

HIRANO TECSEED CO., LTD. (6245 JP)

FURTHER DELAY IN SHIPMENT TOGETHER WITH SURGING COSTS CAUSES SLOW CASH INFLOW

FY24 Q1 RESULTS

Hirano Tecseed (hereinafter HT) reported FY24 Q1 OP of ¥292mil (-53.5% YoY) on sales of ¥12,099mil (-3.9% YoY), which resulted in the OPM deteriorating -2.6ppt YoY to 2.4%.

Although FY24 Q1 sales achieved 53.5% of 1H sales forecast, Q1 OP only achieved 24.4% of 1H OP guidance. However, HT maintained both 1H and FY24 guidance as the weak OP was primarily due to (1) a contraction in the Coating & Laminating Machinery [C&LM] segment OPM, and (2) an operating loss in the Industrial Machinery segment due to low production levels.

EXECUTIVE SUMMARY

- Hirano Tecseed's (hereinafter HT) FY24 1H OP fell -53.5% YoY to ¥292mil on sales of ¥12,099mil (-3.9% YoY). Although FY24 Q1 sales achieved 53.5% of 1H sales forecast, Q1 OP only achieved 24.4% of 1H OP guidance.
- The decline in Q1 OP was mainly due to a -¥10mil operating loss in the Industrial Machinery segment (vs OP of ¥287mil in FY23 Q1). The CL&M segment OP also fell -10.2% YoY to ¥584mil.
- Despite weaker-than-expected Q1 results, HT has not changed its 1H and full-year guidance. The firm is guiding for FY24 1H OP of ¥1,200mil (+55.9% YoY) on sales of ¥22,600mil (+1.1% YoY), and full-year FY24 OP of ¥2,900mil (-10.4% YoY) on sales of ¥44,000mil (-6.3% YoY).
- Although the FY24 guidance was conservative, delays in sales and higher costs are now beyond what management anticipated.
- While HT aims to become a global leader in C&L machinery and is targeting FY27 sales of ¥51,000mil and ROE of 7.5%, the medium-term plan (FY24~27) is regarded a period during which the firm will focus on establishing foundations for growth so as to improve corporate value.
- HT maintains its capital allocation policy under the new medium-term plan. The estimated total capital of ¥8,000mil, comprised of operating cash flow, debt and cash surplus, will be allocated to the following areas:
 - 1) Growth investment ¥3,000mil+,
 - 2) Strategic alliance, or shareholder return ¥3,000mil+,
 - 3) Higher of either DOE of 3.5% or dividend pay-out ratio of 60%
 - 4) Maintenance CAPEX ¥2,000mil
 - 5) Working capital.

Hirano Tecseed (6245 JP): Earnings Summary

(¥mil)	FY23			FY24	
	Q1	1H	FY	Q1	YoY (%)
Sales	12,584	22,346	46,946	12,099	-3.9
GP	1,815	3,030	7,511	1,476	-18.7
GPM (%)	14.4	13.6	16.0	12.2	-2.2ppt
SG&A	1,186	2,260	4,275	1,184	-0.2
SG&A/Sales (%)	9.4	10.1	9.1	9.8	+0.4ppt
OP	629	769	3,236	292	-53.5
OPM (%)	5.0	3.4	6.9	2.4	-2.6ppt
RP	675	814	3,394	427	-36.7
RPM (%)	5.4	3.6	7.2	3.5	-1.8ppt
NP*	467	564	2,438	328	-29.8
EPS (¥)	31.05	37.42	161.70	21.75	-30.0

Source: Nippon-IBR based on Hirano Tecseed's results presentation material (FY24 Q1)

* NP attributed to the parent's shareholders

The Coating and Laminating Machinery [C&LM] segment reported Q1 sales of ¥10,332mil (-1.0% YoY / +10.2% QoQ), in line with expectations as order backlogs were converted to sales. However, while sales slightly dipped from a year ago (-1.0% YoY), the segment's absolute quarterly sales still remain at record levels.

