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Transcript of
Materion Corp.
First Quarter 2020 Earnings Conference Call
April 23, 2020

Participants

Steve Shamrock - Vice President, Corporate Controller and Investor Relations
Jugal Vijayvargiya - President and Chief Executive Officer
Joe Kelley - Vice President, Finance and Chief Financial Officer

Analysts

Edward Marshall - Sidoti & Company
Marco Rodriguez - Stonegate
Phil Gibbs - KeyBanc Capital Markets

Presentation

Operator
Greetings and welcome to the Materion First Quarter 2020 Earnings Conference Call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator instructions]. As a reminder this conference is being recorded.

It is now my pleasure to introduce your host Mr. Steve Shamrock, Vice President, Corporate Controller and Investor Relations. Thank you, sir. You may begin.

Steve Shamrock - Vice President, Corporate Controller and Investor Relations
Good morning. This is Steve Shamrock, Vice President, Corporate Controller and Investor Relations. With me today is Jugal Vijayvargiya, President and Chief Executive Officer; and Joe Kelley, Vice President of Finance and Chief Financial Officer.

Our format for today's conference call is as follows. Jugal Vijayvargiya will provide opening comments on COVID-19 and an update on key strategic initiatives. Following Jugal, Joe Kelley will review detailed financial results for the quarter, and then we will open up the call for questions.

Before we begin, let me remind investors that any forward-looking statements made in this announcement, including those in the outlook section, and during the question-and-answer portion, are based on current expectations.

The Company's actual future performance may materially differ from that contemplated by the forward-looking statements as a result of a variety of factors. Those factors are listed in the earnings press release we issued this morning. Additionally, comments with regard to earnings before interest and taxes, net income, and earnings per share reflect the adjusted GAAP numbers shown in Attachment Number 5 in this morning's press release. The adjustments are made in the prior year period for comparative purposes and remove special items, non-cash charges, and certain income tax adjustments.

And now, I will turn it over to Jugal for his comments.

Jugal Vijayvargiya - President and Chief Executive Officer
Thanks, Steve and welcome everyone. I hope all of you and your loved ones are safe, as we progress through these unprecedented times. Today I'll first share the impacts of COVID-19 to our company and then update you on some key strategic initiatives.

Health and safety of our people has been and remains our overriding priority. Over the last three years, we have reduced our recordable injuries by 77% with a keen focus on prevention. Sixteen of our global facilities have had zero injuries in the past year. As COVID-19 started to emerge, we employed the same level of focus to protect our people. We have listened to all available resources and have enacted changes globally. Three people have been confirmed positive in our global Materion family, and they are doing well at this time. We have majority of our office employees working from home.

All of our factories are operating in support of the essential products and services we provide to critical industries such as healthcare, telecommunications, defense, and energy. In particular, we're proud to support the fight against this virus by supplying products for healthcare equipment used by medical staff around the world. For example, our Precision Coatings business is supplying optical filters which are used in medical systems to test for COVID-19, as well as for critical CO2 gas detection in capnography and ventilator applications. Our PAC business is supplying copper beryllium strip product which are used for ventilators. We have seen increased demand for these products and are determined to maintain supply to help the fight against COVID-19.

While we see increased demand in these products, we are experiencing significantly lower demand in automotive, oil and gas, aerospace, and industrial end markets. Semiconductor and defense end market demand is continuing to hold at this time.

In total, we expect second quarter demand to be comparable or slightly better than first quarter demand. Despite the challenges presented by COVID-19, our teams have been focused on moving the Company forward. Let me share with you some exciting progress towards our One Materion multi-pillar profitable growth strategy.

As you know, investing for organic growth has been our top priority. We have ramped up R&D spending and made significant commercial investments to align with future growth opportunities. In our last earnings call, I highlighted the growth in aluminum-scandium premium targets. Today I am excited to share another major growth opportunity, this time in our engineered clad strip product line. We have unmatched capability to custom design clad material solutions and solve the most pressing challenges our customers face in thermal management, extreme vibration, and high voltage.

