

**HAGIHARA INDUSTRIES (7856 JP)**

BARCHIP CONTINUES TO LEAD GROWTH. TOTAL SHAREHOLDER RETURN ON ADJUSTED FY23 EPS REACHED 92%

**FY23 RESULTS UPDATE**

Hagihara Industries (7856 JP) reported FY23 (Oct year-end) earnings results on 11 December 2023 with operating profit [OP] of ¥1,979mil (+43.7% YoY) on sales of ¥31,245mil (+4.3% YoY). Sales were largely in line with the firm's guidance for FY23, however OP surpassed the FY23 guidance of ¥1,800mil, 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, however, net profit [NP] surged +230.7% to ¥3,118mil, as the firm received ¥2,022mil in compensation payments from the Chinese government related to the same subsidiary during 1H.

Hagihara Industries (7856 JP): Earnings Summary							
(¥mil)	FY22		FY23				
	1H	FY	1H	FYCE	FY	YoY (%)	FY v. FYCE
Sales	14,490	29,953	15,930	31,000	31,245	4.3	0.8
OP	742	1,377	1,010	1,800	1,979	43.7	9.9
OPM (%)	5.1	4.6	6.3	5.8	6.3	+1.7ppt	+0.5ppt
RP	889	1,681	1,091	2,000	2,250	33.8	12.5
RPM (%)	6.1	5.6	6.8	6.5	7.2	+1.6ppt	+0.7ppt
NP	659	943	2,246	3,100	3,118	230.7	0.6
NPM (%)	4.6	3.1	14.1	10.0	10.0	+6.9ppt	flat

Source: Nippon -IBR based on Hagihara Industries' FY23 earnings presentation material

FY23 OPM rose to 6.3% from 4.6% in FY22, however, it has not yet recovered to the 9.2% level achieved in FY20 when the firm enjoyed an improvement in sales mix for its Plastic Products [PLS] segment. FY23 PLS segment OPM was 6.3%, up from 4.6% in FY22, thanks to (1) higher energy and materials costs being successfully passed on to product prices and (2) continued efforts in reducing SG&A. The Engineering [ENG] segment OPM also improved from 4.6% in FY22 to 6.6% in FY23 thanks to improvement in profitability of screen changers. The Engineering segment order backlog remained high at approx. ¥6,944mil – the equivalent of 1.5 years of segment sales.

**Plastic Products [PLS] Segment**

The PLS segment saw FY23 OP improve +40.6% YoY to ¥1,655mil on sales of ¥26,353mil (+3.1% YoY). Of the net +¥783mil increase in sales, +¥2,915mil came from price increases, however, there was also -¥2,479mil negative impact from decline in sales volume. Due to the surge in product prices reflecting the rapid rise in energy and raw material costs, sales volume of sheets and yarns slowed. Flexible container bag sales remained weak due to production adjustments on the back of weak demand. On the other hand, domestic sales of adhesive tape used during natural hazards remained solid. Sales of Meltac, mainly used as vegetable containers also enjoyed sales growth. BarChip, a concrete reinforcing material, reported higher sales thanks to price hikes. The weaker yen also contributed a positive impact of +¥345mil for the segment sales.

**EXECUTIVE SUMMARY**

- Hagihara Industries' FY23 earnings (OP of ¥1,979mil (+43.7% YoY) on sales of ¥31,245mil (+4.3% YoY) reported better than expected OP thanks to progress in passing on price hikes to product prices in the PLS segment, despite sluggish sales volumes.
- FY23 PLS segment OPM was 6.3%, up from 4.6% in FY22, thanks to the successful passing on of higher energy and material costs to product prices and continued reductions in SG&A. The Engineering [ENG] segment OPM also improved from 4.6% in FY22 to 6.6% in FY23 on improvements in profitability of screen changers.
- Hagihara Industries is guiding for FY24 1H OP of ¥1,120mil (+10.8% YoY) on sales of ¥15,950mil (+0.1% YoY), and FY24 OP of ¥2,200mil (+11.2% YoY) on sales of ¥32,000mil (+2.4% YoY).
- The ongoing new medium-term plan, which covers three years between FY23 and FY25, will see Hagihara Industries revisit the RP target of ¥3,300mil on sales of ¥33,000mil.
- 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. FY23 total shareholder return reached 92.2% on the adjusted NP.
- The firm's FY25 ROE target is 8% vs FY23 ROE of 4.8%, based on NP adjusted for aforementioned extraordinary profits related to subsidiaries.

