

Daido Steel Co., Ltd. (5471)

Initiation Report

A Specialty Steel Maker with Strength in High-end Materials



8 JULY 2022

NIPPON INVESTMENT BESPOKE RESEARCH UK LTD

London, UK

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Executive Summary – A High-end Specialty Steel Producer

Daido Steel is one of Japan's major specialty steel makers. Initially founded in 1916 as Electric Steel Manufacturing Co., Ltd, the firm became Daido Steel in 1976 after a reorganisation and having merged with three companies. Currently, comprising of the parent company and 62 consolidated subsidiaries, Daido operates five businesses:

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

Daido Steel's business portfolio is diverse, offering products in the upstream specialty steel value chain, such as the production of electric furnace specialty steel, to downstream products, such as parts for autos and industrial equipment. The firm also provides engineering products and services, such as smelting and refining equipment for auto parts and machine tools, though comprising just 5% of total sales. The High-Performance Materials and Magnetic Materials segment, with a FY21 operating profit margin [OPM] of 13.5%, is Daido Steel's most profitable business, offering products such as high-strength stainless steel with anti-corrosion properties and high-alloy steel, which generating OPMs of over 10%.

According to the research conducted by the Japan Metal Daily on FY20 crude steel production volumes, Daido Steel was ranked 6th overall but was ranked 3rd among electric furnace steel makers. Despite having less production capacity compared to that of the blast furnace steel makers, Daido is unique as it offers a wider range of customised products, many of which are co-developed with users, such as OEM makers, to satisfy specific properties that are now required – e.g., anti-corrosion, heat-resistance, anti-rust etc.

In FY20 and FY21, the firm was not immune to the impact of COVID, especially with supply chain disruptions hitting automobile production volumes. Because of this, the firm failed to meet its medium-term plan target in FY20, which was the final year of the plan. Under the new medium-term plan which started in FY21, Daido identifies areas for growth in mobility, and energy such as CASE (Connectivity, Autonomous, Sharing / Subscription and Electrification), semiconductors and green energy.

Daido Steel is guiding for FY22 1H OP of ¥11,500mil (-40.0% YoY) on sales of ¥280,000mil (+9.7% YoY), and FY22 OP of ¥34,000mil (-8.1% YoY) on sales of ¥600,000mil (+13.3% YoY). The decline in OP forecast assumes 1) some risk of further supply chain issues through FY22 1H but management expects the situation to gradually resolve from 2H in the automobile sector, and 2) raw materials and energy price hikes. Scrap and some alloys price rise can be passed onto customers, but energy price and some alloys are not subject to surcharge fees. These costs will affect 1H OP, but the firm's guidance assumes negotiations with customers will be successful in accepting the surcharges later in the year.

Daido Steel released the current Mid-term Management Plan in June 2021, that will cover three years between FY21~FY23. The firm failed to achieve the previous plan's target of OP of ¥47,000mil on sales of ¥580,000mil in FY20, given FY20 OP declined 59.3% YoY to ¥10,070mil on sales of ¥412,722mil (-15.8% YoY) – mainly due to COVID. The current Plan, on the other hand, is more conservative in its targets. The firm is aiming for OP of ¥40,000mil and ROE of 8.0%, compared to the previous plan's target of 9% but resulted in an ROE of 1.6%.

Daido Steel has two major allocations for its capital: (1) growth investment, including CAPEX and investment related to achieving a carbon neutral status, and (2) dividend payments. Daido Steel does not currently have any shareholder return measure other than an annual cash dividend, 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.

Business Model

Daido Steel has five businesses of which three, 1) Specialty Steel, 2) High Performance Materials and Magnetic Materials, and 3) Parts for Automobile and Industrial Equipment, earn approx. 94% of the total sales and 92% of operating profit [OP], respectively.

1. Specialty Steel

Specialty Steel is the foundation of the firm's business. The segment generated approx. 37% of FY21 sales and 10% of OP. Every specialty steel maker is unique in how they combine steel and alloys – to create properties such as heat resistance, withstand abrasions, and anti-rust – and they each develop tailored products to meet the needs of its customers.

Approx. 80% of segment sales are from the auto and industrial machinery sectors. Main products include specialty steel for auto parts, industrial machinery parts, electrical machinery parts, construction equipment parts, and tool steel. Due to the high exposure to the auto and industrial machinery sectors, auto production volumes, especially by Japanese manufacturers, is an important bellwether for Daido's earnings.

On the cost side, the price of steel scrap impacts segment earnings: The price of alloys affects raw material costs of the segment; however, core alloy materials are subject to surcharges. Energy and graphite electrode prices also affect the operating cost of an electric furnace. However, a portion of specialty steel manufactured in this segment is used internally (discussed further below). In FY21, 26% of segment sales was for internal use.

2. High Performance Materials and Magnetic Materials

Management sees this segment as the core of Daido's future growth. While 37.3% of FY21 total sales came from this segment, it generated 72.0% of total OP. Key products include stainless steel products, rare earth magnets, high alloys, titanium products, and powder metal products. Main applications are for automotive motors, semiconductor production equipment [SPE], mobile phones and consumer electronics. Reasons for the segment's higher margin are due to 1) a larger number of value-added products, 2) products are more specified for high performance, 3) more niche products, and 4) a portion of the material cost is internally supplied.

