

HIRANO TECSEED CO., LTD. (6245 JP)

CAUTIOUS VIEW ON THE EV MARKET CONTINUES BUT THE FIRM CONTINUES TO COMMIT TO MID-TERM SHAREHOLDERS RETURN POLICY.

EXECUTIVE SUMMARY

- **Hirano Tecseed's [HT] Q3 OP of ¥1,830mil (-30.7% YoY) only reached 63.1% of FY24 forecast of ¥2,900mil (-10.4% YoY). Is there any risk of a downward revision?**

HT has maintained its FY24 guidance of OP of ¥2,900mil (-10.4% YoY) on sales of ¥44,000mil (-6.3% YoY) as (1) the firm is yet to see the impact from price negotiations, and (2) HT makes continuous efforts to reduce production costs through standardisation of parts, whose effects are yet to see. Given sales has been boosted by installation works in the US, FY24 sales target of ¥44,000mil (-6.3% YoY) will likely be achieved.

- **What are the main reasons for Q1~Q3 OP declined more than sales?**

The firm's sales boosted by converting order backlog to sales and also increase in installation works in the Coating and Laminating Machinery segment. However, costs such as raw materials, logistics and subcontractors increased compared to when the firm booked those orders, which squeezed OP.

- **Given the rather gloomy outlook for the EV market, will the current shareholders return policy be adjusted?**

Management commits to pay out the higher of a DOE of 3.5% or a dividend pay-out ratio of 60% during the current medium-term plan (FY24~FY27). HT has not changed the view on the medium to long-term growth potential in the EV market, however, for the time being, it remains cautious.

Hirano Tecseed (6245 JP): Share Information

Market Cap (¥mil)		26,200	Market Cap (\$mil)			170	
22-day Average Trading Volume (¥mil)		111	22-day Average Trading Volume (\$mil)			0.7	
Share performance (%)	6245	TOPIX	Earnings Summary (¥mil, %)		FY22	FY23	FY24CE
Share price (¥, 27 Feb 2024)	1,708	2,736.25	Sales		42,423	46,946	44,000
3mo (from 27 Nov 24)	-5.8	+2.7	OP		3,093	3,236	2,900
6mo (from 27 Aug 24)	+5.4	+2.1	OPM (%)		7.3	6.9	6.6
YTD (from 6 Jan 25)	-10.3	-0.7	EBITDA		3,751	4,020	4,000*
1yr (from 27 Feb 24)	-21.6	+2.2	EPS (¥)		148.87	161.70	139.25
5yrs (from 28 Feb 20)	+42.5	+81.1	Financial Leverage (X)		1.6	1.6	1.6*
Per-share and Valuations	6245	TOPIX	Net D/E Ratio (X)		0.0	-0.1	0.0*
EPS (¥, FY24 CE)	139.25	179.35	FCF		-10,159	5,615	2,250*
DPS (¥, FY24 CE)	90	N/A	Shareholder Return Summary		FY22	FY23	FY24CE
BPS (¥, June-24)	2,533	1970.45	Dividend (¥)		56	88	90
FCFPS (¥, FY24EST)	146.2	N/A	Dividend Payout (%)		37.6	54.4	64.4
Forward PER (X)	12.3	15.3	Dividend Yield (%)		N/A	N/A	5.3
PBR (x)	0.7	1.4	DOE (%)		2.3	3.5	3.6
PCFR (x)	11.7	N/A	Treasury Shares (%)		N/A	N/A	1.8
EV/EBITDA (X)	5.2	N/A	ROE (%)		6.2	6.2	5.5

Source: Nippon-IBR based on data on Bloomberg and Toyo Keizai / *Nippon-IBR estimates

FY24 Q3 RESULTS

Hirano Tecseed (hereinafter HT) reported FY24 Q1~Q3 OP of ¥1,830mil (-30.7% YoY) on sales of ¥38,972mil (+12.3% YoY), which resulted in an OPM of 4.7%. Due to the slowdown in the EV market, battery makers have been postponing and reviewing their CAPEX plans. However, HT managed to book sales by (1) converting order backlogs in the Coating and Laminating Machinery [C&LM] segment, which includes sales from the EV secondary lithium-ion battery [LiB] makers, and (2) an increase in extended installation work such as turnkey jobs in the C&LM segment. OP, however, declined on the back of worsening profitability primarily in the C&LM segment, due to surge in production costs on the back of change in shipment timing and location by customers. In Q3 alone, HT earned OP of ¥805mil (-56.9% YoY / +10.0% QoQ) on sales of ¥14,584mil (+18.0% YoY / +18.7% QoQ).