Engineering Products [ENG] Segment

The Engineering Products [ENG] segment reported FY23 OP of ¥324mil (+61.8% YoY) on sales of ¥4,891mil (+11.6% YoY). End applications that led the segment overseas sales growth in the 1H started slowing down, especially in China where the firm used to enjoy demand for slitters such as secondary lithium-ion battery [LiB], semiconductors and displays. However, stronger than expected sales of screen changers on the back of surging demand for recycling plastics supported segment sales. ENG OPM improved +2.0ppts YoY, thanks to a gradual recovery in the supply chain – such as inverters and sensors – and improved lead time for screen changers, which are used in the plastic recycling process.

Segment Sales and OP (Cumulative)											
(¥mil / Oct year-end)	FY20		FY21		FY22		FY23				
	1H	FY	1H	FY	1H	FY	1H	FYCE	FY	YoY (%)	FY v. FYCE (%)
PLS Segment Sales	11,589	22,327	10,872	22,540	12,327	25,570	13,550	26,100	26,353	3.1	1.0
Segment OP	1,132	1,932	941	1,578	557	1,176	912	1,520	1,655	40.6	8.9
Segment OPM (%)	9.8	8.7	8.7	7.0	4.5	4.6	6.7	5.8	6.3	+1.7ppt	+0.5ppt
ENG Segment Sales	2,560	4,904	2,235	5,165	2,163	4,382	2,379	4,900	4,891	11.6	-0.2
Segment OP	289	582	329	677	184	200	98	280	324	61.8	15.7
Segment OPM (%)	11.3	11.9	14.7	13.1	8.5	4.6	4.1	5.7	6.6	+2.0ppt	+0.9ppt
Total Sales	14,150	27,231	13,107	27,705	14,490	29,953	15,930	31,000	31,245	4.3	0.8
Total OP	1,421	2,515	1,270	2,254	742	1,377	1,010	1,800	1,979	43.7	9.9
OPM (%)	10.0	9.2	9.7	8.1	5.1	4.6	6.3	5.8	6.3	+1.7ppt	+0.5ppt

Source: Nippon-IBR based on Hagihara Industries' FY23 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 [CCA]:** This category includes made-in-Japan sheets, such as Blue Sheet – used to protect houses from natural disasters, and adhesive tape cloths.

FY23 sales of this group of products rose +14.9% YoY to ¥4,894mil, 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 sales of Domestically Produced Sheets increased +13.9% YoY to ¥2,550mil, thanks to price revisions.

Sales of adhesive tape cloths, which are also included in CCA, saw FY23 sales of ¥2,343mil (+16.0% YoY), thanks to a surge in demand from adhesive tape makers.

2. **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 do not 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 sales of ¥6,253mil (+8.0% YoY), of which ¥5,289mil (+9.6% YoY), or 84.6%, was from BarChip. Demand for BarChip, especially in Brazil, remained strong. 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. Competition in mines, which requires concrete reinforcing materials for the tunnels to the mining sites, has intensified due to competing products. Hagihara has addressed this issue with the focus on surging demand for flooring materials.

BarChip contributes to shorten the amount of time spent on constructing floors due to its simple but effective method of concrete reinforcement. Majority of concrete reinforcing material for flooring is still steel gage hence there is room for BarChip to grow market share in South America. Furthermore, BarChip has been adopted as a concrete reinforcement material for tunnels by Nippon Expressway Company [NEXCO]. After a dump truck crash and fire accident in the Amagoyama Tunnel in Hyogo and subsequent closure due to risk of explosion of concrete, BarChip gained awareness for its explosion-proof properties.

