

HAGIHARA INDUSTRIES (7856 JP)

NEW MEDIUM-TERM PLAN RE-FOCUSES ON REALISING TARGETS THAT COULD NOT BE ACHIEVED IN THE PREVIOUS PLAN

POST FY22 RESULTS UPDATEFY22 Results

Hagihara Industries (7856 JP) reported FY22 (Oct year-end) earnings results on 12 December 2022 with operating profit [OP] of ¥1,377mil (-38.9% YoY) on sales of ¥29,953mil (+8.1% YoY). The firm had revised down its FY22 guidance when the firm reported Q3 results on 12 September 2022 from OP of ¥1,730mil on sales of ¥30,000mil to OP of ¥1,430mil on sales of ¥29,700mil.

The revision down was the result of 1) the negative impact from rapid surge in crude oil price which led to more than expected hike in major raw material costs, such as plastic resin, and 2) the rapid surge in semiconductor and components amid prolonged disruption in global distribution networks.

While FY22 sales were largely in line with the firm's revised guidance, OP fell short of target due to:

1. The time lag between the rapid surge in raw material costs and passing on those cost increase to prices – which principally affects the Plastic Products [PLS] Segment,
2. Higher components prices and the increase in costs from finding alternative sourcing of those components squeezed earnings in the Engineering Products [ENG] segment, and
3. This led to delays in final inspections after installation in the ENG segment, which will push sales recognition into FY23 Q1.

FY22 net profit [NP] attributed to the parent company's shareholders of ¥943mil (-41.8% YoY) reflects the extraordinary loss of ¥345mil associated with business closure of the firm's subsidiary in Tsingtao, China.

Hagihara Industries (7856 JP): Earnings Summary vs. Forecast					
(¥mil)	FY21	FY22			
	FY	FY CE on Sept '22	FY Actual	FY Actual v. CE (%)	FY Actual YoY (%)
Sales	27,705	29,700	29,953	0.8	8.1
OP	2,254	1,430	1,377	-3.7	-38.9
OPM (%)	8.1	4.8	4.6	-0.3ppt	-3.5ppt
RP	2,372	1,740	1,681	-3.4	-29.1
RPM (%)	8.6	5.9	5.6	-0.3ppt	-3.0ppt
NP	1,619	920	943	2.5	-41.8
NPM (%)	5.8	3.1	3.1	+0.0ppt	-2.7ppt

Source: Hagihara Industries' FY22 FY earnings presentation material

Plastic Products [PLS] Segment

The Plastic Products [PLS] segment saw FY22 OP decline -25.4% YoY while sales rose 13.4% YoY. Segment sales improved by ¥3,030mil YoY of which ¥1,862mil came from price increases, ¥871mil higher sales volume and ¥296mil due to FOREX. Excess inventory in the market for Blue Sheet, one of Hagihara's core products, led to production adjustments.

EXECUTIVE SUMMARY

- Hagihara Industries (7856 JP) reported FY22 (Oct year-end) earnings results on 12 December 2022 with operating profit [OP] of ¥1,377mil (-38.9% YoY) on sales of ¥29,953mil (+8.1% YoY).
- The shortfall against the revised guidance as of 12 Sept is due to 1) the negative impact from the sharp rise in crude oil prices, which resulted in greater-than-expected hikes in major raw material costs, such as plastic resin, and 2) the rapid surge in semiconductor and mechanical components amid prolonged disruption in global distribution.
- Management is guiding for FY23 1H OP of ¥780mil (+5.1% YoY) and NP of ¥2,000mil (+203.5% YoY) on sales of ¥15,600mil (+7.7% YoY) and full year FY23 OP of ¥1,700mil (+23.4% YoY) on a +3.5% YoY rise in sales to ¥31,000mil.
- Having failed to achieve its previous plan's goals, the new medium-term plan will see Hagihara Industries revisit the RP target of ¥3,300mil on sales of ¥33,000mil.
- From its operating cash flow over the medium-term plan, Hagihara Industries will source ¥3,500mil for shareholder returns and ¥10,500mil for strategic investments – of which ¥10,000mil will be for CAPEX and M&A. A further ¥4,000mil will be raised from debt financing.
- Management also aims to raise total shareholder returns from 54.7% in FY22 to 70% (40% via dividend payments and 30% for share buybacks) in FY25. The firm also plans to cancel excess treasury shares above 5% of shares outstanding.

