Transcript of
Materion Corp.
Materion Second Quarter 2022 Earnings Conference Call
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Participants

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Presentation

Operator

Good day, ladies, and gentlemen, and welcome to the Materion Second Quarter 2022 Earnings Conference Call. At this time all participants have been placed on a listen-only mode. And 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, Chief Accounting Officer. Sir, the floor is yours.

John Zaranec - Chief Accounting Officer, Materion Corp.

Good morning and thank you for joining us on our second quarter 2022 earnings conference call. This is John Zaranec, Chief Accounting Officer. 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 in addition to discussing our expectations for the remainder of 2022. We will then open 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 4 through 7 in this morning's press release. The adjustments are made in the prior year period for comparative purposes and remove special items, noncash 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 be with you this morning to share details on another quarter of record performance for Materion and to cover some significant investments we've made on our strategic initiatives.

We are well on track to deliver another record year, as we continue to reset the bar each quarter. In Q2, we achieved our highest ever top- and bottom-line results with value-added sales up 33% and EBITDA up 44% when compared to an already strong Q2 in the prior year. Our teams are really delivering on all fronts, resulting in strong organic growth that is well above end market demand. Fantastic contributions from our HCS-Electronic Materials acquisition and higher profitability with meaningful margin expansion. As we sit today, we are getting close to our midterm target of 20% EBITDA margins.

Our team's efforts are even more impressive when we consider some of the challenges faced, including the impact of the Shanghai lockdown, inflation, currency headwinds and higher interest rates. Despite these, we delivered record earnings per share of $1.28 and set the stage for even stronger performance in the back half of the year.

In addition to our outstanding performance in the quarter, I'm excited to highlight two new organic advancements that will accelerate our growth in strategic markets. First, we have jointly commissioned a molten salt purification plant with our long-term partner Kairos at our Elmore, Ohio location. The facility is now entering the start-up phase for the commercial production of Flibe, a molten salt coolant used in nuclear energy production. Materion is the only domestic supplier of the beryllium fluoride component for Flibe a key component of this energy solution that will help enable the world's transition to clean energy.

Second, as we announced earlier this week, Materion has established a new advanced chemicals facility in Milwaukee to develop and manufacture products for the most advanced semiconductor chips and electric vehicle battery solutions. Within this facility, a leading EV battery customer is funding $6 million to establish a prototype line for the production of advanced chemicals for next-generation battery solutions. We are also working with a number of other leading battery customers to help meet their goals of longer battery life, faster charging times and improved

safety. These important relationships are helping to further strengthen our position as a critical supplier to the automotive industry.

These recent announcements are just examples of the many advancements we have made that drive significant above-market organic growth and feed the pipeline for the future. Our investments in R&D, commercial excellence and deep customer partnerships continue to expand our portfolio and help to deliver consistent double-digit organic growth. We have nearly doubled our R&D spend since I joined the company in 2017. And this has allowed us to ensure we are serving not only our customers' current needs, but staying ahead of the curve, offering next-generation solutions for the evolving complexities of the markets we serve. As a result of our investments, we've seen 13% organic growth year to date. And we're up 20% on an annualized basis from our pre-pandemic levels in 2019. With the exception of the four quarters around the 2020 downturn, we have shown year-on-year organic growth in every quarter since we started on our transformation journey in 2017.

To continue to provide more visibility into the way we are serving important end markets aligned with fast-growing megatrends, I want to spend some time diving a bit deeper into a market that holds significant potential for continued organic outgrowth, the automotive market. There are significant megatrends in play that align ideally with our company's strengths and capabilities.

For years, Materion has been a leading provider of important materials for automotive applications, including connectors, switches and relays, all of which are used in both internal combustion engine vehicles and electric vehicles. As the industry shifts toward more electric, we see an even greater need for our materials with products like cell-to-cell interconnects and fast DC charger connectors. We are known for our ability to deliver products with superior conductivity and thermal management properties, both of which are crucial to safety and reliability in the electric vehicle.

