

## MEC COMPANY (4971 JP)

FY20 IQ OP REACHED 83% OF 1H GUIDANCE THANKS TO SALES VOLUME AND MIX IMPROVEMENT

### 1Q EARNINGS RESULT

MEC reported FY20 (Dec year-end) 1Q OP of ¥498mil (+142.1% YoY / +83.8% QoQ) on sales of ¥2,809mil (+20.7% YoY / +1.7% QoQ). OPM improved to 17.7%, thanks to rise in sales volume and improved sales mix.

Sales of Chemicals was ¥2,661mil (+17.4% YoY / -2.0% QoQ) of which ¥2,551mil was earned in Copper surface treatment chemicals (+19.4% YoY / -1.6% QoQ). Copper surface treatment chemicals sales is further divided into adhesive enhancer (CZ series, V-Bond etc) sales of ¥1,720mil (+26.5% YoY / +1.5% QoQ) and etching chemicals sales of ¥830mil (+7.4% YoY / -7.5% QoQ).

CZ series 1Q sales hit a record of ¥1,507mil (+27.2% YoY / +2.7% QoQ), mainly due to a rapid surge in demand for laptops and tablet PCs amid global lockdown and stay-home policies under the spread of COVID-19. Although MEC's two factories in China have cut production by 50% in February compared to what it was in January, sales in Japan, Korea and Taiwan remains strong to date because of favourable sales growth of CZ series for CPUs used in the aforementioned devices.

In addition, a surge in data transmission on the back of the rapid rise in remote working pushed up the demand for data centre server capacity. CZ-8101 sales went up by 45.7% YoY / 4.5% QoQ to ¥787mil, reflecting the rapid increase in CPUs for data centre servers.

Meanwhile, CZ-8100 sales were ¥246mil (+6.0% YoY / -8.6% QoQ). The quarterly drop in sales was due to weak demand for packages for automobiles, although it was partially offset by the increase in packages used as some simple applications such as a memory card.

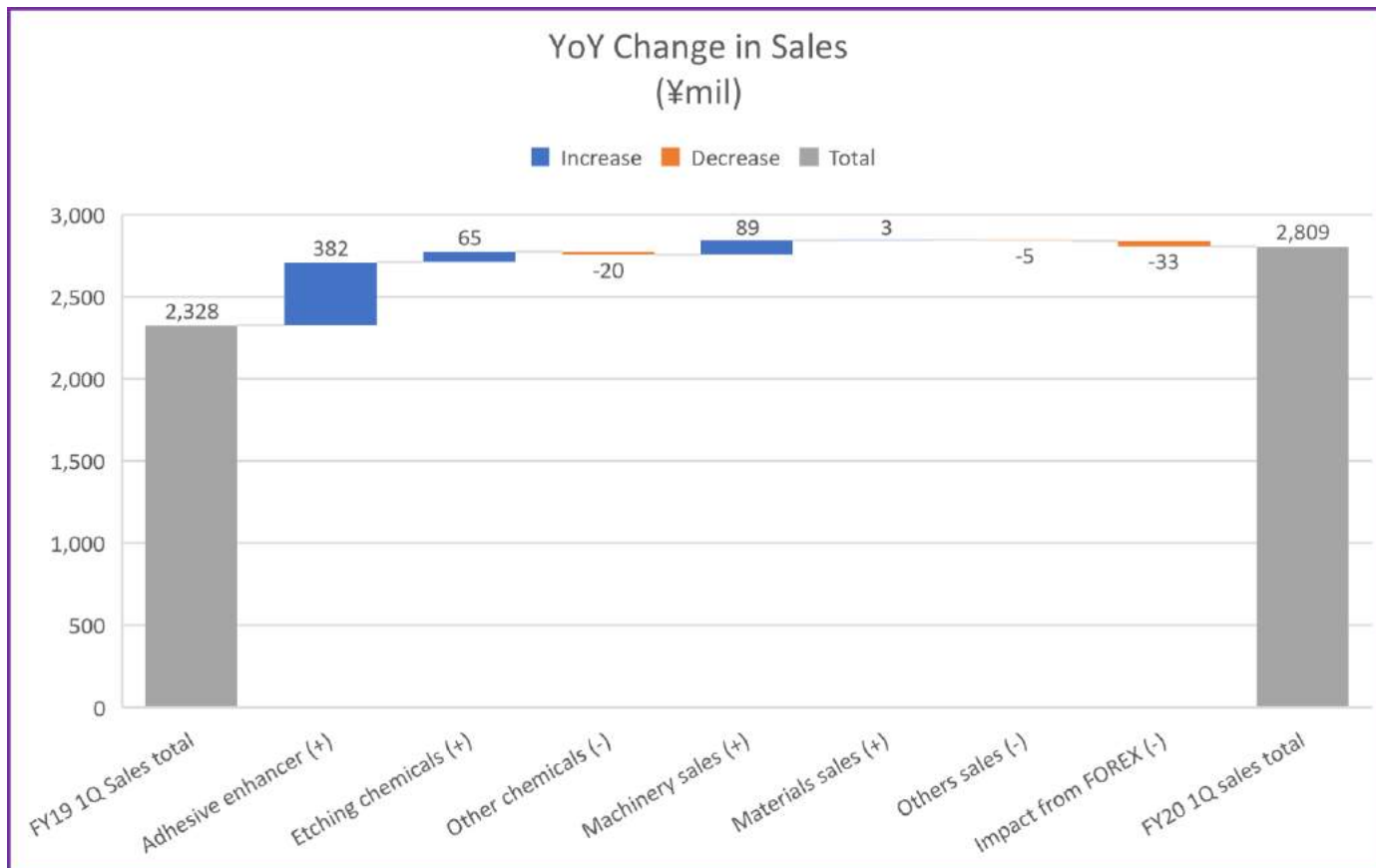
V-Bond, another adhesive enhancing chemical, largely used in automotive applications, was also affected by the weakness in automobile production. 1Q sales were ¥154mil (+3.4% YoY / -11.5% QoQ).

