

**HIRANO TECSEED CO., LTD. (6245 JP)**

FY23 OP WILL STILL BE NEGATIVE YOY DESPITE IMPROVED PRODUCTION. CAPITAL ALLOCATION FRAMEWORK ANNOUNCED

**FY23 1H RESULTS**

Hirano Tecseed (hereafter HT) reported FY23 1H OP of ¥769mil (-48.6% YoY) on sales of ¥22,346mil (+22.3% YoY). Having revised down its 1H guidance prior to the 1H results announcement, sales landed better than expected, thanks to increased production of secondary LiB electrode coating machinery. However, OP fell short of the original forecast of ¥1,040mil (-30.5% YoY) due to 1) higher commission payments to LiB electrode coating machinery distributors as sales increased (+74.7% YoY to ¥16,681mil in 1H), and 2) a deterioration in sales mix in the Industrial Machinery segment, along with lower sales.

The FY23 1H OP YoY decline of -¥727mil (-48.6%) comprised of a +¥77mil YoY (+9.2%) gain in the Coating and Laminating Machinery segment, which was offset by a sharp -¥603mil YoY (-54.4% YoY) decline in the Industrial Machinery.

Hirano Tecseed (6245 JP): Earnings Summary and Guidance							
¥mil	FY22		FY23				
	1H	FY	1H	YoY (%)	1H CE	FY CE	YoY (%)
Sales	18,270	42,423	22,346	22.3	19,000	41,000	-3.4
GP	3,012	6,679	3,030	0.6	N/A	N/A	N/A
GPM (%)	16.5	15.7	13.6	-2.9ppt	N/A	N/A	N/A
SG&A	1,515	3,585	2,260	49.1	N/A	N/A	N/A
SG&A/Sales (%)	8.3	8.5	10.1	+1.8ppt	N/A	N/A	N/A
OP	1,496	3,093	769	-48.6	1,040	2,920	-5.6
OPM (%)	8.2	7.3	3.4	-4.8ppt	5.5	7.1	-0.2ppt
RP	1,557	3,219	814	-47.7	1,100	3,000	-6.8
RPM (%)	8.5	7.6	3.6	-4.9ppt	5.8	7.3	-0.3ppt
NP*	1,078	2,243	564	-47.7	750	2,100	-6.4
EPS (¥)	71.59	148.87	37.42	-47.7	49.76	139.34	-6.4

Source: Nippon-IBR based on Hirano Tecseed's results presentation material  
\* NP attributed to the parent's shareholders

Although 1H production levels improved YoY, the continuous surge in material costs resulted in HT's gross profit margin [GPM] contracting from 15.7% in FY22 to 13.6% in FY23 1H (-2.9ppt YoY). Furthermore, since the firm's sales are reported on a percentage of completion basis, inventory of materials used are also reviewed on the same basis.

1H SG&A expanded +¥744mil / +49.1% YoY, primarily due to a rise in sales commissions to distributors as LiB coating machinery sales increased. This resulted in the OPM declining -4.8ppt YoY to 3.4%.

While the overall order trend in EV-related CAPEX remained strong, 1H orders in the Laminating and Coating Equipment segment slumped -91.0% YoY to ¥3,580mil as customers had (1) front-loaded their orders in FY22, expecting continuous growth in the EV market, and (2) have since, pending orders due to changes in their production locations and alternations and updates in machine specifications. Consequently, deliveries have been delayed.

**EXECUTIVE SUMMARY**

- Hirano Tecseed (hereafter HT) reported FY23 1H OP of ¥769mil (-48.6% YoY) on sales of ¥22,346mil (+22.3% YoY).

- While 1H sales landed in line with guidance, OP fell short due to 1) an increase in commission payments to LiB electrode coating machinery distributors on higher sales, and 2) a worsening sales mix in the Industrial Machinery segment, combined with weaker sales.

- The full year FY23 guidance remains unchanged. While production levels recovered, as material supply issues were gradually resolved, delays in shipments on the back of changes in machine specifications – such as delivery locations which results in different requirements – continued. Consequently, full-year FY23 sales growth will be weaker given the increased number of adjustments to equipment specs.

