COMPANY RESEARCH AND ANALYSIS REPORT

SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange Prime Market

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Index

Summary

For FY3/24 3Q, operating profit increased by 62.7% YoY. Particularly strong sales to North America, albeit with slightly slower profit growth

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 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 3Q

In the consolidated results for FY3/24 3Q, net sales increased 9.8% year on year (YoY) to ¥24,301mn, operating profit increased 62.7% to ¥2,580mn, ordinary profit rose 68.7% to ¥2,676mn, and profit attributable to owners of parent increased 66.1% to ¥1,947mn. The results were largely in line with forecasts. By region, in Japan net sales were up 1.9% YoY as capital investment trends reached a standstill, faced with frequent sales price revisions and a broad range of cost increases, despite a firm market environment against the backdrop of measures to accelerate national land resilience. Overseas sales were strong, increasing 17.5%. In particular, net sales increased 31.8% YoY in the U.S., due to increasing investment in road construction following the passing of the Infrastructure Investment and Jobs Act and the effect of the weak yen. Sales to Asia were down 3.5%, due to slowdowns in the Chinese and ASEAN markets excluding Indonesia (primarily Thailand and Vietnam), despite a recovery in demand in Indonesia. The gross margin improved to 29.1% (vs. 25.6% in the year-before 3Q), due to factors including the effects of sales price revisions, the normalization of transport costs, and the weak yen. SG&A expenses only increased 10.5%, so operating profit rose significantly. Nevertheless, when looking at the three-month 3Q period alone, operating profit only increased 18.5%, indicating slightly slower profit growth compared to 1H.

2. Outlook for FY3/24

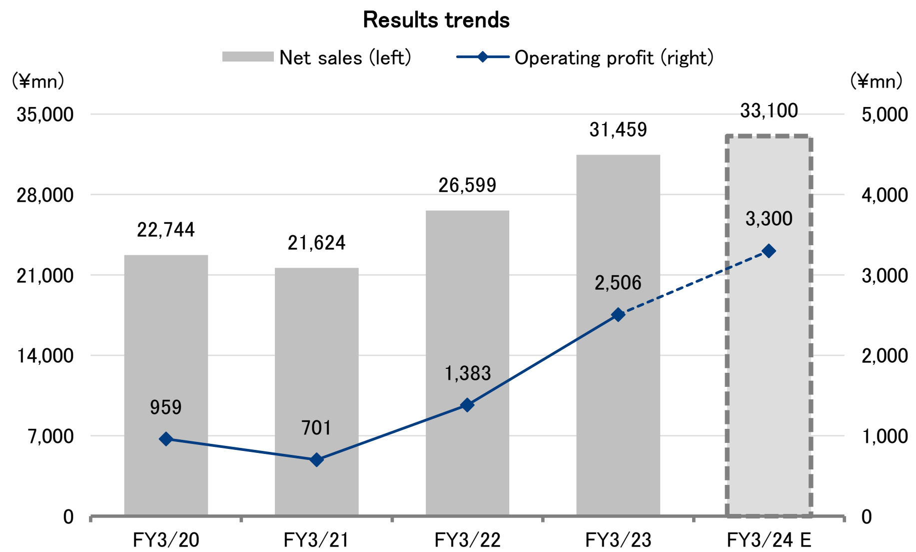
For its FY3/24 consolidated results, the Company has not revised its forecasts from the upwardly revised forecasts in FY3/24 1H, with a forecast for net sales of ¥33,100mn (up 5.2% YoY), operating profit of ¥3,300mn (up 31.7%), ordinary profit of ¥3,300mn (up 41.8%), and profit attributable to owners of parent of ¥2,300mn (up 35.7%). Global demand for construction machinery is forecast to remain solid as infrastructure investment increases globally, but there are concerns about a dulling of demand in certain areas, so the Company has adopted a fairly cautious outlook for 2H. In the U.S. market, which has thus far driven business performance, the Company has also adopted a cautious outlook for 4Q in light of the possibility of delays in parts procurement due to conditions in the Panama Canal, despite firm demand. While it is unlikely for actual results to fall below full-year forecasts at this time, it would be unwise to harbor unrealistic expectations for additional upward revisions to the forecasts.

