,600mil to the rise in OP. In Q3 alone, the improvement in sales mix added +¥2,100mil to the quarterly OP of ¥14,429mil. As a result, the 9-month cumulative OPM improved 1.3ppt YoY to 8.7%. In Q3 alone, the OPM was 9.4% (+2.2ppt YoY / +0.4ppt QoQ). However, despite Q3 OP hitting a record level for the quarter and the progress rate to the full-year OP is over 80%, the firm has maintained its full-year guidance.

EXECUTIVE SUMMARY

- Daido Steel's (5471 JP) FY22 cumulative Q1~Q3 OP (¥37,654mil (+30.2% YoY)) is 84% of the full-year forecast. However, the company has kept its FY22 forecasts for OP of ¥45,000mil (+21.7% YoY) on sales of ¥570,000 (+7.6% YoY).
- Due to declines in auto production, 9-month sales volumes of steel products fell 12.1% YoY to 836,000 tonnes. However, thanks to the firm's efforts to adjust its prices – to reflect higher energy and raw materials costs – sales expanded 11.3% YoY.
- The improvement in the sales mix from sales of open die forging and high-performance stainless steel boosted profitability over Q1~Q3.
- The full year FY22 guidance was maintained due to 1) uncertainty in sales volume trends, 2) FOREX, 3) inventory adjustments of electric components / semiconductors, and 4) the absence of a one-off profit that was recorded in Q3.
- Thanks to Daido Steel's efforts to reduce fixed costs and adjust prices to cover the burden of surging input costs, the medium-term OP target of ¥45,000mill will likely be achieved in FY22 – a year ahead of schedule. Despite this, the firm has revised down its forecast for steel sales volumes from 1,227,000 tonnes to 1,090,000 tonnes. While cost increases were successfully passed on, growth in Daido Steel's strategic products, such as high-performance stainless steel and open die forging, delivered a much-improved change in the sales mix.
- The company currently does not have any shareholder return measures other than an annual cash dividend payout, at 30% of net profit.

Daido Steel (5471 JP): Earnings Results and Guidance Summary								
(¥mil)	FY21			FY22				3Q Progress Rate(%)
	1H	Q3	FY	1H	3Q	Q3 YoY (%)	FYCE	
Steel Products Sales Volume (tonne)	634,000	951,000	1,253,000	540,000	836,000	-12.1	1,090,000	76.7
Sales	255,224	390,499	529,667	281,857	434,726	11.3	570,000	76.3
COGS	209,209	321,092	437,556	230,921	355,823	10.8	N/A	N/A
COGS / Sales (%)	82.0	82.2	82.6	81.9	81.8	-0.4ppt	N/A	N/A
GP	46,015	69,406	92,111	50,935	78,902	13.7	N/A	N/A
GPM (%)	18.0	17.8	17.4	18.1	18.1	+0.3ppt	N/A	N/A
SG&A	26,858	40,492	55,128	27,710	41,247	1.9	N/A	N/A
SG&A / Sales (%)	10.5	10.4	10.4	9.8	9.5	-0.9ppt	N/A	N/A
OP	19,156	28,914	36,982	23,225	37,654	30.2	45,000	83.7
OPM (%)	7.5	7.4	7.0	8.2	8.7	+1.3ppt	7.9	N/A
RP	20,556	31,174	39,200	24,092	39,094	25.4	46,000	85.0
Extraordinary Profit / Loss	-424	2,707	1,546	-407	-460	N/A	N/A	N/A
Corporation Tax	-5,643	9,448	-11,120	-4,225	8,754	N/A	N/A	N/A
NP*	12,840	22,203	26,894	18,294	28,186	26.9	34,000	82.9

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

FY22 Q3 EARNINGS BY SEGMENT

FY22 Q3 earnings for the major three segments are discussed below:

Specialty Steel Segment

Special Steel FY22 Q1~Q3 OP surged +293.5% YoY to ¥8,511mil on sales of ¥162,203mil (+11.9% YoY). Sales volumes declined 12.1% YoY to 836,000 tonnes, though price adjustments to reflect the surge in energy costs and rising raw materials prices that are not subject to surcharge progressed were in line with the firm's expectation.

