Transcript of
Materion Corp.
Materion First Quarter 2023 Earnings Conference Call
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Participants

John Zaranec - Chief Accounting Officer, Head of Investor Relations, Materion Corp.
Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.
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Analysts

Philip Gibbs - KeyBanc Capital Markets
Daniel Moore - CJS Securities
David Silver - CL King & Associates
David Storms - Stonegate Capital Markets

Presentation

Operator

Greetings. Welcome to the Materion First Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions]. Please note this conference is being recorded.

I will now turn the conference over to your host, John Zaranec, Chief Accounting Officer. You may begin.

John Zaranec - Chief Accounting Officer, Head of Investor Relations, Materion Corp.

Good morning, and thank you for joining us on our first quarter 2023 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 through 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 as well as 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 2023. We will then open up the call for questions.

Let me remind investors that any forward-looking statements made in the 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, 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. It's great to be with you today to share details on our strong first quarter performance. Coming off an outstanding 2022, I'm pleased to report that we have continued that momentum into this year, delivering a record first quarter for value-added sales, EBITDA and EPS. We continue to see the power of our transformation into a global leader in high-performance advanced materials as strong execution on our strategic initiatives is enabling us to consistently outgrow our end markets.

We continue to build out our healthy pipeline of growth projects as our customers partner with us to develop next generation solutions aligned with global megatrends. These strategic partnerships continue to position us for future growth and enable us to deliver today even in the face of softness in some markets. In the first quarter, we once again saw double-digit organic sales earnings growth with meaningful margin expansion.

Through a combination of strong volume, operational execution and diligent cost control, we achieved value-added sales growth of 15%, EBITDA growth of 20%, and EPS growth of 12%. These results reflect the 10th straight quarter of year-over-year improvement across all three metrics, more than doubling our quarterly sales, EBITDA and EPS over that time period. Led by our new Precision Clad Strip project, our many outgrowth initiatives contributed to our record performance.

We also continue to benefit from our diversified market strategy with strong end market demand across aerospace, automotive, and energy. Our advanced capabilities have enabled us to increase our content across multiple applications in these markets where we have driven a more than 70% content increase for auto, more than 25% for aerospace, and more than 20% for oil and gas, since 2019. These advances helped us deliver continued organic growth that outpaced the expected slowing of semiconductor and consumer electronics.

In total, our outgrowth initiatives drove top and bottom-line growth with strong margin expansion, reaching nearly 18% EBITDA in the quarter, tracking well towards our midterm target of 20%. Our new Precision Clad Strip facility is contributing meaningfully. The construction of our expansion of this facility is progressing as planned, and we are on track to begin production late next year.

The build out of our new facility in Milwaukee is also on track and production capabilities are scheduled to come online in the first half of next year. This site will expand our capacity to support production of the most sophisticated semiconductor chips as well as broaden our advanced chemicals capabilities to produce materials for next generation batteries for electric vehicles.

On our last call, we noted that we had been awarded a $10 million order to supply critical materials for space propulsion systems. I am pleased to report that the customer has awarded us a second order worth $12 million for a total of $22 million to date. We recently began shipping product and expect to fulfill in the first quarter of this year.

Our products, which are designed to withstand the harsh and demanding conditions of space travel are crucial for carrying out critical missions. We continue to work closely with our increasing portfolio of space customers to align our products and meet the evolving requirements of the industry today and well into the future.

The clean energy megatrend continues to create opportunities for us as well, as the properties of many of our products are ideal for leading-edge solutions. To that end, we achieved a major milestone in our partnership with Kairos Power last month as we completed the first delivery of Flibe. Flibe is a reliable, safe and cost-effective molten salt coolant used in nuclear energy production. This customer-funded molten salt purification plant is off to a fantastic start. Our customer-funded growth initiatives and winning opportunities with new and existing customers are perhaps the most compelling examples of how we are building customer confidence through our deep expertise to help them continuously enable what's next.

