

HAGIHARA INDUSTRIES (7856 JP)

MEDIUM-TERM MANAGEMENT PLAN SHOWS NO REAL GROWTH BECAUSE OF A CONSERVATIVE FORECAST ON STRATEGIC PRODUCTS

FY20 (OCT-20) EARNINGS RESULT

Hagihara Industries (7856 JP) reported FY20 (Oct year-end) operating profit (OP) of ¥2,515mil (-7.7% YoY) on sales of ¥27,231mil (-8.2% YoY). Recurring profit (RP) was ¥2,840mil (-0.3% YoY) and included a ¥290mil insurance payment.

Sales fell ¥2,416mil YoY (-¥1,347mil YoY in Plastic-processed Products (PLS) segment and -¥1,069mil YoY in Engineering Products (ENG) segment) due to the following reasons:

- In the PLS segment, sales were down by ¥220mil YoY due to a fall in unit prices to reflect lower raw material prices. FY20 assumption of naphtha price was ¥42,100/kl but the actual price for the year was ¥32,700/kl.
- PLS sales volumes were also lower by ¥1,087mil YoY as sales volumes for products such as laminated clothes, flexible container bags, artificial grass yarn and Meltac were soft.
- There was a ¥39mil YoY negative impact due to FOREX.
- The ENG segment suffered the most, with sales down ¥1,069mil YoY due to weaker sales of film slitter for lithium-ion battery [LiB] separators in China.

The OP, which fell by ¥208mil YoY, was mostly impacted by the sales decline in the ENG segment. The OP variance is made up of the following factors:

- -¥378mil YoY from the drop in the PLS segment sales.
- +¥274mil YoY thanks to improved gross profit margin (GPM) in the PLS segment because of lower raw material costs.
- SG&A was lower thanks to 1) +¥101mil YoY saved as travelling costs were reduced due to the pandemic and 2) +¥114mil YoY from less marketing activities – trade shows and exhibitions were cancelled.
- -¥335mil YoY drop in the ENG segment sales.
- +¥15mil YoY thanks to an improvement in the ENG segment's GPM.

Hagihara Industries revised down its full-year guidance when it reported IH results. The new guidance assumed the ongoing pandemic situation remains under control while the global economy gradually restarts activities. FY20 sales was 3.8% below the revised company guidance of ¥28,300mil, but OP surpassed by 2.7% compared to the guided OP of ¥2,450mil. While sales fell short of guidance in both segments, the PLS division OP outperformed by 6.2% thanks to an improved sales mix. Sales of BarChip – one of the firm's strategic products – was less affected by the pandemic and contributed to the segment profit.

SEGMENTS

Plastic-Processed Products (PLS)

PLS FY20 OP was ¥1,932mil (-0.1% YoY) on sales of ¥22,327mil (-5.7% YoY). OP surpassed the full-year guidance of ¥1,820mil but fell slightly short of the sales forecast of ¥22,800mil.

Strategic Products are defined as products developed in-house and generate more than 30% GPM. Those products earned sales of ¥11,238mil (-8.9% YoY) in FY20, 70% of which was PLS Products, such as BarChip, Super-light Flame-retardant Clothes (used in construction site), adhesive tape clothes, carpet base layer and artificial grass yarn.

Executive Summary

- Hagihara Industries reported FY20 (Oct-20) OP of ¥2,515mil (-7.7% YoY) on sales of ¥27,231mil (-8.2% YoY).
- Compared to the revised full-year guidance at the time of IH results, sales fell short of the guidance by 3.8% but OP surpassed was ahead by 2.7%.
- While sales were impacted by weak demand under the pandemic, high-margin BarChip sales enjoyed a quicker-than-expected recovery in mining activities. Also, SG&A costs were reduced due to lack of marketing under the pandemic.
- The company is guiding for FY21 OP of ¥2,640mil (+4.9% YoY) on sales of ¥28,000 (+2.8% YoY).
- Since FY20 was the first year of the 3-year Medium-term Management Plan, the firm has revised down its targets for each year of the plan due to the overall weak demand for its products.
- Hagihara Industries changed the way it discloses its Strategic Products. Each Strategic Products is now tagged to SDGs. The final target (FY22) of Strategic Products in the Plan targets sales of ¥12,488mil, 41.6% of the total sales. Products likely to grow the most are those that support the progress of Work-Style Reform such as BarChip and Ultralight Soundproof Sheets, both of which are mainly used in construction sites, although the company's assumptions in the Plan are conservative.
- The FY21 dividend forecast of ¥36/share (+0.0% YoY) generates a pay-out ratio of 28.2%.

