COMPANY RESEARCH AND ANALYSIS REPORT

Hagihara Industries Inc.

7856

Tokyo Stock Exchange First Section

8-Aug.-2019

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Index

Summary

Creating common perceptions of the future by reforming work styles and developing new products

Hagihara Industries <7856> (hereafter, also "the Company"), whose Head Office is in Kurashiki City, Okayama Prefecture, is a manufacturer of plastic processed products and machinery products. It is a highly profitable company that adopts a Blue Ocean strategy pursuing profitability through top shares of niche markets rather than through scale.

1. FY10/19 1H results

In the FY10/19 1H consolidated results, net sales increased 16.8% year-on-year (YoY) to ¥14,788mn, operating income decreased 8.1% to ¥1,301mn, and ordinary income declined 14.7% to ¥1,263mn. Compared to the initial forecasts, net sales were basically as expected, but operating income and ordinary income were below forecast by 9.0% and 15.2%, respectively. In the mainstay plastic processed products business, the soaring prices of raw materials that occurred in the previous fiscal year were transferred onto sales prices in FY10/19 1H, but earnings worsened due to the decline in inventory valuation following sharp declines in the prices of raw materials. The Company was also negatively impacted by stocking up inventory in advance of the 10-consecutive day holiday in May which was right before April, the end of 1H for the Company. Costs increased due to the transfer to Japan of the production of agricultural sheets produced in China as a result of the additional tariffs placed on Chinese products by the United States. An allowance for doubtful accounts was allocated for transactions in Mexico by EPC, which has been made a subsidiary. In the machinery products business, sales and profits fell as a round of demand was completed in China for separator film slitters for lithium-ion batteries.

2. FY10/19 outlook

The Company has left its initial forecasts unchanged for FY10/19, with net sales to increase 9.6% YoY to ¥29,000mn and operating income to rise 4.2% to ¥2,800mn. The two companies acquired in the previous fiscal year will contribute for the full fiscal year. The rise in raw material costs have also been transferred onto sales prices, and the 1H reduction in the inventory valuation will be recovered in the 2H. It expects to collect sales proceeds in Mexico. The increase in costs from transferring production from China to Japan was absorbed by the hike in prices for US customers. In the machinery products business, at the end of the 1H the backlog of orders had increased ¥330mn YoY. The Company's efforts to increase sales in South East Asia are proving successful. Although the full fiscal year forecasts will be high hurdles to clear, the Company is aiming to achieve them through a recovery in the 2H. However, in June a tanker was attacked in the Strait of Hormuz and the price of crude oil rose, strengthening the sense of uncertainty about the future.

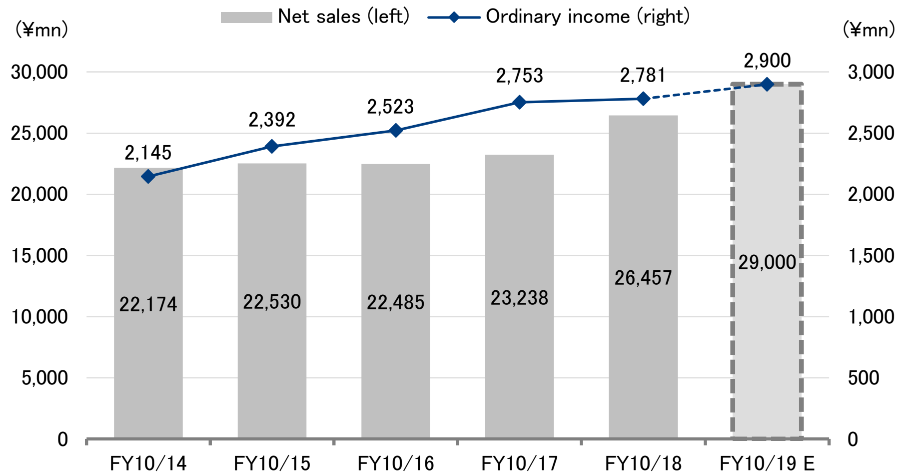
3. A corporate slogan of "Hamidase, Amidase."

The Company will create "the common perceptions" of the future by reforming work styles and developing new products, while also being aware of ESG. It is currently implementing its corporate slogan of "Hamidase, Amidase." In the 8th Companies that are Most Treasured in Japan Awards announced in February 2018, the Company won the highest prize, the Ministry of Economy, Trade, and Industry (METI) Minister's Prize. Also, in response to a request from METI due to a heavy rainfall and flooding disaster that occurred in west Japan in July 2018, the Company worked to produce blue sheets, regardless of whether it was a holiday or day or night, and promptly delivered them to the designated areas, and it received a letter of appreciation from METI for its efforts. In order to affix disasters in the memory and to support the recovery, it is participating in the Blue Seed Major Strategy, in which the blue sheets donated by the Company are being turned into tote bags and part of the proceeds from their sale will be used to support the recovery. In May 2019, it was registered among the Companies Declaring Support for Child Care in Okayama. The points worthy of praise for this include its management of a Company-initiated nursery and a paid-leave system in which leave can be taken on units of an hour. In the development of machinery products, the Company is having young engineers participate in incorporating design-engineering methods to make machines easier to operate, and it is developing products with superior designs.

Key Points

- Creating the common perceptions of the future through "Hamidase, Amidase."
- Sales increased significantly but profits declined in FY10/19 1H
- For the FY10/19 full year, the Company is aiming to recover in the 2H from the dip posted in the 1H

Trends in consolidated net sales and ordinary income



Source: Prepared by FISCO from the Company's financial results

Company profile

Creating the common perceptions of the future through "Hamidase, Amidase."

1. Company profile

Hagihara Industries, whose Head Office is in Kurashiki City, Okayama Prefecture, is a manufacturer of plastic processed products and machinery products. It pursues profitability rather than scale, and it is a highly profitable company with each of ROE, ROA, and the operating income margin about 10% in FY10/18. It conducts businesses for industrial machinery that apply its core technologies of "cutting," "stretching," "winding," and "weaving" that it has cultivated through the production of plastic processed products using flat yarn and flat yarn manufacturing. It is the only manufacturer within Japan that conducts operations from raw materials through to sheet manufacturing, and one of the Company's features is that it has an Engineering Division that conducts the machinery products business.

The Company continued with the slogan in its previous three-year medium-term management plan (FY10/16 to FY10/18) of "Dynamic HAGIHARA 56 (DH56) Dynamic Brave Challenge and New Hagihara Dynamism" that inherited the pioneering spirit of its founder, of "Sounds interesting. Let's try it right away." But from FY10/19, it has set "Hamidase, Amidase." as its corporate slogan. From taking the approach of "Hamidase to go beyond status quo, Amidase for new value." it is communicating its corporate slogan of not being afraid to fail and creating the common perceptions of the future.