With the success and progress on our outgrowth initiatives, we remain confident that we're on pace to deliver a strong 2023, even if the environment grows more challenging, particularly in the semiconductor and consumer electronics markets. With that in mind, our global team remains laser focused on driving operational excellence and targeted cost management actions to ensure we continue to deliver consistent results in an uneven environment.

At the same time, we'll continue to advance and invest in our outgrowth initiatives, positioning Materion for long-term growth and success. I'm very proud of our team's performance as we remain on track to deliver record results on both the top and bottom-line for the third consecutive year. Despite increasing headwinds in certain areas with the strength of our portfolio and diversified end market exposure, coupled with our targeted operational excellence initiatives, I am pleased to share that we are raising our full-year guidance for 2023.

Now let me turn the call over to Shelly to cover more details on the financials.

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

Thanks, Jugal, and good morning, everyone. During my comments, I'll reference the slides posted on our website this morning, starting on Slide 9. As Jugal outlined in his opening remarks, we delivered a record first quarter for value-added sales, adjusted EBITDA, EBITDA margin and earnings per share. Value-added sales, which excludes the impact of pass-through precious metal

costs, were $298.6 million for the quarter, up 15% from the prior year. This increase was driven mainly by strong demand across the aerospace, automotive and energy end markets, where we saw significant above-market growth as well as meaningful contribution from Precision Clad Strip. We delivered adjusted earnings of $1.34 per share in the first quarter, up 12% as compared to the prior year despite roughly $0.15 of interest expense headwinds.

Moving to Slide 10, adjusted EBITDA in the quarter was $53.4 million or 17.9% of value-added sales, up 20% from the prior year with margin expansion of 70 basis points. This increase was driven by higher volume and strong operational performance in Performance Materials, offset by unfavorable mix and some cost inefficiencies within electronic materials due to the declining semiconductor demand.

Moving to Slide 11, let me review first quarter performance by business segment. Starting with our Performance Materials business. Value-added sales were a first quarter record of $168 million, up 30% compared to the prior year. Aerospace, automotive and energy demand drove the increase as well as higher Precision Clad Strip volume. EBITDA, excluding special items, was a first quarter record of $42.8 million with an all-time high EBITDA margin of 25.5%, up 56% compared to $27.5 million in the first quarter of 2022, delivering 420 basis points of margin expansion.

The growth was primarily due to increased volume from our outgrowth initiatives and strong operational performance. The first quarter also included an estimated benefit from the Inflation Reduction Act's advanced manufacturing production credit. We studied the potential impact of this credit during the first quarter and determine the benefit should be larger than we anticipated coming into the year.

Moving to the outlook, we expect another year of outgrowth led by aerospace, energy, and automotive as well as growth in Precision Clad Strip. Next, turning to Electronic Materials on Slide 12. Value-added sales were a first quarter record of $103.9 million, up 2% compared to the prior year, mainly due to higher shipments of tantalum-based products. EBITDA, excluding special items, was $14.4 million or 13.9% of value-added sales in the quarter, a decrease of 24% from the prior year. The decrease was driven by a few items, including the expected Tantalum cost headwinds and unfavorable mix impact from softening precious metal sales.

In addition, sales decelerated through the quarter, resulting in some manufacturing cost inefficiencies, which are currently being addressed through targeted cost reduction activities. As we look forward to the remainder of the year, we expect a stronger second half with semiconductor orders increasing in the third and fourth quarter.

Finally, turning to the Precision Optics segment on Slide 13. Value-added sales were $26.7 million, down 7% compared to the prior year. This decrease was driven mainly by the discontinued consumer electronics application and general market softening. EBITDA, excluding special items, was $2.9 million or 10.8% of value-added sales, up 240 basis points from the prior year. This is largely attributed to cost reduction actions and spend control while the top line is being rebuilt. Looking out towards the next few quarters, we expect sequential improvement to the top and bottom line, supported by improved order rates in defense and space, coupled with the continuation of targeted cost reduction activities.

