Daido Steel Co., Ltd.

FY2023 Interim Financial Results Briefing

Q&A Session (Summary)

Date : October 30, 2023 (Monday)

Respondents: Tetsuya Shimizu, President & CEO, Representative Executive Director
Tsukasa Nishimura, Representative Executive Director, Executive Vice President
Akihito Kajita, Director, Managing Executive Officer
Tatsushi Iwata, Director, Managing Executive Officer

Q. I would like to ask about the outlook for open-die forgings for the second half of the term. First, is the insufficient throughput of that product, which was an issue in the first quarter report, being resolved? Second, please let me ask, “How accurate was the estimated volume of orders for that product that was incorporated into the plan?”

A. The reasons for the low throughput of open-die forgings in the first quarter were the low utilization rate of the vacuum induction melting furnace at the Shibukawa Plant and the low production capacity of the machining equipment. To deal with these problems, we added personnel to the operation there, and arranged to use the corresponding facilities at the Hoshizaki Plant. There was no longer any such problems in the second quarter. Now, we'll turn to your question about the accuracy of our forecast for the number of orders for open-die forgings. This product usually requires a delivery lead time of from about six months to a year after order receipt. Therefore, orders for product planned for sale during the second half of the year have already been confirmed and are already in production. Unless there is some very big problem with equipment, we're sure that open-die forging sales volumes will be on track for the second half of the term.

Q. It was mentioned in your report that low raw materials and fuel prices contributed to the profits made during this term. With the introduction of the surcharge system in many areas, I am wondering if spreads that will widen in the second half of the year will eventually narrow or if you anticipate that these profit margins are sure to be maintained, even in the event that our sales prices fall somewhat.

A. We introduced the energy surcharge system in response to soaring energy prices. We understand that it is currently being applied to about 80% of our users adopting the ferrous scrap surcharge system in Japan. The new surcharge system is now affecting the prices of about half of our total volume of products. If energy prices go down in the future, the reduction in energy costs will be reflected in those prices after a certain amount of lag time, but basically we think that the prices we charge for the other half will remain at the current level.

Q. Is the increase in operating income in the trading and service segment mainly due to the weaker yen?

A. Yes, the increased profits in this segment were mainly due to an increase in overseas sales and the effects of higher profits at overseas subsidiaries, due to the weaker yen. The overseas sales ratio had previously been around 25% (with our target being 30%), but it rose to 27.5% in the first half of FY2023. Inquiries are increasingly being made by overseas customers for open-die forging products, and our subsidiaries -- based in the U.S., China, and Europe -- are handling this product. So, earnings in the foreign trade and service segment that deals with this product are rising, and this is partly due to our benefitting from the weak yen.

Q. While the company's forecast for the production by Japanese car manufacturers is about 5% higher than the estimate you made at the beginning of this term, the specialty steel sales volume has been revised downward by about 5%. Is this because you anticipate a large decline in sales of industrial equipment parts despite shipments to the automobile industry exceeding the initial estimate, or because you envision an inventory adjustment in the automobile-related products to be made as well, causing a downward swing?

A. Automobile production is recovering steadily worldwide, and the sales volume of our automobile-related products is increasing, as well. However, there are some areas other than the automobile industry where inventory adjustments are taking place and demand is weak, so we believe that the overall recovery for this segment is still ongoing.

Q. In the automotive and industrial equipment parts segment, operating income for the second quarter of this fiscal year was 2.1 billion yen, after product throughput improved, while operating income for the second half of the term is projected to be 7.4 billion yen. This is almost double the current quarterly profit level forecast. Could you elaborate on the background behind this increase in profits?

A. Orders for open-die forging products are strong, and we will be able to increase profits by increasing actual shipments. In addition to this, we have factored in both the extremely large sales volume growth, both in Japan and the U.S., of the engine valves produced by one of our group companies and the possibility of an increase in the shipment of our turbocharger-related parts. We also expect other positive factors to contribute to profits in our forecast for operating income of the second half of the year.