Our engineered clad strip is used in electronic applications which serve a variety of end markets including consumer electronics, automotive, energy, and industrial. I am very pleased to report that we've entered into a business arrangement with a new customer to expand our manufacturing capacity for a highly engineered clad strip. This material will be used in a next generation model of an existing product. Therefore, the overall end market demand exists today. We expect to fulfill this market demand and support increased demand as the customers' end product continues to gain acceptance globally.

The customer has also provided a $12 million prepayment towards establishing a new leading-edge manufacturing facility for future product supply. We anticipate finalizing the long-term supply agreement for this exciting new opportunity later this year. At the same time, that we are driving profitable growth in our go forward portfolio, we are also taking the tough decisions to exit non-strategic businesses.

Today I am announcing our intent to sell the Large Area Coatings business. This action will allow our teams to focus their efforts on growing the remaining Precision Coatings business where we have exciting opportunities with our differentiated optical coatings expertise. We anticipate the sale and closing to occur later this year. In

parallel to driving significant organic growth and aligning the portfolio, we are continuing to improve our cost structure. Today I'm announcing the closure of two facilities and consolidating the work in one of our existing facilities. This will be a significant structural cost reduction to the PAC business, where we are the only fully vertically integrated beryllium producer in the world.

We are closing a service center in Detroit, Michigan and will be closing a manufacturing facility in Fremont, California later this year. We expect this action to improve our cost structure by $4 million to $5 million annually.

I would like to thank our global team who has risen to the challenges posed by this global pandemic. With their dedication, we are supplying key components used for critical medical equipment in the fight against COVID-19. In addition, our teams are more broadly focused on continuing to transfer Materion into an advanced materials business.

Now I'll turn the call over to Joe to cover the financials.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Thank you, Jugal, and welcome to everyone joining us on the call today. During my comments I will cover first quarter 2020 financial highlights, review profitability by segment, provide brief comments on the balance sheet, cash flow, and modeling assumptions. And finally, cover the earnings outlook for the second quarter 2020. Following my remarks, we will open the line for questions.

Let me start with a summary of our first quarter financials. We delivered adjusted earnings of $0.43 per share on $158.7 million of value-added sales. We continued our strong cash generation with $9.1 million of cash flow from operations. We ended the quarter with $107.6 million in cash, a record for any first quarter.

Going into more financial detail, first quarter 2020 value-added sales, which exclude the impact of pass-through precious metal cost, were $158.7 million, down 2% compared to the fourth quarter and down 15% versus the $187.7 million in the first quarter of 2019. The recovery in the semiconductor end market continued into the first quarter, as value-added sales in our largest end market increased 10% sequentially and 4% versus the prior year, the second consecutive quarter of year-over-year growth.

Aerospace and defense end market sales were heavily impacted due to timing of defense orders and the continued weakness in the aerospace market. In addition, the COVID-19 pandemic impacted demand from a number of end markets including energy, automotive, industrial, and telecom and data center.

Gross profit was $45.6 million in the first quarter compared to $69.3 million in the prior year first quarter. Excluding a non-cash $1.3 million write-down for oil and gas specific inventory in our PAC business and other non-recurring items related to the COVID-19 situation, adjusted gross profit was $47.1 million or 30% of value-added sales. The decrease in gross profit and margin was driven by lower sales volumes and resulting manufacturing inefficiencies.

Selling, general, and administrative expense totaled $30.7 million, a decrease of $9.4 million versus the prior year of $40.1 million due to a combination of aggressively managing cost in response to the current business conditions and lower variable compensation expense. As a percentage of value-added sales, SG&A expense was 19% in the quarter, down 200 basis points from 21% in the prior year period.

Research and development expense of $4.2 million increased 12% versus 2019 as we continued to make investments to drive long-term profitable growth through development of new products and new applications. During the quarter, we recorded restructuring expense of $2.2 million related to the planned closure of our Detroit and Fremont facilities, primarily for employee severance and other facility closure obligations.

Based on the planned sale of the LAC business, as Jugal mentioned, we classified the LAC business as held for sale. As a result, we recorded non-cash impairment charges of $10.8 million to write-off the remaining LAC goodwill balance of $9.1 million and adjust the remaining net assets to fair value. As a change from past practice, we are moving to utilize earnings before interest and tax EBIT to measure profitability, to maintain comparability given the changes in the Company pension plan moving from 2019 to 2020.

