

MEC COMPANY LTD., (4971 JP)

FY20 EARNINGS GROWTH SUPPORTED BY 5G INFRASTRUCTURE AND DEVICES

FY19 EARNINGS RESULTS AND FY20 FORECAST

Earnings results and company estimate

(¥mil)	FY19		FY20CE			
	FY19	YoY (%)	1H	YoY (%)	FY	YoY (%)
Sales	10,865	-4.1	5,000	-0.5	11,600	6.8
OP	1,637	-26.4	600	-1.7	1,700	3.8
OPM (%)	15.1		12.0		14.7	
RP	1,722	-23	600	-0.6	1,750	1.6
NP	1,236	-30.5	400	-12.5	1,250	1.1
EPS (¥)	65.16	-29.8	21.07	-12.5	65.87	1.1

Source: Nippon-IBR based on MEC's FY19 results material

FY19 EARNINGS RESULTS

MEC reported FY19 (Dec yr-end) earnings results with OP of ¥1,637mil (-26.4% YoY) on sales of ¥10,865mil (-4.1% YoY) but overshot the company's estimate by 1.6% in sales and 5.6% in OP. Negative earnings growth was mostly due to weak 1H earnings. [NB: circa 2.4% of the 4.1% YoY drop in sales, came from FOREX].

Annual sales of Chemical Products in FY19 was ¥10,657mil (-4.3% YoY) of which sales in 2H were ¥5,767mil (+0.4% YoY / +18.0% HoH). For the full-year, MEC saw its core CZ series sales of ¥5,517mil (-1.0% YoY), while sales of CZ-8100 fell 5.1% YoY as automobile components-related demand was weak. CZ-8101 sales also saw negative growth of -2.1% YoY. Both products sales fell short of the firm's estimate by 6.9% and 4.2% respectively. In 2H, CZ-8100 sales recovered to ¥527mil (+0.4% YoY / +7.1% HoH). As for CZ-8101, sales in 2H recovered to ¥1,505mil (+4.6% YoY / +13.2% HoH).

In 4Q alone, however, OP slumped to ¥271mil (-43.0% YoY / -64.1 QoQ) on sales of ¥2,761mil (-4.7% YoY / -11.7% QoQ). After the second highest quarterly figure in history in 3Q, the 4Q QoQ decline was mostly due to a seasonal fall in sales of selective etching agent SF – used in touch sensor panels for the high-end smartphone models and fine wiring formation agent EXE. 4Q sales of SF was ¥222mil (-30.8% YoY / -45.3% QoQ) and that of EXE was ¥278mil (-27% YoY / -24.6% QoQ).

On the contrary, sales of CZ series – the copper surface treatment agent widely used in package substrates for CPUs – have been recovering since they bottomed in 1Q (FY19 1Q with sales ¥1,185mil (-14.4% YoY / -12.1% QoQ) / 2Q sales ¥1,379mil (-2.8% YoY / +16.3 QoQ) / 3Q sales ¥1,484mil (+4.7 YoY / +7.6% QoQ) / 4Q sales of ¥1,468mil (+8.8% YoY / -1.1% QoQ)). 4Q sales of the two core products, CZ-8100 and CZ-8101, reported sales of ¥269mil (+6.6% YoY / +4.6% QoQ) and ¥753mil (+5.6% YoY / flat QoQ) respectively, thanks to an increase in 5G infrastructure-related projects, e.g. for servers for data centres, which boosted demand for CPUs.

EXECUTIVE SUMMARY

- MEC's FY19 Dec yr-end results saw OP come in at ¥1,637mil (-26.4% YoY) on sales of ¥10,865mil (-4.1% YoY), beating company guidance by 1.6% in sales and 5.6% in OP.
- Weakness is mainly due to the weak 1H performance, though MEC sees 1Q as a bottom.
- Chemical Products hit ¥10,657mil (-4.3% YoY) in FY19; 2H sales were ¥5,767mil (+0.4% YoY / +18.0% HoH).
- In the 4Q, Chemical sales fell 4.6% YoY to ¥2,715mil. Sales of adhesive enhancing agents, including the CZ series, improved +7.5% YoY / -1.3% QoQ to ¥1,695mil. Etching agent sales, including EXE and SF series, fell 19% YoY / -25.3% QoQ to ¥897mil.
- CZ series benefited from rising demand for servers at data centres, on the back of the expansion in 5G infrastructure. On the other hands, EXE and SF saw seasonal adjustment in 4Q.
- MEC is guiding for FY20 OP of ¥1,700mil (3.8% YoY) on sales of ¥11,600mil (+6.8% YoY). The firm expects a negative impact from COVID-19 in 1H but assumes the wider confusion in the supply chain to run its course by the end of 1H.
- FY20 estimates assume growth will solely come from the existing products such as CZ-8101 for servers as 5G infrastructure and AiP, 5G smartphones' antenna modules and EXE sales led by application on COF. On the other hand, sales of SF is expected to decline due to high-end smartphone touch panels being replaced by YOCTA which does not require touch panel sensors.

