MEC CO., LTD (4971 JP)

CONTINUES TO INVEST ON EXISTING TECHNOLOGIES AS WELL AS ON HUMAN RESOURCES DURING THE NEXT THREE YEARS

EXECUTIVE SUMMARY

- **FY24 Earnings Highlight:** MEC (4971 JP) reported FY24 (Dec year-end) results, producing OP of ¥4,562mil (+83.0% YoY) on sales of ¥18,234mil (+30.1% YoY). FY24 Chemical segment sales rose +27.0% YoY to ¥17,478mil, thanks to 1) a steady increase in demand for chemicals used in high-end packages, and 2) a gradual recovery in demand associated with PCs, smartphones, and general servers.
- **FY25 Outlook:** MEC is guiding for FY25 1H OP of ¥2,250mil (-4.8% YoY) on sales of ¥9,600mil (+8.1% YoY), and full-year OP of ¥5,000mil (+9.6% YoY) on sales of ¥20,000mil (+9.7% YoY). The main growth driver will be CZ-series chemicals, especially CZ-8101 and the newer 8201 and 8401, whose sales continue to rise as demand for chemicals used in high-end packages such as for generative AI servers expand. A fully-fledged recovery in packages used in PCs and general servers, which will further boost demand for MEC's core products, will likely be seen in FY25 2H onwards.
- **Key messages from MEC's new medium-term plan [MTP] FY25~FY27:** Under the new MTP, MEC aims to achieve sales of ¥25,000mil and OPM of more than 20% in FY27, comprising ¥23,500mil (3-year CAGR of +11.1%) in existing core businesses, with the remainder from applications of existing core businesses. Since the firm already generated an OPM of 25% in FY24, the target of 20% or more might appear rather conservative. However, 20% or more of a statement from the firm that it commits to generate an OPM of 20%, even under the earnings down trend.
- **Examples of "Application and Expansion" during Phase2 MTP (Phase 2, FY25~FY27):** In its current core technology, MEC is focusing on the high-speed communications network field in its existing substrate-related business. It also plans to apply and develop existing technologies to cultivate business opportunities in the field closer to semiconductors, for example.
- **Capital allocation policy over the next three years?:** Plans are for (1) CAPEX of approx. ¥8,000mil of which approx. 50% will be spent on the Kita Kyushu plant and the remaining 50% on CAPEX for the future growth as well as for the maintenance of existing capacities, (2) approx. 10% of consolidated sales on R&D, and (3) target at a 30% consolidated pay-out ratio. The firm will also repurchase shares promptly and proactively.

MEC (4971 JP) : Share Information

Market Cap (¥mil)		50,300	Market Cap ($mil)			335
22-day Average Trading Volume (¥mil)		509	22-day Average Trading Volume ($mil)			3.4
Share performance (%)	**4971**	**TOPIX**	**Earnings Summary (¥mil, %)**	**FY23**	**FY24**	**FY25CE**
Share price (¥, 5 Mar 2025)	2,511	2,718.21	Sales	14,020	18,234	20,000
3mo (from 5 Dec 2024)	-23.3	-0.88	OP	2,492	4,562	5,000
6mo (from 5 Sept 2024)	-30.3	+3.72	OPM (%)	17.8	25.0	25.0
YTD (from 6 Jan 2025)	-33.6	+3.22	EBITDA	3,993	5,487	5,885
1yr (from 5 Mar 2024)	-44.3	-0.06	EPS (¥)	122.29	122.38	192.26
5yrs (from 5 Mar 2020)	+94.6	+84.7	Financial Leverage (X)	1.1	1.2	1.2*
Per-share and Valuations	**4971**	**TOPIX**	Net D/E Ratio (X)	-0.3	-0.4	-0.5*
EPS (¥, FY25 CE)	192.26	184.82	FCF	544	4,251	2,476*
DPS (¥, FY25 CE)	55.00	N/A	**Shareholder Return Summary**	**FY23**	**FY24**	**FY25CE**
BPS (¥, Dec-24)	1,436.45	1956.43	Dividend (¥)	45.0	45.0	55.0
FCFPS (¥, FY25EST)	123.36	N/A	Dividend Payout (%)	36.8	36.8	28.6
Forward PER	13.1	14.7	Dividend Yield (%)	N/A	N/A	4565.5
PBR (x)	1.7	1.4	DOE (%)	3.5	3.3	3.6*
PCFR (x)	20.4	N/A	Treasury Shares (%)	N/A	N/A	5.8
EV/EBITDA (x)	6.6	N/A	ROE (%)	9.6	8.9	12.8

