DAIDO STEEL CO., LTD.

Daido Steel Co., Ltd.

FY2024 1st Quarter Financial Results Briefing

Q&A Session (Summary)

Date : July 29, 2024 (Friday)

Respondents: Akihito Kajita, Director, Managing Executive Officer
Tatsushi Iwata, Director, Managing Executive Officer
Takashi Kano, Executive Officer and General Manager, Corporate Planning Dept.

Q. Could you tell us whether the one-time gain or loss at the magnet production subsidiary in China was included in the earnings forecast made at the beginning of the fiscal year?

A. It was not included in the earnings forecast because at that time we did not anticipate the occurrence of any additional expenses at the Chinese subsidiary.

Q. Please provide, segment by segment, explanations of the reasons that the first-quarter operating profits (excluding one-time gains or losses) exceeded the earnings forecast announced at the beginning of the fiscal year.

A. In the Specialty Steel segment, structural steel shipments were slightly below expectations, while raw material and fuel prices were remaining stable and positive effects such as price hikes in tool steel were being realized. Furthermore, the fixed-cost burden was mitigated by the build-up of inventory in anticipation of higher electricity prices during the summer. However, this same factor will have a negative impact in the second quarter, when inventories are being drawn down. In the High-Performance Materials and Magnetic Materials segment, we had anticipated an increase in demand for stainless steel and indeed demand for the product exceeded expectations slightly, particularly for HDDs. In the Parts for Automobile and Industrial Equipment segment, our ability to produce and ship was in line with our initial assumption that demand for open-die forgings would remain strong.

Q. Would you give us an overview of the issue of unrealized gains or losses on nickel in the first quarter? Additionally, how do you anticipate the impact of changes in nickel prices on demand for your products?

A. During the first quarter, there were valuation gains due to nickel price rises. Demand for our products has been on an upward trajectory since the beginning of the period, and this trend is expected to continue. However, an actual V-shaped recovery has yet to materialize, and we will continue to monitor future trends. Nevertheless we believe that, after bottoming out, we have entered an upward phase.

Q. There is information indicating that aircraft manufacturers are reducing production due to parts shortages. Is there any risk that this will affect orders for open-die forging products?

A. We are aware that there is a possibility that aircraft production may decrease due to parts shortages, but our order environment remains robust. The standard production lead time for our open-die forging products is six to nine months. Given that the orders currently being received will be shipped and recorded as sales in the second half of this fiscal year, we anticipate that no substantial impact will be felt until the next fiscal year or later.

Q. What is your outlook for orders of stainless steel for semiconductor manufacturing equipment?

A. Orders are starting to pick up, albeit somewhat slowly at present. We anticipate a gradual increase in orders from the second half of this fiscal year into the next fiscal year. In anticipation of this, we are taking advantage of current production capacity to begin producing semi-finished products, in preparation for a potential surge in orders.

Q. Could you please provide an update on the production and shipment of automotive parts-related specialty steel products for the second quarter, as compared with the first quarter? Additionally, please give us your insights into the outlook for sales of parts for industrial equipment, which have remained sluggish.

A. Orders for specialty steel for automotive parts increased in the second quarter, but the actual production volume remained at a level similar to the first quarter's, or declined slightly, due to the forward shift in production in anticipation of higher summer electricity prices. Across the industry, the latest statistical data indicates that specialty steel demand for parts for industrial equipment, which had been in a prolonged period of stagnation, is showing signs of recovery following a bottoming out period from January to March 2024. Indeed, our specialty steel orders show a similar trend, although the recovery remains fragile. We anticipate a further recovery in the second quarter and the second half of the year.

Q. Regarding the magnet production subsidiary in China, which you have described as the cause of the one-time gain or loss, could you please elaborate on the reason for the expenses and tell us about the possibility of whether there are any such additional expenses in the offing?

A. We were planning to sell the business site where that subsidiary had operated for many years. We found that it would be necessary to perform soil remediation in accordance with current soil standards. This forced us to make an allowance for these expenses. We have incorporated the full amount of the currently anticipated costs into our projections and do not anticipate any additional expenses to arise.

Q. Orders for open-die forgings remain high. However, last fiscal year saw challenges in production capacity and low productivity due to outsourcing. Are such issues currently being resolved? Please let us know if you will be able to achieve further increases in sales of open-die forging products.

A. Last year, we were unable to completely overcome the negative impacts on production that occurred in the first quarter. Nevertheless, we have made progress in recovering from those negative impacts. Throughput is increasing gradually as we implement various measures. In the first quarter of this fiscal year, both net sales and operating profit improved over last year's levels. We are going to make further enhancements to our production capacity by continuing our improvement efforts.

Q. Please describe the impact on earnings in the first quarter of the fixed cost reductions achieved by building up the specialty steel inventory and the gain in valuation arising from the fact that the prices of nickel used for high-performance and magnetic materials increased simultaneously.

A. We estimate the value of building up the specialty steel product inventory to be approximately 400 million yen, with an unrealized gain from the nickel price changes to be approximately 500 to 600 million yen. Regarding specialty steel, the negative impact on operating profit is expected to be approximately 400 million yen in the second quarter, during which we will draw down inventories in reaction to a positive impact in the first quarter. Should the nickel price remain constant, no unrealized gains or losses related to nickel will occur from the second quarter onward.