Building upon our strong product offering, we have taken several steps to build out our portfolio of products that enable the pervasive megatrends of emissions reduction, connectivity and autonomous driving. With the outlook for electric vehicle production expected to more than quadruple by 2030, we have made purposeful investments in R&D focused specifically on the EV space, and we've formed deep relationships with leading automotive companies to accelerate their next-generation solutions. These efforts have resulted in the important partnerships we mentioned with electric vehicle battery companies to support their quest for faster charging times, longer battery life and enhanced safety.

As the industry pushes closer to self-driving cars, our contributions become even more meaningful. And these vehicles will require all the materials previously mentioned, plus an expansion of our sensing technologies. We are a key provider of thin film optical filters for sensing and detecting and high-performance coatings for components within LIDAR systems, head-up displays, digital instruments and night vision. All of these capabilities will be critical to supporting the strategic shift in the industry, and our acquisition of Optics Balzers only strengthened our position in this market.

To address the demand for faster and enhanced connectivity, the semiconductor industry will continue to face significant demand from the automotive industry. Following our recent acquisition of HCS-Electronic Materials and our recently announced expansion into atomic layer deposition products in Milwaukee, we have strengthened our position as a leading supplier to the global semiconductor industry and are well-positioned to benefit from this shift. The average electric vehicle will require twice the number of semiconductor chips versus a traditional vehicle, with autonomous vehicles requiring 8x to 10x the number of chips to power its many functions.

Our strategic efforts to serve this market are already delivering as we have grown our sales for the auto market by 50% since 2019, while the number of vehicle units produced globally has decreased by 12%, all of this resulting in a 77% increase in content per vehicle. I'm confident this growth will only accelerate as the industry evolves and our people and our products become even more critical to enabling the automotive industry of the future.

As I reflect on the many organic opportunities in our pipeline, the execution of our organic strategy and our expanding record backlog, we remain on track to exceed $1 billion in VA sales in 2022 for the first time in our company's history as we grow our business and continue to outpace our end markets.

With that in mind, we are affirming our earnings guidance for the full year. I remain highly confident that we will drive record value-added sales and earnings as we take another step forward on our transformation journey.

As I close, let me stress how proud I am of what our team has accomplished throughout this first half of 2022, delivering record performance, flawlessly integrating the acquisition of HCS-Electronic Materials, progressing on our strategic organic initiatives and setting the stage for another record year in 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 13.

As Jugal outlined, we achieved record quarterly value-added sales, adjusted EBITDA and earnings per share again in the second quarter. Value-added sales, which excludes the impact of pass-through precious metal costs, were $277.2 million for the quarter, up 33% from the prior year. Organically, VA sales increased 12%, driven by a strong demand across most of our end markets, including semiconductor, industrial, aerospace and energy. Q2 marked our second full quarter of HCS-Electronic Materials contributions, which again exceeded our expectations. We delivered adjusted earnings per share of $1.28, up 41% as compared to the prior year.

Looking at Slide 14, adjusted EBITDA in the quarter was $47 million, up 44% from last year. Our adjusted EBITDA margin of nearly 17% represents a 120-basis point improvement from the same period a year ago. The increase in EBITDA was largely driven by strong volume, positive

price mix, as well as the contribution from our HCS-Electronic Materials acquisition. These drivers were partially offset by investments in R&D, commercial investments to support the growing business and increased travel as we get back to normal levels of activity. Our precision clad strip facility start-up costs were a headwind as expected, but slightly higher than the first quarter as we get closer to full ramp. We were also negatively impacted by the Shanghai lockdown, which began at the end of the first quarter and persisted into the beginning of the second quarter, primarily impacting our Precision Optics business.

Now let me review second quarter performance by business segment, starting with our Performance Materials business on Slide 15. Value-added sales were a record $134 million, an increase of 23% compared to the prior year. The increase is driven by strong performance in the industrial, energy, consumer electronics and aerospace end markets, in addition to the impact of the HCS acquisition. EBITDA, excluding special items, was $27.2 million or 20.3% of value-added sales compared to $22.3 million in the second quarter of 2021. The increase in EBITDA was primarily due to favorable volume and price, partially offset by the new facility start-up costs previously mentioned.