3. Parts for Auto and Industrial Equipment

The segment's primary business is to process in-house manufactured specialty steel materials for auto and industrial equipment parts for manufacturers, including Tier 1 makers. There are two sub-segments: (1) die forging, mainly for autos, and (2) open forging, which is higher margin than die forging and includes non-automotive customers such as SPE makers and the energy sector.

Daido has a high market share in numerous product categories in this segment, for example, aircraft jet engine shaft, automobile engine valves and turbine wheels. The segment earned 17.5% of FY21 sales and 13.5% of total OP. Despite the fact that some materials, including specialty steel, are supplied in-house, the segment OPM remains in the region of 5~7% as 1) fixed costs are proportionately high, and 2) auto parts, such as precision casting for turbo engines, for which there is fierce pricing competition as the market is mature.

Competitive Environment

According to the Japan Metal Daily, a newspaper specialises in the steel sector, in FY20, Daido Steel had a 1.5% market share of Japan's total crude steel production and is ranked 6th after Nippon Steel (5401 JP, 39.9%), JFE Steel (5411 JP, 27.5%), Kobe Steel (5405 JP, 7.0%), Tokyo Steel (5423 JP, 2.7%), and Kyohei Steel (5440 JP, 1.6%). The top three steel makers are blast furnace steel makers, while the remaining makers operate electric furnaces.

Market share differs from product to product, but Daido Steel is known to have a high market share in steel bar and wire products. The firm identifies stainless steel as one of the products that it aims to grow. The survey cites that as of FY20, Daido Steel's market share in hot-rolled stainless steel was 6.9% (+0.5ppt YoY), substantially lower than that of Nippon Steel (57.7%) and JFE Steel (18.3%) but that is because Daido Steel mainly produces steel bars

but not steel plates, hence the market share figures above, which are based on all shapes of stainless steel, can be misleading.

According to the Japan Metal Daily, market shares in major steel bar and wire products as of FY20 are as follows:

Market Share in Specialty Steel Products with High Exposure to Steel Bar and Wire Products								
Bearing Steel		Tool Steel		Structural Alloy Steel		Spring Steel		
Product Type	% of total	Product Type	% of total	Product Type	% of total	Product Type	% of total	
Steel Bar	55.0	Steel Bar	50.0	Steel Bar	58.0	Steel Bar	66.0	
Steel Wire	32.0	Steel Wire		Steel Wire	19.0	Steel Wire	27.0	
Rank	%	Rank	%	Rank	%	Rank	%	
1	Sanyo Spec. Steel	36.8	Nippon Steel	25.6	Nippon Steel	31.0	Nippon Steel	40.5
2	Daido Steel	20.2	JFE Steel	24.1	Aichi Steel	15.8	Kobe Steel	32.0
3	Kobe Steel	15.9	Hitachi Metal	21.2	Daido Steel	15.6	Aichi Steel	15.7
4	Nippon Steel	13.6	Daido Steel	16.8	Kobe Steel	12.3	Daido Steel	10.1
5	Aichi Steel	8.5	Sanyo Spec. Steel	5.4	Sanyo Spec. Steel	9.7	JFE Steel	1.5
6	JFE Steel	4.5	Fujikoshi	3.7	JFE Steel	6.8		
7					Topy Kogyo	4.2		
	Top 6 total	99.5	Top 6 total	96.8	Top 7 total	95.4	Top 5 total	99.8

Source: Nippon-IBR Based on Japan Metal Daily survey on FY20 steel production

- Bearing steel:** FY20 domestic production volume fell 18.2% YoY to 703,000 tonnes due to a drop in demand from the automobile use and inventory adjustment. The top six players comprise 99.5% of the market, which is split to 55% in bars and 32% in wire. Among the top four, Nippon Steel group companies, including Sanyo (51% owned by Nippon Steel) and Nippon Steel (13.6%), hold 50% of the market. Sanyo Specialty Steel (5481 JP) has a 36.8% share, followed by Daido steel with 20.2% of the market.
- Tool Steel:** FY20 domestic production volume fell 22.8% YoY to 161,000 tonnes. Steel bar and wire products combined occupy 50% of the market. Sales by application comprises 47% in alloy tool steel and 46% in carbon tool steel. The main user is the auto industry – steel sheets used as a raw material for auto components, and steel bars are used in die casting, jigs, and tools. Daido Steel was ranked 4th with a 16.8% market share after Nippon Steel (25.6%), JFE (24.1%), and Hitachi Metal (21.2%).
- Structural Alloy Steel (or mechanical constructure steel):** Structure steel is also mainly used by the auto industry. FY20 domestic production volume was approx. 3.0mil tonnes (-19.8% YoY). The split by type of products is 58.0% in steel bar and 19.0% in steel wire. Daido Steel had 15.6% market share in the structure steel market and is ranked 3rd after Nippon Steel (31.0%) and Aichi Steel (5482 JP, 15.8%). Some 99.0% of the market is made up of the top eight companies, and market shares have not changed much.
- Spring Steel:** The total production volume in FY20 was 309,000 tonnes (-16.6% YoY). 70% of the market comprises of Nippon Steel (40.5%) and Kobe Steel (32.0%), both of which have high market shares in automotive specialty steel wire. Daido is ranked 4th with a 10.1% market share. 66.0% of the market is steel bar products and 27.0% is steel wire.

