MEC CO., LTD (4971 JP)

ANOTHER UPWARD REVISION IN FY24 GUIDANCE SOLELY REFLECTS EARLIER THAN EXPECTED SERVER DEMAND RECOVERY

FY24 1H RESULTS SUMMARY

MEC (4971 JP)'s FY24 (Dec year-end) 1H results landed above guidance that was revised up at the time of Q1 results, reporting operating profit [OP] of ¥2,362mil (+181.8% YoY) on sales of ¥8,882mil (+43.3% YoY), compared to the firm's 1H guidance (revised on 10 May) of OP of ¥1,800mil (+114.7% YoY) on sales of ¥8,350mil (+34.7% YoY).

Given the better-than-expected 1H results, MEC revised up its full-year FY24 sales guidance by +8.8% to ¥18,500mil (+32.0% YoY) and OP by +34.2% to ¥4,900mil (+96.6% YoY). Although management have not changed their overall assumptions for FY24 , as explained below, the revision up was due to 1) an increase in sales volume of chemical products, on the back of a favourable pick up in TV monitor production and a gradual recovery in semiconductor demand for data centre servers, and 2) improved production efficiency which led to higher profitability.

In 1H, FOREX impact on sales was +¥422mil YoY and +¥246mil YoY to OP. The major foreign currencies that affect MEC's earnings the most are the Taiwan dollar [NTD] and Chinese yuan [RMB]. Over the cumulative Jan~June period, a ¥0.1/NTD change boosted sales by +¥35mil and OP by ¥26mil. Equally, a ¥0.1/RMB change added +¥13mil to sales and +¥7mil to OP.

MEC (4971 JP): Earnings Summary

(¥mil)	FY23		FY24		
	1H	FY	1H	YoY (%)	1H CE
Sales	6,198	14,020	8,882	43.3	8,350
incl. Chemicals	6,085	13,764	8,384	37.8	N/A
GP	3,646	8,316	5,383	47.6	N/A
GPM (%)	58.8	59.3	60.6	+1.8ppt	N/A
SG&A	2,807	5,824	3,020	7.6	N/A
SG&A/Sales (%)	45.3	41.5	34.0	-11.3ppt	N/A
OP	838	2,492	2,362	181.8	1,800
OPM (%)	13.5	17.8	26.6	+13.1ppt	21.6
RP	1,003	2,683	2,641	163.3	1,900
RPM (%)	16.2	19.1	29.7	+13.5ppt	22.8
NP*	1,076	2,304	1,890	75.7	1,300
EPS (¥)	56.79	122.29	100.97	N/A	69.43
DPS (¥)	20.00	45.00	20.00	N/A	N/A

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

** NP attributed to the parent's shareholders*

Although MEC reported better-than-expected 1H sales growth (+43.3% YoY) overall, the +37.8% YoY increase in Chemical segment sales was due to easy YoY comps, not because of a full recovery. The sales mix also improved thanks to higher sales of CZ series and EXE products, however, shipment volumes increased at a pace of +26.1% YoY to 20,251 ton.

EXECUTIVE SUMMARY

- MEC's (4971 JP) FY24 (Dec year-end) 1H performance came in above the revised guidance released with the Q1 results. FY24 1H OP was ¥2,362mil (+181.8% YoY) on sales of ¥8,882mil (+43.3% YoY), vs the original guidance for OP of ¥1,800mil (+114.7% YoY) on sales of ¥8,350mil (+34.7% YoY).
- While overall sales were better-than-expected (+43.3%), the +37.8% growth in Chemical segment sales was due to easy YoY comps, rather than a full recovery, though shipment volumes rose +26.1% YoY to 20,251 ton. The sales mix also improved thanks to higher CZ series and EXE sales, leading to the OPM rising +13.1ppt YoY.
- Given the 1H performance, the FY24 full-year guidance was revised up from OP of ¥3,650mil (+46.4% YoY) on sales of ¥17,000mil (+21.3% YoY) to OP of ¥4,900mil (+96.6% YoY) on sales of ¥18,500mil (+32.0% YoY).
- A recovery in package demand for AI and PC will likely further boost CZ-8101 sales. EXE and SF sales have been stronger than expected albeit only temporary.
- The FY24 annual consolidated DPS remains unchanged at ¥45.00, which produces pay-out ratio of 23.4%.