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

FY24 RESULTS SUMMARY

MEC's (4971 JP) FY24 (Dec year-end) results saw OP increase +83.0% YoY to ¥4,562mil on sales of ¥18,234mil (+30.1% YoY). While the sales figure landed just shy of the full-year guidance of ¥18,500mil, resulting in OP falling short of guidance by -6.9% to ¥4,900mil, Chemical segment sales rose +27.0% YoY to ¥17,478mil, thanks to 1) a steady increase in demand for chemicals used in high-end packages, and 2) a gradual recovery in demand associated with PCs, smartphones and general servers. However, a recovery, in demand associated with PCs and servers used in general data centres is yet to see a full recovery.

Corporation tax increased +2.6x YoY to ¥2,378mil, and included a tax payment of ¥1,680mil, part of which was related to the transfer of MEC FINE CHEMICAL (ZHUHAI) LTD from MEC HONG KONG) LTD to MEC parent. The rationale behind this restructuring of group companies is to improve operational efficiency. As a result, FY24 net profit [NP] fell -0.6% YoY to ¥2,291mil. Nevertheless, the firm maintained the planned annual dividend of ¥45.00/share, which generates a pay-out ratio of 36.8% and DOE of 3.3%.

MEC (4971 JP): Earnings Summary

(¥mil / Dec year-end)	FY23		FY24				
	1H	FY	1H	FY	YoY (%)	FY CE	FY vs FYCE (%)
Sales	6,198	14,020	8,882	18,234	30.1	18,500	-1.4
incl. Chemicals	6,085	13,764	8,384	17,478	27.0	N/A	N/A
GP	3,646	8,316	5,383	11,101	33.5	N/A	N/A
GPM (%)	58.8	59.3	60.6	60.9	+1.6ppt	N/A	N/A
SG&A	2,807	5,824	3,020	6,539	12.3	N/A	N/A
SG&A/Sales (%)	45.3	41.5	34.0	35.9	-5.6ppt	N/A	N/A
OP	838	2,492	2,362	4,562	83.0	4,900	-6.9
OPM (%)	13.5	17.8	26.6	25.0	+7.2ppt	26.5	-1.5ppt
RP	1,003	2,683	2,641	4,682	74.5	5,200	-10.0
RPM (%)	16.2	19.1	29.7	25.7	+6.6ppt	28.1	-2.4ppt
NP*	1,076	2,304	1,890	2,291	-0.6	3,600	-36.4
EPS (¥)	56.79	122.29	100.97	122.38	N/A	192.26	-36.3
DPS (¥)	20.00	45.00	20.00	45.00	N/A	45.00	100.0