Differentiation Factor – High-end Focus

Daido Steel's strategy is not to capture higher market share in the high-volume, general-purpose products but rather, it aims to capture niche, higher-end markets through product co-development with customers (e.g., motors for EV) and non-automotive applications (e.g., SPE) which are less likely to face pricing pressure.

Daido Steel's strength lies in its:

- Capability to develop high-end specialty steel products, such as those in the High-Performance Materials and Magnetic Materials segment. Its competitors, such as Sanyo Specialty Steel (5481 JP), Aichi Steel (5482 JP) and Nittetsu Stainless (unlisted, JP, 100% subsidiary of Nippon Steel), also have high performance products such as alloy powder and magnetic materials, however, only Daido Steel supplies the high-end materials and has exposure to the SPE industry (4% of the stainless steel in High Performance Materials).
- Track record in the co-development and customised materials with OEMs and Tier 1 makers.
- Cost competitiveness thanks to its ability to manufacture a variety of high-end and customised products in the Chita Factory, the firm's mother factory.
- Being independent of a larger steel company or not solely reliant on just one customer, such as an automobile company, yet obtains a relatively high market share in steel bars and wires products.

On the other hand, the firm's weakness lies in that it:

- Is less cost competitive in manufacturing general-purpose, mass specialty steel products. Therefore, Daido earns only 1~2% of OPM in the Specialty Steel segment but earns 13~14% segment OPM in the High-Performance Materials and Magnetic Materials.
- Has a lower overseas sales ratio than some of its competitors whose majority of sales are earned overseas through acquired overseas subsidiaries. Daido Steel earned approx. 27.6% (+2.7ppt YoY) of its FY21 consolidated sales overseas. The firm plans to achieve overseas growth mainly through exports. Capturing growth in China, India, and ASEAN, especially in the field of high-performance materials business, is one of Daido Steel's mid-term growth strategies and challenges.

FY21 Earnings Results Summary

Daido Steel reported FY21 results with OP of ¥36,982mil (+267.2% YoY) on sales of ¥529,667mil (+28.3% YoY). Demand for specialty steel has recovered from the negative impact on FY20 levels due to COVID, with the firm reporting a 28.1% YoY improvement in sales volume of steel products to 1.25mil tonnes thanks to:

- 1) A recovery in orders across all client groups. Although the automobile sector was hit by repeated temporary production suspensions due to component shortages and the resurgence of COVID, Daido Steel saw steady order flows from Tier 1 makers due to stockpiling demand.
- 2) Demand from the industrial equipment sector improved as manufacturers' CAPEX recovered.
- 3) Orders associated with the semiconductor sector saw solid growth, thanks to expansion in demand related to 5G, data centres and automotive applications.

On the other hand, the sharp increase in key raw material prices, particularly during FY21 2H, resulted in raw materials and energy costs rising ¥51,000mil YoY to FY21 OP, which can be broken down to:

- 1) Higher scrap prices (+¥27,600mil YoY). Scrap prices almost doubled during FY21 (from ¥249,000/t average in FY20 to ¥476,000/t average in FY21) due to the tight supply in the domestic market and price hikes globally.
- 2) The surge in crude oil and LNG prices led to a ¥1,900mil rise in energy costs from the year earlier. A \$1/bbl. change in the Dubai Brent oil price impacts OP by approx. ¥200mil.
- 3) The cost of alloy products such as Nickle surged by ¥21,500mil, due to limited supplies and an increase in global demand. In the case of Nickle, a \$1/lb change in the LME price impacts OP by ¥3,500mil. However, the firm can pass on the rise in some alloy prices (e.g., Nickle, Chrome, Molybdenum etc.) as a surcharge to customers with no lapse – approx. ¥14,500mil in surcharge fees was applied in FY21.

The raw materials cost increase of ¥51,000mil in FY21 was partially offset by the ¥35,400mil gain from price hikes. The energy price surcharge is negotiable with customers. Daido had started negotiations before crude oil prices rose, therefore the impact will start affecting the firm's cost in nine months' time. While scrap price hikes are usually transferrable to customers, albeit with 3~4-month time lag, for alloy products, Daido Steel can apply a surcharge if major alloys such as Nickle, Chrome, Molybdenum, and Vanadium prices go up. However, the rise in price of Mangan, Silicon and Phosphorous are not subject to a surcharge. Daido continues to expand the application of surcharges to a wider variety of alloy metals. Another ingredient, graphite, used for dissolution (melting) electrodes in electric furnaces, saw little price change in FY21.

There was also little impact on OP due to FOREX in FY21 due to the sharp yen weakness in Q4, hence the annualised impact was limited. Furthermore, the weaker yen impact will likely be offset by exporting high value-added products, which will be more competitive under the weaker yen environment.