Weakness of Blue Sheet and sandbags were offset by strong sales in BarChip, laminated cloths and Meltac (used as vegetable container bags). The sales trend of Hagihara Industries' core PLS products are as follows:

- **BarChip:** This is one of the firm's SDGs-related products. FY22 BarChip sales reached a record ¥4,825mil (+31.1% YoY). The product is well received in Latin American countries, such as Brazil, where BarChip is used in the construction of concrete earth floors. Some 85% of FY22 BarChip sales came from overseas, which led the product sales growth. Domestic sales saw steady growth of approx. 4~5% YoY by taking market share in the concrete enforcement materials market from steel gage.
- **Laminated Cloths and Meltac:** Demand remained solid in FY22, especially in the overseas markets. FY22 sales of Laminated Cloths and Meltac grew 12.8% YoY and 89.3% YoY, respectively.
- **Domestic Sheet – one of Hagihara's SDGs-related products:** FY22 sales rose +14.3% YoY to ¥2,238mil. Weak demand for blue sheets used for disaster prevention led to decline in sales volume, which were offset by price increase. Sluggish demand were resulted from fewer natural disasters in Japan which led to excess inventory of the Sheet. Sandbag sales also remained sluggish due to a slowdown in demand from the civil engineering and construction sector.

While the PLS Segment sales enjoyed increases in both product prices and sales volumes, OP fell -25.4% YoY due to higher costs –raw materials and energy (+¥885mil) and shipping costs (+¥542mil).

Engineering Products [ENG] Segment

The Engineering Products [ENG] segment reported FY22 OP of ¥200mil (-70.5% YoY) on sales of ¥4,382mil (-15.2% YoY). Due to difficulties in procuring components and subsequent delays in the final inspection after installation, sales will be pushed into FY23 Q1 onwards.

The -16.1% YoY decline in Film slitters sales to ¥2,862mil, another SDGs-related product, could not be offset by the favourable sales trend in Hagihara's other core products, such as paper slitters, screen changers and recycling machine. Segment OP fell by ¥477mil YoY to ¥200mil, due to 1) a ¥222mil decline in the segment sales, 2) a ¥225mil increase in materials costs, and 3) a ¥29mil increase in the segment SG&A.

In FY22, a total of ¥14,435mil, or 48.2%, of consolidated sales came from SDGs-related products – products that offer solutions for the issues identified under the goals regardless of profitability. Hagihara Industries was initially guiding for FY22 SDGs-related products sales of ¥14,873mil, or 49.6% of consolidated sales.

Segment Sales and OP (Cumulative)							
(¥mil / Oct year-end)	FY20		FY21		FY22		
	1H	FY	1H	FY	1H	FY	FY YoY (%)
PLS Segment Sales	11,589	22,327	10,872	22,540	12,327	25,570	13.4
Segment OP	1,132	1,932	941	1,576	557	1,176	-25.4
Segment OPM (%)	9.8	8.7	8.7	7.0	4.5	4.6	-2.4ppt
ENG Segment Sales	2,560	4,904	2,235	5,165	2,163	4,382	-15.2
Segment OP	289	582	329	677	184	200	-70.5
Segment OPM (%)	11.3	11.9	14.7	13.1	8.5	4.6	-8.5ppt
Total Sales	14,150	27,231	13,107	27,705	14,490	29,953	8.1
Total OP	1,421	2,515	1,270	2,254	742	1,377	-38.9
OPM (%)	10.0	9.2	9.7	8.1	5.1	4.6	-3.5ppt

Source: Nippon-IBR based on Hagihara Industries' FY22 FY earnings results materials

SUSTAINABLE DEVELOPMENT GOALS-RELATED PRODUCTS

From FY21, Hagihara Industries changed the segmentation of each strategic product and categorised them into different Sustainable Development Goals [SDGs]. The firm aims to offer solutions to various issues that have been raised by its customers. SDGs-Related Products are further divided into the following four groups, each of which are tasked with specific sustainability goals.

