

COMPANY RESEARCH AND ANALYSIS REPORT

SAKAI HEAVY INDUSTRIES, LTD.

6358

Tokyo Stock Exchange First Section

30-Sept.-2021

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Summary

A manufacturer specializing in road rollers for road paving and other road construction equipment. Its domestic market share is the highest in the industry at over 70%, and it aims to grow by expanding its overseas market share

Sakai Heavy Industries, Ltd. <6358> (herein after 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 FY3/22 1Q

In the consolidated results for FY3/22 1Q, net sales increased 33.4% year on year (YoY) to ¥6,089mn, operating profit increased 451.0% YoY to ¥202mn, ordinary profit was ¥214mn (compared to a ¥52mn loss in the year-earlier period), and profit attributable to owners of parent was ¥154mn (versus a ¥122mn loss in the year-earlier period). Both net sales and operating profit increased significantly YoY due to the fact that both were heavily impacted by the COVID-19 pandemic in the same period of the previous fiscal year, and it seems that both were slightly higher than the Company’s forecasts. In addition, results in Japan as well as overseas recovered to strong levels.

2. Outlook for FY3/22

For FY3/22 consolidated results, the Company is forecasting net sales of ¥23,500mn (+8.7% YoY), operating profit of ¥900mn (+28.3%), and ordinary profit of ¥800mn (+21.4%), and maintains its initial forecast for profit attributable to owners of parent of ¥520mn (versus ¥4mn in FY3/21). While the impacts of the COVID-19 pandemic remain uncertain, in Japan, the Company expects demand related to civil engineering and roads to remain firm due to disaster prevention and mitigation efforts as well as the national resilience plan, among other factors. In the U.S., massive infrastructure upgrades under the American Jobs Act are being discussed, and a recovery is expected. In Asia, demand is recovering due to economic measures in China and ASEAN nations, and in Indonesia, where demand had been weak, a bottoming out is expected. As a result, despite expecting an increase YoY in SG&A expenses, the Company is forecasting an increase in operating profit in conjunction with higher sales.

3. Medium- to long-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, the Company is aiming for net sales of ¥30bn, 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%). In line with this policy, the Company has announced a dividend payout ratio of 100% for FY3/22 (annual dividend = ¥120), but at FISCO we think that there is a possibility that the Company will increase the dividend if it seems that results will exceed the forecasts. In this way, it is commendable that the Company has released a clear capital policy targeting an improvement in ROE, and is carrying out shareholder returns in line with this policy.

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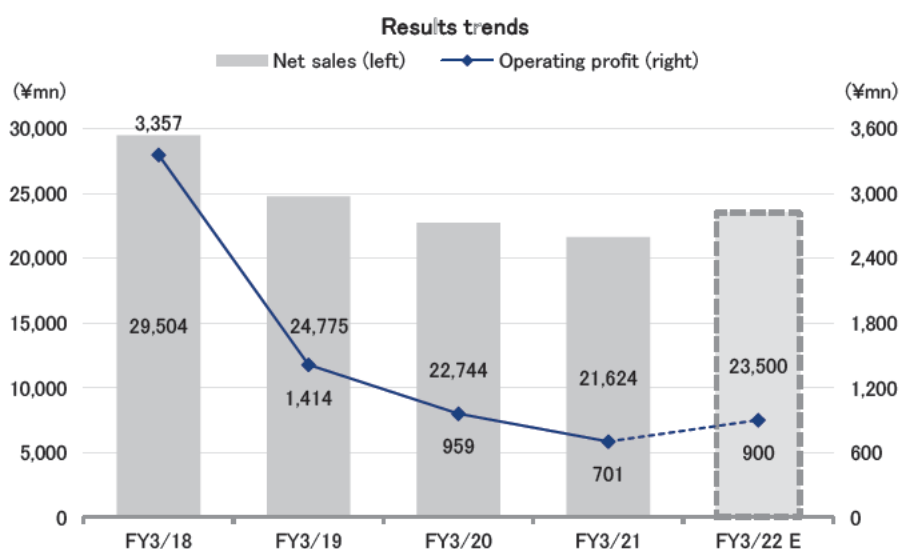
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Summary