FY21 Earnings Results Summary							
¥mil	FY20			FY21			
	1H	2H	FY	1H	2H	FY	YoY (%)
Steel Products Sales Volume (tonne)	378,000	600,000	978,000	634,000	619,000	1,253,000	28.1
Sales	179,490	233,232	412,722	255,224	274,443	529,667	28.3
COGS	158,495	193,031	351,526	209,209	228,347	437,556	24.5
COGS / Sales (%)	88.3	82.8	85.2	82.0	83.2	82.6	-2.6pp
GP	20,994	40,202	61,196	46,015	46,096	92,111	50.5
GPM (%)	11.7	17.2	14.8	18.0	16.8	17.4	+2.6pp
SG&A	24,526	26,600	51,126	26,858	28,270	55,128	7.8
SG&A / Sales (%)	13.7	11.4	12.4	10.5	10.3	10.4	-2.0pp
OP	-3,531	13,601	10,070	19,156	17,826	36,982	267.2
OPM (%)	n/a	5.8	2.4	7.5	6.5	7.0	+4.6pp
RP	-2,112	14,754	12,642	20,556	18,644	39,200	210.1
Extraordinary Profit / Loss	38	-2,615	-2,577	-424	1,970	1,546	n/a
Corporation Tax	-151	-3,946	-4,097	-5,643	-5,477	-11,120	n/a
NP*	-2,318	6,834	4,516	12,840	14,054	26,894	495.5

Source: Nippon-IBR based on Daido Steel's earnings results presentation materials

* NP attributed to the parent's shareholders

Raw Materials Price Trend						
		FY20		FY21		
		Result		Result		
Scrap	H2	¥000/t	24.9		47.6	
	Factory Bundle		28.9		53.9	
Nickle	LME	\$/Lb	6.8		9.3	
Crude Oil	Dubai Brent	\$/bbl.	45.8		76.6	
FOREX	TTM	¥/\$	107.1		113.4	

Source: Daido Steel FY21 Earnings Results Presentation

FY21 Earnings by Segment

Daido Steel's business is largely divided into five segments: Specialty Steel, High Performance Materials & Magnetic Materials, Automobile and Industrial Equipment Parts, Engineering, and Trading and Service. FY21 segment earnings summary for the major three segments are discussed below:

Specialty Steel Segment

Special Steel generated FY21 segment OP of ¥3,827mil (vs an operating loss of ¥2,632mil in FY20) on sales of ¥197,803mil (+35.6% YoY). Despite a series of production closures by OEM makers, which subsequently affected the entire automobile value chain, Daido orders for structural steel recovered thanks to stockpiling by Tier 1 makers. A rise in tool steel sales also improved the segment sales mix.

The hit to OP from the rise in raw material prices (+¥33,800mil), however, was almost entirely offset by (1) an increase in sales volumes (+¥10,700mil) and (2) price hikes (+¥23,600mil). However, the time lag to get the price rise agreed with customers – referred to as the Slide Gap – had a negative impact of ¥4,500mil on OP. The transfer of energy prices and surcharge applications on more materials will be the key issue for FY22. Structural steel, whose main material is scrap, tends to have the Slide Gap during approx. four months between shipment and change in price.

High Performance Materials & Magnetic Materials Segment

High Performance Materials and Magnetic Materials Segment is the most profitable segment. Daido Steel reported FY21 OP of ¥26,650mil (+118.9% YoY) on sales of ¥197,604mil (+32.2% YoY), largely in line with the firm's forecast of OP of ¥26,700mil on sales of ¥198,500mil. Due to a rise in energy costs and alloys that are not subject to surcharges (-¥13,700mil), OP growth was lower than that of sales and OPM temporarily worsened to 12.4% in 2H, compared to 14.7% in 1H. Sales volumes of stainless steel and super alloys remained firm thanks to strong CAPEX momentum in the semiconductor sector. Orders from auto and industrial machinery customers also recovered. Magnetic materials also enjoyed higher sales thanks to stable demand from the semiconductor and auto sectors. Alloy powder, another high margin product for Daido, also saw sales improve. The YoY sales growth of the segment's main products such as super alloy, magnetic materials and alloy power were +52.6% YoY, +27.8% and +46.0%, respectively.

Parts for Automobile and Industrial Equipment Segment

Parts for Automobile and Industrial Equipment Segment reported FY21 OP of ¥4,979mil (vs an operating loss of ¥2,109mil in FY20) on sales of ¥92,504mil (+14.6% YoY). Die forging sales volumes recovered along with a recovery in automobile parts production. Open die forging saw solid demand from the semiconductor and the heavy electricity machinery sectors.