BarChip, a concrete reinforcing material, comprised more than 30% of Strategic Products sales, hence its sales trend is an important indicator for overall earnings. FY20 BarChip sales was ¥3,429mil (+3.6% YoY), while the total sales of Strategic Products fell 8.9% YoY to ¥11,238mil.

FY20 sales of BarChip slightly fell short of the company's growth estimate. However, its sales was less impacted by the pandemic than expected thanks mainly to the below two reasons:

1. Rapidly recovering mining activity in Australia.

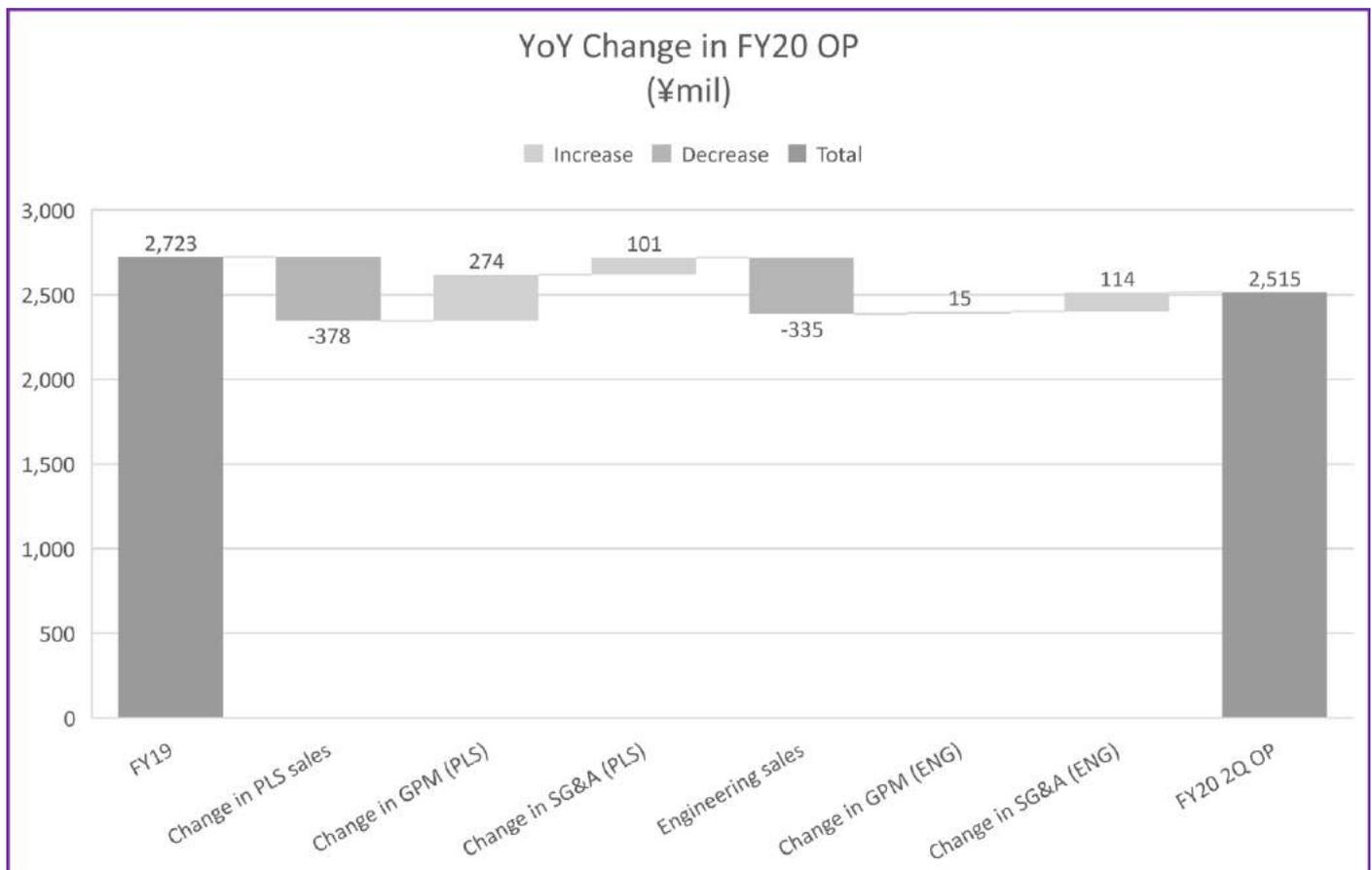
Sales of BarChip tends to correlate with global mining activity as the product is often used as a reinforcing material in concrete structures such as walls and tunnels at mines. It is lightweight and safe to be mixed with concrete and sprayed directly onto surfaces without causing a risk for the concrete structure to fall – unlike a method that uses steel fibres. Globally, mining activities were temporarily suspended during the first wave of COVID-19. In South America, most mines are still closed, while those in China have been gradually reopening. The rapid recovery in Australia was not expected when Hagihara Industries revised down its full-year FY20 forecast with the release of 1H results. FY20 overseas sales of BarChip rose +3.5% YoY to ¥2,709mil.