Won the METI Minister's Prize, the Grand Prize, at the Companies that are Most Treasured in Japan Awards

In the 8th Companies that are Most Treasured in Japan Awards held in February 2018, the Company won the METI Minister's Prize, which is the Grand Prize. In a system that honors companies that conduct "management that makes people happy," Koji Sakamoto, a former professor at Hosei University Graduate Schools, served as the chairman of the judges for this Prize, which is sponsored by METI and other organizations. For "Management that makes people happy," "people" are considered to be five groups; employees and their families, subcontractors and suppliers, customers, local communities, and shareholders. The Company was recognized as being a company of good standing, of being a "company that is correct and that acts correctly."

In response to a request from METI due to a heavy rainfall and flooding disaster that occurred in west Japan in July 2018, the Company worked to produce blue sheets, regardless of whether it was a holiday or day or night, and promptly delivered them to the designated areas, and it received a letter of appreciation from METI for its efforts. In Kumamoto, it is conducting activities where the blue sheets used at the time of the disaster are to be reused as tote bags, and part of the sales proceeds of these bags will be used to support the recovery. In Okayama also, the Company is participating in the Blue Seed Major Strategy (blue seed is a type of recovery), which has been promoted as a symbol to prevent from being forgotten. During the heavy rain and flooding in west Japan, the Company donated sheets because Kurashiki City, in which its Head Office is located, also suffered damage. Rather than throwing away these donated sheets, which were used to protect people from the wind and rain at the time of the disaster, they are reused as the materials for tote bags to help fund the disaster recovery. BRIDGE OKAYAMA received the cooperation of the BRIDGE KUMAMOTO General Incorporated Association for the grand design, and the bags will be made in OKAYAMA, including that the sewing of the bags will be handled by the well-known BAISTONE company in Kurashiki. The recovery-support tote bags will be sold for ¥3,000 from July 2019, and the aim is to produce 500 bags.

Disaster recovery-support tote bags

Source: The Company's press release

In the ranking of popular companies in Okayama on Shunavi 2020, which is managed by a job-search website, the Company rose sharply from 21st place in the previous year to 9th. The top-ranked companies were IT service companies, banks, and well-known retailers, and the Company was the highest ranked from the manufacturing industry. In May 2019, it was registered among the Companies Declaring Support for Child Care in Okayama. The points worthy of praise for this include its management of a Company-initiated nursery and a paid-leave system in which leave can be taken on units of an hour. As long as they do not hinder work and labor productivity, the Company is adopting measures to improve employee satisfaction, regardless of conventional wisdom.

2. History

The Company was established in 1962 in Mizushima, Kurashiki City, Okayama Prefecture, for the production and sales of polyethylene monofilament for tatami-mat vertical yarn. Flat yarn is the name of the yarn made from polyethylene and polypropylene being cut into strips, and it gets strong by stretching out. In the second half of the 1960s, it exported industrial machinery that applied the manufacturing technologies of its in-house manufactured products to the US, the Middle East, Latin America, and Southeast Asia. All of its production bases in Japan were completed within Okayama Prefecture, of the Kasaoka Factory (Kasaoka City) in 1970, the Head Office Factory (Kurashiki City) in 1973, the Satosho Factory (Satosho Town) in 1989, and the Kayo Factory (Kayo Town) in 1997. Overseas, it established production and assembly bases in Indonesia in 1995, in Qingdao, China, in 2003, and in Shanghai in 2005. The Shanghai subsidiary conducts the design, parts procurement, assembly and sale of machinery products. In 2007, it newly established an engineering factory within its Head Office site. In January 2019, the Company purchased Kasaoka Port Industrial Site in Kasaoka City with site area of 114,000 m2. The Company aims to rebuild the site with advanced production system incorporating automations.

In 2000, the Company was listed on the Osaka Stock Exchange (OSE) Second Section, and has been a listed company for 18 years. In May 2014, its listing was upgraded from the Tokyo Stock Exchange (TSE) Second Section to the TSE First Section.

As a new development in FY10/18, the Company conducted M&A domestically and overseas. In February 2018, in Singapore it acquired EPC Holdings Pte. Ltd., which is its overseas sales agency for BarChip, a concrete reinforcing fiber. In June of the same year, it acquired Toyo Heisei Polymer Co.,LTD(Kasumigaura City, Ibaraki Prefecture), which manufactures and sells high-quality and convenient packaging materials and processed goods made from plastics, and made it a subsidiary. It acquired all the shares of both companies.

Business overview

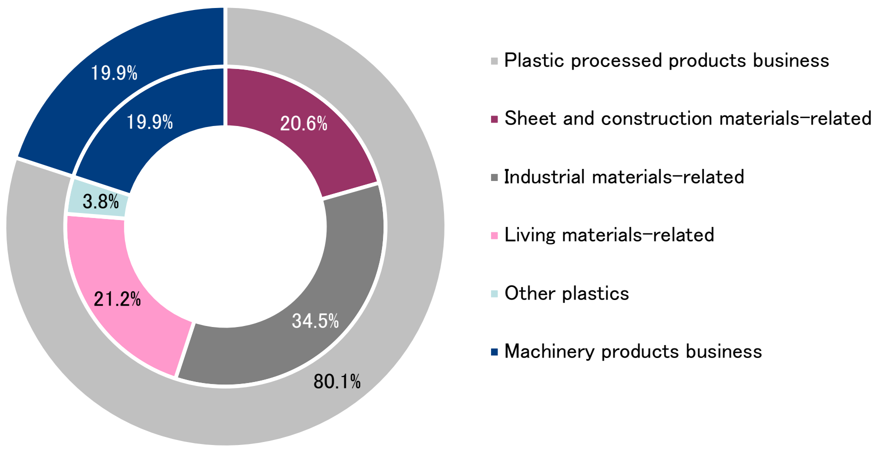
Highly profitable from a Blue Ocean strategy of acquiring top shares of niche markets

1. Business overview

(1) Composition of net sales

Sales are from two businesses: the plastic processed products business for the manufacture and sale of related products using plastics, including flat yarn; and the machinery products (engineering) business for the manufacture and sale of industry machinery. In FY10/19 1H, the percentages of total consolidated net sales (¥14,788mn) by business were that the plastic processed products business contributed 80.1% (within which, sheet and construction materials-related: 20.6%, industrial materials-related: 34.5%, living materials-related: 21.2%, and other plastics: 3.8%), while the machinery products business contributed 19.9%. The operating income margin is high in both businesses, 7.9% in the plastic processed products business and 12.5% in the machinery products business.