The full-year outlook remains strong with an expanding backlog and our precision clad strip project is on track to contribute meaningfully in the second half of the year. As previously shared, we expect the start-up costs to fall off throughout the remainder of the year as the plant ramps in volume and efficiencies.

Next, turning to electronic materials on Slide 16. Second quarter value-added sales were $114.2 million, up 71% versus the prior year and up 17% organically. VA sales were again a record for any quarter, even before the impact of HCS-Electronic Materials. The increase was driven primarily by our accelerating growth initiatives that Jugal talked about, paired with strong end market demand in semiconductor, energy and industrial.

EBITDA, excluding special items, was $22.8 million or 20% of value-added sales in the quarter, compared to $10.4 million in the second quarter last year, an increase of 119% and a 450-basis point improvement. The increase was driven largely by increased volume and price, which more than offset inflationary headwinds. HCS also contributed to margin expansion with a strong quarter of results. As we look forward to 2022, we expect the electronic materials business to deliver a full year of strong outgrowth, particularly within the semiconductor space. And a full year of HCS will deliver a meaningful step-up in both value-added sales and earnings.

Finally, turning to Precision Optics on Slide 17. Value-added sales were $29.4 million, down 10% compared to the prior year due to lower PCR demand and the discontinued consumer electronics applications as expected. As we noted in Q1, those first half headwinds are starting to subside. In Q2, sales were up 3% sequentially and up 10% when adjusted for currency and the impact of the Shanghai shutdown. EBITDA, excluding special items, was $3.6 million or 12.2% of value-added sales, down from the prior year as a result of the sales volume impacts. Sequentially, EBITDA increased 50% with a 390-basis point margin improvement. As we noted earlier in the year, we expect continued improvement into the back half of 2022, supported by the increasing backlog and new business pipeline expected to materialize in the third and fourth quarters.

Moving now to cash, debt and liquidity on Slide 18. We ended the quarter with a net debt position of approximately $465 million and $124 million of available capacity on the company's credit facility. Our pro forma leverage at 2.6x remains within our targeted range, improving from the first quarter. With strong free cash flow and higher EBITDA expected for the remainder of 2022, we expect this leverage ratio to be nearing 2x by year end.

Transitioning now to Slide 19, let me cover our outlook. With the excellent start in the first half of the year, combined with our record backlog, progress on our organic initiatives and the performance of HCS-Electronic Materials business, we are affirming our full-year outlook even when considering current economic headwinds. We have also updated some of our other assumptions for you.

In closing, Q2 capped a fantastic first half of the year. We are extremely proud of our global team's contributions and look forward to delivering an even stronger second half of 2022.

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

Operator

Ladies and gentlemen, the floor is now open for questions. [Operator instructions].

Your first question for today is coming from Daniel Moore. Please announce your affiliation then pose your question.

Q: Thank you. Good morning, Jugal. Good morning, Shelly. It's Dan Moore from CJS Securities.

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

Good morning, Dan.

Q: Good morning, and congrats on the solid results. Start with some of the new initiatives, new facilities, maybe the new facility in Milwaukee. What is the total CapEx you expect? And can you elaborate at all on the prototype and anything specific about the functionality being targeted within EV batteries and maybe the TAM or any color on the size of the opportunity from a revenue perspective?

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

Yes. Dan, we're really excited about this facility. This is a build on to what we do today in our existing facility. We have a facility in Milwaukee, and this is a great add-on to that. Both the items that we talked about, the battery work as well on the ALD work is something that we actually do in our current facilities today. And what we've been able to do is work with our customers on both sides and continue to grow through our organic growth initiatives. So let me

take the first, the ALD product portfolio. We've actually been working on ALD for a number of years now and we have a number of customers that we work with.