Sales, OP and OPM by Segment									
Segment	Sales	FY19	FY20		FY21				YoY (%)
		FY	1H	2H	FY	1H	2H	FY	
Specialty Steel	Sales	181,674	59,834	86,008	145,842	93,168	104,635	197,803	35.6
	OP	5,148	-2,984	352	-2,632	1,441	2,386	3,827	n/a
	OPM (%)	2.8	n/a	0.4	n/a	1.5	2.3	1.9	n/a
High Performance Materials & Magnetic Materials	Sales	167,356	64,806	84,614	149,420	94,756	102,848	197,604	32.2
	OP	13,638	2,175	9,997	12,172	13,921	12,729	26,650	118.9
	OPM (%)	8.1	3.4	11.8	8.1	14.7	12.4	13.5	+5.4pp
Parts for Automobile and Industrial Equipment	Sales	97,343	36,050	44,700	80,750	46,521	45,983	92,504	14.6
	OP	430	-4,096	1,987	-2,109	3,127	1,852	4,979	n/a
	OPM (%)	0.4	n/a	4.4	n/a	6.7	4.0	5.4	n/a
Engineering	Sales	26,583	10,265	9,940	20,205	8,732	9,482	18,214	-9.9
	OP	2,960	489	369	858	-709	-568	-1,277	n/a
	OPM (%)	11.1	4.8	3.7	4.2	n/a	n/a	n/a	n/a
Trading & Service	Sales	17,463	8,533	7,971	16,504	12,047	11,493	23,540	42.6
	OP	2,581	877	909	1,786	1,387	1,447	2,834	58.7
	OPM (%)	14.8	10.3	11.4	10.8	11.5	12.6	12.0	+1.2pp
Total	Sales	490,421	179,490	233,232	412,722	255,224	274,443	529,667	28.3
	OP	24,768	-3,531	13,601	10,070	19,156	17,826	36,982	267.2
	OPM (%)	5.1	n/a	5.8	2.4	7.5	6.5	7.0	+4.6pp

Source: Nippon-IBR based on FY20 & FY21 Earnings Results Materials published by Daido Steel

FY22 Outlook

Daido Steel is guiding for FY22 1H OP of ¥11,500mil (-40.0% YoY) on sales of ¥280,000mil (+9.7% YoY), and for full year FY22 OP of ¥34,000mil (-8.1% YoY) on sales of ¥600,000mil (+13.3% YoY). Management's FY22 outlook is based on the following assumptions:

- 1) Although automobile production is expected to recover, the firm still anticipates some risk of supply chain issues throughout FY22 1H but expects the situation to gradually resolve from 2H. The slow recovery of auto production will give a negative impact of ¥1,100mil to FY22 OP.
- 2) A ¥72,700mil hit from higher raw material and energy costs, with -¥17,000mil from scrap prices, -¥15,000mil from a rise in energy prices, and -¥41,000mil from alloy prices. However, 60% of the scrap price rise is subject to surcharges. Nickel alloy, approx. ¥24,000mil out of the ¥41,000mil increase in alloy prices, is also subject to a surcharge fee. Energy prices and the remaining ¥17,000mil from alloy price hikes are not subject to any surcharges. The firm's guidance assumes negotiations with customers to accept the surcharges for these materials will succeed.
- 3) The cost increase will hit 1H OP due to the time required to implement the product price hikes, however, by 2H, the higher costs, including energy price and alloy prices that are not subject to surcharges, will be fully passed onto customers. Hence, the margin will be back to the 7.0% in 2H.

Daido Steel estimates 2H OP of ¥22,500 (+26.2% YoY / +95.7% HoH) on sales of ¥320,000mil (+16.6% YoY / +14.3% HoH).

Raw Materials Price Trend						
			FY20	FY21	FY22	
			Result	Result	Assumption	YoY (%)
Scrap	H2	¥000/t	24.9	47.6	61.5	29.2
	Factory Bundle		28.9	53.9	66.5	23.4
Nickle	LME	\$/Lb	6.8	9.3	14.0	50.5
Crude Oil	Dubai Brent	\$/bbl.	45.8	76.6	100.0	30.5
FOREX	TTM	¥/\$	107.1	113.4	120.0	5.8
Global Automobile Demand		mil units	78.8	81.9	82.5	0.7
Automobile Production by Japanese Makers		mil units	23.9	24.2	26.6	9.9

Source: Daido Steel FY21 Earnings Results Presentation

Earnings Forecast							
(\$mil)	FY21			FY22			
	1H	2H	FY	1H	2H	FY	YoY (%)
Steel Products Sales Volume (tonne)	634,000	619,000	1,253,000	584,000	643,000	1,227,000	-2.1
Sales	255,224	274,443	529,667	280,000	320,000	600,000	13.3
OP	19,156	17,826	36,982	11,500	22,500	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	23,000	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	-7,000	-10,000	n/a
NP*	12,840	14,054	26,894	9,000	16,000	25,000	-7.0

Source: Nippon-IBR based on Daido Steel's earnings results presentation materials

* NP attributed to the parent's shareholders

FY22 Outlook by Segment

Specialty Steel Segment

Daido Steel expects the segment will be loss making during 1H due to the surge in raw material and energy prices. The impact of passing on price hikes, however, will be more apparent in 2H, for which the firm estimates OP of ¥3,500mil (+46.7% YoY). The prolonged adjustments in auto production in 1H and a possible inventory adjustment by Tier 1 makers will also affect specialty steel sales volumes. Daido Steel is estimating the sales volume of 587,000 tonnes in 1H vs 619,000 tonnes in FY21 2H.

