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Transcript of Materion Corp.
Conference Call
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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

Phil Gibbs – KeyBanc
Justin Bergner – G Research
Marco Rodriguez – Stonegate Capital

Presentation

Operator
Greetings. Welcome to the Materion Conference Call. At this time all participants will be in listen-only mode and a brief question and answer session will follow the formal presentation. [Operator instructions]. Please note that this conference is being recorded.

At this time I'll turn the conference over to Steve Shamrock, Vice President, Corporate Controller and Investor Relations. You may now 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 will provide further commentary on our announcement this morning, and Joe will discuss the key financial aspects of the transaction. Then, we will open up the call for any questions. Please also note that we have issued a presentation for investors to accompany this morning's announcement which is available on our website at investor.materion.com.

Before we begin, let me remind investors that any forward-looking statements made in this announcement, 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 press release we issued this morning.

And now, I'll turn it over to Jugal.

Jugal Vijayvargiya - President and Chief Executive Officer
Thanks, Steve and welcome, everyone. I hope all of you and your loved ones are in good health as we continue to go through some very difficult times.

Today, I am very excited to announce that Materion has embarked on an acquisition which will create the world's leading thin-film optical coatings solutions provider. Over the weekend, we entered into a definitive agreement to acquire Optics Balzers, a pioneer in the industry with a globally recognized brand. This acquisition is a highly complementary fit across geographies, technologies, and end markets. It will accelerate our growth in the optics space with increased exposure to very attractive markets and key megatrends. It will also be accretive to Materion's financial profile.

As I have highlighted in our previous calls, we have been focused on M&A for some time but have continued to maintain a very disciplined approach to ensure any acquisition would be fully aligned with Materion's long-term strategy and create significant shareholder value. Our focus has been on businesses that serve diverse and attractive high growth markets, have a differentiated product portfolio, complement our existing geographic footprint, and have high-quality talent. Optics Balzers represents a clear and undeniable fit with this strategy.

Optics Balzers was started in 1946 and since then, it has had a leading influence in the world of thin film optical coatings. We are privileged to acquire the great talent and expertise which will provide an immediate boost to our existing thin-film optical coatings business. We have been pursuing Optics Balzers for some time given its strength and brand recognition in the thin film optical coatings market. I have personally gotten to know the management and ownership and have developed a deep respect and appreciation for the Optics Balzers' business and its people.

As our relationship grew, discussions continued around the potential strategic benefits arising from a partnership between our two companies. We are very excited that we were able to act on these discussions and join with Optics Balzers to create an industry leading thin film optical coatings business. The entire management team, talented global workforce, and facilities will be merged with the Precision Coatings business segment.

Optics Balzers brings a complimentary and diverse end market and product exposure in support of key megatrends. Let me highlight some key applications: Fluorescence microscopy optical filters for high resolution medical imaging; wafer level optics in support of facial recognition technology; optical filters and anti-reflective coated windows for lidar applications in support of autonomous driving.

With this acquisition, Materion will significantly expand its geographic reach, extending beyond its core of North America to include Europe and Asia. Optics Balzers comes with a very strong European presence with two R&D and manufacturing locations in Balzers, Lichtenstein and Jena, Germany. In addition, they recently launched a state-of-the-art manufacturing facility in Penang, Malaysia which has been a key enabler for their growth in Asia. Together with our facility located near Boston, we will be able to use these facilities to expand our business globally. In addition, we will be able to leverage One Materion manufacturing at the Malaysia facility.

On the technology front, Optics Balzers brings a very strong position in the near infrared and visible light part of the electromagnetic spectrum. When combined with our strength in mid-wave and long-wave infrared part of the spectrum, we will be able to deploy product offerings across the full spectrum. This will enable us to capture leading positions in support of key megatrends.

This acquisition is transforming the Precision Coatings segment into a leading global thin film optical coatings business. For Materion, this transaction expands our portfolio of highly differentiated advanced materials solutions. It provides us with a much stronger position in Europe and Asia while increasing penetration in high growth markets such as life sciences. Overall, it boosts our technical capabilities and innovation portfolio which is at the heart of our profitable growth strategy.

I am very much looking forward to welcoming the entire Optics Balzers family to the Materion family. I am convinced working together, leveraging each other's strengths, will create significant shareholder value.