Composition of net sales by business
(FY10/19 1H: ¥14,788mn)



Source: Prepared by FISCO from the Company's results briefing materials

(2) Product lineup

The markets covered by the Company's plastic processed products business are "living and leisure," "agriculture and fishery," "packaging and distribution," "industrial materials," and "construction and civil engineering." Machinery products business basically provides industrial-use products such slitter, its mainstay product. Sales are more dependent on B-to-B than on B-to-C.

Product lineup

Living and leisure	Agriculture and fishery	Packaging and distribution
Leisure sheets Hibikan Zo Lite Artificial grass Wood-pattern mats	UV sheets Snowtex (for houses) Snowtex (for reflection) Black-out cloth for poultry sheds	Adhesive tape cloth Container bags Truck sheets

Industrial materials	Construction and civil engineering	Machinery
UV clear sheets Barchip M Flat yarn & monofilament-derived yarn	Fireproof sheets Soft-mesh sheets Large sandbags Design sheets	Slitters Inspection devices Winders Recycled pellet manufacturing equipment Extruders

Source: Prepared by FISCO from the Company's materials

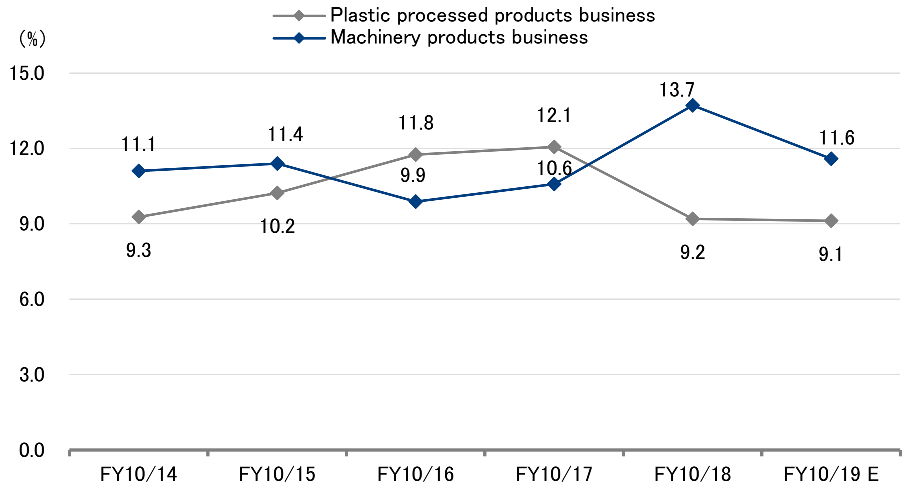
Products for living include leisure sheets, artificial grass, and wood-pattern mats. Products for agriculture and fishery include UV sheets, functional products, and black-out cloth for poultry sheds. Functional products are designed to have various functions depending on their intended use, such as light shielding and lighting functions, waterproofing and water permeability functions, wind-proofing and breathability functions, and a thermal insulation function. Products for the packaging and distribution market include adhesive tape cloth, container bags, and truck sheets. Industrial materials include UV clear sheets, flat yarn, and monofilament-derived yarn. Products for construction and civil engineering include fireproof sheets, soft-mesh sheets, large sandbags, and design sheets. The Company has always produced new products by advancing the functions of existing products.

2. Management strategy

(1) Management that prioritizes profitability

The Company achieves high profits by avoiding price competition in the commoditized products market and maintaining leading shares in niche markets in which there are no new entrants. It has the leading shares for products including pile yarn for artificial grass, multifunctional blue sheets, sandbags, and carpet base cloth. It also has the leading share globally of polypropylene reinforcing fiber for mortar and concrete, which will be described later. Rather than in large markets with fierce competition, it is taking a Blue Ocean strategy of targeting niche markets in which it can obtain the survivor advantage and demonstrate its strengths.

Trends in net sales and operating income margin by business



Source: Prepared by FISCO from the Company's results briefing materials

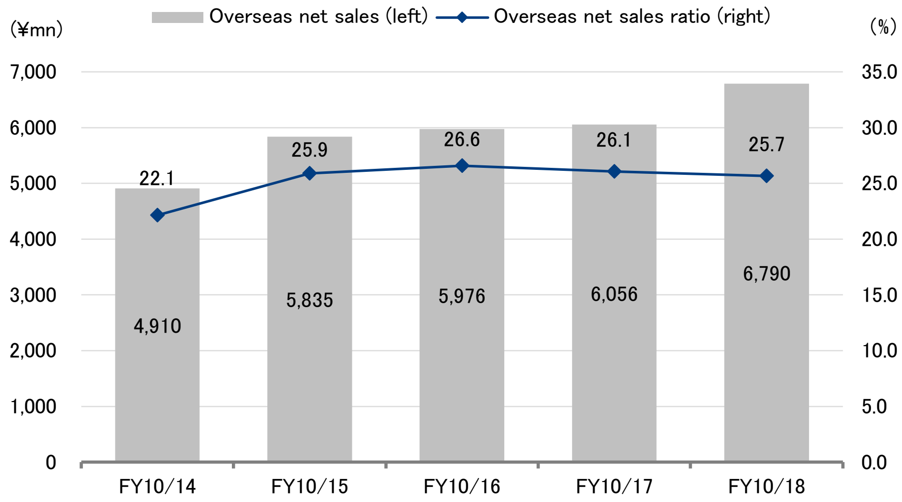
The Company's business stance is not to sell the functions of products, but rather to provide their essential roles. For example, to a transportation company, what is important is not the cost of adhesive tape, but rather securing workers, increasing work efficiency, and reducing the time required for packaging. Adhesive tape cloth, for which the Company has the leading market share, is easy to cut and can be cut into sizes to suit the application, both vertically and horizontally, which increase work efficiency. For its sheets used at construction sites, it uses lightweight materials to contribute to increasing work efficiency and shortening construction periods. For its sandbags, to which it has added an ultraviolet deterioration inhibitor and which are weather resistant, the Company utilizes a technique of placing a black horizontal line on a white background so that anyone can fill the bags with an equal amount of soil or sand. The sand bags introduced by local governments are highly durable and its quality is emphasized. Products that have been adapted according to what customers require as their essential roles can be priced 20% to 30% higher than general-purpose products. By being orientated to the essential value required by customers ahead of these product's functions, the Company is building a highly profitable business model that does not begin and end with price competition.