We reported a $3.6 million loss before interest and taxes in the first quarter of 2020 compared to the prior year first quarter EBIT of $21.1 million. Excluding special items related to non-cash asset impairments, restructuring charges for facility closures, and other non-recurring items, adjusted EBIT was $10.9 million or 7% of value-added sales. Looking at income taxes, we recorded an income tax benefit of $800,000 in the first quarter of 2020. Excluding the tax impact of special items, adjusted tax expense was $1.9 million or an effective tax rate of 18%, in line with our previous guidance.

Our net loss for the first quarter of 2020 totaled $3.1 million. On an adjusted basis we reported net income of $8.8 million or $0.43 per diluted share compared to $16.9 million or $0.82 per share in the prior year. The $8.1 million year-over-year decrease in earnings resulted from a $29 million decrease in value-added sales offset by aggressive cost management. Decremental margins were 28% on a 15% decrease in value-added sales.

Now let me review 2020 first quarter performance by business segment. Looking now to Performance Alloys and Composites business, value-added sales were $83.7 million compared to $109.6 million in 2019. The decrease in sales can be primarily attributed to lower demand across all markets as a result of COVID-19, continued tariff impacts, and the timing of defense sales. EBIT excluding special items was $8.2 million or 10% of value-added sales compared to EBIT of $18.8 million in 2019.

The decrease in profit and margin compared to 2019 is due to lower sales and reduced manufacturing efficiency related to the lower production volumes. Despite the current challenging environment, PAC managed to deliver the eighth consecutive quarter of double-digit profit margins, far north of historical profit levels at comparable sales volumes.

Moving to Advanced Materials, value-added sales in the first quarter 2020 were $59.2 million, up 3% versus the prior year amount of $57.5 million. Semiconductor end market sales increased 12% sequentially and 8% compared to the first quarter of 2019, as commercial performance initiatives specific to new products, combined with increased end market demand, drove the growth.

EBIT excluding special items was $4.9 million in the quarter compared to $7.1 million in 2019. Manufacturing inefficiencies on new product launches, combined with unfavorable product mix, led to the profit decrease. The demand for the new products is strong, and we are focused on improving manufacturing efficiency related to these existing new launches.

Turning finally now to the Precision Coatings segment, first quarter value-added sales were $17 million, down 24% compared to the $22.5 million in the first quarter of 2019, primarily due to lower sales of the Large Area Coatings product for the blood glucose test strip market. Excluding the LAC business, first quarter 2020 value-added sales were $14.3 million, down 3% year-over-year, led by COVID-19 issues. EBIT excluding special items was $1.2 million compared to $2.1 million in the first quarter of 2019. The decline in profits was entirely driven by the year-over-year decrease in sales within the LAC business, which now is classified as held for sale.

Moving to the balance sheet and cash flow. The Company ended the first quarter of 2020 with a net cash position of $105.5 million and $345.8 million available on the Company's credit facility. This compares to a net cash position of $39 million at the end of the first quarter of 2019. We spent $14.8 million on capital investments in the

quarter. The increase versus 2019 is related to the customer funded engineered strip growth opportunity which Jugal covered. Additionally, $6.8 million was spent on the repurchase of 158,000 shares of common stock.

For financial modeling purposes in 2020, capital spending should run approximately $30 million net of customer prepayments related to the new engineered strip project. Mine development investments should be approximately $10 million. Annual depreciation and amortization should run approximately $40 million. Assume an 18% to 20% effective tax rate excluding special items.

And finally, now the earnings outlook for 2020. The impact to the COVID pandemic is fluid and continues to evolve, and, therefore, we cannot predict the extent to which our business, results of operations, financial condition, or cash flows will ultimately be impacted. For these reasons we are withdrawing our previously announced full-year earnings guidance of $3.15 to $3.30 per share.

Related to our near-term outlook, we are cautiously optimistic about second quarter results based on current order entry levels. Certain end markets are expected to be more adversely impacted by the current economic environment such as energy, automotive, aerospace, and industrial, while other end markets are seeing steady or improving demand like semiconductor, medical, and defense. Assuming our factories remain operational in the rapidly changing fight against COVID-19, we expect second quarter results to be comparable or slightly better than first quarter.

