Transcript of
Materion Corporation
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Participants

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Presentation

Operator
Greetings, welcome to Materion's Fourth Quarter and Full Year 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, Kyle Kelleher, Manager of Investor Relations. You may begin.

Kyle Kelleher - Manager, Investor Relations
Good morning and thank you for joining us on our fourth quarter 2023 earnings conference call. This is Kyle Kelleher, Manager, Investor Relations. 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 and full year, as well as an update on key strategic initiatives. Following Jugal, Shelly will review the detailed financial results for the quarter and full year in addition to discussing our expectations for 2024. 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 8 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 Corporation
Thanks, Kyle, and welcome, everyone. It's great to be with you today to talk about our fourth-quarter performance and our record results for the full year 2023. I'm proud of our team's focus and resilience, leading our company to another year of record sales and earnings.

We overcame significant headwinds in some of our largest markets to deliver strong results, demonstrating the power of our balanced portfolio and the extraordinary potential of our unique customer partnerships. Our sharp focus on operational excellence led to continued meaningful margin expansion, structurally improving our profitability and preparing us to maximize performance as markets recover. And while we managed our costs closely, adjusting to uncertain economic conditions, we continue to invest for the future, seeding the pipeline for long-term organic outgrowth.

In the fourth quarter, the diversity of our portfolio continued to be a highlight, while several of our markets remain challenged. When excluding Semiconductor, our largest market, which is experiencing significant market weakness, our sales were up slightly. Our Aerospace and Defense sales grew nearly 70% year-over-year, representing the 11th consecutive quarter of growth for this market.

In addition to the benefits from significant organic wins in Space and Defense, we also saw the impact of continued increase in our content per plane. On the other hand, our Semiconductor and Industrial end markets continued to show significant weakness in Q4. In Semi, we saw our third consecutive quarter of meaningful year-on-year declines, but the order patterns are starting to show signs of stabilization.

We are also seeing some positive indicators in the broader market and expect that the related increase in demand will positively impact us, starting in the second half. Our performance in the Industrial space is impacted by its largest application related to non-residential and warehouse construction builds. With the impacts of COVID on office space utilization, combined with higher interest rates, the demand for our beryllium nickel sprinkler material is seeing a significant inventory correction that will carry through the year.

While our end market outlook remains mixed, we continue to make significant advancements on strategic initiatives that position us for long-term growth. Our organic growth projects, aligned

with compelling global megatrends, have allowed us to win exciting new business and ensure that we continue our strong track record of outgrowing our underlying end markets.

The Emerging Space market continues to be a source of new opportunities for us, as illustrated by a recent fourth order to supply critical materials for space propulsion systems. These four important orders, along with several other organic wins in this market, contributed approximately $90 million in new business orders during the year. We have positioned our company as a trusted partner supplying critical materials into this exciting high-growth market. Our technical expertise continues to lead to new R&D partnerships that will drive innovation and new opportunities in several of our key end markets.

In November last year, we announced that we were awarded a $5 million contract with the United States Air Force for a project to develop additive manufacturing capabilities for beryllium materials. Today, we are pleased to announce a new $4 million award from another government agency to fund additive manufacturing for other advanced materials across the Aerospace, Defense, and Energy markets.

These projects will enable us to better serve both new and existing customers, who will require more complex components for next-generation applications. We are preparing for the recovery in the Semi market by expanding our capabilities. The proliferation of artificial intelligence or AI applications, specifically generative AI tools, will result in increased demand for hardware to power it. That will mean greater worldwide need for chips, which we directly support with our highly engineered semiconductor materials.

Chips used to drive built-in AI capabilities in devices such as smartphones, tablets, and PC's will be in highest demand. By providing materials for both physical vapor deposition and atomic layer deposition, two important methods for the manufacture of these high-powered semiconductor chips, Materion is a vital part of the supply chain, enabling on-device AI functionality. We are pleased to announce that we've recently launched two new atomic layer deposition materials for advanced memory, meeting the needs of our customers, who are rapidly innovating to power these future applications.

