

HAGIHARA INDUSTRIES (7856 JP)

FY22 1H OP LANDED BELOW REVISED GUIDANCE DUE TO RAPID SURGE IN COST OF RAW MATERIALS. NO CHANGE IN FY22 GUIDANCE.

POST FY22 1H RESULTS UPDATEFY22 1H Results

Hagihara Industries (7856 JP) reported FY22 1H (Oct year-end) earnings results on 13 June 2022 with operating profit [OP] of ¥742mil (-41.6% YoY) on sales of ¥14,490mil (+10.5% YoY). The firm had revised down its FY22 1H guidance when the firm reported 1Q results on 7 March due to 1) the negative impact from the prolonged restrictive measures under COVID, 2) the rapid surge in shipping freight, 3) hikes in major raw material costs, such as plastic resin. 1H OP was revised down from ¥1,100mil (-13.4% YoY) to ¥830mil (-34.6% YoY) while 1H sales forecast remains unchanged at ¥14,750mil (+12.5% YoY). 1H sales were largely in line with the firm's revised 1H guidance, however, OP fell short of the revised forecast due to the rapid surge in raw material costs – which principally affects the Plastic Products [PLS] Segment – and not being able to match those changes with higher product prices. Price increases will likely be in effect from August. 1H Recurring profit [RP] and net profit [NP] overshot the revised guidance primarily because of net gains from FOREX totalling ¥52.0mil (+10.2x YoY).

The company also revised down the full-year FY22 forecasts, now guiding for OP to fall 23.2% YoY to ¥1,730mil vs the original target of ¥2,350mil (+4.2% YoY) on a 8.2% YoY rise in sales to ¥30,000mil vs ¥30,150mil (+8.8% YoY).

Hagihara Industries (7856 JP): Earnings Guidance Revision and 1H results				
(¥mil)	FY22			
	1HCE (Old)	1HCE (New)	FYCE (Old)	FYCE (New)
Sales	14,750	14,750	30,150	30,000
OP	1,100	830	2,350	1,730
OPM (%)	7.5	5.6	7.8	5.8
RP	1,110	840	2,540	1,920
RPM (%)	7.5	5.7	8.4	6.4
NP	770	580	1,760	1,330
NPM (%)	8.1	3.9	5.8	4.4

Source: Hagihara Industries' earnings revision on 7 March 2022

Hagihara Industries (7856 JP): Earnings Summary								
(¥mil)	FY21	FY22						
	FY	1H	1HCE (New)	1H YoY (%)	1H vs.1HCE (New) (%)	2HCE (New)	FYCE (New)	YoY (%)
Sales	27,705	14,490	14,750	10.6	-1.8	15,510	30,000	8.3
OP	2,254	742	830	-41.6	-10.6	988	1,730	-23.2
OPM (%)	8.1	5.1	5.6	-3.0pp	-0.5pp	6.4	5.8	-2.3pp
RP	2,372	889	840	-33.2	5.8	1,031	1,920	-19.1
RPM (%)	8.6	6.1	5.7	-2.5pp	+0.4pp	6.6	6.4	-1.2pp
NP	1,619	659	580	-28.1	13.6	671	1,330	-17.9
NPM (%)	5.8	4.5	3.9	-1.2pp	+0.6pp	4.3	4.4	-1.3pp

Source: Nippon IBR based on Hagihara Industries' FY22 1H earnings presentation material and earnings revision on 7 March 2022. 2HCE = FY22 company guidance - 1H results.