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%. Results were strong in the first year of the plan in FY3/22 and the second year in FY3/23, and FY3/24 has been solid thus far, but the plan currently remains the same, and the Company has kept these numerical targets unchanged. Regarding the FY3/24 dividend, given the ROE is forecast to exceed 6.0% and the promised dividend payout ratio of 50%, the Company announced an increased annual dividend to ¥270.0 (interim dividend of ¥90.0 and fiscal year-end dividend of ¥180.0). 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
- With a 62.7% YoY increase in operating profit during FY3/24 3Q, a 31.7% increase is forecast for the full year
- Medium-term numerical targets (net sales of ¥30.0bn and operating profit of ¥3.1bn for FY3/26) remain unchanged



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

Company profile

The leading manufacturer of road rollers with a long history

The Company is a specialized manufacturer of road rollers for paving roads and other road construction equipment, and currently, 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 FY3/23, 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 leading 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."

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 in other regions totaled ¥703mn (2.2%). Moreover, in terms of net sales by region in FY3/24 3Q, net sales in Japan were ¥11,070mn (45.6%), net sales in North America were ¥6,626mn (27.3%), net sales in Asia were ¥5,503mn (22.6%), and net sales in other regions totaled ¥1,101mn (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 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 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 3Q, operating profit increased by 62.7% YoY. Strong sales to North America and other overseas markets

1. Outline of results for FY3/24 3Q

In the consolidated results for FY3/24 3Q, net sales increased 9.8% YoY to ¥24,301mn, operating profit increased 62.7% to ¥2,580mn, ordinary profit rose 68.7% to ¥2,676mn, and profit attributable to owners of parent increased 66.1% to ¥1,947mn. The results were largely in line with plans.

The gross margin improved to 29.1% (vs. 25.6% in the year-before 3Q), due to factors including the effects of sales price revisions, the normalization of transport costs, and the weak yen. SG&A expenses only increased 10.5%, so operating profit rose significantly. Nevertheless, when looking at the three-month 3Q period alone, operating profit only increased 18.5%, indicating slightly slower profit growth compared to 1H.

Overview of FY3/24 3Q consolidated results

(¥mn)

	FY3/23 3Q		FY3/24 3Q		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	22,125	100.0%	24,301	100.0%	2,175	9.8%
Gross profit	5,654	25.6%	7,076	29.1%	1,422	25.1%
SG&A expenses	4,069	18.4%	4,496	18.5%	427	10.5%
Operating profit	1,585	7.2%	2,580	10.6%	994	62.7%
Ordinary profit	1,586	7.2%	2,676	11.0%	1,089	68.7%
Profit attributable to owners of parent	1,172	5.3%	1,947	8.0%	775	66.1%

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

2. Trends by region

Looking at each region, in Japan net sales increased 1.9% YoY to ¥11,070mn, as capital investment trends reached a standstill, faced with frequent sales price revisions and a broad range of cost increases, despite a firm market environment against the backdrop of measures to accelerate national land resilience. Overseas, net sales increased 17.5% to ¥13,231mn, due partly to progress in the recovery of demand for construction machinery in the main markets in addition to the effects of the weak yen. In particular, net sales rose 31.8% to ¥6,626mn in the U.S. due to increasing investment in road construction following the passing of the Infrastructure Investment and Jobs Act and the effect of the weak yen. Sales to Asia were down 3.5% to ¥5,503mn, due to slowdowns in the Chinese and ASEAN markets excluding Indonesia (primarily Thailand and Vietnam), despite a recovery in demand in Indonesia. In other markets, net sales increased 108.2% to ¥1,101mn, reflecting firm conditions in the Oceania market, along with ODA projects for Africa.

Net sales by region

(¥mn)

	FY3/23 3Q		FY3/24 3Q		Change	
	Results	% of total	Results	% of total	Amount	%
Japan	10,864	49.1%	11,070	45.6%	205	1.9%
Oversea	11,261	50.9%	13,231	54.4%	1,970	17.5%
North America	5,028	22.7%	6,626	27.3%	1,598	31.8%
Asia	5,703	25.8%	5,503	22.6%	-200	-3.5%
Other regions	528	2.4%	1,101	4.5%	572	108.2%
Total	22,125	100.0%	24,301	100.0%	2,175	9.8%

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

Stable financial condition, ample cash and deposits of ¥7,674mn. Inventory levels are slightly high in anticipation of sales growth