In Q2 alone, Chemical segment sales increased +32.3% YoY / +13.6% QoQ to ¥4,460mil, 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 ¥3,929 , and FY24 Q1 ¥3,924mil). Equally, shipment volumes improved YoY (FY23: Q1 7,498 ton / Q2: 8,557 ton) to 10,401 ton (+21.5% YoY / +5.6% QoQ) in FY24 Q2 alone. That said, sales volumes have not yet recovered to peak levels seen in FY22.

Sales volume vs Sales Trend

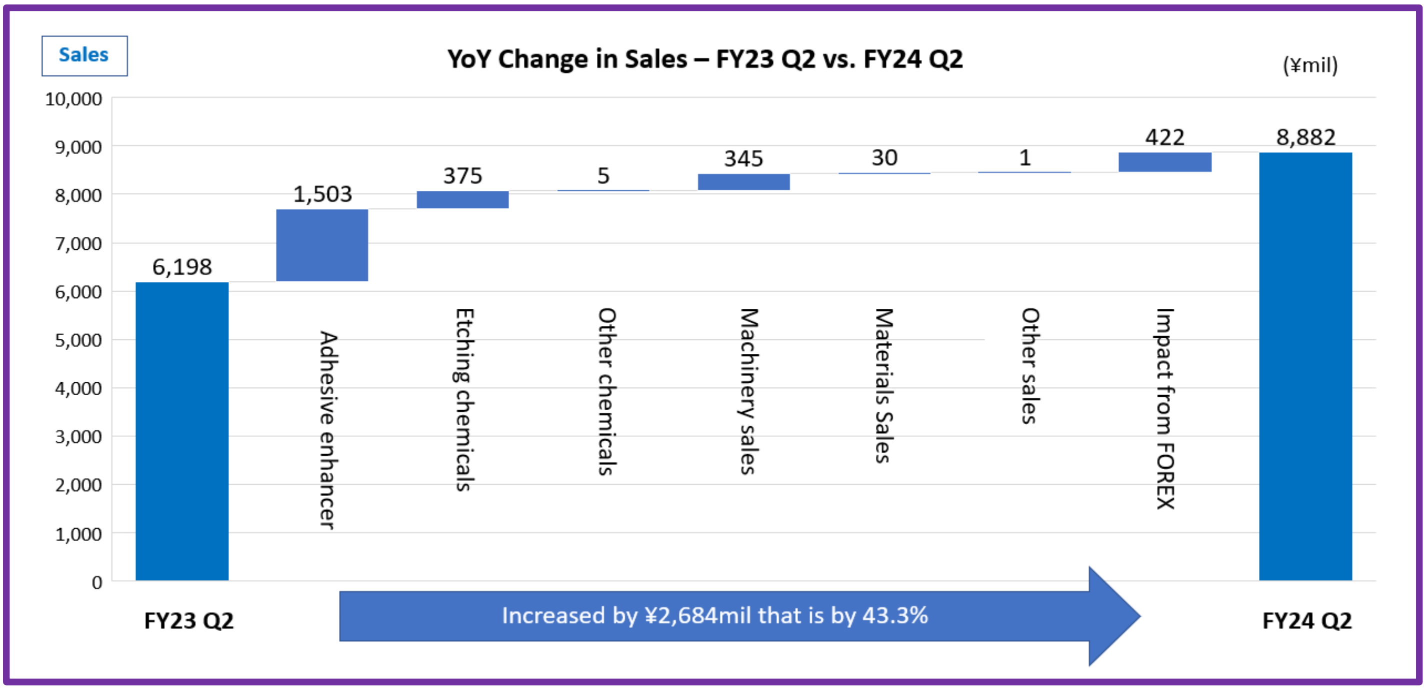
(ton, ¥mil)	FY22				FY23				FY24	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Vol (CUM)	11,384	23,127	34,725	44,962	7,498	16,055	25,439	35,398	9,850	20,251
Sales (CUM)	3,898	8,032	12,214	16,042	2,712	6,085	9,834	13,764	3,924	8,384
Vol (QTR)	11,384	11,743	11,598	10,237	7,498	8,557	9,384	9,959	9,850	10,401
Sales (QTR)	3,898	4,134	4,181	3,827	2,712	3,372	3,749	3.929	3,924	4,460

