

DAIDO STEEL CO., LTD. (5471 JP)

NO CHANGE IN FY23 FORECASTS. TARGETING BOTH GROWTH AND OPTIMISING BS IS THE FRAMEWORK TO ACHIEVE PBR 1X.

FY23 1H RESULTS

Daido Steel (5471 JP) reported FY23 1H (March year-end) results on 30 October 2023 with operating profit [OP] of ¥19,003mil (-18.2% YoY) on sales of ¥288,594mil (+2.4% YoY). 1H sales were largely in line with expectations. 1H steel product sales volumes dipped -2% YoY to 529,000 tonnes on the back of slow recovery in demand from the industrial machinery sector, although the firm saw solid recovery in production volume by Japanese OEM makers.

Slow demand recovery from the industrial machinery sector will likely continue in the 2H. Nevertheless, the 1H results were essentially in line with the firm's assumption that steel products sales volumes will continue to rise throughout the year, from 529,000 tonnes (-2.0% YoY / -2.9% HoH) in 1H to 547,000 tonnes (+0.4% YoY / +3.4% HoH) in H2 as auto production, especially by Japanese OEMs, has been better than expected. However, compared to forecasts at the time of Q1 results on 28 April, the full-year sales volume assumption was revised down by -4.7% to 1,076,000 tonnes.

1H OP was in line with expectations thanks to price hikes that reflected the surge in the cost of energy and raw materials, despite a YoY drop in steel products sales volumes. The -18.2% YoY fall in OP was mainly due to lower shipments of high-performance materials due to sluggish semiconductor markets.

The progress rate of 1H OP to the full-year FY23 guidance of ¥47,000mil (+0.0% YoY) is just 40.3%, mainly on inventory adjustment delays in the stainless-steel market on the back of sluggish demand from SPE makers. On the other hand, open die forging, which has a lead time of around 6~12 months, has seen solid orders during 1H, which will be realised in 2H earnings and beyond. Consequently, management have kept their full year forecasts.

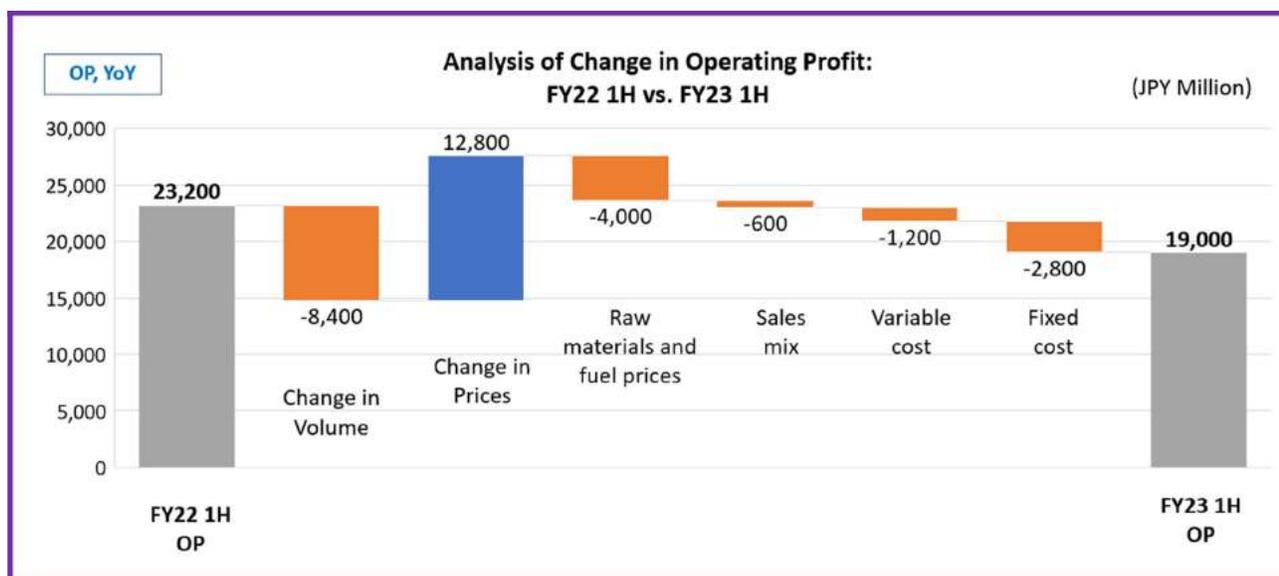
The -¥8,400mil YoY decline in sales volumes was offset by a +¥12,800mil YoY boost from price revisions – including a hike in base prices and an improved slide gap (+¥200mil YoY). Compared to FY23 1H, higher raw materials (steel scrap +¥4,400mil YoY / alloys, such as nickel -¥2,000mil YoY) and energy costs (-¥6,400mil) squeezed overall OP by -¥4,000mil.