Full-year FY19 OP fell 26.4% YoY on the back of weak sales volumes – accounting for 7.5% of the 26.4% drop – and led to a decline in GPM from 63.9% in FY18 to 60.9% (10.3% of the 26.4% drop) and FOREX impact to GP (9.2% of the 26.4% drop). Although the 2H sales volume improved slightly (+1.0% YoY), the GPM of Chemical Products further worsened in 4Q, falling from 63.9 in FY18 Q4 to 60.0%, as higher margin EXE sales fell, thus lowering sales mix, along with drop in sales volume and FOREX impact.

Earnings Summary

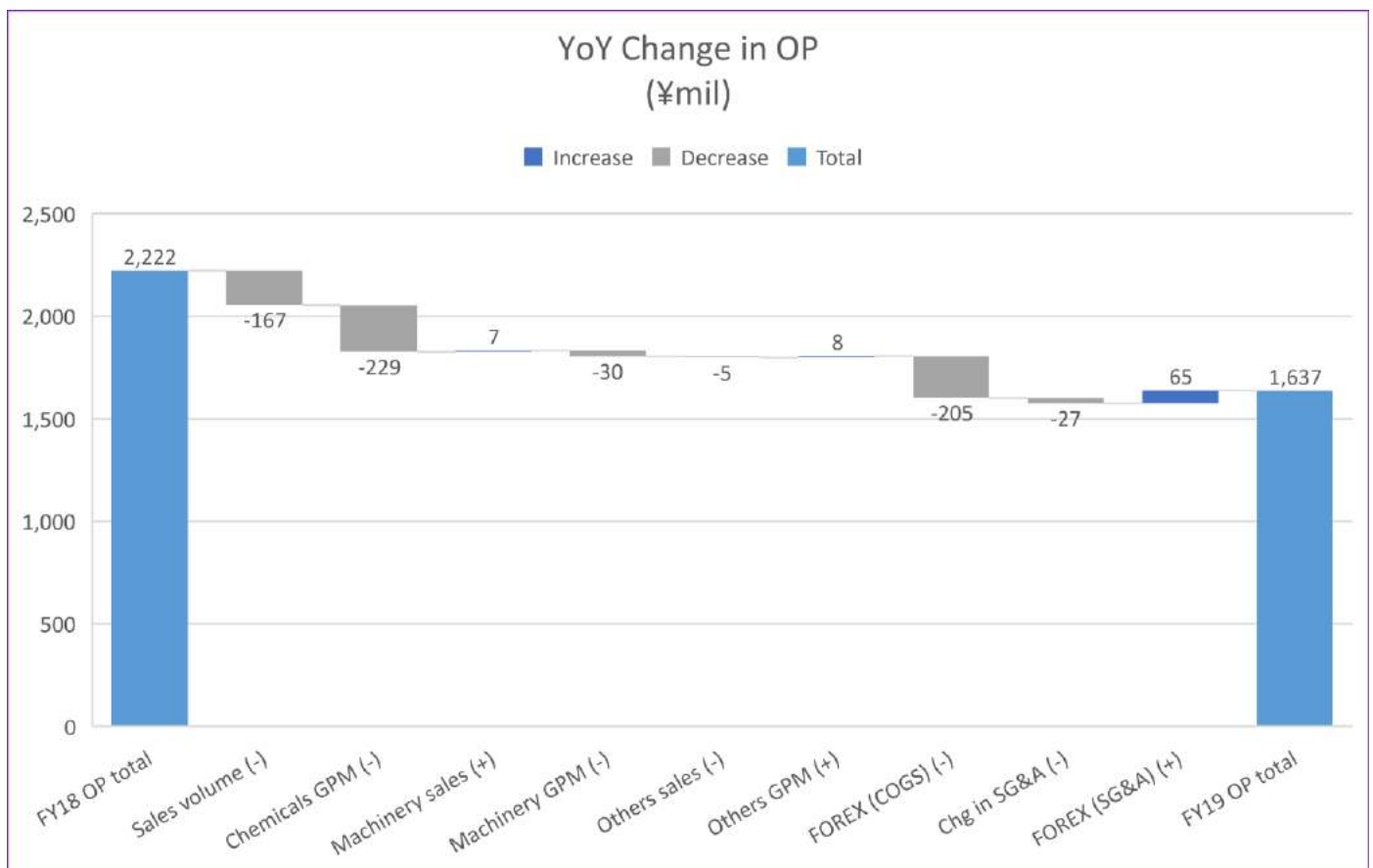
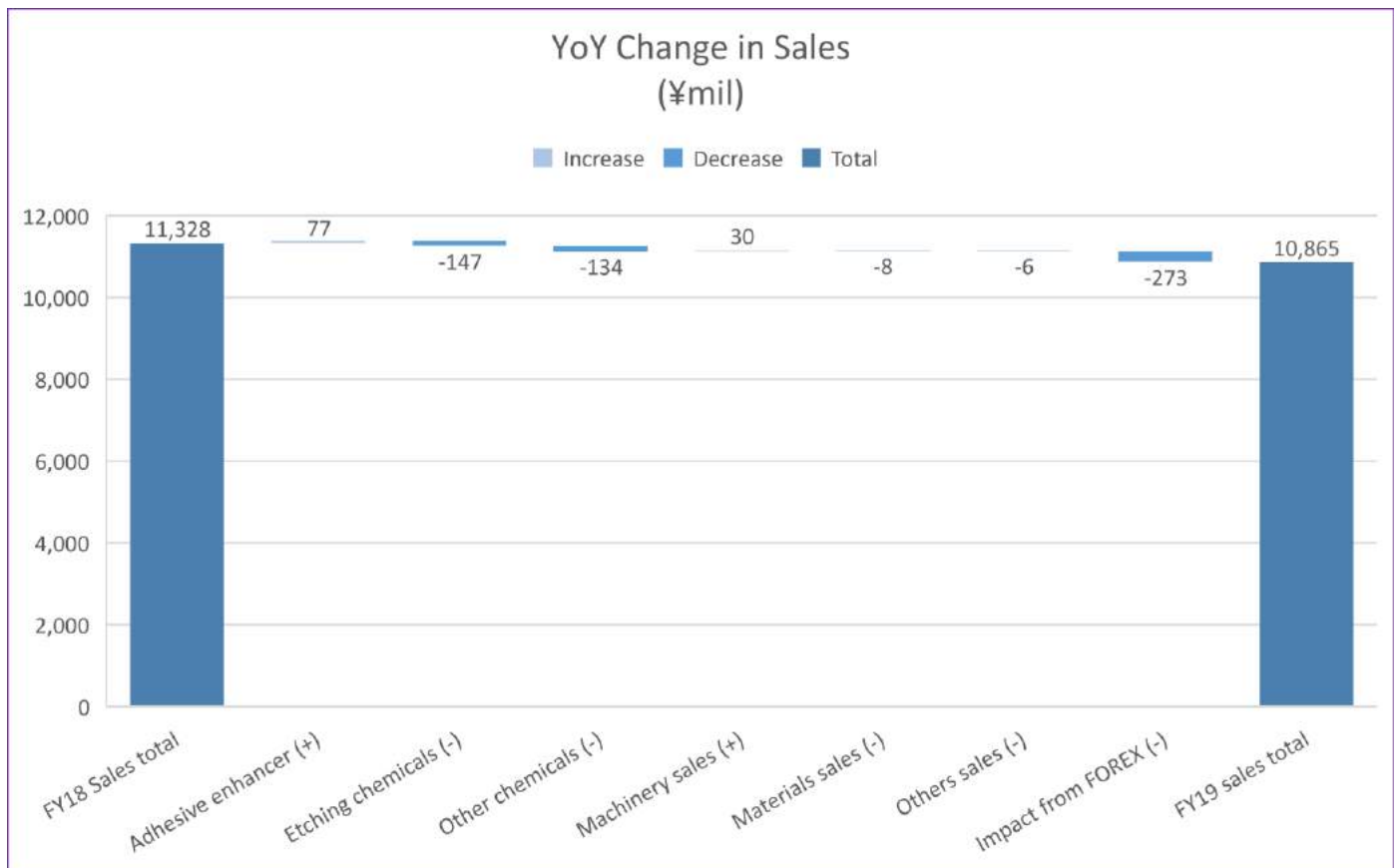
(¥mil)	Q4			2H			FY			
	FY18	FY19	YoY (%)	FY18	FY19	YoY (%)	FY18	FY19	YoY (%)	vs. CE (%)