2. Increase in applications of BarChip in various concrete structures.

Domestic sales of BarChip also grew, +3.8% YoY. The concrete reinforcement process using BarChip requires much less time and manpower compared to a method that uses steel bars. It is widely used in concrete floors, such as in warehouses, in Japan. Recently, BarChip has been deployed for a bridge repair in Takayama City, Gifu.

Engineering Products (ENG)

ENG segment OP dropped 26.1% YoY to ¥582mil on sales of ¥4,904mil (-17.9% YoY). However, the final stage of sales, such as installation and inspection, were postponed due to restricted travel under COVID, with sales of the firm's core products, such as film slitters and screen changers, also affected. While Hagihara Industries reckons that the sales of film slitters for LiB separators in China peaked out in FY19, it managed to capture new sources of demand, such as laminating equipment for large LCD panels and high-filtration type screen changers.



Source: Hagihara Industries' FY20 results presentation

Segment Sales and OP									
(¥mil / Oct year-end)	FY19			FY20CE					
	IH	FY	YoY (%)	IH	YoY (%)	FY	CE	vs. CE (%)	YoY (%)
Plastic-processed Products Segment	11,838	23,674	13.5	11,589	-2.1	22,327	22,800	-2.1	-5.7
Sheet and construction materials	3,044	6,281	1.6	2,917	-4.2	n/a	5,304	n/a	n/a
Industrial materials	5,095	10,038	6.8	5,148	1.0	n/a	10,594	n/a	n/a
Living materials	3,139	6,164	43.8	2,970	-5.4	n/a	6,130	n/a	n/a
Other plastics	559	1,189	20.6	552	-1.2	n/a	771	n/a	n/a
Segment OP	932	1,934	0.9	1,132	21.5	1,932	1,820	6.2	-0.1
Segment OPM (%)	7.9	8.2	-1.0pp	9.8	+1.9pp	8.7	8.0	+0.7PP	+0.5PP
Engineering Products Segment	2,949	5,973	6.6	2,560	-13.2	4,904	5,500	-10.8	-17.9
Segment OP	369	788	2.7	289	-21.7	582	630	-7.6	-26.1
Segment OPM (%)	12.5	13.2	-0.3pp	11.3	-1.2pp	11.9	11.5	+0.4PP	-1.3PP
Total Sales	14,788	29,647	12.1	14,150	-4.3	27,231	28,300	-3.8	-8.2
Total OP	1,301	2,723	1.4	1,421	9.2	2,515	2,450	2.7	-7.7
OPM (%)	8.8	9.2	-1.0ppt	10.0	+1.2pp	9.2	8.7	+0.5PP	+0.0PP

Source: Nippon-IBR based on Hagihara Industries' FY20 earnings results materials

FY21 OUTLOOK AND REVISION OF MEDIUM-TERM MANAGEMENT PLAN

Hagihara Industries is guiding for FY21 OP of ¥2,640mil (+4.9% YoY) on sales of ¥28,000mil (+2.8% YoY) based on the assumption that the naphtha price is ¥30,600/kl. Furthermore, the firm assumes that the global economy and demand for its products will likely remain weak during FY21 IH (Nov 20~Apr 21). Although management expects FY21 sales of BarChip is to be flat YoY, products which performed poorly during FY20, such as artificial grass yarn, carpet base layer clothes and flexible container bags, will likely remain weak. FY20 RP is estimated at 2,740mil (-3.5% YoY) because there will not be any insurance payment expected in FY21. Sales of Strategic Products is estimated at ¥11,671mil (+3.9% YoY, 41.7% of the total sales). The dividend payment is estimated at ¥36.00/share (+0.0% YoY), which makes the pay-out ratio of 28.2%.