This concludes our prepared remarks. We will now open the line for questions.

Operator
[Operator instructions]. Our first question comes from the line of Edward Marshall with Sidoti and Company. Please proceed with your question.

Q: Hi Jugal, Joe, Steve. Good morning. I hope everyone in your families are doing well in this period. Can you talk about the new customer? You gave a lot of detail, I'm curious could you give what market this new customer is in?

Jugal Vijayvargiya - President and Chief Executive Officer
Ed, let me start on that. So first of all, I hope you and your family are safe in this very difficult situation that we're all facing. This is an exciting opportunity for us. As you know over the last couple of years, we've been talking about investing more in R&D, really our top priority being organic growth, and I think this is a result of great work done by our team over the last year plus.

This is a perfect match where we have some great capability, and we've been able to leverage that capability into really a market that we've not played too much in the past. So, we can't specifically talk to you about what market this is. But what I can tell you is that, it is a market that I think is an exciting market. It will be a hopefully a long-term activity for us. It's not intended to be a cyclical or a seasonal type of an activity. But it is something we're very excited about and one that I think it will be an important part of our Company going forward, and it's a great example, I think, of the work that our team is doing with the R&D collaboration that we've been trying to drive within the Company.

Q: Do you serve this market already?

Jugal Vijayvargiya - President and Chief Executive Officer
Well we serve the broader market that this happens to fall in already. So yes, we serve the broader market. But as you know each market has various sub segments, and I would say, a sub-segment that this happens to fall is something that is new for us, and so it's quite exciting.

Q: Got it. So, moving onto the test strip business, if I remember correctly that's about $30 million revenue line annually. Was that included in the 1Q results and will it be 2Q until you divest that business or sell that business or have you divested it? I'm just curious, discontinued sales?

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, go ahead Joe. Why don't you take that?

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes, so you are correct Ed. This was historically approximately a $30 million business. You'll recall some of the changes that took place last year in the back half of 2019, and so it is included in our Q1 results and will be in our Q2 results. But the business today is relatively immaterial in the sense that the value-added sales were less than $3 million in Q1, and the profit did not have a material impact on Materion's Q1 profits. So, from a divestiture standpoint going forward, it won't be a change to our current baseline.

Q: Got it. The cost savings that you put in place; do you have the timing of that $4 million to $5 million when it rolls through?

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, let me first just talk about, I think, the cost savings in general. As you know we've been driving operational improvement; that's one of our pillars of our strategic profitable growth objectives that we've had for the Company. And we've been driving operational improvements across the Company. But in particular in our PAC business just because of, I think, where that business was few years back and then you've seen the growth that business has delivered and profitability. So, this is just a continuation of the operational improvements that we're driving in the Company. So, I think that's, we've been talking about it actually for the last several months, and then we really were able to pull that off.

As I indicated the first part of the closure is now basically finishing up. It's our Detroit service center. The second part will actually be later this year which is the Fremont, California site, and so we would expect that both of those will be completely done by the end of the year, and, therefore, I think the full run rate of the savings should be in effect after that.

Q: Got it, next year. Okay. And you didn't mention the beryllium hydroxide sales. Was there beryllium hydroxide sales or was that pushed further like it was in Q4?

Joe Kelley - Vice President, Finance and Chief Financial Officer
No, there were beryllium hydroxide.

Jugal Vijayvargiya - President and Chief Executive Officer
We continue to have, I think, a relationship with our customer, and, therefore, we did have sales in Q1. I think our progress with them this year, we would expect it to be the same as kind of what we've communicated to you before.

Q: All right. Final one from me. The guidance that you provided, just so I'm clear, you talked about relatively flattish quarter-to-quarter, potentially slightly up. Were you referring to revenue, rather value-added revenue, and EPS or were you referring to just one specific item, just curious?

Jugal Vijayvargiya - President and Chief Executive Officer
Obviously, EPS is related to the value-added sales. I mean directly related to value-added sales, and so I would say in general I think our business, we believe will be comparable or slightly better than Q1, and so I think it probably encompasses both elements.

Q: Thanks very much, guys, I appreciate all your comments. Be safe and be well.

