MEC CO., LTD (4971 JP)

UPWARD REVISION IN FY24 GUIDANCE SOLELY REFLECTS FOREX IMPACT AND IMPROVED PRODUCTION EFFICIENCY IN Q1

FY24 Q1 RESULTS SUMMARY

MEC (4971 JP) produced better-then-expected FY24 Q1 (Dec year-end) earnings with operating profit [OP] of ¥1,053mil mil (+523.7% YoY) on sales of ¥4,354mil (+57.5% YoY). Although the firm has not changed assumptions for FY24 guidance as explained below, FY24 1H and full-year guidance figures were revised up, thanks to 1) weaker yen, 2) sales increase in sales volume of chemical products, and 3) improved production efficiency which led to higher profitability. FY24 1H guidance was revised from OP of ¥1,300mil (+55.0% YoY) on sales of ¥7,850mil (+26.6% YoY) to OP of ¥1,800mil (+114.7% YoY) on sales of ¥8,350mil (+34.7% YoY), and full-year FY24 OP of ¥3,000mil (+20.3% YoY) on sales of ¥16,300mil (+16.3% YoY) to OP of ¥3,650mil (+46.4% YoY) on sales of ¥17,000mil (+21.3% YoY). 1H sales was revised by ¥500mil, which includes overshoot of ¥650mil to Q1 sales, which is split to overshoot of approx. ¥370mil in Chemicals segment (especially CZ-8101 outperformed the expectation as well as the other products such as V-Bond series, EXE series, and SF series) and ¥250mil in Machinery segment. Furthermore, 1H sales guidance upward revision of ¥500mil is split into +¥650mil in Q1 and -¥150mil in Q2. This is because Machinery segment sales that was expected to come in Q2 was brough forward in Q1.

In Q1, FOREX impact was +¥176mil YoY in sales and ¥100mil YoY in OP. Major foreign currencies that affect MEC's earnings on the most are Taiwan dollar [NTD] and Chinese yuan [RMB]. On the quarterly basis, ¥0.1 change/NTD will give ¥16mil in sales and ¥12mil in OP, respectively. Equally, ¥0.1 change/RMB will give ¥6mil in sales and ¥3mil in OP, respectively.

Earnings Summary (Cumulative)

Dec year-end (¥mil)	FY23			FY24	
	Q1	1H	FY	Q1	YoY (%)
Sales	2,765	6,198	14,020	4,354	57.5
incl. Chemicals	2,712	6,085	13,764	3,924	44.7
GP	1,583	3,646	8,316	2,549	61.0
GPM (%)	57.3	58.8	59.3	58.5	+1.2ppt
SG&A	1,414	2,807	5,824	1,496	5.7
SG&A/Sales (%)	51.2	45.3	41.5	34.4	-16.8ppt
OP	168	838	2,492	1,053	523.7
OPM (%)	6.1	13.5	17.8	24.2	+18.1ppt
RP	223	1,003	2,683	1,132	406.4
RPM (%)	8.1	16.2	19.1	26.0	+17.9ppt
NP	82	1,076	2,304	779	848.2
EPS (¥)	4.32	56.79	122.29	41.62	N/A
DPS (¥)	N/A	20.00	45.00	N/A	N/A

