Transcript of
Materion Corp.
Materion First Quarter 2022 Earnings Conference Call
April 28, 2022

Participants

John Zaranec - Vice President, Corporate Controller and Investor Relations, Materion Corp.
Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.
Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Analysts

Phil Gibbs - KeyBanc Capital Markets
Marco Rodriguez - Stonegate Capital Markets
Daniel Moore - CJS Securities
David Silva – CL King
Justin Bergner - Gabelli Funds

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Materion First Quarter 2022 Earnings Conference Call. At this time all participants have been placed on listen-only mode. The floor will be opened for questions and comments after the presentation.

It is now my pleasure to turn the floor over to your host, John Zaranec, Vice President, Corporate Controller and Investor Relations for Materion Corporation. Sir, the floor is yours.

John Zaranec - Vice President, Corporate Controller and Investor Relations, Materion Corp.

Good morning. And thank you everyone for joining us on our first quarter 2022 earnings conference call. This is John Zaranec, Vice President, Corporate Controller, and Investor Relations for Materion Corporation. Before we begin our remarks this morning, I would like to point out that we have posted materials on the company's website that we will reference as part of today's review of the quarterly results. You can also access the materials throughout the download feature on the earnings call webcast link.

With me today is Jugal Vijayvargiya, President and Chief Executive Officer; and Shelly Chadwick, Vice President and Chief Financial Officer. Our format for today's conference call is as follows. Jugal will provide opening comments on the quarter and an update on key strategic initiatives.

Following Jugal, Shelly will review the detailed financial results for the quarter and in addition to discussing our expectations for the remainder of 2022, then we will open up the call for questions. Let me remind investors that any forward-looking statements made in this presentation, including those in the outlook section, and during the question-and-answer portion are based on current expectations. The company's actual 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 regarding earnings before interest, taxes, depreciation, depletion, and amortization, net income and earnings per share reflect the adjusted GAAP numbers shown in attachments four through seven in this morning's press release. The adjustments are made in the prior period for comparative purposes and remove special items, non-cash charges, and certain discrete income tax adjustments.

And now, I'll turn over the call to Jugal for his comments.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Thanks, John, and welcome everyone. I'm pleased to share details of our record performance in Q1 and cover some significant advancements on our strategic initiatives.

We have started the year out strong and our momentum is building as we're on track to deliver another year of record performance. In Q1 we achieve record sales in earnings with value added sales up 34% and EBITDA up almost 50% when compared to an already strong Q1 last year. Our record results were possible thanks to our team's tireless efforts to serve our customers despite challenging supply chain and macroeconomic conditions along with the impact of the Shanghai lockdown.

Our transformation strategy continues to position us for significant sales growth. Robust and market demand, coupled with our organic initiatives helped to drive double-digit organic growth, with VA up 13% versus last year. We saw strong output across many of our end markets such as semiconductor, industrial, aerospace, and energy. As we continue to partner with our customers to develop innovative products and solutions and increase content on our fast-growing applications.

Q1 also marked the first full quarter results from the largest acquisition in our company's history. HCS electronic materials, which has significantly strengthened our position as a critical supplier to the fast-growing semiconductor market. So far, the integration has been seamless, even better than we expected. As our teams have joined together quickly and collaboratively with a shared focus on driving higher levels of performance. We are already investing in this new facility to add capacity, broaden our capabilities, and increase yields to support our customers. The acquisition is contributing to our results ahead of expectations. And we are excited about what the future holds.

Our organic and inorganic initiatives are delivering and helping to reshape our company. As we progress along our transformation journey, we're updating the names of two of our operating

segments. The new names of electronic materials and performance materials better reflect their strength of our portfolios, and the progress we've made in both businesses. In addition to our strong organic growth and the success of our recent acquisition, our precision cloud strip project is advancing through the qualification phase. With the project remaining on track to contribute meaningfully in the second half of this year. We continue to receive positive feedback from our customer and strengthen the trust and confidence they have in our company.