With that, I'll turn the call over to Joe to cover the financial aspects of the deal.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Thank you, Jugal, and welcome to everyone joining us on the call today. I would like to reiterate how pleased we are to announce this transaction. The acquisition of Optics Balzers represents a significant step to accelerate our global growth in thin film optical coatings.

The combination significantly enhances our business by diversifying sources of revenue from a product, geographic, and end market perspective, creating significant opportunities for commercial synergies. Additionally, operational synergy opportunities exist through leveraging the global manufacturing platform and technical capabilities of the combined business and sharing best practices. The combined commercial and operational synergies fully align with our profitable global growth objective.

Under the terms of the proposed transaction, Materion will acquire Optics Balzers in an all-cash transaction with a total enterprise value of approximately $160 million. The transaction values Optics Balzers at 12x trailing twelve month (TTM) adjusted EBITDA, or 8x pro forma for synergies. The transaction is expected to be accretive in year one, excluding one-time acquisition costs; and accretive to EBITDA margins and growth rate.

With respect to financing, we intend to fund the transaction with a combination of cash on hand and borrowings under our revolving credit facility. Pro forma for the acquisition, Materion Q1 2020 net debt to adjusted EBITDA would increase to a modest leverage ratio of 0.4x on a TTM basis. Our balance sheet remains strong and continues to offer meaningful financial flexibility.

We plan to close the transaction during the third quarter of 2020, subject to regulatory approvals.

In summary, we are very excited about this acquisition. We believe this transaction is financially compelling and offers significant strategic benefits while maintaining a strong and flexible balance sheet. We are excited to join with Optics Balzers to create a diversified thin film optical coatings platform and move Materion another step forward in our transformation into an advanced materials business.

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

Operator
Thank you. We will now be conducting a question and answer session. [Operator instructions]. Our first question is from the line of Phil Gibbs with KeyBanc.

Q: Good morning.

Steve Shamrock - Vice President, Corporate Controller and Investor Relations
Good morning, Phil.

Q: First question is just on the current competitive overlap that you have with this company. Is there a lot of similar products that you're selling and they're selling, or is this very much complementary to what you're already doing? I mean complementary that it augments what you do.

Jugal Vijayvargiya - President and Chief Executive Officer
Phil, let me take that on. I think this is a great complementary fit for our company. When you look at, first of all, from just an overall geography standpoint, it's a great complementary fit because we're very, very strong in North America, they're extremely strong in Europe and Asia, so I think we end up having a really strong global presence.

When you look at the technology and the product side, we are extremely strong. And in fact, one of our charts we included in the investor deck includes that; we're extremely strong in the more IR space of the optical filters, the thin film optical filters. They're extremely strong in the visible light and a little bit of the IR, so I think from a technology standpoint it's an excellent, excellent fit. So, in general, whether you look at the technology or you look at the geography, it's a great complementary fit.

When you look at the markets, they bring a significant presence in the life sciences market, something that we have been looking at and working on, but we have not been able to make the level of inroads that they have been able to make. So really, a third of their business is in the life sciences side and that's a great complementary fit for us.

So I think with any company, there could certainly be some overlap, but really for us this is a great complementary fit when we look at end markets, when we look at geographies, when we look at [audio disruption] and in particularly on the technology side, we're very [audio disruption]. I think the legacy and the history that they come forward with, it is THE industry recognized name in thin film optics. So to be able to get that legacy work, the technology that they bring, we're very excited about that.

Joe Kelley - Vice President, Finance and Chief Financial Officer
It's the combination that Jugal references of the lack of overlap from a geography standpoint and then the lack of overlap from a products standpoint when you talk about the electromagnetic spectrum range that creates the commercial synergy opportunities that have us excited.

Q: When you talk about the synergies, your presentation suggests they're largely topline related. How long do these take to play out in your mind? I mean, big different between the $13 million that this company is generating in terms of EBITDA the trailing 12 and then your target of $20 million, so what's the aspiration there in terms of how quickly this company can grow? And is it largely all commercial? It doesn't sound like there's any cost synergy.

Jugal Vijayvargiya - President and Chief Executive Officer
I wouldn't say there's any cost synergies because obviously I think in any acquisition there's opportunities, both topline and bottom line, but what's really got us excited – and you hit it – is the growth prospects that we have between our two companies. Leveraging the geographic positioning that we have and leveraging the technology position that we have, the two companies have, we really believe we can take significant actions in North America by leveraging the technology platforms that they have, and we believe we can take significant actions in Europe and Asia by leveraging the technology platforms that we have out of North America. So that cross-regional work that is going to go on I think is going to be very significant, and I'm very excited about it. The teams have had discussions on how we can go ahead and potentially leverage that in the future, so that will be an important part.