The slide gap of steel scrap in FY22 Q3 – the effect of which tends to have a time lag – improved by nearly ¥4,000mil from a year earlier [FY21 Q3 -¥4,600mil]. The 9-month cumulative +¥6,348mil YoY (+293.5% YoY) improvement in OP is thanks to contributions from price adjustments (+¥27,000mil) which offset the -¥17,700mil hit from higher energy and raw material costs and the -¥3,900mil hit from declines in sales volume. The slide gap over the 9-month period has improved with each quarter – FY22 Q1 to -¥700mil (-¥200mil QoQ) / Q2 to ¥600mil (+¥1,300mil QoQ) / Q3 to ¥700mil (+¥100mil QoQ). Changes in the sales mix (+¥900mil) and reductions in fixed cost (+¥1,000mil) also contributed to segment OP growth over the Q1~Q3 period. In Q3 alone, segment sales volumes were 296,000 tonnes (-6.6% YoY / +13.8% QoQ) and in line with Daido Steel's assumption that car production would likely recover in 2H compared to 1H.

High Performance Materials & Magnetic Materials Segment

The segment reported FY22 Q3 OP of ¥20,034mil (-5.0% YoY) on sales of ¥167,253mil (+14.5% YoY), resulting in the OPM contracting -2.4ppt YoY to 12.0%. OP fell by ¥1,054mil YoY (-5.0% YoY) due to (1) lower sales volumes (-¥5,600mil) on the back of the weak shipments of stainless steel to the auto industry and inventory adjustments by customers such as hard-disc makers, and 2) increases in fixed cost (-¥2,000mil), which were partially offset by the improved sales mix on the back of strong demand from the SPE sector. The hit from rising raw material costs, such as nickel (-¥21,100mil), however, was able to be passed on in price hikes (+¥24,100mil). In Q3 alone, the segment OP was ¥6,597mil (-8.0% YoY / +11.2% QoQ) on sales of ¥57,687mil (+12.5% YoY / +4.6% QoQ).

Parts for Automobile and Industrial Equipment Segment

Parts for Automobile and Industrial Equipment reported FY22 Q3 OP of ¥5,913mil (+36.8% YoY) on sales of ¥75,230mil (+8.3% YoY). Although die forging sales volumes declined along with the reduction in auto parts production, there was solid demand for open die forging, especially overseas, from the semiconductor, energy, and shipbuilding (used in engine valves) industries. Demand from the aircraft industry also kicked in. As a result, the improvement in the sales mix added +¥8,900mil to Q1~Q3 segment OP (+¥1,589mil YoY), offsetting the negative impact from the surge in raw materials and energy costs (-¥6,800mil) and the decline in sales volume (-¥2,100mil).

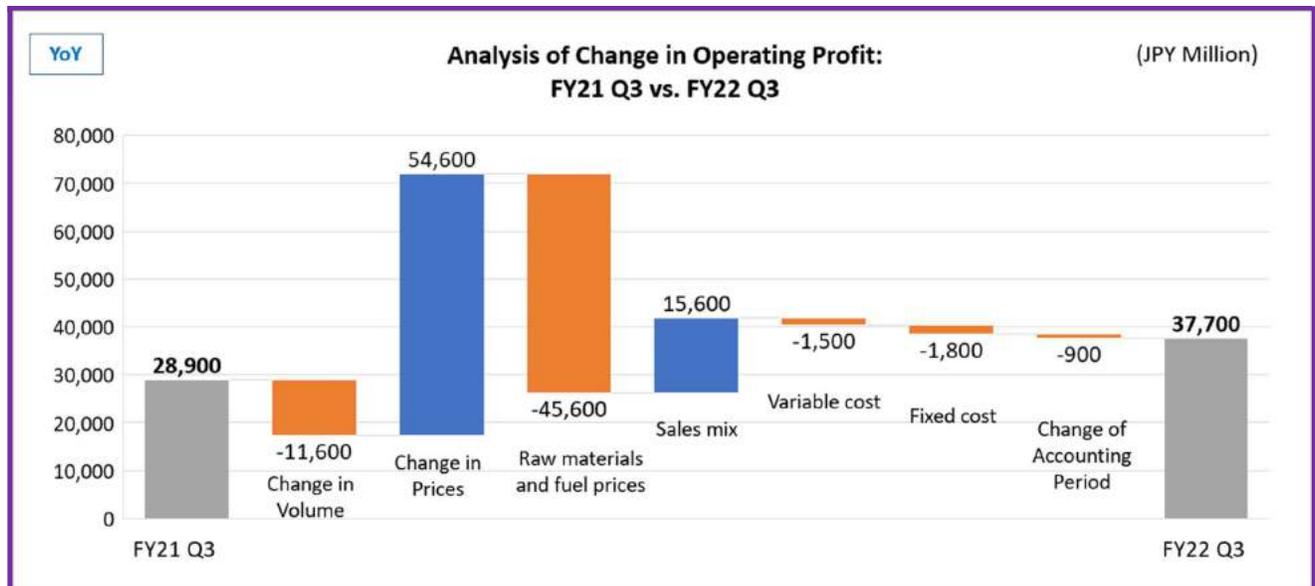
Open die forging has a relatively long lead time of approx. 6~9 months because Daido Steel provides an all-round service from design to production. In Q3 alone, the segment earned OP of ¥2,551mil (+113.3% YoY / +59.0% QoQ) on sales of ¥25,745mil (+12.3% YoY / +0.3% QoQ).