Etching Chemicals sales were ¥830mil (+7.4% YoY / -7.5% QoQ). SF, a key material used is touch panel sensors, shipments have been rising since February, resulting in 1Q sales of ¥182mil (+25.5% YoY / -18.0% QoQ). Sales of EXE – another etching chemical – were ¥301mil (+1.3% YoY / +8.3% QoQ), which was weaker than expected due to a slowdown in demand from COF (chip-on-film) use.

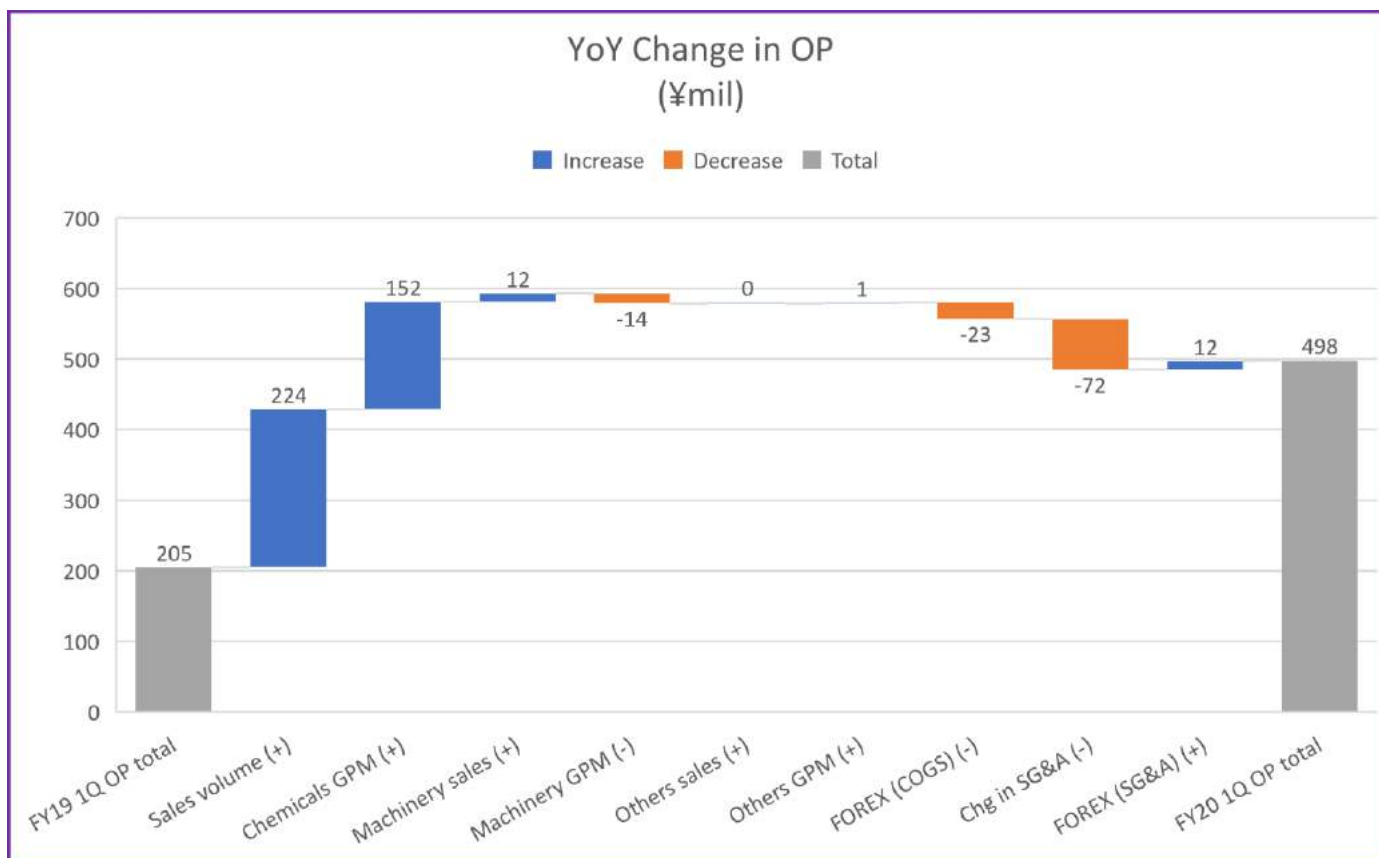
The QoQ jump in OP growth was due to high quarterly sales of CZ series and an improved sales mix. OP rose 142.1% YoY (+¥292mil), of which positive contributions came from the rise in chemical sales volumes (+¥224mil) and +¥152mil from the improved sales mix.