EXECUTIVE SUMMARY

- FY22 (Oct yr-end) 1H results at Hagihara Industries saw operating profit [OP] fall short of the March revised guidance, coming in at ¥742mil (-41.6% YoY) on sales which were largely in line with estimates of ¥14,490mil (+10.5% YoY).
- The ¥88mil shortfall in OP was due to the rapid surge in raw material costs, which principally affects the Plastic Products [PLS] segment, and not being able to match it with price hikes.
- The PLS segment saw FY22 1H OP fall 40.7% YoY while sales rose 13.4% YoY. The rise in the cost of raw materials, energy, and sea freight charges could not be sufficiently offset by the rise in sales, although the firm's core product BarChip saw strong sales growth.
- The full-year FY22 guidance was lowered from OP of ¥2,350mil (+4.3% YoY) on sales of ¥30,150mil (+8.8% YoY) to OP of ¥1,730mil (-23.2% YoY) on sales of ¥30,000mil (+8.3% YoY). The PLS segment will likely see a recovery in OP in Q4, after price rises are applied.
- Given the revised FY22 guidance, it is likely that the firm will fall short of the Medium-Term Plan's final year RP target (¥3,000mil vs. FY22 guidance of ¥1,920mil) although the sales target will likely be met thanks primarily to strong sales of BarChip.
- Management's two new objectives in FY22 is to (1) redefine the Tarpee brand as part of its strategy to reorganise the PLS business, and (2) open overseas production facilities in close proximity to areas of demand for BarChip. An investment of ¥200mil was made to build a local production base in Paraguay to cater to demand in Brazil.
- The FY22 dividend forecast of ¥36/share (+0.0% YoY) generates a payout ratio of 39.6%.

Plastic Products [PLS] Segment

The Plastic Products [PLS] segment saw FY22 1H OP decline -40.7% YoY while sales rose 13.4% YoY. The segment sales improved by ¥1,453mil of which ¥429mil came from price increases, ¥928mil higher sales volume and ¥96mil due to FOREX. One of Hagihara's core products, BarChip saw favourable overseas sales, especially in Brazil where BarChip is used in the construction of concrete earth floors. Demand for flexible container bags, laminator cloths and Meltac (used as vegetable container bags) also recovered, especially in the overseas markets. On the other hand, demand for blue sheets used for disaster prevention – one of Hagihara Industries' other core products – remained weak as there were fewer natural disasters in Japan which led to weak demand for stockpiling. Sandbag sales also remained sluggish due to a slowdown in demand from the civil engineering and construction sector. While the weakness was offset by growth in overseas sales (approx. +60% YoY on a Japanese yen denominated basis), especially for BarChip, the large 40.7% YoY decline (-¥765mil YoY) in segment OP came despite the increase in sales due to 1) higher raw material and energy costs (-¥553mil YoY), and 2) an increase in sea freight charges (-¥212mil YoY).

Engineering Products [ENG] Segment

The Engineering Products [ENG] segment reported FY22 1H OP of ¥184mil (-43.9% YoY) on sales of ¥2,163mil (-3.2% YoY). The prolonged lockdown in Shanghai gave an unexpected negative impact to sales in China, although order backlogs hit a record level of ¥4,900mil as of the end of April – almost equivalent to the segment's annual sales. Demand for paper slitters, which saw solid demand in FY21, peaked out, which led to a decline in sales and OP contracted due to the rise in materials costs. Segment OP fell ¥144mil YoY, of which ¥23mil came from the decline in segment sales, and ¥121mil was due to the surge in the cost of materials.

Segment Sales and OP (Cumulative)								
(¥mil / Oct year-end)	FY19		FY20		FY21		FY22	
	1H	FY	1H	FY	1H	FY	1H	YoY (%)
PLS Segment Sales	11,838	23,674	11,589	22,327	10,872	22,540	12,327	13.4
Segment OP	932	1,934	1,132	1,932	941	1,576	557	-40.7
Segment OPM (%)	7.9	8.2	9.8	8.7	8.7	7.0	4.5	-4.2pp
ENG Segment Sales	2,949	5,973	2,560	4,904	2,235	5,165	2,163	-3.2
Segment OP	369	788	289	582	329	677	184	-43.9
Segment OPM (%)	12.5	13.2	11.3	11.9	14.7	13.1	8.5	-6.2pp
Total Sales	14,788	29,647	14,150	27,231	13,107	27,705	14,490	10.5
Total OP	1,301	2,723	1,421	2,515	1,270	2,254	742	-41.6
OPM (%)	8.8	9.2	10.0	9.2	9.7	8.1	5.1	-4.6pp

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

SDGS-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.

In FY22 1H, a total of ¥6,817mil, or 47.1%, of consolidated sales came from SDGs-related products – products that offer solutions for the issues identified under the goals regardless of profitability. Hagihara Industries is guiding for FY22 SDGs-related products sales of ¥14,873mil, or 49.6% of consolidated sales.

