SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange Prime Market

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Index

Summary

For FY3/24, operating profit increased by 22.8% YoY. Particularly strong sales to North America

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 has a long history in this field, and boasts the industry's highest 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 FY3/24 1Q

In the consolidated results for FY3/24 1Q, net sales increased 9.7% year on year (YoY) to ¥7,529mn, operating profit increased 22.8% to ¥551mn, ordinary profit rose 34.0% to ¥692mn, and profit attributable to owners of parent increased 17.2% to ¥471mn. By region, net sales were down 0.4% YoY due to delays in construction progress caused by unseasonable weather and other factors, but demand itself remained stable against a backdrop of measures to accelerate the national resilience plan. Overseas sales were also strong, especially in the U.S., where net sales grew 33.1% YoY due to increasing investment in road construction following the passing of the Infrastructure Investment and Jobs Act. Sales to Asia were down 4.2% YoY due to signs of slowing growth in some markets, despite a recovery in demand in Indonesia. Although the Company did not announce its initial forecast for 1Q, the results were largely in line with its plan.

2. Outlook for FY3/24

For FY3/24 consolidated results, the Company forecasts remain unchanged from the initial forecasts for net sales of ¥33,000mn (up 4.9% YoY), operating profit of ¥2,950mn (up 17.7%) ordinary profit of ¥2,800mn (up 20.3%), and profit attributable to owners of parent of ¥1,830mn (up 8.0%). The outlook for net sales and profit by customer region has not been disclosed, but the Company's policy is to pursue sales increases in all regions. Demand for construction machinery is forecast to remain stable as infrastructure investments increase globally. Although concerns regarding further increases in material prices still remain, the Company expects profit margins to improve due to factors such as the further penetration of price revisions, and it is forecasting that the operating profit margin will increase by 0.9 points YoY. However, it plans to review its progress on a quarterly basis and revise its financial results if necessary.

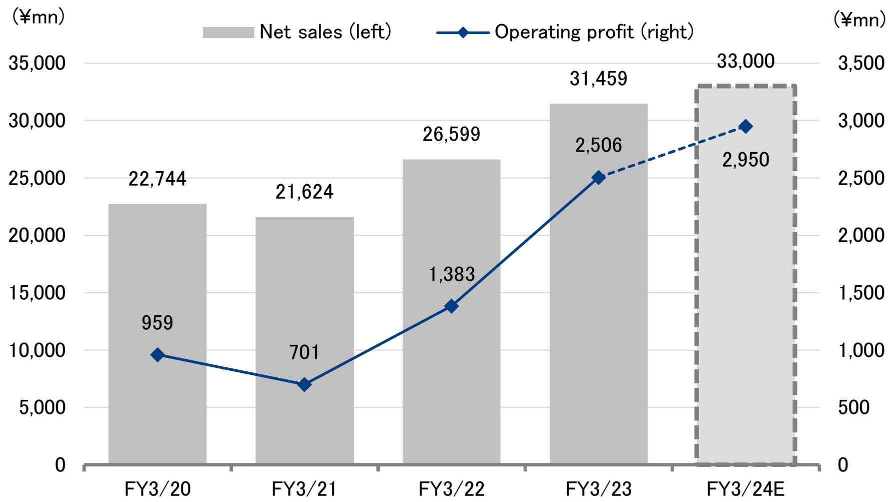
3. Medium-term growth strategy

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%. Although results have been strong in the first year of the plan in FY3/22 and the next year in FY3/23, but the plan currently remains the same, and the Company has kept these numerical targets unchanged. For FY3/24, given the ROE forecast to exceed 6.0% and the promised dividend payout ratio of 50%, it announced an increased annual dividend of ¥215.0 (interim dividend of ¥90.0 and fiscal year-end dividend of ¥125.0). The Company should be rated highly for announcing a clear capital policy to improve ROE and then implementing shareholder returns in accordance 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
- For FY3/24 1Q, the operating profit increased by 22.8% YoY, but the Company did not change its full-year forecasts
- As medium-term numerical targets, the Company is aiming for net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26

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 long history

The Company develops as a specialized manufacturer of road rollers for paving roads and other road construction equipment, and currently, the Company is the top 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 March 31, 2023, 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 in 1964, and its shares were reclassified to the First Section of the Tokyo Stock Exchange in 1981. In conjunction with the Tokyo Stock Exchange's market recategorization in April 2022, it moved to the Prime Market.