Q. I understand that one-time expenses at the magnet production subsidiary in China, which were not included in the earnings forecast made at the beginning of this fiscal year, are items that would have been recorded as extraordinary losses under Japanese GAAP until last year, but which are now included in operating profit. Do you anticipate that the 2 billion yen expense that was not included in the initial forecast will be offset by other items by the end of the fiscal year? If this is the case, which items do you anticipate will exceed the initial forecasts?

A. We anticipate that the entire Daido Group will achieve the operating profit of 48 billion yen announced in the earnings forecast, despite our incurring a one-time expense amounting to 2 billion yen. For instance, if stainless steel sales remain robust the High-Performance Materials and Magnetic Materials segment is expected to produce a positive outcome. Similarly, sales of open-die forgings commenced on a promising note in the first quarter, and are anticipated to exceed the initial plan if their trajectory persists. While we are not yet in a position to examine the figures for each segment in detail, we believe that they will fall within the range that will result in covering our one-time expenses.

Q. Could you please provide an update on customer inquiries for tool steel in the Specialty Steel segment?

A. Demand for tool steel as well as that for parts for industrial equipment both exhibited weakness during the previous fiscal year. While demand for tool steel bottomed out, the volume of orders remains low. Although the number of orders remains at the level planned for at the beginning of the fiscal year, we are not yet at the stage where we can sense a full-fledged recovery. We will therefore continue to monitor the situation closely.

Q. What impact would a further appreciation of the yen against the U.S. dollar have on your business performance?

A. As a result of focusing our efforts on maintaining a balance between sales and procurement -- factors that are affected by exchange rate fluctuations -- the effects of the exchange rate are expected to remain stable over the medium term. However, while exchange rate fluctuations' effects on sales are seen relatively early, costs are affected a little later, so those fluctuations can have either a positive or a negative impact in the short term. In the first quarter of the current fiscal year, the yen's depreciation to nearly 160 yen/$ had a positive effect on our revenue. However, a stronger yen in the future could have a temporary negative impact. In any case, we recognize that the exchange rate has no impact on our earnings results in the long run.

Q. In the context of general inflationary pressures on labor costs and freight rates, what measures are you implementing to cope with these pressures and what is their current status? In addition, in February of this year, you announced steel price hikes. However, since that time, there have been changes in the raw materials prices. Therefore, I would like to know how big an effect the price revisions are expected to have, in actual fact.

A. We have been addressing various cost-push factors according to our roadmap in line with the policy of securing margins through a combination of sales price hikes, cost reduction efforts, and productivity improvements. We are currently bending our efforts toward implementing sales price hikes for our steel products. While we have been able to increase sales prices in some areas in response to customer appreciation, we are still in discussions with others, so not all of the sales price increases have been effected. On the other hand, in terms of costs, we believe that we were able to maintain margins in the first quarter because not all of the cost increases have been realized yet.

Q. There is speculation that Japanese automakers may withdraw from China or reduce production capacity there. Furthermore, the joint venture between Nippon Steel Corporation and Baoshan Iron & Steel Co., Ltd. has been dissolved, and a number of other changes are taking place in the business environment in Japan as well as abroad. Is there a juncture at which Daido Steel must reassess its business strategy in the structural steel and magnet businesses?

A. We will monitor the business trends of Japanese automobile manufacturers in China, as they will undoubtedly affect the sales volume of specialty steel products. The market share of Japanese automakers in China has declined significantly in recent years. We will therefore be monitoring the NEV ratio in China, which might increase from somewhere just over 40% to someplace higher. However, we do not export a significant volume of specialty steel products to Japanese automakers in China. Additionally, the majority of our products is exported in limited quantities or exported indirectly as parts. Therefore, our business strategy is not at a level that will require a major revision over the medium to long term.

Q. Regarding open-die forgings, could you tell us about your overview of the current business environment in fields other than the aircraft industry?

A. The oil-and-gas drilling and heavy electricity machinery sectors are performing in line with the forecast we made at the beginning of the fiscal year. The oil and gas industry is experiencing a surge in drilling activity, which is contributing to an increase in demand for open-die forging products. Sales of diesel engine exhaust valves for ships remain consistent with previous levels.

Q. I understand that your products' sales prices are linked to raw materials and fuel prices, although there is a time lag, so significant margin changes do not occur suddenly. In comparison with the same period last year (i.e., in the first quarter), the Specialty Steel segment has experienced less decline in sales prices than the actual impact of the raw materials and fuel prices. On the other hand, the decline of high-performance and magnetic materials' sales prices has exceeded that of the raw materials and fuel prices. Please provide an explanation of the margin concept for each segment.

A. The correlation between sales prices and raw materials and fuel prices is contingent upon the specifics of each transaction and product. So, I'd like to explain this issue in more general terms. Our products in the Specialty Steel segment are destined for the automotive industry, and we introduced the ferrous scrap surcharge and alloy surcharge systems early on. Under these systems, product sales prices are revised after the actual market prices of raw materials and fuels can be checked, after a time lag of approximately three to six months. Consequently, sales price changes may lag slightly behind raw material and fuel price fluctuations. Although the High-Performance and Magnetic Materials segment includes products for automotive parts, the sales prices of high-performance and magnetic materials sold to steel trading companies are in general maintained at a certain level for a certain period of time. We then revise sales prices in an appropriate manner while checking whether our margins are being correctly maintained. In the first quarter of the current fiscal year, there was a steeper decline in sales prices than in the raw materials and fuel prices. as compared with the same period in the previous year. However, we believe that, all the same, our margins have been securely maintained.