As a result of the successful relationship, we have been awarded a second increment of business that will allows us to expand our capacity by two-thirds and service even higher levels of expected demand. The total investment for this expansion project is about $60 million, with approximately $40 million being contributed upfront by the customer. We have already received $4.4 million towards the new project and expect to receive another $2.8 million next week. Engineering work has already been started and orders have been placed for long lead time of footprint. We expect to have the new capacity available in 2024.

This additional commitment is a meaningful win for our company, deepening our relationship with an important customer and ensuring even higher levels of growth for years to come. The confidence placed in Materion further demonstrates our position as a critical partner for our customers in the development of innovative solutions for their most important technical challenges.

For this year, we remain on track to exceed a billion dollars in VA sales for the first time in our history. As we grow our business and continue to outpace our end markets. Our already strong order book grew again in the first quarter, giving us confidence optimism for the rest of the year, even with the uncertainty that exists in the broader environment.

With that in mind, we are increasing our earnings guidance for the full year. I remain highly confident that we can achieve record value added sales earnings as we take another step forward on our transformation journey.

In closing, let me reiterate how proud I am of what our team has accomplished to start the year, delivering record performance, and setting us on the path for outstanding 2022.

Now, let me turn the call over to Shelly to cover the financials.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Thanks, Jugal. And good morning, everyone. During my comments, I will reference the slides posted on our website this morning. Starting on Slide 11.

As Jugal outlined, we achieved record quarterly value-added sales, adjusted EBITDA, and earnings per share in the first quarter. Value added sales, which excludes the impact of pass-through precious metal costs were $266.8 million for the quarter, up 34% from the prior year. Organically VA sales increased 13% driven by strong demand across most of our end markets, including semiconductor, industrial, aerospace, energy, and telecom, and data center. Q1 also marked our first full quarter of HCS electronic materials results, which exceeded our

expectations. We delivered adjusted earnings of $1.20 per share up 38% as compared to the prior year.

Looking at Slide 12 adjusted EBITDA in the quarter was $44.6 million, up 49% from last year. Our adjusted EBITDA margin of 16.7% represents a 160-basis point improvement from the same period a year ago. The increase in EBITDA was largely driven by strong volume, improved pricing and favorable mix, as well as a full quarter of the accretive HCS electronic materials acquisition. These drivers were partially offset by investments in R&D, and sales and marketing and the facility startup costs related to our new precision cloud strip plant. We were also negatively impacted by the COVID related absences in January and the Shanghai lockdown which began in March.

Now, let me review first quarter performance by business segments. Starting with our performance materials business on Slide 13. Value added sales were $129.1 million, an increase of 28% compared to the prior year. The year-over-year increase is driven by strong performance in the industrial, energy, and aerospace and markets, higher shipments of beryllium hydroxide, as well as the impact of the HCS acquisition. EBITDA excluding special items was $27.5 million or 21.3% of value-added sales compared to $16.8 million, or 16.7% of value-added sales in the first quarter of 2021. The increase was primarily due to higher volumes, positive pricing and mix, operational performance and the impact of the HCS electronic materials acquisition, partially offset by through contemplation and the impact of the new facility startup costs.

The full-year outlook is strong with a growing order book, and our precision cloud strip project remains on track to contribute meaningfully to the second half of the year. The startup costs seen in Q1 will repeat in Q2 as we expected but will fall off in the second half of the year. As the project comes fully online. Startup costs for the new increment of capacity have not yet been contemplated.

Next turning to electronic materials on Slide 14. Value added sales were $109.9 million up 74% versus the prior year and up 16.4% organically. VA sales were a record for any quarter even before the impact of HCS electronic materials. The increase was driven primarily by our accelerating growth initiatives, coupled with strong end market demand in semiconductor and energy. As mentioned, HCS performance was also very strong, with results exceeding our initial expectations.

EBITDA excluding special items was $18.9 million, or 17.2% of value-added sales in the quarter, compared to $10.9 million in the first quarter last year, an increase of 73%. The increase was driven primarily by favorable volume, price, and the impact of the acquisition. As we look forward to 2022, we expect the electronic materials business to deliver another year of strong outgrowth, especially in the semiconductor and energy space. Additionally, a full year of HCS will deliver a meaningful step-up in both value-added sales and earnings.