EXECUTIVE SUMMARY

- Daido Steel (5471 JP) reported FY23 1H (March year-end) results on 30 Oct 2023 with OP of ¥19,003mil (-18.2% YoY) on sales of ¥288,594mil (+2.4% YoY). Both sales and OP were largely in line with expectation, however, OP was affected by a fall in shipments of high-performance stainless steel due to the weak semiconductor market.
- The firm has kept its FY23 full-year guidance for OP of ¥47,000mil (flat YoY) on sales of ¥600,000mil (+3.7% YoY). The annual DPS of ¥230.00 has also been maintained, generating a pay-out ratio of 30.6%.
- Management's assumptions for sales volumes of both steel products and stainless-steel have been revised, due to the delays in inventory adjustment. and weaker-than-expected demand from the industrial machinery sector. However, in 2H, they now expect the rise in energy and raw material costs to wane, as well as open die forging sales to improve.
- FY23 is the last year of Daido's 3-year medium-term management plan. The plan's OP target of over ¥40,000mil was achieved in FY22. Growth in the firm's strategic products, such as high-performance stainless steel and open die forging, has led to a marked improvement in sales mix. As a result, the ROE hit 10.4% in FY22, surpassing the medium-term target of 8%.
- The company has also announced the framework of how it intends to realise a PBR of 1x – with a focus on growth opportunities and by optimising the BS.

Daido Steel (5471 JP): Earnings Results and Guidance Summary						
(¥mil)	FY22		FY23			
	1H	FY	1H	YoY (%)	FYCE	YoY (%)
Steel Products Sales Volume (tonne)	540,000	1,085,000	529,000	-2.0	1,076,000	-0.8
Sales	281,857	578,564	288,594	2.4	600,000	3.7
COGS	230,921	476,224	240,953	4.3	N/A	N/A
COGS / Sales (%)	81.9	82.3	83.5	+1.6ppt	N/A	N/A
GP	50,935	102,340	47,640	-6.5	N/A	N/A
GPM (%)	18.1	17.7	16.5	-1.6ppt	N/A	N/A
SG&A	27,710	55,353	28,637	3.3	N/A	N/A
SG&A / Sales (%)	9.8	9.6	9.9	+0.1ppt	N/A	N/A
OP	23,225	46,986	19,003	-18.2	47,000	0.0
OPM (%)	8.2	8.1	6.6	-1.6ppt	7.8	-0.3ppt
RP	24,092	48,122	21,083	-12.5	48,500	0.8
Extraordinary Profit / Loss	-407	1,241	-2,680	N/A	N/A	N/A
Corporation Tax	-4,225	-10,867	-5,941	N/A	N/A	N/A
NP*	18,294	36,438	11,465	-37.3	32,000	-12.2

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



Source: Nippon-IBR based on FY23 1H Earnings Results Materials published by Daido Steel

FY23 1H EARNINGS BY SEGMENT

The FY23 Q1 performance for Daido Steel's three major segments is discussed below:

1. Specialty Steel Segment

[FY23 1H Sales ¥108,904mil (+6.0% YoY) / OP ¥6,322mil (+49.7% YoY) / OPM 5.8% (+1.7ppt YoY)]

Specialty Steel FY23 1H sales rose +6.0% YoY to ¥108,904mil, thanks to a recovery in auto production as the supply of semiconductors improved. Segment 1H OP surpassed the original forecast of ¥5,000mil, landing at ¥6,322mil, primarily thanks to lower-than-expected prices of energy and raw materials.

