COMPANY RESEARCH AND ANALYSIS REPORT

SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange Prime Market

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Contents

Summary

For FY3/25 1Q, operating profit declined 18.5% YoY. Full-year forecasts have been left unchanged

SAKAI HEAVY INDUSTRIES, LTD. <6358> (hereinafter also referred to as "the Company") is a manufacturer specializing in road rollers for road paving and other road construction equipment. It boasts the industry's leading market share in Japan at over 70%. In recent years, the Company has been focusing on developing overseas markets, especially in North America and Southeast Asia.

1. Outline of results for FY3/25 1Q

In the consolidated results for FY3/25 1Q, net sales decreased 10.9% year on year (YoY) to ¥6,706mn, operating profit decreased 18.5% to ¥449mn, ordinary profit declined 27.2% to ¥503mn, and profit attributable to owners of parent increased 46.3% to ¥690mn. Although this was roughly the result expected at the beginning of the fiscal year, operating profit was down YoY. In terms of sales by region, the domestic market environment was strong due to measures to accelerate the national resilience plan, but repeated price revisions and overtime restrictions in the construction industry caused capital investment by construction equipment rental companies, which are major customers, to stagnate, resulting in a 10.8% decrease compared to the same period of the previous fiscal year. Overseas sales were also down 11.0% YoY. In North America, final demand was strong due to the expansion of road construction investment against the backdrop of the Infrastructure Investment and Jobs Act, but inventory adjustments by major dealers resulted in a 4.3% decrease YoY. Although sales fell, profit increased due to profit structure reform and the effect of the weak yen. Meanwhile, looking at Asia, demand in Indonesia was sluggish due to the influence of the presidential election, and demand also slowed in the ASEAN market (mainly Thailand and Vietnam), resulting in a 21.1% decrease YoY in sales. Although the gross margin improved to 30.2% (26.9% in the same period of the previous fiscal year) due to the effect of price revisions, stabilization of transportation costs and the depreciation of the yen, operating profit decreased by 18.5% YoY due to decreased sales and increased SG&A expenses (up 7.0% YoY).

2. Outlook for FY3/25

For FY3/25 consolidated results, the Company has not changed its forecasts from the start of the fiscal year, and is still forecasting net sales of ¥33,000mn (down 0.1% YoY), operating profit of ¥2,730mn (down 17.7%), ordinary profit of ¥2,700mn (down 18.8%), and profit attributable to owners of parent of ¥1,830mn (down 25.0%). The Company expects that global demand for construction machinery will remain firm amid expanding infrastructure investment worldwide, but there are concerns that demand may stagnate in certain domains, and the Company is taking a cautious stance, especially regarding 1H. As a result, and taking into account the fact that 1Q results were in line with expectations, the Company has not changed its full-year forecast at this time. The Company has stated that it will revise its forecasts if necessary depending on the results from 2Q onwards, so future developments will be closely watched.