Finally, turning to Precision Optics segment on Slide 15. First quarter value-added sales were $28.5 million down 20% compared to the prior-year period, but up 3% when excluding the discontinued consumer electronics application, and PCR COVID testing declines mentioned last quarter, as well as the unexpected temporary Shanghai shutdown. We expect Q1 to be the low

point for the year for Precision Optics as their pipeline of organic opportunities are expected to begin contributing meaningfully as we move forward. EBITDA excluding special items was $2.4 million or 8.3% of value-added sales. The decrease in EBITDA was driven by lower volume. As we mentioned in our year-end earnings call, we anticipated these near-term headwinds and have growing visibility into the segments returned to growth with new business opportunities coming online. We expect to take a step forward in Q2 with higher sales and a return to double-digit EBITDA margins and improve further in the back half.

Moving now to cash debt and liquidity on Slide 16. We ended the quarter with a net debt position of $475 million, and $127 million of available capacity on the company's credit facility. Our full-year cash flow expectations contemplated the first quarter usage due to the timing of incentive compensation and payroll tax payments after a record 2021. Our pro forma leverage at 2.7x remains within our target range. With strong free cash flow and higher EBITDA expected for the remainder of the year, we expect this leverage ratio will come down toward the middle of our range by year-end.

Transitioning now to Slide 17, let me cover our outlook. With the excellent start in Q1, combined with our strong order book, progress on our organic initiatives and the performance of HCS electronic materials, we are increasing our full-year outlook. We now expect adjusted EPS excluding acquisition amortization, in the range of $5.50 to $5.90 for the full year, an increase of 14% from 2021 at the midpoint, we have provided some detailed modeling assumptions for you specifically calling out higher interest expense given the current Fed outlook and a higher tax rate with a geographic mix of earnings and a change in the timing of R&D Tax Credit with evolving tax laws. You'll also see an expected increase in capital spending, driven primarily by the new expansion for the precision cloud strip opportunity. Of the expected $27 million spend, $22 million will be pre-funded by the customer. Our organic pipeline continues to provide many value creating investment opportunities funded by our strong free cash flow and select joint investments with our customers.

In closing, Q1 was a fantastic start to the year. We are extremely proud of our global teams contributions to date and we are excited to build upon our momentum and deliver another record year in 2022.

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

Operator

Thank you, ladies and gentlemen. The floor is now open for questions. [Operator Instructions] And the first question is coming from Phil Gibbs from KeyBanc Capital Markets. Phil, your line is live.

Q: Hey, good morning.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Hey, good morning, Phil.

Q: We talk a bit here just about I think the elephant in the room for everybody in the investment community is just the semi market and you saw Texas Instruments saw some impacts from these Chinese lock downs. And I know you guys are typically the last to see it, but they're pointing to some of the least near-term weakness. I don't think its demand related but appears more supply related. How does that jive with the increases you're making to your full-year guidance and what you're embedding for semi momentum?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

So, our semi market is impacted by, one, the acquisition that we made, which has been a great add for us and it's adding tremendous growth for us on the semi side. But really, on the other side of semi, we've got a great set of products that's impacting our semi business. But at the same time, I think, the fact that there's been a shortage of supply for the automotive side, I think is a big upside for us as we go forward for semi, which we hope will continue to pick up. We're not seeing at this stage any type of a, let's say, a downturn on the semi side. We expect with our new products, with the mix of products that we have, we expect semi to continue and continue well, I think, throughout the year. So, if there are some short-term supply issues that come up, I mean, certainly we'll react to those. But at this stage, I would say our semi market demand continues to move up.

Q: And then on the pickup in the order book that you mentioned in the prepared remarks, is that broad based or is that targeted at a couple of specific end markets?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

No, it really is across really all three of our businesses and across all of our end markets. When you look at, I think, the recovery that's going on, for example, in aerospace, the recovery that's going on in oil and gas, I mean, those are clearly contributing. The semi comment that we just made; we expect automotive to continue to be a strong market for us. Industrial has been, and I think continues to be a strong market for us, especially with our beryllium nickel products. Defense, we expect defense to continue to do well throughout the year, and especially with everything that's going on in the world right now we expect defense to continue – to increase. So, I think we're seeing a good increase across the board.