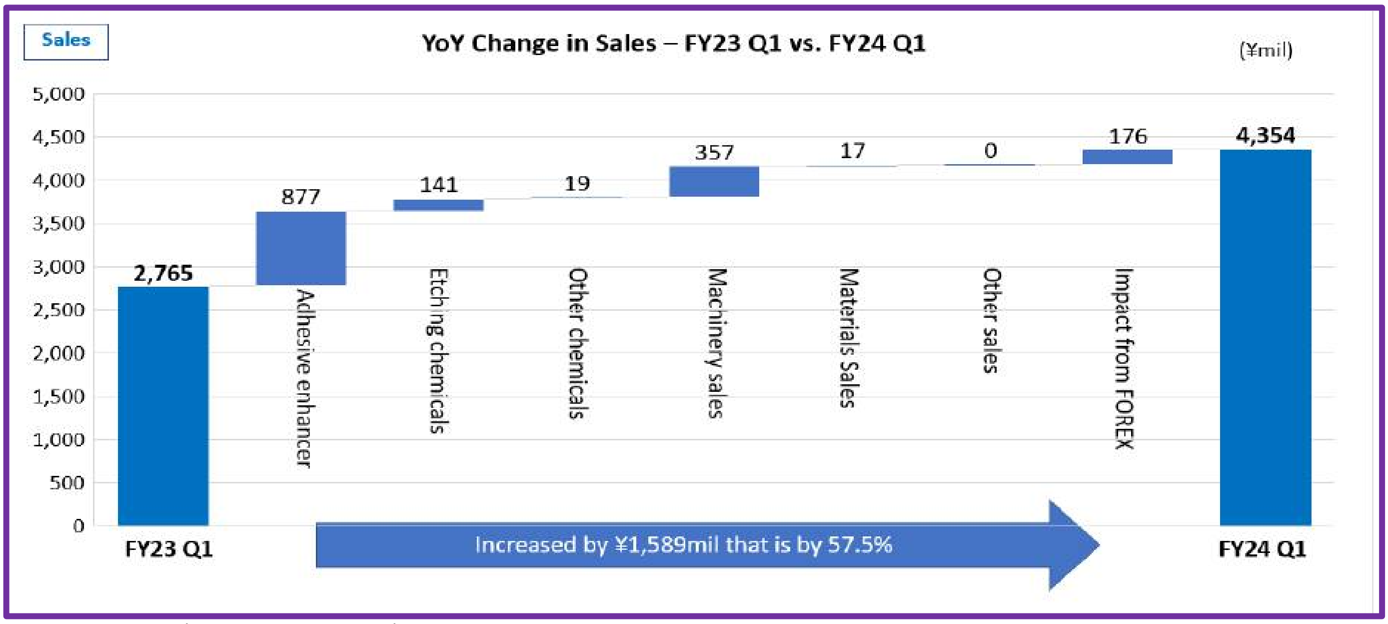
Source: Nippon-IBR based on MEC's results presentation material

EXECUTIVE SUMMARY

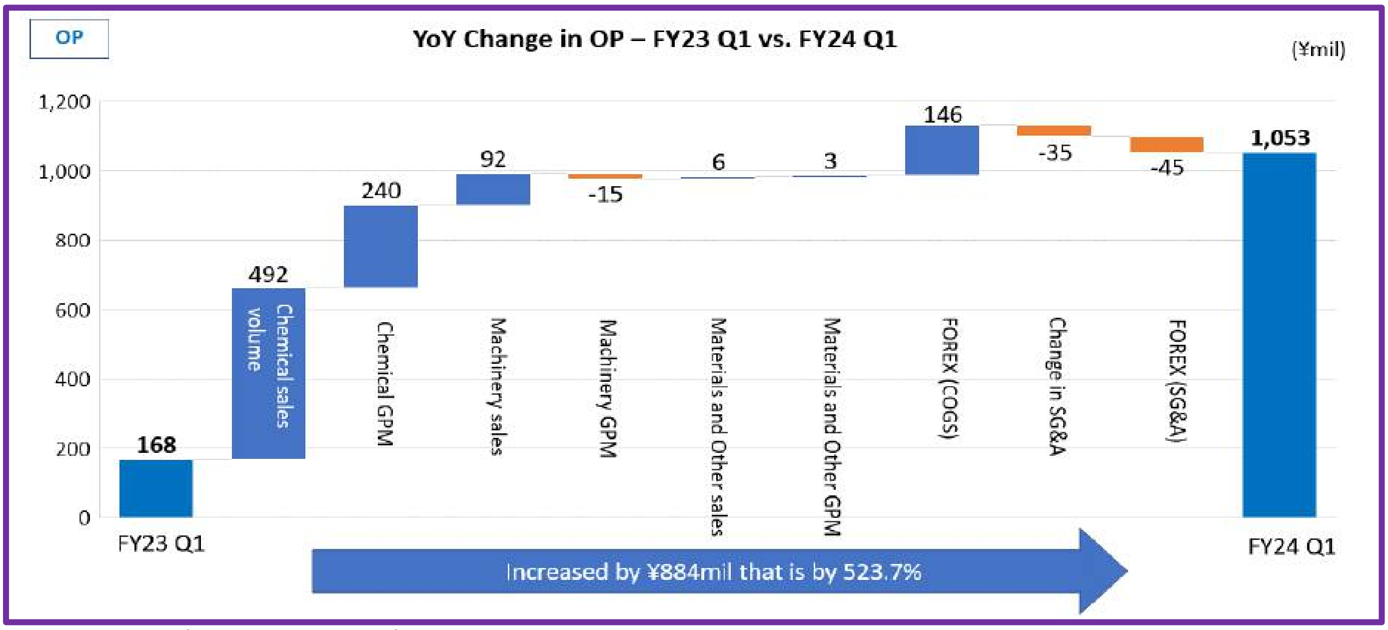
- MEC (4971 JP) produced better-then-expected FY24 Q1 (Dec year-end) earnings with operating profit [OP] of ¥1,053mil mil (+523.7% YoY) on sales of ¥4,354mil (+57.5% YoY). Although the firm has not changed assumptions for FY24 guidance as explained below, FY24 1H and full-year guidance figures were revised up, thanks to 1) weaker yen, 2) increase in sales volume of chemical products, and 3) improved production efficiency which led to higher profitability.
- The Chemical segment sales increased +44.7% YoY to ¥3,924mil: 1) Adhesive Enhancer Chemicals, whose FY24 Q1 sales improved +53.9% YoY to ¥2,877mil (-1.3% QoQ) as the external business environment improved, and 2) Etching Chemicals, which produced FY24 Q1 sales of ¥871mil (+25.5% YoY / +6.1% QoQ).
- MEC revised up its guidance from FY24 1H OP of ¥1,300mil (+55.0% YoY) on sales of ¥7,850mil (+26.6% YoY) to ¥1,800mil (+114.7% YoY) on sales of ¥8,350mil (+34.7% YoY) and from full-year FY24 OP of ¥3,000mil (+20.3% YoY) on sales of ¥16,300mil (+16.3% YoY) to OP of ¥3,650mil (+46.4% YoY) on sales of ¥17,000mil (+21.3% YoY).
- Although 1H sales and OP guidance were revised by ¥500mil each, reflecting Q1 results that were boosted by 1) sales volume increase in Chemical segment, 2) weaker yen and 3) improved production efficiency, the firm revised up 2H sales and OP by only ¥200mil and ¥150mil, respectively. This is because MEC has not changed its assumptions on the market environment for its core products.
- MEC plans to increase CAPEX (FY23~FY26) on the new Kita Kyushu plant from approx. ¥4,000mil by ¥700mil to meet potential change in production technology.
- FY24 annual consolidated dividend remains unchanged at ¥45.00/share, which produces pay-out ratio of 31.8%.