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 sales rose +6.5% YoY to ¥1,205mil. Although sales declined -15.4% YoY, screen changers still comprise the largest proportion (FY23 sales of ¥787mil) 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.
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 sales improved +11.5% YoY to ¥3,628mil, thanks to solid domestic demand for slitters used in industrial materials, however, demand for those used for label films for PET bottles was weak. Hagihara also saw a rise in slitting demand from the food industry such as zipper tapes for containing and preserving food. In overseas, slitting demand for lithium-ion battery [LiB] packaging in China, semiconductor and display related materials which led slitter sales growth softened. FY23 sales of Film Slitters improved +8.6% YoY to ¥3,109mil. FY23 sales of Paper Slitters saw +32.4% YoY to ¥519mil.

<b>Consolidated Sales for SDGs-related Products</b>											
(¥mil / Oct year-end)	FY19	FY20	FY21		FY22		FY23				
	FY	FY	1H	FY	1H	FY	1H	FY CE	FY	YoY (%)	FY v. FYCE (%)
Climate Change Adaptations	4,199	3,867	2,028	3,977	2,119	4,259	2,477	4,037	4,894	14.9	21.2
Domestically Produced Sheets (inc. Blue Sheet)	2,340	1,986	991	1,957	1,106	2,238	1,371	2,026	2,550	13.9	25.9
Adhesive Tape Cloths	1,859	1,881	998	2,019	1,013	2,020	1,106	2,010	2,343	16.0	16.6
Work-style Reform	4,287	4,329	2,101	4,613	2,549	5,789	3,137	6,061	6,253	8.0	3.2
Flame Retardant Sheets & Mesh Sheets	976	899	433	933	469	963	488	997	963	0.0	-3.4
BarChip	3,311	3,429	1,667	3,680	2,080	4,825	2,649	5,063	5,289	9.6	4.5
Recycling-oriented Society	1,183	944	452	759	589	1,131	631	1,303	1,205	6.5	-7.5
Blue Sheet Branded by Eco-mark	80	76	25	47	27	76	110	303	184	142.1	-39.3
Screen Changers	902	623	352	594	492	930	373	727	787	-15.4	8.3
Recycling Machines	200	245	74	116	69	124	147	272	234	88.7	-14.0
Solutions for Industry & Technology Innovations	4,506	3,883	1,765	4,339	1,558	3,255	1,644	3,802	3,628	11.5	-4.6
Film Slitters	3,771	2,964	1,144	3,413	1,460	2,862	1,553	3,278	3,109	8.6	-5.2
Paper Slitters	735	918	620	925	97	392	91	524	519	32.4	-1.0
<b>Total Sales of SDGs-related Products</b>	<b>14,178</b>	<b>13,025</b>	<b>6,347</b>	<b>13,689</b>	<b>6,817</b>	<b>14,434</b>	<b>7,889</b>	<b>15,203</b>	<b>15,980</b>	<b>10.7</b>	<b>5.1</b>
% of Total Sales	47.8%	47.8%	48.4%	49.4%	47.0%	48.2%	49.5%	49.0%	51.1%	+3.0ppt	+2.1ppt

Source: Nippon -IBR based on Hagihara Industries FY21, FY22 and FY23 earnings presentation material

## FY24 OUTLOOK

Hagihara Industries is guiding for FY24 1H OP of ¥1,120mil (+10.8% YoY) on sales of ¥15,950mil (+0.1% YoY), and FY24 OP of ¥2,200mil (+11.2% YoY) on sales of ¥32,000mil (+2.4% YoY). Management continues to view external factors, such as energy costs, global demand, and the slowdown in the Chinese economy, as unclear.

The firm assumes that the rising costs of raw materials and logistics, however, have peaked. Moreover, more customers are now accepting the price surcharge other than on the naphtha price [naphtha slide]. BarChip will likely continue to lead earnings growth, thanks to continued strong demand in Latin American countries, especially in Brazil, as it is used as a flooring enforcement material. Hagihara Industries does not disclose FY24 BarChip sales forecast.