Moving now to cash, debt and liquidity on Slide 14. We ended the quarter with a net debt position of approximately $418 million and $187 million of available capacity on the company's existing credit facility. Our leverage at 2x, sits slightly below the midpoint of our target range and down from year-end, with free cash flow improving by $40 million compared to the first quarter of '22 despite higher CapEx spend.

Lastly, let me transition to Slide 15 to address our full year outlook. The first quarter was a great start to the year. While we see some pockets of market softness going forward, we also see areas of healthy growth and meaningful opportunity from our outgrowth initiatives. With this, we are raising our full-year adjusted EPS to $5.60 to $6 per share, representing a 10% increase from 2022 at the midpoint. Our modeling assumptions have been noted, and you'll see that we continue to expect roughly $95 million in capital expenditures in '23 to fund exciting growth opportunities throughout our company.

In closing, 2023 is shaping up to be another year of meaningful outgrowth and strong execution from Materion, leading to continued record results and long-term sustainable value creation for all of our stakeholders.

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

Operator

At this time, we will be conducting a question-and-answer session. [Operator Instructions] And the first question this morning is coming from Phil Gibbs from KeyBanc Capital Markets. Phil, please go ahead.

Q: Hey, thanks. Good morning.

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

Good morning.

Q: You mentioned you had some benefits from the Inflation Reduction Act in performance materials. And it sounds like some of that was baked into your prior guidance given you said benefits were larger than you anticipated. Any color on what the credit may have been in the quarter? And how long we should think those credits persist?

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

Yes, sure. So we're certainly pleased with the settlement of the Inflation Reduction Act. And coming into the year, we were still studying it and didn't really fully appreciate what the benefit would be for Materion, but we did know it would be a positive. So we kind of built that into our thinking on Performance Materials margin expansion. Now that we've had more time to look at it, we're looking at roughly an $8 million benefit for the year. So that's recorded with production. So you can assume that's somewhat ratable as you go through the year.

And yes, so we expect to get that pretty even through the year. When you asked about when it goes away, the way it's written is it does not phase out for critical materials -- and at least for our high-purity beryllium that would be a critical material. And so we don't expect a phase out there.

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

Yes. Phil, just to add to that. As Shelly mentioned, it is for the critical materials and that are deemed by the U.S. government. Beryllium is definitely on that list. So we participate in this. There may be some other materials. So we continue to study it and see if there's other things to look at, but that's what we're looking at right now is the Beryllium and that's what Shelly's noted.

Q: So mechanically, how does that work? You're producing some material and above a certain threshold, you get a credit or based on revenue? I mean, how does -- how did it come about?

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

Yes. So it's really to encourage production of these critical minerals in the U.S. and to sell them by a U.S. taxpayer. So certainly, that benefits us. The way we understand it, it only applies to our high purity beryllium, so 99% and above. And the credit is based on a percent of production cost. So roughly 10% of our cost to produce that material would come to us as a credit.

Q: Okay. That makes sense. Thank you. And then on Electronic Materials year-on-year, I think the operating margins were down about 370 basis points. Any color in terms of slicing that up between the tantalum misalignment mix and some of the weaker absorption you talked about?

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

Yes. So you've got those drivers, right, Phil. We've talked about the tantalum issue kind of starting late last year and leading into this year. We also had the mix with lower precious metal target sales. And then we do have some cost inefficiencies as volumes are stepping down. We saw a pretty meaningful step down in March. So it really was decelerating through the quarter. I would say those items are kind of a third, a third, a third. They're really equally impactful the way we look at it.

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

Yes. And again, just to add to that a little bit, Phil, when you look at our precious metal targets, those are used quite a bit on consumer electronics type devices. They're used in a bit of the memory devices as well. Both of those in the semiconductor space have been impacted. And as a result, that impacts our precious metal target sales, which are favorable from a mix standpoint.

So we expect this deceleration that Shelly mentioned that happened in March. We expect that to continue here in Q2. And the recovery that has been noted by all the chip manufacturers in Q3 and Q4, we would expect to participate in that recovery. But I think one of the things that we've got is we're a very diversified company when it comes to the markets that we play in. And so we have

other markets that are very favorable to be able to help us move forward in Q2 and then for the rest of the year.