FY24 Q1 Chemical segment sales increased +44.7% YoY to ¥3,924mil, steadily improving from the recent bottom of quarterly sales in FY23 Q1(FY23: Q1 sales of ¥2,712mil / Q2 ¥3,372mil / Q3 ¥3,749mil / Q4 ¥3,929mil). The segment has two product groups: 1) Adhesive Enhancer Chemicals, whose FY24 Q1 sales improved +53.9% YoY to ¥2,877mil (-1.3% QoQ) thanks to gradual recovery in demand, and 2) Etching Chemicals, which produced FY24 Q1 sales of ¥871mil (+25.5% YoY / +6.1% QoQ).

FY24 Q1 gross profit margin [GPM] improved +1.2ppt to 58.5%, thanks to 1) increase in sales and sales volume (+31.4% YoY to 9,850 tonnes) of chemical products, and 2) sales mix improved by increase in sales of CZ-8101 (+60.2% YoY) and EXE (+37.0% YoY). FY24 Q1 OP surged +¥884mil YoY, or +523.7% YoY (including FOREX impact of ¥100mil YoY) to ¥1,053mil. Three main positive factors are 1) an increase in FY24 Q1 sales and sales volume of chemical products (+¥492mil) , and 2) improvement in GPM of Chemical segment (+¥240mil YoY) thanks to an improved sales mix reflecting the strong CZ-8101 sales (+60.2% YoY / +4.8% QoQ) and recovery in EXE sales (+37.0% YoY / +18.5% QoQ), and 3) increase in Machinery sales (+¥92mil YoY).



Source: MEC Co., Ltd. FY24 Q1 earnings results presentation



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SEGMENTS PERFORMANCE

Adhesive Enhancers

FY24 Q1 Adhesive Enhancer sales surged +53.9% YoY to ¥2,877mil (-1.3% QoQ), as did CZ series sales (+58.1% YoY / -0.8% QoQ to ¥2,589mil).

