

HAGIHARA INDUSTRIES (7856 JP)

1H OP WAS REVISED UP ON THE BACK TO PROGRESS IN PRICE REVISION, HOWEVER, FY23 FORECAST UNCHANGED.

FY23 1H RESULTS UPDATE

Hagihara Industries (7856 JP) reported FY23 1H (Oct year-end) earnings results on 12 June 2023 with operating profit [OP] of ¥1,010mil (+36.2% YoY) on sales of ¥15,930mil (+9.9% YoY). Sales were largely in line with the firm's guidance for 1H, however OP surpassed the 1H guidance of ¥780mil, thanks to progress in price revisions to offset the rapid surge in material and energy costs. In 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 Qingdao, China. For FY23 1H, however, net profit [NP] surged +240.5% to ¥2,246mil, as the firm received ¥2,022mil in compensation payments from the Chinese government related to the same subsidiary.

Hagihara Industries (7856 JP): Earnings Summary							
(¥mil)	FY22		FY23				
	1H	FY	1H	YoY (%)	1HCE	FYCE	FYCE YoY (%)
Sales	14,490	29,953	15,930	9.9	15,600	31,000	3.5
OP	742	1,377	1,010	36.2	780	1,700	23.4
OPM (%)	5.1	4.5	6.3	+1.2ppt	5.0	5.5	+1.0ppt
RP	889	1,681	1,091	22.7	800	1,800	7.0
RPM (%)	6.1	5.6	6.8	+0.7ppt	5.1	5.8	+0.2ppt
NP	659	943	2,246	240.5	2,000	2,700	186.3
NPM (%)	4.6	3.1	14.1	+9.5ppt	12.8	8.7	+5.6ppt

Source: Hagihara Industries' FY23 Q2 earnings presentation material

FY23 1H OPM rose to 6.3% from 5.1% in FY22 1H, however, it has not yet recovered to 9.6% level achieved in FY21 1H when Hagihara Industries enjoyed an improvement in the in sales mix for its Plastic Products [PLS] segment. FY23 1H PLS segment OPM was 6.7%, up from 4.5% in FY22 1H, thanks to the successful passing on of cost increases into product prices. However, the Engineering [ENG] segment OPM fell from 8.5% in FY22 1H to 4.1% in FY23 1H due to parts shortages (sensors) for a large development project, therefore contributions to sales could not be realised. As a result, the segment order backlog expanded to approx. ¥6,950mil – the equivalent of 1.5 years of segment sales.

Plastic Products [PLS] Segment

The PLS segment saw FY23 1H OP improve 63.7% YoY to ¥912mil on sales of ¥13,550mil (+9.9% YoY). Of the net +¥1,223mil increase in sales, +¥2,133mil was from price increases, offsetting the -¥1,075mil from the slower pace in sales growth (vs FY22 1H OP +13.4% YoY). In addition, the weaker yen also boosted segment sales by +¥164mil. The +¥355mil YoY improvement in OP was boosted by higher sales (+¥491mil YoY) which absorbed the negative impact from higher costs such as energy (-¥61mil YoY) and increases in SG&A (-¥74mil YoY).

Weakness in demand for Sheets products were offset by strong sales in BarChip, laminated cloths and Meltac (used as vegetable container bags) in overseas markets. In addition, yarn for artificial grass also showed a post-COVID recovery.

EXECUTIVE SUMMARY

- Hagihara Industries' FY23 1H sales were largely in line with guidance, but OP beat the initial forecast thanks to progress in passing on cost increases onto prices.
- FY23 1H PLS segment OPM was 6.7%, up from 4.5% in FY22 1H, thanks to successful price hikes. However, the Engineering [ENG] segment OPM fell from 8.5% in FY22 1H to 4.1% in FY23 1H due to sales recognition delays due to parts shortages (sensors) for one large development project.
- The firm is guiding for full year FY23 OP of ¥1,700mil (+23.4% YoY) on a +3.5% YoY rise in sales to ¥31,000mil. Despite stronger than expected 1H OP thanks to price revisions, Hagihara has kept its initial forecast.
- 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 allocate ¥3,500mil to shareholder returns and ¥10,500mil for strategic investments – the bulk 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.

Engineering Products [ENG] Segment

The Engineering Products [ENG] segment reported FY23 1H OP of ¥98mil (-46.9% YoY) on sales of ¥2,379mil (+10.0% YoY). Sales rose thanks to higher sales of large slitters as display panel production in China as well as growth in domestic production of electronic components improved. Sales of winders for zipper tapes used in the food industry were also solid. However, the segment OP declined -46.9% YoY due to difficulties in procuring components – such as inverters and sensors – and subsequent delays in the production processes.

