COMPANY RESEARCH AND ANALYSIS REPORT

SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange Prime Market

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Summary

3Q FY3/25 profits declined significantly YoY, but were mostly in line with expectations

SAKAI HEAVY INDUSTRIES, LTD. <6358> (hereafter, also "the Company") is a manufacturer specializing in road rollers for road paving and other road construction equipment. It boasts the industry's leading 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. Overview of 3Q FY3/25 results

In the consolidated results for 3Q FY3/25, net sales decreased 16.7% year on year (YoY) to ¥20,243mn, operating profit decreased 47.0% to ¥1,368mn, ordinary profit fell 47.2% to ¥1,413mn, and profit attributable to owners of parent decreased 26.3% to ¥1,435mn. Profit attributable to owners of parent decreased by a smaller extent due to the posting of a gain on sale of investment securities of ¥288mn as extraordinary income in 1Q. In terms of sales by region, the domestic market environment was strong due to measures to accelerate the national resilience plan, but repeated price revisions and overtime restrictions in the construction industry caused capital investment by construction equipment rental companies, which are major customers, to remain stagnant, resulting in a 14.3% decrease YoY. Overseas sales also saw an 18.7% decline YoY, with a continued downward trend since 2Q. In North America, inventory adjustments by dealers accelerated amid persistently high interest rates, resulting in a 25.1% decrease YoY. Looking at Asia, demand in Indonesia was sluggish due to the influence of the presidential election, and demand also slowed in some parts of ASEAN markets, resulting in a 14.3% decrease YoY in sales. Although profits declined significantly YoY, they were mostly in line with the expectations of the Company's plan, which was revised downward at the end of 1H.

2. FY3/25 forecasts

For FY3/25 consolidated results, the Company expects net sales of ¥27,200mn (down 17.6% YoY), operating profit of ¥1,740mn (down 47.6%), ordinary profit of ¥1,700mn (down 48.9%), and profit attributable to owners of parent of ¥1,700mn (down 30.3%), unchanged from the revised forecast at the end of 1H (The assumed exchange rate for 2H FY3/25 is ¥140/USD). The adjustment phase in the global construction machinery market is forecast to persist, and the challenging business environment is expected to continue for the time being.

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3. Medium-term growth strategy

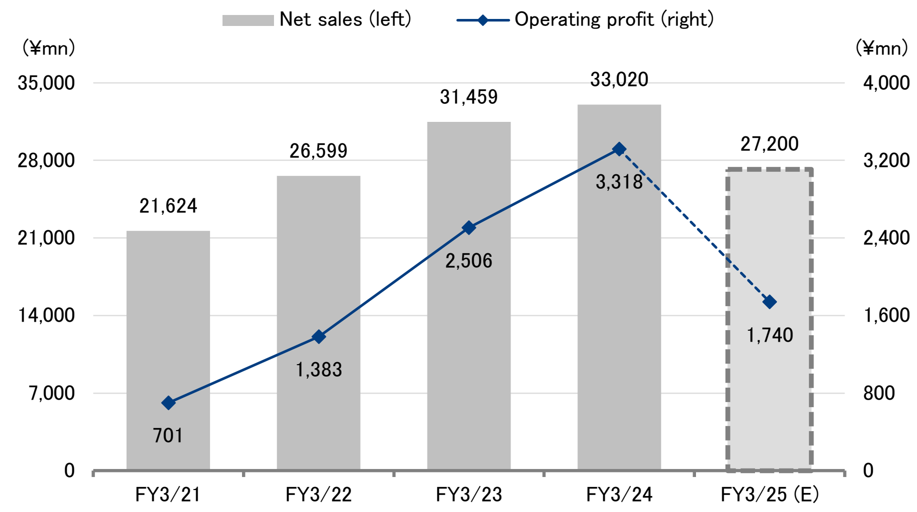
In June 2021, the Company released its Medium-Term Management Policy which runs through FY3/26. The ultimate goal is to increase corporate value and shareholder value, and in order to achieve this, the Company is promoting a business growth strategy and an efficient capital strategy. In terms of numerical targets, in FY3/26, the Company is aiming for net sales of ¥30.0bn, operating profit of ¥3.1bn, return on equity (ROE) of 8.0%, and will aim to maintain a stable dividend payout ratio of 50%. The Company has already surpassed its targets for net sales and operating profits in FY3/24, but has opted to leave its numerical targets unchanged, given that it forecasts a decline in sales and profits for FY3/25. In addition, with regard to annual dividends, as the forecast ROE is expected to decrease to 5.8% due to downward revisions to the business forecasts for FY3/25, the Company has lowered its annual dividend forecast* to ¥103.0 (from an initial forecast of ¥107.5) in accordance with its basic policy (if ROE is 6.0% or lower, dividend on equity (DOE) will be 3.0%). Although recent business results have leveled off, the Company's stance of announcing a clear policy to improve ROE and carrying out shareholder returns in line with that policy is worthy of recognition.