The ongoing 3-year Medium-term Management Plan, UPGRADE For Next 60, was revised down as FY20 earnings fell short of the target under the Plan (RP of ¥3,000mil on sales of ¥31,000mil). The final year (FY22) target was revised from the original RP of ¥3,300mil on sales of ¥33,000mil (3-yr CAGR of +5% and +3.6%, respectively) to RP of ¥3,000mil (3-yr CAGR of 1.7%) on sales of ¥30,000mil (3-yr CAGR of +0.4%). Despite seeing an increase in Strategic Products sales, the Plan is conservative as it does not factor any growth ahead.

Although Hagihara Industries stopped disclosing sales breakdown of Strategic Products, the firm now categorises each strategic product with different Sustainable Development Goals [SDGs]. In the final year of the plan, the firm aims to earn total of ¥12,488mil from sales of Strategic Products (3-yr CAGR +0.4%). Although products most likely to show growth will be ones that contribute to work-style reform such as BarChip and Super-light Soundproof Sheet, the current medium-term management plan does not expect much growth in those products. Instead, the plan includes some earnings contribution from new products made by zero-order emission technology Laysys (FY22 sales of ¥600mil).

Furthermore, one of the challenges during the Medium-term Management Plan is to establish a recycling value chain of Blue Sheet. The firm plans to establish a network of sheet collection stations. Hagihara Industries started a trial with a local home centre in Okayama which set up a collection point for Blue Sheet. Most of the imported blue sheets are not fit for recycling, therefore, the first process after collection will be to separate the recyclable sheets from others and to wash them. However, it is still premature to include any investment in and earnings contribution from a recycling value chain to the medium-term forecast.

Hagihara Industries: Medium-term Management Plan

(¥mil / yr end)	Oct-	FY19		FY20			FY21		FY22	
		Actual	CE	Actual	vs. CE (%)	YoY (%)	CE	YoY (%)	CE	YoY(%)
Sales		29,647	28,300	27,231	-3.8	-8.1	28,000	2.8	30,000	7.1
PLS		23,674	22,800	22,327	-2.1	-5.7	22,500	0.8	24,425	8.6
ENG		5,973	5,500	4,904	-10.8	-17.9	5,500	12.2	5,575	1.4
OP		2,723	2,450	2,515	2.7	-7.7	2,640	4.9	2,900	9.8
PLS		1,934	1,820	1,932	6.2	-0.1	2,060	6.6	2,250	9.2
ENG		789	630	582	-7.6	-26.2	580	-0.3	650	12.1
OPM (%)		9.2	8.7	9.2	+0.5pp	+0.0pp	9.4	+0.2pp	9.7	+0.3pp
PLS		8.2	8.0	8.7	+0.7pp	+0.5pp	9.2	+0.5pp	9.2	+0.0pp
ENG		13.2	11.5	11.9	+0.4pp	-1.3pp	10.5	-1.4pp	11.7	+1.2pp
RP		2,850	2,730	2,840	4.0	-0.4	2,740	-3.5	3,000	9.5
RPM (%)		9.6	9.6	10.4	+0.8pp	+0.8pp	9.8	-0.6pp	10.0	+0.2pp

Source: Nippon-IBR based on Hagihara Industries presentation materials

Sales trend of Strategic Products

(¥mil / Oct year-end)	FY19		FY20		FY21CE				FY22CE	
	FY	FY	YoY(%)	IH	2H	FY	YoY (%)	FY	3-yr CAGR (%)	
Sales of Strategic Products	12,338	11,238	-8.9	5,755	5,916	11,671	3.9	12,488	0.4	
Incl. BarChip	3,311	3,429	3.6	n/a	n/a	n/a	n/a	n/a	n/a	
Japan	693	719	3.8	n/a	n/a	n/a	n/a	n/a	n/a	
Overseas	2,617	2,709	3.5	n/a	n/a	n/a	n/a	n/a	n/a	
% of total sales	41.6	41.3	-0.3pp	41.2	42.1	41.7	+0.4pp	41.6	n/a	