Segment Sales and OP (Cumulative)										
(¥mil / Oct year-end)	FY20		FY21		FY22		FY23			
	1H	FY	1H	FY	1H	FY	1H	YoY (%)	FYCE	FYCE YoY (%)
PLS Segment Sales	11,589	22,327	10,872	22,540	12,327	25,570	13,550	9.9	26,100	2.1
Segment OP	1,132	1,932	941	1,576	557	1,176	912	63.7	1,430	21.6
Segment OPM (%)	9.8	8.7	8.7	7.0	4.5	4.6	6.7	+2.2ppt	5.5	+0.9ppt
ENG Segment Sales	2,560	4,904	2,235	5,165	2,163	4,382	2,379	10.0	4,900	11.8
Segment OP	289	582	329	677	184	200	98	-46.9	270	35.0
Segment OPM (%)	11.3	11.9	14.7	13.1	8.5	4.6	4.1	-4.4ppt	5.5	+0.9ppt
Total Sales	14,150	27,231	13,107	27,705	14,490	29,953	15,930	9.9	31,000	3.5
Total OP	1,421	2,515	1,270	2,254	742	1,377	1,010	36.2	1,700	23.5
OPM (%)	10.0	9.2	9.7	8.1	5.1	4.5	6.3	+1.2ppt	5.5	+1.0ppt

Source: Nippon-IBR based on Hagihara Industries' FY23 Q2 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.

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

FY23 1H sales of this group of products rose +16.9% YoY to ¥2,477mil, thanks to price hikes that reflect the surge in material and energy costs. Sales volumes of Domestically Produced Sheets, including Blue Sheet, remained sluggish as demand was tapered due to excess inventory in the market. FY23 1H sales of Domestically Produced Sheets surged +24.0% YoY to ¥1,371mil, thanks to price revision.

Sales of adhesive tape cloths, which are also included in CCA, saw FY23 1H sales of ¥1,106mil (+9.2% YoY), thanks to a surge in pent-up demand from adhesive tape makers.

- Work-style Reform:** This group includes super-light flame-retardant sheets – which are used to prevent job-related injuries and improve the health and safety of workers at construction sites – and mesh sheets. Being light weight, these products don't require as many people to carry them around. Hagihara's core product, BarChip, is also included in this category.

Work-style Reform products reported FY23 1H sales of ¥3,137mil (+23.1% YoY), of which ¥2,649mil (+27.4% YoY), or 84.4%, was from BarChip. Strong demand for BarChip, especially in Brazil. The firm spent approx. ¥200mil for a new factory in Paraguay, to cater to the rising local demand for BarChip as they are used as a base material for concrete floors in Latin America. Work-style Reform products saw the most growth among Hagihara's SDGs-related products in FY22, thanks to a strong demand for BarChip – and notched up record sales in 1H. Competition in Brazil has intensified due to competing products. Hagihara has addressed this issue with the launch of a new type of

BarChip. 70~80% of concrete reinforcing material is still steel gage hence there is room for BarChip to grow market share.

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. FY23 1H sales rose +7.1% YoY to ¥631mil. Although sales declined -24.2% YoY, screen changers still comprise the largest proportion (FY23 1H sales of ¥373mil, -24.2% YoY) of this category. Thanks to rising interest in plastic recycling, demand for Hagihara's screen changers remains solid as it is necessary for the removal of contaminants in used plastics during the process of producing used plastic resin.
FY23 1H sales rose +7.1% YoY to ¥631mil. Demand for screen changer remained solid.

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. FY23 1H sales improved +5.5% YoY to ¥1,644mil, thanks to solid demand for film slitters used in lithium-ion battery [LiB] packaging, and label films for PET bottles. In 1H, Hagihara also saw a rise in slitting demand from the food industry such as zipper tapes for containing and preserving food.