This resulted in segment OP improving +49.7% / +¥2,099mil compared to the original assumption and offset the negative impact from the more-than-anticipated decline in sales volumes (-¥800mil) and weaker sales mix (-¥1,500mil).

Successful price adjustments (+¥500mil) also contributed to the stronger-than-expected 1H OP, despite sales falling short of the firm's forecast announced on 28 April by ¥3,100mil.

In the Q2 alone, the segment OP came in at ¥3,590mil (-12.2% YoY / +31.4% QoQ) on sales of ¥53,571mil (+2.7% YoY / -3.2% QoQ).

2. High Performance Materials & Magnetic Materials Segment

[FY23 1H sales ¥102,609mil (-6.3% YoY) / OP ¥7,066mil (-47.4% YoY) / OPM 6.9% (-5.4ppt YoY)]

The segment reported FY23 1H OP of ¥7,066mil (-47.4% YoY) on sales of ¥102,609mil (-6.3% YoY), resulting in the OPM contracting -5.4ppt YoY to 6.9%. The result was short of management's expectation due to inventory adjustment delays, and led to the -¥3,400mil YoY decline in sales volumes.

In the Q2 alone, the segment reported OP of ¥3,735mil (-37.0% YoY / +12.2% QoQ) on sales of ¥51,357mil (-6.9% YoY / +0.2% QoQ).

The main reason for the weaker 1H performance is weak shipments of stainless steel on the back of delayed inventory adjustments by customers such as industrial machinery manufacturers. Unlike the specialty steel that is also used in the auto industry – e.g., structural steel for drive shafts and gear powertrains – stainless steel is mostly used in highly processed auto parts such as sensors and fuel injection high pressure parts.

Stainless steel used in these sort of auto parts tends to have a longer value chain before delivery to the end-users. Consequently, the impact from inventory adjustments tends to appear with a time lag. However, demand from the auto sector started to recover during Q2.

On the other hand, Daido Steel had expected demand from the SPE sector would likely peak out in FY23, along with the silicon cycle trend. Compared to the peak in FY22, when the shipment hit 6x of FY19 level, FY23 1H shipments fell back to 4x FY19-levels, which was in line with management's expectation.

3. Parts for Automobile and Industrial Equipment Segment

[FY23 1H sales ¥51,402mil (+3.9% YoY) / OP ¥2,576mil (-23.4% YoY) / OPM 5.0% (-1.8ppt)]

Parts for Automobile and Industrial Equipment reported FY23 1H OP of ¥2,576mil (-23.4% YoY) on sales of ¥51,402mil (+3.9% YoY). In the Q1, sales of high alloy products, such as open die forging, were affected by the shortage of throughput at Daido's Shibukawa Factory, though the issue was resolved in Q2. As a result, the sales mix of the segment improved which led to a rise in the OPM to 7.5% in Q2 alone, from 2.2% in Q1. Demand for open die forging products from energy, aircraft, and oil and gas sectors remained solid, while that from the SPE sector was still weak.

In the Q2 alone, the segment produced OP of ¥2,047mil (+27.6% YoY / +287.0% QoQ) on sales of ¥27,320mil (+6.5% YoY / +13.4% QoQ).