Consolidated Sales for SDGs-related Products								
(¥mil / Oct year-end))	FY19	FY20	FY21		FY22			
	FY	FY	1H	FY	1H	YoY	FY	YoY
	Results	Results	Results	Results	Results	(%)	Estimate	(%)
Climate Change Adaptations	4,199	3,867	2,028	3,977	2,119	4.5	4,234	6.5
Domestically Produced Sheets (inc. Blue Sheet)	2,340	1,986	991	1,957	1,106	11.6	2,144	9.6
Adhesive Tape Cloths	1,859	1,881	998	2,019	1,013	1.5	2,090	3.5
Work-style Reform	4,287	4,329	2,101	4,613	2,549	21.3	5,794	25.6
Flame Retardant Sheets & Mesh Sheets	976	899	433	933	469	8.3	1,064	14.0
BarChip	3,311	3,429	1,667	3,680	2,080	24.8	4,730	28.5
Recycling-oriented Society	1,183	944	452	759	589	30.3	943	24.2
Blue Sheet Branded by Eco-mark	80	76	25	47	27	8.0	69	46.8
Screen Changers	902	622	352	594	492	39.8	855	43.9
Recycling Machines	200	245	74	116	69	-6.8	19	-83.6
Solutions for Industry & Technology Innovations	4,506	3,883	1,765	4,339	1,558	-11.7	3,902	-10.1
Film Slitters	3,771	2,964	1,144	3,413	1,460	27.6	3,022	-11.5
Paper Slitters	735	918	620	925	97	-84.4	880	-4.9
Total Sales of SDGs-related Products	14,176	13,025	6,347	13,689	6,817	7.4	14,873	8.6
% of Total Sales	47.8%	47.80%	48.4%	49.4%	47.1%	-1.3pp	49.6%	+0.2pp

Source: Nippon-IBR based on Hagihara Industries FY21 and FY22 1H earnings presentation material

SDGs-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 – used to protect houses from natural disasters, and adhesive tape cloths. While FY22 1H sales of this group of products rose 4.5% YoY to ¥2,119mil, sales for disaster prevention Blue Sheet continued to be affected by fall in stockpiling demand. 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. From FY22, Laysys®, currently included in this segment, is to be removed from the SDGs-related product groups into Others, given its uses are not just for climate change but also for multiple other uses such as medical, pharmaceutical and toiletry products to name a few. Adhesive tape cloths, which is also included in Climate Change Adaptation, saw stable sales. The firm is guiding for FY22 segment sales of ¥4,234mil (+6.5% 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 flame-retardant sheets help prevent job-related injuries and improve 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 1H sales of ¥2,549mil (+21.3% YoY), of which ¥2,080mil (+24.8% YoY), or approx. 82%, 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 in Latin America. During FY21, the firm suffered intense price competition from other plastic concrete reinforcing materials, especially in Latin American and Australian mines. Hagihara reckons that BarChip's quality exceeds the requirements for use in mining tunnels, and so given the pricing pressure from the mining side, the firm is looking to expand into other markets such as civil engineering and construction. Work-style Reform products will see the most growth among the SDGs-related products in FY22, thanks to a strong growth of BarChip sales which will likely increase 28.5% YoY to ¥4,730mil. The firm's guidance for the segment FY22 sales is ¥5,794mil (+25.6% 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. FY22 1H sales rose 30.3% YoY to ¥589mil, largely in line with company guidance. Hagihara's screen changer – a machine that filters out impurities during the polymer extrusion process – is unique in that it uses recycled plastic products such as PET bottles as a raw material. FY22 1H sales of screen changer reached ¥492mil (+39.8% YoY) which achieved 57.5% of the full-year sales estimate of ¥855mil (+43.9% YoY), and closer to the recent peak sales of ¥902mil reported in FY19. The segment FY22 sales is estimated at ¥943mil (+24.2% YoY).

4. Solutions for Industry and Technology Innovations:

FY22 1H sales of this segment fell 11.7% YoY to ¥1,558mil. Sales of paper slitters, which is roughly 30% of the segment sales, slumped 84.4% YoY to ¥97mil. The largest product in this group is the film slitter which, as the name implies, is used to slit various types of film. Boosts in demand for displays led to a surge in demand for the firm's film slitter. In recent years, rising demand from LiB separator makers in China led to a recovery in demand for film slitter sales in FY21 2H to reach ¥2,269mil, however, a year later, FY22 1H sales appear to have peaked out (-34.3%), although absolute levels still remain solid. FY22 1H sales of the film slitter subsegment were ¥1,460mil (+27.6% YoY). Hagihara Industries is guiding for FY22 segment sales of ¥3,902mil (-10.1% YoY).

