

**HAGIHARA INDUSTRIES (7856 JP)**

FY22 CHALLENGES ARE TO STABILISE THE PLS SEGMENT PROFITABILITY UNDER FIERCER COMPETITION AND RISING COSTS

**POST FY21 RESULTS UPDATE**FY21 Results

Hagihara Industries (7856 JP) reported FY21 (Oct year-end) earnings results on 13 Dec 2021 with operating profit [OP] of ¥2,254mil (-10.4% YoY) on sales of ¥27,705mil (+1.7% YoY). The firm had revised down its FY21 full-year guidance on 26 Nov from OP of ¥2,640mil (+5.0% YoY) on sales of ¥28,000mil (+2.8% YoY) to OP of ¥2,250mil (-10.5% YoY) on sales of ¥27,700mil (+1.7% YoY) on the back of historically high hikes in sea freight charges, soaring raw material costs and production adjustments in Q4. As a result, in Q4 alone, OP fell -62.0% QoQ.

Plastic Products [PLS] Segment

The Plastic Products [PLS] segment saw FY21 OP decline 18.4% YoY while sales rose 1.0% YoY. The segment sales improved by ¥212mil of which ¥109mil came from price increases, ¥81mil higher sales volume and ¥21mil due to FOREX. Demand for one of Hagihara Industries' core products, blue sheets used for disaster prevention, remained weak on the back of fewer natural disasters in Japan which led to weak demand for stockpiling. Flexible container bags and sandbags also remained sluggish due to a slowdown in demand from the civil engineering and construction sector. However, weakness in those products were offset by the firm's another core products – BarChip, which enjoyed favourable overseas sales, and adhesive tape cloths and yarns. Segment OP saw a larger decline than sales because of 1) the rapid increase in sea freight especially in Q4, and 2) raw material cost increases. These factors led to production adjustments, which resulted in the firm's inability to cover fixed cost.

Engineering Products [ENG] Segment

Engineering Products [ENG] Segment reported FY21 OP of ¥677mil (+16.3% YoY) on sales of ¥5,165mil (+5.3% YoY). Thanks to a boost in global demand for displays, the firm received orders for film slitters for optical films. Sales of lithium-ion battery [LiB] separator slitter and filtration equipment used in PET bottle recycling also contributed to the segment sales.

Segment Sales and OP (Cumulative)							
(¥mil / Oct year-end)	FY19		FY20		FY21		
	1H	FY	1H	FY	1H	FY	YoY (%)
PLS Segment Sales	11,838	23,674	11,589	22,327	10,872	22,540	1.0
Segment OP	932	1,934	1,132	1,932	941	1,576	-18.4
Segment OPM (%)	7.9	8.2	9.8	8.7	8.7	7.0	-1.7pp
ENG Segment Sales	2,949	5,973	2,560	4,904	2,235	5,165	5.3
Segment OP	369	788	289	582	329	677	16.3
Segment OPM (%)	12.5	13.2	11.3	11.9	14.7	13.1	+1.2pp
Total Sales	14,788	29,647	14,150	27,231	13,107	27,705	1.7
Total OP	1,301	2,723	1,421	2,515	1,270	2,254	-10.4
OPM (%)	8.8	9.2	10.0	9.2	9.7	8.1	-1.1pp

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

**EXECUTIVE SUMMARY**

- Hagihara Industries (7856 JP) reported FY21 (Oct year-end) earnings results on 13 Dec 2021 with OP of ¥2,254mil (-10.4% YoY) on sales of ¥27,705mil (+1.7% YoY), in line with a revised forecast.
- Plastic Products [PLS] Segment saw FY21 OP fall 18.4% YoY on a 1.0% YoY rise in sales. Demand was weak in Blue Sheet for Disaster Prevention as fewer natural disasters meant there was less need for stockpiling. In addition, sales of flexible container bags and sandbags were also sluggish. The weakness, however, was offset by demand for BarChip and adhesive tape cloths and yarns.
- Engineering Products [ENG] enjoyed solid demand in film slitters used for display films and LiB separators. Sales of screen changers for PET bottle recycling also remains firm.
- Hagihara Industries is guiding for FY22 1H OP of ¥1,100mil (-13.4% YoY) on sales of ¥14,750mil (+12.5% YoY) and full year FY22 OP of ¥2,350mil (+4.2% YoY) on sales of ¥30,150mil (+8.8% YoY). The firm assumes that sea freight charges remain at the current high levels throughout 1H, although the impact from raw material price hikes will be absorbed by delayed product price adjustments.
- 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 close to areas of demand for BarChip. These projects will not require major investment.
- The FY22 dividend forecast of ¥36/share (+0.0% YoY) generates a pay-out ratio of 29.6%.

## SDGS-RELATED PRODUCTS

From FY21, the firm 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 FY21, a total of ¥13,689mil, or 49.4%, of consolidated sales came from SDGs-related products – products that offer solutions for the issues identified under the goals regardless of profitability.