This is a great, great, exciting technology that is used in the most sophisticated semiconductor chips that are being produced. And the outlook is very strong for this technology. So, as we work with our customers, we see a greater pipeline and then, therefore, we need more capacity. And we're working with our customers to install that capacity so that we can certainly grow that business.

On the battery side, we have actually been working again with a number of customers over the last few years. There are always next-generation batteries that are being required. Those next-generation batteries, whether it's longer life or faster charging, just range issues, packaging, et cetera. All those are very, very important criteria for battery manufacturers, and we have been working with them on providing samples and prototypes for advanced chemicals.

Now we have an opportunity to actually expand that and put a prototype line in place. The really interesting thing, a great thing about this is that our customer that we are working with will actually contribute $6 million, approximately $6 million to put the prototype line in place. We'll contribute a little bit of money as well. Obviously, we're contributing the facility and the know-how and the people, certainly that so that we can produce those prototype samples and continue to help develop with this customer. And then we're working with a number of other battery manufacturers as well.

This is a 150,000 square foot facility. So, it has really good floor space for us to be able to expand in not only the ALD and the battery, but we do advanced chemicals for a number of different other applications as well. So, we can certainly expand there also. So, we're very, very excited about this because this is right down the alley of the megatrends that we have been talking about over the last several quarters, and it supports our strong push into the organic growth that we've been talking about.

Q: Very helpful, and maybe just to step back and talk more generally about the Chips Act and what that could do for semiconductor capacity in North America, and how you see it impacting your potential growth trajectory over the next few years?

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

Yes. Well, as you know, semiconductor is a market that we have put a lot of focus on over the last few years. I mean if I just go back to our journey, I mean, we were really very focused on more of the precious metals and, I would say, primarily the gold precious metals targets business. Several years back, we invested a lot of money on the R&D side to build out a stronger portfolio on the non-precious metals.

And that business has been growing substantially in particular, the aluminum scandium that we've talked about a number of times in our calls. We made a major acquisition, as you know, at the end of last year, giving us capability on tantalum and niobium type of products. Tantalum, in

particular, is a very growth activity for us. And then, of course, this ALD that we just spoke about.

So, we have been developing a very robust, comprehensive portfolio for deposition materials that can be used in this growth to support the North America market and of course, with the Chips Act as it's going forward. We've heard a lot of investment announcements from a number of different fab companies. And then we certainly want to be able to continue to support Europe and Asia as well. So, we're really well-positioned with the facilities that we have.

And then this new facility, is going to give us even more opportunity to support this fantastic opportunity. So, we've got a great group of customers, that we work with, and we're excited about it.

Q: Perfect. Thank you. Lastly, just quickly, Shelly, I wonder if you have any color on cadence as we think about Q3, Q4 for the balance of the year relative to the guidance? Thanks again for the color.

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

Yes. Sure. Great question. So, as we think about the rest of the year, we're excited that we'll be able to take a meaningful step-up both in sales and earnings. You'll see us take kind of measured steps up in Q3 and Q4 that will look about the same. So, you'll keep seeing sequential improvement in both Q3 and Q4 as the organic initiatives continue to play out and especially the clad strip project continues to come online.

Q: Perfect. Thank you again.

Operator

Your next question is coming from Phil Gibbs. Please announce your affiliation, then pose your question.

Q: KeyBanc Capital Markets, Phil Gibbs.

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

Good morning, Phil.

Q: The question is on clad, and you had the almost $5 million in start-up costs this quarter, clearly a drag on margins and clearly expected. But in terms of that cadence and progress, do those start-up costs go away completely in the third quarter? I mean when do we get to the point where it's generating positive operating income?

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

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Yes. Phil. Shelly, I'm sure will comment on the financials. Let me just give you a little bit of perspective on our status of the project. So, as we've indicated, second quarter was really focused on getting approvals with our customers, and it has been a very, very good quarter for that. We have been working with the customer diligently, and we have been able to get approvals with them. And so, the project is progressing as we had planned. Q3 is really now the ramp. So, we're starting to build production level units.