- With the 1H results release, HT announced its surplus cash capital allocation, which is estimated at ¥7,000mil + during the medium-term management plan. The funds will be allocated to five areas:

- Growth investment ¥3,000mil+,
- Strategic alliance, or shareholder return ¥3,000mil+,
- DPS (minimum ¥56.00 /share),
- Maintenance CAPEX ¥1,000mil,
- Working capital.

Hirano Tecseed (6245): Sales, Production, Order and Order Backlog Breakdown												
¥mil		FY22					FY23					
		Q1	Q2	1H	FY	YoY (%)	Q1	Q2	YoY (%)	QoQ (%)	1H	YoY (%)
Coating and Laminating Machinery	Sales	6,657	6,163	12,821	31,179	17.5	10,441	7,785	26.3	-25.4	18,227	42.2
	Production	5,783	5,493	11,277	27,352	22.5	9,050	6,938	26.3	-23.3	15,989	41.8
	Order Received	24,499	15,258	39,758	46,503	-20.5	849	2,731	-82.1	221.6	3,580	-91.0
	Order Backlog	71,430	80,525	80,525	68,912	28.6	59,319	54,265	-32.6	-8.5	54,265	-32.6
Industrial Machinery	Sales	2,262	2,533	4,796	9,774	-2.2	1,720	1,540	-39.2	-10.4	3,261	-32.0
	Production	1,729	1,751	3,480	7,196	-3.8	1,364	1,247	-28.7	-8.5	2,612	-24.9
	Order Received	715	1,462	2,178	4,757	-62.7	626	1,620	10.8	158.6	2,247	3.2
	Order Backlog	13,221	12,150	12,150	9,750	-34.0	8,657	8,737	-28.1	0.9	8,737	-28.1
Others	Sales	306	347	653	1,470	10.2	422	435	25.4	3.0	857	31.3
	Production	235	264	500	1,195	19.3	354	360	36.1	1.7	714	42.9
	Order Received	623	357	980	2,233	67.2	337	531	48.5	57.7	868	-11.5
	Order Backlog	796	807	807	1,242	159.2	1,157	1,253	55.3	8.3	1,253	55.3
Total	Sales	9,226	9,044	18,270	42,423	12.0	12,584	9,761	7.9	-22.4	22,346	22.3
	Production	7,748	7,509	15,257	35,744	16.0	10,769	8,547	13.8	-20.6	19,316	26.6
	Order Received	25,838	17,079	42,917	53,494	-26.3	1,812	4,883	-71.4	169.4	6,696	-84.4
	Order Backlog	85,448	93,482	93,482	79,906	16.1	69,134	64,256	-31.3	-7.1	64,256	-31.3

Source: Nippon-IBR based on Hirano Tecseed's FY22 and FY23 Tanshin

As of FY23 Q2-end, the order backlog for the Coating and Laminating Machinery segment of ¥54,265mil (-32.6% YoY / -8.5% QoQ) has contracted from the FY22 Q2 peak of ¥80,525mil. Although production levels have been recovering, resulting in 1H sales landing better than the initial company estimate, both GPM and OPM worsened as HT's prices were fixed at the time when the orders were received, while costs surged at an unexpected rate, especially in FY22.

Moreover, HT had procured materials and components upfront during the COVID pandemic when the cost of those materials was also much higher due to supply shortage. To tackle these cost issues and improve GPM and OPM, the firm aims to improve sales by:

- Reviewing its supply contracts when a change in specifications is required due to changes in shipment location by customers.
- Pass on cost increases associated with required upgrades to the price.
- Improve production systems, including those of its subcontractors, by frontloading specifications Increase production capacity to monetise order backlog so as to gain new orders.

At the same time, HT aims to reduce COGS and SG&A by the following measures:

- Reduce production costs by using standardised designs and specifications across product models.
- Raise the in-house production of core components.
- Increase monitoring of production costs.
- Review distributor contracts to negotiate commission rate.
- Improve productivity of the operation of the company by promoting digital transformation.

## PERFORMANCE BY SEGMENT

HT has three business segments, of which two – the Coating and Laminating Machinery segment and the Industrial Machinery segment – combined generate 96.2% of total consolidated sales and 96.8% of consolidated OP. Consolidated sales can also be divided by applications.