The -¥808mil YoY (-30.7% YoY) decline in Q1~Q3 OP is primarily broken down primarily into the following components:

- A -¥137mil YoY decline in the C&LM segment OP came from (1) +¥338mil YoY in the segment gross profit [GP], thanks to increase in sales from installation works despite surge in costs of raw materials and subcontractors, and (2) surge in SG&A by +¥476mil YoY, due mainly to increase in commission payments to distributors,
- A -¥669mil YoY decline in Industrial Machinery [IM] OP, mainly due to lacklustre sales which led to a -¥658mil decline in segment GP,

As a result, Q1~Q3 OP has only achieved 63.1% of the full-year forecast.

Hirano Tecseed (6245 JP): Earnings Summary						
(¥mil)	FY23			FY24		
	1H	Q3	FY	1H	Q3	YoY (%)
Sales	22,346	34,709	46,946	24,388	38,972	12.3
GP	3,030	5,843	7,511	3,433	5,504	-5.8
GPM (%)	13.6	16.8	16.0	14.1	14.1	-2.7ppt
SG&A	2,260	3,204	4,275	2,409	3,674	14.7
SG&A/Sales (%)	10.1	9.2	9.1	9.9	9.4	+0.2ppt
OP	769	2,638	3,236	1,024	1,830	-30.7
OPM (%)	3.4	7.6	6.9	4.2	4.7	-2.9ppt
RP	814	2,740	3,394	1,201	2,067	-24.6
RPM (%)	3.6	7.9	7.2	4.9	5.3	-2.6ppt
NP*	564	1,924	2,438	867	1,504	-21.8
EPS (¥)	37.42	127.64	161.70	57.37	99.50	22.0

Source: Nippon-IBR based on Hirano Tecseed's Earnings results materials
 * NP attributed to the parent's shareholders

PERFORMANCE BY PRODUCT SEGMENT

HT has three business segments, of which two – C&LM and IM – combined generate 96.8% of total consolidated sales and 91.3% of consolidated OP. In FY24 Q1~Q3, 69.7% of consolidated sales (+23.9% YoY) came from North America, 17.6% (-5.8% YoY), East Asia (incl. China, Korea, and Taiwan), and 10.7% (-8.8% YoY) from Japan. Sales from the North America are mostly energy-related that includes coating and laminating machine used in the LiB manufacturing process, and installation of such manufacturing machinery.

C&LM Segment:

The largest component of this segment is electrode coating equipment for secondary LiBs. FY24 Q1~Q3 segment OP fell -5.3% YoY to ¥2,455mil on sales of ¥33,935mil (+21.2% YoY). In Q3 alone, the segment reported Q3 OP of ¥1,090mil (-34.9% YoY / +39.9% QoQ) on sales of ¥13,305 (+36.2% YoY / +29.2% QoQ). Here, HT has expanded its services from just shipping the machines to now include installation work for the entire coating line, which boosted sales.

C&LM sales are recognised based on the percentage of completion method. Delays in revenue recognition due to alterations in specifications, as customers changed where they received their coating machines, continued during Q1~Q3, which led to higher costs for HT. While sales of installation work in North America are not disclosed, the contribution to OP was likely negligible.

The firm admits that its view on the recovery in the EV market was optimistic while in reality, its customers' CAPEX was held back. Consequently, any delays to the production process will be reflected in the order backlog and contract assets on the balance sheet [BS], which is still as much as 92% of estimated annual sales in FY24, which was reduced from 1.3x as of 1H as HT continued to convert order backlog to sales. The issue remains is that costs of raw materials, logistics and subcontractors surged compared to when the order was booked.

Given the current conditions in the EV market, HT changed its view on the current growth perspective of the EV market although the firm has maintained its outlook for the medium- to long-term growth potential. In the short-term, however, the following risks to earnings have become apparent:

1. Budgeted costs for some orders are now outdated given the increase in raw material, logistics and subcontractor costs. Although HT does not have any unprofitable orders on a GP basis, the gross profit margin [GPM] of those orders has been squeezed – unless it can get customers to compensate for the extra costs when the project is completed.
2. Further delays in projects might eventually lead to cancellations prior to completion. HT will still be paid on the percentage of completion basis even if there is a cancellation, although not fully, in addition to 30% advanced payments paid upfront.
3. Although the sales are boosted by installation jobs, such works only exist when the coating and laminating machine is sold. With a slow sales of coating and laminating machinery to the LiB battery makers, installation works might eventually take a hit.