Business overview

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

The term "road roller" actually covers quite a wide range of machines in terms of capabilities and size, among other features. The Company has roughly 20 platforms alone for road rollers, and when different variations are added the total number of products is in the 70-80 range. There is also a wide range in sizes, from 1 ton to 20 tons (for large civil engineering projects). The core price range is from ¥5mn (medium-size rollers) to ¥10mn (large rollers), but the Company also has road cutters and other machines that cost tens of millions in yen. Production is carried out on an expected production basis, and the Company does not manufacture machines based on individual orders. The useful lives of the Company's products are in the 20-30 years range, but very few customers use a machine until the end of its useful life. In most cases, they replace it after statutory depreciation (6-7 years) with a new one. Most of the depreciated equipment are resold as used machines to overseas customers (especially in developing countries).

In terms of net sales by region in FY3/23, net sales in Japan were ¥15,208mn (48.3% of total net sales), net sales in North America were ¥7,751mn (24.7%), net sales in Asia were ¥7,796mn (24.8%), and net sales to other regions totaled ¥703mn (2.2%). Moreover, in terms of net sales by region in FY3/24 1Q, net sales in Japan were ¥2,798mn (37.2%), net sales in North America were ¥2,301mn (30.5%), net sales in Asia were ¥2,092mn (27.8%), and net sales to other regions totaled ¥337mn (4.5%).

2. Characteristics and strengths

As mentioned above, the Company is a specialized manufacturer of road rollers and other road construction equipment, and 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 of road rollers and other road construction equipment 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 experience engineering and 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. For this type of experience engineering, the Company's strength lies in the fact that it is a brand which customers have used for many years and that has accumulated long-term insight due to abundance of worksite experiences, and these are points that have earned the trust of many customers.

3. Market share and competitors

According to data from the Japan Construction Equipment Manufacturers Association, in FY2022 domestic construction equipment shipment value was ¥3.5tn, 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 this road equipment market, making it the top 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 is around 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

For FY3/24 1Q, operating profit increased by 22.8% YoY. Strong sales to North America and other overseas markets

1. Outline of results for FY3/24 1Q

In the consolidated results for FY3/24 1Q, net sales increased 9.7% YoY to ¥7,529mn, operating profit increased 22.8% to ¥551mn, ordinary profit rose 34.0% to ¥692mn, and profit attributable to owners of parent increased 17.2% to ¥471mn.

By region, net sales were down 0.4% YoY due to delays in construction progress caused by unseasonable weather and other factors, but demand itself remained stable against a backdrop of measures to accelerate the national resilience plan. Overseas sales were also strong, especially in the U.S., where net sales grew significantly due to increasing investment in road construction following the passing of the Infrastructure Investment and Jobs Act. Sales to Asia were down due to signs of slowing growth in some markets, despite a recovery in demand in Indonesia, resulting in overall weak sales. Although the Company did not announce its initial forecast for 1Q, the results were largely in line with its plan.

The gross margin improved significantly to 26.9% (25.6% in the year-earlier period), mainly due to progress in profit structure reform through the penetration of sales price revisions in Japan and overseas. On top of this, there was the impact of higher sales, and gross profit increased 15.3% YoY to ¥2,022mn. On the other hand, however, SG&A expenses increased by 12.7% due to increased business activity, higher personnel costs, and other factors. As a result, operating profit increased by 22.8% YoY.

Analyzing the change factors for operating profit, the improvement in sales had a positive ¥169mn impact, the increase in the cost of goods sold ratio had an impact of plus ¥98mn, and the increase in SG&A expenses had an in impact of minus ¥165mn. (Breaking down the increase, personnel expenses had a positive ¥93mn impact, technology and research expenses had a positive ¥16mn impact, advertising expenses had a positive ¥10mn impact, and other expenses had a positive ¥44mn impact).

Overview of FY3/24 1Q consolidated results

(¥mn)

	FY3/23 1Q		FY3/24 1Q		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	6,865	100.0%	7,529	100.0%	664	9.7%
Gross profit	1,754	25.6%	2,022	26.9%	267	15.3%
Selling, general and administrative expenses	1,305	19.0%	1,470	19.5%	165	12.7%
Operating profit	448	6.5%	551	7.3%	102	22.8%
Ordinary profit	516	7.5%	692	9.2%	175	34.0%
Profit attributable to owners of parent	402	5.9%	471	6.3%	69	17.2%

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

2. Trends by region

With respect to FY3/24 1Q net sales by region, the overall results can be said to have been solid. Domestically, sales centered mainly on orders for public investments such as road and civil engineering projects were strong against a backdrop of measures to accelerate the national resilience plan. However, due to delays in construction progress caused by unseasonable weather and other factors, net sales remained low at ¥2,798mn (down 0.4% YoY). Nevertheless, demand itself was solid and orders were strong, so this was not a concern.