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

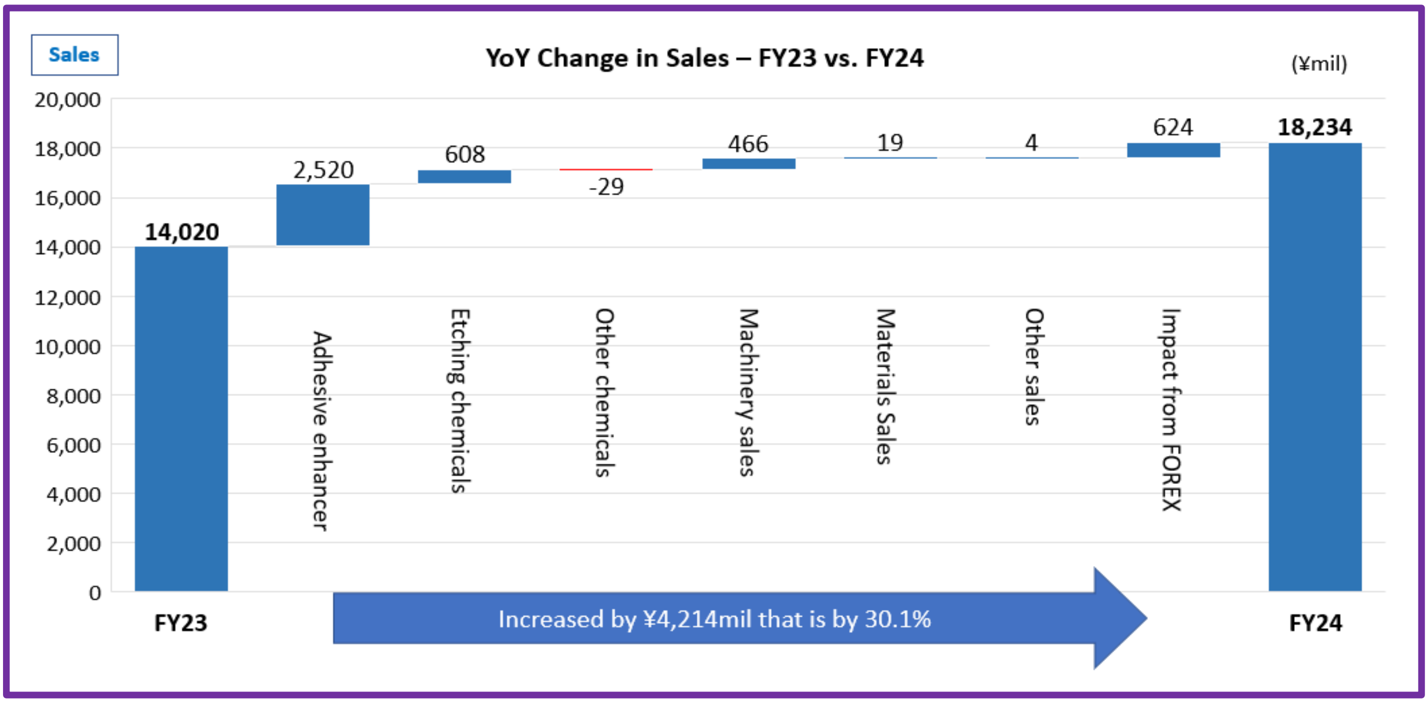
** NP attributed to the parent's shareholders*

In Q4 alone, MEC produced OP of ¥913mil (+11.3% YoY / -29.0% QoQ) on sales of ¥4,552mil (+12.7% YoY / -5.1% QoQ). The QoQ decline is due to seasonal factors: Q3 sales peak as the firm ship chemicals prior to the new model launch of end-application products. Although demand associated with generative AI continued remained strong in Q4, the recovery in demand related to PC and servers, which has a greater impact on MEC's earnings, remained lacklustre. Chemical segment sales rose +12.9% YoY / -4.7% QoQ to ¥4,436mil, while shipment volumes were up +6.8%YoY to 10,641 ton (-4.8% QoQ). Sales volumes, however, have not yet recovered to peak levels seen in FY22.

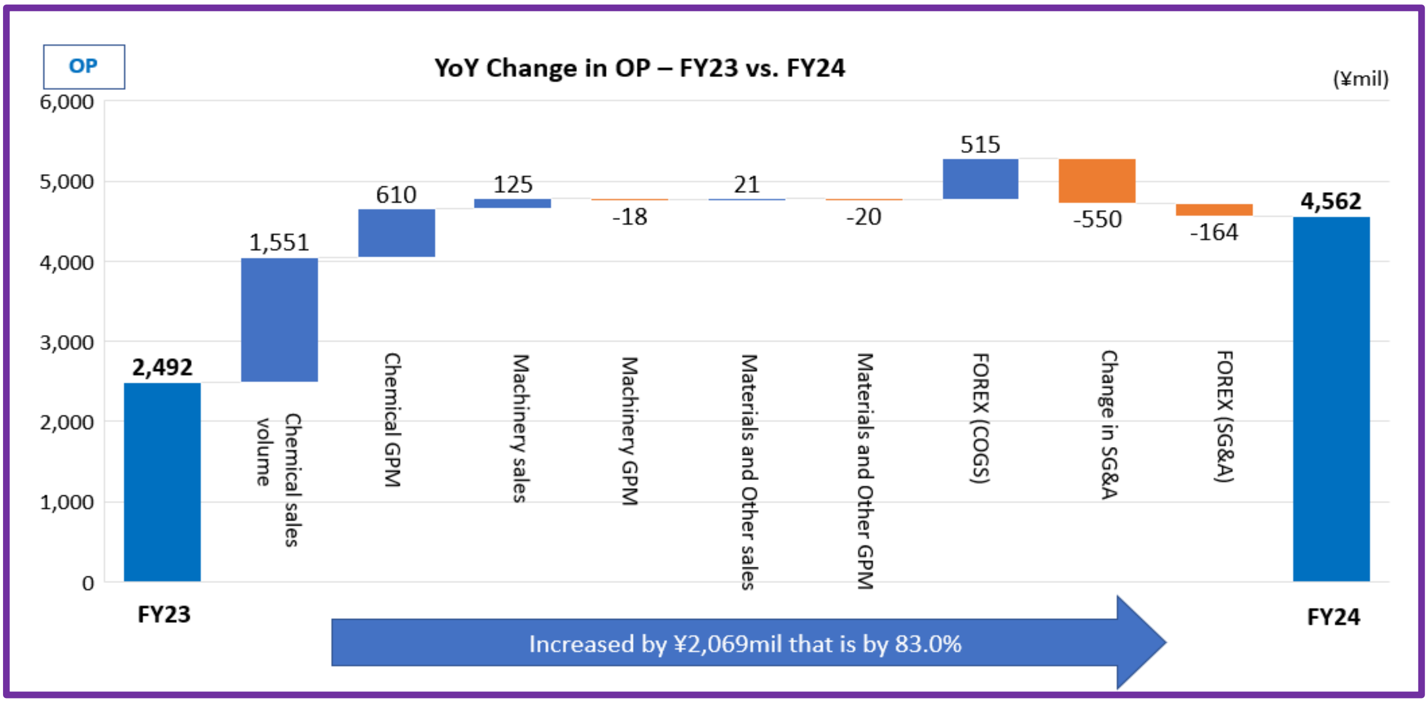
On a full-year basis, FOREX added +¥624mil YoY to sales and +¥351mil (NET) YoY to OP. The major foreign currencies that have the greatest impact on MEC's earnings are the Taiwanese dollar [NTD] and Chinese yuan [RMB]. In FY24, a ¥0.1/NTD change boosted sales by +¥70mil and OP by +¥51mil and a ¥0.1/RMB change added +¥27mil to sales and +¥16mil to OP.