Management acknowledges the earnings risk associated with the existing order contracts, therefore they have started negotiating a payment cycle as well as implementing price hikes. Sales are currently recognised when the machinery is loaded on a container ship. HT is willing to modify the payment method to include upfront advanced payments and thereafter royalty-based payments. However, it is still premature to fully reflect such changes on the existing order backlog.

The FY24 C&LM forecast has not yet been revised as HT aims to:

1. Promote sales of extended installation work such as turnkey contracts (e.g. not just the sale of coating and laminating equipment, the firm installs the equipment and ensures the whole laminating line is ready to operate) and service and maintenance in the US through its US branch, which has already started contributing to the segment sales in Q1~Q3,
2. Shorten the time to design the equipment by standardising parts and components, and
3. Enhance production capacity by finding a business partner.

Industrial Machinery Segment:

IM segment Q1~Q3 OP declined -78.7% YoY to ¥181mil on a -31.4% YoY fall in sales to ¥3,790mil. In Q3 alone, the segment produced an operating loss of -¥62mil (OP of ¥346mil in FY23 Q3 / OP of ¥254mil in FY24 Q2) on sales of ¥849mil (-62.5% YoY / -49.5% QoQ). Although deposition equipment mainly used in electronic materials applications, such as MLCCs and forming polyimide films, saw increased interest from customers both in Japan and in South-East Asia, order volumes trended down.

Deposition equipment for electronics materials is still one of HT's core products, however, sales declined on a YoY basis. HT had prioritised orders for coating equipment for energy-related equipment including LiB electrode coating equipment, therefore the order backlog was relatively low.

As with the C&LM segment, HT recognises segment sales using the percentage of completion method. When production levels are low, sales are not able to cover the fixed costs, consequently leading to operating losses. The firm has not yet revised its segment forecasts as it views MLCCs as its target market for its deposition equipment and is looking to further expand its market share.

The table below shows the sales breakdown by applications of HT's equipment. Energy-related application sales, which is largely for Lib electrode coating equipment, hit a quarterly record in Q1 of ¥10,154mil (+7.1% YoY / +12.1% QoQ), remained at a relatively high level in Q2 of ¥9,789mil (+35.9% YoY / -3.6% QoQ) and in Q3 of ¥12,484mil (+33.8% YoY / +27.5% QoQ) by converting order backlogs to sales and installation work.

Hirano Tecseed (6245): Segment Financial Summary (Cumulative)									
(¥mil)		FY22		FY23		FY	FY24		
		1H	FY	1H	3Q		1H	3Q	YoY (%)
Coating and Laminating Machinery	Sales	12,821	31,179	18,227	27,998	37,374	20,629	33,935	21.2
	Operating Profit	841	1,985	918	2,593	3,168	1,364	2,455	-5.3
	OPM (%)	6.6	6.4	5.0	9.3	8.5	6.6	7.2	-2.0ppt
Industrial Machinery	Sales	4,796	9,774	3,261	5,529	7,850	2,941	3,790	-31.4
	Operating Profit	1,107	2,069	504	851	1,257	244	181	-78.7
	OPM (%)	23.1	21.2	15.5	15.4	16.0	8.3	4.8	-10.6ppt
Others	Sales	653	1,470	857	1,182	1,720	817	1,246	5.4
	Operating Profit	63	82	47	278	269	149	250	-10.3
	OPM (%)	9.7	5.6	5.5	23.6	15.7	18.2	20.1	-3.5ppt

Source: Nippon-IBR based on Hirano Tecseed's Earnings results materials

Hirano Tecseed (6245): Segment Financial Summary (Quarterly)											
(¥mil)		FY23					FY24				
		Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	YoY (%)	QoQ (%)
Coating and Laminating Machinery	Sales	10,441	7,785	9,771	9,376	37,374	10,332	10,297	13,305	36.2	29.2
	Operating Profit	650	267	1,674	575	3,168	584	780	1,090	-34.9	39.9
	OPM (%)	6.2	3.4	17.1	6.1	8.5	5.7	7.6	8.2	-8.9ppt	+0.6ppt
Industrial Machinery	Sales	1,720	1,540	2,268	2,321	7,850	1,260	1,681	849	-62.6	-49.5
	Operating Profit	287	217	346	406	1,257	-10	254	-62	-118.1	-124.7
	OPM (%)	16.7	14.1	15.3	17.5	16.0	-0.8	15.1	-7.4	-22.7ppt	-22.5ppt
Others	Sales	422	435	324	538	1,720	506	310	429	32.3	38.1
	Operating Profit	20	27	231	-9	269	67	81	101	-56.4	23.6
	OPM (%)	4.7	6.3	71.5	-1.7	15.7	13.3	26.3	23.6	-47.9ppt	-2.8ppt
Total	Sales	12,584	9,761	12,363	12,236	46,946	12,099	12,289	14,584	18.0	18.7
	Operating Profit ¹	629	140	1,869	597	3,236	292	732	805	-56.9	10.0
	OPM (%)	5.0	1.4	15.1	4.9	6.9	2.4	6.0	5.5	-9.6ppt	-0.4ppt

Source: Nippon-IBR based on Hirano Tecseed's Earnings results materials

*1: Total OP = Total segment OP deducted by HQ costs.