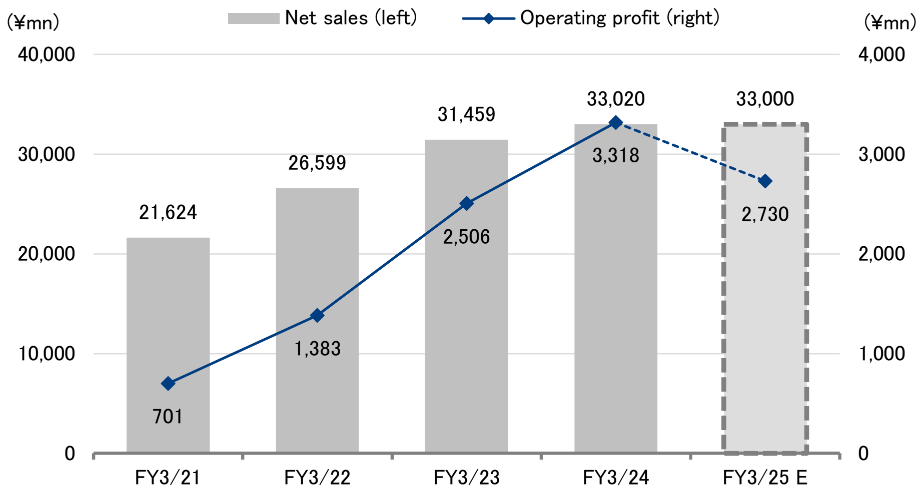
3. Medium-term growth strategy

In June 2021, the Company released its Medium-Term Management Policy which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this, the Company will promote a business growth strategy and an efficient capital strategy. In terms of numerical targets, in FY3/26, the Company is aiming for net sales of ¥30.0bn, operating profit of ¥3.1bn, ROE (return on equity) of 8%, and will aim to maintain a stable dividend payout ratio of 50%. The Company has already surpassed its target for net sales, but has nonetheless opted to leave its numerical targets unchanged at this point in time given that it forecasts a decrease in operating profit in the ongoing FY3/25. Meanwhile, the Company paid annual dividends of ¥200.0 (dividend payout ratio of 49.9%) and ¥285.0 (dividend payout ratio of 49.6%) for FY3/23 and FY3/24, respectively, and furthermore maintains its plans to pay an annual dividend of ¥215.0 (dividend payout ratio of 49.9%) in FY3/25. As such, the Company deserves high marks for its stance of announcing a clear capital policy to improve ROE and then furnishing shareholder returns in line with that policy.

Key Points

- Japan's leading manufacturer of road rollers with a long history. Domestic market share is over 70%, and the Company aims to grow by expanding its overseas market share
- In FY3/25 1Q results, 18.5% decline YoY in operating profit. Company forecasting 17.7% YoY decline in operating profit in FY3/25
- Medium-term numerical targets (net sales of ¥30.0bn, operating profit of ¥3.1bn in FY3/26) are unchanged

Results trends



Note: The Accounting Standard for Revenue Recognition, etc., has been applied from FY3/22
Source: Prepared by FISCO from the Company's financial results

Company profile

The top manufacturer of road rollers with a domestic market share of over 70%

The Company is a specialized manufacturer of road rollers for paving roads and other road construction equipment. The Company is the leading manufacturer in Japan, and boasts a market share of over 70%. In 1970, the Company established a joint venture in Indonesia, as part of the Company's effort to expand business overseas at an early stage. As of the end of FY3/24, the Company has four domestic subsidiaries, and four overseas subsidiaries (U.S., China, two in Indonesia). The Company listed its shares on the Second Section of the Tokyo Stock Exchange (TSE) in 1964, and its shares were reclassified to the First Section of TSE in 1981. In conjunction with the TSE's market recategorization in April 2022, it moved to the Prime Market.

Business overview

Will seek growth by offering high added value and expanding overseas market share

1. Business description

The Company's main business is the manufacture and sale of road rollers used in road paving and other applications, and road roller-related net sales account for approximately 95% of all net sales. Also, the Company's corporate philosophy is to "Contribute to the social project of global land development through the road construction equipment business."

In terms of net sales by region in FY3/24, net sales in Japan were ¥14,320mn (43.4% of total net sales), net sales in North America were ¥9,700mn (29.4%), net sales in Asia were ¥7,566mn (22.9%), and net sales in other regions totaled ¥1,432mn (4.3%).

2. Characteristics and strengths

The Company has the following special characteristics and strengths.

(1) Long history as a specialized manufacturer

The Company's greatest strength is its long history as a specialized manufacturer of road rollers and other road construction equipment. In other words, by deploying a global niche strategy through selection and concentration, the Company has increased its level of expertise and accumulated its own unique technologies.

(2) Technological capabilities

When it comes to hardening and paving roads, the necessary pressure, torque, and other variables (compaction technology) differ depending on the specific land, land quality, soil, and other conditions. Therefore, roadwork companies often require different types of road rollers to match individual worksites (ground, etc.). Because the Company has been a specialized manufacturer for many years, it boasts a high level of technological capabilities with respect to compaction technology, and it is not easy for its competitors to catch up to it.

(3) Credibility

Credibility backed by abundant worksite experience and a track record is also a strength of the Company. The technology to ensure underground compaction quality is a black box, and is not something that is easy for late-arriving manufacturers and non-specialized manufacturers to copy. For example, asphalt mixture brought in at high temperatures must be worked on within a limited time, and if the work is of poor quality, it must be redone which involves a large price. Also, work quality issues for roads and embankments are slow to emerge, and the compaction quality at the time that work is completed tends to be a black box. The Company's strength lies in the fact that it has accumulated long-term insight due to an abundance of worksite experience, and it has earned the trust of many customers.

3. Market share and competitors

According to data from the Japan Construction Equipment Manufacturers Association, in FY2023 domestic construction equipment shipment value including exports was ¥3.7tn, and road roller and other road construction equipment (the Company's main products) account for 2.3% of this amount. The Company has a share of over 70% in the road roller market, making it the leading manufacturer in Japan. Competitors include companies such as Hitachi Construction Machinery Co., Ltd. <6305>, but none of these companies are specialized manufacturers. Some overseas manufacturers have entered the market in Japan, but none have much of a presence. In Japan, the Company's earnings rise and fall along with the ups and downs of the market.