Hagihara Industries (7856 JP): Earnings Summary and Guidance											
(¥mil)	FY22			FY23				FY24 CE			
	1H	2H	FY	1H	2H	FY	YoY (%)	1H	2H	FY	YoY (%)
Sales	14,490	15,462	29,953	15,930	15,314	31,245	4.3	15,950	16,050	32,000	2.4
OP	742	634	1,377	1,010	968	1,979	43.7	1,120	1,080	2,200	11.2
OPM (%)	5.1	4.1	4.6	6.3	6.3	6.3	+1.7ppt	7.0	6.7	6.9	+0.5ppt
RP	889	792	1,681	1,091	1,159	2,250	33.8	1,180	1,120	2,300	2.2
RPM (%)	6.1	5.1	5.6	6.8	7.6	7.2	+1.6ppt	7.4	7.0	7.2	flat
NP	659	283	943	2,246	871	3,118	230.7	830	770	1,600	-48.7
NPM (%)	4.5	1.8	3.1	14.1	5.7	10.0	+6.8ppt	5.2	4.8	5.0	-5.0ppt

Source: Nippon-IBR based on Hagihara Industries' FY23 earnings presentation material

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

Hagihara Industries announced the current medium-term plan, which covers three years between FY23~FY25, 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 [FY23 segment profit of ¥1,655mil (+40.6% YoY) on sales of ¥26,353mil (+3.1% YoY)]:**

- PLS Segment sales target is ¥26,600mil (CAGR of +1.3%), a +¥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 rise in Meltac sales compared to FY22 sales of ¥419mil.
  - A -¥1,200mil decline in segment sales by eliminating unprofitable products.
- PLS segment RP target is ¥2,300mil (CAGR of +15.3%), up +¥800mil compared to that of FY22.
  - +¥100mil on the back of higher sales.
  - A +¥700mil increase amid improved profitability by 1) optimal pricing, 2) an increase in local production and cultivating overseas demand.

#### **ENG Segment [FY23 segment profit of ¥324mil (+61.8% YoY) on sales of ¥4,891mil (+11.6% YoY)]:**

- ENG Segment sales target of ¥6,400mil (CAGR of +13.4%), a rise of +¥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%), a +¥800mil rise 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 optimal pricing.  
Hagihara Industries managed to pass on price hikes on non-Naphtha materials and energy to product prices during FY23 in PLS segment.
2. Establish optimal production and distribution networks. Hagihara plans to open overseas BarChip production facilities in close proximity to areas of demand, such as the new production base of BarChip in Paraguay which started production in FY23 and will commence full operation 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 trend. 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 strategic investment planned during the medium-term plan. Of the ¥4,000mil strategic investment, ¥700mil was spent in FY23. 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 which completed in May 2023. Management is considering an optimal production location for the ENG segment. Total investment including aforementioned strategic investment, Kasaoka Factory, and maintenance CAPEX during the three years will total ¥10,500mil. In FY23, a total of ¥4,400mil was invested.

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 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	-0.2	8.1	33,000	3.3	
PLS	25,570	4.7	13.4	26,600	1.3	
ENG	4,382	-21.4	-15.2	6,400	13.5	
OP	1,377	-52.5	-38.9	N/A	N/A	
PLS	1,176	-47.7	-25.4	N/A	N/A	
ENG	200	-69.2	-70.5	N/A	N/A	
OPM (%)	4.6	-5.1ppt	-3.5ppt	N/A	N/A	
PLS	4.6	-4.6ppt	-2.4ppt	N/A	N/A	
ENG	4.6	-7.1ppt	-8.5ppt	N/A	N/A	
RP	1,681	-44.0	-29.1	3,300	25.2	
RPM (%)	5.6	-4.4	-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' capital allocation policy in the current medium-term plan (FY23~FY25) calls for spending of ¥14,000mil (¥10,000mil 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.

In FY23, the firm paid a total of ¥696mil (+35.4% YoY) in dividends and bought back shares in total of ¥536mil, which makes the total shareholder return of 39.7%. Based on net profit [NP] adjusted for ¥2,022mil in compensation payments from the Chinese government for the Qingdao factory and ¥250mil one-off gain from closing down a subsidiary, dividend pay-out ratio was 52.0%, and total shareholder return was approx. 92.2%, compared to 54.7% in FY22.

- ¥10,500mil for aforementioned strategic investments (including CAPEX and M&A).

The firm's FY25 ROE target is 8% vs FY23 ROE of 4.8%, based on NP adjusted for aforementioned extraordinary profits related to subsidiaries. Management has not disclosed its ROIC targets.

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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](mailto:enquiries@nippon-ibr.com)



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