MEC CO., LTD (4971 JP)

PACKAGE DEMAND FOR AI CHIPS BOOSTED CZ-8101 SALES, HOWEVER FULL-FLEDGE DEMAND RECOVERY WILL LIKELY BE IN FY25.

EXECUTIVE SUMMARY

- **MEC revised up its full-year FY24 guidance for the second time with the release of the Q2 results in August. What drove growth?**
  The +118.3% YoY growth in FY24 Q1~Q3 operating profit [OP] of ¥3,649mil on sales of ¥13,682mil (+37.1% YoY)] was due to easy comps, rather than a full recovery, especially in demand associated with PCs and servers used in general data centre. One of the growth drivers in FY24 is package demand associated with generative AI, to which MEC's core products, CZ-8101 and CZ-8401 chemicals are used.

- **There is only one quarter left to the end of FY24 (December-end). Are there any earnings risks?**
  Although earnings to date have been in line with the upward revised guidance made at the time of Q2 results release, potential risk to earnings include: 1) the recovery in package demand related to PCs and data centre servers, which is critical to MEC's earnings, remains lacklustre, not coming before FY25, and 2) TV inventory adjustments peak, which will lead to a deterioration in sales mix.

- **What is MEC's shareholders return policy?**
  MEC has maintained its FY24 guidance for a consolidated annual dividend payment 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.

- **New Kita Kyushu Plant**
  MEC revised its FY24 CAPEX budget for the plant to ¥2,097mil and FY25 to ¥1,669mil due to a modification in production facility design, taking total FY24 CAPEX to ¥3,474mil vs ¥3,107mil previously. While production at the new plant is currently dedicated to the CZ series, the design of the plant has been set up to be able to cater for future technological changes, e.g. for production methods such as no coarsening / smooth surface adhesion will be required.

MEC (4971 JP): Share Information						
Market Cap (¥mil)		**657,000**	**Market Cap ($mil)**			**4,380**
22-day Average Trading Volume (¥mil)		**448**	**22-day Average Trading Volume ($mil)**			**3.0**
Share performance (%)	**4971**	**TOPIX**	**Earnings Summary (¥mil, %)**	**FY22**	**FY23**	**FY24CE**
Share price (¥, 05 Dec 2024)	3,275	2,665	**Sales**	16,329	14,020	18,500
3mo (from 6 Sept 2024)	-7.2	+2.6	**OP**	4,004	2,492	4,900
6mo (from 6 March 2024)	-20.8	-3.3	**OPM (%)**	24.5	17.8	26.5
YTD	-26.8	+11.3	**EBITDA**	4,763	3,265	4,413*
1yr	-18.9	+11.6	**Financial Leverage (X)**	1.1	1.1	1.1*
5yrs	+111.0	+55.5	**Net D/E Ratio (X)**	-0.3	-0.2	-0.2*
Per-share and Valuations	**4971**	**TOPIX**	**FCF**	2,871	544	939*
EPS (¥, FY24 CE)	192.26	179.35				
DPS (¥, FY24 CE)	45	N/A	**Shareholder Return Summary**	**FY22**	**FY23**	**FY24CE**
BPS (¥, June-24)	1,983	1970.45	**Dividend (¥)**	45	45	45
FCFPS (¥, FY24EST)	46.8	N/A	**Dividend Payout (%)**	27.9	36.8	23.4
Forward PER	17.0	14.86	**Dividend Yield (%)**	N/A	N/A	1.4
PBR (x)	1.7	1.35	**DOE (%)**	3.7	3.4	2.3
PCFR (x)	3.5	N/A	**Treasury Shares (%)**	N/A	N/A	1.6
EV/EBITDA (x)	63.7	N/A	**ROE (%)**	13.8	9.6	14.5*

*Source: Nippon-IBR based on data on Bloomberg and Toyo Keizai / *Nippon-IBR estimates*

FY24 Q3 RESULTS SUMMARY

MEC's (4971 JP) FY24 (Dec year-end) Q1~Q3 results landed largely in line with guidance that was revised up at the time of Q2 results, reporting operating profit [OP] of ¥3,649mil (+118.3% YoY) on sales of ¥13,682mil (+37.1% YoY). Chemical segment sales for the 9-month period rose +32.6% YoY to ¥13,041mil, however, the growth was due to easy YoY comps, not because of a full recovery, especially in demand associated with PCs and servers used in general data centres. Meanwhile, demand for packages used in generative AI servers has been steadily increasing.