* These figures are adjusted to reflect the two-for-one split of the Company's shares carried out on October 1, 2024.

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
- In 3Q FY3/25, operating profit declined 47.0% YoY. The Company forecasts a 47.6% YoY decline in operating profit in FY3/25
- Medium-term numerical targets (net sales of ¥30.0bn, operating profit of ¥3.1bn in FY3/26) are unchanged

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 domestic market share of over 70%

The Company is a specialized manufacturer of road rollers for paving roads and other road construction equipment. 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 its effort to expand business overseas at an early stage. As of the end of FY3/24, 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 (TSE) in 1964, and its shares were reclassified to the First Section of TSE in 1981. In conjunction with the TSE's market recategorization in April 2022, it moved to the Prime Market.

Business overview

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 FY3/24, net sales in Japan were ¥14,320mn (43.4% of total net sales), net sales in North America were ¥9,700mn (29.4%), net sales in Asia were ¥7,566mn (22.9%), and net sales in other regions totaled ¥1,432mn (4.3%).

2. Features and strengths

The Company's features and strengths are as follows.

(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 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.

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(3) Credibility

Credibility backed by abundant worksite experience and a 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. The Company's strength lies in the fact that it has accumulated long-term insight due to an abundance of worksite experience, and it has earned the trust of many customers.

3. Market share and competitors

According to data from the Japan Construction Equipment Manufacturers Association, in FY2023 the total construction equipment shipment value including domestic and exports was approximately ¥3.7tn, and road roller and other road construction equipment (the Company's main products) account for about 2.3% of this amount. The Company has a share of over 70% in the road roller 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 12%. 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

3Q FY3/25 operating profit declined 47.0% YoY, mostly in line with expectations

1. Overview of 3Q FY3/25 results

In the consolidated results for 3Q FY3/25, net sales decreased 16.7% YoY to ¥20,243mn, operating profit decreased 47.0% to ¥1,368mn, ordinary profit declined 47.2% to ¥1,413mn, and profit attributable to owners of parent decreased 26.3% to ¥1,435mn. Profit attributable to owners of parent decreased by a smaller extent due to the posting of a gain on sale of investment securities of ¥288mn as extraordinary income in 1Q.

The gross margin improved by 0.1 percentage points YoY (from 29.1% in the same period of the previous fiscal year to 29.2%) due to factors including the effects of price revisions and the depreciation of the yen, but the decline in sales resulted in a 16.3% YoY decline in gross profit to ¥5,920mn. Meanwhile, operating profit fell 47.0% due to the increase in SG&A expenses (up 1.3%).

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Overview of 3Q FY3/25 consolidated results

(¥mn)

	3Q FY3/24		3Q FY3/25		YoY change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	24,301	100.0%	20,243	100.0%	-4,058	-16.7%
Gross profit	7,076	29.1%	5,920	29.2%	-1,156	-16.3%
SG&A expenses	4,496	18.5%	4,552	22.5%	56	1.3%
Operating profit	2,580	10.6%	1,368	6.8%	-1,212	-47.0%
Ordinary profit	2,676	11.0%	1,413	7.0%	-1,263	-47.2%
Profit attributable to owners of parent	1,947	8.0%	1,435	7.1%	-511	-26.3%

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

2. Trends by region

Net sales by region have not seen a significant change from the trends up to 1H. In Japan, the market environment was strong due to measures to accelerate the national resilience plan, but repeated price revisions and overtime restrictions in the construction industry caused capital investment by construction equipment rental companies, which are major customers, to stagnate, resulting in a 14.3% YoY decrease in net sales to ¥9,490mn. Overseas sales were also down 18.7% YoY to ¥10,753mn. In North America, final demand was strong due to the expansion of road construction investment against the backdrop of the Infrastructure Investment and Jobs Act, but continued inventory adjustments by major dealers, which partly reflected the impact of persistently high interest rates, resulted in a 25.1% YoY decrease in net sales to ¥4,965mn. In Asia, demand in Indonesia was sluggish due to the influence of the presidential election, and demand also slowed in other ASEAN markets (mainly Thailand and Vietnam), resulting in a 14.3% decrease YoY in net sales to ¥4,715mn. In other regions, net sales were also lackluster, decreasing 2.7% YoY to ¥1,072mn.