(2) Overseas business development

In the fourth year after its establishment, the Company exported flat yarn manufacturing equipment. In 1976, it exported a complete bag manufacturing large plant to an Indonesian, state-owned fertilizer company. In 1995, it established the local subsidiary P.T. HAGIHARA WIHARTA INDONESIA (currently, P.T. HAGIHARA WESTJAVA INDUSTRIES), which is conducting a plastic processed products business. In China, in 2002 in Qingdao, it established Qingdao Hagihara Industries Co., Ltd., which conducts a plastic processed products business. Further, in 2005 in Shanghai, it established the subsidiary Hagihana Machinery (Shanghai) Co., Ltd., which designs machinery and procures and assembles parts. Currently, they are in actuality the Company's wholly-owned subsidiaries. In the machinery products business, it is strengthening overseas sales, including by newly establishing a sales department in the Shanghai subsidiary. Since June 2019, the newly established subsidiary in Thailand has started providing after-sales services, such as for maintenance. It is progressing measures to strengthen in South East Asian countries, which have been defined as promising markets.

In FY10/18, overseas net sales were ¥6,790mn, which was 25.7% of total net sales.

Trends in overseas net sales and the overseas net sales ratio



Source: Prepared by FISCO from the Company's financial results

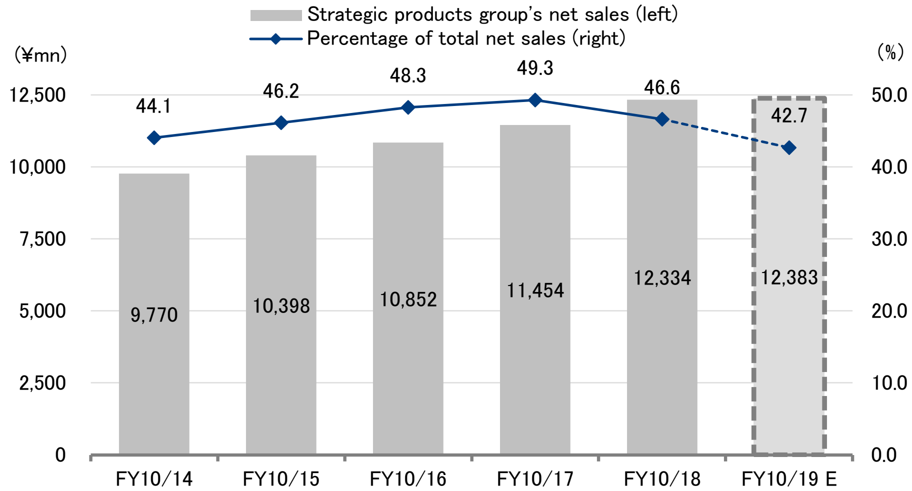
For its plastic processed products business, the Company is adopting an exporting strategy that pinpoints products that are highly competitive. A product representative of this that is being used in Australia is the inner sheets that are attached to the inside of steel water storage tanks to prevent rust and to delay the tank's deterioration. The Company's products use a polyolefin material, so they have the advantage of being light and strong compared to the competing products that are made of vinyl chloride. Moreover, in North America, it is positioning its grain cover laminated cloth as a strategic product in this market, due to the enormous area of arable land and harvest volume.

For overseas sales of BarChip, a concrete reinforcing fiber, EPC covered a wide area. After it was made a subsidiary in February 2018, the number of sales bases in the Company Group immediately increased by 9 bases. This subsidiary's head office is located in Singapore, while it has bases in Australia, Ireland, Canada, USA, Mexico, Chile, Peru, and Brazil. It has adopted an integrated manufacturing and sales system, which makes it easier to feed-back customer needs into development. It also made it easier for the Company's sales strategy to spread throughout its workplaces. In the summer of 2018, Group employees from bases throughout the world gathered together with the aim of sharing information. As it has secured many sales bases, going forward the Company is considering sales promotions not only of BarChip, but also of other products it produces.

(3) Strategic products group

The Company selects strategic products from viewpoints such as leading share, high profitability, and growth potential, and it is focusing on expanding their sales. Currently, this applies to BarChip, adhesive tape original fabric, other advanced functional products, and film slitters. The Company-wide gross profit margin is 29.1% (FY10/18), but it is over 30% for this strategic products group. It aims for 50% of total net sales to be provided by the strategic products group. It remained at 41.2% in FY10/19 1H due to a fall in the penetration of grain cover laminated cloth and the completion of a round of demand for film slitters for China. Toyo Heisei Polymer, which has been made a subsidiary, will contribute for the full 12 months, so it is forecast that the strategic products' percentage of total sales will decline from 46.6% in the previous fiscal year to 42.7%. However, some of Toyo Heisei Polymer's products correspond to strategic products, such as its medical-use drip packs and internal packaging tape for packed beverages, and this is likely to add to their percentage of total sales in the future.

Trends in the strategic products group's net sales and its percentage of total net sales



Source: Prepared by FISCO from the Company's results briefing materials

(4) Strategic product BarChip

BarChip is a strategic product for which there are major expectations. It is a polypropylene reinforcing fiber for mortar and concrete developed from the plastic fiber stretching and manufacturing technologies that the Company has cultivated over many years. More than 20 years have passed since the Company launched BarChip and other market participants have appeared in this time. The increase in the number of suppliers has the merit of accelerating the market's expansion. In the domestic reinforcing fiber market, the Company has an overwhelming large share of around 70% to 80%. Its strength includes its comprehensive power, such as a product lineup with cost advantage relative to performance and fibers of different thickness, and also applications development.

For construction applications, more than 20 years have passed since BarChip was used in the soil-floor concrete of a distribution facility, and its durability has been demonstrated at this work site. It enables the installation of troublesome mesh wires to be omitted, and both cost reduction and shortening of work time can be achieved. The top priority at construction sites is securing manpower, and meshless concrete that incorporates BarChip has acquired an excellent reputation for labor saving.

In civil engineering applications, it is known from its use in mines, such as in Australia and South America, and in Tokyo's outer ring road. In 2003, it became possible to use the reinforcing fiber BarChip JK, a reinforcing fiber used for tunnel-cover concrete, in the NEXCO (formerly Nippon Highway Public Corporation) Tunnel Construction Management Guidelines. It was confirmed that the crosslinking effect of the fiber added to concrete contributes to preventing concrete pieces from falling and third-party damage. In terms of its applications for railway tracks, it is used to reinforce the concrete used to adjust the height of sleepers and concrete roads, to prevent the fall of mortar and concrete from tunnel covers, and to suppress and reinforce cracks. It is highly probable that it will be used at the entrances of railroad tunnels where shock waves occur. Overseas, it is being used in Hungary for electric tram tracks and in Spain for sewer concrete segments. The Company's highly durable product is being adopted because it is difficult to conduct repair work after the segments have been buried underground.