Daido Steel (5471JP): Sales, OP and OPM by Segment (Cumulative)										
(¥mil)		FY21			FY22					
		1H	Q3	FY	1H	Q3	Q3 YoY (%)	FYCE	FYCE YoY (%)	3Q Progress (%)
Specialty Steel	Sales	93,168	144,915	197,803	102,740	162,203	11.9	210,000	6.2	77.2
	OP	1,441	2,163	3,827	4,223	8,511	293.5	8,000	109.0	106.4
	OPM (%)	1.5	1.5	1.9	4.1	5.2	+3.7ppt	3.8	+1.9pp	n/a
High Performance Materials & Magnetic Materials	Sales	94,756	146,011	197,604	109,566	167,253	14.5	215,000	8.8	77.8
	OP	13,921	21,089	26,650	13,437	20,034	-5.0	24,000	-9.9	83.5
	OPM (%)	14.7	14.4	13.5	12.3	12.0	-2.4ppt	11.2	-2.3pp	n/a
Parts for Automobile and Industrial Equipment	Sales	46,521	69,437	92,504	49,485	75,230	8.3	105,000	13.5	71.6
	OP	3,127	4,323	4,979	3,362	5,913	36.8	9,000	80.8	65.7
	OPM (%)	6.7	6.2	5.4	6.8	7.9	+1.7ppt	8.6	+3.2pp	n/a
Engineering	Sales	8,732	13,044	18,214	8,336	13,544	3.8	18,000	-1.2	75.2
	OP	-709	-962	-1,277	412	678	n/a	1,000	n/a	67.8
	OPM (%)	n/a	n/a	n/a	4.9	5.0	n/a	5.6	n/a	n/a
Trading & Service	Sales	12,047	17,091	23,540	11,727	16,493	-3.5	22,000	-6.5	75.0
	OP	1,387	2,321	2,834	1,816	2,502	7.8	3,000	5.9	83.4
	OPM (%)	11.5	13.6	12.0	15.5	15.2	+1.6ppt	13.6	+1.6pp	n/a
Total	Sales	255,224	390,499	529,667	281,857	434,726	11.3	570,000	7.6	76.3
	OP	19,156	28,914	36,982	23,225	37,654	30.2	45,000	21.7	83.7
	OPM (%)	7.5	7.4	7.0	8.2	8.7	+1.3ppt	7.9	+0.9pp	n/a

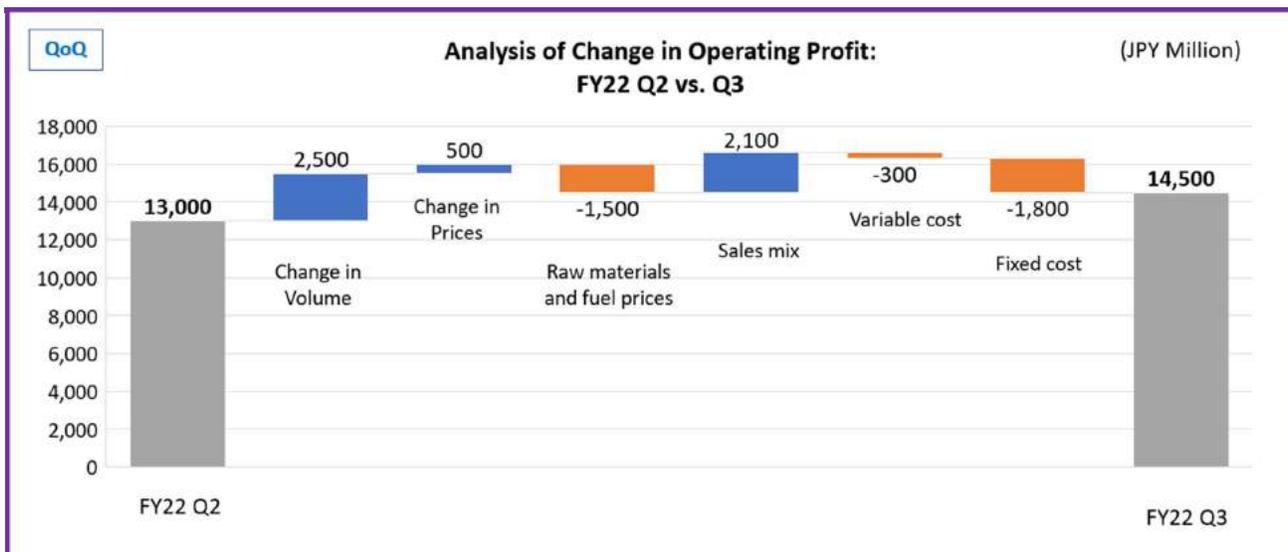
Source: Nippon-IBR based on FY21 & FY22 Earnings Results Materials published by Daido Steel