And then that ramp and as you know, with any new plant, will continue every week. Each week, our expectation is to produce more than the prior week and support the customers. So that's progressing and then it will continue into Q4. Our expectation, of course, for Q4 will be certainly a lot better and a lot more sales than we have in Q3. So, the project is progressing as we have talked and kind of as we have planned.

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

Yes, and maybe just to talk about the cost a little bit. If you think about the start-up costs, there are kind of two components. The main one is normal operating costs that will be ongoing. So those will get absorbed by additional volumes and create better profitability. The other piece is material that may be out of spec or something that we're running trial runs and you need to write that off. So, I would see the kind of scrap material costs coming down, but that is the smaller portion of the start-up costs, and the operating costs will continue. With this kind of a project, it's about yields and efficiencies.

So as yields improve, and we become more efficient, the profitability will improve. So, I think we'll see that continue to move forward through the third quarter and be even better in the fourth.

Q: Is there any way to think about utilization on the asset or target utilizations there is the third quarter, somewhere around a 50% utilization. And then we think we're getting 80% by the fourth quarter? Or can you just frame it up in that way?

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

Yes, well you certainly can look at it that way. Keep in mind, in Q3, as I said, our goal is to be able to produce more each week and get more out to the customer, a good product out of the customer. And so, as you kind of take that and you kind of take the average of that, I can see it's 50% of the right number, but probably maybe a little bit less than that.

So, a third to 50% could be a range. Because of the fact that you're averaging out in Q3 with all the initial ramp to a little bit better ramp towards the end of Q3 and then probably about three quarters away, I would say, in Q4.

Q: Okay, that's helpful. And then as you announced these projects in Milwaukee and then with Kairos here and your Elmore, what could those two projects collectively mean either to sales or revenue or profitability? I mean they seemed like decent size proclamations, particularly as it relates to Milwaukee because you're putting in capital for a very, very large facility. So, I don't

want to gloss over it. They seem like things that could be needle movers, maybe not next year, but '24, '25.

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

Yes. Clearly, like you said, I think next year is really getting the equipment installed, the facility is up and running, and we really would start to see some impact towards the end of next year, let's say, beginning of '24, certainly is going to be impactful for the company.

I would say that the way that we have planned the plant because we've done a 150,000 square foot, we purposely made sure that we've got enough capacity to be able to leverage the organic growth on these two things that we've announced, which is the battery project as well as the ALD project, along with other customers that we can get there and as well as other advanced chemicals products.

I think both of these can be, to your point, meaningful impacts, plus in the '24, '25, '26 timeframe, particularly, I would say, the longer cycle is certainly the battery side because of that next-generation work that needs some development work since this is more in the prototype phase where the ALD is much more of a production phase. But I could see a combined scenario where it's easily in the '24, '25 timeframe, double-digit type of figures from there.

But as far as the Flouride salt coolant facility, the MSPP, that we talked about in our Elmore, Ohio facility, that one is, I would say, in a little bit longer term in terms of development, but it's a very important step in this prototype phase.

Probably you're looking at $1 million to $2 million worth of prototype type sales, perhaps later this year into next year and then maybe reaching mid-single digits the following year, et cetera. So that type of a small ramp to support the prototype development activity for that facility.

Q: Okay. And then last one, just a clarification. I think you said almost an 80% increase in content per vehicle, and it may only accelerate from here. So, is that 77% increase? Is that relative to 2017? Is that relative to when you came into the company? I'm just trying to figure out what the baseline is for the comments.

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

Yes, that's relative to 2019. So roughly in 2019, one of our slides that what we've shared, Phil, is that we had sales in the automotive sector of about $60 million, and there were about 90 million vehicles produced in that year. Last year, our sales were roughly $90 million, and then the number of units was down to about 76 million.

