23-D-0205
May 30, 2023

Highlights of Special Steel Manufacturers' Financial Results for Fiscal Year Ended March 2023

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended March 2023 (FY2022) and earnings forecasts for FY2023 of four special steel manufacturers (collectively, the "Companies"): Daido Steel Co., Ltd. ("Daido Steel"), Sanyo Special Steel Co., Ltd. ("Sanyo Special Steel"), AICHI STEEL CORPORATION ("AICHI STEEL") and Mitsubishi Steel Mfg. Co., Ltd. ("Mitsubishi Steel Mfg.").

1. Industry Trend

Domestic special steel production (based on hot-rolled steel) in FY2022 was 16.35 million tons, down from FY2021's 18.31 million tons (Chart 1), because the shortage of semiconductors and parts had lingering impact in the domestic automotive industry, a major steel purchaser, and demand weakened even for steel products for industrial machinery in the second half. Currently, such shortage problems are beginning to be resolved, and JCR predicts that production activities of automakers will accelerate going forward. Yet, because many of specialty steel products undergo long processes before they are installed in final products, full demand recovery is not expected until the second half of FY2023.

Prices of iron scraps kept going up in FY2020 to FY2021 but reached their peak in FY2022. As a result, progress was made in passing higher raw material prices on to product prices, where this action had previously been stagnant, and the manufacturers' metal spreads improved.

Meanwhile, prices of raw materials and fuels, other than iron scraps, rose sharply in FY2022. Not only the prices of secondary raw materials, such as nickel and molybdenum, went up, but also energy prices soared. That said, because the surcharge system has been introduced for iron scraps and ferroalloys, it is now structurally possible to pass such increases on to product prices, albeit with a time lag. There are moves among some companies to introduce the surcharge system also for energies.

2. Financial Results

Operating income of the Companies combined (gross profit less SG&A expenses for AICHI STEEL) rose 25.3% over the year to 84.9 billion yen in FY2022, growing for two years in a row (Chart 2). Moreover, Daido Steel and Sanyo Special Steel achieved a new high. All of the Companies saw a decrease in sales volume but still improved profitability with progress in raising product prices, which had been stagnant despite the rise in raw material and fuel prices. Income growth was also helped by Sanyo Special Steel's reporting of temporary profits in the amount of approximately 9.6 billion yen for Ovako AB, a consolidated subsidiary in Sweden. Thanks to growth in operating income, net income attributable to owners of the parent of the Companies combined (profit attributable to owners of the parent for AICHI STEEL; hereinafter the same) improved 28.9% to 60.9 billion yen.

Comparison with pre-COVID levels shows different trends among the Companies. The profit level for FY2022 was higher than for FY2018 for Daido Steel, Sanyo Special Steel and Mitsubishi Steel Mfg. For AICHI STEEL, although simple comparison is not possible because IFRS has been adopted since FY2021, the profit level was lower in FY2022 than in FY2018. Possible factors behind this include: i) differences in customers and product mix; and ii) the amount of profit contribution from the overseas business. For Daido Steel, products for semiconductor manufacturing equipment, etc. sold well, and the improvement of the product mix pushed up the profits. Mitsubishi Steel Mfg. enjoyed robust demand from construction machinery manufacturers, its main customers. In the overseas business, a turnaround in the business performance of Ovako for Sanyo Special Steel and Indonesian JATIM TAMAN STEEL MFG. for Mitsubishi Steel Mfg. helped boost the profits. AICHI STEEL is fairly strongly affected by sluggish domestic automobile production due to its low weight in the overseas business and high proportion of automotive products in total sales compared to Daido Steel and Mitsubishi Steel Mfg.

On the financial front, interest-bearing debt of the Companies combined as of the end of FY2022 grew 14.8% from a year before (Chart 3). Working capital requirements increased due to the rise in raw material and fuel prices. Equity capital of the Companies combined (equity attributable to owners of the parent for AICHI STEEL; hereinafter the same) improved 7.7% from a year before with profit accumulation.

Consequently, D/E ratio of the Companies combined at the year-end based on interest-bearing debt and equity capital slightly worsened from 0.5x a year before to 0.6x.

3. Highlights for Rating

Net income attributable to owners of the parent of the Companies combined for FY2023 is expected to turn downward, falling 14.7% to 52.0 billion yen, which however is largely due to the elimination of the aforementioned temporary profits reported by Sanyo Special Steel with respect to Ovako. The income otherwise will likely remain almost flat as the increase in the costs of energies and various materials will be covered by the revision of product prices and growth in sales volume.

