

HAGIHARA INDUSTRIES (7856 JP)*1H EARNINGS OVERSHOT GUIDANCE BUT NO CHANGE IN FY24 ESTIMATES. BARCHIP CONTINUES TO LEAD GROWTH.***FY24 1H RESULTS UPDATE**

Hagihara Industries (7856 JP) reported FY24 1H (Oct year-end) earnings results that overshoot the firm's guidance. 1H operating profit [OP] came in at ¥1,271mil (+25.8% YoY) on sales of ¥16,374mil (+2.8% YoY) versus OP target of ¥1,120mil (+10.8% YoY) on sales of ¥15,950mil (+0.1% YoY).

FY24 1H sales increased by ¥443mil (+2.8% YoY). Although sales volume declined, especially in laminated cloths and yarn in the Plastic Products [PLS] segment (impact to 1H sales of -¥527mil), it was offset by 1) price hikes to pass on a surge in energy and raw material costs (+¥373mil), 2) a boost to sales reflecting the weaker yen (+¥77mil YoY), and 3) increase in sales of paper slitters and recycling equipment in the Engineering Products [ENG] products (+¥520mil) segment. Furthermore, FY24 1H OP improved by +¥260mil YoY (+25.8% YoY), thanks to 1) sales increase of high margin products (+¥44mil) and price hikes (+¥188mil) in the PLS segment, and 2) increase in sales (+¥135mil) and improved profit margin (+¥36mil) in the ENG segment. In both segments, SG&A rose by ¥100mil and ¥44mil, respectively, offsetting some of the positive impacts to FY24 1H OP.

Hagihara Industries (7856 JP): Earnings Summary						
(¥mil)	FY22		FY23		FY24	
	1H	FY	1H	FY	1H	YoY (%)
Sales	14,490	29,953	15,930	31,245	16,374	2.8
OP	742	1,377	1,010	1,979	1,271	25.8
OPM (%)	5.1	4.6	6.3	6.3	7.8	+1.4ppt
RP	889	1,681	1,091	2,250	1,405	28.8
RPM (%)	6.1	5.6	6.8	7.2	8.6	+1.7ppt
NP	659	943	2,246	3,118	960	-57.3
NPM (%)	4.6	3.1	14.1	10.0	5.9	-8.2ppt

Source: Nippon-IBR based on Hagihara Industries' FY23 & FY24 1H earnings presentation materials

Whilst FY24 1H OPM improved to 7.8% from 6.3% in FY23, it has not yet recovered to the 9.2% level achieved in FY20 when the firm enjoyed a more favorable sales mix at the Plastic Products [PLS] segment. FY24 1H PLS segment OPM was 7.8%, up +1.1ppt YoY and +1.5ppt compared to FY23, thanks to (1) higher energy and materials costs being successfully passed on to product prices (+¥188mil YoY), (2) effect of a sales increase in high margin products (+¥44mil) which offset an increase in SAG&A (-¥100mil YoY), and (3) continued efforts to reduce SG&A. The Engineering [ENG] segment OPM also improved from 6.6% in FY23 to 7.8% in FY24 1H, thanks to 1) a rapid recovery in sales of paper slitters, 2) solid sales of screen changers and recycling machines, and 3) improvement in profitability of screen changers.

EXECUTIVE SUMMARY

- Hagihara Industries (7856 JP) reported FY24 1H (Oct year-end) earnings results that overshoot the firm's guidance. 1H operating profit [OP] came in at ¥1,271mil (+25.8% YoY) on sales of ¥16,374mil (+2.8% YoY) versus OP target of ¥1,120mil (+10.8% YoY) on sales of ¥15,950mil (+0.1% YoY).
 - In FY24 1H, the PLS segment saw OPM of 7.8%, +1.1ppt YoY and +1.5ppt compared to FY23, thanks to price hikes to reflect surge in costs. The ENG segment also saw OPM improvement to 7.8%, compared to 6.6% in FY23, thanks to sales increase in core products and improvement in profitability of screen changers.
 - Hagihara Industries is guiding for FY24 OP of ¥2,200mil (+11.2% YoY) on sales of ¥32,000mil (+2.4% YoY).
 - The current new medium-term plan, which covers the 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% via share buybacks) in FY25. The firm also plans to cancel excess treasury shares above 5% of shares outstanding.
- The firm's FY25 ROE target is 8% vs FY23 ROE of 4.8%, based on NP adjusted for extraordinary profits related to subsidiaries. Estimated FY24 ROE is 5.7%.