Similarly, while the order backlog contracted -14.1% YoY / -8.6% QoQ to ¥50,983mil, the absolute level remains approx. 1.2x that of the firm's FY24 sales guidance due to long lead times on the back of change in specifications by HT's LiB electrode coating machine customers to meet the requirements in the US. However, Q1 OP fell -10.2% to ¥584mil as the surge in raw material and labour costs was higher than the firm anticipated.

C&LM FY24 Q1 orders surged +554.2% YoY to ¥5,555mil thanks to strong demand for installation work. However, orders for LiB electrode coating machines remained low, as customers had:

1. Front-loaded orders since FY21, on expectations of high growth in the EV market.
2. They have since, pended orders due to changes in their production locations and updates in machine specifications.
3. Consequently, deliveries have been delayed as HT's customers are now more cautious on the outlook for the EV market.

On the other hand, Q1 Industrial Machinery segment sales declined -26.8% YoY / -45.7% QoQ to ¥1,260mil. Here, in recent years, HT had prioritised orders for secondary LiB electrode coating equipment for energy-related equipment. As a result, the order backlog is relatively lower, hence the decline in sales.

PERFORMANCE BY SEGMENT

Hirano Tecseed (6245): Segment Performance								
(¥mil)		FY23				FY24		
		Q1	Q2	Q3	Q4	Q1	QoQ (%)	YoY (%)
Coating and Laminating Machinery	Sales	10,441	7,786	9,771	9,376	10,332	10.2	-1.0
	OP	650	268	1,675	575	584	1.6	-10.2
	OPM (%)	6.2	3.4	17.1	6.1	5.7	-0.5ppt	-0.6ppt
Industrial Machinery	Sales	1,720	1,540	2,269	2,320	1,260	-45.7	-26.8
	OP	287	217	347	406	-10	N/A	N/A
	OPM (%)	16.7	14.1	15.3	17.5	-0.8	-18.3ppt	-17.6ppt
Others	Sales	422	435	325	538	506	-5.9	19.9
	OP	20	27	231	-9	67	N/A	235.2
	OPM (%)	4.7	6.2	71.1	-1.7	13.3	+15.0ppt	+8.5ppt
Total	Sales	12,584	9,762	12,363	12,237	12,099	-1.1	-3.9
	OP*	629	140	1,869	598	292	-51.2	-53.5
	OPM (%)	5.0	1.4	15.1	4.9	2.4	-2.5ppt	-2.6ppt

Source: Nippon-IBR based on Hirano Tecseed's FY23 & FY24 Q1 Tanshin

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

HT has three business segments, of which two – the C&LM segment and the Industrial Machinery segment – combined generate 95.8% of total consolidated sales and almost all consolidated OP. Consolidated sales can also be divided into the following applications.

C&LM Segment:

The largest component of this segment is electrode coating equipment for secondary LiBs. FY24 Q1 segment OP declined -10.2% YoY to ¥584mil on sales of ¥10,332mil (-1.0% YoY). Here, HT has expanded its services from just shipping the machines to now include installation work for the entire coating line.

C&LM sales are recognised based on the percentage of completion method. Delays in revenue recognition due to alterations in specifications as customers changed the location to receive their coating machines continued in Q1, which led to higher costs for HT. While roughly 25% of segment sales (+70% QoQ) came from installation work in the US, the contribution to OP was therefore negligible.

The firm admits that its view on the recovery in the EV market was optimistic while in reality, its customers' CAPEX was further delayed, thus, any delays to the production process will be reflected in the order backlog and contract assets on the BS.

Despite a record level quarterly revenue, C&LM segment OPM deteriorated -0.6ppt YoY / -0.5ppt QoQ to 5.7% due to:

- The rapid surge in material and energy costs over the past year had not been reflected in the order backlogs,
- Production delays caused by customers changing machine specifications to ensure they are fit for purpose at new shipment locations increased HT's production costs.