Sales	2,896	2,761	-4.7	5,829	5,889	1.0	11,328	10,865	-4.1	1.6
incl. Chemicals	2,847	2,715	-4.6	5,745	5,767	0.4	11,131	10,657	-4.3	
GP	1,829	1,606	-12.2	3,750	3,588	-4.3	7,242	6,618	-8.6	
GPM (%)	63.2	58.2		64.3	60.9		63.9	60.9		
SG&A	1,353	1,335	-1.4	2,566	2,561	-0.2	5,019	4,981	-0.7	
SG&A/Sales (%)	46.7	48.4		44.0	43.5		44.3	45.8		
OP	475	271	-43.0	1,183	1,026	-13.3	2,222	1,637	-26.4	5.6
OPM (%)	16.4	9.8		20.3	17.4		19.6	15.1		
RP	473	326	-31.0	1,194	1,083	-9.3	2,236	1,722	-23.0	7.6
RPM (%)	16.3	11.8		20.5	18.4		19.7	15.9		
Pre-tax profit	468	322	-31.1	1,209	1,061	-12.2	2,328	1,710	-26.5	
NP	348	229	-34.1	888	779	-12.3	1,778	1,236	-30.5	7.5
EPS (¥)							92.85	65.16	-29.8	7.5
DPS (¥)							26.00	26.00	0.0	0.0