Q: Appreciate that. And then the last one here, just on the clad strip facility, it sounds like, I mean, there is a Phase 2 investment taking place. Is this the same, is this the same customer and the same types of materials that you'd be doing on Phase 1 or is this a new customer?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

No, this is the same customer and the same product. They just see a significantly higher demand as they kind of project out what's going to happen over the next few years. And they want to make sure they're prepared. And so they are working with us to put that increased capacity in place. As we indicated, I think, in our prepared remarks, I mean, this is a great win for us. We have talked about the fact that we've got additional space in our facility that we had gotten and

we were prepared to be able to add incremental capacity. So, I think this is going to be a really, really good step up for us. Roughly about $60 million, $65 million worth of investment in total, with approximately two-thirds from the customer. Same type of a model as what we have done with the customer before. So, this is a great add for us.

Q: Thank you. And then just lastly, you did provide an update on the full-year earnings guidance. But did you did you give any color in terms of what the second quarter expectations are relative to the first quarter, just give us some ideas of tempo here?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yeah. Well, I mean, as you know, our big step up really happens in the second half of the year. I mean, as we have the clad strip project come on board, full speed sort of to speak, as we ramp up into the second half. Our second quarter will continue to kind of move from the first quarter. We would expect it to be similar with some incremental improvements from Q1 to Q2, but really a big step up is then in the Q3, Q4 timeframe so the back half of the year.

Q: Thank you.

Operator

Thank you. And the next question is coming from Marco Rodriguez from Stonegate Capital Markets. Marco, your line is live.

Q: Good morning, everybody. Thank you for taking my questions.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Hey, Marco.

Q: Hey, I was wondering if maybe we could start a little bit on gross margins. That seemed a little light kind of given your revenue performance and what we were expecting and then also in relation to kind of the commentary you had about some lot of benefits from a price mix aspect Can you kind of walk us through some of the puts and takes there and the drivers there?

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Yeah, sure. I mean, Jugal was just talking about the clad strip project really taken off in the second half. And so, if you think about what we've been taking on in the first half, has been all that startup cost really with no associated margin with that. So, that's been a bit of a drain on gross margin. We've also taken some pricing actions, which really feather in over the year as we're working through orders that were already on hand. So, we'll see price take a bigger step forward as we move into Q2 and the rest of the year.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yeah. I think the other thing that – on the gross margin side as we've talked, is we've got this acquisition, that we've done – the acquisition comes in with great EBITDA margins for us, but lower gross margin. So, we've got a mix that's happening with the acquisition which, by the way, the results in Q1 were just fantastic. Really, really excited about what this has done for us, but that certainly has a negative mix on the gross margin side, but then positive mix on the earnings side.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Yes, and just the last thing to mention, if you're just looking at the face of the P&L, it's got the inventory step up impact for the acquisition, which is adjusted out. So you almost need to adjust the gross margin to see really what we look like, versus last year and last quarter.

Q: Got it. Very helpful. And then real quick, I didn't notice you had about $9.6 million in M&A costs that were excluded here from an adjusted standpoint. Where was that cost on the P&L? Was that all in SG&A or was that spread?

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

So the inventory step up I just mentioned is the biggest part of that, and that would be in COGS. And the rest was in SG&A.

Q: Okay. Got it. And then in relation to that, though, also the SG&A seemed a bit lower than recent quarterly kind of run rates. And obviously, given the higher revenue we'd expect variable costs would be a bit higher there. Were there any sort of one-time items that were beneficial in the quarter or any type of timing issues that caused SG&A to be lower? Or is that kind of a good run rate for you guys?