Consolidated Sales for SDGs-related Products										
(¥mil / Oct year-end)	FY19	FY20	FY21		FY22		FY23			
	FY	FY	1H	FY	1H	FY	1H	YoY (%)	FYCE	YoY (%)
Climate Change Adaptations	4,199	3,867	2,028	3,977	2,119	4,259	2,477	16.9	4,037	-5.2
Domestically Produced Sheets (inc. Blue Sheet)	2,340	1,986	991	1,957	1,106	2,238	1,371	24.0	2,026	-9.5
Adhesive Tape Cloths	1,859	1,881	998	2,019	1,013	2,020	1,106	9.2	2,010	-0.5
Work-style Reform	4,287	4,329	2,101	4,613	2,549	5,789	3,137	23.1	6,061	4.7
Flame Retardant Sheets & Mesh Sheets	976	899	433	933	469	963	488	4.1	997	3.5
BarChip	3,311	3,429	1,667	3,680	2,080	4,825	2,649	27.4	5,063	4.9
Recycling-oriented Society	1,183	944	452	759	589	1,131	631	7.1	1,303	15.2
Blue Sheet Branded by Eco-mark	80	76	25	47	27	76	110	307.4	303	298.7
Screen Changers	902	622	352	594	492	930	373	-24.2	727	-21.8
Recycling Machines	200	245	74	116	69	124	147	113.0	272	119.4
Solutions for Industry & Technology Innovations	4,506	3,883	1,765	4,339	1,558	3,255	1,644	5.5	3,802	16.8
Film Slitters	3,771	2,964	1,144	3,413	1,460	2,862	1,553	6.4	3,278	14.5
Paper Slitters	735	918	620	925	97	392	91	-6.2	524	33.7
Total Sales of SDGs-related Products	14,176	13,025	6,347	13,689	6,817	14,435	7,889	15.7	15,203	5.3
% of Total Sales	47.8%	47.8%	48.4%	49.4%	47.1%	48.2%	49.5%	+2.4pp	49.0%	+0.8pp

Source: Nippon-IBR based on Hagihara Industries FY20~FY23 1H earnings presentation material

FY23 OUTLOOK

Hagihara Industries is guiding for FY23 OP of ¥1,700mil (+23.4% YoY) on sales of ¥31,000mil (+3.5% YoY). Although 1H OP surpassed the original forecast, the firm has not changed the full-year OP forecast as electricity costs are expected to continue to rise. Although management reckons that there is not any significant earnings risk in 2H, surge in energy cost, which rose approx. ¥30mil per month on a parent basis year-to-date, will likely continue throughout FY23.

The firm assumes that the rising cost of raw materials, however, has peaked. Moreover, more customers are now accepting the price surcharge on the naphtha price [naphtha slide]. BarChip will likely continue to lead the earnings growth – FY23 sales of BarChip is estimated at ¥5,063mil (+4.9% YoY), thanks to continued strong demand in Latin American countries, especially in Brazil as it is used as a flooring enforcement material.

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

Hagihara Industries announced the current medium-term plan at the time of FY22 results. Given the shortfall in achieving the previous medium-term plan, the new medium-term plan starts with a revisit of the previous plan’s targets.

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

- 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:

- Enhance product competitiveness to realise optimal pricing.
- Establish optimal production and distribution networks, such as the 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 it 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 total of ¥5,000mil (of which ¥2,500mil had already been invested at the time of the Medium-term Plan announcement) 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.

- 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 undergoes 1) a wash, then the resin and ink is extracted, 2) filtration of the resin via screen changer, and 3) the product is improved / altered through the re-pellet and pelletiser process. The recycling business will also boost Hagihara Industries’ ENG product development and sales.

Hagihara Industries: Medium-term Management Plan					
(¥mil)	FY22			FY25	
	Results	Actual v. plan (%)	YoY (%)	Plan	% CAGR (3-yr)
Sales	29,953	-9.23	8.1	33,000	3.3
PLS	25,570	-3.87	13.4	26,600	1.3
ENG	4,382	-31.53	-15.2	6,400	13.5
OP	1,377	-56.97	-38.9	N/A	N/A
PLS	1,176	-48.87	-25.4	N/A	N/A
ENG	200	-77.78	-70.5	N/A	N/A
OPM (%)	4.6	-5.1ppt	-3.5ppt	N/A	N/A
PLS	4.6	-4.0ppt	-2.4ppt	N/A	N/A
ENG	4.6	-9.5ppt	-8.5ppt	N/A	N/A
RP	1,681	-49.06	-29.1	3,300	25.2
RPM (%)	5.6	-43.88	-3.0ppt	10.0	N/A

Source: Nippon-IBR based on Hagihara Industries' Mid-term Management Plan presentation materials

Capital Allocation during the Medium-term Plan

Hagihara Industries indicates the following capital allocation policy in the current medium-term plan. During the three years (FY23~FY25), the firm plans to spend total of ¥14,000mil (¥10,000 from operating cash flow and ¥4,000mil from debt finance). Although the firm is able to finance all of the ¥14,000mil from cash flow, management plans to use debt to seek an optimal balance so as to realise PBR1x as guided by the Tokyo Stock Exchange [TSE] for all the TSE Prime listed companies. The split of the ¥14,000mil is as follows:

- ¥3,500mil planned for shareholder returns. The firm plans to improve the total shareholder return 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.
- ¥10,500mil for aforementioned strategic investments (including CAPEX and M&A).

The firm's WACC calculated at the launch of the ongoing medium-term plan was 7.56% vs ROE 8% target. Management has not disclosed its ROIC targets.

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