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
- Domestic demand is firm and overseas demand is recovering, so although the Company has left its initial FY3/22 forecasts unchanged, 1Q results exceeded the forecasts
- As medium-term numerical targets, the Company is aiming for net sales of ¥30bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26



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

Company profile

The top 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 is the top manufacturer in Japan, with a market share of above 70%. In 1970, the Company established a joint venture in Indonesia, as part of its effort to expand overseas business at an early stage. As of March 31, 2021, the Company has four domestic subsidiaries and five overseas subsidiaries (U.S., China, three 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.

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Business overview

The top manufacturer of road rollers with a domestic market share of over 70%. Will seek growth by offering high value-added and expanding overseas market share

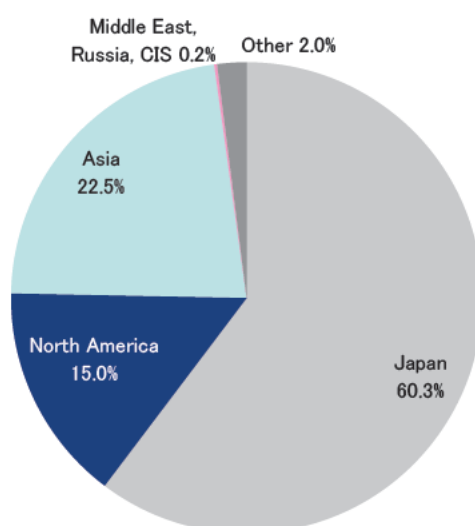
1. Business description

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. 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 one ton to 20 tons (for large civil engineering projects). The core price range is from ¥5mn (medium-size rollers) to ¥10mn (large rollers).

In terms of net sales by region*, in FY3/21 net sales in Japan were ¥13,042mn (60.3% of total net sales), net sales in North America were ¥3,245mn (15.0%), net sales in Asia were ¥4,854mn (22.5%), net sales in the Middle East, Russia, and the CIS were ¥32mn (0.2%) and net sales to other markets totaled ¥449mn (2.0%).

* Net sales by region is the amount of products actually sold to customers, and differs from the reportable segment "Net Sales by Location" in the financial results.

Ratio of net sales by region in FY3/21



Source: Prepared by FISCO from the Company's results briefing materials

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Business overview

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 roller 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 brand which customers have used for many years and the long-term insight due to variety of worksite experiences are strengths, 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 FY2020 domestic construction equipment shipment value was ¥2.2tn, and road roller and other road construction equipment (the Company's main products) account for 2.8% 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 6-7% 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 20%. The Company's main competitors in the global market include Caterpillar <CAT>, FAYAT, Deere <DE>, and Volvo, but none of these companies are manufacturers that specialize in road rollers.

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Results trends

Both sales and profits increased significantly in FY3/22 1Q, and even exceeded the Company's forecasts. Both the domestic and overseas businesses are recovering from the impacts of the COVID-19 pandemic and are performing well

1. Outline of results for FY3/22 1Q

In the consolidated results for FY3/22 1Q, net sales increased 33.4% YoY to ¥6,089mn, operating profit increased 451.0% YoY to ¥202mn, ordinary profit was ¥214mn (compared to a ¥52mn loss in the year-earlier period), and profit attributable to owners of parent was ¥154mn (versus a ¥122mn loss in the year-earlier period).

Both net sales and operating profit increased significantly YoY due to the fact that both were heavily impacted by the COVID-19 pandemic in the same period of the previous fiscal year, and it seems that both were slightly higher than the Company's forecasts. In addition, results in Japan as well as overseas recovered to strong levels. The gross margin declined 2.4pp YoY to 23.7%, but this was due to the change in the product mix and the fact that sales in the year-earlier period were relatively high margin sales. As a result, gross profit was ¥1,443mn (up 21.3%). Meanwhile, SG&A expenses increased 7.6% YoY due to the increase in business travel and networking/entertainment expenses resulting from more sales activity than in the year-earlier period as well as an increase in personnel expenses. However, the SG&A expense ratio declined to 20.4% from 25.3% in the year-earlier period. As a result, each profit line increased significantly.