Q: Thank you.

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

Thank you.

Operator

The next question this morning is coming from Daniel Moore from CJS Securities. Please proceed with your question.

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

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

Good morning.

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

Good morning, Dan.

Q: Color, particularly around the content growth and the drivers of share gains, it does sound like maybe perhaps incrementally more cautious as you just mentioned, Jugal, around semi and consumer electronics. Is that the right takeaway? Or are you just sort of pointing out the ongoing choppiness in those end markets? That's one and two. Just talk about your visibility to continuing to outpace that market growth in H2 and into fiscal '24?

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

Yes. Yes, I would say I think there is a little bit of more cautiousness in that market than perhaps what we had a few months back. We've been continuing to monitor what's going on in the chip industry. I'm sure you've been listening to the various calls and reports from those companies. They all tend to indicate that Q2 perhaps will be a low point with a recovery in Q3, Q4, maybe a little bit to the right, shifting to the right a bit.

And so we certainly have a bit of a cautious take on that compared to, as I said, a couple of months back. Our content, I will stress, though, we participate in a very diversified part of the whole semiconductor chain. And so our content has not dropped anywhere near the level that some of the chip manufacturers have talked about. In fact, if anything, if you saw in Q1, our business was actually flat to a little bit up.

We would expect, of course, a softer Q2 in that space, but then the recovery in Q3 and Q4. And we would continue to expect to outperform the overall semiconductor market and with the -- I

think with the diversified portfolio that we have within semi. And then as I indicated, I think the diversified portfolio that we have for the entire company, aerospace, oil and gas, auto, telecom, many parts of the industrial, those are very, very strong markets for us and the content increase that we've had in each of those markets, if you just look at the last two, three years, I think positions us well to continue to be able to deliver. And frankly, that's exactly the -- some of the drivers for being able to raise our guide.

Q: Very helpful. Maybe shifting quickly to Precision Optics. It gets a little less attention. I think you mentioned sequential quarterly improvement. We given some of the new business wins you expect to return to growth in H2 or by fiscal '24. And just talk about the sort of maybe trajectory towards getting back to a more normalized low to mid-teens margins in that business?

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

Right. Well, you saw margin expansion, right, on this business here in Q1 with some of the targeted actions that we have taken. And I would expect that we'll continue to build on that as we move forward the rest of the year. As for the top line, we are having good success, particularly in the defense and space and some of the auto areas for that business. And so maybe a bit of it in the second half of this year, but really '24 would be, I think better set for good top line growth turnaround. But I would start to see maybe in the second half of this year. But on the bottom line side, I think our actions are taking place, taking hold, as evidenced by the Q1 improvement, and I would expect to see improvement throughout the year.

Q: Got it, I will jump back with follow-ups. Thank you.

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

Thanks.

Operator

Thank you. Your next question is coming from David Silver from CL King. Please proceed with your question.

Q: Yes, hi. Good morning. Thank you.

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

Good morning, David.

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

Good morning.

Q: Good morning. First question is going to be a clarification one, and I apologize for its naive sounding nature of it. But you did -- it's about the organic growth. You did talk about double-digit

organic growth. When I looked through the press release when I'm looking through the slide deck, I don't really see any like detail on that, like what the absolute number is or how it breaks down by segment. Am I missing something? Or is that just not being presented?

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

So let me take that one. I think you see in our materials posted on the website that we do list our performance by end market, which I think is an indicator. But also important to remember that all of our acquisitions have anniversaried, so right now, everything is organic growth.

Q: Okay. Very good. All right. I had a question, I'm following up on your comments in your prepared remarks about the timeline for, let's say, your discretionary CapEx projects in Massachusetts and in Milwaukee, in 1Q or first half 2024 startup. A couple of questions. Do you have similar timelines for some of the performance materials, customer-focused projects. I do recall, second half of last year, there was a noticeable step-up when the certain phase of the clad strip project was completed and turned on. So do you have any kind of timelines or targets that we can focus on for the space propulsion and any remaining key contracts that are under development, customer funded or whatever. I'll let you take it away. Thank you.