Source: MEC FY19 earning results material

Chemical Sales by Products

(¥million)	FY2018				FY2019				QoQ (%)	YoY (%)
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Copper surface treatment chemicals	2,454	2,617	2,716	2,685	2,134	2,497	2,919	2,592	-11.2	-3.5
Adhesive enhancer (CZ,V-Bond, FlatBOND, UT)	1,598	1,641	1,640	1,577	1,360	1,588	1,718	1,695	-1.3	7.5
CZ-8100	270	279	272	253	232	260	257	269	4.7	6.3
CZ-8101	723	733	725	713	540	789	752	753	0.1	5.6
Etching chemicals (EXE, SF etc.)	855	975	1,076	1,108	773	909	1,200	897	-25.3	-19.0
SF	191	275	347	321	145	205	407	222	-45.5	-30.8
EXE	277	286	296	381	297	349	369	278	-24.7	-27.0
Other surface treatment chemicals	158	156	181	162	132	125	133	122	-8.3	-24.7
Chemical Sales Total	2,612	2,773	2,898	2,847	2,266	2,623	3,052	2,715	-11.0	-4.6

Source: Nippon-IBR based on MEC's FY19 Result Presentation



Source: MEC FY19 earnings results material

CZ series sales

(#mil)	Q4				2H			FY			
	FY18	FY19	YoY (%)	QoQ (%)	FY18	FY19	YoY (%)	FY18	FY19	YoY (%)	vs. CE (%)
CZ Sales	1,348	1,468	8.8	-1.0	2,766	2,952	6.7	5,571	5,517	-1.0	-3.5
% chemical sales	47.4	54.1			48.1	51.2		50.0	51.8		
CZ-8100	253	269	6.6	0.0	525	527	0.4	1,074	1,020	-5.1	-6.9
% chemical sales	8.9	9.9			9.1	9.1		9.7	9.6		
CZ-8101	713	753	5.6	4.7	1,439	1,505	4.6	2,896	2,836	-2.1	-4.2
% chemical sales	25.1	27.7			25.1	26.1		26.0	26.6		
Other CZ	382	445	16.5	-6.1	801	919	14.7	1,599	1,660	3.8	-0.1
% chemical sales	13.4	16.4			13.9	15.9		14.4	15.6		
Direct overseas sales ratio (%)								54.4	55.2		
Total overseas sales ratio (%)								72.8	74.5		