Daido Steel (5471JP): Sales, OP and OPM by Segment (Cumulative)										
(¥mil)		FY21		FY22		FY23				
		1H	FY	1H	FY	1H	YoY (%)	2H CE	FY CE	YoY (%)
Specialty Steel	Sales	93,168	197,803	102,740	214,770	108,904	6.0	118,100	227,000	5.7
	OP	1,441	3,827	4,223	9,771	6,322	49.7	7,200	13,500	38.2
	OPM (%)	1.5	1.9	4.1	4.5	5.8	+1.7ppt	6.1	5.9	+1.4ppt
High Performance Materials & Magnetic Materials	Sales	94,756	197,604	109,566	219,724	102,609	-6.3	107,400	210,000	-4.4
	OP	13,921	26,650	13,437	24,286	7,066	-47.4	11,900	19,000	-21.8
	OPM (%)	14.7	13.5	12.3	11.1	6.9	-5.4ppt	11.1	9.0	-2.1ppt
Parts for Automobile and Industrial Equipment	Sales	46,521	92,504	49,485	101,232	51,402	3.9	62,600	114,000	12.6
	OP	3,127	4,979	3,362	8,217	2,576	-23.4	7,400	10,000	21.7
	OPM (%)	6.7	5.4	6.8	8.1	5.0	-1.8ppt	11.8	8.8	+0.7ppt
Engineering	Sales	8,732	18,214	8,336	18,956	11,014	32.1	12,000	23,000	21.3
	OP	-709	-1,277	412	1,425	1,066	158.7	400	1,500	5.3
	OPM (%)	N/A	N/A	4.9	7.5	9.7	+4.8ppt	3.3	6.5	-1.0ppt
Trading & Service	Sales	12,047	23,540	11,727	23,881	14,662	25.0	11,300	26,000	8.9
	OP	1,387	2,834	1,816	3,293	1,951	7.4	1,100	3,000	-8.9
	OPM (%)	11.5	12.0	15.5	13.8	13.3	-2.2ppt	9.7	11.5	-2.3ppt
Total	Sales	255,224	529,667	281,857	578,564	288,594	2.4	311,400	600,000	3.7
	OP	19,156	36,982	23,225	46,986	19,003	-18.2	28,000	47,000	0.0
	OPM (%)	7.5	7.0	8.2	8.1	6.6	-1.6ppt	9.0	7.8	-0.3ppt

Source: Nippon-IBR based on FY21, FY22 & FY23 Q2 Earnings Results Materials published by Daido Steel

FY23 OUTLOOK

Daido Steel has maintained its guidance for the full year, looking for FY23 OP of ¥47,000mil (+0.0% YoY) on sales of ¥600,000mil (+3.7% YoY). The FY23 annual dividend will remain at ¥230/share, or a pay-out ratio of 30.6%.

Earnings Forecast									
(¥mil)	FY21			FY22			FY23 CE		
	1H	2H	FY	1H	2H	FY	1H	2H CE	FY CE
Steel Products Sales Volume (tonne)	634,000	619,000	1,253,000	540,000	545,000	1,085,000	529,000	547,000	1,076,000
Sales	255,224	274,443	529,667	281,857	296,707	578,564	288,594	311,400	600,000
OP	19,156	17,826	36,982	23,225	23,761	46,986	19,003	28,000	47,000
OPM (%)	7.5	6.5	7.0	8.2	8.0	8.1	6.6	9.0	7.8
RP	20,556	18,644	39,200	24,092	24,030	48,122	21,083	27,400	48,500
Extraordinary Profit / Loss	-424	1,970	1,546	-407	1,648	1,241	-2,680	2,700	0
Corporation Tax	-5,643	-5,477	-11,120	-4,225	-6,642	-10,867	-5,941	-9,600	-16,500
NP*	12,840	14,054	26,894	18,294	18,144	36,438	11,465	20,500	32,000

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

* NP attributed to the parent's shareholders

Although the firm maintained its FY23 OP forecast as of 28 April, the factors affecting OP have been revised as follows:

1. FY23 specialty steel sales volumes were reduced from 1,129,000 tonnes (+4.1% YoY) to 1,076,000 tonnes (-0.8% YoY) and are based on Daido's own CY23 Japanese OEM's global auto production estimates of 26.5mil units (+10.4% YoY) – 1H 12.9mil units (+8.4% YoY / +3.2% HoH) and 2H 13.7mil units (+9.6% YoY / +6.2% HoH). This compares to the previous forecast of 25.1mil units (+4.6% YoY).