FY22 OUTLOOK

As noted above, Hagihara Industries revised down its FY22 guidance from OP of ¥2,350mil (+4.3% YoY) on sales of ¥30,150mil (+8.8% YoY) to OP of ¥1,730mil (-23.2% YoY) on sales of ¥30,000mil (+8.3% YoY). The annual dividend remains unchanged from FY21 levels at ¥36.00/share. Based on the revised EPS of ¥91.90, the dividend pay-out ratio will be 39.6%.

Naphtha prices hit a recent high of ¥85,000/kl. Although the firm has experienced higher naphtha price in the past, the current situation is such that the pace of the price surge is rapid, and prices have remained at high levels. Hagihara Industries is guiding for 2H OP of ¥988mil (+0.4% YoY/ +33.2% HoH) on sales of ¥15,510mil (+6.2% YoY / +7.0% HoH). 2H OP will increase by ¥246mil (+33.2%) HoH. OP by segment is as follows:

PLS Segment

The PLS segment FY22 OP is forecast to rise ¥260mil HoH to ¥817mil (+28.7% YoY/ +46.7% HoH). Hagihara expects that the negative impact on segment OP from the surge in the cost of materials and energy will continue in Q3 (May~July) as the new higher prices won't be applied until the August shipments. The firm expects a negative impact of ¥50mil from higher raw material costs in Q3, but that will be offset by price increases (+¥80mil). Also, increased sales of BarChip will add +¥230mil HoH to 2H segment OP thanks to recovery in demand from mines as mining activities restart, and an increase in applications for dirt floors.

The prices for the firm's long-term customers are subject to the naphtha slide, hence the impact of the naphtha price surge is usually promptly reflected onto Hagihara's prices. What makes the current situation difficult is that the price of materials, such as plastic resin and energy, are constantly renewing their highs. Consequently, the firm needs to repeatedly notch up prices for the entire range of its products. Although the firm is willing to increase customers that are subject to swings in the naphtha price, customers such as municipalities decide procurement based on a tender bidding process. Since the municipalities tend to be price sensitive, they often choose to buy imported Blue Sheets for the hazard-prevention purposes as they are almost half the cost of Hagihara Industries' sheets. At the moment, however, import products are less price competitive due to the weaker yen, hence not many imported sheets are currently being sold in the domestic market.

The firm reckons that price competitiveness can be improved by targeting 1) stockpiling demand: Municipalities replace the hazard-prevention sheets every five years as the quality deteriorates. The firm also plans to replace the sheets as well as collect the old sheets for recycling, and 2) boosting production efficiency.

ENG Segment

2H ENG segment OP is forecast to decline ¥10mil HoH to ¥174mil (-50.0% YoY / -5.4% HoH). Hagihara Industries reckons that the prolonged lockdown in Shanghai will have a negative impact of approx. ¥30mil to 2H segment OP, though the sales of backlog orders will contribute +¥20mil to the segment OP in 2H.

Segment Sales and OP Results and Forecast (Cumulative)								
(¥mil / Oct year-end)	FY20		FY21		FY22			
	1H	FY	1H	FY	1H	YoY (%)	FYCE (New)	YoY (%)
PLS Segment Sales	11,589	22,327	10,872	22,540	12,327	13.4	24,425	8.4
Segment OP	1,132	1,932	941	1,576	557	-40.7	1,373	-12.9
Segment OPM (%)	9.8	8.7	8.7	7.0	4.5	-4.3pp	5.6	-1.4pp
ENG Segment Sales	2,560	4,904	2,235	5,165	2,163	-3.2	5,575	7.9
Segment OP	289	582	329	677	184	-43.9	357	-47.3
Segment OPM (%)	11.3	11.9	14.7	13.1	8.5	-6.2pp	6.4	-6.7pp
Total Sales	14,150	27,231	13,107	27,705	14,490	10.5	30,000	8.3
Total OP	1,421	2,515	1,270	2,254	742	-41.6	1,730	-23.2
OPM (%)	10.0	9.2	9.7	8.1	5.1	-4.6pp	5.8	-2.3pp

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

THE FINAL YEAR VIEW ON THE MEDIUM-TERM PLAN

The ongoing 3-year Medium-term Management Plan, UPGRADE For Next 60, which concludes 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 revised FY22 guidance, it is likely that Hagihara Industries will fall short of the Plan's final year profit target, although the sales target will likely be met thanks primarily to strong sales of BarChip.