Based on these assumptions, the firm is guiding for an operating loss of ¥2,500mil (OP of ¥1,441mil in FY21 1H) in FY22 1H on sales of ¥102,000mil (+9.5% YoY), and for the full year FY22, OP of ¥1,000mil (-73.9% YoY) on sales of ¥222,000mil (+12.2% YoY). Although the segment is forecast to return to profitability in 2H, earning OP of ¥3,500mil (+46.7% YoY), the full-year FY22 segment OPM of 5.7% (-1.3ppt YoY) reflects the impact of the weak 1H.

High Performance and Magnetic Materials Segment

Daido Steel assumes that sales volumes will likely be flattish, given solid stainless-steel sales will be offset by inventory adjustments in magnetic materials, though the auto production cuts in FY21 will start affecting FY22 earnings. The firm is guiding for FY22 1H segment OP of ¥12,000mil (-13.8% YoY) on sales of ¥110,000mil (+16.1% YoY), and FY22 segment OP of ¥25,500mil (-4.3% YoY) on sales of ¥237,000mil (+19.9% YoY).

While strong semiconductor-related demand should improve the sales mix, the surge in raw materials and energy price in 1H will take its toll on full-year OP. The firm also estimates a rise in fixed costs, such as a rise in labour cost and an increase in travel and subsistence along with a recovery in marketing activities., which will lower segment OPM by 2.7ppt YoY to 10.8% in FY22.

Parts for Automobile and Industrial Equipment Segment

Management expects solid sales growth; however, segment OP will be affected by an increase in fixed costs such as labour, travel, and subsistence, as well as the change in the accounting period at its overseas subsidiaries. Daido Steel is guiding for FY22 1H segment OP of ¥1,000mil (-68.0% YoY) on sales of ¥50,000mil (+7.5% YoY), and FY22 OP ¥4,500mil (-9.6% YoY) on sales of ¥103,000mil (+11.3% YoY). The firm assumes that sales volumes of automobile parts will be flat YoY, but open die forging sales will benefit from strong demand from the semiconductor and heavy electric machinery sectors.

Sales, OP and OPM by Segment									
Segment	Sales	FY21				FY22CE			
		1H	2H	FY	YoY (%)	1HCE	2HCE	FYCE	YoY (%)
Specialty Steel	OP	93,168	104,635	197,803	35.6	102,000	120,000	222,000	12.2
	OPM (%)	1.5	2.3	1.9	n/a	-2.5	2.9	0.5	-1.4pp
		1,441	2,386	3,827	n/a	-2,500	3,500	1,000	-73.9
High Performance Materials & Magnetic Materials	OP	94,756	102,848	197,604	32.2	110,000	127,000	237,000	19.9
	OPM (%)	14.7	12.4	13.5	+5.4pp	10.9	10.6	10.8	-2.7pp
		13,921	12,729	26,650	118.9	12,000	13,500	25,500	-4.3
Parts for Automobile and Industrial Equipment	OP	46,521	45,983	92,504	14.6	50,000	53,000	103,000	11.3
	OPM (%)	6.7	4.0	5.4	n/a	2.0	6.6	4.4	-1.0pp
		3,127	1,852	4,979	n/a	1,000	3,500	4,500	-9.6
Engineering	OP	8,732	9,482	18,214	-9.9	9,500	11,000	20,500	12.6
	OPM (%)	n/a	n/a	n/a	n/a	n/a	4.5	2.4	n/a
		-709	-568	-1,277	n/a	0	500	500	n/a
Trading & Service	OP	12,047	11,493	23,540	42.6	8,500	9,000	17,500	-25.7
	OPM (%)	11.5	12.6	12.0	+1.2pp	11.8	16.7	14.3	+2.3pp
		1,387	1,447	2,834	58.7	1,000	1,500	2,500	-11.8
Total	OP	255,224	274,443	529,667	28.3	280,000	320,000	600,000	13.3
	OPM (%)	7.5	6.5	7.0	+4.6pp	4.1	7.0	5.7	-1.3pp
		19,156	17,826	36,982	267.2	11,500	22,500	34,000	-8.1

Source: Nippon-IBR based on FY20 & FY21 Earnings Results Materials published by Daido Steel

FY21-23 Medium-term Plan

Daido Steel released the current Mid-term Management Plan in June 2021, that will cover three years between FY21~FY23. The firm failed to achieve the previous plan's target of OP of ¥47,000mil on sales of ¥580,000mil in FY20, given FY20 OP declined 59.3% YoY to ¥10,070mil on sales of ¥412,722mil (-15.8% YoY) – mainly due to COVID. Despite aggressive CAPEX by Daido Steel to enhance production capacity, returns on investment were slow to appear, though the High Performance and Magnetic Materials Segment reported record earnings in FY20.