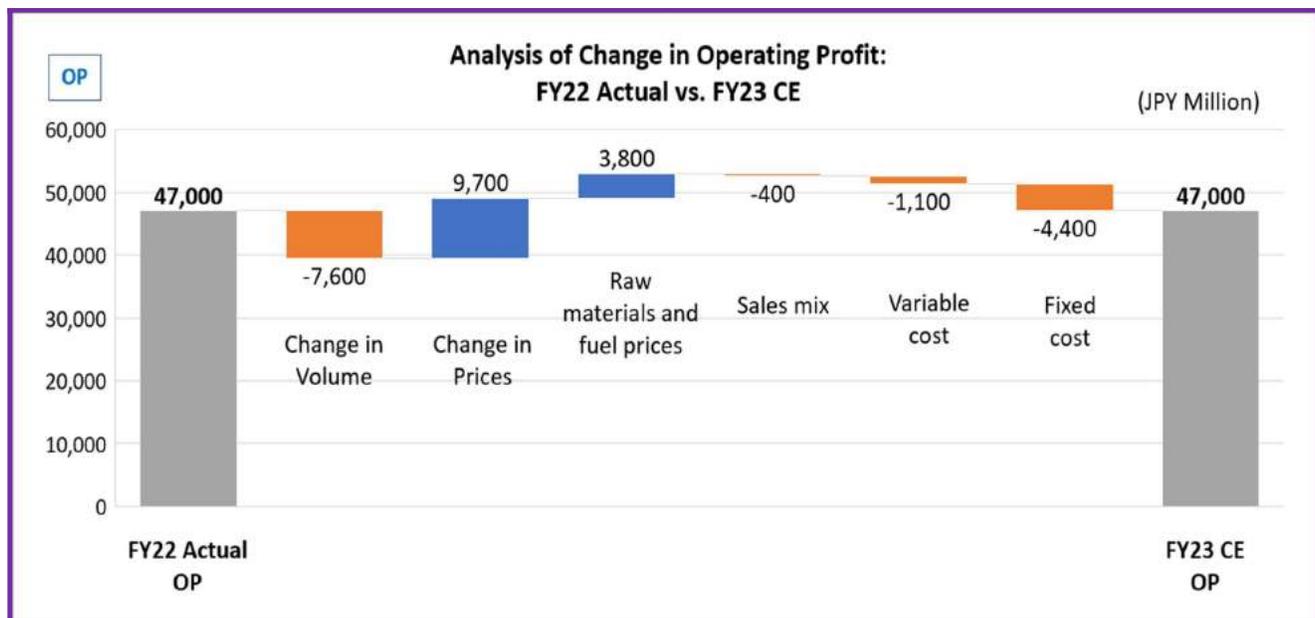
Meanwhile, demand from the industrial machinery sector has been weaker than expected on the back of slowing overseas demands, including China. As a result, compared to the full-year forecast announced on 28 April, the expected fall in sales volumes will likely have a negative impact of -¥12,200mil to FY23 OP.

- Higher costs for energy and raw materials, however, appears less severe vs the original forecast, giving a positive +¥17,800mil impact to the FY23 OP forecast compared to the forecast announced on 28 April.

Raw Material's Price Trend			FY20	FY21	FY22		FY23	
			Result	Result	Assumption	Result	1H Result	2H Assumption
Scrap	H2	¥000/t	24.9	47.6	61.5	46.3	42.9	44.0
	Factory Bundle		28.9	53.9	66.5	50.7	46.8	48.0
Nickle	LME	\$/Lb	6.8	9.3	14.0	11.6	9.7	10.0
Crude Oil	Dubai Brent	\$/bbl	45.8	76.6	100.0	90.3	81.1	85.0
FOREX	TTM	¥/\$	107.1	113.4	120.0	135.5	140.9	145.0

Source: Daido Steel FY23 Q2 Earnings Results Presentation

- The company has introduced energy price-linked surcharges on approximately 50% of its total sales volume. Therefore, the profit decline due to price changes has limited the downward revision to -¥4,300 million vs the original forecast as of 28 April.