And so, the content per vehicle over that time frame has increased by approximately 80%, as you said. So, goal is to continue to drive this, continue to drive not only the overall automotive sector, but really play a lot on the EV side, the emission reduction, the connectivity, the autonomous vehicles. So those megatrends, we're really making sure that our portfolio is much more aligned to those and then we can continue to drive growth in that area.

Q: Thanks. And then just last question for Shelly. Net working capital, I mean, clearly, for you all and for most everyone I've seen in the industrial universe. There's been a pretty big build in inventory associated with some pickup in demand, but also a lot of inflation and raw materials and things of that nature. So maybe talk about net working capital progression in the second half. Thanks.

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

Yes. Sure. Good question. And with increased organic demand, of course, we get increased working capital. So, it's a good problem to have, but certainly something we spend time talking about. It is driven by a few things.

You mentioned inflation. So, we do have some higher-priced materials, especially around the metal space. Also, as you can imagine, we've had to add materials and inventory for the clad strip project. So that's a little bit of a step forward as well as we've added a little bit of inventory in HCS to plan for some growth there. But as we look at the second half, we have very targeted initiatives, really, I would say, on the base, both in inventory and AR and AP to make sure that working capital is positive in the second half. So, we are looking for positive contribution overall from working capital in the second half.

Q: Thank you.

Operator

Your next question for today is coming from David Silver. Please announce your affiliation, then pose your question.

Q: Yes, hi, good morning. CL King.

I have a number of questions. I think maybe I'll start with the financial guidance one first. But thank you for clarifying kind of the reiterating your full-year guidance. And I was wondering if you could indulge me a little bit, but I believe you said the initial range, $550 million to $590 million in late April, right, with your first quarter results. And I'm not a global economist, but I'll take it here. But since then, I mean, I would say that the macro environment has kind of changed meaningfully.

I think the potential for currency headwinds has increased, interest rate levels have risen and there's more uncertainty regarding the global economic outlook, maybe more people anticipating a general slowdown. So, when I think about you reiterating your full-year guidance, I mean I'm kind of scratching my head and I'm saying, is it a fact that the outlook for your base assumptions back in April haven't changed? Or is it the case where your assumptions internally have improved while the macro environment and the risk system higher interest expense or negative currency translation have been offset. So just maybe a thought on maintaining or reiterating the guidance over a period where the macro-outlook has changed?

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

Yes. So, David, all the points that you've made are really great points. Clearly, there's been a lot of change the topic, whether it be inflation, interest rates, just the macro environment, the global situation, the geopolitical situations. I think all of those are definitely a factor, right? And we're experiencing all of those.

But at the same time, there's really, really great work that's going on in our company that we are very proud of. When you look at our order rates that we continue to receive from our customers, they continue to be positive. If you look at our backlog, our backlog has improved again in the second quarter. We noted that our backlog had improved in the first quarter from year-end by roughly $30 million / $35 million.

We have another step-up of $30 million / $35 million of backlog improvement in Q2. If you look at our backlog over the last six quarters, we roughly doubled our backlog over the last six quarters. So, if you go back to probably end of '20, beginning of '21. So just from those factors, give us confidence.

Our organic growth pipeline continues to be very strong. The work that's going on with our customers. Our Ops excellence activities, as you know, we went through significant new hires over the last four to five quarters.

Most companies have gone through that. Our team has been doing a great job of getting those new hires in place and then getting them trained so that we can actually deliver better Operations excellence as we go forward. The full price impact, frankly, we've been very focused on making sure that we're positive on a price/cost equation. And sometimes those pricing impacts don't come into the same quarter as the cost, but our team has done a nice job of making sure those prices are being put in place. And then so we're having the full effect of that.

Our performance on the HCS acquisition continues to be really well. We're very impressed with what the team has been able to do there. Not only do we get a great business, but we've got a great set of people that are focused on accelerating the growth curve for that business.

So, all the headwinds that you outlined, believe me, we are facing all of those headwinds. Shelly talked about that in her prepared remarks. But at the same time, we've got several things that our teams are involved in that we feel good about. And that's why we've been able to hold our guidance for the balance of the year and really for the full year.