Analyzing the change factors for operating profit, the increase in sales had a positive ¥397mn impact, the increase in the cost of goods sold ratio had an impact of minus ¥144mn, and the increase in SG&A expenses had an impact of minus ¥87mn (shipping expenses had a minus ¥19mn impact, technology and research expenses had a positive ¥18mn impact, personnel expenses had a positive ¥11mn impact, and other expenses had a positive ¥39mn impact).

Overview of FY3/22 1Q consolidated results

	FY3/21 1Q		FY3/22 1Q		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	4,565	100.0%	6,089	100.0%	1,523	33.4%
Gross profit	1,190	26.1%	1,443	23.7%	253	21.3%
Selling, general and administrative expenses	1,153	25.3%	1,241	20.4%	87	7.6%
Operating profit	36	0.8%	202	3.3%	165	451.0%
Ordinary profit	-52	-1.2%	214	3.5%	267	-
Profit attributable to owners of parent	-122	-2.7%	154	2.5%	276	-

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

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Results trends

2. Trends by region

In looking at FY3/22 1Q sales by region, on the whole, sales are on a recovery trend from the impacts of the COVID-19 pandemic. In Japan, net sales were ¥2,765mn (up 13.9% YoY), as a result of strong performance in road and civil engineering projects, as well as other public investment-related projects, despite continued impacts from COVID-19.

Overseas net sales increased 55.4% YoY to ¥3,323mn, due to the recovery in demand for construction machinery in key markets. Net sales in North America were ¥1,376mn (up 85.0%), due to the recovery in demand for construction machinery, which had been slowing down, amid firm construction investment, as well as an increase in market share (from 3.5% to 5.0% according to Company estimates). Net sales in Asia were ¥1,782mn (up 32.0%), as demand recovered in Thailand, Vietnam, South Korea, China and elsewhere due to the rejuvenation of the economy, while there were signs of a bottoming out in Indonesia. In other regions, net sales increased 289.1% to ¥163mn, based on the relative strong performance in Australia, New Zealand and Latin America.

Net sales by region

	FY3/21 1Q		FY3/22 1Q		Change	
	Results	% of total	Results	% of total	Amount	%
Japan	2,427	53.2%	2,765	45.4%	338	13.9%
Overseas	2,138	46.8%	3,323	54.6%	1,185	55.4%
North America	743	16.3%	1,376	22.6%	632	85.0%
Asia	1,350	29.5%	1,782	29.3%	431	32.0%
Middle East, Russia, CIS	2	0.1%	2	0.0%	-0	-17.3%
Other	41	0.9%	163	2.7%	121	289.1%
Total	4,565	100.0%	6,089	100.0%	1,523	33.4%

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

Stable financial condition, ample cash and deposits of ¥7,629mn

3. Financial condition

In terms of the Company's financial condition as of June 30, 2021, current assets were ¥23,089mn (up ¥161mn from the end of the previous fiscal year). The main factors included a ¥645mn increase in cash and deposits, a ¥546mn decrease in notes and accounts receivable – trade, and a ¥282mn decrease in inventory assets. Non-current assets were ¥12,026mn (down ¥147mn). The main factors included a ¥112mn increase in property, plant and equipment, and a ¥221mn decrease in investments and other assets. As a result, total assets were ¥35,115mn (up ¥14mn YoY). As of June 30, 2021, cash and deposits stood at a high level of ¥7,629mn.

Meanwhile, total liabilities were ¥13,097mn (up ¥34mn from the end of the previous fiscal year). The main factors among current liabilities included a ¥430mn increase in payables (notes and accounts payable – trade and electronically recorded obligations – operating), an ¥82mn decrease in short-term borrowings, and a ¥103mn decline in non-current liabilities. Total net assets stood at ¥22,017mn (down ¥20mn), with the main factors including a ¥61mn decline in retained earnings due to dividend payments, a ¥295mn increase in foreign currency translation adjustment, and a ¥170mn decrease in valuation difference on available-for-sale securities. As a result, the equity ratio as of June 30, 2021, was 62.6% (versus 62.7% at the end of the previous fiscal year).