In the global market, although there are no accurate statistics, the Company's market share (on a units produced basis) is estimated to be in the 5-6% range. However, this is on a global basis, and if we limit the scope to the main markets that the Company operates in (Japan, ASEAN, North America), the Company's market share appears to be around 12-15%. The Company's main competitors in the global market include Caterpillar <CAT>, FAYAT SAS, HAMM AG, and Volvo Personvagnar AB, but none of these companies are manufacturers that specialize in road rollers.

Results trends

FY3/25 1Q operating profit declined 18.5% YoY

1. Outline of results for FY3/25 1Q

In the consolidated results for FY3/25 1Q, net sales decreased 10.9% YoY to ¥6,706mn, operating profit decreased 18.5% to ¥449mn, ordinary profit declined 27.2% to ¥503mn, and profit attributable to owners of parent increased 46.3% to ¥690mn. The increase in profit attributable to owners of parent increased due to the posting of a gain on the sale of investment securities of ¥288mn. These results were generally as initially expected, but operating profit declined YoY. Looking at sales by region, sales declined everywhere except for other regions, but this was also as expected.

The gross margin improved by 3.3 points YoY (from 26.9% in year-earlier period to 30.2%) due to factors including the effects of price revisions, stabilization of transportation costs and the depreciation of the yen, but the decline in sales resulted in gross profit being flat YoY. Meanwhile, operating profit declined due to the increase in SG&A expenses (up 7.0%).

Overview of FY3/25 1Q consolidated results

(¥mn)

	FY3/24 1Q		FY3/25 1Q		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	7,529	100.0%	6,706	100.0%	-822	-10.9%
Gross profit	2,022	26.9%	2,022	30.2%	0	0.0%
SG&A expenses	1,470	19.5%	1,573	23.5%	103	7.0%
Operating profit	551	7.3%	449	6.7%	-102	-18.5%
Ordinary profit	692	9.2%	503	7.5%	-188	-27.2%
Profit attributable to owners of parent	471	6.3%	690	10.3%	218	46.3%

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

2. Trends by region

In Japan, the market environment was strong due to measures to accelerate the national resilience plan, but repeated price revisions and overtime restrictions in the construction industry caused capital investment by construction equipment rental companies, which are major customers, to stagnate, resulting in a 10.8% YoY decrease in net sales to ¥2,497mn. Overseas sales were also down 11.0% YoY to ¥4,209mn. In North America, final demand was strong due to the expansion of road construction investment against the backdrop of the Infrastructure Investment and Jobs Act, but inventory adjustments by major dealers resulted in a 4.3% YoY decrease in net sales to ¥2,203mn. Although sales fell, profit increased due to profit structure reform and the effect of the weak yen. In Asia, demand in Indonesia was sluggish due to the influence of the presidential election, and demand also slowed in the ASEAN market (mainly Thailand and Vietnam), resulting in a 21.1% decrease YoY in net sales to ¥1,650mn. In other regions, net sales rose 5.3% YoY to ¥355mn as a result of the strong demand in the Oceania market and the addition of ODA projects in Africa.

Net sales by region

(¥mn)

	FY3/24 1Q		FY3/25 1Q		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Japan	2,798	37.2%	2,497	37.2%	-301	-10.8%
Overseas	4,730	62.8%	4,209	62.8%	-521	-11.0%
North America	2,301	30.5%	2,203	32.9%	-97	-4.3%
Asia	2,092	27.8%	1,650	24.6%	-441	-21.1%
Other regions	337	4.5%	355	5.3%	17	5.3%
Total	7,529	100.0%	6,706	100.0%	-822	-10.9%

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

The Company has a solid financial foundation and ample cash and deposits on hand of ¥8,847mn. The Company will make inventory adjustments to further lessen financial burden

3. Financial condition

In terms of the Company's financial condition as of the end of FY3/25 1Q, current assets were ¥28,473mn (down ¥163mn from the end of the previous fiscal year). The main factors included an ¥464mn increase in cash and deposits, a ¥2,327mn decrease in notes and accounts receivable - trade (including electronically recorded monetary claims - operating), and a ¥1,469mn increase in inventories. Non-current assets were ¥15,902mn (up ¥302mn). The main factors include a ¥173mn increase in property, plant and equipment, a ¥302mn increase in intangible assets, and a ¥174mn decrease in investments and other assets (mainly a ¥105mn decrease in investment securities). As a result, total assets were ¥44,375mn (up ¥138mn). Inventories increased but the Company has stated that the construction equipment market is entering an adjustment period amid the global economic slowdown, and that it is in the process of adjusting inventories to appropriate levels.