Consolidated Sales for SDGs-related Products					
(¥mil / Oct year-end)	FY19	FY20	FY21		
	FY	FY	1H	FY	YoY
	Results	Results	Results	Results	(%)
Climate Change Adaptations	4,199	3,867	2,028	3,977	2.8
Domestically Produced Sheets (inc. Blue Sheet)	2,340	1,986	991	1,957	-1.5
Adhesive Tape Cloths	1,859	1,881	998	2,019	7.3
Work-style Reform	4,287	4,329	2,101	4,613	6.6
Flame Retardant Sheets & Mesh Sheets	976	899	433	933	3.8
BarChip	3,311	3,429	1,667	3,680	7.3
Recycling-oriented Society	1,183	944	452	759	-19.6
Blue Sheet Branded by Eco-mark	80	76	25	47	-38.2
Screen Changers	902	622	352	594	-4.5
Recycling Machines	200	245	74	116	-52.7
Solutions for Industry & Technology Innovations	4,506	3,883	1,765	4,339	11.7
Film Slitters	3,771	2,964	1,144	3,413	15.1
Paper Slitters	735	918	620	925	0.8
<b>Total Sales of SDGs-related Products</b>	<b>14,176</b>	<b>13,025</b>	<b>6,347</b>	<b>13,689</b>	<b>5.1</b>
% of Total Sales	47.8%	47.8%	48.4%	49.4%	+1.6pp

Source: Hagihara Industries FY21 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 FY21 sales of this group of products rose 2.8% YoY to ¥3,977mil, it fell short of the firm's original forecast of ¥4,056mil (+4.9% YoY) due to a 1.5% YoY fall in sales of disaster prevention Blue Sheet. The weakness of Blue Sheet sales was offset by a +7.3% YoY improvement in adhesive tape cloths sales. The segment previously included sales from the firm's new Laysys® technology – notably used for insect repellents – and Earth Corporation (4985 JP) has incorporated Laysys® into one of its new repellents for its ability to release the contents over about 90 days. From FY22, however, given its uses are not necessarily for climate change but also for multiple other uses such as medical, pharmaceutical and toiletry products to name a few, Laysys® will be removed from the SDGs-related products groups into Others.

### 2. Work-style Reform

This group includes super-light frame 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 health and safety of workers at construction sites. Hagihara's core product, BarChip, is also included in this category. Work-style Reform products reported FY21 sales of ¥4,613mil (+6.3% YoY), of which ¥3,680mil (+7.3% YoY) was from BarChip. The company was initially guiding for FY21 Work-style Reform products sales of ¥4,274 (-1.3% YoY), of which ¥3,349mil is from BarChip (-2.3% YoY). During FY21, sales of BarChip were affected by shipping disruptions and mine closures in Indonesia. 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.

### 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. FY21 sales fell 19.6% YoY to ¥759mil, 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. FY21 sales of screen changer surpassed the original forecast ¥464mil (-24.5% YoY) and came in at ¥594mil (-4.5% YoY). However, since the last earnings guidance, demand for screen changers has been even stronger than the firm expected.

### 4. Solutions for Industry and Technology Innovations

FY21 sales of this group rose 11.7% YoY to ¥4,339mil, falling short of the initial forecast of ¥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. 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 has led to a recovery in the growth of film slitter sales in FY21 2H, having peaked out in FY20 as many smaller separator film makers have been consolidated or merged into 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 their equipment as to do so would require a review of the entire manufacturing process. An unlisted Japanese competitor holds a dominant player in this field in China, however, Hagihara plans to tackle the market by producing a new design which improves productivity for its slitter.

In FY21, film slitter sales came in ahead of the original company guidance of ¥3,328mil (+12.3% YoY), rising 15.1% YoY to ¥3,413mil.

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## FY22 OUTLOOK AND PROGRESS ON MEDIUM-TERM MANAGEMENT PLAN

Hagihara Industries is guiding for FY22 1H OP of ¥1,100mil (-13.4% YoY) on sales of ¥14,750mil (+12.5% YoY) and full year FY22 OP of ¥2,350mil (+4.2% YoY) on sales of ¥30,150mil (+8.8% YoY). The firm assumes sea freight charges will remain at a peak level throughout 1H, although the pressure from raw material price hikes will be absorbed by delayed product price adjustments. On the other hand, management is looking for those costs to peak out in 2H. The planned FY22 dividend will remain unchanged YoY at ¥36/share.

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 linger on during 1H.

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 demands from municipalities which naturally are led by the occurrence of natural disasters. The firm 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 usage, 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 supplies now 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 be remade to yarn first, and then processed into various PLS products. Moreover, the recycling business will 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 drastic 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 close to areas of demand, with production scheduled to commence from FY24, therefore, not only avoid the soaring cost of shipping but also 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	CE	YoY (%)
Sales	29,647	27,231	-8.1	27,705	1.7	30,000	30,150	8.8
PLS	23,674	22,327	-5.7	22,540	1.0	24,425	24,550	8.9
ENG	5,973	4,904	-17.9	5,165	5.3	5,575	5,605	8.5
OP	2,723	2,515	-7.7	2,254	-10.4	2,900	2,350	4.3
PLS	1,934	1,932	-0.1	1,576	-18.4	2,250	1,680	6.6
ENG	789	582	-26.2	677	16.3	650	670	-1.0
OPM (%)	9.2	9.2	+0.0pp	8.1	-1.3pp	9.7	7.8	-0.3pp
PLS	8.2	8.7	+0.5pp	7.0	-2.2pp	9.2	6.8	-0.2pp
ENG	13.2	11.9	-1.3pp	13.1	+2.6pp	11.7	12.0	-0.9pp
RP	2,850	2,840	-0.4	2,372	-16.5	3,000	2,540	7.1
RPM (%)	9.6	10.4	+0.8pp	8.6	-1.3pp	10.0	8.4	-0.2pp

Source: Nippon-IBR based on Hagihara Industries presentation materials

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