Hagihara Industries plans to make the following three reviews in the PLS business in this fiscal year (FY22) so as to improve the segment profitability:

1) Redefine the brands by usage:

The PLS segment's OPM tends to be volatile because sales of some products heavily rely on the timing of orders from specific customers. For example, in case of Blue Sheet, sales tend to fluctuate depending on stock piling demand from municipalities which naturally are led by the occurrence of natural disasters.

Hagihara Industries aims to identify markets for each PLS product to improve product development to meet demand, therefore stabilising segment sales. Furthermore, by recategorising the PLS products by use, the firm will be able to review and consolidate product types and standards, and ultimately improve the production efficiency and optimise inventory levels. Take Blue Sheet, for example, Hagihara Industries' sheets are not only made to order, but they also use yarns unique to each customer. Given there are several different sizes and multiple types of weaving, that the firm has never reviewed this process thoroughly suggests opportunities to improve profitability. Despite the number of products Hagihara Industries currently supplies have been substantially slimmed down from some 1,500 to 170 types, the firm reckons it could reduce them by a further 10% in FY22 by clarifying the usage and then tagging the products to a usage-based brand.

2) Establish a horizontal recycling model:

PLS products face increasing competition against cheaper, though lower quality, imported products. The firm is hoping to differentiate its products and expand its market share by establishing a horizontal plastic recycling model which sellers of imported products cannot copy.

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 first be remade into yarn and then processed into various PLS products. The recycling business will also boost Hagihara Industries' engineering (ENG) product development and sales. The first step of the recycling value chain is to collect used Blue Sheets. From FY22, Hagihara will begin organising the collection network of its Blue Sheet for recycling.

3) Prepare to open a production base in a country near areas of demand for BarChip:

In the latter half of FY21, Hagihara's earnings were affected by the sharp increase in shipping costs. While the firm expects the high freight rates to peak out in FY22 2H, it assumes they will not go back down to pre-COVID levels. To avoid the influence of such costs, Hagihara plans to open overseas BarChip production facilities in close proximity to areas of demand, with production scheduled to commence from FY24, therefore, not only avoid the soaring cost of shipping but also enabling the firm to get a better grasp local market trends.

Hagihara Industries: Medium-term Management Plan									
(¥mil / Oct-yr end)	FY19	FY20		FY21		FY22			
	Actual	Actual	YoY (%)	Actual	YoY (%)	Plan	% CAGR (3-yr)	CE (New)	% CAGR (3-yr)
Sales	29,647	27,231	-8.1	27,705	1.7	30,000	0.40	30,000	0.40
PLS	23,674	22,327	-5.7	22,540	1.0	24,425	1.05	24,425	1.05
ENG	5,973	4,904	-17.9	5,165	5.3	5,575	-2.27	5,575	-2.27
OP	2,723	2,515	-7.7	2,254	-10.4	2,900	2.12	1,730	-14.03
PLS	1,934	1,932	-0.1	1,576	-18.4	2,250	5.17	1,373	-10.79
ENG	789	582	-26.2	677	16.3	650	-6.26	357	-23.23
OPM (%)	9.2	9.2	+0.0pp	8.1	-1.3pp	9.7	n/a	5.8	n/a
PLS	8.2	8.7	+0.5pp	7.0	-2.2pp	9.2	n/a	5.6	n/a
ENG	13.2	11.9	-1.3pp	13.1	+2.6pp	11.7	n/a	6.4	n/a
RP	2,850	2,840	-0.4	2,372	-16.5	3,000	1.72	1,920	-12.34
RPM (%)	9.6	10.4	+0.8pp	8.6	-1.3pp	10.0	n/a	6.4	n/a

Source: Nippon-IBR based on Hagihara Industries presentation materials

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