Daido Steel (5471JP): Sales, OP and OPM by Segment (Quarterly)											
(¥mil)		FY21		FY22							
		Q3	Q4	Q1	Q2	3Q	QoQ (%)	YoY (%)	2H CE	FY CE	YoY (%)
Specialty Steel	Sales	51,747	52,888	50,591	52,149	59,463	14.0	14.9	107,200	210,000	6.2
	OP	722	1,664	135	4,088	4,288	4.9	493.9	3,800	8,000	109.0
	OPM (%)	1.4	3.1	0.3	7.8	7.2	-0.6ppt	+5.8ppt	3.5	3.8	+1.9ppt
High Performance Materials & Magnetic Materials	Sales	51,255	51,593	54,431	55,135	57,687	4.6	12.5	105,400	215,000	8.8
	OP	7,168	5,561	7,507	5,930	6,597	11.2	-8.0	10,600	24,000	-9.9
	OPM (%)	14.0	10.8	13.8	10.8	11.4	+0.6ppt	-2.6ppt	10.1	11.2	-2.3ppt
Parts for Automobile and Industrial Equipment	Sales	22,916	23,067	23,828	25,657	25,745	0.3	12.3	55,500	105,000	13.5
	OP	1,196	656	1,758	1,604	2,551	59.0	113.3	5,600	9,000	80.8
	OPM (%)	5.2	2.8	7.4	6.3	9.9	+3.6ppt	+4.7ppt	10.1	8.6	+3.2ppt
Engineering	Sales	4,312	5,170	3,778	4,558	5,208	14.3	20.8	9,700	18,000	-1.2
	OP	-253	-315	-65	477	266	-44.2	n/a	600	1,000	n/a
	OPM (%)	n/a	n/a	n/a	10.5	5.1	-5.4ppt	n/a	6.2	5.6	n/a
Trading & Service	Sales	5,044	6,449	5,051	6,676	4,766	-28.6	-5.5	10,300	22,000	-6.5
	OP	934	513	883	933	686	-26.5	-26.6	1,200	3,000	5.9
	OPM (%)	18.5	8.0	17.5	14.0	14.4	+0.4ppt	-1.1ppt	11.7	13.6	+1.6ppt
Total	Sales	135,275	139,168	137,682	144,175	152,869	6.0	13.0	288,100	570,000	7.6
	OP	9,758	8,068	10,190	13,035	14,429	10.7	47.9	21,800	45,000	21.7
	OPM (%)	7.2	5.8	7.4	9.0	9.4	+0.4ppt	+2.3ppt	7.6	7.9	+0.9ppt

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



Source: Nippon-IBR based on FY22 Q3 Earnings Results Materials published by Daido Steel



Source: Nippon-IBR based on FY22 Q3 Earnings Results Materials published by Daido Steel

FY22 FULL YEAR OUTLOOK

Daido Steel kept its FY22 OP guidance unchanged at ¥45,000mil (+21.7% YoY) on sales of ¥570,000mil (+7.6% YoY). As of Q3, the OP of ¥37,654mil represents 84% of the full-year OP forecast. Despite this progress, Daido Steel did not revise its full year guidance because of the following assumptions:

- Management remains conservative on demand for specialty steel products. While specialty steel sales volumes showed improvements in FY22 Q3 on the back of a recovery in auto production volumes, the recovery proved to be rather short-lived due to sluggish sales by Japanese OEM makers. That said, the current guidance is based on the assumption that 2H sales volume (550,000 tonnes) will stay above 1H’s 540,000 tonnes. Encouragingly, Japan’s automakers saw sales volume rose 16% YoY in January as the part shortage eased.
- FOREX risk: Daido’s net FOREX impact in case of weaker yen – a ¥1 move vs the USD reduces earnings by -¥100mil. The firm assumes a negative FOREX impact in Q4.
- Demand for semiconductor and electric components materials will likely be weak due to inventory adjustments in High Performance and Magnetic materials.
- In Q3 alone, the firm reported a one-off profit that boosted OP by some ¥3,000mil, primarily thanks to a positive slide gap of ¥700mil and FOREX revaluation gain of ¥900mil that includes gains from FOREX hedge.

