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4971 MEC COMPANY LIMITED

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Greater revenue and profit achieved with favorable sales of chemicals and shipment volume

◆ Topics related to third-quarter results of the fiscal year ending December 2018

From the fiscal year ended December 2017, we changed the last day of our business year to December 31 from March 31. Accompanying this, we did not prepare third-quarter consolidated financial statements for the fiscal year ended December 2017, and so we do not state year-on-year changes for the third quarter of the current term.

In the third quarter, sales of our products for use in servers, datacenters, and automobiles remained steady, but sales of those sold for use in smartphones were generally stagnant overall. Sales of our products for uses related to virtual currencies, which had been going well during the first half of the year, slowed down.

Foreign exchange rates were almost the same as our assumed levels, and the differences from the actual rates were not large. The actual exchange rate (to the U.S. dollar) was 109.92 yen against the assumed rate of 113.00 yen (compared to 112.25 yen in the previous year), and (to the Taiwanese dollar) was 3.66 yen against the assumed rate of 3.70 yen, (3.66 yen in the previous year). The impact of foreign exchange caused sales to go up by 63 million yen year-on-year and increased operating income by 31 million yen year-on-year.

Sales of chemicals were up 9.2% and shipments grew 9.1% over the same period last year.

Sales for the third consolidated quarter amounted to 8,432 million yen (an increase of 8.5% year-on-year), operating income was 1,747 million yen (an increase of 4.3% year-on-year), ordinary income was 1,763 million yen (an increase of 3.8% year-on-year), and net income for the quarter was 1,429 million yen (an increase of 16.0% year-on-year).

Chemicals accounted for 98.2% of the total sales (an increase of 0.5 percentage points year-on-year) coming in at 8,284 million yen (up 9.2%). The overseas sales ratio was 54.7% (up 0.2 percentage points from the same period of the previous year). But when adding in sales of products for use overseas that were sold by agents in Japan it becomes 73.5%. Sales of the CZ Series were 4,222 million yen (up 11.7% year-on-year), and they accounted for 51.0% of all chemicals sales (up 1.2 percentage points).

The gross margin was 64.2% (down 0.5 percentage points year-on-year). Expenditure increased mainly due to capital investment, personnel increases, and such like. Although with the higher sales, both operating income and ordinary income increased only slightly, but they were within the planned amounts.

◆ Results for the third quarter of the year ending December 2018

Shinji Kitamura, Chief Financial Officer

Operations in the third quarter resulted in higher year-on-year revenue and profit. In terms of the composition of net sales by product type, as a result of sales of chemicals expanding to account for 98.2%, net sales increased by 8.5%.

Looking at the consolidated balance sheets, in current assets, inventories of merchandise and finished goods, work in process, and raw materials and supplies increased because operations at subsidiaries went

well and so the level of inventory in Japan, the country from which items are shipped, grew. This resulted in inventory increasing by 213 million yen. In fixed assets, investment securities decreased by 36 million yen due to market price declines. As a result, total net assets came to 19,530 million yen (up 282 million yen compared with the end of the previous consolidated fiscal year).
We repaid 500 million yen of long-term loans payable scheduled to be repaid within one year in current liabilities, and 500 million yen of long-term loans payable in fixed liabilities. There were repayments totaling 1,000 million yen of the Amagasaki Headquarters construction fund (total of 2,000 million yen borrowed). Accounts payable and income taxes payable in current liabilities fell mainly due to payments of consumption tax and other tax. The items of capital surplus and treasury stock in shareholders' equity in net assets were due to a transfer to capital surplus accompanying the accounting for stock-based compensation plans and the purchase of fractional shares.
As a result, total net assets came to 15,368 million yen (an increase of 781 million yen), and the equity ratio was 78.7%.
With respect to cash flow, the beginning balance of cash and cash equivalents was 3,664 million yen and the balance at the end of the period was 3,745 million yen, meaning there was an increase of about 80 million yen.
Looking at the trends in the quarters, sales have soared from the first quarter. Operating income slightly fell. This was because of an increase in shipments of products with high raw material costs, which was related to the product composition, and also an increase in transport expenses because of higher shipping quantities. Net income for the quarter was up due to an increase in subsidy revenue of approximately 95 million yen, as well as an increase in extraordinary income such as a tax refund in Taiwan.
With respect to quarterly changes by product, sales of others, materials, and machinery decreased, but sales of chemicals increased. Looking at quarterly trends by chemical, sales of others, stripping agents, fluxing agents and rust inhibitors remained almost flat, while those of copper surface treatment agent increased significantly. When dividing chemicals up into others, etchants, and adhesion improvers, we see that sales of the main chemicals—etchants and adhesion improvers—increased and sales of others decreased. Shipment volumes grew steadily year-on-year for all chemicals.
Looking at the sales trends of CZ-8100 and CZ-8101, which are the main products of the CZ Series, not only CZ-8101 but also the old product CZ-8100 are being used for automobile-related applications, and their sales have been increasing slightly.
In terms of sales trends and overseas ratios by regional segment, our performance remained very steady in Japan, Asia and Europe.
As the consolidated earnings forecast for the fiscal year ending in December 2018, we plan to achieve net sales of 11,600 million yen, operating income of 2,300 million yen, ordinary income of 2,400 million yen, and net income of 1,750 million yen. Please note that there are uncertain factors such as the product mix, raw material price, and transport expenses, and hence we have left the forecasts we made at the beginning of the term unchanged.