3. Financial condition

In terms of the Company's financial condition as of the end of FY3/24 3Q, current assets were ¥29,871mn (up ¥2,431mn from the end of the previous fiscal year). The main factors included a ¥190mn increase in cash and deposits, an ¥895mn decrease in notes and accounts receivable - trade (including electronically recorded monetary claims - operating), and a ¥2,610mn increase in inventories. Non-current assets were ¥15,000mn (up ¥1,635mn). The main factors include a ¥265mn increase in property, plant and equipment, a ¥58mn decrease in intangible assets, and a ¥1,429mn increase in investments and other assets (mainly a ¥1,487mn increase in investment securities). As a result, total assets were up ¥4,067mn to ¥44,871mn. Inventories increased, but only owing to an increase in parts for increased production and safety stock. The increase in inventories is not a cause for concern because it represents the Company's adjustments to optimize inventory levels in response to an easing of supply constraints for parts and other items.

Total liabilities were ¥16,440mn (up ¥931mn from the end of the previous fiscal year). The main factors among current liabilities included a ¥657mn increase in payables (notes and accounts payable - trade and electronically recorded obligations - operating), a ¥10mn increase in short-term borrowings, and a ¥506mn increase in non-current liabilities. Total net assets stood at ¥28,431mn (up ¥3,135mn). As a result, the equity ratio as of the end of FY3/24 3Q was 63.2% (61.8% at the end of the previous fiscal year).

Net working capital (trade receivables + inventories – trade payables) at the end of FY3/24 3Q increased by 10.2% to ¥12,827mn (up ¥1,182mn YoY). This was mainly due to a decrease in trade receivables (down ¥1,197mn), an increase in inventories (up ¥2,262mn) and a decrease in trade payable (down ¥117mn). The inventory turnover decreased 0.16 times YoY to 2.79 times per year, mainly reflecting an increase in inventory levels due to increased production and reduced risk of part shortages, despite steady sales (net sales).

Net working capital

(¥mn)

	FY3/23 3Q results	FY3/24 3Q results	Change	
			Amount	%
Consolidated net sales (annualized consolidated net sales)	28,931	33,635	4,704	16.3%
Trade receivables	9,765	8,568	-1,197	-12.3%
Inventories	9,800	12,062	2,262	23.1%
Trade payables	-7,920	-7,803	117	-1.5%
Net working capital	11,645	12,827	1,182	10.2%
Inventory turnover (times)	2.95	2.79	-0.16	

Note: Consolidated net sales (annualized) = Net sales of 1Q-3Q in the current fiscal year + 4Q in the previous fiscal year
Source: Prepared by FISCO from the Company's results briefing materials

Outlook

FY3/24 forecast is for a 31.7% YoY increase in operating profit

● Outlook for FY3/24

For FY3/24 consolidated results, the Company is forecasting net sales of ¥33,100mn (up 5.2% YoY), operating profit of ¥3,300mn (up 31.7%), ordinary profit of ¥3,300mn (up 41.8%), and profit attributable to owners of parent of ¥2,300mn (up 35.7%). The upwardly revised forecasts in FY3/24 1H remain unchanged. The Company is assuming an exchange rate of ¥140/USD.

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 2.0 points YoY.

Global demand for construction machinery is forecast to remain solid as infrastructure investment increases globally, but there are concerns about a dulling of demand in certain areas, so the Company has adopted a fairly cautious outlook for 2H. In the U.S. market, which has thus far driven business performance, the Company has also adopted a cautious outlook for 4Q in light of the possibility of delays in parts procurement due to conditions in the Panama Canal, despite firm demand. While it is unlikely for actual results to fall below full-year forecasts at this time, it would be unwise to harbor unrealistic expectations for additional upward revisions to the forecasts.

Consolidated outlook for FY3/24

(¥mn)

	FY3/23		FY3/24		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	31,459	100.0%	33,100	100.0%	1,641	5.2%
Operating profit	2,506	8.0%	3,300	10.0%	794	31.7%
Ordinary profit	2,327	7.4%	3,300	10.0%	973	41.8%
Profit attributable to owners of parent	1,694	5.4%	2,300	6.9%	606	35.7%

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 of net sales of ¥30.0bn and operating profit of ¥3.1bn are unchanged

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% (DOE of 4%). As mentioned above, the forecasts for FY3/24 already exceed these targets, 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