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

Yes. No, great question. I can talk about two, three key projects, and then certainly, we can do any other discussions you'd like as a follow-up as well. When you look at, for example, the space propulsion, we announced a contract Phase 1 of the contract we announced in the last earnings call, which was worth $10 million. We now have announced a second phase, which is $12 million.

Our expectation is that the Phase I will be able to complete this year. Earlier, we had thought that maybe it would be somewhat this year and then the remaining next year, but our teams have continued to make great progress on that, and we think we'll be able to finish Phase 1 of it this year. And then Phase 2, we would expect into next year. We also announced a clean energy project in our last call, and we indicated that, that clean energy project would start to ship perhaps a little bit at the end of this year and then finish out at the by the end of next year.

This was the one you may recall, where the customer is funding 100% of the investment, approximately $15 million of investment that they're funding. We're in the process of putting that capacity in place in a couple of our facilities, and we'll get that done. Of course, the other one that we have talked about for the last couple of years is the Precision Clad Strip. But that one, we had going from our legacy facility. We now have our new facility up and running. We're producing from both facilities.

And as the demand is there, and at some point, we'll decide with our customer on how that production needs to continue, but we're continuing that. We do have a Phase 2 implementation of that. And the Phase 2 implementation is in process. We expect that to start production towards the end of next year. And then really, I would look for sales than in the '25 timeframe, meaningful sales in the '25 timeframe. So hopefully, that helps with, I think, some of the key projects that we've talked about on the PM side of the business.

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

And maybe just to take the capital side of that, you likely noted that our capital spending in Q1 was strong, especially for our first quarter. We had a lot of activity coming out of the year last year on several of these projects. So a lot of that came into Q1 and made our first quarter a bit higher. We've held our guide for CapEx at that sort of $95 million range. So you take $30 million off that and expect it should be roughly equivalent. It's really hard to peg because the timing of how those -- how that work gets done and the invoices come in, but you know what we have rest of year.

Q: That's great color. Thank you. Maybe I'll just stick with Shelly on this one. But I was looking at your cash flow statement. And I did notice that even though CapEx was up, as you pointed out, free cash flow was meaningfully better and the difference or the big part of the difference is working capital. The last few, couple of years have been years where working capital was kind of a use consistently. And I do expect it to reverse or diminish somewhat this year, but what kind of release of working capital that's been built up maybe over the past couple of years, do you think is likely as 2023 progresses? Or is it just too contingent on various developments?

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

Yes. No, great question. As you can imagine, the last couple of years where we have been in a high-growth mode, there's been pretty significant working capital added. Some of that for new projects where you've got to fill the pipeline. Precision Clad Strip would be a great example of that, where you go from kind of no inventory to needing to fill a pipeline for raw materials and then hold a certain amount of finished goods, that's pretty structural for us going forward.

But when we think about getting into a more steady-state situation with semiconductor, we do expect working capital to be more manageable this year. We have several initiatives going on to kind of focus on making sure we've got the right inventory, the right working capital and that we're improving that where we can to increase cash flow. So I do expect that we're going to see a positive out of working capital this year. We haven't really put a number on that, but it's definitely going to be not the burn it's been in the last couple of years.

Q: Okay. Thank you. I have one more, and then I'll get back in queue. But this has to do with the -- I just wanted to clarify on the electronic materials expansions in Milwaukee and at the HCS unit. Can you just remind me, but I'm assuming that those units -- sorry, those expansions in both locations are essentially like base loaded already. In other words, once they are completed and commissioned, there are orders in hand to take up a fair amount of the new capacity added. Is that the case? Or would you say it's built in anticipation of orders, but no real firm orders in hand at this point?

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

Yes. So let me start with our HCS, as you indicated, which is our Newton facility. We're making investments in that facility because we're confident that the tantalum content will continue to increase on the semiconductor side. We see that happening in all the designs that are taking place,

the smaller and smaller node chips that are being introduced. We also see good growth in our aerospace and defense side of that business, the industrial side of that business. And so David, we are confident that the capacity that we're going to put in place is going to have good, meaningful demand.