MEC's core product in this product group, CZ-8101 – an adhesive-enhancing chemical used in packages primarily for PCs, servers and chiplet packaging such as CoWos – which had enjoyed sales growth in FY22, slumped in FY23 Q1 to ¥883mil (-30.8% YoY / -30.8% QoQ). However, quarterly sales improved gradually throughout FY23 and recovered close to the peak level reported in FY22 to ¥1,415mil (+60.2% YoY / +4.8% QoQ) in FY24 Q1. MEC observes that demand from end applications such as PCs and data centre servers still remained sluggish, however, solid package demand for AI servers and better-than-expected demand for packages for memories, telecoms and auto boosted Q1 CZ-8101 sales. MEC has not changed its assumption that demand for CZ-8101 from PCs and servers will only recover from FY24 2H because better than expected Q1 sales was solely due to seasonal stockpiling. Production efficiency of CZ-8101 improved in Q1. In FY21, when production volume of CZ-8101 reached the maximum production volume allowance at the Suzhou factory in China, MEC transferred a part of CZ-8101 production to Japan. Given additional allowance granted at the Suzhou factory, the firm transferred CZ-8101 production back to the factory, which helped improve profitability of CZ-8101.

The FY24 Q1 performance of Other CZ chemicals sales, which includes adhesive chemicals using pre- and post-adhesive processes, surged 71.5% YoY to ¥866mil (-8.1% QoQ). Sales of the newer generation of CZ series products – CZ-8201 and CZ-8401 – used in conjunction with miniaturisation of wiring, are also included in this category.

The CZ-8100 product, which is partly used in packages for auto components, remained solid in FY24 Q1, reporting quarterly sales of ¥308mil (+23.2% YoY / -2.8% QoQ). Volume used per automobile has been increasing steadily along with a pickup in demand for packages used in EVs and ADAS.

V-Bond, another adhesive-enhancing chemical used in multilayer substrates for autos and smartphones, reported FY24 Q1 sales of ¥194mil (+7.2% YoY / +3.7% QoQ).

Etching Chemicals

FY24 Q1 Etching Chemicals sales increased +25.5% YoY to ¥871mil (+6.1% QoQ). The segment sales improved thanks to 1) solid FY24 Q1 sales in EXE – as continued solid sales of chip-on-film [COF] on the back of continuing TV monitor production post-production adjustments during FY22, and (2) +8.5% YoY increase in in SF sales, a key material used in touch panels, to ¥141mil (+19.5% QoQ) prior to the launch of a new high-end tablet.

Chemical Sales by Products (Quarterly)

(¥mil / Dec year-end)	FY22				FY23				FY24		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	QoQ (%)	YoY (%)
Copper surface treatment chemicals	3,695	3,931	3,981	3,660	2,564	3,150	3,536	3,736	3,748	0.3	46.2
Adhesive enhancer (CZ,V-Bond etc.)	2,676	2,911	3,073	2,797	1,870	2,335	2,608	2,915	2,877	-1.3	53.9
CZ Series Total	2,402	2,609	2,784	2,517	1,638	2,071	2,311	2,609	2,589	-0.8	58.0
CZ-8100	315	316	340	313	250	276	283	317	308	-2.8	23.2
CZ-8101	1,276	1,410	1,464	1,276	883	1,080	1,229	1,350	1,415	4.8	60.2
Other CZ chemicals	811	883	980	928	505	715	799	942	866	-8.1	71.5
Etching chemicals (EXE, SF etc.)	1,019	1,020	908	863	694	814	928	821	871	6.1	25.5
SF	204	246	235	192	130	112	184	118	141	19.5	8.5
EXE	360	308	187	226	224	319	312	259	307	18.5	37.0
Other surface treatment chemicals	202	202	200	166	148	222	213	193	175	-9.3	18.2
Chemical Sales Total	3,898	4,134	4,181	3,827	2,712	3,372	3,749	3,929	3,924	-0.1	44.7

Source: Nippon-IBR based on MEC's earnings presentation materials

FY24 OUTLOOK

MEC revised up its guidance from FY24 1H OP of ¥1,300mil (+55.1% YoY) on sales of ¥7,850mil (+26.6% YoY) to ¥1,800mil (+114.7% YoY) on sales of ¥8,350mil (+34.7% YoY) and from full-year FY24 OP of ¥3,000mil (+20.3% YoY) on sales of ¥16,300mil (+16.3% YoY) to OP of ¥3,650mil (+46.4% YoY) on sales of ¥17,000mil (+21.3% YoY).