Examples of BarChip use


Concrete segment in the Tokyo outer ring road


Building soil-floor


Slope


Spraying of tunnel inner walls


Electric tram tracks (Hungary)


Sewer concrete segments (Spain)


Hybrid Prestressed and Concrete Roofs (Okinawa Prefecture, Japan)

Source: Prepared by FISCO from the Company's materials and results briefing materials

Although the peak of the Tokyo outer ring road work has passed, the Company is progressing BarChip's applications development and demand is expected to continue to remain at a high level within Japan. For large projects in the future, there are expectations for the Linear Chuo (Central) Shinkansen (Bullet Train) Line. The anticipated demand is that BarChip will be used as a reinforcing material for the track and for tunnel-cover concrete. With a total route of 438 kilometers, the Linear Chuo Shinkansen is scheduled to open in 2027 between Shinagawa and Nagoya and in 2037 between Nagoya and Osaka. As it is scheduled to connect Shinagawa to Nagoya in 40 minutes at top speed, the plan is to run a direct route with a top speed of 505 km/h. In the metropolitan areas of Tokyo, Nagoya and Osaka where it is difficult to secure land, it will utilize the "deep underground," for which it not necessary to compensate landowners because it is highly public in nature. About 250 kilometers, or more than 80%, of the route from Shinagawa to Nagoya will be covered by tunnels. It will take a straight route, from the vicinity of Kofu City, Yamanashi Prefecture, via the Southern Japanese Alps (the Akaishi Mountain Range) to the vicinity of Nagoya City. It is expected that reinforcing materials will be used at places where construction and maintenance work will be difficult. The Company has received an order for BarChip to be used in the construction for Kitashinagawa. It is expected to contribute to earnings in FY10/20 or later.

In Europe, a movement has emerged to replace disposable plastic straws and plastic bags with alternatives. Plastics, which are useful in daily life and in industrial fields, are converted into micro-plastics by waves and ultraviolet light if they leak into the ocean due to the inappropriate disposal of used products or inadequate waste management. There are concerns about their adverse impact on people and ecosystems through the food chain of marine organisms. In Japan, in May 2019 the Japan Plastics Industry Federation issued a declaration and launched activities toward solving the problem of marine plastic waste. The companies and organizations that have signed the declaration statement include not only comprehensive chemical manufacturers, but also the Japan Flat Yarn Industrial Association, of which the Company is a member, and the Japan Polyethylene Products Industrial Federation, which is its upper organization. The Japan Plastics Industry Federation plans to announce the outstanding measures for this initiative by the various participating companies and organizations.

Performance trends

Sales increased significantly but profits declined in FY10/19 1H

1. Review of FY10/19 1H results

(1) Results summary

In the FY10/19 1H consolidated results, net sales increased 16.8% YoY to ¥14,788mn, operating income decreased 8.1% to ¥1,301mn, ordinary income was down 14.7% to ¥1,263mn, and net income attributable to the owners of the parent was down 14.5% to ¥867mn. Compared to the initial forecasts, net sales were basically as expected, but operating income and ordinary income fell short by 9.0%, or ¥129mn, and 15.2%, or ¥227mn, respectively.

FY10/19 1H consolidated results

(¥mn)

	FY10/19 1H		FY10/19 1H			YoY		Forecast
	Amount	% of net sales	Initial forecast	Amount	% of net sales	Change	YoY	YoY
Net sales	12,658	100.0%	14,800	14,788	100.0%	2,130	16.8%	-0.1%
Plastic processed products business	9,566	75.6%	-	11,838	80.1%	2,272	23.8%	-
Sheet and construction materials-related	2,841	22.5%	-	3,044	20.6%	203	7.1%	-
Industrial materials-related	4,312	34.1%	-	5,095	34.5%	783	18.1%	-
Living materials-related	1,939	15.3%	-	3,139	21.2%	1,200	61.9%	-
Other plastics	473	3.7%	-	559	3.8%	86	18.0%	-
Machinery products business	3,091	24.4%	-	2,949	19.9%	-141	-4.6%	-
Gross profit	3,633	28.7%	-	4,082	27.6%	448	12.3%	-
SG&A expenses	2,218	17.5%	-	2,780	18.8%	562	25.4%	-
Operating income	1,415	11.2%	1,430	1,301	8.8%	-114	-8.1%	-9.0%
Plastic processed products business	996	10.4%	-	932	7.9%	-64	-6.4%	-
Machinery products business	419	13.6%	-	369	12.5%	-50	-11.9%	-
Ordinary income	1,481	11.7%	1,490	1,263	8.5%	-217	-14.7%	-15.2%
Net income attributable to the owners of the parent	1,014	8.0%	1,030	867	5.9%	-146	-14.5%	-15.8%

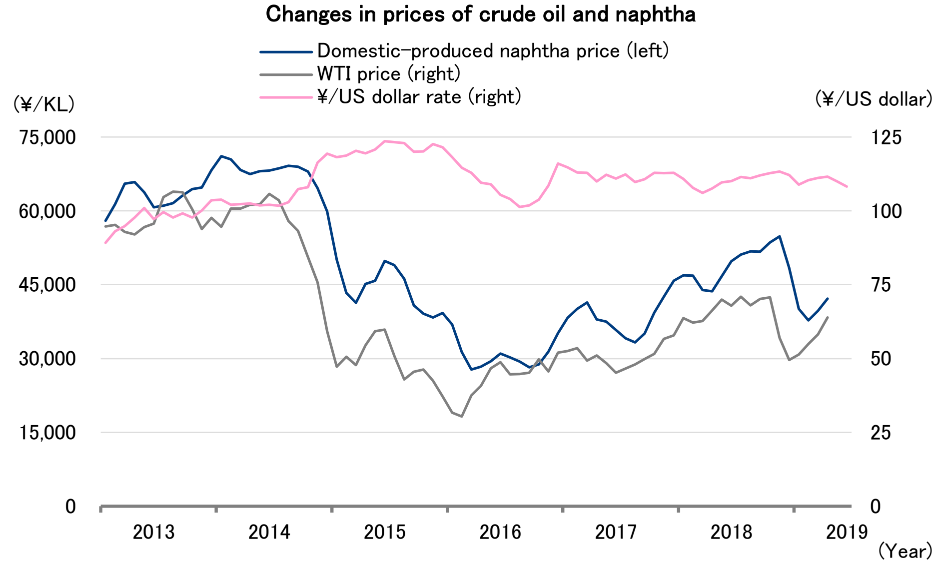
Source: Prepared by FISCO from the Company's results briefing materials