Innovation and just expanding the served markets overall through this process will be a very important part as well, so clearly topline. Then when you look at Asia, they have a state-of-the-art facility that they have just put in, in the last few years that they have invested a lot of money and we think we're going to be able to use that not only to grow the business in Asia for precision coatings and these thin film optical filters, but we're going to be able to use that from a One Materion perspective.

Certainly, there will be some cost opportunities as well. I mean, the typical things where you can leverage procurement, where you can leverage maybe operation excellence. You've seen what we've done on operational excellence and other things over the last two to three years as you've followed us. We will certainly use best practices to be able to drive all of that, but we're very excited about being able to do the topline synergies really all around the world.

Q: My last question just goes along the lines of growth. You have some things that you're doing internally from an organic R&D standpoint and we talked about the cladding business here over the next couple of years. You have the M&A pipeline going. How do you make sure that you're not doing too much at the same time and keeping yourself focused on execution as you grow the business? Thanks.

Jugal Vijayvargiya - President and Chief Executive Officer
As you know, we've had a very, very disciplined approach and execution over the last three years. Our operational excellence, commercial excellence activities that we've been involved in have been very focused with the organizational structure that we put in place. We brought in some tremendous leadership capability in all areas, and we brought them in, in our technology area, in our operational area, in our commercial area, and those people have really done a nice job of driving effective processes across the company. So, as we move forward, we will continue to stay disciplined in that regard.

One of the things I want to highlight, and we've said this in a number of conversations before, that we didn't want to do M&A just for the sake of doing M&A. So we wanted to do M&A because it was the right thing, we felt it was the right complementary fit, and that we could drive and manage it because the execution of the M&A is very important.

As we look at our businesses, the other thing to note is that the business that we talked about during our earnings call is in our PAC segment. This business is in our PC segment, so of course there's a little bit of different leadership involved there. But at the end of the day, we don't want to derail the progress that we've made over the last three years with a lack of execution. So disciplined execution is important to us, we take that into account as we're making these decisions, and I'm convinced that our organization, the way we've set it up, we'll work at it and we'll deliver the results.

Operator
[Operator instructions]. The next question is from the line of Justin Bergner with G Research.

Q: Hi, Jugal. Hi, Joe. Congratulations on this morning's announcement.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Thank you, Justin.

Q: Thanks for taking my question. I guess just a couple of questions to clarify some of the metrics for the deal and Optics Balzers. Do you have an estimate for how much the synergies and integration costs to achieve those synergies will be and sort of the timeline to lift up the EBITDA to the level consistent with that 8x pro forma multiple?

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes. The 8x pro forma was a 36-month number in terms of when we hit that synergy rate. That, Justin, is a net synergy, so that does include some incremental costs associated with realizing those synergies, but it's a net synergy number.

Jugal Vijayvargiya - President and Chief Executive Officer
And Justin, in general, the specific questions about dollar amounts, that's something that we don't normally get into. We're focused on delivering shareholder value, and at the end of the day whatever means that we need to take, that's what we're going to do to deliver those.

Q: Understood. Thank you.

As I think about the cost of financing for this deal, obviously you have $100 million plus net cash on the balance sheet and will be using that and the revolver. In terms of thinking about accretion, should I be thinking about a cost of financing, something in sort of like the 2% range given the cash that's earning close to zero at the present point in time?

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes. Two percent is a good number.

Q: Okay, great. And then, any comments on the growth rate, maybe like 2016 to 2019 topline for Optics Balzers just to get a sense as to how it's performed?

Jugal Vijayvargiya - President and Chief Executive Officer
I can speak to that. They've had very good historical growth rate, well in excess of good double-digit growth rates. It's been a high performing business and we expect it to continue and going to do everything we can to deliver on the legacy of this business. As I mentioned earlier, we're very, very privileged to have this business in our portfolio with the great people that have worked on it and have done the things that have resulted in some great work.

Q: Okay, thank you. Just lastly, any comments on capex needs and amortization costs? Will the capex needs be consistent with what you see in your broader business today?