◆ Future business developments

Kazuo MAEDA, CEO & President

It is often said that we are in an age where there is a shift "from consumption of goods to consumption of services." But we are working on roughing surfaces, improving adhesion, providing services, getting information, and acquiring peripheral information for these things, and obtaining information for future developments. Although it is the very vague concept of "changing to services," we have high expectations that the fields in which we can be active will expand further in the future.
Moving from an information society to a smart society means that a 5G network will be needed to utilize IoT and AI. To this end, we have high hopes for not only investments in networks but also in various devices

ranging from consumer to industrial ones, centering on the audio and images they handle to support a smart society.
Today, the number of PCs, servers and datacenters is increasing dramatically, and they account for 20% of our total product sales. Our products for use in automobiles make up 20%, while 10% is accounted for by our products for use in televisions, and 10% for other uses. Sales of our products for use in smartphones and tablet PCs make up about 40%, down from the peak of nearly 50%, and we see this as being a slight decrease.
Many of the CZ Series products are being used for PCs, servers, datacenters and automobiles, and their sales for smartphones are decreasing. Although sales of our products for use in processors and sensors have been going well overall, sales for their use in memory are being adjusted and it is also conceivable they will be affected by virtual currencies.
Sales of our products for use in automobiles are growing in tandem with safer driving. But accompanying the move to self-driving and extended communication systems such as connected cars, we believe such products will become even more important in future and so we are also focusing on marketing activities.
Devices, mainly those that handle images, are being put to consumer and industrial use; but in terms of numbers, we believe those for consumer use, especially smartphones and televisions, will become important to our business. And we think that television sets will become relatively important in various scenes as they shift to 4K and 8K and handle 5G communication in the future and we expect our products for them will grow steadily. Our processes are widely adopted in COF (chip on film), and we will focus on that area more in the future.
Although we are putting the most emphasis on developing products for PCs, servers and datacenters, we are also refining technology to enhance adhesion strength while not roughening a surface but keeping it flat. And while high-speed and low-delay communications will come to be required with the arrival of 5G in the future, we expect to bolster our performance in this area and improve our business results.
The production of smartphones and tablet PCs is expected to exceed the current level of 1.5 billion units a year, thanks to the creation of high-end models that can incorporate an even greater number of services in the future. Meanwhile, it is predicted that there will be movements all over the world to produce items that are close to the current luxury goods as general-purpose products. It will be necessary for manufacturers to produce things with complicated specifications extremely easily and with a good production yield, and our processes are very effective for achieving that.
We expect technologies for servers and datacenters will be used in the high-end area. We will continue to respond to needs for that, while also focusing on addressing needs related to smartphones in the next volume zone. Motherboards with high-density features called high density interconnect boards (HDI) need to have finer wire and denser wiring, and we are recommending the EXE Series as a way to achieve that. We see the market as being very large.
This is a strategy to go from COG (Chip On Glass) to COF (Chip On Film) for the chips for the drive IC for smartphone image processing. We will apply the EXE Series that realizes high-density wiring patterns and create a market. We will attempt to make products of a high quality, at a low cost and easily. Besides that, there are sufficient business opportunities to capture demand for the CZ Series for use in motherboard exteriors, and V-Bond for interiors, and contribute to our performance.
A Substrate-Like PCB is an electronic substrate, but it is also a substrate like a semiconductor package board, and the term mainly refers to an HDI board and smartphone motherboard. At the Company, if the same product performance is achieved, we think that it may be good to form patterns with the subtractive method depending on usability or the manufacturer's way of thinking.
Regarding fan-out packages, U.S. communication equipment makers use wafer level packaging (WLP) for the main chip scale packages (CSP), but other manufacturers are not particular about using WLP especially. Basically, they use a method similar to the conventional substrate.
System-in-package (SiP) is used for datacenters and servers in the high-end area, and we see it as

gradually being put to more use with 2.5D becoming the mainstream.
The EXE Series is our core technology to neatly form wiring. The CZ Series, UT Series and V-Bond Series of rougheners use physical adhesion. SF, our selective etching product, is used for display-related applications.
For use with high-frequency substrates, flat processing is used when the speed is increased and the delay is low. We have already built up a track record of about four years and plan to further mass produce these products in the future.
We are also making environmental, social and governance (ESG) investments, and are working hard according to our company size. We will strive for further improvements in the future. We put high value on technology marketing. We will promote open innovation. We are making daily efforts while positioning the ESG-H strategy (adding the employment, development and success of human resources or "H" to ESG) at the basis and foundation of our management.

◆ Q&A

Are there any factors other than virtual currency causing the slowdown compared to the previous term and the term before that? Also, will there be an effect on business after this term?
Sales of smartphones were stagnant. It is difficult to predict the future, but we think their sales will not grow so rapidly from now on. However, we think there will be a business opportunity with the switch to 5G.

How much growth of the EXE Series do you expect next year?
In the future, that series will be concretely evaluated by customers, and its growth will depend on the result. At its peak, with the EXE Series for HDI, there was one company that made products for the U.S., and sales to it were over 200 million yen. Although it varies from country to country, we see there being a large potential market, and growth of the EXE Series will be on a certain scale when we acquire a certain market share.

Do you assume the fixed cost increase will continue to cancel out the increase in revenue next fiscal year?
The recruitment of human resources, which has a large weight in our fixed costs, has been slightly delayed from the initial schedule. Hence, next year such recruitment will take place throughout the year and so it will push up fixed costs like it has done this year.

(November 19, 2018, Tokyo)

* Briefing materials on the day can be viewed at the following website.
http://www.mec-co.com/en/ir/library/