- Coating and Laminating Machinery Segment:**

The largest component of this segment is electrode coating equipment for secondary LiBs. FY23 1H segment OP improved +9.2% YoY to ¥918mil on sales of ¥18,227mil (+42.2% YoY). The segment OPM continued to deteriorate, from 6.6% in FY22 1H, 6.4% in FY22 and then to 5.0% in FY23 1H. In Q2 alone, the segment reported OP of ¥267mil (-24.7% YoY / -58.9% QoQ) on sales of ¥7,785mil (+26.3% YoY / -25.4% QoQ), generating an OPM of 3.4%. Sales were further split into domestic sales of ¥687mil (-29.0% YoY) and overseas sales of ¥17,539mil (+48.0% YoY).

The main reason for the deterioration in the FY23 1H OPM, was the rise in sales commissions due to the increase in LiB electrode coating equipment sales. Given the production delays, progress on changes to specifications by customers and higher costs (subcontractors / materials) also increased production costs.

Given HT pays its suppliers and subcontractors within a month of receiving an order, delays in revenue recognition were extended to as much as 12 months due to changes in specifications as customers change shipment locations of coating machines. Although the 1H segment order backlog declined by -32.6% YoY to ¥54,265mil on the back of improved levels of production, it is still as high as 1.7x of the segment's recent peak sales in FY22.

Sales are recognised based on the percentage of completion method. As a result, any delays to the production process will be reflected in the order backlog and contract assets on the BS. At the same time, the firm reviews the production costs as production progresses. The rapid surge in material and energy costs of over the past year is not reflected in orders currently included in order backlog.

- Industrial Machinery Segment:**

FY23 1H segment OP fell -54.4% YoY to ¥504mil on sales of ¥3,261mil (-32.0% YoY). Sales are further split into domestic sales of ¥1,422mil (+1.9% YoY) and exports of ¥1,839mil (-45.9% YoY). HT's deposition equipment is mainly used in electronic materials applications such as MLCCs and forming polyimide films. Demand remains solid especially in China. FY23 1H segment orders rose +3.2% YoY to ¥2,247mil while the order backlog declined -28.1% YoY to ¥8,737mil. 1H OPM worsened by -7.6ppts YoY to 15.5%, with the Q2 OPM contracting -12.7ppt YoY / -2.6ppt QoQ to 14.1%, due to changes in product mix. Compared to FY22 1H, sales of ceramic sheet forming equipment were flat YoY, while sales of polyimide films forming equipment and glass cloth production equipment declined.

Hirano Tecseed (6245): Segment Financial Summary											
(¥mil)		FY22				FY23					
		Q1	Q2	1H	FY	Q1	Q2	YoY (%)	QoQ (%)	1H	YoY (%)
Coating and Laminating Machinery	Sales	6,657	6,163	12,821	31,179	10,441	7,785	26.3	-25.4	18,227	42.2
	Operating Profit	485	355	841	1,985	650	267	-24.7	-58.9	918	9.2
	OPM (%)	7.3	5.8	6.6	6.4	6.2	3.4	-2.3ppt	-2.8ppt	5.0	-1.5ppt
Industrial Machinery	Sales	2,262	2,533	4,796	9,774	1,720	1,540	-39.2	-10.4	3,261	-32.0
	Operating Profit	429	677	1,107	2,069	287	217	-68.0	-24.4	504	-54.4
	OPM (%)	19.0	26.8	23.1	21.2	16.7	14.1	-12.7ppt	-2.6ppt	15.5	-7.6ppt
Others	Sales	306	347	653	1,470	422	435	25.4	3.0	857	31.3
	Operating Profit	25	37	63	82	20	27	-28.0	35.8	47	-25.2
	OPM (%)	8.3	10.9	9.7	5.6	4.7	6.3	-4.6ppt	+1.5ppt	5.5	-4.2ppt
Total	Sales	9,226	9,044	18,270	42,423	12,584	9,761	7.9	-22.4	22,346	22.3
	Operating Profit <sup>1</sup>	674	822	1,496	3,093	629	140	-82.9	-77.6	769	-48.6
	OPM (%)	7.3	9.1	8.2	7.3	5.0	1.4	-7.7ppt	-3.6ppt	3.4	-4.7ppt