(2) Segment trends

a) Plastic processed products business

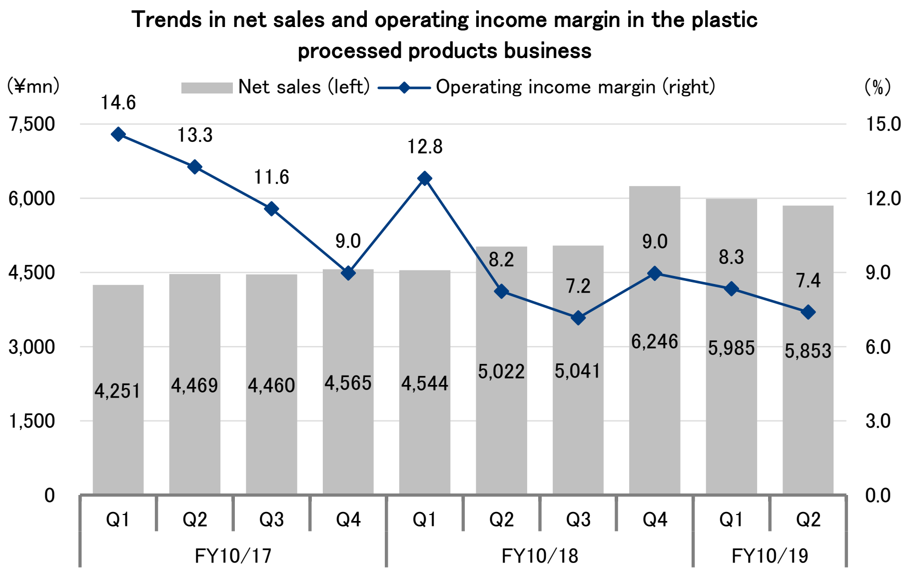
In the plastic processed products business, net sales increased 23.8% YoY to ¥11,838mn, but operating income decreased 6.4% to ¥932mn. The main factors behind the increase in net sales (¥2,272mn) were ¥324mn from higher unit prices and ¥1,941mn from an increase in the sales volume. The main change factors for operating income were +¥664mn from the effects of the higher sales, -¥188mn from the worsening of the gross profit margin, and -¥540mn from the increase in SG&A expenses. The contributions of EPC and Toyo Heisei Polymer, which were acquired and entered the scope of consolidation in the previous fiscal year, were +¥711mn for profits, -¥150mn from the decrease in the profit margin, and -¥412mn from the increase in SG&A expenses, so they had a net positive effect.

The worsening of the gross profit margin was due to the extreme fluctuations in the prices of raw materials. The Company's basic policy is to transfer increases in the prices of raw materials onto sales prices. But when the prices of raw materials rise, there is a time lag until the increase in costs is transferred onto prices. This causes profits to decline and was the main reason for the decline in the profit margin in the previous fiscal period. The price of domestically produced naphtha, which is the main raw material, was assumed to be ¥43,900 per kiloliter (KL) in the Company's FY10/18 budget. The quarterly markets prices were ¥45,096 in Q1 (up 25.6% YoY), ¥44,830 in Q2 (down 0.6%), then rising to ¥49,199 in Q3 (up 9.7%) and ¥52,355mn in Q4 (up 6.4%). In the previous full fiscal year, the price was ¥47,800, exceeding the budget by 8.9%. For FY10/19, the assumed price in the budget is ¥53,500 per KL, an increase of ¥5,700 (11.9%). The market price was ¥47,782 in Q1 (down 8.7% YoY), and ¥39,886 in Q2 (down 16.5%), so it has been trending in a low range.



Source: Prepared by FISCO from various market data

Looking at the segment profit margin by quarter in the plastic processed products business, compared to 9.2% for the FY10/18 full year, it fell to 8.3% in FY10/19 Q1 and 7.4% in Q2. The Company had stocked up inventory in advance of the 10-consecutive day holiday in May which was right before April, the end of 1H for the Company. Normally, price corrections would have been progressed in Q2 and the spread should have widened with the cheaper prices of raw materials. But in fact, a fall in the inventory valuation of ¥70mn occurred alongside the recent fall in the prices of raw materials, causing profits to worsen. The WTI crude oil price reached US$70.98 to the barrel in July 2018, but it had fallen to US$49.52 by December before recovering to US$63.86 in April 2019. The Company transferred the rises in raw materials costs in the previous fiscal period onto prices during FY10/19 1H. If the inventory revalued in the 1H is recorded as sales in the 2H, it is likely that profits will recover.



Source: Prepared by FISCO from the Company's financial results

b) Machinery products business

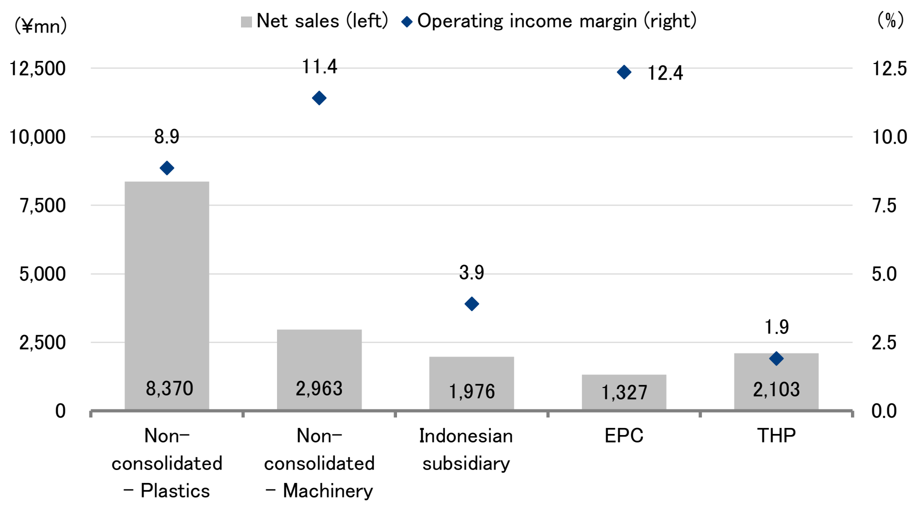
In the machinery products business, net sales declined 4.6% YoY to ¥2,949mn and operating income decreased 11.9% to ¥369mn. In profits, the main change factors were -¥130mn from the decline in sales of film slitters, -¥18mn from the increase in SG&A expenses to exhibit at exhibitions and elsewhere, and +¥29mn from the improvement in the profit margin of paper slitters. For film slitters for lithium-ion battery-use separator films for China, a round of capital investment was completed and ended. The Company is aware of market trends and has been strengthening measures to increase sales in South East Asia for the last two years. At the end of FY10/19 1H, the backlog of orders had increased ¥330mn YoY.

Sales of slitters and rewinders in Thailand and its neighboring South East Asia countries exceeded 100 units. The Company is delivering film slitters for food packaging not only to Japanese companies, but to local companies as well. Hagihara Industries (Thailand) Co., Ltd., was established in March 2019 as a base for services, of after-sales services and regular visits to existing customers.