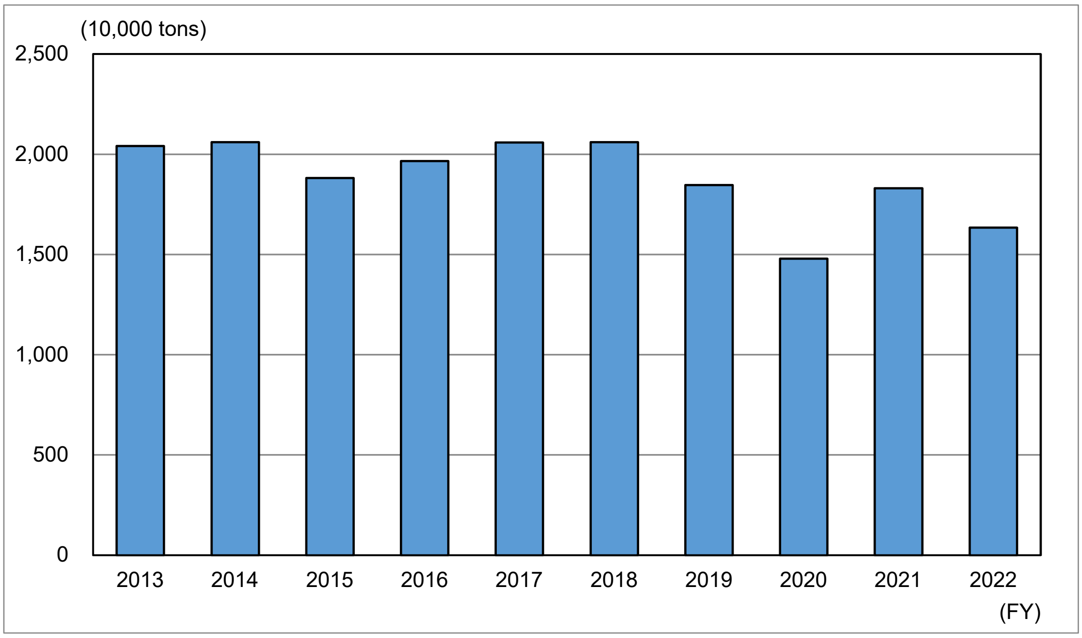
While production in the manufacturing industry has picked up with the mitigation of the impact of the COVID crisis, the shortage of semiconductors and parts has lingered in the automotive industry, requiring time for demand recovery. Currently, the shortage problems are beginning to be resolved, and the number of automotive units produced will probably increase further in the medium run. On the other hand, the risk of economic slowdown in overseas markets has been heightening since March 2023, as indicated by multiple overseas financial institutions falling into bankruptcy following interest rate hikes in Europe and the U.S. Should the economy slow down further, making consumers less willing to purchase cars, demand for specialty steel could be pushed down again.

JCR is watching whether the Companies can bring selling prices to appropriate levels and maintain certain profitability. Given that the surcharge system is introduced for iron scraps and ferroalloys, the pass-through of cost increases to selling prices probably is possible, albeit with a time lag. That said, where the period until surcharges are actually applied is long, the customers are tend to be affected significantly by the time lag. Therefore, JCR will pay particular attention to whether the Companies can curb fluctuations in business results by, for instance, shortening the said period. In addition, once the Companies introduce surcharges for energies, this is expected to contribute to improving the stability of their performance.

As the Companies have all contained capital investment because of the deterioration of the business environment in the wake of the COVID crisis, capital investment of the Companies combined in FY2022 was less than depreciation expenses for the third consecutive year (Chart 4). However, it is expected to exceed depreciation expenses for the first time in four years in FY2023 as the Companies will likely accelerate investment to increase the production of products with growth potential in demand and upgrade aging facilities. That said, given that the Companies' cash flow generation capacity has picked up with a turnaround in the business environment, the current level of a financial structure can probably be maintained.

Masayoshi Mizukawa, Akihiro Kondo

(Chart 1) Domestic Hot-Rolled Special Steel Production Volume



(Source: Prepared by JCR based on data of The Japan Iron and Steel Federation, and The Ministry of Economy, Trade and Industry)

(Chart 2) Consolidated Financial Performance of Four Special Steel Manufacturers

(JPY 100 mn, %)

		Net Sales	YOY	Operating Income	YOY	Ordinary Income	YOY	Ordinary Income / Net Sales	Net Income Attributable to Owners of the Parent	YOY
Daido Steel (5471)	FY2021	5,296	*28.3*	369	*267.2*	392	*210.1*	7.4	268	*495.4*
	FY2022	5,785	*9.2*	469	*27.1*	481	*22.8*	8.3	364	*35.5*
	FY2023F	6,000	*3.7*	470	*0.0*	485	*0.8*	8.1	320	▲*12.2*
Sanyo Special Steel (5481)	FY2021	3,632	*72.4*	214	-	216	-	6.0	152	-
	FY2022	3,938	*8.4*	284	*33.0*	288	*33.2*	7.3	207	*35.9*
	FY2023F	3,940	*0.0*	200	▲*29.8*	200	▲*30.7*	5.1	140	▲*32.5*
Mitsubishi Steel Mfg. (5632)	FY2021	1,462	*49.6*	62	-	57	-	4.0	40	-
	FY2022	1,705	*16.6*	55	▲*11.5*	37	▲*35.2*	2.2	21	▲*46.2*
	FY2023F	1,650	▲*3.2*	80	*44.2*	55	*46.9*	3.3	30	*37.0*