The sales mix also improved, which led to a +1.6ppt YoY rise to 60.9% in the gross profit margin [GPM] in FY24, thanks to 1) an increase in both sales (+27.0% YoY) and shipment volumes (+18.9% YoY) of chemical products, and 2) an improved sales mix – CZ-8101 sales expanded +28.0% YoY to ¥5,816mil and EXE sales rose +22.5% YoY to ¥1,366mil. Consequently, FY24 OP surged +¥2,069mil YoY / +83.0 % YoY (including a FOREX net impact of +¥351mil YoY) to ¥4,562mil reflecting:

1. Higher sales volume of chemical products (+¥1,551mil),
2. The aforementioned improved Chemical segment GPM (+¥610mil YoY), and
3. An increase in Machinery sales (+¥125mil 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 Adhesive Enhancer sales increased +30.5% YoY to ¥12,699mil, and CZ series sales expanded +31.0% YoY to ¥11,305mil. In Q4 alone, MEC reported Adhesive Enhancer sales of ¥3,317 (+13.8% YoY / -1.6% QoQ) and CZ series sales of ¥2,928mil (+12.2% YoY / -1.4% QoQ).

MEC's core product in this product group, CZ-8101 – an adhesive-enhancing chemical used in packages primarily for PCs / smartphones / servers and chiplet packaging such as CoWoS – reported record sales of ¥5,816mil (+28.0% YoY), thanks to rising demand from generative AI-related packaging demand, which also boosted sales of more advanced chemicals such as CZ-8401. Quarterly sales also hit a record of ¥1,486mil (+10.1% YoY / +1.2% QoQ) in Q4. Management noted that while there was solid package demand for AI servers, package demand for general servers and PCs is slow to recover.

For Other CZ chemicals, which includes adhesive chemicals using pre- and post-adhesive processes, FY24 segment sales rose +41.2% YoY to ¥4,182mil. 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 Q4 alone, other CZ chemicals hit a record level of quarterly sales, coming in at ¥1,120mil (+18.9% YoY / -3.8% QoQ).

The CZ-8100 product, which is partly used in packages for auto components, remained solid in FY24, with sales up +16.1% YoY to ¥1,307mil. 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 Q4 alone, CZ-8100 sales were ¥322mil (+1.6% YoY / -4.5% QoQ).

V-Bond, another adhesive-enhancing chemical used in multilayer substrates for autos and smartphones, reported FY24 sales of ¥832mil (+11.8% YoY). In Q4 alone, V-Bond sales hit ¥207mil (+10.7% YoY / -8.0% QoQ), thanks to solid demand from the auto sector.