Q: Okay, no, great. Second question would be about the Milwaukee expansion. I read the press release a couple of days ago with great interest. And I was wondering if you could maybe just talk about the genesis, I guess, of the decision. I assume it's been some time in coming, but I was thinking in particular about the idea that you already have orders in hand, I forget the precise wording. But did the ALD opportunity and the decision to expand in Milwaukee.

I mean is that a function of, I guess, your base business. Is that a function of HCS and maybe some cross-selling or some synergies there? Or -- and then secondly, in terms of -- my sense is if

you are expanding into kind of a leading-edge area such as ALD, there's going to have to be a certain amount of support, R&D, technical type of support that goes along with the physical equipment and whatnot.

So just a little bit of a background on how the ALD opportunity materialized would be helpful. And then apart from the physical assets, what else do you need to put in place in Milwaukee or elsewhere to kind of ensure the success of that important initiative. Thank you.

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

Yes. As I indicated earlier, we're really excited about this expansion and the investment that we're making, and our customer is making. This is in a growth area, a very high-growth area, semiconductors and EV battery space. This is not related to our business that we acquired, the tantalum and niobium business, the HCS-Electronic Materials business.

This is really based on, the work that our teams have been doing for a number of years. As I indicated earlier, we have been focused on developing a portfolio for ALD. We feel ALD deposition technology is something that's going to continue to increase. And in fact, I would say, increase at a much faster rate than maybe the typical semi space.

As it provides really great coverage for these lower node type of products. And so, we have invested in it, and we're going to continue to invest in it. To your point about having investment beyond the physical, we've been doing that. As I indicated, I mean, our R&D, and I'm speaking about R&D in total for the company, we've doubled almost the R&D spend for the company over the last few years.

And part of that is exactly on the ALD space. A part of that is on the battery space as we have been working with a number of different customers on the battery side. So, it's a combination of things, and we look forward to putting capacity in that facility in both areas and growing that business.

Q: Okay and just a follow-up. So, the ALD opportunities, maybe more an extension of your sputtering type of technology as opposed to maybe something related to the barrier layer operations of HCS.

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

Yes.

Q: Okay, thank you for that. I was just wondering if we could provide a little more clarity or qualitatively, just some extra color on the battery opportunity that you discussed. So, you did say it's advanced chemicals for next-generation batteries. And I'm just, I admit upfront, I'm not super familiar with your range of chemical activities currently. But is this related to the electrolyte function within the battery? Or is this maybe more of a material type of activity that you're being asked to develop and supply.

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

Yes, so as I indicated, we have been working on this for a number of years, with a number of different customers. We now are at a stage where one of the customers is going to be making the investment approximately $6 million of investment to prototype line in place. We aren't able to talk specifically about the material.

So, to your point about the electrolyte or other parts of the battery. That's something that we'll continue to have the battery manufacturers talk about that. I mean this is a very competitive space, as you know. Various companies are always trying to figure out how to get that next-generation battery with that longer range and faster charging and smaller packaging et cetera.

Our goal is to make sure that we take all of our advanced chemical's expertise and share it with them and then be able to help support their cost, their overall cost for these next-generation batteries. So, it's quite exciting because it's certainly in a high-growth segment and one where we have a number of different customers that we're involved in discussions with. So, the potential that's there over the years down the road as we kind of get through these various prototype phases and discussions with the customers on this could be substantial. But we have to see as we go through the initial phases.

Q: Alright. And then last one for me would be just on customer reaction to the consolidation steps that you've taken, adding HCS and what not. But it's been a theory of mine or a belief of mine that on the electronic materials side, the customers actually want the industry to consolidate pretty much everywhere so that they're dealing with fewer, stronger, more committed counterparts that will likely translate into faster development cycles and just greater success overall. I was wondering if you could, I know it's early, but I'm wondering if you could just share the customer reactions to date from the combination of HCS with your legacy electronic materials activities.