In Q3 alone, the firm produced Q3 OP of ¥1,287mil (+54.5% YoY / -1.7% QoQ) on sales of ¥4,800mil (+26.9% YoY / +6.0% QoQ). Although demand associated with generative AI continued to be strong in Q3, the recovery in demand related to PC and servers, which has a greater impact on MEC's earnings, remained slow. Chemical segment Q3 sales rose +24.2% YoY / +4.4% QoQ to ¥4,657mil, a steady improvement from the recent bottom of quarterly sales [FY23: Q1 sales of ¥2,712mil / Q2 ¥3,372mil / Q3 ¥3,749mil / Q4 ¥3,929, FY24 Q1 ¥3,924mil, and FY24 Q2 ¥4,460mil]. Equally, shipment volumes improved YoY to 11,183 ton (+19.2% YoY / +7.5% QoQ), though sales volumes have not yet recovered to the peak levels seen in FY22.

In the Q1~Q3 period, FOREX added +¥502mil YoY to sales and +¥320mil YoY to OP. The major foreign currencies that have the greatest impact on MEC's earnings are the Taiwanese dollar [NTD] and Chinese yuan [RMB]. Over the cumulative Jan~Sept period, a ¥0.1/NTD change boosted sales by +¥52mil and OP by +¥39mil and a ¥0.1/RMB change added +¥20mil to sales and +¥12mil to OP.

MEC (4971 JP): Earnings Summary

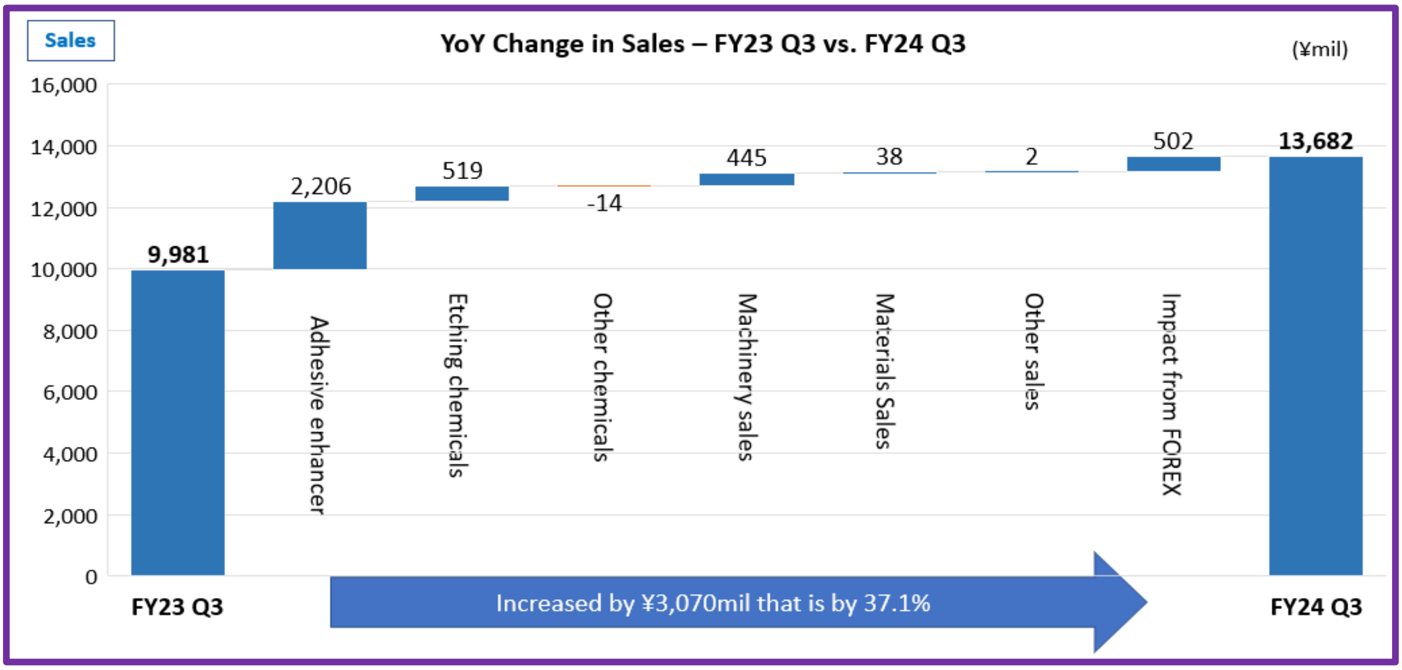
Dec year-end (¥mil)	FY23				FY24					
	Q1	1H	Q3	FY	Q1	1H	Q3	YoY (%)	New FY CE	YoY (%)
Sales	2,765	6,198	9,981	14,020	4,354	8,882	13,682	37.1	18,500	32.0
incl. Chemicals	2,712	6,085	9,834	13,764	3,924	8,384	13,041	32.6	N/A	N/A
GP	1,583	3,646	5,886	8,316	2,549	5,383	8,397	42.7	N/A	N/A
GPM (%)	57.3	58.8	59.0	59.3	58.5	60.6	61.4	+2.4ppt	N/A	N/A
SG&A	1,414	2,807	4,214	5,824	1,496	3,020	4,747	12.6	N/A	N/A
SG&A/Sales (%)	51.2	45.3	42.2	41.5	34.4	34.0	34.7	-7.5ppt	N/A	N/A
OP	168	838	1,671	2,492	1,053	2,362	3,649	118.3	4,900	96.6
OPM (%)	6.1	13.5	16.7	17.8	24.2	26.6	26.7	+10.0ppt	26.5	+8.7ppt
RP	223	1,003	1,878	2,683	1,132	2,641	3,700	97.0	5,200	93.8
RPM (%)	8.1	16.2	18.8	19.1	26.0	29.7	27.0	+8.2ppt	28.1	+9.0ppt
NP*	82	1,076	1,707	2,304	779	1,890	2,627	53.9	3,600	56.2
EPS (¥)	4.32	56.79	90.39	122.29	41.62	100.97	140.32	55.2	192.26	N/A
DPS (¥)	n/a	20.00	N/A	45.00	N/A	20.00	N/A	N/A	45.00	N/A