Earnings Guidance)

Dec year-end (¥mil)	FY23		FY24			
	1H	FY	1H CE	YoY (%)	FY CE	YoY (%)
Sales	6,198	14,020	8,350	34.7	17,000	21.3
incl. Chemicals	6,085	13,764	N/A	N/A	N/A	N/A
GP	3,646	8,316	N/A	N/A	N/A	N/A
GPM (%)	58.8	59.3	N/A	N/A	N/A	N/A
SG&A	2,807	5,824	N/A	N/A	N/A	N/A
SG&A/Sales (%)	45.3	41.5	N/A	N/A	N/A	N/A
OP	838	2,492	1,800	114.7	3,650	46.4
OPM (%)	13.5	17.8	21.6	+8.1ppt	21.5	+3.7ppt
RP	1,003	2,683	1,900	89.4	3,800	41.6
RPM (%)	16.2	19.1	22.8	+6.6ppt	22.4	+3.3ppt
NP	1,076	2,304	1,300	20.8	2,650	15.0
EPS (¥)	56.79	122.29	69.43	22.3	141.52	15.7
DPS (¥)	20.00	45.00	N/A	N/A	45.00	0.0

Source: Nippon-IBR based on MEC's results presentation material

Although 1H sales and OP guidance were revised by ¥500mil each, reflecting Q1 results that were boosted by 1) sales volume increase in Chemical segment, 2) weaker yen and 3) improved production efficiency, the firm revised up 2H sales and OP by only ¥200mil and ¥150mil, respectively. This is because MEC has not changed its assumptions on the market environment for its core products. To recap, MEC's FY24 guidance are based on the following assumptions:

1. MEC expects a gradual recovery in end applications such as server and PC during 1H, and assumes a full-fledged recovery of server demand, which should boost earnings of MEC's core product CZ-8101, from FY24 2H. As a result, CZ chemicals will still be MEC's growth driver, with the firm guiding for an improvement of 15~20% YoY in FY24. Demand for packages used in high-end servers that support generative AI technology has been strong. Moreover, packages for memories telecoms and auto will likely continue to increase. On the other hand, full-fledged recovery in packages used for PCs will likely be in FY25.
2. A decline in V-Bond sales due to weakness in demand for smartphones, although demand for use in automobiles will likely remain solid. MEC assumes FY24 V-Bond sales to see a littleYoY decline.
3. A cautious view on Etching Chemical sales, SF series and EXE series. MEC assumes sales of EXE to be solid, however, unlike FY23, where the firm saw an increase in production of TV displays after inventory adjustments peaked, there is uncertainty regarding demand for COF in FY24. As for the SF series, MEC also remains cautious with demand for end applications.

CAPITAL ALLOCATION POLICY

CAPEX: For FY23, MEC spent ¥1,870mil for CAPEX, of which ¥933mil was for the new Kita Kyushu plant, which will be completed in April 2024, with operations planned to commence in July 2025. MEC increased CAPEX on Kita Kyushu plant by ¥700mil on top of initially planned total CAPEX of ¥4,000mil spent over four years (FY23~FY26), which includes the cost of the land for the new plant, financed by cash flow as well as debt. The initial CAPEX plan was to spread the cost over four years – FY23 ¥933mil / FY24 ¥1,730mil / FY25 ¥1,026mil / FY26 ¥311 mil, but MEC revised FY24 CAPEX to ¥2,097mil and FY25 to ¥1,669mil] due to change in production concept at the new plant. In FY24, the total CAPEX was initially budgeted at ¥3,107mil, which is now revised to ¥3,474mil. The new plant was initially considered to boost production of the main CZ series, however, the firm plans ahead of beyond the existing CZ chemicals and try to design the plant to potentially cater for change in production method when technology such as no coarsening / smooth surface adhesion.

Depreciation costs related to Kita Kyushu plant is revised from initial cost of ¥150mil~¥200mil/annum to ¥200~¥250mil/annum, after the plant is completed. In FY24, MEC is guiding for a total depreciation cost of ¥813mil. This compares to FY23 depreciation of ¥773mil (+5.2% YoY).

Shareholder Return: MEC maintained consolidated annual dividend payment unchanged at ¥45/share in FY24. Based on the revised FY24 EPS of ¥141.52, the dividend pay-out ratio was 31.8%. Management aims to achieve a consolidated dividend pay-out ratio of at least 30% under the ongoing medium-term management plan.

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