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Outlook

Left the initial FY3/22 forecast of 8.7% increase in net sales and a 28.3% increase in operating profit unchanged

● Outlook for FY3/22

For FY3/22 consolidated results, the Company has left its initial forecast of net sales of ¥23,500mn (+8.7% YoY), operating profit of ¥900mn (+28.3%), ordinary profit of ¥800mn (+21.4%) and profit attributable to owners of parent of ¥520mn (versus ¥4mn in FY3/21) unchanged.

While the impacts of the COVID-19 pandemic remain uncertain, in Japan the Company expects demand related to civil engineering and roads to remain firm due to factors including the government's ¥15tn national resilience plan to speed up countermeasures for disaster prevention and mitigation. In the U.S., massive infrastructure upgrades under the American Jobs Act, which will invest US\$2.25tn over an eight-year period are being discussed, and a recovery is expected. In Asia, demand is recovering due to economic measures in China and ASEAN nations, and in Indonesia, where demand had been weak, a bottoming out is expected. As a result, despite expecting an increase YoY in SG&A expenses, the Company is forecasting an increase in operating profit in conjunction with higher sales.

Consolidated outlook for FY3/22

	FY3/21		FY3/22		Change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	21,624	100.0%	23,500	100.0%	1,875	8.7%
Operating profit	701	3.2%	900	3.8%	198	28.3%
Ordinary profit	659	3.0%	800	3.4%	140	21.4%
Profit attributable to owners of parent	4	0.0%	520	2.2%	515	-

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

Medium- to long-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 ¥30bn 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 ¥30bn, 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%).

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Medium- to long-term growth strategy

1. Business strategy

(1) Domestic market: Create added value through stabilization and developing next-generation businesses

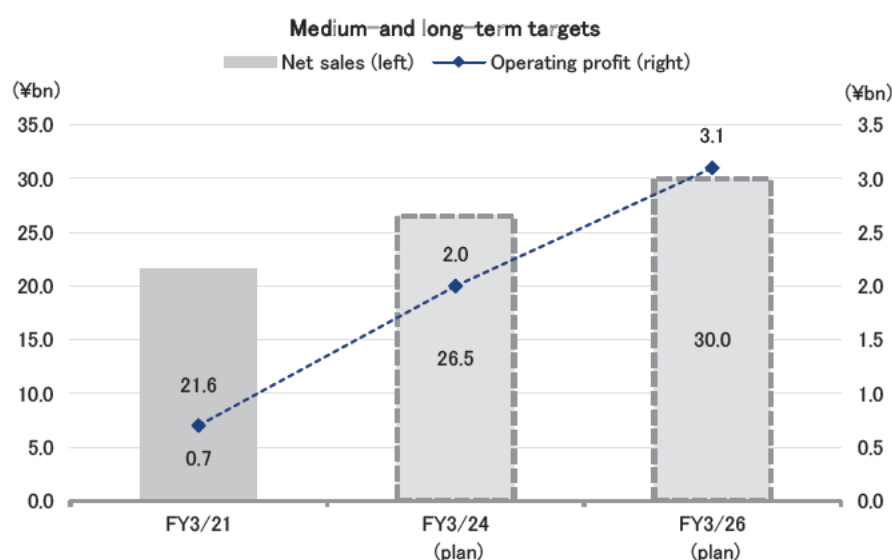
The domestic market for road rollers is already in its mature phase and the Company's market share is large. Therefore, the Company will aim to grow by adding new value to existing products (high-performance, etc.), in other words, by developing next-generation businesses.

(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- and long-term numerical targets, the Company aims for net sales of ¥26.5bn, operating profit of ¥2.0bn, and ROE of 5.5% in FY3/24, and net sales of ¥30.0bn, operating profit of ¥3.1bn, and ROE of 8% in FY3/26.



Source: Prepared by FISCO from the Company's Medium-Term Management Policy

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. This would be DOE (ratio of dividends to equity) of 4%.