The current Plan, on the other hand, appears more conservative than the previous plan's target. The company is aiming for OP of ¥40,000mil and ROE 8.0%. During the current Plan, the firm will focus on:

- 1) Expanding business in fast growing fields in the near future such as CASE (Connected, Autonomous/Automated, Shared, and Electric) in the automobile field. In addition, areas that the firm identifies to be the next growth areas include a) semiconductor-related products such as materials for highly clean valves, which the firm manufactures using its own production technology such as special melting technology, as well as products that are difficult to machine, and b) green energy field products such as stainless steel and super alloy that resist becoming brittle by biomass, hydrogen, and ammonia.
- 2) Strengthening management's capability to cope with fast changing business environments.
- 3) Expanding its overseas business, especially in the high-performance materials (e.g., high-performance stainless steel, super alloy, and tool steel business) in East Asia, where the firm sees opportunities to cultivate the market, especially in high performance stainless steel, super alloy, and tool steel.
- 4) ESG-based management: Daido Steel plans to 1) reduce CO₂ emissions by 14% vs FY13 levels by FY23 and will plan a staged reduction with the aim to see emissions fall by 38% vs that of FY13 in FY25, by 50% in FY30 and then to zero in FY50 and b) improve corporate governance: the firm made several decisions, such as scrapping the poison pill policy, reducing cross-held stocks, encouraging management to speed up their decision-making across the group and the proposal to increase the external director ratio to 1/3 of the Board.

Over the Plan's three-year tenure, Daido Steel has pledged a total of ¥85,000mil in CAPEX of which ¥70,000mil is marked to 1) improve productivity at three of its existing facilities at the Chita Plant, 2) to enhance its competitive advantage in high performance stainless steel at the Hoshizaki Plant, and 3) reduce costs and improve production yields at the Shibukawa Factory. The firm, so far, has invested ¥21,000mil (completion base) in FY21 and plans to spend ¥24,600mil (completion base) in FY22. A separate ¥10,000mil will be dedicated to environmental issues such as achieving the firm's CO₂ emission targets and meeting environmental regulations. The remaining ¥5,000mil will be for human resources.

Progress on the Plan

As of FY21, Daido Steel made several progresses on the Medium-term Plan.

- 1) **Expand business in fast growing fields in the near future:** Testing equipment to evaluate the newly developed materials that have growth potential in areas such as mobility, energy, etc was introduced.
- 2) **Enhance management's resilience to fast changing environments:** An example for this is some ¥2,500mil invested to (1) improve production efficiency, e.g., stainless melting efficiency, enhancement of VAR (vacuum arc remelting), (2) increase the production capacity of high-performance materials and (3) the digital transformation of the Chita factory.
- 3) **ESG efforts:** The firm continues to work on reducing its CO₂ emissions (-9% vs FY13's level). In terms of Scope 1 (carbon neutral in fuel emissions), Daido Steel introduced a high efficiency burning technology and hydrogen combustion technology. In Scope 2 (carbon neutral in electricity), the firm is targeting 20% of the electricity used in the Nagoya region can be switched to CO₂-free energy in FY22, an improvement from the 10% level achieved in FY21. The firm will also introduce solar power in the Shibukawa Factory from July 2022.

Daido Steel will also focus on improving Corporate Governance. Important progress made includes the scrapping of the poison pill policy at the Annual General Meeting (AGM) in June 2021. Another was to reduce cross-held shares, including those owned through the firm's pension fund, to below 20% of consolidated net assets.

As of the end of FY21, the firm has reduced cross-held shares to approx ¥68,500mil, 18.8% of net assets. Including shares owned by the pension fund, equity holdings are 25.6% (approx ¥93,300mil) of consolidated net assets. Daido Steel pledges to use the proceeds from selling cross-held shares on investments to achieve carbon neutral. In FY21, the firm unwound six stocks (total value of approx ¥7,400mil) out of its portfolio it held with important suppliers and customers such as Nippon Steel, OEM makers and Tier 1 makers, generating income of ¥5,497mil, a significant increase from ¥94mil in FY20.

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 unwinding some of its investment securities. Daido Steel does not currently have any shareholder return measure other than annual cash dividend, 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.

Appendix – Financial Summary

P&L Summary									
(¥mil)	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22 EST	FY23 EST
Accounting Standard (Japan)	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol
Sales	460,577	445,122	505,219	543,255	490,421	412,722	529,667	600,000	650,000
YoY (%)	-4.8	-3.4	13.5	7.5	-9.8	-15.9	28.3	13.2	8.3
COGS	386,145	366,687	412,712	451,755	409,382	351,526	437,556		
Gross Profit (GP)	74,432	78,435	92,506	91,500	81,039	61,196	92,111		
GPM (%)	16.2	17.6	18.3	16.8	16.5	14.8	17.4		
SG&A	50,000	52,921	56,287	57,684	56,270	51,126	55,128		
Operating Profit (OP)	24,432	25,513	36,218	33,815	24,768	10,070	36,982	34,000	35,000
YoY (%)	19.7	4.4	41.9	-6.7	-26.8	-59.4	267.2	-8.1	2.9
OPM (%)	5.3	5.7	7.1	6.2	5.0	2.4	6.9	5.6	5.3
Interest & dividend received	2,258	1,869	1,936	2,528	2,090	1,629	2,149		
Interest payment	1,309	966	941	922	793	823	823		
Investment gains & losses	417	811	978	1,134	760	-189	621		
Recurring Profit (RP)	25,108	26,373	36,130	34,343	24,298	12,642	39,200	35,000	36,000
YoY (%)	15.5	5.0	36.9	-5.0	-29.3	-48.0	210.0	-10.8	2.8
RPM (%)	5.5	5.9	7.2	6.3	5.0	3.1	7.4	5.8	5.5
Pre-tax Profit	14,980	27,355	36,831	33,110	21,170	10,065	40,746		
Tax costs	5,877	9,091	10,143	10,224	9,095	4,097	11,120		
Minority shareholder interest	-2,357	-1,877	-2,767	-1,703	-1,087	-1,451	-2,730		
Net Profit (NP)	6,746	16,386	23,920	21,182	10,987	4,516	26,894	25,000	25,700
YoY (%)	-38.1	142.8	45.9	-11.5	-48.2	-58.9	495.5	-7.1	2.8
Comprehensive Profit	-15,212	29,655	32,946	8,871	-8,886	32,439	34,168		