Source: Nippon-IBR based on Hirano Tecseed's FY21, FY22 and FY23 Tanshin

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

Sales by Application												
(¥mil)	FY21					FY22					FY23	
	Q1	Q2	Q3	Q4	FY Total	Q1	Q2	Q3	Q4	FY Total	Q1	Q2
Display - related	1,636	1,321	596	150	3,704	662	1,144	1,223	783	3,815	661	291
Electronic materials-related	2,579	1,413	1,622	2,155	7,770	2,123	2,005	2,495	1,579	8,203	1,257	1,654
Household product-related	296	195	250	313	1,056	256	108	168	157	690	94	79
Energy- related	3,464	5,687	5,383	6,613	21,150	5,036	4,517	6,861	8,633	25,048	9,480	7,201
Other	870	1,139	1,107	1,066	4,184	1,147	1,268	1,208	1,041	4,666	1,089	535
Total	8,847	9,757	8,961	10,299	37,866	9,226	9,044	11,958	12,194	42,423	12,584	9,761

Source: Hirano Tecseed Co., Ltd.

## FY23 OUTLOOK

Although the 1H results were short of the firm's original forecast provided with the release of its FY22 results, HT had revised down the 1H guidance prior to the results announcement and has kept its full-year FY23 guidance for OP of ¥2,920mil (-5.6% YoY) on sales of ¥41,000mil (-3.4% YoY).

Although production levels recovered as issues with the supply of materials gradually eased, delays in shipments on the back of changes in machine specifications still continue. Therefore, full-year sales growth will likely be weaker YoY due to a rising number of equipment specifications adjustments – such as changes in delivery location which result in different requirements – and will lead to delivery delays.

Based on the firm's FY23 guidance, the OPM is estimated to improve to 7.1% from 3.4% in 1H. HT continues to engage in price negotiation to pass on cost increases and costs associated with updating and upgrading machine specifications to customers.

As well as aiming to promote further delivery management and productivity improvements, while also keeping a close eye on customers' CAPEX trends, HT is looking to capture new market demand to ensure growth over the medium to long term, especially in the US. The company set up a subsidiary in the US to gain the turnkey contracts rather than just selling coating machinery and establish service and maintenance businesses. However, HT's lack of production capacity remains an issue. Although HT's LiB electrode coating equipment is highly rated by global battery makers, shortage of production capacity continues to delay shipments.

With the order backlog at record levels, the average lead time from order receipt to the equipment delivery (installation) currently takes between 2~2.5 years. Some 80% of the current order backlog is made of orders received before FY22. Currently, HT is in a position not to drastically increase orders without risking longer delivery cycle.

Since orders for LiB electrode coating equipment rapidly surged in FY21, the firm's requirement for working capital reached approx. ¥10,100mil, to satisfy the level of production. However, due to changes in specifications of LiB electrode coating equipment, some orders in the current order backlog have become less profitable – though not unprofitable. Consequently, as noted above, HT is considering renegotiating prices in some cases. In the case of cancellations, the firm has already realised revenue based on the percentage of completion basis, hence will unlikely report impairment losses in the future.

## LONG-TERM VISION 2030

### Vision and Targe - Recap

Hirano Tecseed announced its Long-Term Vision 2030 plan, 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 based on the following three goals:

1. Capturing the top market share in coating equipment in 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

The two areas of growth focus will remain 1) energy-related application, including LiB electrode coating equipment, but will also extend to next generation batteries, such as solid-state batteries [SSB] and fuel cells, and 2) 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 development of the 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.**

With the 1H results announcement, HT outlined its capital allocation plan for its surplus cash, which is estimated at ¥7,000mil+, during the medium-term management plan. 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+**

HT plans to invest approx. ¥2,000mil on global production capacity expansion, as well as ¥1,000mil 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+**

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 buyback.

#### **3. Dividend Payments**

As for shareholder returns, management aim to maintain a minimum annual dividend of ¥56.00/share and pay out more than 35% of EPS. Dividends will be regularly reviewed to optimise shareholder equity which will subsequently improve PBR and ROE.

#### **4. Maintenance CAPEX ¥1,000mil**

HT plans to allocate ¥1,000mil on updating existing factories.

#### **5. Working Capital**

This will be equivalent to three-month sales.

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