Source: Nippon-IBR based on MEC's earnings results materials
** NP attributed to the parent's shareholders*

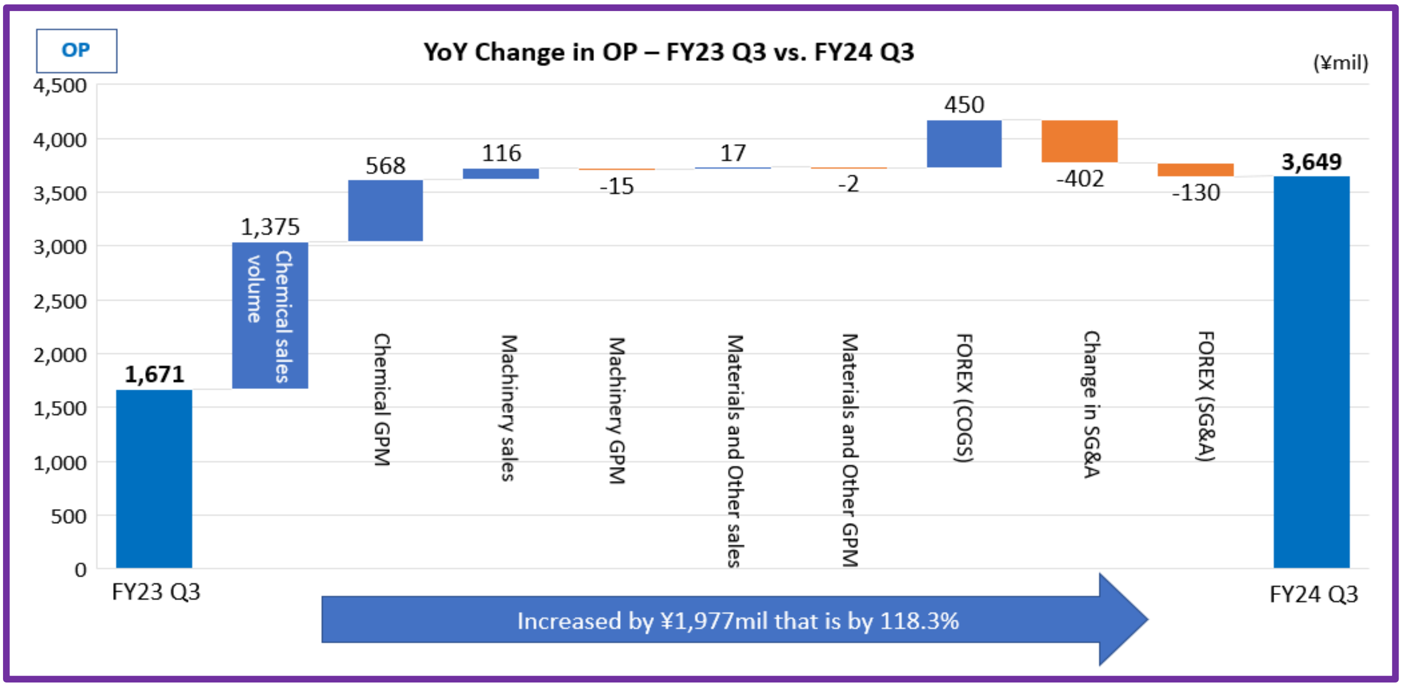
The sales mix also improved, which led to a +2.4ppt YoY rise in gross profit margin [GPM] in the Q1~Q3 period to 61.4%, thanks to 1) an increase in sales and shipment volumes of chemical products, and 2) an improved sales mix – CZ-8101 sales rose +35.7% YoY to ¥4,330mil and EXE sales were ¥1,072(+25.4% YoY).