Joe Kelley - Vice President, Finance and Chief Financial Officer
I think it would be relatively consistent with what you see in our broader business today. They have invested significantly over the last several years as they built out, as Jugal referenced, their state-of-the-art facility in Malaysia, but also the capex and investments have been done in Germany and Lichtenstein facility as well. So on a go forward basis, I would model it more consistent with what we see at the Materion level percentage-speaking.

Q: And any thoughts on amortization just for how we think about that number or would you rather get back to us at a later point?

Joe Kelley - Vice President, Finance and Chief Financial Officer
I think that would be later following some purchase accounting and closing.

Q: Great. Thanks so much for taking all my questions.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Thank you, Justin.

Operator
[Operator instructions]. Our next question will be coming from the line of Marco Rodriguez with Stonegate Capital.

Q: Good morning, guys. Thank you for taking my question.

Jugal Vijayvargiya - President and Chief Executive Officer
Good morning, Marco.

Q: I was wondering if you could talk a little bit more coming back to the topline synergies, if you could perhaps just go into some detail with what you can on the two different sales forces. Just trying to get a little better sense that you have two areas of the product roadmap that are probably very technical sales. So I'm just kind of wondering, what are the opportunities and the challenges you have to bring in the two sales forces together? Is it going to be a cross-training event or perhaps the Optics Balzers individuals are going to introduce the Materion force? Just any sort of information you could provide there from the sales aspects would be very helpful.

Jugal Vijayvargiya - President and Chief Executive Officer
First of all, I think both businesses, as we have looked at their business and of course I know our business have very, very good, strong, solid sales force and sales presence. Their accomplishments have clearly been sales driven. And they have, as I indicated earlier, great work that they've done in life sciences. They have other end markets that they have really excelled in. The technologies that they offer, invisible light and near infrared are just absolutely second to none. And so their work, their core that they have – and then of course the selling arm that they have – is very, very strong.

In this space, to your point about cross-training, the folks that are out selling the products here in North America for us, there are folks that are out selling the products in Europe and Asia, they will easily be able to cross-train. That won't be a difficulty. I mean, people that are understanding the electromagnetic spectrum will be able to learn each other's products and be able to [audio disruption] as an issue.

I think the real issue and I think the real excitement that we have is the burning desire and sort of the underlying desire I think that our two companies have to work together, to leverage our capabilities, to leverage the technical strength and the end market strength and geographic strength to drive the topline, and that's what's just got us excited about this.

Q: That's helpful. Then to follow up on a prior question just in terms of these synergies, realization, what sort of timeline should we be thinking about here? Is this a one-year type event, a three-year type event?

Jugal Vijayvargiya - President and Chief Executive Officer
First of all, as Joe indicated, with the pulled synergy multiple, he was talking about maybe 36 months or really three years out when he was talking about the multiple, but I think the synergies are going to be throughout. There are some synergies, as you know, that will be fairly easy for us to work through and start putting together between our two companies where we can leverage each other's strength. There are others that will take a little bit more time. Certainly topline synergies, as I think was mentioned earlier by Phil, tend to take a little bit longer than some of the bottom line synergies just because it's something that's directly under your control on the bottom line side, where perhaps you're having to work with customers on the topline, but I think in general we're quite excited about the total level of synergy opportunity and value creation that we have between our companies. And we expect that to start as soon as we get the closing completed and then get our two organizations to start working together and delivering value.

Q: Can you talk a little bit about the regulatory approvals that are necessary to close this transaction?

Jugal Vijayvargiya - President and Chief Executive Officer
Yes, so the regulatory approval is that we will be doing a filing in Germany and then we will go through the process. We expect, as we indicated, that we will be closing in Q3.

Q: And is the regulatory approval just sort of a standard request, if you will, or are there sort of certain hurdles you need to overcome, if you will?

Jugal Vijayvargiya - President and Chief Executive Officer
We're going to go through and process the regulatory things, and then the things that come in the way, we will certainly address those. We have, as I said, a great complementary fit in the business that we have in terms of the markets that we deal with, the technology that we deal with, the customers that we deal with, the regions that we deal with, so I think based on that, without me saying a whole lot, hopefully you can kind of interpret what that means from a regulatory perspective, but we will certainly do whatever is necessary to work through the regulatory hurdles and our expectation is to close in Q3.

Q: Got it. Last quick question, if I heard you correctly, I believe you had mentioned that the entire management team is going to be merging over as well as the employees, but just in terms of the management team, are there any sort of incentive structures that are in place with this acquisition to incentivize that team to stay long term?