(3) Earnings conditions at the consolidated subsidiaries

At the end of FY10/19 1H, the consolidated operating income margin was 8.8%. The operating income margins of the Company on a stand-alone basis and its subsidiaries with net sales of more than ¥1bn were as follows; for the Company on a stand-alone basis, 8.9% in the plastic processed products business and 11.4% in the machinery products business, and for the subsidiaries, 3.9% in P.T. Hagihara West Java Industries, 12.4% in EPC, and 1.9% in Toyo Heisei Polymer. In P.T. Hagihara West Java Industries, sales of flexible container bags have been weak, but they are currently recovering. In Toyo Heisei Polymer, the impact of the soaring prices of raw materials has remained. The Company Chairman Hagihara is involved in the management of Toyo Heisei Polymer as the President, and it is taking measures to improve the profit margin.

Net sales and the operating income margins of the Company on a stand-alone basis and the main subsidiaries(FY10/19 1H)



Note: the Indonesian subsidiary is P.T. Hagihara West Java Industries, while EPC refers to EPC Holdings Pte. Ltd., and THP to Toyo Heisei Polymer.
Source: Prepared by FISCO from the Company's results briefing materials

2. Financial position and management indicators

At the end of FY10/19 1H, total assets were up ¥433mn on the end of the previous fiscal year to ¥32,222mn. Current assets decreased ¥361mn to ¥19,160mn, with the main increase and decrease items including cash and deposits (-¥1,088mn), notes and accounts receivable (+¥560mn), and inventory assets (+¥139mn). The decrease in cash and deposits was from the acquisition of industrial sites. Notes and accounts receivable rose due to the higher sales. In advance of 10 consecutive days of holidays in May, inventory assets were increased. In debits, interest-bearing debt increased ¥2,892mn as a result of additional borrowing for the acquired subsidiaries. Net assets rose ¥514mn. The current ratio, which shows the ability to make short-term payments, was 209.8%, while the equity ratio, which is a long-term indicator, was 67.1%, and both indicate an extremely high level of financial stability.

Consolidated balance sheet

(¥mn)

	As of October 31, 2018	As of April 30, 2019	Change
Current assets	19,522	19,160	-361
Cash and deposits	5,407	4,318	-1,088
Notes and accounts receivable - trade	7,628	8,188	560
Inventories	5,911	6,051	139
Property, plant and equipment	8,793	9,604	811
Intangible assets	1,063	1,021	-41
Investments and other assets	2,410	2,435	25
Total assets	31,789	32,222	433
Current liabilities	8,884	9,131	246
Non-current liabilities	1,789	1,462	-327
Total liabilities	10,674	10,593	-80
(Interest-bearing debt)	2,857	2,892	35
Net assets	21,114	21,629	514
Stability			
Current ratio	219.7%	209.8%	
Equity ratio	66.4%	67.1%	

Source: Prepared by FISCO from the Company's financial results

Outlook

For the FY10/19 full year, the Company is aiming to recover in the 2H the drop posted in the 1H

● FY10/19 outlook

The 1H results were below the initial forecasts, but the full year forecasts have been left unchanged. For consolidated results for FY10/19, the Company projects a 9.6% YoY increase in net sales to ¥29,000mn, a 4.2% rise in operating income to ¥2,800mn, a 4.3% increase in ordinary income to ¥2,900mn, and a 6.1% increase in net income attributable to the owners of the parent to ¥2,000mn, and sales and profits are expected to increase.

The reduction in the inventory valuation in the plastic processed products business in the 1H is expected to be recovered through the recording of sales in the 2H. Due to the imposition by the United States of an additional tariff of 25% on Chinese products, costs increased from transferring the final processing in China to Japan, including for black-out cloth for poultry sheds for the US market produced by Qingdao Hagihara Industries Co., Ltd., in China. However, US customers have accepted the price increases. An allowance for doubtful accounts (¥30mn) was allocated for sales in Mexico by EPC, which is responsible for sales of BarChip. But this was the result of considering an unlikely scenario, and it is assumed that these funds will be recovered. Also, in the non-operating income balance in the 1H, a foreign exchange loss caused profits to decrease ¥78mn. In total, these special factors were worth around ¥200mn, which basically corresponds to the operating income amount short of the initial forecast. The hurdles that the Company must clear to achieve the full fiscal year forecasts have become higher, but there is still time for a recovery, so it has left the initial forecasts unchanged.

The Company has left the results forecast by business unchanged. The forecasts for the plastic processed products business are net sales of ¥22,700mn (up 8.9% YoY), operating income of ¥2,070mn (up 7.9%), and an operating income margin of 9.1%. The forecasts for the machinery products business are net sales of ¥6,300mn (up 12.4%), operating income of ¥730mn (down 5.0%), and an operating income margin of 11.6%. So the increases and decreases in these two businesses will supplement each other, and therefore as a whole, sales and profits are expected to increase.

(1) Plastic processed products business

In the plastic processed products business, the prices of raw materials declined after the hikes in sales prices, and they are at rebound level. If the prices of raw materials do not spike to the previous high prices, then we can expect this business to secure earnings as expected.

The two companies acquired during FY10/18 will contribute to the full year's results in FY10/19. In FY10/18, operating income from EPC was ¥245mn (eight months) and from Toyo Heisei Polymer was ¥46mn (three months). The FY10/19 operating income forecasts calculated for 12 months are for ¥368mn from EPC and ¥184mn from Toyo Heisei Polymer. 1H operating income was ¥164mn at EPC and ¥40mn at Toyo Heisei Polymer. The elimination of unrealized profits at EPC caused profits to increase ¥209mn, while M&A costs also ended. However, in June a tanker was attacked in the Strait of Hormuz and the price of crude oil rose, strengthening the sense of uncertainty about the future.

(2) Machinery products business

In the machinery products business, the operating income margin rose from 10.6% in FY10/17 to 13.7% in FY10/18. It is forecast to fall to 11.6% in FY10/19, but even so, it will still be higher than the average for the FY10/14 to FY10/18 period, of 11.3%. Demand for lithium-ion battery related products in China is strong, but there are concerns about a bubble forming, so the Company is not planning to invest in expanding production. In Southeast Asia, it is opening up new markets, but it seems that the profit margin will be lower, including due to differences in the product mix.