In addition, our tantalum materials are used to fabricate logic chips that power AI, as well as high bandwidth memory chips employed in AI processing centers. We expect the market for those chips to significantly grow over the next five years and are making investments to ensure we are ready to support that demand. Our Semiconductor capabilities will also be critical to the continued evolution of the automotive industry, as the shift toward electric and autonomous vehicles continues to advance.

As a reminder, these vehicles require two to 10 times more chips per vehicle. The transition in advanced mobility is supporting growth for our precision optics business, which is seeing an increase in demand for optical components. We are pleased to share that we've secured another customer contract to supply optical components for LIDAR technologies autonomous vehicles.

Our materials are in LIDAR modules at six vehicle OEMs currently and we are actively providing prototypes to expand further. We have positioned ourselves as a critical technical

partner in these exciting next-generation products and are looking forward to additional opportunities to serve this emerging market.

We're building a strong pipeline of opportunities to support the clean energy transition with the successful development of two clean energy opportunities last year. We have also continued our work with Kairos Power and will be supplying additional material in support of their molten salt nuclear reactor program.

In addition, we successfully completed the facility upgrades required to support a customer-funded $15 million investment to provide critical materials for power generation. Our shipments to the customer remain ahead of schedule. Our precision-clad strip facility is now fully ramped and contributing meaningfully to our performance. We remain on track with our capacity expansion, which we expect to start production at the end of this year.

We have also secured a record $60 million in new defense orders in '23, as we continue to strengthen relationships with our key partners. Our materials are critical to the performance of leading-edge defense applications. The advancements I've outlined underscore the significance of our outgrowth initiatives that continue to create momentum and give us confidence as we move forward.

As we shared during the year, we have been focused on making targeted adjustments to improve our cost structure, in order to improve the efficiency and performance of our business. This approach has been a key enabler, as we expanded margins by 170 basis points last year, reaching 19.3% of sales, nearing our mid-term target of 20%.

We'll continue to focus on operational excellence as we head into 2024 to manage through market softness and maximize our performance as markets gradually recover in the second half of the year. Our performance in '23 strengthened the confidence we have in our strategy as we delivered another record year despite volatile market conditions. I'm very proud of our team's hard work and relentless focus on delivering results and creating value for all of our stakeholders. The advances we made in '23 are paving the way for another year of record results this year.

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

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation

Thanks, Jugal, and good morning, everyone. During my comments, I will reference the slides posted on our website this morning, starting on Slide 13. In the fourth quarter, value-added sales, which exclude the impact of pass-through precious metal costs were $289.7 million, down slightly from prior year, but up 7% sequentially.

Despite strength in Aerospace and Defense, Semiconductor and Industrial remain challenged as Jugal outlined. When looking at the earnings per share, we delivered adjusted earnings of $1.41 in the fourth quarter, down slightly from prior year.

Moving to Slide 14, adjusted EBITDA in the quarter was $53.3 million or 18.4% of value-added sales, down 4% from the prior year, with margin expansion of 10 basis points. This year-over-year decrease is mainly due to the volume decline, but strong price mix and operational performance, including the targeted cost improvement initiatives, are contributing to the increase in margins. These results also include the year-to-date adjustment to the expected manufacturer's production credit benefit, as we announced earlier this year.

Moving to Slide 15, let me now review the fourth quarter performance by business segment. Starting with Performance Materials, value-added sales were $186 million, up 5% compared to prior year and up 10% sequentially. This record quarter and year-over-year increase was driven by strength across the Aerospace and Defense end markets, including meaningful contributions from space applications.

EBITDA, excluding special items was $46 million or 24.7% of value-added sales, up 4% compared to $44.3 million in the fourth quarter of '22. This growth was primarily due to higher volume, favorable price mix, and strong operational performance, despite the unfavorable year-to-date adjustment to the manufacturer's production credit.