Segment Sales and OP (Cumulative)										
(¥mil / Oct year-end)	FY20		FY21		FY22		FY23		FY24	
	1H	FY	1H	FY	1H	FY	1H	FY	1H	YoY (%)
	PLS Segment Sales	11,589	22,327	10,872	22,540	12,327	25,570	13,550	26,353	13,473
Segment OP	1,132	1,932	941	1,576	557	1,176	912	1,655	1,046	14.6
Segment OPM (%)	9.8	8.7	8.7	7.0	4.5	4.6	6.7	6.3	7.8	+1.1ppt
ENG Segment Sales	2,560	4,904	2,235	5,165	2,163	4,382	2,379	4,891	2,900	21.9
Segment OP	289	582	329	677	184	200	98	324	225	130.00
Segment OPM (%)	11.3	11.9	14.7	13.1	8.5	4.6	4.1	6.6	7.8	+3.6ppt
Total Sales	14,150	27,231	13,107	27,705	14,490	29,953	15,930	31,245	16,374	2.8
Total OP	1,421	2,515	1,270	2,254	742	1,377	1,010	1,979	1,271	25.8
OPM (%)	10.0	9.2	9.7	8.1	5.1	4.5	6.3	6.3	7.8	+1.4ppt

Source: Nippon-IBR based on Hagihara Industries' FY23 and FY24 1H earnings results materials

Plastic Products [PLS] Segment

The PLS segment saw FY24 1H OP improve by +14.6% YoY to ¥1,046mil on sales of ¥13,473mil (-0.6% YoY). The segment earned 67.3% (¥9,060mil, -2.8% YoY) from domestic businesses, while 32.7% (¥4,412mil, +4.3% YoY) was earned from overseas. The segment saw mixture of positive and negative factors on sales during FY24 1H. Positive factors were:

- Price hikes to reflect a surge in costs of energy and raw materials continued to progress.
- Sales of adhesive tape yarns were boosted on the back of demand from natural hazard areas and housing uses.
- Prioritised supply of Blue Sheets to meet post-Earthquake restoration demand in the Noto peninsula.
- Overseas sales at BarChip increased. Two of Hagihara Industries' major overseas subsidiaries, BarChip Group and Hagihara Wastjana Industries (Indonesia), both reported increased sales of +5.4% YoY and +1.6% YoY, respectively. Total BarChip sales rose 6.5% YoY to ¥2,822mil.
- A surge in exports given the weaker yen, especially Meltac used in food containers.

Negative factors were:

- Sales volume declined especially in yarns used in general materials.
- Sales volume declined in laminated cloths, mainly used in the agriculture sector, due to a shrinkage in demand on the back of surge in prices of raw materials.

Despite a slight decline in FY24 1H sales, segment OP improved by 14.6% YoY thanks to:

- Price hikes
- Improved sales mix thanks to solid sales of core products such as BarChip (+6.5% YoY) and adhesive tape cloths (+4.8% YoY).

PLS Segment - Sales Breakdown by Products							
(¥mil)		FY21	FY22	FY23	FY24		
Products	Usage	FY	FY	FY	1H	FY CE	YoY (%)
Sheets & Construction Materials	Sheets, Laminated cloths, sandbags	5,421	5,804	5,935	2,988	5,771	-2.8
Others	Flexible container bags etc.	5,360	6,109	5,521	2,847	6,073	10.0
BarChip	Infrastructure, construction, mines	3,680	4,825	5,289	2,822	5,924	12.0
Living Materials	Adhesive products, artificial grass yarns, Meltac	7,125	7,862	8,678	4,401	8,358	-3.7
Others	Merchandise	951	967	927	412	833	-10.1
PLS Total		22,540	25,570	26,353	13,473	26,962	2.3

Source: Nippon-IBR based on Hagihara Industries' FY24 1H Earnings Material

Engineering Products [ENG] Segment

The Engineering Products [ENG] segment reported FY24 1H OP of ¥225mil (+130.0% YoY) on sales of ¥2,900mil (+21.9% YoY). The segment had only 12.3% overseas sales of ¥356mil (-50.1% YoY) in FY24 1H, while domestic sales represented

87.7% (¥2,545mil, +52.6% YoY). The market for film slitters related to secondary lithium-ion battery [LiB] separators has become more competitive, hence Hagihara Industries has decided not to go deep in that market. On the other hand, stronger than expected sales of screen changers on the back of surging demand for recycling plastics supported segment sales. YoY sales growth (+325.3% YoY) to ¥387mil in paper slitters was due to lack of sales in FY23 1H. Segment OPM improved +3.8ppts YoY, thanks to improvement in procurements of parts for screen changers which are used in the plastic recycling process.