Although the firm has not changed its view on the medium- to long-term growth of the EV market, a few risks to earnings have become apparent:

1. There are some orders for which the firm's budgeted costs are now outdated given the increase in raw material and subcontractor costs. Although the firm does not have any unprofitable orders on a gross profit [GP] basis, the gross profit margin [GPM] of those orders has been squeezed – unless HT could get customers to compensate for the extra costs when the project is completed.
2. Further delays in projects might eventually lead to cancellations before 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.

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.

HT has not yet revised its FY24 C&LM forecast. HT aims to:

1. Promote sales of extended installation works 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,
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:

The segment reported an operating loss of -¥10mil in FY24 Q1, vs FY23 Q1 OP of ¥287mil, on a -26.8% YoY decline in sales to ¥1,260mil. 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. Because the order backlog was relatively low given HT had prioritised orders for coating equipment for energy-related equipment including LiB electrode coating equipment.

As with the C&LM segment, HT pays its suppliers and subcontractors earlier in the production cycle than it receives revenue, which led to an operating loss when production level is low. The firm has not yet revised segment forecasts. Here, the firm views MLCCs as its target market for its deposition equipment and is looking to further expand its market share.

Hirano Tecseed (6245): Sales, Production, Order and Order Backlog Breakdown												
(¥mil)		FY22				FY23				FY24		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	QoQ	YoY (%)
Coating and Laminating Machinery	Sales	6,657	6,163	8,495	9,863	10,441	7,785	9,771	9,376	10,332	10.2	-1.0
	Production	5,784	5,493	7,672	8,401	9,050	6,939	7,667	8,257	9,049	9.6	0.0
	Order Received	24,449	15,258	1,270	5,475	849	2,731	9,070	11,572	5,555	-52.0	554.2
	Order Backlog	71,431	80,525	73,300	68,912	59,319	54,265	53,564	55,760	50,983	-8.6	-14.1
Industrial Machinery	Sales	2,262	2,533	3,035	1,942	1,720	1,540	2,268	2,321	1,260	-45.7	-26.8
	Production	1,729	1,751	2,105	1,612	1,364	1,248	1,814	1,805	1,182	-34.5	-13.3
	Order Received	715	1,462	909	1,668	626	1,620	1,127	773	1,299	68.1	107.3
	Order Backlog	13,221	12,150	10,024	9,750	8,657	8,737	7,597	6,049	6,088	0.6	-29.7
Others	Sales	306	347	427	389	422	435	324	538	506	-5.9	19.9
	Production	235	264	342	352	354	360	67	505	391	-22.6	10.4
	Order Received	623	357	925	327	337	531	342	265	355	34.1	5.5
	Order Backlog	796	807	1,304	1,242	1,157	1,253	1,272	998	847	-15.1	-26.8
Total	Sales	9,226	9,044	11,958	12,194	12,584	9,762	12,363	12,236	12,099	-1.1	-3.9
	Production	7,748	7,509	10,120	10,366	10,769	8,547	9,549	10,568	10,622	0.5	-1.4
	Order Received	25,839	17,079	3,105	7,471	1,812	4,883	10,540	12,611	7,210	-42.8	297.7
	Order Backlog	85,448	93,483	84,629	79,906	69,134	64,256	62,433	62,808	57,919	-7.8	-16.2

Source: Nippon-IBR based on Hirano Tecseed's FY22, FY23 & FY24 Q1 Tanshin

FY24 OUTLOOK

Despite weaker-than-expected Q1 results, HT has not changed its 1H and full-year FY24 guidance for FY24 1H OP of ¥1,200mil (+55.9% YoY) on sales of ¥22,600mil (+1.1% YoY), and full year FY24 OP of ¥2,900mil (-10.4% YoY) on sales of ¥44,000mil (-6.3% YoY).