Q. You mentioned that products sales volume recovery continues to be weak. I would like to know if there is a difference in recovery between structural steel, which has a short supply chain, and stainless steel and tool steel, which have longer supply chains. Please clarify the situation of recovery by steel type.

A. We believe that sales of structural steel for automobiles have already recovered. The supply chain for stainless steel for automobiles is so long that inventory adjustments have been delayed, but we believe that sales volumes will return to the expected level in the second half of the year. On the other hand, demand for industrial equipment parts other than automotive parts still remains weak. Demand for stainless steel for semiconductor manufacturing equipment has declined due to the semiconductor cycle, but sales have bottomed out and there are signs that orders will be returning gradually. For tool steel, overall domestic demand is declining, especially in the automotive industry, and recovery is likely to still be some time down the road.

Q. Profits in the parts for automobiles and industrial equipment segment are increasing. Are the sales volumes also increasing? In addition, what is your outlook for sales volume and earnings for those products for the next fiscal year and beyond? Namely, assuming that the sales volume and earnings outlook in the second half of FY 2023 remain positive, is it possible to maintain this situation and achieve even more production flexibility for those products?

A. Orders for open-die forgings have been stronger than anticipated in our medium-term management plan, particularly in the aircraft, heavy electric machinery, and energy sectors. We expect this situation to continue for the foreseeable future. In terms of increased flexibility of production capacity, the special melting furnace at the Shibukawa Plant has started commercial operation, and the two special melting furnaces under construction at the Chita No. 2 Plant are scheduled to be hot-run in FY2024. Although the vacuum induction melting furnace at the Shibukawa Plant currently has sufficient capacity to meet today’s demand, we are considering investing in this 25-ton vacuum induction melting furnace to increase its capacity to cope with the anticipated increase in demand in 2025-2026.

Q. You left the operating income forecast for the current fiscal year unchanged at 47 billion yen. Did you lower the forecast of close to 50 billion yen to 47 billion yen to be conservative in outlook, even though you had anticipated that operating income would reach nearly 50 billion yen due to strong demand for open-die forgings? Or, on the other hand, was your new estimate only slightly over 45 billion yen and you left it at 47 billion yen since the difference was not so large that you thought you didn’t need to revise it downward? Would you tell us about the current course of operating income, whether you are actually on pace to garner 47 billion yen of operating income? What progress you have made in terms of profits, so far?

A. We did not revise our full-year forecast for operating income because we expect it to be about 47 billion yen, as planned.

Q. Where do you see the company's strengths, President Shimizu? Also, is there anything you would like to add, regarding the existing management style?

A. I believe that one of the company's strengths is "co-creation". That means we work together with our customers so we get a good handle on their needs and create new types of product in collaboration with them. In addition, the range of facilities we have to support the production of specialty steel, and our accumulated production technology are excellent operational plusses. We intend to make the most of these strengths to make our businesses really grow! In the future, we would also like to focus on expanding into new businesses, and to this end, we would like to focus on speed, including quick and responsive decision-making.

Q. In order to achieve a PBR of 1x, I think it is important to generate stable earnings by changing the sales mix of your products and improving your margins. To this end, please explain the concepts behind the measures you are implementing now and your views on reducing low-profit businesses.

A. We have been steadily implementing product portfolio reforms to improve the sales mix of our products, and we will continue to do so in the future. Automobiles are a sector that provides stable demand for our products, but we need to advance further into fields that involve many variables and in which we are strong. For example, semiconductors, aircraft, and clean energy are expected to undergo growth. By improving in various ways the portfolio of our products that relate to these sectors we can also avoid the risks associated with demand fluctuations. To this end, we will continue to develop new materials, make appropriate capital investments, and on the “costs” side, increase operating efficiency by consolidating production facilities across our worldwide array of plants. And, yes, we have been focusing on business selection and concentration, and will continue our policy of reorganizing unprofitable businesses.