Source: Nippon-IBR based on MEC's FY22-24 results presentations

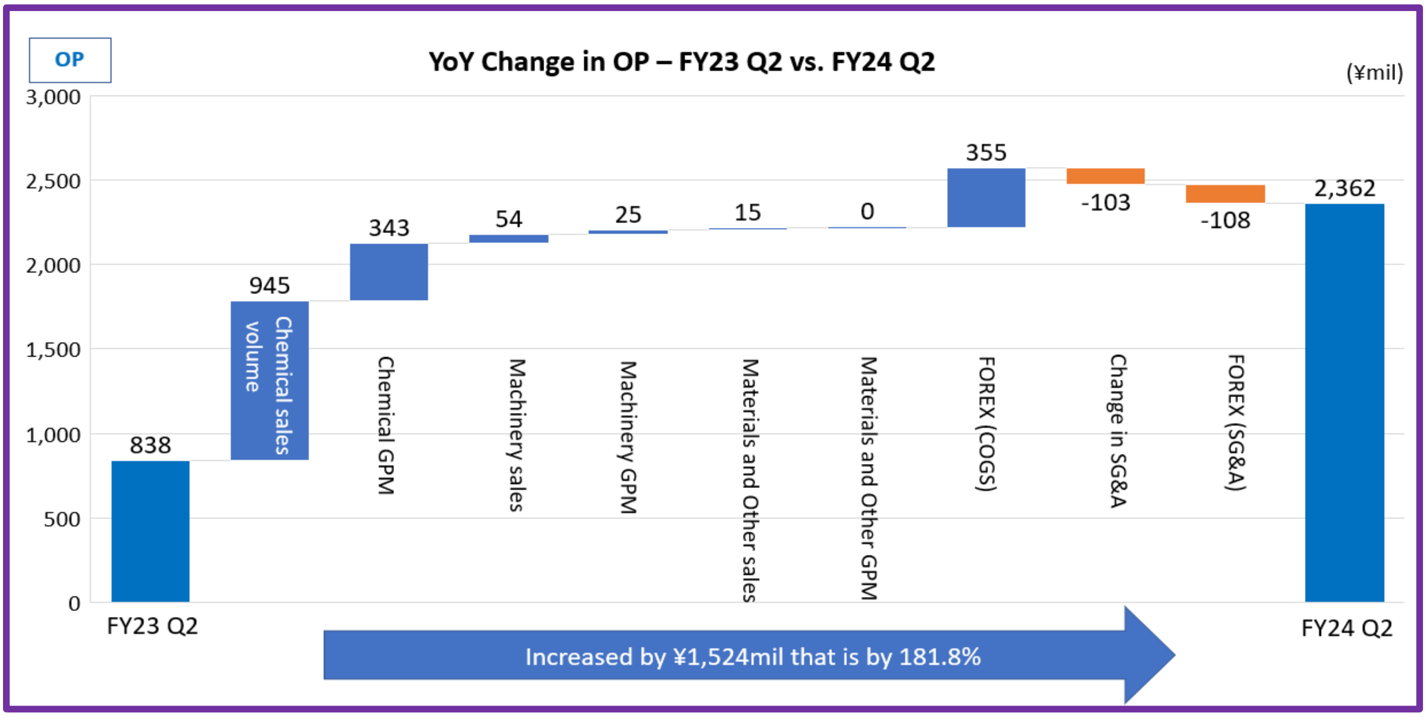
FY24 1H gross profit margin [GPM] improved +1.8ppt YoY to 60.6%, thanks to 1) an increase in sales and shipment volumes of chemical products, and 2) an improved sales mix – CZ-8101 sales rose +45.7% YoY to ¥2,861mil and EXE sales were ¥749 (+37.9% YoY).

FY24 1H OP surged +¥1,524mil YoY / +181.8% YoY (including FOREX net impact of +¥246mil YoY) to ¥2,362mil thanks to:

1. An increase in FY24 1H sales and sales volume of chemical products (+¥945mil),
2. Improvements in the Chemical segment GPM (+¥343mil YoY) due to an improved sales mix reflecting the aforementioned strong CZ-8101 and EXE sales, and
3. Higher in Machinery sales (+¥54mil YoY).



Source: Nippon-IBR based on MEC's FY24 1H results presentation



Source: Nippon-IBR based on MEC's FY24 1H results presentation

SEGMENTS PERFORMANCE

Adhesive Enhancers

FY24 1H Adhesive Enhancer sales increased +43.0% YoY to ¥6,012mil, and CZ series sales expanded +45.8% YoY to ¥5,407mil. In Q2 alone, MEC reported Adhesive Enhancer sales of ¥3,135 (+34.3% YoY / +9.0% QoQ) and CZ series sales of ¥2,818mil (+36.1% YoY / +8.8% QoQ).

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 Q3 of ¥1,415mil (+60.2% YoY / +4.8% QoQ) in FY24 Q1 and rose further in FY24 Q2 to ¥1,446mil (+33.9% YoY / +2.2% QoQ).