Operator
Thank you. Our next question comes from the line of Marco Rodriguez with Stonegate. Please proceed with your question. Mr. Rodriguez, your line is now live.

Q: Sorry about that guys. Thanks for taking my questions. I was on mute there. Can you hear me?

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes, we can hear you Marco.

Q: Okay, great. I wanted to talk a little bit more here about the manufacturing inefficiencies that you guys kind of called out on the call earlier. You specifically mentioned in the PAC business there were some manufacturing inefficiencies which I'm assuming was mostly on a volume basis, but then on the Advanced Materials, you did have higher volumes, but I believe you spoke about new product launches as being a manufacturing inefficiency there. So maybe if you can talk a little bit more about the two specific areas, and if you can, on the Advanced Materials side at least, help us kind of think about the quantification of the drag that you saw from the new product launches.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, let me start with I think some general comments, Marco and then Joe can certainly jump and talk more specifics. When we talk about manufacturing inefficiencies at the Company level, I think really, we're talking about three major categories. One I would say the manufacturing inefficiencies that I think we're experiencing as a result of the COVID-19 pandemic.

As you know we have all had to implement social distancing and other elements to make sure that our employees that are operating in each of our facilities is safe because that is our utmost priority, and so, when I think about what we've had to, we've had to do shift structure changes, we've had to implement many other things, cleaning and other things, so that has resulted in general manufacturing inefficiencies in our plant.

Second part of manufacturing inefficiencies is just generally lower volume. I mean there are certain markets that the end market demand is much lower and that lower volume resulted in manufacturing inefficiencies. And then the third element is the new product launches which are in the AM business. What's exciting to us on the AM business is that, number one, we've been talking about semiconductor market for the last couple of years, and we're starting to see, we mentioned in our prior calls as well, that maybe we're starting to see some light at the end of the tunnel with that market starting to recover.

So not only are we seeing a little bit of market recovery, but I think more importantly, we're really starting to see some of the investments and the R&D that we put in place that is resulting in those new products. So that new product and new activity that we're putting through our plants is certainly causing some manufacturing inefficiencies which clearly is under our control. I can assure you that we're absolutely focused on it because step one is to make sure we can actually get sales which our team has done a fantastic job of getting these new products launched and getting sales with our customer; and step two is to make sure that we can actually produce it in an efficient manner and get the right cost, and I think that's what we're fully, fully focused on as we

go through the new launches. So, I'd probably put three high level sort of categories I think of these manufacturing inefficiencies that we encountered here in Q1.

Q: Understood and then in regard to that, just the plants that you have open that are delivering product to the essential businesses. Maybe you can kind of talk a little bit about what utilization levels kind of look like right now given the fact that you do have to implement a lot of different procedural changes for the social distancing. And then maybe, if you can then talk what your expectations of those facilities might look like if and when things start to open up a little bit more. I mean what is that going to kind of look like from a capacity utilization standpoint going for the rest of this fiscal year.

Jugal Vijayvargiya - President and Chief Executive Officer
Well, I mean clearly the utilization is something that has been impacted. One as you said, just based on some of the policies that we've had to put in place to protect our people and two, just the general lower volume. So, I don't have a specific number that we typically share in that area, so we don't actually talk about a utilization percentage of our plants. But I can tell you that it certainly is more challenging.

The plants that we have by the way and just want to mention, it is really all of our plants so it's not just some of our plants that are open. All of our plants are open, and we continue to shift all the demand that's coming in to them. I mean so we're on track through this quarter in support of our customers. And then when this does come back, I mean we intend to continue the practices that are required to ensure that our people are safe. But I think we'll continue to get smarter as well and learn more about how to make sure we're driving the proper utilization across all of our plants.

So, I would expect that our utilization will continue to improve actually as we continue to get more volume through the plant. I mean the key is the market demand coming back stronger. I think that's what important.