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). 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%.

We encourage readers to review our complete legal statement on "Disclaimer" page.

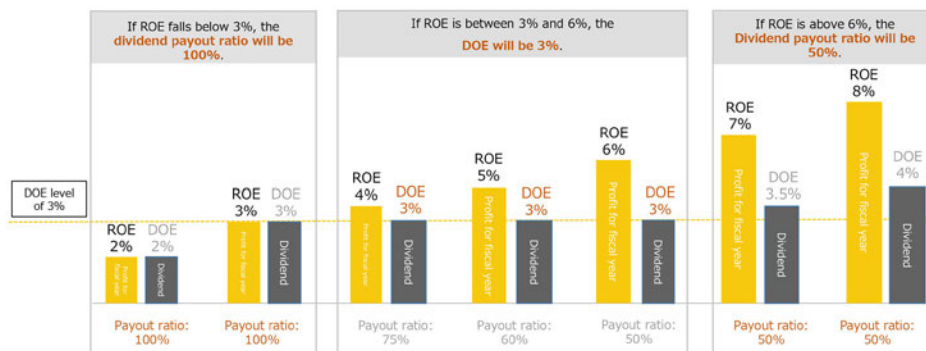
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Medium- to long-term growth strategy

Basic capital policy approach



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).

Shareholder return policy

The Company plans to pay an annual dividend of ¥120.0 (up ¥40.0 YoY) in FY3/22. Depending on financial results, there is a chance this dividend might be increased

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.

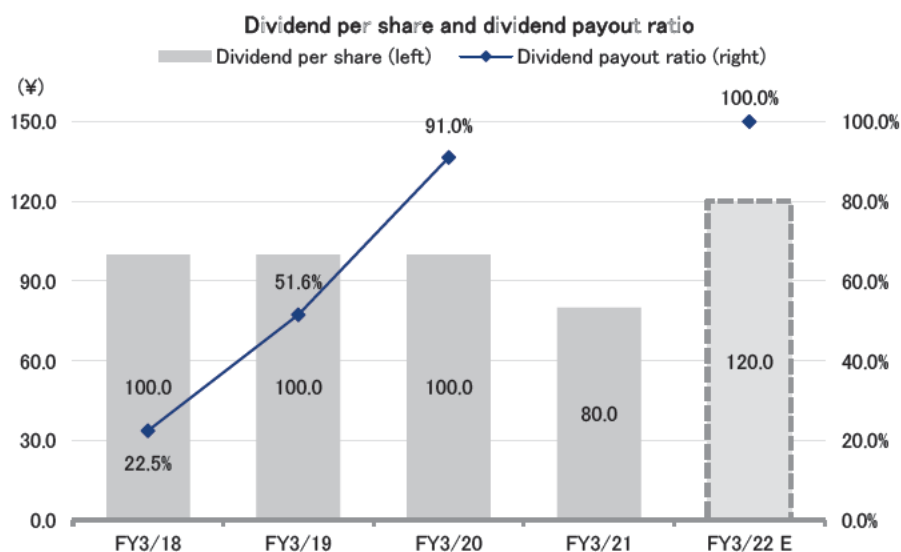
The Company paid an annual dividend of ¥100.0 in FY3/20, and an annual dividend of ¥80.0 in FY3/21. For FY3/22, the Company has announced a dividend payout ratio of 100% (annual dividend = ¥120.0), but at FISCO we think that there is a possibility that the Company will increase the dividend if it appears that results will exceed the forecasts. Concerning share buybacks, the Company has announced that it will buy back up to a maximum of 130,000 shares (¥500mn) by December 2021, and as of July 15, the Company has purchased 130,000 shares (¥340mn).

The Company's stance of announcing a clear plan to improve ROE and carrying out shareholder return plans in line with that plan is commendable.

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Shareholder return policy



Note: The Company consolidated ten shares into one share effective October 1, 2017. Figures for FY3/18 have been revised retroactively.

FY3/21 dividend payout ratio is not shown due to the fact that it was 8,602.2%.

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

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