1. **Climate Change Adaptations:** This category includes made-in-Japan sheets, such as Blue Sheet – used to protect houses from natural disasters, and adhesive tape cloths.

While FY22 sales of this group of products rose 7.1% YoY to ¥4,259mil, sales for disaster prevention Blue Sheet continued to be affected by a fall in stockpiling demand due to excess inventory.

Weak Blue Sheet sales were offset by a rise in sales of domestically manufactured sheet products, that are mainly used in construction, civil engineering and farming sectors, such as anti-UV weather-proof sheets and reflective sheets. Adhesive tape cloths, which is also included in Climate Change Adaptation, saw stable sales of ¥2,020mil (flat YoY).

2. **Work-style Reform:** This group includes super-light flame retardant sheets and mesh sheets. Being light weight, therefore requiring less people to carry, the firm's frame-retardant sheets help prevent job-related injuries and improve the health and safety of workers at construction sites. Hagihara's core product, BarChip, is also included in this category.

Work-style Reform products reported FY22 sales of ¥5,789mil (+25.5% YoY), of which ¥4,825mil (+31.1% YoY), or 83.3%, was from BarChip. Strong demand for BarChip, especially in Brazil, led the firm to open a new factory in Paraguay, spending approx. ¥200mil to cater to the local demand for using the product as a material for concrete earth floors in Latin America. Work-style Reform products saw the most growth among Hagihara's SDGs-related products in FY22, thanks to a strong growth of BarChip sales which surpassed the company's original FY22 guidance of ¥4,730mil.

3. **Recycling-oriented Society:** This category includes Blue Sheets branded with an eco-mark, plastic recycling machines and screen changers, all of which support recycling activities.

FY22 sales rose 49.0% YoY to ¥1,131mil, surpassing the initial full-year target of ¥943mil (+24.2% YoY), thanks to stronger-than-expected screen changer sales. Hagihara's screen changer – a machine that filters out impurities during the polymer extrusion process – is unique in that it offers high efficiency in removal of impurities. FY22 screen changer sales surged +56.6% YoY to a new record level of ¥930mil, surpassing the firm's full-year sales target of ¥855mil (+43.9% YoY).

4. **Solutions for Industry and Technology Innovations:** The largest product in this group is the film slitter which, as the name implies, is used to slit various types of film.

FY22 sales declined -25.0% YoY to ¥3,255mil, well short of the firm's initial guidance of ¥3,902mil (-10.1% YoY) as paper slitter sales slumped 57.6% YoY to ¥392mil. Boosts in demand for displays led to a surge in demand for Hagihara's film slitter. Rising demand from LiB separator makers in China led to a recovery in demand for film slitters (FY21 2H rose 83.4% YoY to ¥2,269mil), however, sales appear to have peaked out in FY22 1H (-34.3% YoY), resulting in full year FY22 sales of the film slitter subsegment to decline -16.1% YoY to ¥2,862mil.

Consolidated Sales for SDGs-related Products								
(¥mil / Oct year-end)	FY19	FY20	FY21		FY22			
	FY	FY	1H	FY	1H	FY	FY	YoY
	Results	Results	Results	Results	Results	Guidance	Results	(%)
Climate Change Adaptations	4,199	3,867	2,028	3,977	2,119	4,234	4,259	7.1
Domestically Produced Sheets (inc. Blue Sheet)	2,340	1,986	991	1,957	1,106	2,144	2,238	14.4
Adhesive Tape Cloths	1,859	1,881	998	2,019	1,013	2,090	2,020	0.0
Work-style Reform	4,287	4,329	2,101	4,613	2,549	5,794	5,789	25.5
Flame Retardant Sheets & Mesh Sheets	976	899	433	933	469	1,064	963	3.2
BarChip	3,311	3,429	1,667	3,680	2,080	4,730	4,825	31.1
Recycling-oriented Society	1,183	944	452	759	589	943	1,131	49.0
Blue Sheet Branded by Eco-mark	80	76	25	47	27	69	76	61.7
Screen Changers	902	622	352	594	492	855	930	56.6
Recycling Machines	200	245	74	116	69	19	124	6.9
Solutions for Industry & Technology Innovations	4,506	3,883	1,765	4,339	1,558	3,902	3,255	-25.0
Film Slitters	3,771	2,964	1,144	3,413	1,460	3,022	2,862	-16.1
Paper Slitters	735	918	620	925	97	880	392	-57.6
Total Sales of SDGs-related Products	14,176	13,025	6,347	13,689	6,817	14,873	14,435	5.4
% of Total Sales	47.8%	47.80%	48.4%	49.4%	47.1%	49.6%	48.2%	-1.2pp