Q: Got it. And next I was wondering if you maybe can talk a little bit about what sort of scenario analysis do you guys have conducted internally. Not necessarily looking here for any specific guidance, but just trying to get a sense as far as how you guys are expecting the environment to sort of play out through this next fiscal year and obviously, I understand this is very difficult question and no one's crystal ball is any better than anyone else's. But just trying to get a sense as far as what you guys are expecting from a base case standpoint.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, well first of all, we have done various scenario analyses as you can imagine. I'm sure every company is going through and looking at that to ensure that things can continue. I think I want to highlight a few things. Number one, I think are liquidity. I mean we have adequate liquidity for our Company. As you've seen, I think the cash generation that we've delivered over the last couple of years and what we've been trying to do to continue to drive operational improvements in the Company, we feel very blessed that we have adequate liquidity to deal with whatever difficult times that may be coming forward.

What I can also tell you, is more near-term, I mean as we've indicated on a near-term basis, we see comparable to slightly improving results here in the second quarter. So, I think on a near-term with our order entry that we have and kind of understanding of what the markets are telling us, I think we can talk about that. Look on a longer-term basis, I think anybody's guess is there in terms of what longer term will bring. But what I can tell you, is that we are focused. We are focused on making sure that our business is properly positioned coming out of this thing, both from a financial perspective and strategic perspective.

I mean you saw here today, I mean we've announced three very important strategic items that I think continue to move the business forward. In fact, significantly forward from the levels that we've had even over the last three years and as you know, you've seen the results over the last three years as well for the business.

So, I think in general, we see our business continue to move forward. We are focused on how we'll respond to it, when it comes out. I will tell you though that, you look at our results, and we had 15% less sales and only 28% decremental margins. I mean that's very healthy considering what's going on in the environment. So, I think we're properly positioned to be able to handle what's going to come up. But most importantly we're really focused on being able to come out strong whenever this thing starts to lift, and our strategic initiatives that you've heard about today hopefully demonstrate that.

Q: Thanks for that additional color. Last question from me. Just circling back on the Large Area Coatings sale. Do you have current buyers lined up or is there an investment bank that's been hired to conduct an auction? Any sort of expectations of cost savings, cash proceeds, any sort of information you might be able to provide there?

Jugal Vijayvargiya - President and Chief Executive Officer
Yes. I mean as we've talked, this is a very important initiative for us as we continue to optimize our portfolio going forward. We want to be able to make sure we can dedicate our resources on the go forward Precision Coatings business where we have great, great expertise. So, we are, I would say, relatively early in the process. We want to make sure that we communicate to you that it is our intent to sell this business, and as we make progress on it, we'll certainly communicate.

Joe Kelley - Vice President, Finance and Chief Financial Officer
And I would add from a cash flow standpoint, if you look at our balance sheet, the assets have been written down to approximately $4 million, the assets held for sale on a net basis.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes. And Marco before we go to the—because I think you mentioned that was your last question. Right?

Q: Yes.

Jugal Vijayvargiya - President and Chief Executive Officer
Okay, before we go to the next question, I have an update. Really exciting news. I'm just getting this real time, so I'm sharing it with you guys, regarding our project that we mentioned, this customer project. So, I mentioned, and we talked about the prepayment that the customer is making. I want to inform you all that we now have a signed investment agreement, actually, a full agreement with our customer and, in fact, I can also share with you that this $12 million prepayment that I mentioned to you earlier actually will result in a $70 million investment by our customer. So, it will be a prepayment. We expect the remainder up to the $70 million to be in the next 12 months so that we can go ahead and get this facility up and running with the expectation, of course, that we will be supplying this product on a long-term basis and in this really, exciting business that we have.

So yes, an update that I'm being handed, that I can share with you based on, I think, tremendous progress our team has continued to make even though the customer, and us of course have been in this very difficult COVID-19 situation. So, great news and I want to make sure that you have that update as I'm getting that update.

Q: That's excellent news. Thank you, guys, for your time. Wishing you and your families stay safe and, also wishing your employees that have the coronavirus a speedy recovery. Thank you, guys.

Operator
Thank you. Our next question comes from the line of Phil Gibbs with KeyBanc Capital Markets. Please proceed with your question.

Q: Is this $70 million investment by your customer is this within a brownside-type arrangement within one of your existing facilities or would this be a brand new facility?