Part of that is based on discussions and orders that we have with customers. And part of that is just continued development of new initiatives and new projects that we're involved in. So we're feeling good about the capacity that we're putting in place and what I think -- what we think it can do for us in '24, '25, '26 timeframe. When it comes to the Milwaukee facility, as we indicated, I think, when we first announced it, we've got a building that gives us the opportunity to expand. But what we're doing in terms of putting the capacity in is we're putting very targeted capacity that is based on customers' discussions, customer contracts, new business opportunities.

So we are really making sure that we're doing investments on a very targeted basis based on growth in the semiconductor space, again, on smaller node ALD type of programs as well as we announced that we are working on next-generation battery materials with a number of different customers. And one of the customers actually made an investment with us. And so that investment, we're doing a joint activity with them. And so that, I think is one that we're feeling very good about as well. And so in general, I would say we're very excited about the capacity we're putting in place in both locations, and we expect those to have good meaningful impact over the next three to five years.

Q: That's great. I am going to get back in queue, but thank you very much for all the detail. Much appreciated.

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

Thank you.

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

Thanks.

Operator

Thank you. Your next question is coming from Dave Storms from Stonegate Capital Markets. Please proceed with your question.

Q: Thank you and good morning.

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

Good morning.

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

Good morning, Dave.

Q: Good morning. Just hoping you could start by speaking a little bit about the targeted cost reduction actions that you've mentioned. Just trying to get through some of the short-term softness you're seeing in a couple of markets?

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

Yes. Dave, good question. As you know, we have had a very good track record of operational excellence. I think within our company, we've driven that over the last several years, and that's just something that we do as a normal part of our business. Whenever we feel that there's needed actions, we look at them. We did that during the pandemic time as it was needed, and we've looked at that over the last several years. So as we see some softening in some of the areas, we make sure that we take appropriate action.

I think one of the things that we're very focused on and have been very focused on is making sure that we don't take action where we lose capacity. We want to make sure that we can support our customers in a meaningful way. And so there's a lot of discussion about the ramp-ups that will happen in the second half for the semiconductor side, and we want to make sure we're well positioned to capitalize on those ramp-ups. So any type of reduction is that we do put in place. We're making sure that they're very well thought out and don't impact our capacity and don't impact our ramp-up, that may be required at some point. So it's just, I would say a normal course of action just based on market conditions, and it's something that we'll just continue to look at as we move forward.

Q: That's great color. Thank you. One more for me. You mentioned that all your acquisitions are anniversaried. I was just wondering if you could shed a little light on what you're seeing in the M&A market? The potential for rate hikes and rate hike pause in the second half of the year is given the market's a little more certainty and clarity or if multiples are still pre-elevated, just anything you could give us there?

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

Yes. I think the M&A side, what I would say is that the expectations, I think are still there from the seller side to be able to get a good price for the properties they have. And so we just have to be very diligent in our evaluations. We continue to look at M&A, and we just have to be very diligent in understanding what the offering is. And does it make sense for us? Does it fill a certain portfolio gap for us? Does it give us some adjacency like we've done over the last couple of acquisitions? And if it's the right type of thing for us, then we'll evaluate it based on the returns. But in general, I would say that the M&A pricing side is probably still a bit elevated and probably has not seen the drop that maybe some of the other areas have seen.

Q: That's very helpful. Thank you.

Operator

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Thank you. We have a follow-up question from Phil Gibbs of KeyBanc Capital Markets. Phil, your line is live. Please go ahead.

Q: Thanks very much. The mine development cost this year, the $11 million, have those been spent? And then secondarily, a similar line question with the customer pre-funded credits that you'd expect for Clad Phase 2. What's the size in '23? And have those been realized yet? Thanks.

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

Yes. So on the mine development side, we talked about another pit opening with an $11 million roughly spend this year. And as you know, we put that on the balance sheet and amortize that really over production to capture that as kind of cost of goods sold. Not a lot of that has been spent yet. So you would see that really still most of it will come in the next few quarters. In terms of the prepayments, we received some of that last year. We expect a little bit more to come this year, but we did receive a good portion of that in '22.