Management expects the C&LM segment will see declines in both sales and OP due to customers' sentiments on CAPEX waning given the uncertainty surrounding the global EV markets, which might last longer than management initially anticipated. 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; however, management recognises that the sentiment surrounding the EV market is now even more cautious than its own assumption.

Hirano Tecseed (6245 JP): Earnings Summary and Guidance							
(¥mil)	FY23		FY24				
	1H	FY	1H CE	YoY (%)	FYCE	YoY (%)	
Sales	22,346	46,946	22,600	1.1	44,000	-6.3	
GP	3,030	7,511	N/A	N/A	N/A	N/A	
GPM (%)	13.6	16.0	N/A	N/A	N/A	N/A	
SG&A	2,260	4,275	N/A	N/A	N/A	N/A	
SG&A/Sales (%)	10.1	9.1	N/A	N/A	N/A	N/A	
OP	769	3,236	1,200	55.9	2,900	-10.4	
OPM (%)	3.4	6.9	5.3	+1.9ppt	6.6	-0.3ppt	
RP	814	3,394	1,300	59.7	3,000	-11.6	
RPM (%)	3.6	7.2	5.8	+2.2ppt	6.8	-0.4ppt	
NP*	564	2,438	910	61.3	2,100	-13.9	
EPS (¥)	37.42	161.69	60.34	61.3	139.25	-13.9	

Source: Nippon-IBR based on Hirano Tecseed's results presentation material

* NP attributed to the parent's shareholders

While the firm assumes that earnings will recovery once customers resume CAPEX on LiB secondary battery production lines, the pressing issue is declining cash inflow. While the firm receives 30% of advanced payments upfront, with the remainder only paid at the time of shipment, HT pays its suppliers and subcontractors within 30 days of placing orders.

LONG-TERM VISION 2030 AND NEW MEDIUM-TERM PLAN

Vision and Target – Recap

Hirano Tecseed 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. HT is looking 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 business, 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 delay in its customers' CAPEX and subsequent slower cash inflow to the firm, HT maintains its capital allocation policy. Capital will be allocated to capture growth as well as directed to improve shareholder equity so as to improve 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. The firm 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 yield 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

During the previous medium-term plan, HT achieved constant sales growth in the C&LM segment although rising order backlogs remained as an issue. Still, overall earnings heavily rely on the segment as the size of the LiB secondary battery market is far bigger than that for MLCCs and electronics components. Although the segment achieved +34.1% sales CAGR over the past three years, the OPM deteriorated because shipments were delayed by customers changing specifications, combined with the fact that HT pays its subcontractors within 30 days of an order being placed.

In addition to achieving record sales in C&LM, HT has also drastically altered its shareholder return policy after reviewing the strength of its balance sheet and will either pay out 3.5% DOE from retained earnings or 60% of the year's NP, whichever higher.

Hirano Tecseed (6245 JP): Previous Medium-term Plans (FY21~23)					
	Base Year	MT FY21~FY23			
	FY20	FY21	FY22	FY23	3-yr CAGR (%)
Total Sales (¥mil)	25,800	37,866	42,423	46,946	22.1
Coating and Laminating Equipment (¥mil)	15,485	26,533	31,179	37,374	34.1
OPM (%)	9.9	10.5	7.3	6.9	N/A
ROE (%)	5.9	9.5	6.4	6.5	N/A

Source: Hirano Tecseed Medium-term Management Plan Presentation FY24-FY27

While HT aims to become a global leading company 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 Target and Revenue Breakdown by Customers' Industries			
(¥mil)	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

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 LiB. 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 +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 with offers long-term growth opportunities. HT guides for FY27 segment sales of ¥2,000mil from no sales in FY23.

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For further enquiry, please contact:

Yumi Yamamoto-Tyrrell

Nippon Investment Bespoke Research UK Ltd

118 Pall Mall

London SW1Y 5EA

TEL: +44 (0)20 7993 2583

Email : enquiries@nippon-ibr.com



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