Overseas, net sales increased steadily, amounting to ¥4,730mn (up 16.7% YoY) because of progress in the recovery of demand for construction machinery in the main markets in addition to the effects of the weaker yen. Of this amount, in North America net sales increased significantly to ¥2,301mn (up 33.1%) as a result of the market expanding against the backdrop of robust investment in construction, as well as the effects of cultivating dealers and penetration of price revisions. In Asia, despite a strong recovery of demand in Indonesia, signs of slowing growth were seen in some markets, resulting in sales of ¥2,092mn (down 4.2%). In other regions (Africa, Oceania, Central and South America, etc.), net sales totaled ¥337mn (up 140.5%), due to the realization of ODA projects in Africa.

Net sales by region

(¥mn)

	FY3/23 1Q		FY3/24 1Q		Change	
	Results	% of total	Results	% of total	Amount	%
Japan	2,811	41.0%	2,798	37.2%	-12	-0.4%
Overseas	4,053	59.0%	4,730	62.8%	676	16.7%
North America	1,729	25.2%	2,301	30.5%	572	33.1%
Asia	2,184	31.8%	2,092	27.8%	-92	-4.2%
Other regions	140	2.0%	337	4.5%	197	140.5%
Total	6,865	100.0%	7,529	100.0%	664	9.7%

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

Stable financial condition, ample cash and deposits of ¥7,760mn. Currently adjusting inventory levels to the appropriate level

3. Financial condition

In terms of the Company's financial condition as of the end of FY3/24 1Q, current assets were ¥28,286mn (up ¥846mn from the end of the previous fiscal year). The main factors included a ¥276mn increase in cash and deposits, a ¥730mn decrease in notes and accounts receivable - trade (including electronically recorded monetary claims - operating), and a ¥1,206mn increase in inventories. Non-current assets were ¥14,147mn (up ¥783mn). The main factors include a ¥15mn increase in property, plant and equipment, a ¥36mn decrease in intangible assets, and an ¥804mn increase in investments and other assets (mainly a ¥770mn increase in investment securities). As a result, total assets were ¥42,434mn, an increase of ¥1,630mn. Although cash and deposits remained at a high level of ¥7,760mn as of the end of FY3/24 1Q, inventories were increasing slightly, and the Company stated that it is in the process of adjusting inventory levels to an appropriate level.

Total liabilities were ¥16,423mn (up ¥915mn from the end of the previous fiscal year). The main factors among current liabilities included a ¥682mn increase in payables (notes and accounts payable – trade and electronically recorded obligations – operating), a ¥75mn increase in short-term borrowings, and a ¥244mn increase in non-current liabilities. Total net assets stood at ¥26,010mn (up ¥714mn), with the main factors including a ¥36mn decrease in retained earnings due mainly to the payment of dividends, and a ¥537mn increase in valuation difference on available- for-sale securities, and a ¥212mn increase in foreign currency translation adjustment. As a result, the equity ratio as of the end of FY3/24 1Q was 61.1% (61.8% at the end of the previous fiscal year).

As a result of the above, net working capital (trade receivables + inventories – trade payables) at the end of FY3/24 1Q increased by 24.7% to ¥11,563mn (up ¥2,290mn YoY). This was mainly due to increases in trade receivables (up ¥1,027mn), inventories (up ¥3,200mn) and a decrease in trade payable (down ¥1,937mn). The inventory turnover decreased 0.66 times YoY to 3.01 times per year, mainly reflecting an increase in inventory levels due to increased production and to reduce risk of part shortages, despite steady sales (net sales).

Net working capital

(¥mn)

	FY3/23 1Q Results	FY3/24 1Q Results	Change	
			Amount	%
Consolidated net sales (annualized consolidated net sales)	27,375	32,123	4,748	17.3%
Trade receivables	7,706	8,733	1,027	13.3%
Inventories	7,458	10,658	3,200	42.9%
Trade payables	-5,891	-7,828	-1,937	32.9%
Net working capital	9,273	11,563	2,290	24.7%
Inventory turnover (times)	3.67	3.01	-0.66	

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

Outlook

FY3/24 forecast is for a 17.7% YoY increase in operating profit

● Outlook for FY3/24

For FY3/24 consolidated results, the Company is forecasting net sales of ¥33,000mn (+4.9% YoY), operating profit of ¥2,950mn (+17.7%), and ordinary profit of ¥2,800mn (+20.3%), and profit attributable to owners of parent of ¥1,830mn (+8.0%), unchanged from the initial forecasts.