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Yes, there is a little bit of timing on -- I know, incentive comp was a different year-on-year. So that's one item. And then I think we're just seeing, some spending ramping as we move into the year and return to investments as we get back out on the road, traveling and seeing our customers et cetera.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yes, and we would continue to expect that I think, SG&A to continue to ramp through the year, just exactly for the reasons that Shelly has mentioned. We want to make sure we're getting out to our customers and frankly, growing our business with the growth plans that we've got, and I think what we've demonstrated so far. Customer engagement is a key, and employee engagement is a key. And so that's going to be an important element of what we do for the rest of the year.

Q: Got it. And last question for me, just on the HCS integration, if maybe you can talk a little bit more about the roadmap that you're looking at, where you have full integration there and if you can maybe spend a little bit of time and update us on the sales and marketing integration or the

revenue synergy efforts as well. I know you sort of touched on them in your prepared remarks. But if you can kind of give us a little bit better more sense as far as where you are on that timeline would be helpful.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yeah. Well, I mean, there's always kind of two elements of the integration, as we look at it. One is sort of the process side of the integration which, I think, has gone really well. We've been making sure that all the things that we were involved in on the TSA side, Transition Services Agreements, we're starting to move off of those and getting those in-house, process-related things within our – basic things such as health and safety, finance, other things like that. I mean, we've been making good progress on those. From the business side, and to your point on the sales and marketing side, that's going really, really well. We fully integrated the organization into our two business units, the Performance Materials and the Electronic Materials business units. And it's going well. We are making, I would say, joint customer calls, looking at what we can do from a product development and innovation perspective and drive top line growth, which is, I think, what we really based the acquisition on. And so we're excited about that.

Q: Got it. Very helpful. Thank you, guys, for your time. I really appreciate it.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Thanks, Marco.

Operator

Thank you. And the next question is coming from Daniel Moore from CJS Securities. Daniel, your line is live.

Q: Thank you, and good morning, Jugal. Good morning, Shelly. Thanks for taking the questions.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.
Good morning.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Hi, good morning Dan.

Q: I start with kind of piggybacking on Marco's question. Any initial examples of within HCS, creating more opportunity for you with your semi customer? Maybe just talking about some of those dialogues and where you see kind of longer-term opportunity to gain share, maybe opening.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yeah. A number of opportunities, Dan, I mean, as you can imagine, I mean, I can't get into specific customer names, but I can tell you that we've had a number of meetings with our existing customers. I mean, let me back up a little bit, and we have mentioned that between the customer base that HCS had and the customer base that we had, we were going to be providing to the top 15 semiconductor manufacturers in the world. And so we've had actually a number of meetings with their customers, and let's say, our customers, talking about the portfolio. Very, very good interest from both sides of the house. I'm going to say sort of speak from the customer side. And I expect that over the next year or two, three, because as you know, these are sort of longer cycle developments that we're going to have good top-line accretion. So that's going very well.

From the cost side, we're actually making significant investments. We talked about investments, I mean, that's part of our capital plan in the business that to make sure that we can drive continued capability, continued capacity, as well as via, frankly, be able to reduce the cost and increase our margins. And we want to make sure we can do that. And so it's going really well. And our first quarter results, I think speak to the progress I think our team is team is making.

Q: Very helpful. Shifting gears a little bit. Maybe just can you quantify at all the impact on Shanghai lockdowns, both for the last couple of weeks in Q1, as well as what your expectations are for Q2 at this stage?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yeah. the Shanghai lockdown for us is impacting our Precision Optics business. We have a facility in Shanghai that actually makes product for the display market, and we did have an impact in the last part of the Q1. I would say it was not a meaningful impact to the entire company, certainly a meaningful impact for our Precision Optics business. So, roughly about, I'm going to say, between $0.5 million to $1 million type of an impact. And then we would expect, of course, the impact to continue until the situation gets better here in the second quarter. So, that's kind of how I see it. But it is certainly a meaningful impact to the Optics business, and one that we hope we can quickly get through.

Q: Great. And one more, just modeling purposes, the incremental capacity expansion for the cloud strip facility, more likely to incur those costs in 2023, Shelly, versus the second half of this year? Just how should we think about that?

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

For the startup cost versus the capital?

Q: Correct.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Transcript Provided by
ISSUERDIRECT®

Yeah. So there could be some costs here, and we're kind of working through that planning right now. But yes, more likely to see that traditional startup costs that we're incurring now late next year and into 2024.