Source: Hagihara Industries' FY19&20 earnings presentation and from interviews with the firm

Strategic Products and SDGs

Products	SGE Goal	FY22 Sales Target (¥mil, approx.)	Solutions
Made-in-Japan Blue Sheet used in disaster prevention	13. Climate Action	4,400	Improve climate change adaptability by providing durable products.
Adhesive Tape Clothes			
Super-light Soundproof Sheet	5. Gender Equality 8. Decent Work & Economic Growth	4,400	Providing solutions to reform work styles
BarChip			
Blue Sheet branded by eco-mark	12. Responsible Consumption and Production	380	Providing solutions to promote plastic recycling
Plastic Recycling Machine			
Film Slitter	9. Industry, Innovation & Infrastructure	3,600	Contributing to industry and technology innovations by providing solutions to an important process of manufacturing

Source: Hagihara Industries

Hagihara Industries (7856 JP) : Financial Summary

(¥mil)	FY16	FY17	FY18	FY19	FY20	FY21CE
Sales	22,485	23,238	26,457	29,647	27,231	28,000
Operating Profit	2,548	2,721	2,685	2,723	2,515	2,640
Recurring Profit	2,523	2,753	2,781	2,850	2,840	2,740
Net Profit	1,856	1,964	1,884	2,014	1,891	1,850
EPS (JPY)	256.64	-	130.27	139.23	130.75	124.18
Adjusted EPS (JPY)*	-	-	-	-	-	-
Cash flow from operation (CFO)	3,904	2,535	2,009	3,604	3,315	-
Cash flow from investment (CFI)	-1,320	-848	-3,341	-1,801	-670	-
Cash flow from finance (CFF)	-739	-326	-837	-407	-1,228	-
Cash and cash equivalent	4,923	6,317	4,167	5,556	6,940	-
Free cash flow (FCF)	2,584	1,687	-1,332	1,803	-	-
CFO per share (JPY)	539.70	340.32	138.87	249.13	-	-
FCF per share (JPY)	357.22	226.48	-92.07	124.63	-	-
Total asset	24,874	27,114	31,789	32,572	32,800	-
Liabilities	6,924	7,269	10,674	10,217	9,275	-
Net asset	17,949	19,844	21,114	22,354	23,525	-
Capital	1,778	1,778	1,778	1,778	1,778	-
Shareholders' equity	17,948	19,843	21,113	22,353	23,524	-
BPS (JPY)	2,481.25	-	1,459.46	1,545.15	1,625.54	-
OPM (%)	11.33	11.71	10.15	9.18	9.24	9.43
ROE (%)	10.58	10.39	9.20	9.27	8.24	-
ROA (%)	10.10	10.28	8.92	8.25	7.54	-
Shareholder equity ratio (%)	72.16	73.18	66.42	68.63	71.72	-
D/E ratio (%)	38.58	36.63	50.56	45.71	39.43	-
Total asset turnover (X)	0.91	0.89	0.90	0.92	0.83	-
Interest coverage (x)	53.17	50.44	41.37	35.91	44.98	-
Current ratio (%)	289.63	294.79	219.74	226.45	264.96	-
Interest-bearing debt	1,051	966	2,856	2,866	2,151	-
EBIT	2,571	2,807	2,846	2,926	-	-
EBIT Margin (%)	11.43	12.08	10.76	9.87	-	-
EBITDA	3,459	3,704	3,900	4,123	4,106	-
EBITDA margin (%)	15.38	15.94	14.74	13.91	15.08	-
Dividend (JPY)	60.00	64.00	32.00	34.00	36.00	36.00
Total dividend payment from retained earnings	434	462	462	491	523	523
Dividend pay-out ratio (%)	23.40	23.60	24.60	24.40	27.50	28.99
DOE (%)	2.50	2.30	2.30	2.20	2.20	2.20
Shares outstanding (shares)	7,448,800	7,448,800	14,897,600	14,897,600	14,897,600	14,897,600
Treasury (shares)	215,132	215,440	430,980	431,013	426,213	426,213

Source: Nikkei Value Search

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