Jugal Vijayvargiya - President and Chief Executive Officer
So, Phil, we actually have I think two things that we're doing to ensure that we're properly supporting the launch with this customer. In order to support the launch with a customer on a more near-term basis, we're taking one of our existing facilities and actually adding capacity in that existing facility so that we can start to produce product relatively quickly and start. And then this investment that the customer is making with us, that's something that we expect to have a new facility. We have been working on that and basically laying out the plan, so it will be a new facility for us.

Q: Okay, so some basically some trialing, getting things bugged out with your existing assets and then taking it on a bigger scale several months from now. Okay.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, I would say it's a little bit more than trialing because I think we've been involved with the customer for a while now, and we've been doing, I would say, the trailing, the prototyping and back and forth with the product and developing. I think we, actually, our intent is to actually start launching on a production basis as soon as we can get this increased capacity in our existing facility and then be able to launch it in the new facility on a much higher scale. I'm sure you can imagine that if there's investment of $70 million being made by the customer that that's a fairly large facility, as well as a large potential supply that we would have with the customer.

What's important to note here is that, this falls right in line with the capability and the expertise that we have of making this engineered clad strip. So, we produce engineering clad strip products today, that is the specialty that we have in one of our businesses, and so this is really a significant expansion of that capability, and so that's what's quite exciting about it. And the great thing is from a customer standpoint, we believe it's an area that has existing demand that would be replacing sort of an existing product. And so I think it's a really nice win-win with existing capability, existing skill set where we're expanding to a market that has some existing demand.

Q: Okay, thank you. And then as you look out into the second quarter, it sounds like defense, medical, and semiconductor are strong, resilient markets right now. Maybe just describe a little bit just about in terms of what you're seeing. Is some of this related to COVID, increased government spending, surge demand? Any texture to maybe strengthen those through Apple building for the new launch. I mean anything that you can give on those three markets specifically would be helpful. Thanks, I'll keep it at two and a half.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, so when you look at those key markets for us. The medical is certainly related to the COVID-19. As I indicated, we have the privilege, sort of very proud of supporting the fight against COVID with some of our products, particularly in our Precision Coatings business as well as in our PAC business as indicated earlier. Defense as you know is lumpy. One quarter can be a really, really, strong quarter, and the next quarter can be relatively weak. And so, what we expect is that sequentially, we expect the defense to be a stronger quarter for us from Q1 to Q2, but I think defense in general we are seeing that the defense contractors are continuing, and the demand should be there.

I think from a semiconductor side it's really, I think, the downturn that that industry faced over the last couple of years, and how that's been coming up. The Tier 1 semiconductor suppliers are producing, and they seem to be producing at capacity, and we're starting to see the benefits of that. Will there be an impact down the road due to COVID-19 in that area? I mean obviously that's anybody's guess, if that will be the case. So, I think in general, those three areas seemed to have good solid demand and fundamentals as we move forward.

Operator
Thank you. Our next question is a follow-up from Edward Marshall with Sidoti & Company. Please proceed with your question.

Q: I don't know if I've ever gotten a real time update like that- that's fantastic. Gee, I'm assuming it was in email or something that came through kind of mid-conference call.

Jugal Vijayvargiya - President and Chief Executive Officer
We did, yes.

Q: So, $70 million that's a big investment. First, I guess how much of that investment was in Q1 versus how much was company-funded capex? I guess that's the first question.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, so as I mentioned there are two elements. There is the near-term project that we mentioned which is the getting the capacity up and running for near-term and then there is the larger project. As I indicated, we received this $12 million of prepayment in Q1. Joe, why don't you go ahead and talk the specifics on this spend.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes. So, on the spend, Ed, if you look at our cash flow statement, approximately $10 million of the capital investment this quarter was the spend associated with the $12 million pre-funding that we had already received.

Q: Got it. This is the second type of agreement that I can remember covering Materion that went this route. The other one was with the pebble plant. If I remember correctly, the spend would come in from the customer, but you still carry the D&A. Is that the same way I should expect that here, with this facility?

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes, on the accounting. They are similar. We are spending the capital, but it's very different from a commercial standpoint, that was pre-funding from the government for the pebble plant. This cash that we're receiving, Ed, is a prepayment on products that we're going to start shipping in the back half of 2021 potentially. So, it is very different in the sense that it is prepayment for products that we're going to ship in the future.

