

HAGIHARA INDUSTRIES (7856 JP)

1H RESULTS FELL SHORT YET NO CHANGE IN FY21 GUIDANCE. NEED A BIGGER GROWTH TO ACHIEVE MEDIUM-TERM TARGET IN FY22

EARNINGS SUMMARY

FY21 1H Results

Hagihara Industries (7856 JP) reported FY21 (Oct year-end) 1H operating profit (OP) of ¥1,270mil (-10.6% YoY) on sales of ¥13,107mil (-7.4% YoY). Net profit [NP] attributed to the parent's shareholders was ¥916mil (-19.6% YoY). The firm reported a ¥52,998mil extraordinary gain from the sale of a fixed asset last year but since there was no such sale in 1H this year, NP saw a larger YoY decline than OP. 1H Free cash flow [FCF] was ¥716mil.

Hagihara Industries (7856 JP): Earnings Summary							
(¥mil)	FY20			FY21			
	1H	2H	FY	1H	YoY (%)	2HCE	FYCE
Sales	14,150	13,080	27,231	13,107	-7.4	14,893	28,000
OP	1,421	1,093	2,515	1,270	-10.6	1,370	2,640
OPM (%)	10.0	8.4	9.2	9.7	-0.3pp	9.2	9.4
RP	1,656	1,183	2,840	1,331	-19.6	1,409	2,740
RPM (%)	11.7	9.1	10.4	10.2	-1.5pp	9.5	9.8
NP	1,139	752	1,891	916	-19.6	934	1,850
NPM (%)	8.1	5.8	6.9	7.0	-1.1pp	6.3	6.6

Source: Nippon-IBR based on Hagihara Industries FY21 1H earnings presentation material

The Plastic Products [PLS] segment 1H OP fell 16.9% YoY to ¥941mil on sales of ¥10,872mil (-6.2% YoY) while the Engineering Products [ENG] segment OP rose 13.7% YoY to ¥329mil on sales of ¥2,235mil (-12.7% YoY).

Total sales were down ¥1,043mil (-7.4%) YoY (PLS ca. -¥715mil YoY / ENG ca. -¥325mil) and fell short of the firm's 1H guidance by ¥853mil due to the following reasons:

- PLS sales were down by ¥99mil YoY due to (1) a fall in BarChip prices, especially in the mines where BarChip is used as a plastic concrete reinforcing material in tunnels, and (2) price competition against the similar but inferior quality plastic concrete reinforcing materials which led to a pricing competition.
- PLS sales volumes were also lower by ¥600mil YoY as (1) demand for contingency stock led to weak sheet sales and (2) Covid affecting flexible container bags sales which are more economically sensitive.
- There was a ¥16mil YoY negative impact to the PLS sales due to FOREX.
- ENG sales fell ¥325mil YoY primarily due to China demand for film slitter sales used in lithium-ion battery [LiB] separators peaking out.

1H OP, which fell by ¥151mil (-10.6%) YoY and fell short of the firm's 1H forecast by ¥110mil, was mostly impacted by weak sales and the increase in overseas shipping costs in the PLS segment.

The OP variance is made up of the following factors:

- ¥214mil YoY from the drop in PLS segment sales.
- +¥144mil YoY thanks to lower raw material costs.

EXECUTIVE SUMMARY

- Hagihara Industries (7856 JP) reported FY21 (Oct year-end) 1H operating profit (OP) of ¥1,270mil (-10.6% YoY) on sales of ¥13,107mil (-7.4% YoY). 1H results were in short of the firm's guidance.
- The Plastic Products [PLS] segment saw 1H OP of ¥941mil (-16.9% YoY) on sales of ¥10,872mil (-6.2% YoY). In addition to weak sales volumes of sheets and flexible container bags, sales of BarChip, the firm's core product used to reinforce concrete surface, were affected by pricing competition during 1H. However, demand for BarChip has been recovering in Q3. Engineering Products [ENG] segment earned 1H OP of ¥329mil (+13.7% YoY) on sales of ¥2,235mil (-12.7% YoY).
- Hagihara discontinued sales disclosure of Strategic Products and instead categorised its products by linking them to solutions to specific Sustainability Development Goals [SDGs]. In FY21, SDGs-related products sales are estimated to be ¥13,824mil (+6.1% YoY).
- Despite 1H results fell short of the firm's guidance, full-year guidance remains unchanged. The risks remain with 1) rapid surge in naphtha price, 2) pricing pressure on BarChip at mines.
- Suppose that the firm achieves FY21 forecast - OP of ¥2,640mil (+4.9% YoY) on sales of ¥28,000 (+2.8% YoY), next year, it will still need to see even higher growth in earnings – OP by 9.8% and sales by 7.1% - to meet the final year target. The firm reckons that it is possible to achieve the target with a recovery from COVID influence.
- The FY21 dividend forecast of ¥36/share (+0.0% YoY) generates a pay-out ratio of 28.2%

- -¥121mil YoY due to an increase in SG&A due to higher overseas shipping costs.
- -¥106mil YoY drop in the ENG segment sales.
- +¥122mil YoY thanks to an improvement in the ENG segment sales mix.
- +¥23mil YoY thanks to drop in ENG segment SG&A as there was less travelling and advertising due to Covid.