### EXECUTIVE SUMMARY

- MEC reported FY20 1Q OP of ¥498mil (+142.1% YoY / +83.8% QoQ) on sales of ¥2,809mil (+20.7% YoY / +1.7% QoQ). OPM improved to 17.7%.
- 1Q OP was boosted by special COVID-led demand for laptop PCs and tablets on the back of a surge in remote working, generating 83% of 1H OP guidance.
- Sales of CZ series hit a quarterly record of ¥1,507mil (+27.2% YoY / +2.7% QoQ).
- The largest growth driver for both sales and OP was CZ Series thanks to 1) the increased demand for remote working devices and 2) an increase in data centre server capacity.
- MEC is guiding for FY20 1H OP of ¥600mil (-1.7% YoY) on sales of ¥5,000mil (+0.5% YoY). 1Q OP has achieved 83% of the 1H target, however, the firm has not revised either its 1H or FY guidance as visibility beyond 2Q is low.
- For FY20, MEC is eyeing OP of ¥1,700mil (+3.8% YoY) on sales of ¥11,600mil (+6.8% YoY) thanks to growth achieved solely from its existing products:
  - CZ series sales ¥5,986mil (+8.5% YoY),
  - V-Bond sales ¥725mil (+5.8% YoY),
  - EXE sales ¥1,558mil (+20.5% YoY)
  - SF sales ¥718mil (-26.7% YoY).
- In addition to existing products, such as CZ series for next generation packages and EXE for COF, the next generation CZ-series for AiP and EXE for high-end smartphone HDI subtractive method can provide prospects for growth beyond this year as 5G-related devices are developed.



Source: MEC Company FY20 1Q earnings presentation



Source: MEC Company FY20 1Q earnings presentation

**Chemical Sales by Products**

(#million)	FY2018				FY2019				FY20		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	QoQ (%)	YoY (%)
Copper surface treatment chemicals	2,454	2,617	2,716	2,685	2,134	2,497	2,919	2,592	2,551	-1.6	19.5
Adhesive enhancer (CZ,V-Bond, FlatBOND, UT)	1,598	1,641	1,640	1,577	1,360	1,588	1,718	1,695	1,720	1.5	26.5
CZ-8100	270	279	272	253	232	260	257	269	246	-8.6	6.0
CZ-8101	723	733	725	713	540	789	752	753	787	4.5	45.7
Other CZ chemicals	392	407	420	382	413	330	475	446	474	6.3	14.8
Etching chemicals (EXE, SF etc.)	855	975	1,076	1,108	773	909	1,200	897	830	-7.5	7.4
SF	191	275	347	321	145	205	407	222	182	-18.0	25.5
EXE	277	286	296	381	297	349	369	278	301	8.3	1.3
Other surface treatment chemicals	158	156	181	162	132	125	133	122	109	-10.7	-17.4
Chemical Sales Total	2,612	2,773	2,898	2,847	2,266	2,623	3,052	2,715	2,661	-2.0	17.4