ENG Segment - Sales Breakdown by Products							
(¥mil)		FY21	FY22	FY23	FY24		
Products	Usage	FY	FY	FY	1H	FY CE	YoY (%)
Paper Slitters	Electronics materials and parts	925	392	519	387	1,004	93.4
Film Slitters	Soft packaging materials, optical materials, LiB separators	3,413	2,862	3,109	1,402	2,692	-13.4
Screen Changer, Recycling Equipment	PET bottle recycling	711	1,055	1,021	1,066	1,145	12.1
Others	Winder	115	71	241	25	195	-19.1
ENG Total		5,165	4,382	4,891	2,900	5,037	3.0

Source: Nippon-IBR based on Hagihara Industries' FY24 1H Earnings Material

In FY21, Hagihara Industries changed the segmentation of each strategic product and categorised them into different tasks to reach Sustainability Development Goals [SDGs]. The firm, however, removed detailed explanations of SDGs-related product breakdowns from FY24 due to the fact that almost all of its products are somewhat related to SDGs. For reference, the sales breakdown of SDGs-related products is shown in the table below. The firm aims to offer solutions to various issues that have been raised by its customers.

Consolidated Sales for SDGs-related Products								
(¥mil / Oct year-end)	FY22		FY23		FY24			
	1H	FY	1H	FY	1H	YoY (%)	FY CE	YoY (%)
Climate Change Adaptations	2,119	4,259	2,477	4,894	2,478	0.0	4,607	-5.9
Domestically Produced Sheets (inc. Blue Sheet)	1,106	2,238	1,371	2,550	1,319	-3.8	2,452	-3.8
Adhesive Tape Cloths	1,013	2,020	1,106	2,343	1,159	4.8	2,155	-8.0
Work-style Reform	2,549	5,789	3,137	6,253	3,252	3.7	6,798	8.7
Flame Retardant Sheets & Mesh Sheets	469	963	488	963	430	-11.9	874	-9.2
BarChip	2,080	4,825	2,649	5,289	2,822	6.5	5,924	12.0
Recycling-oriented Society	589	1,131	631	1,205	1,221	93.5	1,428	18.5
Blue Sheet Branded by Eco-mark	27	76	110	184	155	40.9	282	53.3
Screen Changers	492	930	373	787	635	70.2	693	-11.9
Recycling Machines	69	124	147	234	431	193.2	451	92.7
Solutions for Industry & Technology Innovations	1,558	3,255	1,644	3,628	1,808	10.0	3,697	1.9
Film Slitters	1,460	2,862	1,553	3,109	1,420	-8.6	2,692	-13.4
Paper Slitters	97	392	91	519	387	325.3	1,004	93.4
Total Sales of SDGs-related Products	6,817	14,435	7,889	15,980	8,761	11.1	16,532	3.5
% of Total Sales	47.1%	48.2%	49.5%	51.1%	53.5%	+4.0ppt	51.7%	+0.5ppt

Source: Nippon-IBR based on Hagihara Industries FY22, FY23, and FY24 1H earnings presentation materials

FY24 OUTLOOK

Hagihara Industries is guiding for FY24 OP of ¥2,200mil (+11.2% YoY) on sales of ¥32,000mil (+2.4% YoY). Although 1H earnings overshot the firm's guidance, Hagihara Industries did not revise up the full year forecast because 1H sales were partly boosted by external factors such as the weaker yen, and because management continues to view external factors, such as energy costs, global demand, and the slowdown in the Chinese economy, as unclear. Labour and physical distribution costs, as represented by Japan's "2024 Problem," will likely lead to a surge in costs. Although the firm aims to pass on such cost increases to price, there will be a time lag for the price hikes to take effect. Furthermore, the firm is also concerned about customer sentiment regarding price hikes, which could negatively affect sales volume.

Hagihara Industries plans to pay an annual dividend of ¥50.00/share which will result in a dividend payout ratio of 50%.

Hagihara Industries (7856 JP): Earnings Summary and Guidance											
¥mil	FY22			FY23				FY24			
	1H	2H	FY	1H	2H	FY	YoY (%)	1H	2H CE	FY CE	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 & FY24 1H earnings presentation material

PLS Segment

Hagihara Industries guides for FY24 PLS segment sales of ¥26,963mil (+2.3% YoY). The product that will likely lead growth is the BarChip, with FY24 sales forecast at ¥5,924mil (+12.0% YoY). BarChip contributes to shorten the amount of time spent on constructing surfaces with concrete due to its simple but effective enforcement method. It is used in mining tunnels, highway tunnels as well as warehouse flooring, which is lately leading growth of BarChip sales. Majority of concrete reinforcing material for flooring is still rebar. Hence there is room for BarChip to grow market share especially in South America. Hagihara Industries opened Hagihara Industries Yguazu SRL, a new BarChip factory in Paraguay and commenced operation in September 2023 to meet demand in South America, especially in Brazil. The firm co-works on R&D of advanced paving methods using BarChip with the Paraguayan Road Association. Furthermore, BarChip has been adopted as a concrete reinforcement material for tunnels by Nippon Expressway Company [NEXCO]. After a dump truck crash/fire accident in the Amagoyama Tunnel in Hyogo in Dec 2023 and subsequent closure of the tunnel owing to risk of explosion of concrete, BarChip gained awareness for its explosion-proof properties.