Total liabilities were ¥14,698mn (down ¥373mn from the end of the previous fiscal year). The main factors included a ¥329mn decrease in payables (notes and accounts payable – trade and electronically recorded obligations – operating), a ¥165mn decrease in short-term borrowings among current liabilities, and a ¥220mn increase in non-current liabilities. Total net assets stood at ¥29,677mn (up ¥511mn). As a result, the equity ratio as of the end of FY3/25 1Q was 66.7% (65.8% at the end of the previous fiscal year).

Net working capital (trade receivables + inventories – trade payables) at the end of FY3/25 1Q was ¥12,503mn, up ¥940mn from the end of the previous fiscal year. This was mainly due to a ¥2,562mn decline in trade receivables, a ¥1,469mn increase in inventories, and a ¥2,033mn decline in trade payables. Although sales (net sales) were solid, the construction machinery market entered an adjustment period, resulting in the net sales/inventory turnover decreasing by 0.36 times to 2.65 times.

Net working capital

(¥mn)

	FY3/24 1Q Results	FY3/25 1Q Results	Change	
			Amount	%
Consolidated net sales (annualized consolidated net sales)	32,123	32,197	74	0.2%
Trade receivables	8,733	6,171	-2,562	-29.3%
Inventories	10,658	12,127	1,469	13.8%
Trade payables	-7,828	-5,795	2,033	-26.0%
Net working capital	11,563	12,503	940	8.1%
Inventory turnover ratio (times)	3.01	2.65	-0.36	

Note: Consolidated net sales (annualized) = Net sales of 1Q in the current fiscal year + 2Q-4Q in the previous fiscal year
Source: Prepared by FISCO from the Company's financial results

Outlook

For FY3/25 the Company is forecasting a 17.7% YoY decline in operating profit, which is unchanged from the initial forecast

● Outlook for FY3/25

For FY3/25 consolidated results, the Company forecasts net sales of ¥33,000mn (down 0.1% YoY), operating profit of ¥2,730mn (down 17.7%), ordinary profit of ¥2,700mn (down 18.8%), and profit attributable to owners of parent of ¥1,830mn (down 25.0%). The forecast remains unchanged from the initial forecast.

The Company expects that global demand for construction machinery will remain firm amid expanding infrastructure investment worldwide, but there are concerns that demand may stagnate in certain domains, and the Company is taking a cautious stance, especially regarding 1H. As a result, and taking into account that 1Q results were generally in line with expectations, the Company has not changed its full-year forecast at this time. The Company has stated that it will revise its forecasts if necessary depending on the results from 2Q onwards, so future developments will be closely watched.

Consolidated outlook for FY3/25

(¥mn)

	FY3/24		FY3/25		Change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	33,020	100.0%	33,000	100.0%	-20	-0.1%
Operating profit	3,318	10.1%	2,730	8.3%	-588	-17.7%
Ordinary profit	3,324	10.1%	2,700	8.2%	-624	-18.8%
Profit attributable to owners of parent	2,440	7.4%	1,830	5.5%	-610	-25.0%

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

Medium-term growth strategy

The Company has stated its key strategies of a business growth strategy and an efficient capital strategy. In terms of numerical targets, the Company is aiming for net sales of ¥30.0bn and operating profit of ¥3.1bn in FY3/26

In June 2021, the Company released its Medium-Term Management Policy which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this the Company will promote a business growth strategy and an efficient capital strategy. In terms of numerical targets, the Company is aiming for net sales of ¥30.0bn, operating profit of ¥3.1bn, ROE of 8% in FY3/26, and will aim to maintain a stable dividend payout ratio of 50%. The Company has already exceeded its net sales target, but has nonetheless opted to leave its numerical targets unchanged at this point in time given that it maintains its forecast projecting that operating profit will decrease in FY3/25.

1. Business strategy

(1) Domestic market: Create added value through stabilization and developing next-generation businesses

The domestic market for road rollers is already in its mature phase and the Company's market share is large. Therefore, the Company will aim to grow by adding new value to existing products (high-performance, etc.), in other words, by developing next-generation businesses.

(2) Overseas markets: Increase market share and expand business domains

In overseas markets, there are many regions (countries) where demand is increasing, and there is significant room for growth given the Company's low market shares. Therefore, the Company will seek growth through the two strategies of more fully cultivating existing markets and expanding its business domains.