Q: So how much is left on that, Shelly, for the...

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

Yes, roughly $4 million or $5 million.

Q: Thank you.

Operator

Thank you. And we have a follow-up coming from David Silver from CL King. David, your line is live. Please go ahead.

Q: Okay, thank you. So Jugal, I guess this is kind of a big picture question. But you've talked or Shelly talked earlier made some comments about the Inflation Reduction Act and their benefits to you. And you've talked about a number of customer-focused projects. I'm just going to try and maybe integrate them. But one reason I think your prospects might be bright longer-term, not the only reason. But I do think the restrictions on technology trade with China and some other issues in Asia, are spurring some incremental, I guess, onshoring or reshoring opportunities on top of the ones that you developed outside of that.

But I'm wondering when you look at the environment for aligning yourself with new customers or getting involved in newer projects as time goes on, in part due to a shift from Asia to the U.S. or North America for various technology products. I mean, is there any impediment? In other words, is the fact that the United States doesn't have quite the same ecosystem supplies, maybe skilled labor, research capabilities. Does any of that factor in that maybe you're not going to be able to avail yourself of as much of the opportunity as possible? Or maybe you could just comment on how you think maybe the trade restrictions that were issued late last year, the IRA and other things kind of feed into, let's say, your three to five-year outlook? And is there enough of an ecosystem?

Or is there any bottlenecks currently in the U.S. that might get in the way if you're hitting your long-term growth objectives.

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

Yes. Well, a couple of things. One, I want to continue to stress that we have been focused on making sure that we grow our business globally. So certainly, the activity that's been going on in the U.S. is a factor, and I'll talk about that. But just to give you a data point, we had approximately, I'm going to say, 46%, a little bit north of 46% of our sales in the U.S. And then that's been coming down and actually now we're around 43%.

So we've actually increased our outside of the U.S. share by three points just on a year-over-year basis. And so that, I think speaks to the great work that our teams are doing to make sure that we're capturing share in Asia, in Europe, and we're going to continue to work on that. We're going to continue to make sure that we're absolutely focused on growing our business globally. Now with regard to your question, I think on the U.S. side, one of the things that I'm really pleased with is that we have for this area is we have great R&D capability and manufacturing capability in the U.S.

A lot of our R&D centers and really the main R&D centers for Electronic Materials, for Performance Materials, Precision Optics, our located here in the U.S. Our manufacturing, I mean, our legacy manufacturing with all of our Performance Materials is located here in the U.S. As you know, David, when we acquired the HCS business, the Newton facility, that's in the U.S. and then the investment that we just talked about in Milwaukee that we're putting in place, that's in the U.S. So I think between the R&D side and the manufacturing side and then our sales support and our other back office support, I believe we're really well positioned and we have what is necessary to be able to capture the work that's going on, on the U.S. front.

And at the same time, we're making the necessary investments outside the U.S. so that we can continue to grow our business in Asia and in Europe. So over the next three to five years, I expect us to be able to do both. I expect us to be able to take advantage of the initiatives that the U.S. government is working on or just the onshoring activity that's involved here in the U.S., but I also expect us to be able to grow our business in Asia and Europe and continue to be a good global well-diversified company.

Q: Very complete, the very thorough answer. I appreciate it. Thanks very much.

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

Thank you.

Operator

We have reached the end of the question-and-answer session, and I will now turn the call over to John Zaranec for closing remarks.

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John Zaranec - Chief Accounting Officer, Head of Investor Relations, Materion Corp.

Thank you. This concludes our first quarter 2023 earnings call. A recorded playback of this call will be available on the company's website, materion.com. I'd like to thank you for participating on the call this morning and your interest in Materion. I will be available for any follow-up questions. My number is (216) 383-4010. Thanks again.

Operator

This concludes today's conference and you may disconnect your lines at this time. Thank you for your participation.

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