The outlook for net sales and profit by region has not been disclosed, but the Company's policy is to pursue sales increases in all regions. Demand for construction machinery is forecast to remain stable as infrastructure investments increase globally. On the other hand, there are many uncertain factors such as global inflation, security issues, and social structural changes, but by promoting profit structure reform, improving productivity and creating new added value, and modifying global business activities, it is forecasting that the operating profit margin will increase by 0.9 points YoY. It has stated that in the future, it will make revisions going as needed when it discloses quarterly financial results, but as of the 1Q announcement, no revisions had been made. Attention must be given to future developments.

Consolidated outlook for FY3/24

(¥mn)

	FY3/23		FY3/24		Change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	31,459	100.0%	33,000	100.0%	1,540	4.9%
Operating profit	2,506	8.0%	2,950	8.9%	443	17.7%
Ordinary profit	2,327	7.4%	2,800	8.5%	472	20.3%
Profit attributable to owners of parent	1,694	5.4%	1,830	5.5%	135	8.0%

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

Medium-term growth strategy

As its medium-term growth strategy, the Company will seek to grow its overseas market share, expand overseas business domains, and create added value by developing next-generation businesses. FY3/26 targets include net sales of ¥30.0bn and operating profit of ¥3.1bn

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%. Based on results in the first year of the plan in FY3/22 and FY3/23, net sales is developing at a pace exceeding the plan, but the policy currently remains the same, and the Company has kept these numerical targets unchanged.

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

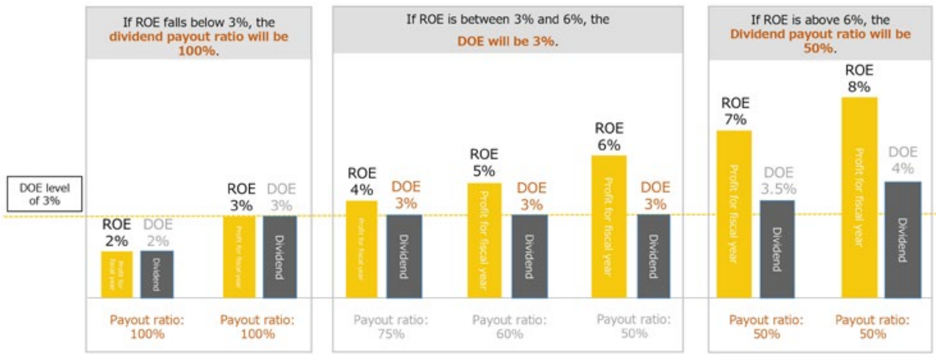
As medium-term numerical targets, the Company aims for net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26.

2. Capital strategy

As its basic policy for capital strategy, the Company will return profits to shareholders at a level that supports the Company's objective of ROE of 8%, and will increase shareholder value (improve capital efficiency). As a final target for FY3/26, the Company will strive to achieve ROE of 8% and a 50% dividend payout ratio.

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 will be 3%, and if ROE is above 6%, the dividend payout ratio will be 50%.

Basic capital policy approach



Source: 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 capital (ROIC).

3. Initiatives for ESG

The Company is proactively addressing ESG through various initiatives. Currently, it is particularly focusing on the following initiatives.

(1) Initiatives contributing to carbon neutrality

The Company is actively promoting research and development in electric rollers to reduce CO_2 emissions at construction sites. It has already completed a demonstration electric roller and it plans to carry out practical tests at actual road paving sites in the near future. It will use these to collect data aimed at realizing commercialization.

It has also created a concept model for an Electric Walk Behind Roller equipped with portable and swappable batteries made by Honda Motor Co., Ltd. <7267>.

Initiatives contributing to carbon neutrality

Source: The Company's results briefing materials

(2) Initiatives solving social issues through business activities

The Company is scheduled to start producing road planers in Indonesia from January 2024. The aim is to contribute to road infrastructure in Southeast Asia while also expanding the area covered by the Company's business.

(3) Initiatives strengthening corporate governance

In order to strengthen corporate governance, the Company appointed Haruyasu Asakura, whose experience includes positions at the Innovation Network Corporation of Japan and Marunouchi Capital Inc., as an outside director at the Annual General Meeting of Shareholders held in June 2023. The Company believes he is suitable to serve as an outside director due to his extensive experience in private equity funds, which has helped him develop broad insight into capital markets and corporate value improvement.

Shareholder return policy

Plans to pay an annual dividend of ¥215.0 in FY3/24 in line with its commitment. Aims to conduct share buybacks with an upper limit of ¥0.5-2.0bn by FY3/26

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, for FY3/24, given the ROE forecast to exceed 6.0% and the promised dividend payout ratio of 50%, it announced an increased annual dividend of ¥215.0 (interim dividend of ¥90.0 and fiscal year-end dividend of ¥125.0). The Company should be rated highly for announcing a clear capital policy to improve ROE and then implementing shareholder returns in accordance with that policy.

Disclaimer

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