(3) Numerical targets

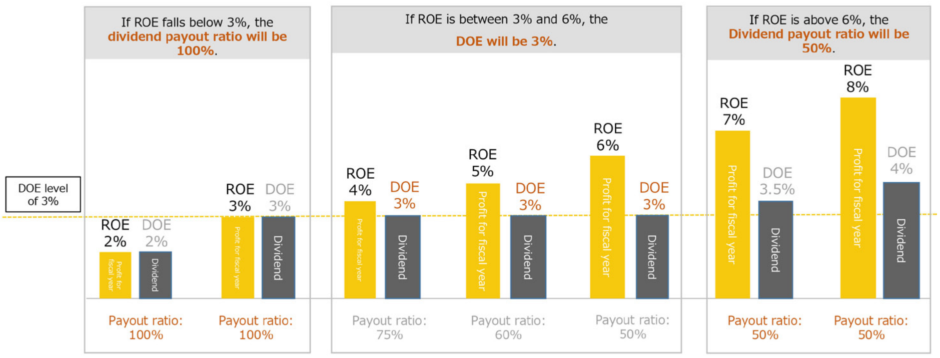
As medium-term numerical targets, the Company aims for net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26.

2. Capital strategy

As its basic policy for capital strategy, the Company is targeting ROE of 8%. To this end, the Company has stated that it plans to increase shareholder value (improve capital efficiency) through shareholder returns.

Generally, two things need to be improved in order to increase ROE. One is of course increasing profit attributable to owners of parent, while the other is suppressing shareholders' equity (not increasing shareholders' equity more than necessary, or decreasing it). In order to increase operating profit, the Company plans to promote the business strategies discussed above, but at the same time, in order to keep from increasing shareholders' equity more than needed, the Company plans to execute a dividend policy in which, if ROE falls below 3%, the dividend payout ratio will be 100%, if ROE is between 3% and 6%, the DOE (dividend on equity) will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%.

Basic capital policy approach



Source: Company's Medium-Term Management Policy

In terms of share buybacks, through FY3/26 the Company will consider flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn. With respect to investment securities, the Company will review investment securities from the perspective of business strategy. Also, concerning growth investment, the Company will consider utilizing leverage with an emphasis on return on invested capital (ROIC).

3. Medium-Term Management Policy: Progress on KPI

Regarding the status of progress on key KPI announced as part of the Medium-Term Management Policy, the Company's full fiscal year forecasts are for net sales of ¥33,000mn and ROE of 6.2%, so the Company expects to achieve the net sales target but fall short of the ROE target. Because the improvements to the profit structure implemented in the previous fiscal year include upside factors other than actual performance, such as the weak yen, in addition to penetration of price revisions and the normalization of transportation costs, going forward the Company will aim for profit structure improvements that enable it to continually achieve ROE of 8%.

Medium-Term Management Policy KPIs

(Millions of yen)

	First three months ended June 30, 2023 (Results)	First three months ended June 30, 2024 (Results)	Fiscal year ended March 31, 2024 (Results)	Fiscal year ending March 31, 2025 (Forecast)	Target for the fiscal year ending March 31, 2026
Net sales	7,529	6,706	33,020	33,000	30,000
Operating profit	551	449	3,318	2,730	3,100
Return on equity (ROE) *1	7.4%	9.4%	9.0%	6.2%	8.0%
Share buybacks	–	–	–	Cumulative amount of share buybacks 340*2	500 ~ 2,000*3

*1 The annualized ROEs were calculated based on the year-to-date results of the corresponding fiscal year.
*2 The amount represents the cumulative amount of share buybacks that had been executed as of August 9, 2024.
*3 The amount represents the targets of the cumulative amount of share buybacks through March 31, 2026.

Source: Company's results briefing materials

Shareholder return policy

For FY3/25, plan to pay a ¥215.0 annual dividend

The Company works to secure a stable management base over the long term, and also places importance on the continuation of stable dividends, and makes it a basic policy to distribute results that are supported by business performance and a sound financial structure. Based on this basic policy, the Company decides dividends and conducts share buybacks. As discussed above, the Company's medium-term shareholder return policy is as follows. If ROE falls below 3%, the dividend payout ratio will be 100%, if ROE is between 3% and 6%, the DOE will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%. With respect to share buybacks, the Company is considering flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn by FY3/26.

Based on the above dividend policy, the Company paid a ¥200.0 annual dividend (a dividend payout ratio of 49.9%) in FY3/23 and a ¥285.0 annual dividend (49.6%) in FY3/24. For ongoing FY3/25, the Company plans to pay a ¥215.0 annual dividend (49.9%). Furthermore, with regard to the share buybacks, it conducted a buyback of 130,000 shares (¥340mn) in FY3/22, but currently has no plans to conduct buybacks going forward. The Company's stance of announcing a clear policy to improve ROE and carrying out shareholder return in line with that policy is worthy of recognition.

FISCO

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