Q: And the guidance excludes that any of those incremental costs, correct?

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

It does. Yes.

Q: Okay. Perfect. All right. Thank you.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

Thank you.

Operator

Thank you. The next question is coming from David Silva from CL King. David, your line is live.

Q: Okay, thank you. So I'm going to preface my remarks by saying I joined your call a little bit late. So I will apologize in advance.

Shelly Chadwick - Vice President, Finance and Chief Financial Officer, Materion Corp.

No problem.

Q: If I make you repeat yourself. So when I looked at the financials, I was kind of a little curious why the R&D spend wasn't a little bit higher. And I'm looking at your slide deck, Slide 18, and the second comment there is that you're going to build out a robust pipeline with investments in R&D, as you play out your overall broader strategies. So I'm just wondering if you could maybe highlight, maybe from a full-year basis, where you think the R&D spend needs to go and over what period of time might you hit that targeted rate of R&D spend? And, secondarily, if you wanted to, if you could highlight any areas of incremental emphasis, I think that that would be helpful. Thank you.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yes. Good question. And it's one item that, as you know, we've been extremely focused on over the last five years since I joined the company. We've made substantial investments into the R&D. And when you look at our R&D spend for Q1, it's approximately a 7% to 8% improved spend compared to the average quarterly spend from 2021. So, we've actually spent more on R&D, let's say 7% to 8% more than the quarterly average for 2021. That's first point.

Transcript Provided by
ISSUERDIRECT®

Second is, R&D tends to be, in our case, lumpy, because there are times when we have certain projects that we're investing more on in terms of prototype builds or things like that. So, there will be some variation, but I can tell you that our focus continues to be on R&D and targeting that R&D on the right type of projects. We would expect our R&D spend for 2022 to be higher than 2021 and then we would expect our R&D to continue to increase. I mean, we've mentioned in the past that we've gone from about a 1.8% R&D spend to a roughly approximately a 3% R&D spend. And then I would expect that to continue and probably reach maybe a 4% in the next few years. So, I think we're making the right investments for R&D. And I'm really excited about the pipeline. And we talked that our that our pipeline and our backlog is stronger than it's ever been. It increased in Q1 compared to what it was at year-end. And so we're excited about kind of where we're headed.

Q: Okay. Thanks for that. My next question, I just would like to maybe hone in on the HCS business for a moment. And in particular, I think one of the most attractive markets that their product lines that that brings to you is the ADM, the thin films advanced deposition materials. And with the electronic materials companies, I follow, I mean they discuss kind of the value proposition not just in terms of the physical material itself, but a global footprint, technical service, et cetera a full and collaborative R&D by the way.

So, from – Jugal, you've talked about the transformation journey your company is on. But I'm just wondering regarding kind of exploiting or building out the – making the – the optimizing the very significant investment you made in HCS, I mean what incremental capabilities do you think you might need to bring in-house or develop organically or inorganically to really optimize what HCS brings to you in terms of the ability to participate in some of the most strategic elements in chip making.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yeah. Well, that's a great question and one that, I think, we've been looking at actually as we have transitioned from an Advanced Materials business unit to this Electronic Materials business unit, and acquiring HCS was a great step for us, giving us the capability in a new material, tantalum, which is something that is needed in chip making process. There's really a limited number of players in this market. I think getting that facility here in North America is actually really a plus when we think about some of the onshoring discussions that are going on and the investments that are taking place here in North America. So, I think it's been a really, really good add. And to your point about the deposition technology, I think we really are creating a much broader portfolio of that deposition technology with this acquisition.

And then, of course, along with that, as you know, we've been investing a lot on ALD as well, which has been – which is just another add to our overall deposition offering. When we look at – going forward, I mean, there's a number of things I think that we need to continue to do. One of them, I mentioned earlier, we're making significant investments in this business to be able to have more capability, more capacity. A significant amount of our CapEx spend when you look at our slide 17 is related to ATS. And so, there's definitely a capability that we need to be able to put in place. We're also looking at how we can make sure that we can have the right type of capability that can support not only the growth that's going on here in North America and sort of

the onshoring activity that's going on in North America, but how can we put capability and capacity in place, particularly in Asia. And when you look at the semiconductor value chain, as you know, that's a big part of the market, and we want to make sure we can be local to those companies. And so we are looking at how we can take a more – greater role in the Asia market and be local to our customers.