Management observes that solid package demand for AI servers and better-than-expected demand for packages for memories, telecoms and autos boosted 1H CZ-8101 sales.

The FY24 1H performance of Other CZ chemicals, which includes adhesive chemicals using pre- and post-adhesive processes, reported a +55.6% YoY jump in sales to ¥1,898mil. 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. Although CZ-8101 is still the leading product in the CZ series, MEC's new factory in Kita Kyushu is designed to manufacture CZ series chemicals – not only 8101 but also 8201 and 8401 – more efficiently for more advanced packages. In Q2 alone, other CZ chemicals hit a record level of quarterly sales, coming in at ¥1,032mil (+44.3% YoY / +19.2% QoQ).

The CZ-8100 product, which is partly used in packages for auto components, remained solid in FY24 1H, with sales of ¥648mil (+23.2% YoY). Volumes used per automobile have been increasing steadily along with a pickup in demand for packages used in EVs and ADAS. In Q2 alone, CZ-8100 sales were ¥340mil (+23.2% YoY / +10.4% QoQ).

V-Bond, another adhesive-enhancing chemical used in multilayer substrates for autos and smartphones, reported FY24 1H sales of ¥400mil (+11.4% YoY). In Q2 alone, V-Bond sales was ¥206mil (+15.7% YoY / +6.2% QoQ), thanks to solid demand from the auto sector.

Etching Chemicals

FY24 1H Etching Chemicals sales rose +31.7% YoY to ¥1,986mil thanks to:

1. Solid EXE sales (¥749 +37.9% YoY), with Q2 sales alone of ¥442mil (+38.6% YoY / +44.0% QoQ) – as demand for chemicals for chip-on-film [COF] continues to improve on the back of TV monitor production post-production adjustments that began in FY22, and
2. A +32.9% YoY increase in 1H SF sales, a key material used in touch panels, to ¥322mil thanks to solid demand related to a new high-end tablet.

Although higher EXE sales contributed to the improvement in sales mix, MEC reckons that current strength in display production is temporary.

Chemical Sales by Products (Quarterly)

(¥mil / Dec year-end)	FY22				FY23				FY24			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	QoQ (%)	YoY (%)
Copper surface treatment chemicals	3,695	3,931	3,981	3,660	2,564	3,150	3,536	3,736	3,748	4,250	13.4	34.9
Adhesive enhancer (CZ,V-Bond etc.)	2,676	2,911	3,073	2,797	1,870	2,335	2,608	2,915	2,877	3,135	9.0	34.3
CZ Series Total	2,402	2,609	2,784	2,517	1,638	2,071	2,311	2,609	2,589	2,818	8.8	36.1
CZ-8100	315	316	340	313	250	276	283	317	308	340	10.4	23.2
CZ-8101	1,276	1,410	1,464	1,276	883	1,080	1,229	1,350	1,415	1,446	2.2	33.9
Other CZ chemicals	811	883	980	928	505	715	799	942	866	1,032	19.2	44.3
V-Bond	207	206	189	187	181	178	198	187	194	206	6.2	15.7
Etching chemicals (EXE, SF etc.)	1,019	1,020	908	863	694	814	928	821	871	1,115	28.0	37.0
SF	204	246	235	192	130	112	184	118	141	181	28.4	61.6
EXE	360	308	187	226	224	319	312	259	307	442	44.0	38.6
Other surface treatment chemicals	202	202	200	166	148	222	213	193	175	209	19.4	-5.9
Chemical Sales Total	3,898	4,134	4,181	3,827	2,712	3,372	3,749	3,929	3,924	4,460	13.7	32.3

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

Chemical Sales by Products (Cumulative)

(¥mil / Dec year-end)	FY22				FY23				FY24		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	YoY (%)
Copper surface treatment chemicals	3,695	7,626	11,607	15,267	2,564	5,714	9,250	12,986	3,748	7,998	40.0
Adhesive enhancer (CZ,V-Bond etc)	2,676	5,587	8,660	11,457	1,870	4,205	6,813	9,728	2,877	6,012	43.0
CZ Series Total	2,403	5,011	7,795	10,312	1,638	3,709	6,020	8,629	2,589	5,407	45.8
CZ-8100	315	631	971	1,284	250	526	809	1,126	308	648	23.2
CZ-8101	1,276	2,686	4,150	5,426	883	1,963	3,192	4,542	1,415	2,861	45.7
Other CZ chemicals	811	1,694	2,674	3,602	505	1,220	2,019	2,961	866	1,898	55.6
V-Bond	207	413	602	789	181	359	557	744	194	400	11.4
Etching chemicals (EXE, SF etc.)	1,019	2,039	2,947	3,810	694	1,508	2,436	3,257	871	1,986	31.7
SF	204	450	684	877	130	242	426	544	141	322	32.9
EXE	360	668	855	1,081	224	543	855	1,114	307	749	37.9
Other surface treatment chemicals	202	404	604	770	148	370	583	776	175	384	3.8
Chemical Sales Total	3,898	8,032	12,213	16,042	2,712	6,085	9,834	13,764	3,924	8,384	37.8