Daido Steel also maintained the segment sales and OP which was revised at the time of 1H results.

Earnings Forecast									
(¥mil)	FY21			FY22					YoY (%)
	1H	2H	FY	1H	2HCE	Q3	Q4CE	FYCE	
Steel Products Sales Volume (tonne)	634,000	619,000	1,253,000	540,000	550,000	296,000	254,000	1,090,000	-13.0
Sales	255,224	274,443	529,667	281,857	288,143	152,869	135,274	570,000	7.6
OP	19,156	17,826	36,982	23,225	21,775	14,429	7,346	45,000	21.7
OPM (%)	7.5	6.5	7.0	8.2	7.6	9.4	5.4	7.9	+0.9pp
RP	20,556	18,644	39,200	24,092	21,908	15,002	6,906	46,000	17.3
Extraordinary Profit / Loss	-424	1,970	1,546	-407	7	-53	60	-400	n/a
Corporation Tax	-5,643	-5,477	-11,120	-4,225	-7,375	-4,529	-2,846	-11,600	n/a
NP*	12,840	14,054	26,894	18,294	15,706	9,892	5,814	34,000	26.4

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

PROGRESS ON MEDIUM-TERM MANAGEMENT PLAN TARGETS

FY22 is the second year of the three-year medium-term management plan, ending in FY23. Thanks to the firm's efforts to reduce fixed costs and adjust prices to meet surging input costs, the medium-term OP target of ¥45,000mil will likely be achieved in FY22, and despite management revising down their steel products sales volume assumptions from 1,227,000 tonnes to 1,090,000 tonnes. Passing on cost increases to selling prices progressed as expected. More importantly, growth in Daido Steel's strategic products, such as high-performance stainless steel and open die forging, delivered a marked improvement in sales mix. As a result, ROE will likely reach 10.0% in FY22, surpassing the medium-term target of 8%.

On the other hand, the firm's aim to reduce its D/E ratio to 0.5x will likely fall short. With the surge in FY22 Q1 raw material and energy costs, Daido Steel's working capital contracted and cash flow from operations (CFO) was affected. To secure working capital, Daido Steel borrowed short-term debt in FY22 Q1. As a result, the D/E ratio will likely be 0.66x in FY22.

Daido Steel also committed to reducing its strategic holdings of investment securities, including shares contributed to the firm's employee pension trust, to 20% of net assets during the ongoing medium-term management plan. As of the end of FY21, strategic holdings of shares alone (excluding those contributed to the employee pension trust) were reduced to ¥68,500mil to comprise 18.8% of net assets of ¥365,004mil.

Medium-term Management Plan (FY21~FY23) Target			
	Target to achieve in FY23	FY22 Forecast	Progress
OP (¥mil)	40,000	45,000	To be achieved in FY22
ROE (%)	8.0	10.0	To be achieved in FY22
D/E ratio (x)	0.5	0.66	Unlikely to be achieved
Investment (¥mil)	85,000	85,000	In line
Sales volume (tonne)	1.2mil	1.09mil	Lower than expected

Source: Nippon-IBR based on Daido Steel's FY22 1H earnings results presentation

CAPITAL ALLOCATION POLICY

Daido Steel has three major allocations for its capital: investment for growth, including (1) CAPEX and (2) investment related to achieve a carbon neutral status for which Daido Steel financed ¥10,000mil via issuance of transition bond, and (3) dividend payments. The firm plans to finance CAPEX via cash flow, bank loans and the proceeds from the unwinding of some of its investment securities.

1. CAPEX: The open die forging business is currently operating at full capacity at the Shibukawa plant. Daido Steel plans to invest in expanding remelting capacity.
2. Investment to achieve a carbon neutral status: At the ESG presentation held on 19 December 2022, the firm announced a renewed initiative, *Daido Carbon Neutral Challenge 2030*, which aims to reduce Scope 1 & Scope 2 CO2 emissions by 50% by 2030 compared to emission volume of approx 1mil tonne in FY13 and to become carbon neutral by 2050 on a parent basis.
3. Dividend policy: The company currently does not have any shareholder return measures other than an annual cash dividend payout, at 30% of net profit. The semi-annual cash dividend was revised from ¥80/share to ¥100/share to reflect the strong earnings. The annual dividend will be ¥200/share, which will generate a dividend payout ratio of 25.1% based on the current FY22 earnings guidance, vs ¥180/share in FY21.

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