Hirano Tecseed (6245 JP): Sales by Application								
(¥mil)	FY23					FY24		
	Q1	Q2	Q3	Q4	FY Total	Q1	Q2	Q3
Display - related	661	291	528	724	2,205	249	625	452
Electronic materials-related	1,257	1,654	2,002	1,701	6,615	996	986	977
Household product-related	94	79	52	84	311	38	80	146
Energy- related	9,480	7,201	9,327	9,057	35,067	10,154	9,789	12,484
Other	1,089	535	452	668	2,746	659	807	525
Total	12,584	9,761	12,363	12,236	46,946	12,099	12,289	14,584
Source: Hirano Tecseed Co., Ltd.								

FY24 OUTLOOK

Although Q3 OP achieved only 63.1% of its full-year FY24 guidance for OP of ¥2,900mil (-10.4% YoY) on sales of ¥44,000mil (-6.3% YoY), the firm has maintained its original forecasts.

Given the uncertainty surrounding global EV markets, which might last longer than initially anticipated, management expects earnings in the C&LM segment will remain weak due to customers' sentiment on CAPEX waning. Moreover, although production levels have recovered, shipment delays due to changes in machine specifications will likely continue. HT took a conservative view with its FY24 forecasts; though it recognises that sentiment surrounding the EV market is now even more cautious than its own assumption. Under the medium-term plan ending FY27, Energy-related sales are guided to decline (4-year CAGR -5.9%), mainly due to weak sales of coating equipment for secondary LiB electrodes.

Hirano Tecseed (6245 JP): Earnings Summary and Guidance							
(¥mil)	FY23			FY24			
	1H	Q3	FY	1H	Q3	FY CE	YoY (%)
Sales	22,346	34,709	46,946	24,388	38,972	44,000	-6.3
GP	3,030	5,843	7,511	3,433	5,504	N/A	N/A
GPM (%)	13.6	16.8	16.0	14.1	14.1	N/A	N/A
SG&A	2,260	3,204	4,275	2,409	3,674	N/A	N/A
SG&A/Sales (%)	10.1	9.2	9.1	9.9	9.4	N/A	N/A
OP	769	2,638	3,236	1,024	1,830	2,900	-10.4
OPM (%)	3.4	7.6	6.9	4.2	4.7	6.6	-0.3ppt
RP	814	2,740	3,394	1,201	2,067	3,000	-11.6
RPM (%)	3.6	7.9	7.2	4.9	5.3	6.8	-0.4ppt
NP*	564	1,924	2,438	867	1,504	2,100	-13.9
EPS (¥)	37.42	127.64	161.70	57.37	99.50	139.25	-13.9
Source: Nippon-IBR based on Hirano Tecseed's Earnings results materials							
* NP attributed to the parent's shareholders							

While HT assumes that earnings will recovery once its customers resume CAPEX on LiB secondary battery production lines, the more pressing issue is the firm's declining cash inflow. Although 30% of payments are received upfront, with the remainder only paid at the time of shipment, HT's suppliers and subcontractors are paid the full amount within 30~60 days of orders being placed.

LONG-TERM VISION 2030 AND NEW MEDIUM-TERM PLAN – RECAP

Vision and Target – Recap

HT announced its Long-Term Vision 2030 plan in May 2023, during which the firm's aim is to become a global leader in coating machines and to enhance corporate value by establishing a stable revenue base supported by the following three goals:

1. Capturing the top market share in coating equipment for energy-related and electronic materials.
2. Expanding its coverage globally from manufacturing to maintenance through enhancing its overseas network.
3. Contributing to industrial development and the global environment through its coating technology.

HT will continue to focus on expanding growth in:

- Energy-related applications, including LiB electrode coating equipment and also extending to next generation batteries, such as solid-state batteries and fuel cells, and
- Electronic materials applications, including coating equipment for capacitors loaded in EVs, and for electronic materials used in 5G high-frequency wave.

By expanding its existing businesses, as well as developing cutting-edge technologies, HT is targeting an OPM of 12.0% in FY30 vs 7.3% in FY22, on sales of ¥60,000mil (8-yr CAGR +4.4%), and ROE of more than 10.0% (vs 6.4% in FY22).