Source: Nippon-IBR based on MEC's FY20 1Q earnings presentation material

**ONGOING EARNINGS TREND AND FORECAST**

At the beginning of FY20 (Dec year-end), MEC estimated 1Q to be the bottom of the earnings trend. It was initially guiding for a recovery in 2Q, followed by rapid growth in 2H thanks to a surge in demand for 1) CZ series – as 5G infrastructure got under way and next generation packages were introduced – and 2) opportunities for EXE to be taken up as an etching chemical for smartphone HDI. However, 1Q presented with a positive surprise from the special demand for laptop PCs and tablets as remote working increased and led to the firm generating 83% of 1H OP guidance in Q1. MEC is guiding for FY20 1H OP of ¥600mil (-1.7% YoY) on sales of ¥5,000mil (+0.5% YoY). Given visibility beyond Q2 is difficult to assess, MEC did not revised its 1H nor its FY guidance. However, management is of the mindset that should market conditions show better visibility, they will be prompt to announce adjustments to their earnings guidance. FY20 dividend remains at ¥26/share, unchanged from FY19.

The reason behind the firm's initial assumption of growth in 2H was 5G-related demand, driven by the launch of the next generation packages. However, due to impact of COVID-19 on the supply chain, the installation of base stations and data centre capacity expansion have been delayed. Although 1Q earnings growth was rather an unexpected positive surprise, the timing of 5G-related demand is still unknown. The best scenario is for 5G-related demand to start picking up in time to offset the slowdown in special demand for PCs and tablets.

2H earnings relies on, therefore, the timing for the restart of 5G infrastructure investment. Without infrastructure being ready, device and application launches are also likely to be postponed.

MEC reckons that 5G-related demand will likely continue even after base station and server demand has peaked out. Package makers continue to make sizeable investment for next generation packages. Once the infrastructure is ready, the launch of 5G millimetre wave smartphone devices will follow. In the automobile industry, demand for ADAS (Advanced Drive Assistance Systems)-related devices such as camera, sensor and millimetre wave radar will also likely advance which will lead to increase in demand for semiconductors that control those devices and packages (on which semiconductors are mounted).

**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	Combining 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 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 ¥5,986mil (+8.5% YoY), EXE is ¥1,558mil (+20.5% YoY), SF is ¥718mil (-26.7% YoY) and V-Bond is ¥725mil (+5.8% YoY). MEC expects sales of CZ-series to grow thanks to the 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. The newer generation of CZ series chemicals are being tested for 5G server packages and AiP. However, the contribution to earnings from those newer generation chemicals are not included in the current guidance.

Growth in EXE sales is assumed to be led by application on COF for display, although in IQ, demand for use in COF remained flattish. However, further upside would be possible if EXE is to be employed for smartphones' HDI motherboards as the subtractive method partially replacing the existing MSAP (Modified Semi-additive Process). Some high-end smartphone makers are said to have decided to partially use subtractive method on motherboards. On the other hand, sales of SF is expected to drop as some high-end smartphone touch panels are now being replaced by Y-OCTA which does not require touch panel sensors.

**Applications and trend for MEC's main chemicals**

Chemicals	Applications	Trend	FY19 (¥mil)	FY20CE (¥mil)	YoY (%)
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)	5,516	5,986	8.5
EXE series	Smartphones	Increasing enquires for the subtractive wire forming method, in which EXE is used, in HDI motherboard	1,293	1,558	20.5
V-Bond series	Pre-lamination treatment for multilayer substrates	Sales grew in line with automotive and Chinese smartphone production	685	725	5.8
SF series	Touch panel sensor	Decline in sales expected because of Y-OCTA, a new display that does not require sensor.	979	718	-26.7

Source: Nippon-IBR based on MEC's FY20 IQ results presentation material

**Earnings Summary**

(¥mil)	Q1				IH			FY		
	FY19	FY20	YoY (%)	vs. IHCE (%)	FY19	FY20CE	YoY (%)	FY19	FY20CE	YoY (%)
Sales	2,328	2,809	20.7	56.2	4,976	5,000	0.5	10,865	11,600	6.8
OP	205	498	142.1	83.0	610	600	-1.7	1,637	1,700	3.8
OPM (%)	8.8	17.7	+8.9pp		12.3	12.0	-0.3pp	15.1	14.7	-0.4pp
RP	240	463	92.9	77.2	638	600	-6.0	1,722	1,750	1.6
RPM (%)	10.3	16.5	+6.2pp		12.8	12.0	-0.8pp	15.9	15.1	-0.8pp
NP	158	317	100.0	79.3	457	400	-12.5	1,236	1,250	1.1
EPS (¥)	n/a	n/a	n/a	n/a	24.09	21.07	-12.5	65.10	65.87	1.1
DPS (¥)	n/a	n/a	n/a	n/a	12.00	12.00	0.0	26.00	26.00	0.0

Source: MEC FY20 IQ results presentation material

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