Jugal Vijayvargiya - President and Chief Executive Officer
I think it's most important to know that the entire management team and all of the people, all of the facilities, the entire Optics Balzers business is going to be coming into the Materion family. I think that's the first and foremost and the part that we are most excited about.

The second thing I can tell you is I have personally met with the management team, not once, not twice, but multiple times. They're excited. They're excited to be part of the Materion family. They see the same type of value creation that we see. And so I think certainly there's all types of incentives at the end of the day that people have, but I think the most important incentive that we all have is our desire to grow and our desire to make this the world's leading thin film optical coatings company, which I think is what everybody on the management team and I'm sure the people of Optics Balzers are going to be excited about as they're hearing about this news. So we're looking forward to it, Marco, very, very much.

Q: Got it. Thanks. I appreciate your time.

Joe Kelley - Vice President, Finance and Chief Financial Officer
Marco, this is Joe. Let me just add one thing to your timing.

The synergies, we start realizing synergies in year one and then this is accretive in year one, but also in year one then we have some investments to start realizing those synergies more long term. But I just wanted to make the point that the synergies do start and it's accretive in year one.

Q: Got it. Thanks, guys. Appreciate the time.

Operator
The next question is from the line of Justin Bergner with G. Research.

Q: Thanks, guys, for the follow up. I guess just to make sure I understood the comment about net synergies, you're referring to sort of adding the costs to obtain the synergies to the enterprise value to sort of get to that 8x? Is that the right way to think about the math?

Joe Kelley - Vice President, Finance and Chief Financial Officer
Yes. So the right way to think about the math, Justin, just specifically is you have your base EBITDA on a trailing 12 months and we're adding the synergies, net synergies in 36 months out. Those synergies include cost that we

will add to realize those synergies, so it's a net number. So you could [audio disruption] plus 10 minus 3 type thing.

Q: Okay. I was just thinking the costs would actually come ahead of the sort of full realization of the synergies, 36 months out. I wasn't sure.

Joe Kelley - Vice President, Finance and Chief Financial Officer
No, by the time you get there, it's a net synergy, net positive.

Q: Okay. You advertised that your net debt would only be 0.4 times after this deal. Should I think of that as sort of signaling that we shouldn't expect another material deal in the near future? That you're going to focus on this deal in the large capital investment that you announced recently?

Joe Kelley - Vice President, Finance and Chief Financial Officer
The purpose of that disclosure is to show you that we still have a very flexible balance sheet. We have said publicly that we would be comfortable at 1.5 times debt to EBITDA and even post pro forma for this transaction we're not there. So it was intended to signal that we continue to have a very strong balance sheet with plenty of financial flexibility.

Jugal Vijayvargiya - President and Chief Executive Officer
Let me comment just in general. I think our strategy, and we've been saying that I think in all of our calls and meetings that we've had with you guys, look, our strategy is very simple. Our objective, I should say, is very simple. It's to drive global profitable growth. And the steps that we need to take, we're going to take to get there. We've been taking steps over the last three years. This is a nice step that we're taking, and we're going to continue to take the steps. So we want to make sure that it's the right thing, so I wouldn't walk away with the impression that these guys are going to take a break, but I wouldn't walk away with the impression that they're going to do another one tomorrow.

We are very, very disciplined in our M&A strategy. And as has been demonstrated by what we brought forward here and are communicating with you today, this is an extremely complementary fit with just great opportunities across the board. And that's the type of value creation opportunity that we are looking for, we're going to continue to look for, in all three of our businesses. And when we find it, we're going to go after it, and we're going to go after it hard.

So, I wouldn't walk away with any impression that we're going to stop, or we're going to do another one tomorrow. I think we're going to just stay very disciplined in support of our strategy.

Q: Great. Then lastly, I take it there's no update on sort of the large capital investment that you disclosed coming out of the first quarter that [audio disruption] for the second quarter call for any potential update there?

Jugal Vijayvargiya - President and Chief Executive Officer
No, today's call clearly is focused on the announcement that we've made and the excitement that we have around this acquisition. We have no other updates for the rest of our business. We're just really, really excited about welcoming the Optics Balzers family into our family here as we go through this process.

Q: Great. Thank you.

Operator
At this time we have reached the end of our question and answer session. I'll hand the call back over to Steve Shamrock for closing remarks.

Steve Shamrock - Vice President, Corporate Controller and Investor Relations
Thank you. This is Steve Shamrock and this concludes our conference call this morning. 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 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.