The Q1~Q3 gross profit margin [GPM] rose +2.4ppt YoY to 61.4%, thanks to 1) an increase in both sales and shipment volumes of chemical products, and 2) an improved sales mix – CZ-8101 sales expanded +35.7% YoY to ¥4,330mil and EXE sales rose +25.4% YoY to ¥1,072. Consequently, the FY24 Q1~Q3 OP surged +¥1,977mil YoY / +118.3 % YoY (including a FOREX net impact of +¥320mil YoY) to ¥3,649mil reflecting:

1. Higher sales volume of chemical products (+¥1,375mil),
2. The aforementioned improved Chemical segment GPM (+¥568mil YoY), and
3. An increase in Machinery sales (+¥116mil YoY).



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



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

PERFORMANCE BY PRODUCT SEGMENT

Adhesive Enhancers

FY24 Q1~Q3 Adhesive Enhancer sales increased +37.7% YoY to ¥9,382mil, and CZ series sales expanded +39.1% YoY to ¥8,377mil. In Q3 alone, MEC reported Adhesive Enhancer sales of ¥3,370 (+29.2% YoY / +7.5% QoQ) and CZ series sales of ¥2,970mil (+28.5% YoY / +5.4% 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 hit a record level of ¥1,469mil (+19.5% YoY / +1.6% QoQ).

Management noted that there was (1) solid package demand for AI servers and (2) better-than-expected demand for packages for memory, telecoms and autos continued which resulted in the boost to CZ-8101 sales during the Q1~Q3 period. The cumulative 9-month performance of Other CZ chemicals, which includes adhesive chemicals using pre- and post-adhesive processes, reported a +51.7% YoY jump in sales to ¥3,062mil. 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, whose sales are boosted by package demand for AI servers, 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 Q3 alone, other CZ chemicals hit a record of quarterly sales, coming in at ¥1,164mil (+45.7% YoY / +12.8% QoQ).

The CZ-8100 product, which is partly used in packages for auto components, remained solid in FY24 Q1~Q3, with sales of ¥985mil (+21.8% YoY). CZ-8100 was first launched in 1995 and is a stable revenue source; however, it is not a product that adds new customers. Current growth is supported by the steady rise in packages used in automobiles, including EVs and ADAS and a pickup in demand for simple packages used in various other devices. In Q3 alone, CZ-8100 sales were ¥337mil (+19.1% YoY / -0.9% QoQ).

V-Bond, another adhesive-enhancing chemical used in multilayer substrates for autos and smartphones, reported 9-month sales of ¥625mil (+12.2% YoY). In Q3 alone, V-Bond sales hit ¥225mil (+13.6% YoY / +9.2% QoQ), thanks to solid demand from the auto sector.

Etching Chemicals

FY24 Q1~Q3 Etching Chemicals sales rose +25.8% YoY to ¥3,065mil, bolstered by a solid performance from:

1. Solid EXE sales (¥1,072 / +25.3% YoY), with Q3 sales alone of ¥323mil (+3.5% YoY / -26.9% QoQ) – as demand for chemicals for chip-on-film [COF] continues to improve on the back of TV stockpiling post-production adjustments that began in FY22, and
2. A +24.6% YoY increase in Q1~Q3 SF sales, a key material used in touch panels, to ¥532mil thanks to solid demand related to a new high-end tablet.