Capital Allocation Policy to optimise shareholder equity.

Although uncertainty surrounding the EV market continues, which led to delays in customers' CAPEX and subsequent slower cash inflow to the firm, HT has maintained its capital allocation policy and commits to shareholders return of either the higher of DOE of 3.5% or a dividend pay-out of 60% during the medium-term plan [FY24~FY27]. Capital will be allocated to capture growth as well as to improve shareholder equity, the ROE and PBR.

HT plans to allocate capital into the following five areas:

1. Growth investment ¥3,000mil+

Approx. ¥2,000mil will be dedicated to global production capacity expansion, and the remaining ¥1,000mil will be on digital twin / smart factory technology to improve production efficiency. HT may invest additional capital to expand its service and maintenance business in the US and other investment to enhance enterprise value.

2. Strategic Alliance ¥3,000mil+ or allocated to shareholders return if not spent.

HT plans to allocate funds to build strategic alliances to solidify its procurement capability of core components. If strategic alliances are not realised during the medium-term plan, the excess funds will be allocated to either growth investments, or to shareholder return including share buybacks.

3. Dividend Payments

As for shareholder returns, management commits to paying the higher of either a dividend on equity [DOE] of 3.5% or a dividend pay-out of 60%. Dividends will be regularly reviewed to optimise shareholder equity which will subsequently improve PBR and ROE.

4. Maintenance CAPEX ¥2,000mil

HT plans to allocate ¥2,000mil on updating existing factories.

5. Working Capital

This will be equivalent to three-month sales.

Medium-term Plan FY24~FY27

While HT aims to become a global leader in coating and laminating equipment and to realise sales of ¥51,000mil and a ROE of 7.5% by the end of its medium-term plan (FY24~27), management sees this period as a time to establish a foundation for future growth in order to further enhance corporate value.

Given one of the key issues for investors has been how HT can shorten the lead time and solve the order backlog issues, HT will focus on the following three main issues:

1. Diversify revenue streams.
2. Expand supply capabilities.
3. Improve organisational capabilities.

Details of the plan can be found on HT's website below:

(https://www.hirano-tec.co.jp/en/mt_asset/Medium-Term%20Management%20Plan%20FY2024-FY2027.pdf).

Medium-term Outlook by Segment

Energy-related: HT expects FY27 energy-related contributions (including secondary LiB electrode coating equipment) sales of ¥27,500mil (4-yr CAGR -5.9%) based on 1) shipment delays over FY24~FY25 as the outlook for the global EV market and the corresponding unwillingness of its customers to further spend on CAPEX, and 2) the lack of profit growth in FY24 given FY24 sales do not include final shipments of LiB electrode coating machines.

Although the firm is expecting the current weak outlook for the EV market to be a short-term factor, it is still seeing solid demand in LiBs. To capture the medium- to long-term demand, HT plans to undertake orders on a turnkey contract basis and also aims to establish a business for next generation batteries.

Electronics components and optical film sector: FY27 revenue, which includes (1) sales from equipment for MLCC and electronics components, is guided to reach ¥9,000mil (4-yr CAGR +8.1%), and (2) optical film coating equipment revenues expected to enjoy 4-yr CAGR of +25.7% to ¥9,000mil. HT aims to realise growth by diversifying the segment's revenue stream by capturing both domestic and overseas demand.

Service and Maintenance: HT is keen to establish a service and maintenance business as it leads to capturing replacement demand. The firm is guiding for FY27 segment sales of ¥3,500mil (4-yr CAGR +21.6%). Moreover, given this segment is expected to enjoy higher margins, it will help stabilise segment earnings.

Others (incl. new businesses): HT plans to make some seed investments on newly developed high value-added businesses and M&A that offer long-term growth opportunities. HT guides for FY27 segment sales of ¥2,000mil from no sales in FY23.

Medium-term Target and Revenue Breakdown by Customers' Industries			
¥mil / March year-end	FY23	FY27	4-year CAGR
Energy-related (incl. secondary LiB electrode coating equipment)	35,100	27,500	-5.9
Electronic materials	6,600	9,000	8.1
Optical Film etc.	3,600	9,000	25.7
After Service & Maintenance	1,600	3,500	21.6
Others	0	2,000	N/A
Total Sales	46,946	51,000	2.1
OP	3,236	4,100	6.1
OPM (%)	6.9	8.0	N/A
ROE (%)	6.5	7.5	N/A

Source: Hirano Tecseed Medium-term FY24-27 presentation material

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