Source: Nippon -IBR based on Hagihara Industries FY21 and FY22 earnings presentation material

FY23 OUTLOOK

Hagihara Industries is guiding for FY23 1H OP of ¥780mil (+5.1% YoY) on sales of ¥15,600mil (+7.7% YoY) and full year FY23 OP of ¥1,700mil (+23.4% YoY) on sales of ¥31,000mil (+3.5% YoY). The firm is guiding for FY23 1H NP of ¥2,000mil (+203.5% YoY) because of estimated subsidy associated with the closure of the firm's factory in Tsing Tao, China.

Management attribute the weak earnings trend in FY22 to the performance of the ENG Segment, caused by delays in shipments amid shortage of sensors. While management anticipate the shortages are likely to continue to squeeze the segment OPM, the current order backlog is as much as approx. 80% of the firm's annual sales forecast of ¥4,966mil (+13.3% YoY). Apart from BarChip, which will likely remain one of the core growth drivers, the firm also aims to directly expand sales of Meltac and agricultural sheets in the US by establishing production facilities in McAllen, Texas

Hagihara Industries (7856 JP): Earnings Summary								
(¥mil)	FY22				FY23			
	1H	2H	FY	FY YoY (%)	1HCE	2HCE	FYCE	FYCE YoY (%)
Sales	14,490	15,462	29,953	8.1	15,600	15,400	31,000	3.5
OP	742	634	1,377	-38.9	780	920	1,700	23.4
OPM (%)	5.1	4.1	4.5	-3.6ppt	5.0	6.0	5.5	+1.0ppt
RP	889	792	1,681	-29.1	800	1,000	1,800	7.0
RPM (%)	6.1	5.1	5.6	-3.0ppt	5.1	6.5	5.8	+0.2ppt
NP	659	283	943	-41.8	2,000	700	2,700	186.3
NPM (%)	4.6	1.8	3.1	-2.7ppt	12.8	4.5	8.7	+5.6ppt

Source: Hagihara Industries' FY22 FY earnings presentation material

“V FOR J” – V-SHAPE RECOVERY FOR JUMP STARTING GROWTH

The 3-year Medium-term Management Plan, UPGRADE For Next 60, which concluded in FY22, was revised down in December 2020 as FY20 earnings fell short of the Plan’s target (RP of ¥3,000mil on sales of ¥31,000mil). The final year’s (FY22) targets were revised down by 10%, 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%) due to unprecedented cost increases whose influence will likely linger on.

Given the shortfall in achieving the previous medium-term plan, Hagihara Industries new medium-term plan starts with revisiting the previous plan’s targets.

The firm made the following reviews in each segment under the previous plan:

1. The PLS Segment UPGRADE For Next 60 Initial Target: OP of ¥2,300mil on Sales of ¥26,600mil

The PLS Segment fell short of sales and OP by ¥1,000mil and ¥1,100mil, respectively due to:

- Sales fell short of target due to 1) weaker than expected Blue Sheet, due to a lack of disaster prevention demand and subsequent excess inventory, 2) demand for flexible container bags remain weak due to shipping disruptions, and 3) delays in new applications for Laysys technology beyond the current use of insect repellent.
- Segment OP fell short due to the time lag between the rise in costs of raw materials, shipping and energy and passing those increase to prices.
- Thanks to the weaker yen, price competition from overseas products eased and Hagihara Industries’ products improved their price competitiveness in the overseas market. However, raw material and shipping costs remain at the high level and energy costs continued to surge. Additionally, weaker yen worked negatively on imported materials.

2. The ENG Segment UPGRADE For Next 60 Initial Target: OP of ¥900mil on Sales of ¥6,400mil

The ENG segment fell short of sales of OP by ¥2,000mil and ¥700mil, respectively.