And whether you can cite or you're confident that the revenue synergy potential that maybe you envisioned initially. Maybe you could just comment on whether that continues to progress?

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

Yes, well, David, as you know, when we announced the acquisition, one of the main things that we talked about was exposure to the customers because between our legacy business and then now this new business, we have exposure to the top 15 semiconductor manufacturers in the world. So, it's been a fantastic addition. And I would say the discussions with our customers have been very, very positive.

Our goal has been to make sure that we're out there. We're talking about our entire portfolio. I mean just getting back to what I just talked about, ALD, premium targets, non-premium or non-precious metal targets, the tantalum and niobium business, et cetera. So, we've got a really, really comprehensive portfolio and our customers, value that.

We received calls from our customers all the time, wanting to now talk about that full comprehensive portfolio. And frankly, we're out visiting the customers as well and talking about it. So, I would say the reaction has been extremely positive. And part of that, I'm sure, is maybe what you're talking about, which is maybe those chip manufacturers looking for consolidation.

But I would like to just look at it as we're providing a much broader value equation to the chip manufacturers, and they very much appreciate that.

Q: Okay, great. Thank you very much.

Operator

Your next question is coming from Marco Rodriguez. Please announce your affiliation, then pose your question.

Q: Good morning. This is Marco Rodriguez with Stonegate Capital Markets. Thank you, guys, for taking my questions.

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

Hi, Marco

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

Hi, Marco.

Q: Most of my questions have been asked and answered. So, I just have kind of a couple of follow-ups if you will. Maybe if I can ask one question in a slightly different way when it comes to guidance and the conversations you're having with your customers.

Obviously, a lot has changed on the macroeconomic landscape, inflation is still an issue which you guys have called out. And there's more risk of recessionary environments for a lot of different places, but it definitely sounds as if perhaps your demand is increasing because maybe you're taking market share, or your new products are really just accelerating at a much faster pace. But can you kind of balance those conversations or those comments with any sort of discussions you've had with your customers where maybe you're noticing a shift in their sentiment to become perhaps maybe a little bit more defensive just kind of given that macroeconomic backdrop.

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

Yes. Marco, the important thing for us is the organic growth initiatives that we have. So that if there are any type of defensive conversations, then they're really being offset by the number of initiatives that we have going on. If you just look at kind of the couple of the markets and the normal market demand, aerospace continues to progress, they continue to be more builds every quarter.

I mean we've had a fifth consecutive quarter of growth on the aerospace side. Oil and gas is another one that has announced a sixth consecutive quarter of growth for us. So, there's a couple of markets that we have content increase going on. We have more types of products actually being used in both aerospace and oil and gas, along with the fact that the market continues to move forward.

Perhaps if there's some discussion, I mean, I would say maybe in the industrial side or perhaps on the automotive side, automotive only because of maybe chip demand. If there continues to be some pressure from the chip side for automotive. But when we listen to some of the automotive commentary, the customers are tending to be more positive for the second half. And so, right now I would say the general discussion continues to be positive. But more importantly, our organic growth initiatives are being very supportive for us.

Q: Got it. And then last quick question for me. Just on the cash flow question prior. Just trying to get a sense, as you do see improvement in the second half in your cash flow from operations, is there an expectation that you're going to be generating free cash flow in the year?

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

Yes, I'd expect we're putting a lot of cash to work in CapEx. So, if we were out doing M&A with that money, the free cash flow would be much more positive. It's probably going to be a little bit of a push after we put the investments in CapEx that we're planning, but those organic projects are going to provide great returns. So, we're looking at this year as a year of investment and are comfortable with where we're going to land.

Q: Got it. Thank you, guys, very much for your time. Appreciate it.

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

Sure.

Operator

There are no further questions in queue. I would like to turn the floor back over to John Zaranec for any closing remarks.

John Zaranec - Chief Accounting Officer, Materion Corp.

Thank you. This concludes our second quarter 2022 earnings call. A recorded playback of this call will be available on the company's website, materion.com. And I'd like to thank 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. Thanks again.

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Operator

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