Daido Steel Co., Ltd.

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FY2023 3rd Quarter Financial Results Briefing
Q&A Session (Summary)

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Respondents: Tsukasa Nishimura, Representative Executive Director, Executive Vice President
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Q. If the level of profit that was earned in the third quarter continues in the fourth quarter, operating income will reach 47 billion yen, which is exactly what you projected in your annual earnings forecast. Please explain the outlook. Am I mistaken to think there are some differences in operating income among the segments?

A. We expect the Specialty Steel, Engineering, and Trading & Service segments to exceed the current forecasts in the fourth quarter. We are bending our efforts to building up profits, to achieve the profit plan we made at the beginning of the term, in the High-Performance Materials & Magnetic Materials segment on one hand and the Parts for Automobile & Industrial Equipment segment on the other. However, there is a possibility that these figures could fall short of the plan.

Q. You posted an operating income of approximately 14 billion yen, despite low stainless and tool steel sales volumes in the third quarter. If we simply multiplied this by four and converted it to an annual figure, we would be looking at 56 billion yen. Is it correct to think that if the demand for semiconductors recovers, and basing the calculations on an operating income of 56 billion yen, we would be able to aim for 60 billion yen? Or, since the 14 billion yen earned in the third quarter includes one-off gains, should we avoid the temptation to expect the same level of profit for the next term? Could you give us a framework for considering this point?

A. Orders for high-performance and magnetic materials are currently declining, but we expect sales volumes to increase gradually from the fourth quarter through the next fiscal year. On the other hand, we made efforts to secure appropriate margins by raising base selling prices and applying energy price surcharges in the face of the sharp rise in energy prices that continued up until the last fiscal year. However, since energy prices have been declining, we expect to see the impact of lower energy prices appearing in the number of orders from the fourth quarter onward. Although there are a variety of factors that may cause an increase or decrease in operating income, we think we have become able to earn a consistent operating income of about 47 billion yen a year.

Q. Are there any signs of recovery in demand for semiconductor-related products? Also, please tell us if open die forging products will continue to perform well.

A. There is a view that demand for semiconductor-related products will recover in the next fiscal year, and we tend to think this is likely. We expect that, from the beginning of the next fiscal year, the recovery in the semiconductor market will be reflected in the number of orders for our steel products, which as of course you know are used as materials for the manufacture of semiconductor manufacturing equipment. However, we have a feeling that it is from the second quarter to the second half of FY2024 that sales of our semiconductor-related steel products will actually increase and contribute to profits. In FY 2023, sales of open die forgings have been higher in the third quarter than those in the first half, and we believe they will continue to be strong. The key point is how flexible we can be in our response to any increase in the number of orders, in terms of turning out our products reliably, in the face of increasing demand.

Q. When comparing the results of the 2nd and 3rd quarters, we can see that the sales volume of specialty steel increased by 23 thousand tons and the total of net sales of all segments increased by 3.1 billion yen. I have a feeling that the effect attributed to the increased sales volume of specialty steel on the total of net sales is a bit too large. Could you shed some light on this?

A. Looking at the sales volume of specialty steel in the 3rd quarter of this term, we see that the increases in the sales volumes of stainless steel, in addition to those of structural steel, had a significant effect on profit growth. Selling prices are on a downward trend due to the drop in prices of raw materials such as nickel, but margins remain unchanged. The result is that the balance between sales and profit levels has changed, as you mentioned.

Q. Sales volume of specialty steel increased approximately 9% from the 2nd quarter to the third quarter. Statistics for the industry as a whole do not show such an increase. I would like to know if there are any special reasons for the increase we experienced.

A. The increase in sales volume of our specialty steel products was primarily due to strong demand from automobile manufacturers, following the resolution of supply constraints on semiconductors. In addition, the sales volume of stainless steel also increased, resulting in the overall sales volume increase of about 9% that we reported.

Q. Why is it that profits in both the High-Performance Materials & Magnetic Materials segment and the Parts for Automobile & Industrial Equipment segment have been weak, as compared to the annual plan? Could you explain the background of this?

A. The profit level of the High-Performance Materials & Magnetic Materials segment has been rising gradually each quarter, but we had initially expected the pace of recovery to be a little faster. On the other hand, we had factored in the decline in the semiconductor cycle. Therefore, the main reason for the slow recovery is a longer-than-expected inventory adjustment of stainless steel for general construction equipment and industrial machines. We believe that this is due not only to weak domestic demand, but also to the economic trends in neighboring Asian countries, such as China. The Parts for Automobile & Industrial Equipment segment posted an operating income of 2.6 billion yen in the 3rd quarter, making the total operating income of this segment closer to the level we had expected at the beginning of the year. However, the negative impact of the lack of throughput of open die forging products in the first quarter continues to make it difficult for us to achieve the target figure set at the beginning of the term. Still, orders for products for this segment, including highly profitable superalloy, are extremely strong. Therefore, if we can maintain the current level of production, this segment should be able to generate the expected profits.