Source: Nippon-IBR based on FY23 1H Earnings Results Materials published by Daido Steel

FY23 FORECASTS BY SEGMENT

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	OPM (%)	7.5	7.0	8.2	8.1	6.6	-1.6ppt	9.0	7.8	-0.3ppt

Source: Nippon-IBR based on FY21, FY22 & FY23 Q2 Earnings Results Materials published by Daido Steel

FY23 earnings outlook for Daido Steel's three major segments are as follows:

1. Specialty Steel

[FY23 sales ¥227,000 mil (+5.7% YoY) / OP ¥13,500mil (+38.2% YoY) / OPM 5.9% (+1.4ppt)]

Daido Steel is guiding for FY23 OP of 13,500mil (+38.2% YoY) on sales of ¥227,000mil (+5.7% YoY). The sales forecast was revised down from the original forecast of ¥232,000mil (+8.0% YoY) due to (1) continuing inventory adjustments in tool steel and (2) weak demand from the industrial machinery sector. However, the segment OP forecast remains unchanged and assume that:

1. Sales volumes start to increase on a YoY basis towards 2H, as global auto production volumes recover,
2. OPMs will be optimized as much a possible on the back of price adjustments to offset higher energy and raw materials costs, and
3. Tool steel prices in the 2H will be raised by approx. +5~15%. The slide gap will likely fall back by -¥1,000mil YoY to ¥400mil compared to the positive impact of ¥1,400mil in FY22.

2. High Performance Materials & Magnetic Materials

[FY23 sales ¥210,000mil (-4.4% YoY) / OP ¥19,000mil (-21.8% YoY) / OPM 9.0% (-2.1ppt)]

The segment full-year earnings forecast was revised down by 4.5% in sales and 11.6% in OP, respectively, due to the decline in shipment volumes. Inventory adjustments of stainless steel will likely continue through the 2H. Signs of a recovery in shipments will likely become apparent from FY24 given:

1. The weak auto production during FY22 suggests high inventory levels of stainless steel remain throughout the entire supply chain. However, thanks to the recovery in auto production volumes, destocking of inventory will gradually progress in 2H.

- Inventory adjustments in the industrial machinery sector tries to find a bottom in 2H.
- According to World Semiconductor Trade Statistics [WSTS] market forecast, the semiconductor market is expected to bottom out in April~June 2024. Based on the market assumption, Daido Steel’s order from the SPE sector is estimated to bottom out in Oct~Dec 2023 quarter and will lead to full-fledged recovery in FY2024.