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

FY24 OUTLOOK

MEC revised up its full-year FY24 guidance from OP of ¥3,650mil (+46.4% YoY) on sales of ¥17,000mil (+21.3% YoY) to OP of ¥4,900mil (+96.6% YoY) on sales of ¥18,500mil (+32.0% YoY) – YoY sales up +¥1,500mil and OP up +¥1,250mil to reflect the overshoot in the 1H – sales by +¥532mil and OP by +¥562mil.

FY24 Guidance

(¥mil)	FY23			FY24				
	1H	FY	YoY (%)	1H	YoY (%)	FY CE (Previous)	FY CE (New)	YoY (%)
Sales	6,198	14,020	-14.1	8,882	43.3	17,000	18,500	32.0
Operating Profit [OP]	838	2,492	-37.8	2,362	181.8	3,650	4,900	96.6
OP Margin [OPM] (%)	13.5	17.8	-6.7ppt	26.6	+13.1ppt	21.5	26.5	+8.7ppt
Recurring Profit [RP]	1,003	2,683	-36.8	2,641	163.3	3,800	5,200	93.8
NP for the parent's s/holders	1,076	2,304	-24.8	1,890	75.7	2,650	3,600	56.2
EPS (¥)	56.79	122.29	-24.1	100.97	77.8	141.52	192.26	57.2

Source: Nippon-IBR based on MEC Co., Ltd.'s FY23 & FY24 H1 Earnings Results Material

MEC has not changed its view on the market environment for its core products. The firm's initial assumptions and updates as of 1H are as follows:

1. Although end applications, such as for servers and PCs, have gradually started to show signs of a recovery during 1H, MEC does not yet expect a full-fledged recovery in server demand until FY24 2H, which should boost earnings of its core product CZ-8101. As a result, CZ chemicals will continue to be MEC's main growth driver, with YoY gains likely to come in higher than initial expectation of 15~20% in FY24.

   Demand for packages used in high-end servers that support generative AI technology has also been strong. However, more critical to MEC's earnings is the increased demand for packages used in data centre servers. Packages for memory used in telecoms and autos is also expected to remain solid, though a full-fledged recovery in packages used for PCs will likely not come before FY25.

2. A slight increase in V-Bond sales thanks to solid demand for use in autos and recovery in demand for use in smartphones.
3. MEC initially assumed a cautious view on Etching Chemical sales, SF series and EXE series, however, sales of both EXE and SF landed stronger than expected. MEC continues to expect sales of EXE to be solid, however, unlike FY23, where the firm saw an increase in production of TV monitors after inventory adjustments peaked, there is uncertainty regarding demand for COF in FY24 2H and beyond. As for the SF series, the firm also remains cautious with demand for end applications.

CAPITAL ALLOCATION POLICY

CAPEX: For FY23, MEC spent ¥1,870mil on CAPEX, of which ¥933mil was for the new Kita Kyushu plant; construction began in August 2024 with operations scheduled to commence in October 2025. CAPEX for the plant rose by +¥700mil on top of the overall CAPEX of ¥4,000mil to be spent over four years (FY23~FY26) – FY23 ¥933mil / FY24 ¥1,730mil / FY25 ¥1,026mil / FY26 ¥311 mil, which includes the cost of the land for the new plant, financed by cash flow as well as debt.

With the release of the Q1 results, MEC revised its FY24 CAPEX budget for the plant to ¥2,097mil and FY25 to ¥1,669mil due to a change in production concept at the new plant, taking total FY24 CAPEX to ¥3,474mil vs ¥3,107mil previously. 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. FY24 and FY25 CAPEX schedule for the new factory was also brought forward.

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

Shareholder Returns: MEC has maintained its FY24 guidance for a consolidated annual dividend payment unchanged of ¥45/share. Based on the revised FY24 EPS of ¥192.26, the dividend pay-out ratio will be 23.4%. Management aims to achieve a consolidated dividend pay-out ratio of 30% under the ongoing medium-term management plan.

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