Source: Nippon-IBR summarised based on Daido Steel's earnings release

Per-share indicators									
	FY15	FY16	FY17	FY18	FY19	FY20	FY21CE	FY22 EST	FY23 EST
EPS (¥)	156.20	385.90	561.08	496.88	257.76	105.96	630.94	575.40	591.50
BPS (¥)	5,452.60	6,672.02	6,697.44	6,417.37	7,111.48	7,734.92			
Dividend (¥)	75.00	100.00	66.00	130.00	70.00	35.00	180.00	180.00	180.00
Total Dividend Payment (¥mil)	3,236	4,227	5,117	5,543	2,984	1,492	7,675		

Source: Nippon-IBR summarised based on Daido Steel's earnings release

Historical Trend of Financial KPIs									
	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22 EST	FY23 EST
	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol	Consol
ROE (%)	2.8	6.3	8.4	7.4	4.0	1.4	8.1	7.3	7.7
ROA (%)	1.0	2.8	3.7	3.2	1.7	0.6	3.6	3.3	3.5
EBITDA (¥mil)	46,886	48,788	56,958	56,986	49,430	35,982	63,779		
Financial Leverage (x)	2.3	2.2	2.2	2.2	2.2	2.1	2.2		
Net D/E Ratio (x)	0.4	0.4	0.4	0.4	0.4	0.4			
Total Asset Turnover (x)	0.8	0.7	0.7	0.8	0.7	0.6	0.7		

Source: Nippon-IBR summarised based on Daido Steel's earnings release

Balance Sheet Summary							
(¥mil)	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Accounting Standard (Japan)	Consol	Consol	Consol	Consol	Consol	Consol	Consol
Current Asset	238,467	257,208	301,895	313,081	310,641	319,364	391,686
Fixed Asset	297,208	316,960	343,145	337,616	315,257	346,142	336,500
Tangible	188,778	190,915	212,029	226,078	237,492	231,846	223,701
Intangible	2,583	2,193	1,697	1,502	1,619	2,721	3,776
Investment and others	105,846	123,851	129,419	110,035	76,145	111,574	109,022
Total Asset	535,675	574,169	645,041	650,697	625,899	665,506	728,187
Current Liability	143,486	152,790	212,138	221,091	198,419	181,445	230,104
Fixed Liability	123,843	130,877	116,492	111,465	118,344	144,706	133,078
Net Asset	268,345	290,501	316,409	318,140	309,136	339,535	365,004
Capital	37,172	37,172	37,172	37,172	37,172	37,172	37,172
Capital Surplus	28,722	29,927	30,337	30,285	30,449	30,427	31,228
Retained Earnings	155,250	169,496	187,799	203,299	212,136	216,357	238,443
Treasury Shares	-3,560	-3,613	-3,644	-3,651	-3,656	-3,660	-3,663
Minority Interest	35,513	30,649	31,974	32,631	35,574	36,210	35,290
Shareholders' Equity	232,832	259,851	284,435	285,508	273,561	303,143	329,713
Shareholders' Equity Ratio (%)	43.4	45.2	44.0	43.8	43.7	45.5	45.2
Interest-bearing Debt	134,685	141,397	159,494	174,273	192,435	197,364	

Source: Nippon-IBR summarised based on Daido Steel's earnings release

Cash Flow Summary							
(¥mil / Mar yr-end)	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Accounting Standard (Japan)	Consol	Consol	Consol	Consol	Consol	Consol	Consol
Operating Cash Flow	45,731	28,390	31,043	28,114	41,033	33,766	-16,684
Depreciation	22,454	23,275	20,740	23,171	24,662	25,912	26,797
Goodwill Amortisation	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Change in Sales Receivables	6,102	-14,181	-20,750	1,258	16,128	-7,949	-23,896
Change in inventories	12,444	-3,479	-16,346	-17,206	3,109	8,333	-50,893
Change in Accounts Payable	-9,929	6,795	15,146	-3,163	-22,242	-760	-2,817
Investment Cash Flow	-23,164	-26,449	-30,215	-33,707	-39,326	-29,395	-14,568
Free Cash Flow	22,567	1,941	828	-5,593	1,707	4,371	-31,525
Finance Cash Flow	-20,164	-1,843	5,477	5,589	10,526	2,999	19,402
Cash and Cash Equivalent	33,773	33,685	40,259	40,728	57,843	65,558	55,644

Source: Nippon-IBR summarised based on Daido Steel's earnings release

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