Segment Sales and OP						
(¥mil / Oct year-end)	FY19		FY20		FY21	
	1H	FY	1H	FY	1H	YoY (%)
Plastic-processed Products Segment	11,838	23,674	11,589	22,327	10,872	-6.2
Segment OP	932	1,934	1,132	1,932	941	-16.9
Segment OPM (%)	7.9	8.2	9.8	8.7	8.7	-1.1pp
Engineering Products Segment	2,949	5,973	2,560	4,904	2,235	-12.7
Segment OP	369	788	289	582	329	13.7
Segment OPM (%)	12.5	13.2	11.3	11.9	14.7	+3.4pp
Total Sales	14,788	29,647	14,150	27,231	13,107	-7.4
Total OP	1,301	2,723	1,421	2,515	1,270	-10.6
OPM (%)	8.8	9.2	10.0	9.2	9.7	-0.3pp

Source: Nippon-IBR based on Hagihara Industries' FY20 & FY21 1H earnings results materials

SDGS-RELATED PRODUCTS

Hagihara stopped disclosing the sales breakdown of Strategic Products – products that are (1) developed and made in-house by Hagihara and (2) generates more than 30% gross profit margin [GPM]). FY21 marks the second year of the three-year Medium-Term Plan, in which the firm aims to achieve Strategic Products sales of ¥12,488mil (3-yr CAGR +0.4%).

Although Hagihara Industries discontinued disclosure the sales breakdown of Strategic Products, the firm now categorises each strategic product with different Sustainable Development Goals [SDGs], from which it aims to offer solutions to various issues that have been raised by SDGs. In 1H, a total of ¥6,347mil, or 48.4%, of consolidated sales came from SDGs-related products and is targeting total sales of ¥13,824mil (6.1% YoY) for FY21. While Strategic Products were categorised based on the level of each product's GPM, SDG-related products include products that offer solutions for issues identified under the goals regardless of profitability.

SDG-Related Products are further divided into four groups each tagged with specific sustainability goals. Those are:

1. Climate Change Adaptations

This category includes made-in-Japan sheets, such as Blue Sheet that is used to protect houses from natural disasters, adhesive tape cloths, and Laysys®, which enables the slow and controlled release of medicinal and cosmetic ingredients. 1H sales of this group were ¥2,028mil and the firm's FY21 forecast is ¥4,056mil (+4.9% YoY). Sales of made-in-Japan sheets were ¥991mil and the full-year forecast is ¥2,176mil (+9.6% YoY). Laysys® is employed in a new insect repellent launched by Earth Corporation (4985 JP) for its ability to release the contents for about 90 days. Although its sales are still small, the firm reckons Laysys®'s unique property will be sought after for products that need long-term, slow release of medicinal ingredients. It is also employed in septic tank-use pesticides. Under the current Medium-term Plan, Laysys® is expected to generate sales of ¥600mil in FY22 compared to this year's sales forecast of ¥59mil.

2. Work-style Reform

This group includes super light frame retardant sheets and mesh sheets that are mandatory at construction sites. Requiring less people to carry and being light weight helps prevent job-associated injuries. Hagihara's core product, BarChip is also included in this category. Work-style Reform products earned 1H sales of ¥2,101mil, of which ¥1,667mil (-6.7% YoY) was from BarChip. During the 1H, sales volumes of BarChip in Indonesian mines declined due to closures under the pandemic. At the same time, price competition against other plastic concrete reinforcing materials intensified, especially in Latin American and Australian mines. Hagihara reckons that BarChip's quality exceeds the requirements for use in mining tunnels, and given the pricing pressure from the mining side, the firm is looking to expand into other markets such as civil engineering and construction for BarChip. The company is

guiding for FY21 Work-style Reform products sales of ¥4,274 (-1.3% YoY), of which ¥3,349mil is from BarChip (-2.3% YoY).

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. The group earned 1H sales of ¥452mil and ¥756mil (-19.9% YoY) for the full year. Hagihara's screen changer – a machine that filters out impurities during the polymer extrusion process of – is unique in that it uses of recycled plastics products such as PET bottles. However, FY21 sales are forecast to fall 25.4% to ¥464mil based on the current order backlog. However, since the last earnings guidance, demand for screen changers has been stronger than the firm expected.

4. Solutions for Industry and Technology Innovations

1H sales of this group were ¥1,765mil, and the FY21 forecast is for ¥4,736mil (+22.0% YoY). The largest product in this group is the film slitter which, as the name implies, is used to slit various types of film. In recent years, demand from lithium-ion battery [LiB] separator makers in China led to film slitter sales growth, but the firm reckons that demand has peaked as many smaller separator film makers have been consolidated or merged to larger players. Larger separator film makers use slitters made by one of Hagihara Industries' competitors. Slitters are such an important piece of the manufacturing equipment used in the separator film production process that manufacturers rarely change them, and to do so would require a review of the entire manufacturing process. The competitor is a dominant player in this field in China, however, Hagihara plans to tackle that market by coming up with a new design which improves productivity for its slitter.