Q. The third quarter operating income for the specialty steel segment is 5.9 billion yen. What is our actual earning capacity, if all the one-off factors are removed?

A. The operating income recorded in the 3rd quarter is inflated by about 700 million yen due to the time lag in energy price surcharges and the ferrous scrap surcharge gap. In addition, in the third quarter, sales volumes of specialty steel for automobiles were larger than in the first half of the year, which had the effect of increasing the sales volume of specialty steel in the 3rd quarter. Although it depends on which period is regarded as the one to provide the correct sales volume to serve as the base of calculations, we believe that the specialty steel segment will be able to post a constant operating income of about 5 billion yen, on the assumption that the business environment remains favorable, if there is no surcharge gap and if the sales volume of tool steel recovers.

Q. Industry statistics indicate that the demand for stainless steel and tool steel are heading for a slight bottoming-out trend attributable to the inventory cycle. Would you share your opinion about this with us?

A. Yes, we are seeing demand for stainless steel bottoming out. At this point, we cannot confirm from an analysis of the statistical data that demand for tool steel has bottomed out. However, since the number of orders we are receiving show a slight recovery, we expect that orders for tool steel will recover enough to be confirmed by firm statistical data in the future.

Q. In the section titled: "Changes in Operating Income", the sales mix of the 3rd quarter recorded a loss of 1.9 billion yen in total, as compared to the previous year. Could you give us a breakdown of the positive and negative aspects of that?

A. The increase in sales of open die forgings and improvements in sales of engineering & trading services are positive factors that brought a gain of 5.6 billion yen. On the other hand, there were negative factors causing a loss of 7.5 billion yen, including deterioration in the stainless steel sales mix, a decrease in the sales of tool steel, and a one-off loss of profit that occurred last year at a group company. The net result was thus a decrease of 1.9 billion yen.

Q. If you can post an operating income of 28.0 billion yen in the second half of the current fiscal year as projected, the annualized pace will be 56.0 billion yen. Do you think it is possible to aim for an operating income of 50 billion yen or more in the next fiscal year? Or, considering the possibility of automobile production levels lowering or the loss of one-off gains thanks to a time lag in the application of energy price surcharges, do you expect profits to remain at the same level as in the current fiscal year?

A. Uncertainty in the demand for stainless steel is fed by the conditions related to the demand for machine tools and industrial machinery in China. However, we think that demand for stainless steel for semiconductor manufacturing equipment is certain to recover next year. Tool steel has also bottomed out and its sales are expected to be higher than in FY 2023. Orders for open die forgings are expected to be at least as strong as in FY 2023, given the fact that demand for open die forgings is strong in the energy and aircraft fields, and the likelihood that semiconductor-related demand will return. We think that sales of specialty steel for the automotive industry should not be lower than in FY2023, because semiconductor supply constraints and inventory adjustment problems in the supply chain will ease in FY 2024. On the negative side, we will lose the one-off profits we have enjoyed thanks to energy price surcharges, due to the elimination of time lags, and we foresee that fixed costs such as logistics and labor costs will increase. Considering these factors, although we have not yet flatly declared so, we do expect to reach the 50 billion yen profit level in FY2024.

Q. Could you tell us the growth rate of open die forgings on a sales volume basis in FY2023, as compared to the previous year? Also, what upward flexibility do you have in terms of production capability for open die forgings, including the effects of investments in vacuum re-melting furnaces, etc. to be performed between FY2024 and FY2025?

A. Open die forging sales volumes increased in the second half of FY2023, as compared with the first half, with the increase being about 10 to 20 % above FY2022. We expect this situation to continue in FY2024 and beyond, due to strong demand for products in the energy-related and oil and gas drilling industries. We are aware of the challenge of securing production capacity to meet increasing demand, and are planning to install two vacuum re-melting furnaces for the production of superalloys and stainless steel for semiconductor manufacturing equipment. Since construction will not be completed until December 2024, the furnaces will not contribute to profits until FY2025. In FY2024, we expect to increase our production capacity by improving operations, and from FY2025 we will have even more capacity due to the installation of new furnaces.

Q. Could you tell us about the changes in sales volume of semiconductor-related products during the period from FY2022 to FY2024?

A. Let me explain the changes in sales volume of stainless steel by taking semiconductor manufacturing equipment as a representative example. If we take the level of FY2019 as 100, the product sales volume was about 600 in FY2022. The figure declined to about 400 in the first half of FY2023 and dropped further, to slightly below 200 in the second half. However, the figure is still higher than it was in FY2019. We expect it to increase to about 400 in FY2024 and then to about 600 in FY2025.