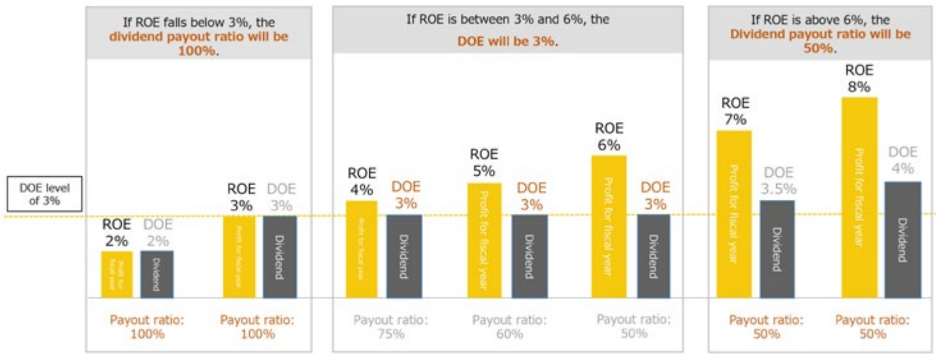
As medium-term numerical targets, the Company aims for net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26.

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. Medium-Term Management Policy: Progress on KPI

Looking at the progress made on the main KPI announced in the Medium-Term Management Policy, for its FY3/24 full-year results the Company is forecasting net sales of ¥33,100mn and ROE of 8.6%, so it is expecting to achieve the values in its medium-term management policy. Improvements to the profit structure in FY3/24 include upside factors other than actual performance, such as the weak yen, in addition to penetration of sales price revisions and the normalization of transport costs. Therefore, the Company will aim to solidify this profit structure and further improve business performance moving forward.

Medium-Term Management Policy KPI

(Millions of yen)

	Nine months ended December 31, 2022 (Results)	Nine months ended December 31, 2023 (Results)	Fiscal year ending March 31, 2024 (Forecast)	Target for the fiscal year ending March 31, 2024	Target for the fiscal year ending March 31, 2026
Net sales	22,125	24,301	33,100	26,500	30,000
Operating profit	1,585	2,580	3,300	2,000	3,100
Annualized return on equity (ROE)*1	6.5%	9.7%	8.6%	5.5%	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 February 9, 2024.
*3 The amount represents the targets of the cumulative amount of share buybacks through March 31, 2026.

Source: The Company's results briefing materials

4. Sustainability initiatives

The Company is proactively working on sustainability initiatives, and is advancing a variety of measures. Currently, it is focusing in particular on the following measures.

(1) Providing added value by contributing to the realization of a decarbonized society

The Company introduced its autonomous rollers (SV514D)* at construction sites in FY3/24. This will make compaction efficient, contributing to a reduction in CO_2 emissions at construction sites.

* Test data has shown that autonomous rollers enable approximately 20% more labor-saving than manned work.

(2) Resolving social issues and expanding business domains

JICA selected the Company's stabilizer method (road repair technology) and products for a business validation survey in Indonesia. Using the Company's stabilizer method and products (PM550-s road stabilizers) aims to both contribute to infrastructure development in Indonesia and expand the use and sale of its products.

(3) Human capital management initiatives: Initiatives to increase the percentage of women in management positions and reduce the gender pay gap

The Company set* a target of 15% for the percentage of women in management positions by March 2026. The low percentage of women in management positions is considered to be one factor in a gender pay gap, as earnings by women are 82.4% of men among permanent workers, excluding those in management positions. The Company's policy is to actively work to improve the percentage of women in management positions from the perspective of reducing the gender pay gap.

* This target was set on the basis of raising the percentage of women in management positions to approximately match the percentage of management positions among all employees. Consequently, this target may be subject to change in future due to changes affecting factors such as the number of employees and the number of employees in management positions.

Human capital management initiatives

■ Ratio of women in management positions

March 2023 (Result)	September 2023 (Result)	March 2026 (Target)
3.0%	5.0%	15.0%

■ Female worker earnings as percentage of male worker earnings (fiscal year ended March 31, 2023)

All workers	Permanent workers	Permanent workers (excluding management positions)
67.4%	75.1%	**82.4%**

Source: The Company's results briefing materials

Shareholder return policy

Announced an annual dividend increase to ¥270.0 in FY3/24 in line with its commitment. Aims to conduct share buybacks with an upper limit of ¥0.5bn to ¥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 annual dividend of ¥215.0 (interim dividend of ¥90.0 and fiscal year-end dividend of ¥125.0). However, in conjunction with the upward revision of full-year forecasts, the Company announced that it will increase the annual dividend to ¥270.0 (interim dividend of ¥90.0 and fiscal year-end dividend of ¥180.0). 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.

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