In 1H, film slitter sales were ¥1,144mil and the firm forecasts full year sales of ¥3,328mil (+12.3% YoY). The growth will likely be achieved by converting the order backlog, which stood at ¥3,458mil as of the end of 1H – higher than the firm's comfortable minimum of ¥3,200mil – into sales. Most of the existing order backlog is from customers in Japan. Another product in this group is the paper slitter. The firm is guiding for FY21 sales of ¥1,408mil (+53.4% YoY) thanks to a rise in orders from paper companies.

Consolidated Sales for SDGs-related Products					
(¥mil / Oct year-end))	FY19	FY20	FY21		
	FY	FY	1H	FYCE	YoY (%)
Climate Change Adaptations	4,199	3,867	2,028	4,056	4.9
Domestically Produced Sheets (inc. Blue Sheet)	2,340	1,986	991	2,176	9.6
Adhesive Tape Cloths	1,859	1,881	998	1,820	-3.2
Laysys©	-	0	39	59	n/a
Work-style Reform	4,287	4,329	2,101	4,274	-1.3
Flame Retardant Sheets & Mesh Sheets	976	899	433	925	2.9
BarChip	3,311	3,429	1,667	3,349	-2.3
Recycling-oriented Society	1,183	944	452	756	-19.9
Blue Sheet Branded by Eco-mark	80	76	25	71	-6.6
Screen Changers	902	622	352	464	-25.4
Recycling Machines	200	245	74	220	-10.2
Solutions for Industry & Technology Innovations	4,506	3,883	1,765	4,736	22.0
Film Slitters	3,771	2,964	1,144	3,328	12.3
Paper Slitters	735	918	620	1,408	53.4
Total Sales of SDGs-related Products	14,176	13,025	6,347	13,824	6.1
% of Total Sales	47.8%	47.8%	48.4%	49.4%	+1.6pp

Source: Nippon-IBR based on Hagihara Industries FY21 1H earnings presentation material

FY21 OUTLOOK AND PROGRESS ON 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). Although 1H earnings fell short of the firm's guidance by 6.1% in sales and 8.0% in OP respectively, FY21 guidance remains unchanged. The full-year guidance assumes a naphtha price of ¥30,600/kl. Although the domestic naphtha price has surged throughout 1H and hit ¥49,401/kl in July, Hagihara Industries stocked enough inventory prior to price rise. Therefore, the firm does not feel the need to revise its full-year guidance. Still, the firm has been able to introduce higher prices for 30~40% of its products to reflect the rising naphtha price and to maintain margin regardless of the naphtha price. That said, the firm assumes that the global economy and demand for its products will likely remain weak during FY21 1H (Nov 20~Apr 21).

Management expects FY21 sales of BarChip is to be down 2.3%YoY because of the price competition and weak demand during 1H in Indonesian mines which are relatively higher margin market for the firm. However, from Q3, demand for BarChip has been recovering thanks to the reopening of mines in Indonesia, following the reopening's in Australia and Latin America in Q2, though management expects pricing competition will likely continue. Products which performed poorly during FY20 and 1H, such as artificial grass yarn, carpet base layer cloths and flexible container bags, will likely remain weak. On the cost side, the continuous rise in the shipping cost, especially marine shipping, remains as a concern. FY20 RP is estimated at ¥2,740mil (-3.5% YoY) because there will not be any gain from cancellation of insurance expected in FY21. The dividend payment is estimated at ¥36/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 Plan's target (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%). Should the firm achieve its FY21 forecast (OP of ¥2,640mil (+4.9% YoY) on sales of ¥28,000 (+2.8% YoY)), next year, it will still need to see OP growth of 9.8% and sales to improve 7.1% to meet the final year target. The firm reckons that it is possible to achieve the medium-term target once the global economy is free of COVID impact.

Furthermore, one of the challenges during the Medium-term Management Plan is to establish a recycling value chain of Blue Sheet. The firm aims to establish a network of sheet collection stations where they will collect used blue sheets. Hagihara started a trial with some local home centres in Okayama which set up a collection point for blue sheets. Through this trial, the firm encountered several obstacles in the recycling process. For example, some of the recycled sheets – included ones that were not made by Hagihara Industries – could affect the quality of the recycled pellets. The firm discovered that most of the imported blue sheets were not fit for recycling, therefore, once collected, they had to be separated from the others before sent for the washing process. The firm plans to establish the Recycling Specialised Business division the focus of which will be purely on the plastic recycling business. However, it is still premature to include any investment in and earnings contribution from the recycling value chain to the medium-term forecast.

Hagihara Industries: Medium-term Management Plan

(¥mil / end)	Oct-yr	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		788	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

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