- Sales fell short of target due to delays to shipments and supply chain issues for components.
- Segment OP fell short amid the higher cost to procure components off the shelf.
- Although supply chain disruptions are showing some signs of improvement, management are anticipating the tough conditions will likely continue for the time being as its customers have become more cautious on CAPEX.

Under the new V for J Plan, the firm aims to achieve:

1. To meet the targets that were missed during the previous medium-term, which call for recurring profit [RP] of ¥3,300mil (CAGR over 3 years of 25.2%) on sales of ¥33,000mil (CAGR of 3.3%). Segment split for Sales and RP is as follows:

PLS Segment:

- PLS Segment sales target is ¥26,600mil (CAGR of 1.3%), +¥1,000mil increase compared to FY22 segment sales of ¥25,570mil. The ¥1,000mil increase in sales comprises of:
 - +¥1,800mil increase in BarChip sales to ¥6,625mil (CAGR of 11.1%) vs FY22 sales of ¥4,825mil.
 - +¥400mil increase in Meltac sales compared to FY22 sales of ¥419mil.
 - Decline in the segment sales by -¥1,200mil by eliminating unprofitable products.
- PLS segment RP target is ¥2,300mil (CAGR of 15.3%), +¥800mil compared to that of FY22.
 - +¥100mil on the back of higher sales.
 - +¥700mil increase amid improved profitability by 1) optimal pricing, 2) an increase in local production and cultivating overseas demand.

ENG Segment:

- ENG Segment sales target of ¥6,400mil (CAGR of 13.4%), +¥2,000mil vs FY22 segment sales of ¥4,382mil. The breakdown of the ¥2,000mil increase includes:
 - +¥1,600mil due to shorter procurement cycle of components.
 - +¥400mil from new products.
- ENG segment RP target is ¥1,000mil (CAGR of +71.0%), +¥800mil increase compared to that of FY22 thanks to:
 - +¥100mil from the increase in sales.
 - +¥700mil thanks to normalised profitability

To achieve the aforementioned numerical targets, the firm has put in place the following strategies to encourage a V-shape recovery and to jump start growth:

1. Enhance product competitiveness to realise the optimal pricing.
2. Establish optimal production and distribution networks, such as a new production base of BarChip in Paraguay. Hagihara plans to open overseas BarChip production facilities in close proximity to areas of demand, with production scheduled to commence from FY24. This would not only help the firm avoid the soaring cost of shipping but also enable the firm to get a better grasp local market trends. Hagihara also plans to build a plant in US for Meltac. Capex for the two overseas production facilities will comprise ¥650mil in Paraguay and approx. ¥1,000mil in Texas of the ¥4,000mil in total CAPEX planned during the medium-term plan. In addition, the firm will bring back sheet production in China to Japan by spending ¥2,500mil on the Kasaoka Factory, and is considering an optimal production location for the ENG segment. Total investment including aforementioned CAPEX during over three years will be ¥10,500mil.
3. Establish a horizontal recycling model: The ultimate aim is to establish a model that enables repeated recycling rather than just one-off recycling. Every time a used Blue Sheet is recycled, it will be processed to 1) be washed, separate the resin and be deinked, 2) filter the resin via screen changer, 3) improve or alternate quality through the re-pellet and pelletiser processes. The recycling business will also boost Hagihara Industries' engineering (ENG) product development and sales.

Capital Allocation during the Medium-term Plan

Hagihara Industries plans to finance the ¥3,500mil planned for shareholder return and ¥10,500mil for aforementioned strategic investments (including CAPEX and M&A) from operating cash flow (¥10,000mil) and ¥4,000mil from debt finance during the medium-term plan. The firm also plans to improve total shareholder returns from 54.7% in FY22 to 70% (40% from dividend and 30% in share buybacks) in FY25 and plans to cancel excess treasury shares above 5% of shares outstanding.

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For further enquiry, please contact:

Yumi Yamamoto-Tyrrell

Nippon Investment Bespoke Research UK Ltd

118 Pall Mall

London SW1Y 5EA

TEL: +44 (0)20 7993 2583

Email : enquiries@nippon-ibr.com



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Japanese Equity Specialist

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