Source: MEC FY19 earning results material

FY20 FORECAST

MEC is guiding for FY20 OP of ¥1,700mil (+3.8% YoY) on sales of ¥11,600mil (+6.8% YoY) thanks to growth achieved solely from its existing products; sales of CZ series is estimated at ¥5,980mil (+8.4% YoY), EXE is ¥1,550mil (+20% YoY) and SF is ¥710mil (-27.6% YoY). MEC expects sales of CZ-8101 to grow thanks to continuous rise in need for servers as 5G infrastructure expands and from a pick-up in demand for AiP – the antenna module used in millimetre wave 5G smartphones. Growth in EXE sales is assumed to be led by application on COF. However, further upside would be possible if it were employed for HDI motherboards for smartphone models by the subtractive method (EXE series is one example) partially replacing the existing MSAP (Modified Semi-additive Process). On the other hand, sales of SF is expected to drop as some high-end smartphone touch panels are now being replaced by YOCTA which does not require touch panel sensor.

The FY20 IH guidance – OP of ¥600mil (-1.7% YoY) on sales of (+0.5% YoY) – reflects some impact from COVID-19 on the wider supply chain. In January, MEC saw fairly stable sales thanks to front-loading of orders ahead of the lunar new year. Utilisation rates tend to fall after the Chinese New Year, however, in February this year, MEC has been experiencing 20~30% lower utilisation rates due to the virus. MEC's China plant restarted operations as of Feb10, so the firm expects a recovery in 2H. However, the impact from COVID-19 to the supply chain will be difficult to accurately estimate, so the company is monitoring the situation. As many other manufacturers are currently experiencing, the problem lies in the fact that many employees simply cannot get to work.

Applications and trend for MEC's main chemicals

Chemicals	Applications	Trend
CZ series	5G infrastructure (server) and devices (AiP in 5G smartphones)	Shift to 5G in infrastructure and devices help boost CZ-8101 sales. (servers and AiP in high-end 5G smartphones)
EXE series	Smartphones	Increasing enquires for the subtractive wire forming method, in which EXE is used, in HDI motherboard
BO series	Pre-lamination treatment for multilayer substrates	Sales grew in line with automotive and Chinese smartphone production
SF series	Touch panel sensor	Decline in sales expected because of YOCTA, a new display that does not require sensor.

Source: Nippon-IBR based on MEC's FY19 results material

Potential demand for CZ series - trend in technology for 5G infrastructure

Chip maker	Packaging Technology	Specifications	Change in packaging	Applications
Intel	EMIB	2.nD packaging by silicon bridge	Embed silicon bridge together with miniaturisation	Servers
Intel	Foveros	3D packaging with TSV	Miniaturisation	PCs
Intel	Co-EMIB	Convening Foveros and EMIB	Embed silicon bridge together with miniaturisation	Super computers, servers
AMD	Chiplets	2D packaging competing with Intel's EMIB and Foveros	Larger package with miniaturisation	Servers, PCs

Source: MEC's FY19 earnings results material

MEC'S ESG-H

MEC introduces ESG-H – its policy to support human resources in addition to ESG. The basic principle of the policy is to serve society through MEC's technology and products. For example, the company has eco-friendly products such as BO series, a microetching agent used as pre-lamination treatment for multilayer substrates, that replaces the existing black oxide treatment. MEC actively hires new graduates, both male and female, with backgrounds in Chemistry. The firm is keen to promote work-life balance and support female staff members. In terms of the Board structure, MEC has recently set up additional committees, an ESG committee and a nomination and remuneration committee to be voted for approval at the next AGM. More than half of the Board is formed with external independent directors.

MEC's ESG-H initiatives

Environment	Launch environment-friendly products (e.g. BO series) and contribute to environment improvement at its packaging factories.
Social	Contribute to development of new technology such as 5G and autonomous drive through its products. Promote work-life balance and support career of female employees
Governance	Progressive Board structure by having more than half of the Board members from external independent directors Newly establishes the ESG committee and the nomination and remuneration committee
Human Resources	Actively promote human resources

Source: MEC's FY19 earnings results material

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