Moving to the outlook, we expect Aerospace and Defense to remain strong in 2024 and we remain on track with the expansion of our precision clad strip facility, which is expected to ramp in the latter part of 2024. Despite these growth drivers, we expect the Industrial and Automotive end markets to remain challenged, while they face continued inventory corrections.

Next, turning to Electronic Materials on Slide 16, value-added sales were $77.7 million, down 21% compared to the prior year as a result of the significant weakness in the Semiconductor market. EBITDA excluding special items was $11 million or 14.2% of value-added sales in the quarter. Despite the sizable volume decline, targeted cost-improvement initiatives helped to mitigate the Semiconductor market softness.

As we look forward to 2024, we expect Semiconductor to remain challenged through the first half of the year with a gradual recovery starting in the second half. As we saw a delay in the market downturn's impact on Materion, we will experience a similar delay with the overall market upturn based on our position in the inventory chain. The first quarter of 2023 was among the strongest in the company's history for Semi, with the decline beginning in Q2. And while we managed through the end of a downturn, we expect to see continued benefit from our operational excellence initiatives.

Finally, turning to Precision Optics segment on Slide 17, value-added sales were $26 million, down 6% compared to the prior year. This decrease was mainly driven by reduced PCR filter demand and general softening in the consumer electronics market, partially offset by strength in Defense. EBITDA, excluding special items was $3.8 million or 14.7% of value-added sales.

The decrease in volume was a meaningful driver of this year-over-year decline offset by a positive price mix and the benefit of targeted cost improvement initiatives. From a sequential standpoint, we saw another quarter of EBITDA growth along with 170 basis points of margin

expansion. Looking out to 2024, we expect Defense, Space, and Automotive to drive topline growth and expect a continued benefit from the cost improvement initiatives implemented.

Moving to Slide 18, let me comment on the full year. We delivered our third consecutive year of record value-added sales, adjusted EBITDA, and adjusted earnings per share. Value-added sales reached an all-time high of $1.1 billion, up about 1% from the prior year. This year-over-year increase was mainly attributed to strength in Aerospace and Defense and precision clad strip offset by the significant Semiconductor market weakness.

Adjusted EBITDA for the year was $217.7 million, or 19.3% of value-added sales, up 11% from the prior year with margin expansion of 170 basis points. The significant margin performance was largely driven by a favorable price mix, strong operational performance including the targeted cost improvement initiatives, and the benefit from the manufacturer's production credit.

We delivered $5.64 in adjusted earnings per share for the year, up 7% as compared to the prior year despite a $0.40 interest expense headwind. 2023 did provide a favorable tax rate at 13.3% from the impact of the non-taxable production credit and an outsized benefit from foreign earnings.

Moving now to cash debt and liquidity on Slide 19, we ended the quarter with a net debt position of approximately $413 million and approximately $180 million of available capacity on the company's existing credit facility. Our leverage at 1.9 times remains slightly below the mid-point of our target range.

Lastly, let me transition to Slide 20 and address the full-year outlook. While we expect some of our key end markets to remain challenged in the near term due to macroeconomic conditions, we expect another year of record results driven by our organic pipeline and close customer partnerships. These growth drivers, along with continued operational excellence and the impact of our targeted cost initiatives, will help drive earnings growth in 2024.

With this, we are guiding to the range of $6.10 to $6.50 adjusted earnings per share, a 12% increase from the mid-point versus the prior year. We expect Q1 to be comparable to last year, but we'll see sequential improvement each quarter thereafter. In closing, despite some market headwinds, 2024 is shaping up to be another exciting year of market outgrowth and strong execution from Materion, leading to yet another year of record results.

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

Operator
Thank you. [Operator Instructions] And the first question today is coming from Daniel Moore from CJS Securities. Daniel, your line is live.