Net sales by region

(¥mn)

	3Q FY3/24		3Q FY3/25		YoY change	
	Amount	% of total	Amount	% of total	Amount	%
Japan	11,070	45.6%	9,490	46.9%	-1,579	-14.3%
Overseas	13,231	54.4%	10,753	53.1%	-2,478	-18.7%
North America	6,626	27.3%	4,965	24.5%	-1,661	-25.1%
Asia	5,503	22.6%	4,715	23.3%	-788	-14.3%
Other regions	1,101	4.5%	1,072	5.3%	-29	-2.7%
Total	24,301	100.0%	20,243	100.0%	-4,058	-16.7%

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

The Company has a solid financial foundation and ample cash and deposits on hand of ¥6,567mn. Inventories swelled due to sluggish net sales growth

3. Financial position

In terms of the Company's financial position as of the end of 3Q FY3/25, current assets were ¥28,145mn (down ¥492mn from the end of the previous fiscal year). The main factors included a ¥1,807mn decrease in cash and deposits, a ¥1,503mn decrease in notes and accounts receivable-trade (including electronically recorded monetary claims-operating), and a ¥2,427mn increase in inventories. Non-current assets were ¥15,621mn (up ¥21mn). The main factors include a ¥122mn decrease in property, plant and equipment, a ¥278mn increase in intangible assets, and a ¥134mn increase in investments and other assets (mainly an ¥83mn decrease in investment securities). As a result, total assets were ¥43,766mn (down ¥471mn). Regarding the increase in inventories, the Company has stated that the level remains somewhat high, so it is in the process of adjusting inventories to appropriate levels. However, net sales growth has been sluggish. Progress is not on track as expected.

Total liabilities were ¥14,033mn (down ¥1,038mn from the end of the previous fiscal year). The main factors included a ¥1,177mn decrease in payables (notes and accounts payable – trade and electronically recorded obligations – operating), a ¥261mn increase in short-term borrowings among current liabilities, and a ¥171mn increase in non-current liabilities. Total net assets stood at ¥29,732mn (up ¥567mn), with the main factors including a ¥244mn increase in retained earnings, a ¥237mn increase in foreign currency translation adjustment. As a result, the equity ratio as of the end of 3Q FY3/25 was 67.8% (65.8% at the end of the previous fiscal year).

Net working capital (trade receivables + inventories – trade payables) at the end of 3Q FY3/25 was ¥15,132mn, up ¥2,305mn from the end of the previous fiscal year. This was mainly due to a ¥1,574mn decline in trade receivables, a ¥1,023mn increase in inventories, and a ¥2856mn increase in trade payables. The construction machinery market entered an adjustment period, resulting in the net sales/inventory turnover decreasing by 0.58 times to 2.21 times.

Net working capital

(¥mn)

	3Q FY3/24 Results	3Q FY3/25 Results	YoY change	
			Amount	%
Annualized consolidated net sales	33,635	28,962	-4,673	-13.9%
Trade receivables	8,568	6,994	-1,574	-18.4%
Inventories	12,062	13,085	1,023	8.5%
Trade payables	-7,803	-4,947	2,856	-36.6%
Net working capital	12,827	15,132	2,305	18.0%
Inventory turnover ratio (times)	2.79	2.21	-0.58	-

Note: Annualized consolidated net sales = Cumulative net sales in 3Q of the fiscal year under review + net sales in 4Q of previous fiscal year
Source: Prepared by FISCO from the Company's results briefing materials

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Outlook

The Company is expecting a 47.6% YoY decline in operating profit for FY3/25

● FY3/25 forecasts

For FY3/25 consolidated results, the Company has revised the full-year forecasts downward from the initial forecasts (net sales of ¥33,000mn; operating profit of ¥2,730mn) in the 2Q announcement, and now expects net sales of ¥27,200mn (down 17.6% YoY), operating profit of ¥1,740mn (down 47.6%), ordinary profit of ¥1,700mn (down 48.9%), and profit attributable to owners of parent of ¥1,700mn (down 30.3%). As the adjustment phase in the global construction machinery market is now expected to persist in 2H FY3/25, the outlook remains challenging. (The assumed exchange rate for 2H FY3/25 is ¥140/USD).

Consolidated forecasts for FY3/25

(¥mn)

	FY3/24		FY3/25		YoY change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	33,020	100.0%	27,200	100.0%	-5,820	-17.6%
Operating profit	3,318	10.1%	1,740	6.4%	-1,578	-47.6%
Ordinary profit	3,324	10.1%	1,700	6.3%	-1,624	-48.9%
Profit attributable to owners of parent	2,440	7.4%	1,700	6.3%	-740	-30.3%

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

Medium-term growth strategy

The Company has stated its key strategies of a business growth strategy and an efficient capital strategy. In terms of numerical targets, the Company is aiming for net sales of ¥30.0bn and operating profit of ¥3.1bn in FY3/26

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 is promoting 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 of 8.0%, and will aim to maintain a stable dividend payout ratio of 50%. The Company has already surpassed its targets for net sales and operating profit in FY3/24, but has opted to leave its numerical targets unchanged, given that it forecasts a decline in sales and profits for FY3/25.