ENG Segment

Guidance for FY24 ENG segment sales is ¥5,037mil (+3.0% YoY). Paper slitter sales is estimated to grow 93.4% YoY to 1,004mil. Whilst this reflects weak sales in FY22 and FY23, FY24 sales will likely be boosted by a cyclical demand. The firm guides for FY24 film slitter sales of ¥2,692mil (-13.4% YoY). In FY23, slitting demand for lithium-ion battery [LiB] packaging in China and semiconductor/display related materials softened. The situation continued into FY24 1H. The firm expects film slitter sales to recover in 2H, although LiB separator film related demand will likely remain weak. There is also a rise in slitting demand from the food industry such as zipper tapes for containing and preserving food. 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. Whilst the firm guides for FY24 screen changer sales of ¥693mil (-11.9% YoY), the firm has already reported 1H sales of ¥635mil (+70.2% YoY). Similarly, 1H sales of recycling machines has already reached ¥431mil (+193.2% YoY) relative to FY24 guidance of ¥451mil (+92.7% YoY).

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

Hagihara Industries announced the current medium-term plan, which covers the 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 the following:

1. 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 is comprised of:
 - A +¥1,800mil increase in BarChip sales to ¥6,625mil (CAGR of +11.1%) vs FY22 sales of ¥4,825mil. FY23 BarChip Sales came in at ¥5,289mil (+9.6% YoY). The growth rate in sales underperformed CAGR. However, with increase in production capacity in Paraguay to meet surging demand in Latin American markets, the firm assumes accelerating growth. In FY24, Hagihara Industries guides for BarChip sales of ¥5,924mil (+12.0% YoY).
 - A +¥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.
 - A +¥100mil increase 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 the PLS segment.
2. Establish optimal production and distribution networks. Hagihara plans to open overseas BarChip production facilities in close proximity to areas of demand. An example is the new production base of BarChip in Paraguay which started production in FY23 and will commence full operations from FY24. This would not only help the firm avoid the soaring cost of shipping but also enable it to get a better grasp of local market trends. Hagihara also plans to build a plant in the US for Meltac.

CAPEX for the two overseas production facilities will be ¥650mil in Paraguay and approx. ¥1,000mil in Texas out 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) at the Kasaoka Factory which was completed in May 2023. Management is considering an optimal production location for the ENG segment. Total investment including the aforementioned strategic investments,

the Kasaoka Factory, and maintenance CAPEX during the three years will total ¥10,500mil. In FY23, a total of ¥4,400mil was invested.

- 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 after which the resin and ink are extracted, 2) filtration of the resin via screen changer, and 3) product enhancement/ alteration 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	FY23	FY25		% CAGR (3-yr)
	Actual	Actual	Plan		
Sales	29,953	31,245	33,000		3.3
PLS	25,570	26,353	26,600		1.3
ENG	4,382	4,891	6,400		13.5
OP	1,377	1,979	3,300		33.8
PLS	1,176	1,655	2,300		25.1
ENG	200	324	1,000		71.0
OPM (%)	4.6	6.3	10.0		N/A
PLS	4.6	6.3	8.6		N/A
ENG	4.6	6.6	15.6		N/A
RP	1,681	2,250	3,300		25.2
RPM (%)	5.6	7.2	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 the use of debt to achieve an optimal balance that optimises capital cost.

The split of the ¥14,000mil is as follows:

- ¥3,500mil is planned for shareholder returns. The firm plans to improve the total shareholder return from 54.7% in FY22 to 70% (40% from dividends 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 valued at ¥536mil resulting in a 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, the dividend pay-out ratio was 52.0%, and the total shareholder return was approx. 92.2%, compared to 54.7% in FY22. The firm is guiding for ¥50.00/share dividend in FY24, hence the total dividend payment will be ¥696mil.

- ¥10,500mil for aforementioned investments, including 1) ¥4,000mil on strategic investment such as overseas production bases and strengthening of strategic products, 2) ¥2,500mil on the Kasaoka Factory, and 3) ¥4,000mil on maintenance CAPEX.

The firm's FY25 ROE target is 8% vs 4.8% in FY23 based on NP adjusted for aforementioned extraordinary profits related to subsidiaries. FY24 ROE is estimated to be 5.7%. Management has not disclosed its ROIC targets.

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