FY10/19 consolidated forecast

(¥mn)

	FY10/18		FY10/19 E		YoY	
	Amount	% of net sales	Amount	% of net sales	Change	YoY
Net sales	26,457	-	29,000	-	2,543	9.6%
Plastic processed products business	20,854	78.8%	22,700	78.3%	1,846	8.9%
Machinery products business	5,602	21.2%	6,300	21.7%	698	12.4%
Operating income	2,685	10.2%	2,800	9.7%	115	4.2%
Plastic processed products business	1,917	9.2%	2,070	9.1%	153	7.9%
Machinery products business	768	13.7%	730	11.6%	-38	-5.0%
Ordinary income	2,781	10.5%	2,900	10.0%	119	4.3%
Net income attributable to the owners of the parent	1,884	7.1%	2,000	6.9%	116	6.1%

Source: Prepared by FISCO from the Company's results briefing materials

Longer-term growth strategies

Practically achieved the numerical targets in DH56, the medium-term management plan

1. Medium-term management plan DH56

The Company completed DH56, the three-year the medium-term management plan, in FY10/18, and it is currently formulating the next medium-term management plan.

(1) The extents to which the targets in the medium-term management plan were achieved

The numerical targets in DH56, the three-year the medium-term management plan, for the plan's final year of FY10/18, were net sales of ¥27,000mn, ordinary income of ¥2,800mn, and an ordinary income margin of 10.4%. The actual results were net sales of ¥26,457mn, ordinary income of ¥2,781mn, and an ordinary income margin of 10.5%. So compared to the targets, net sales were 2.0% and ordinary income was 0.7% below their respective targets, which can be said to be within an acceptable error range.

(2) Basic policies

In the previous medium-term management plan, in order to realize new growth, the Company set the slogan of "Dynamic HAGIHARA 56 (DH56) Dynamic Brave Challenge and New Hagihara Dynamism." The plan's basic policies were 1) Strengthen sales of strategic products and open-up markets, 2) Expand overseas sales, 3) Rebuild the product manufacturing process, and 4) Create value for customers by integrating new technologies. There are ongoing projects within these policies, so it is highly likely that they will be continued in the next medium-term management plan. The pioneering spirit of the Company's founder, of "Sounds interesting. Let's try it right away." is being continued in the new "Hamidase, Amidase." corporate slogan, of "Hamidase to go beyond status quo, Amidase for new value."

2. Rebuilding the production system

The Company currently has four domestic factories in Okayama Prefecture. It is considering reorganizing its factories to achieve one of its objectives, of improving flow lines between them. In January 2019, it acquired the 114,000m2 Kasaoka Port Industrial Site (Kasaoka City) from Okayama Prefecture for ¥911mn. It was able to receive preferential treatment, such as subsidies, to acquire the land. The construction of a new factory was not included in the plan for FY10/19, but it seems likely that it will be one of the pillars of the next medium-term management plan. For new bases, the Company will renew manufacturing facilities with the aims of expanding and strengthening capacity and further reducing costs. In FY10/18, in addition to capital investment of ¥998mn, it spent ¥2,304mn on M&A (after the deduction of cash held by the acquired subsidiaries). In FY10/19, it is planning capital investment of around ¥2,000mn, while depreciation and amortization expenses will increase slightly, from ¥1,054mn in the previous fiscal year to ¥1,100mn.

3. Product development strategy

The Company is not only reducing costs and upgrading existing products through improving production technologies, it is also using its core technologies for “slitting, stretching, winding, and weaving” to develop new products that go beyond the common perceptions of the past. In the machinery products business, the Company is having young engineers participate in incorporating design-engineering methods to make machines easier to operate, and it is developing products with superior designs.

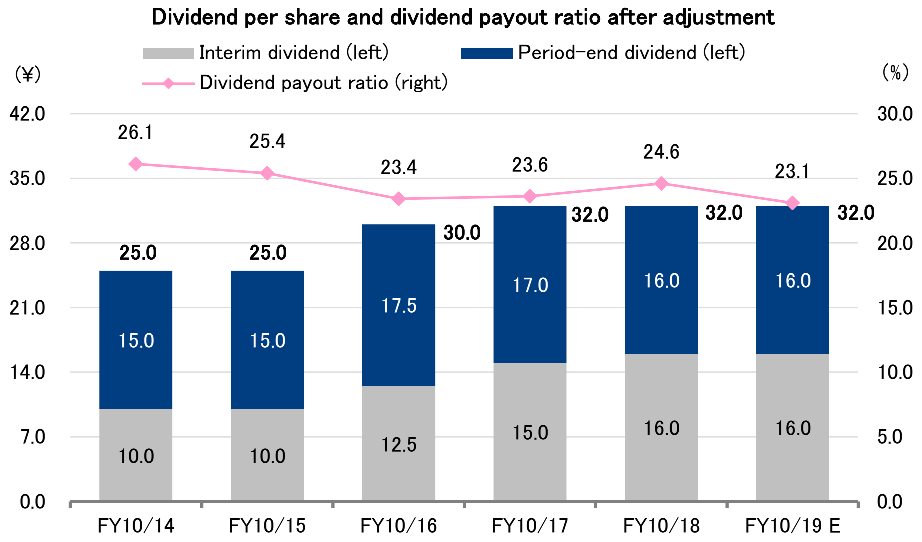
Shareholder return policy

Plans to continue to pay an annual dividend of ¥32 for FY10/19

1. Dividend policy

Dividend policy is to return profits to shareholders and maintain stable dividends. The dividend payout ratio standard is around 20%.

In FY10/16, the Company recorded extraordinary income of ¥322mn as compensation for land acquisition, and therefore it returned profits to shareholders by increasing the annual dividend to ¥30 per share. In FY10/17, results were better than forecast, so it increased the annual dividend to ¥32.0. In FY10/18, even though net income attributable to the owners of the parent declined 4.1% YoY, it maintained the dividend at ¥32.0. The forecast for FY10/19 is again an annual dividend per share of ¥32.0, which will be comprised of a dividend at the end of 2Q of ¥16.0 and a period end-dividend of ¥16.0, for a dividend payout ratio of 23.1%.



Note: The Company made a 2-for-1 share split on November 1, 2017.
Source: Prepared by FISCO from the Company's financial results

2. Shareholder benefits program

In FY10/16, the Company introduced a benefits program for shareholders registered at the end of the fiscal year. Shareholders who satisfy certain requirements can select from among the products or donations listed by the Company. Shareholders who have held shares continuously for less than 3 years can choose a product with a value of ¥1,000 if they hold from 100 to less than 1,000 shares, and of ¥3,000 if they hold 1,000 or more shares. Shareholders who have held shares continuously for 3 years or more can choose a product with a value of ¥2,000 if they hold from 100 to less than 1,000 shares and of ¥6,000 if they hold 1,000 or more shares.

The number of shareholders temporarily decreased to around 2,000 people, but by the end of April 2019, it had increased to 6,489 people, including due to the effects of the share split and the introduction of the shareholder benefits program.

Information security

In addition to restricting the taking-out of information devices, including ordinary laptop computers, in preparation for the occurrence of a disaster or other emergency situation, the Company plans to move its systems to the Cloud as part of its business continuity plan (BCP).

FISCO

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