So, a lot going on in this business. It's quite exciting to see kind of all the transformation our teams have been making on it, and we'll certainly be talking more about it as we make some of those commitments and investments.

Q: That's great. Thank you very much.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Thanks, David.

Operator

Thank you. [Operator Instructions] And the next question is coming from Justin Bergner from Gabelli Funds. Justin, your line is live.

Q: Good morning, Jugal. Good morning, Shelly.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Good morning, Justin.

Q: A lot has been covered. But just a couple of additional questions. Within your end market exposure, are there any end markets you would highlight as being a bit weaker or weakening as the quarter progressed, just given some of the challenges that the external world has offered over the last couple months?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yes, I would say really the only market I probably would comment on, Justin, is maybe the automotive build and automotive sales tentative to take a little bit of a cautious approach here in the March timeframe. I think the sales rate in January, February was relatively good and then in March, it took a little bit of a question mark. Part of that had to do with the COVID situation in China, part of that had to do with the European conflict that's underway. But we really see that as a bit of a more of a temporary situation. I mean, I think Automotive is going to continue to do well. I mean, that's kind of what we're hearing. I mean, as you hear some of the earnings announcements from the various automotive OEMs, I believe for the rest of the year, they feel that they're going to continue to do well, particularly on the EV side, they really see that progressing. So, that's the one market that there was maybe perhaps a little bit of a question mark here in Q1, but I don't really see that as a question mark for the full year.

And then from our side, with the content increases, I think that we're making, whether it's the content increases on airplanes, I mean our content is up significantly, when you look at the single aisle type of planes, and that's where the build is going on. When you look at the oil and gas, the rigs, I mean, our content is up significantly as they look at a much more automated directional drilling, for example, if you look at the content increase we are making on semiconductor, industrial, I think our objective is to continue to grow well above market. And right now, I would say that we see all the markets moving in the right direction.

Q: Got it. Thank you. And then, on that note, your slide highlights some of the headwinds, mainly below the operating line to the revised earnings outlook. Within that net plus $0.20 number, is the primary beneficial driver increase volume or better margins or a bit of both?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

I think it's all of the above. Look, I mean, we want to make sure we're really a company that's driving improvement across the board, right. So, whether it's a dynamic pricing model that's taking into account what's happening in the world, whether it's the HCS acquisition which performed really well in Q1 and is expected to perform well as we go rest of the year, the clad - making sure that we hit the right things on the clad strip project, the general.

Q: Got it. And then, lastly, this Phase 2 or the expansion of the clad strip investment, so, just to compare this to the first phase or the initial phase, this is $60 million to $65 million, and it gives you two-thirds additional capacity, and how does that compare to the total cost for the initial phase, as it stands now?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.

Yes, I mean the initial phase was approximately, and I think we said like $100 million, it was roughly about 70-ish million from the customer. And I mean, I'm rounding here, okay. And it's kind of like a similar situation here for this second phase as well.

Q: Okay, thank you, and best of luck.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation

Thanks, Justin.

Operator

Thank you. There were no other questions in queue at this time, I would like to hand the floor back to John Zaranec for any closing remarks.

John Zaranec - Vice President, Corporate Controller and Investor Relations, Materion Corporation

Transcript Provided by
ISSUERDIRECT®

Thank you. This concludes our first quarter of 2022 earnings call. A recorded playback of this call will be available on the company's website, materion.com. We'd like to thank you all for participating on the call this morning and your interest in Materion. I will be available to answer any follow-up questions. And my direct number is 216-383-4010. Thank you again.

Operator

Thank you, ladies and gentlemen, this does conclude today's conference. You may disconnect your lines at this time and have a wonderful day. Thank you for your participation.