3. Parts for Automobile and Industrial Equipment Segment

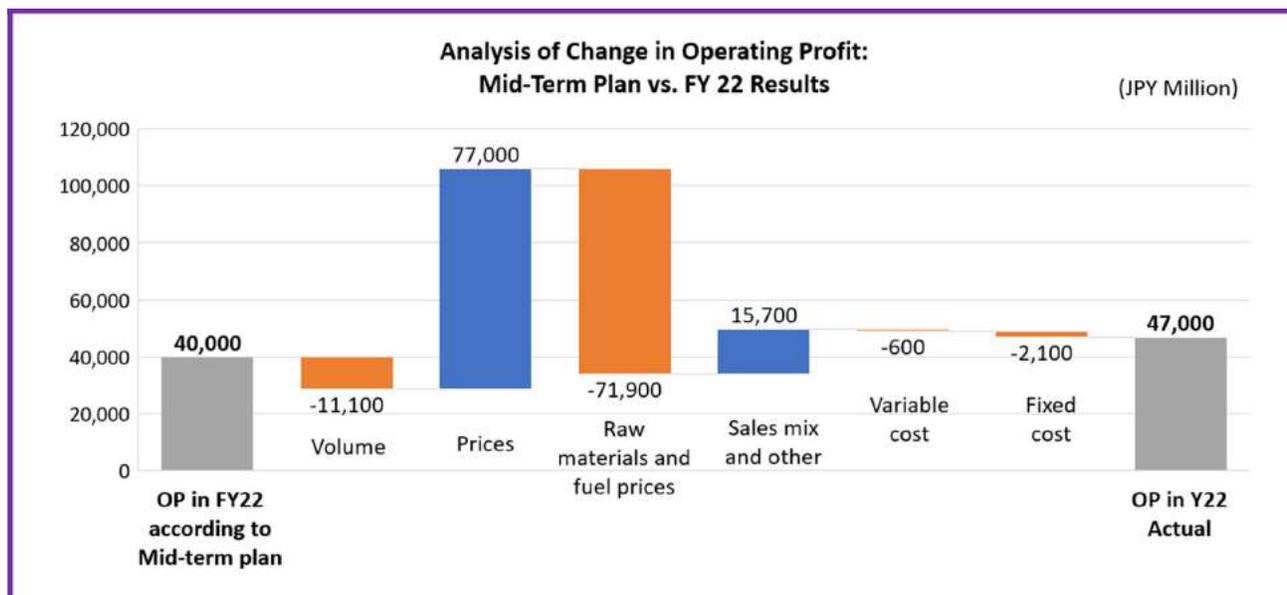
[FY23 sales ¥114,000mil (+12.6% YoY) / OP ¥10,000mil (+21.7% YoY) / OPM 8.8% (+0.7ppt)]

The segment will likely enjoy solid growth in open die forging. Compared to 1H segment OP of ¥2,576mil (-23.4% YoY), the 2H OP forecast is expected to reach ¥7,400mil, supported by:

- Open die forging lead times between order and shipment is usually 6~12 months. Given the fact that orders have remained solid throughout 1H, the visibility for the sales performance in the 2H is high – bar any production issues such as the low throughput experienced in Q1.
- A subsidiary which manufactures engine valves is seeing a surge in demand in Japan and the US.
- Shipment volumes of turbo-related products will likely increase along with the auto production recovery in 2H

MEDIUM TERM PLAN - RECAP

FY23 is the last year of the three-year medium-term management plan. The plan’s OP target of over ¥40,000mil was achieved in FY22. Growth in Daido Steel’s strategic products, such as high-performance stainless steel and open die forging, has led to a marked improvement in sales mix. As a result, ROE reached 10.4% in FY22, surpassing the medium-term target of 8%.



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

Medium-term Management Plan (FY21~FY23) Target				
	Target to achieve in FY23	FY22 Results	FY23 Forecast	Progress
OP (¥mil)	40,000	47,000	47,000	Achieved in FY22
ROE (%)	8.0	10.4	8.4	Achieved in FY22
D/E ratio (x)	0.5	0.64	0.65	Likely fall short of the target.
Investment (¥mil)	85,000	-	90,000	Strategically invest on growing businesses
Sales volume (thousand tonne)	1,200	1,085	1,076	Likely fall short due to weak auto production

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

NEW FOCUS FOR GROWTH OPPORTUNITIES

Engineering Segment

Daido Steel held a separate meeting solely focusing on its Engineering Segment business. The segment is estimated to generate FY23 OP of ¥1,500mil (+5.3% YoY) on sales of ¥23,000mil (+21.3% YoY). Here, the firm sells electric furnaces and refinery furnaces, for which the firm has the top domestic market share, and heat treatment furnaces such as heat treatment for rare earth magnets and for specialty steels. The business is derived from Daido's own engineering expertise and production technology.