Etching Chemicals

FY24 Etching Chemicals sales rose +22.8% YoY to ¥4,000mil, bolstered by a solid performance from:

1. Solid EXE sales (¥1,366 / +22.5% YoY), with Q4 sales alone of ¥294mil (+13.5% YoY / -9.0% 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 +19.6% YoY increase in FY24 SF sales, a key material used in touch panels, to ¥652mil 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 it is still unknown if the current trend of higher display production will continue going forward.

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

(¥mil / Dec year-end)	FY23				FY24				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	YoY (%)
Copper surface treatment chemicals	2,564	5,714	9,250	12,986	3,748	7,998	12,447	16,699	28.6
Adhesive enhancer (CZ, V-Bond etc)	1,870	4,205	6,813	9,728	2,877	6,012	9,382	12,699	30.5
CZ Series Total	1,638	3,709	6,020	8,629	2,589	5,407	8,377	11,305	31.0
CZ-8100	250	526	809	1,126	308	648	985	1,307	16.1
CZ-8101	883	1,963	3,192	4,542	1,415	2,861	4,330	5,816	28.0
Other CZ chemicals	505	1,220	2,019	2,961	866	1,898	3,062	4,182	41.2
V-Bond	181	359	557	744	194	400	625	832	11.8
Etching chemicals (EXE, SF etc.)	694	1,508	2,436	3,257	871	1,986	3,065	4,000	22.8
SF	130	242	426	544	141	322	532	652	19.6
EXE	224	543	855	1,114	307	749	1,072	1,366	22.5
Other surface treatment chemicals	148	370	583	776	175	384	590	772	-0.5
Chemical Sales Total	2,712	6,085	9,834	13,764	3,924	8,384	13,041	17,478	27.0

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

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

(¥mil / Dec year-end)	FY23				FY24					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	YoY (%)	QoQ (%)
Copper surface treatment chemicals	2,564	3,150	3,536	3,736	3,748	4,250	4,449	4,252	13.8	-4.4
Adhesive enhancer (CZ, V-Bond etc.)	1,870	2,335	2,608	2,915	2,877	3,135	3,370	3,317	13.8	-1.6
CZ Series Total	1,638	2,071	2,311	2,609	2,589	2,818	2,970	2,928	12.2	-1.4
CZ-8100	250	276	283	317	308	340	337	322	1.6	-4.5
CZ-8101	883	1,080	1,229	1,350	1,415	1,446	1,469	1,486	10.1	1.2
Other CZ chemicals	505	715	799	942	866	1,032	1,164	1,120	18.9	-3.8
V-Bond	181	178	198	187	194	206	225	207	10.7	-8.0
Etching chemicals (EXE, SF etc.)	694	814	928	821	871	1,115	1,079	935	13.9	-13.3
SF	130	112	184	118	141	181	210	120	1.7	-42.9
EXE	224	319	312	259	307	442	323	294	13.5	-9.0
Other surface treatment chemicals	148	222	213	193	175	209	206	182	-5.7	-11.7
Chemical Sales Total	2,712	3,372	3,749	3,929	3,924	4,460	4,657	4,436	12.9	-4.7

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

FY25 OUTLOOK

MEC is guiding for FY25 1H OP of ¥2,250mil (-4.8% YoY) on sales of ¥9,600mil (+8.1% YoY), and full-year OP of ¥5,000mil (+9.6% YoY) on sales of ¥20,000mil (+9.7% YoY), based on the following assumptions:

1. Demand for packaging used in PCs and general servers will see a pick-up in the pace of recovery, which will likely boost sales of CZ-8101. Additionally, demand for packages for generative AI servers will continue to grow. MEC assumes sales growth of CZ-series chemicals to rise 10%+ YoY in FY25. Management expects continuous growth of CZ-8101 but anticipates sales to expand for CZ-8201 and CZ-8401.
2. V-Bond sales growth will be led by a recovery related to auto, communication satellite and smartphone production in FY25.
3. EXE demand for chemicals for chip-on-film [COF] continues to improve on the back of TV stockpiling post-production adjustments in the short-term, however, it is unclear if this trend will last. MEC assumes FY25 EXE sales growth to show a slight increase YoY.
4. SF sales growth is assumed to be flattish, as it is sensitive to tablet sales.