Q: Got it.

Joe Kelley - Vice President, Finance and Chief Financial Officer
But the accounting will be very similar.

Q: Got it. If I remember correctly and it's been a while since I've been out there, but the Elmore facility had quite a lot of capacity and adjacent capacity and land that you owned around it, but it sounds like there is a new greenfield facility. I'm curious, are you strategically positioning this next to another facility as a sole source of supply? I'm just kind of trying to figure out why that wouldn't just be added into the Elmore facility which has the capacity.

Jugal Vijayvargiya - President and Chief Executive Officer
Right. Well, I mean we are looking at a number of different options, Ed, so we have not settled on a facility where I can tell you that I think that's something that we'll be able to announce in the future. I do want to highlight that this is a non-beryllium product for us, and so one of the things that we're looking at is, what's the best location to produce plus where do we have the best expertise in this area within the clad strip area. So where can we leverage the expertise, the manufacturing expertise that we have that we can put in place? That's something that will get announced sometime in the near future.

Q: I guess what I'm asking is, are you giving the customer any kind of decision power kind of seeing that there is a pre-investment here as to maybe strategically locating it near somewhere that might be advantageous to them and ultimately you as well.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, I'm not sure if I would say it's a decision power issue. I mean I think the customer obviously is relying on us for the expertise and the capabilities to be able to manufacture this, with what we've been doing for many years. So, I think it's more what's the best that we can offer them with the expertise and logistics and everything else. Now, they're certainly involved in the discussion. Don't get me wrong, but I think the decision making of where best to produce it, will be something that we'll be making.

Q: Got it and how do we look at the revenue ramp on this and potentially the scale that this could produce? I mean obviously you have some return figures that you could talk about.

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, we do, and I mean we're certainly not prepared to talk about those figures. But what I can tell you is that we're certainly planning to start in the near-term in our existing facility, and then with this investment, it's our intent to put the capacity in place and ramp up and supply this for a long period of time. We expect this to be a very large project for us, by far the largest project that Materion has ever faced in terms of supply to a customer. I mean, that's our intent as we continue to work with the customer and finalize on overall supply terms and conditions.

Q: And finally, I guess, if I look back to your pillars and initiatives that you put in place when you came onboard. This has obviously been a focus for you, but this is your big first win, I won't say it's your first one, but it's your first big win. What you think, how many of these other opportunities as you look out over the next say 12, 24 months are there for you to kind of, you're either kind of middle innings or close upon, or is this kind of standalone? Just curious.

Jugal Vijayvargiya - President and Chief Executive Officer
Well I mean, I think anytime you go through organic growth, you have all types. You have the very, very incremental, $0.02, $0.04 incremental to the mid-segment to these, let's say, game changing. I mean typically the very large opportunities as you put it, you have a number of those in the pipeline, not all of those of course come through. You're lucky to bat I don't know, maybe it's one out of five or two out of five or something like that. You're lucky to bat.

We do have focus on all elements of the organic growth all the way from the nickel-and-dime type of improvements that we can make to these larger opportunities. I can tell you, we are working on other larger opportunities. I can't get into the specifics, but it's our intent to continue to ramp up R&D spending, and it's our intent to continue to drive organic growth, as our absolutely top number one priority in the Company.

Q: Got it, got it. By the way do you have any number that you can provide on the order book, maybe a book-to-bill? You talked about how it was strong in the quarter. I'm just curious.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes, we don't disclose a book-to-bill ratio, but what we can disclose is our current order entry rate is supportive of the guidance we provided for Q2.

Q: Got it. Appreciate it guys. Thanks very much. I know there's been a lot of questions. Thank you.

Operator
Thank you. There are no further questions at this time. I would like to turn the call back over to Mr. Shamrock for any closing remarks.

Steve Shamrock - Vice President, Corporate Controller and Investor Relations
Thank you. This is Steve Shamrock, and this concludes our first quarter 2020 earnings call. A recorded playback of this call will be available on the Company's website, materion.com. We would like to thank all of you for participating on the call this morning and your interest in Materion. I will be available to answer any follow-up questions. My direct number is 216-383-4010. Thank you very much.

Operator
Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation and have a nice day.