The firm aims to capture demand associated with carbon neutrality and lower energy consumption, such as blast furnace steel makers' investment on electric furnace. According to a press release on 15 November, Daido received an order for a new electric furnace from JFE Steel [a core company of JFE Holdings, 5411 JP]. Daido's electric furnace will be installed at the steelmaker's 4th steel mill in East Japan Steel Plant in an aim to reduce carbon emission. The firm aims to achieve orders of ¥30,000mil in FY29 (6-yr CAGR +12.2%). The segment will likely be one of the main areas in which the firm will focus in energies to ensure it meets its next medium-term growth targets.

Titanium Business

The Titanium business has been steadily growing since FY2010, and achieved record semi-annual earnings in FY23 1H. Titanium used for medical purposes – a niche market with competition against titanium specialist makers mainly in US and Russia – is growing on the back of global population growth and increasing demand for advanced medicine. Currently, Daido Steel has around a 10% global market share, aiming to raise that to 20% in 2030. FY23 orders were 1.6x that of FY18. Daido Steel aims to further expand its titanium orders to 2.1x of FY18 levels by 2030.

CAPITAL ALLOCATION POLICY

Daido Steel has three major allocations for its capital: strategic investment for growth: (1) CAPEX, (2) investments related to achieve a carbon neutral status and (3) dividend payments. Over the current medium-term plan, Daido plans to spend total of ¥90,000mil for investment.

In FY23, the firm has earmarked CAPEX of ¥32,900mil which includes strategic investments, including business portfolio restructuring, and cost and productivity improvement, carbon neutral-related investment and IT investment vs. depreciation costs of ¥26,800mil.

1. **CAPEX:** Daido Steel identifies 1) business portfolio restructuring, and 2) improvement in cost and production efficiency as a strategic investment focus. For example, in FY23, it plans to dedicate approx ¥5,200mil in CAPEX on a second vacuum remelting furnace (VAR) for the Chita Second Factory. This should enhance production capacity of high-performance stainless steel and high alloys used for SPEs, for which Daido has approx 40% global market share. FY22 CAPEX was ¥24,300mil with depreciation of ¥26,100mil.
2. **Investment to achieve a carbon neutral status:** At the ESG presentation held on 19 Dec 2022, a renewed initiative, *Daido Carbon Neutral Challenge 2030*, was announced. The aim is to (1) reduce Scope 1 & Scope 2 CO₂ emissions by -50% by 2030 compared to emission volume of approx 1mil tonne in FY13 and (2) 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. FY22 annual dividend was ¥230/share vs forecast of ¥200/share, which was revised due to better-than-expected profit level. FY23 dividend is currently guided for ¥230/share, which will generate 30.6% of FY23 profit forecast.

HOW TO ACHIEVE PBR1X

Daido Steel had already achieved the ongoing medium-term plan's OP target of more than ¥40,000mil in FY22. So far, the firm has put the following strategies in place to improve ROE:

1. Expand sales of high value-added products, such as open die forging, high-performance stainless steel, and titanium products.
2. Restructure lower profit businesses, and allocate management resources to the growing businesses.
3. Solidify optimal margins by passing on energy cost increases to price.

While the OPM has improved over the past three years, the stock is still valued below PBR 1x (0.77x as of 22 Nov). The Tokyo Stock Exchange [TSE] launched an initiative for all TSE Prime and Standard Markets listed companies to achieve a PBR 1x, which means those valued below a PBR 1x must improve their capital efficiency.

Daido Steel will focus on investments for growth in areas such as open die forging, high performance stainless steel, titanium products and engineering products so as to improve profit. At the same time, slimming down the balance sheet will be achieved by the following:

1. Optimise inventory levels.
2. The sale of assets such as strategically held shares and shares owned by the firm's pension fund with the aim to reduce the holdings to below 20% of net assets. As of FY22, the equity holding came down to ¥98,900mil, which was 24.3% of net asset as of FY22 (¥405,500mil).
3. Capitalise other assets such as real estate assets.

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