MEC (4971 JP): Earnings Trend and FY25 Guidance

(¥mil / Dec year-end)	FY23		FY24			FY25 CE			
	1H	FY	1H	FY	YoY (%)	1H CE	YoY (%)	FYCE	YoY (%)
Sales	6,198	14,020	8,882	18,234	30.1	9,600	8.1	20,000	9.7
Operating Profit [OP]	838	2,492	2,362	4,562	83.0	2,250	-4.8	5,000	9.6
OP Margin [OPM] (%)	13.5	17.8	26.6	25.0	+7.2ppt	23.4	-3.2ppt	25.0	flat
Recurring Profit [RP]	1,003	2,683	2,641	4,682	74.5	2,300	-12.9	5,100	8.9
NP for the parent's s/holders	1,076	2,304	1,890	2,291	-0.6	1,450	-23.3	3,600	57.1
EPS (¥)	56.79	122.29	100.97	122.38	0.1	77.4	-23.3	192.26	57.1

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

Shareholder Returns: MEC plans to pay a dividend of ¥55.00/share, which will generate a pay-out ratio of 28.6%. Excluding the extra tax payments made for the transfer of MEC ZHUHAI, normalised FY24 EPS would have been above ¥200.00, which would have produced a pay-out ratio of approx. 23.0%. Under the medium-term management plan [MTP] that completed in FY24, management was aiming for a consolidated dividend pay-out ratio of 30%.

THE "2020 VISION" – MEDIUM-TERM PLAN FY25~FY27

During the Phase1 of the 2030 Vision ending in FY24, MEC focused on the development of its core products and investing for future growth. The MTP target and achievements were as follows:

1. The FY24 target to achieve an OPM of over 20% was exceeded with the firm reporting an OPM of 25%
2. ROE target of more than 10% in FY24 was missed, although the firm achieved 13.8% in FY22, when demand for CZ-8101 used in packaging for PC and data centre servers led earning's growth.
3. R&D spending target of 10% of FY24 consolidated sales was not met, spending just 7.3% of FY24 sales. During the tenure of the MTP, MEC has underspent its R&D budget.
4. MEC spent only ¥3,260mil of planned CAPEX of ¥5,000mil over the three years, which includes the new Kita Kyushu factory. Some of the CAPEX is pushed back to Phase 2 of the MTP.
5. The dividend pay-out ratio target of 30% was met. The firm also repurchased shares in FY23 to enhance shareholders return but they have not been cancelled.

Under the new MTP, MEC plans to achieve sales of ¥25,000mil and OPM of more than 20% in FY27, comprising sales from existing core businesses of ¥23,500mil (3-year CAGR of +11.1%) and the remainder (¥1,500mil) from application and expansion of existing technologies. Given the firm has already generated an OPM of 25% in FY24, the OPM of 20% or more might appear rather conservative. Management is committed to a minimum OPM target of 20% or more even during the earnings downtrend.

Over the next three years, the firm plans to further invest on building businesses by applying existing technologies. MEC assumes its core markets, such as semiconductor and packaging, will likely continue to expand given growth opportunities of end applications such as 5G / 6G in next generation communication network, IoT, diversified AI technologies and next generation mobility. For those end applications to be launched, technologies such as high-speed information processing, low energy consumption, miniaturisation, less signalling noise, and higher density will be required. MEC will be able to provide ultra-fining and no surface roughening technologies to realise faster signal speed and higher density. Currently, MEC's core products CZ-series are used in packages. The firm is aiming to develop the new no-roughening surface treatment chemical, AP series, which can be deployed for PCB substrate, which are used in data centres etc.

CAPITAL ALLOCATION POLICY

MEC allocates capital (operating cash flow plus debt finance) on three major areas below:

- Growth investment, which includes

1. R&D,
2. M&A,
3. Enhancing the global supply network, and
4. Expanding technological support marketing

- Reinforcing business foundation, which includes

1. Investment on personnel, and
2. Focusing on the ESG management,

- Shareholders returns:

1. Dividend and
2. Prompt and proactive share buyback.

Core items for capital allocations during the tenure of Phase2 (FY25~FY27) are:

CAPEX: MEC plans to invest total of approx. ¥8,000mil allocating 50% to be spent on the Kita Kyushu plant and the remaining 50% on CAPEX for the future growth as well as for the maintenance of existing capacities.

R&D: Spending approx. 10% of consolidated sales

Shareholders return: Target a 30% consolidated pay-out ratio. The firm also will repurchase shares promptly and proactively.

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