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

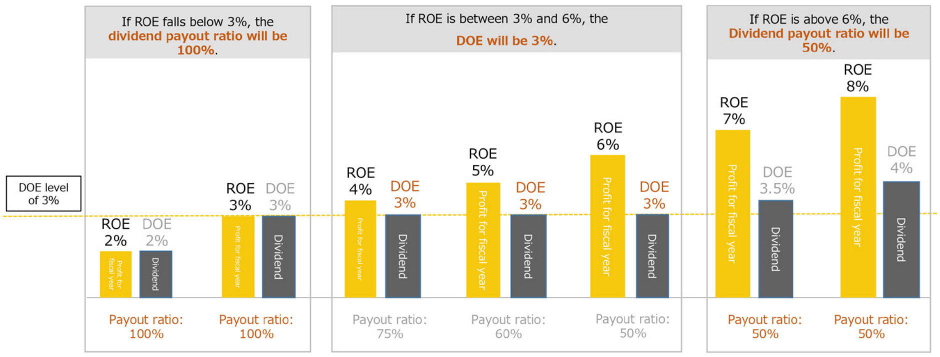
In overseas markets, there are many regions (countries) where demand is increasing, and there is significant room for growth given the Company's low market shares. Therefore, the Company will seek growth through the two strategies of more fully cultivating existing markets and expanding its business domains.

2. Capital strategy

As its basic policy for capital strategy, the Company is targeting ROE of 8.0%. To this end, the Company has stated that it plans to increase shareholder value (improve capital efficiency) through shareholder returns.

Generally, two things need to be improved in order to increase ROE. One is of course improving (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 implements the business strategies discussed above, but at the same time, in order to keep from increasing shareholders' equity more than needed, the Company is executing 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: The Company's Medium-Term Management Policy

In terms of share buybacks, through FY3/26 the Company is considering conducting flexible share buybacks with an upper limit of ¥0.5bn to ¥2.0bn. With respect to investment securities, the Company is reviewing investment securities from the perspective of business strategy. Also, concerning growth investment, the Company will consider utilizing leverage with an emphasis on return on invested capital (ROIC).

3. Medium-Term Management Policy: Progress on KPI

Regarding the status of progress on main KPIs announced as part of the Medium-Term Management Policy, the Company has downwardly revised its full-year forecasts to net sales of ¥27.2bn and ROE of 5.8%, so it expects both net sales and ROE to fall short of their targets. Because the improvements to the profit structure implemented in the previous fiscal year include upside factors other than actual performance, such as the weak yen, in addition to penetration of price revisions and the normalization of transportation costs, going forward the Company will aim for profit structure improvements that enable it to continually achieve ROE of 8.0%.

Medium-Term Management Policy KPIs

(Millions of yen)

	Nine months ended December 31, 2023 (Results)	Nine months ended December 31, 2024 (Results)	Fiscal year ended March 31, 2024 (Results)	Fiscal year ending March 31, 2025 (Forecast)	Target for the fiscal year ending March 31, 2026
Net sales	24,301	20,243	33,020	27,200	30,000
Operating profit	2,580	1,368	3,318	1,740	3,100
Return on equity (ROE) *1	9.7%	6.5%	9.0%	5.8%	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 13, 2025.
*3 The amount represents the targets of the cumulative amount of share buybacks through March 31, 2026.
Source: The Company's results briefing materials

Shareholder return policy

Annual dividend for FY3/25 downwardly revised to ¥103.0

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, in terms of the Company's medium-term shareholder return policy, the Company has declared that it will provide returns 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, the Company paid a ¥100.0 annual dividend* (a dividend payout ratio of 49.9%) in FY3/23 and a ¥142.5 annual dividend (49.6%) in FY3/24. For ongoing FY3/25, the Company initially planned to pay a ¥107.5 annual dividend (49.9%). However, the Company has revised its full-year business forecasts downward, and the forecast ROE is now 5.8%. For this reason, the Company has lowered its annual dividend forecast for FY3/25 to ¥103.0 in accordance with its basic policy (if ROE is 6.0% or lower, DOE will be 3.0%).

* On October 1, 2024, the Company conducted a two-for-one stock split of its common shares. Prior dividends have been retrospectively adjusted to reflect this stock split.

With regard to share buybacks, the Company conducted a buyback of 130,000 shares (¥340mn) in FY3/22, but currently has no plans to conduct buybacks going forward. The Company's stance of announcing a clear policy to improve ROE and carrying out shareholder returns in line with that policy is worthy of recognition.

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