		Revenue	YOY	Gross Profit - SG&A Exp.	YOY	Operating Income	YOY	Operating Income / Revenue	Profit Attributable to Owners of the Parent	YOY
AICHI STEEL (5482)	FY2021	2,601	*28.6*	31	▲*35.4*	21	▲*59.8*	0.8	10	▲*65.3*
	FY2022	2,851	*9.6*	39	*25.7*	32	*52.4*	1.1	16	*47.8*
	FY2023F	3,140	*10.1*	-	-	50	*53.4*	1.6	30	*86.3*

		Net Sales	YOY	Operating Income	YOY	Net Income	YOY
Total	FY2021	12,993	*40.7*	677	*1417.9*	473	-
	FY2022	14,280	*9.9*	849	*25.3*	609	*28.9*
	FY2023F	14,730	*3.1*	-	-	520	▲*14.7*

*1: Figures for AICHI STEEL are based on IFRS, and those for the other three on J-GAAP.
*2: Net Sales under Total is Revenue for AICHI STEEL.
*3: Operating Income under Total is Gross Profit - SG&A Exp. for AICHI STEEL.
*4: Net Income under Total is the sum of Net Income Attributable to Owners of the Parent based on J-GAAP and Profit Attributable to Owners of the Parent based on IFRS.
(Source: Prepared by JCR based on the financial materials of above companies)

(Chart 3) Financial Structure of Four Special Steel Manufacturers

(JPY 100 mn, times, %)

		Interest-bearing Debt	Equity Capital	D/E Ratio	Equity Ratio
Daido Steel (5471)	End-FY2020	1,973	3,031	*0.7*	45.6
	End-FY2021	2,264	3,297	*0.7*	45.3
	End-FY2022	2,342	3,687	*0.6*	47.6
Sanyo Special Steel (5481)	End-FY2020	703	1,783	*0.4*	55.9
	End-FY2021	789	1,969	*0.4*	52.1
	End-FY2022	963	2,143	*0.4*	53.4
Mitsubishi Steel Mfg. (5632)	End-FY2020	485	388	*1.2*	29.4
	End-FY2021	475	426	*1.1*	29.8
	End-FY2022	649	431	*1.1*	27.6

		Interest-bearing Debt	Equity Attributable to Owners of the Parent	D/E Ratio	Ratio of Equity Attributable to Owners of the Parent
AICHI STEEL (5482)	End-FY2020	758	1,929	*0.4*	54.7
	End-FY2021	666	2,015	*0.3*	55.3
	End-FY2022	863	2,037	*0.4*	52.9

		Interest-bearing Debt	Equity Capital	D/E Ratio	Equity Ratio
Total	End-FY2020	3,921	7,133	*0.5*	48.5
	End-FY2021	4,196	7,708	*0.5*	47.8
	End-FY2022	4,819	8,300	*0.6*	48.3

*1: Interest-bearing Debt covers corporate bonds, CP and borrowings.
*2: Equity Capital under Total is Equity Attributable to Owners of the Parent for AICHI STEEL.
*3: Equity Ratio under Total is Ratio of Equity Attributable to Owners of the Parent for AICHI STEEL.
(Source: Prepared by JCR based on the financial materials of above companies)

(Chart 4) Capital Expenditures of Four Special Steel Manufacturers

(JPY 100 mn)

		Capital Expenditures	Depreciation Expenses
Daido Steel (5471)	FY2021	210	267
	FY2022	242	260
	FY2023F	329	268
Sanyo Special Steel (5481)	FY2021	117	159
	FY2022	136	138
	FY2023F	145	145
AICHI STEEL (5482)	FY2021	158	172
	FY2022	185	178
	FY2023F	265	175
Mitsubishi Steel Mfg. (5632)	FY2021	25	37
	FY2022	28	41
	FY2023F	40	36
Total	FY2021	512	636
	FY2022	592	617
	FY2023F	779	624

(Source: Prepared by JCR based on the financial materials of above companies)

<Reference>

Issuer: Sanyo Special Steel Co., Ltd.

Long-term Issuer Rating: A Outlook: Stable

Issuer: AICHI STEEL CORPORATION

Long-term Issuer Rating: A Outlook: Stable

Issuer: Mitsubishi Steel Mfg. Co., Ltd.

Long-term Issuer Rating: BBB Outlook: Stable

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