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

MEC (4971 JP): Chemical Sales by Products (Cumulative)

(¥mil / Dec year-end)	FY22				FY23				FY24			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	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	12,447	34.6
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	9,382	37.7
CZ Series Total	2,403	5,011	7,795	10,312	1,638	3,709	6,020	8,629	2,589	5,407	8,377	39.1
CZ-8100	315	631	971	1,284	250	526	809	1,126	308	648	985	21.8
CZ-8101	1,276	2,686	4,150	5,426	883	1,963	3,192	4,542	1,415	2,861	4,330	35.7
Other CZ chemicals	811	1,694	2,674	3,602	505	1,220	2,019	2,961	866	1,898	3,062	51.6
V-Bond	207	413	602	789	181	359	557	744	194	400	625	12.3
Etching chemicals (EXE, SF etc.)	1,019	2,039	2,947	3,810	694	1,508	2,436	3,257	871	1,986	3,065	25.8
SF	204	450	685	877	130	242	426	544	141	322	532	24.6
EXE	360	668	855	1,081	224	543	855	1,114	307	749	1,072	25.3
Other surface treatment chemicals	202	404	604	770	148	370	583	776	175	384	590	1.2
Chemical Sales Total	3,898	8,032	12,213	16,042	2,712	6,085	9,834	13,764	3,924	8,384	13,041	32.6

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

MEC (4971 JP): Chemical Sales by Products (Quarterly)

(¥mil / Dec year-end)	FY22				FY23				FY24				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	YoY (%)	QoQ (%)
Copper surface treatment chemicals	3,695	3,931	3,981	3,660	2,564	3,150	3,536	3,736	3,748	4,250	4,449	25.8	4.7
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	3,370	29.2	7.5
CZ Series Total	2,402	2,609	2,784	2,517	1,638	2,071	2,311	2,609	2,589	2,818	2,970	28.5	5.4
CZ-8100	315	316	340	313	250	276	283	317	308	340	337	19.1	-0.9
CZ-8101	1,276	1,410	1,464	1,276	883	1,080	1,229	1,350	1,415	1,446	1,469	19.5	1.6
Other CZ chemicals	811	883	980	928	505	715	799	942	866	1,032	1,164	45.7	12.8
V-Bond	207	206	189	187	181	178	198	187	194	206	225	13.6	9.2
Etching chemicals (EXE, SF etc.)	1,019	1,020	908	863	694	814	928	821	871	1,115	1,079	16.3	-3.2
SF	204	246	235	192	130	112	184	118	141	181	210	14.1	16.0
EXE	360	308	187	226	224	319	312	259	307	442	323	3.5	-26.9
Other surface treatment chemicals	202	202	200	166	148	222	213	193	175	209	206	-3.3	-1.4
Chemical Sales Total	3,898	4,134	4,181	3,827	2,712	3,372	3,749	3,929	3,924	4,460	4,657	24.2	4.4

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

FY24 OUTLOOK

MEC maintained its full-year FY24 guidance with OP of ¥4,900mil (+96.6% YoY) on sales of ¥18,500mil (+32.0% YoY) to reflect the overshoot in the 1H performance – sales by +¥532mil and OP by +¥562mil – vs 1H guidance.

MEC (4971 JP): 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 ME's earnings results materials

There are a several potential earnings risks to the full-year forecast:

1. Although end applications, such as for servers and PCs, have gradually started to show signs of a recovery during Q1~Q3, the recovery lacks pace. Demand for packages used in high-end servers that support generative AI technology has been contributing to MEC's FY24 earnings to date. More critical to MEC's earnings growth from next year onwards is the increased demand for packages used in PCs and data centre servers as packages for those applications use more volume. Packages for memory used in telecoms and autos is also expected to remain solid, though a full-fledged recovery in packages used for PCs and data centre servers is not expected to come before FY25.

2. MEC initially assumed a cautious view on Etching Chemical sales, SF series and EXE series, however, sales of both products landed stronger than expected. MEC continues to expect sales of EXE to be solid, however, unlike FY23, where the firm saw an increase in stockpiling production of TVs after inventory adjustments peaked, there is uncertainty regarding demand for COF in FY24 Q4 and beyond. As for the SF series, the firm also remains cautious with demand for end applications.

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.

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, 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 for boosting 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. As a result, FY24 and FY25 CAPEX schedule for the new factory was also pushed back.

Post-completion depreciation costs related to the plant were 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).

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