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

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

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Good morning, Dan.

Q: Good morning. Maybe start with the outlook and appreciate all the color. Just give us a sense for what level of value-added sales growth is associated with your guide for '24 and maybe just talk to the cadence a little bit given a much tougher comp in Q1 as you described, embedded within those assumptions?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. Dan, as you look at our deck that we provided, we did share some of the end market growth outlooks between the various markets that we serve. We see a couple of markets. On the positive favorable side, I'd say more than a 3% type of growth, particularly Aerospace, Defense, and then more of the Space segment of Aerospace with the new business wins that we've had.

I would say low-single digits on several of our markets and a couple of markets that we frankly see contracting. So when we look at our overall growth for year-over-year, I would say mid-single digits, it's probably reasonable for the full-year. However, I would see that skewed to the back half of the year.

I think the first half of the year, especially with our Q1 comps semi, as Ms. Shelly noted, was a very, very strong quarter for us last year in Q1, one of the strongest I think in the company's history. As the Semi slowdown had not caught up to us, whereas now of course, we're in the full semi-slowdown mode and it'll start to show the signs of recovery here in the second half of the year.

So I would expect just slight growth in the first half of the year, but a much more robust growth in the back half of the year, led by Semi, but then also other markets as well, as well as new business activities. And so I could see roughly a mid-single-digit overall for the year.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yeah, and as you heard in my comments, first quarter is going to look a lot like first quarter of last year. So when I think about the year from an earnings perspective, I'm expecting maybe a 45%, 55% from a percent, waiting first half to second half.

Q: Very helpful. No, it makes perfect sense. And then shifting gears a little bit longer term, I appreciate all the commentary. On the Semi side, beyond the market growth, how should we think about the opportunity for content gains driven by higher powered logic chips, some of those, which you described Jugal in your prepared remarks looking out over the next three to five years, and has that outlook changed at all?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Right. Frankly, the outlook has not changed at all for us for the longer term. Semi is our largest market. It's one that we're very excited about and we continue to be very excited about where things are headed in the next three to five years. We are continuing to invest in the Semi space.

For example, we just mentioned today that we're launching two ALD materials. These are atomic layer deposition materials that are going to be used for advanced memory and AI applications. We all are hearing what's going on on the AI front and I think we're really, really well prepared for both advanced memory as well as advanced logic, with our tantalum portfolio, as well as the number of other materials that we have.

In addition to that, I think when you look at overall Semi investments on the capacity side, we're putting the right investments in on the capacity side for the short-term uptick, but also be able to capture the long-term growth. So I think on the Semi side, we remain excited. I would say probably even more so than we were earlier because of the uptick that's going to happen here in the near term, but then continued growth in the three to five years. Our portfolio is really well positioned.

Last comment, I think on the Power side, as you know, Power Semiconductor is an important part of our portfolio. We see the applications for Power Semiconductor continuing to increase, whether it's EV applications or other industrial applications. And our positioning with the portfolio – the product portfolio that we have, but also, I would say, just equally as important, the customer portfolio that we have on the Power Semi is extremely, extremely strong. So we're very – we're feeling very confident, I think in our ability to grow both short-term and long-term for the Semi market.

Q: Perfect. Last one and I'll jump out is, the guide implies we're closing in on that 20% EBITDA margin goal. Just wondering maybe if not necessarily providing an updated goal today, but talk about the operating leveragability of the business beyond what you've already generated over the last two to three years? Thanks again.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. So let me just comment a little bit. First of all, on '23, right, two of the four quarters, we delivered 20% margins. And I've said this a number of times that we'd like to be able to see that on a more consistent basis. I feel that we're positioning ourselves more and more to be able to deliver that on a consistent basis, and would not be surprised if '24 represents a much more consistent basis for that 20% margin delivery and then clearly, that's not the end for us.

As you know, we continue to challenge ourselves more and more, and we will be setting an objective that I'm sure we'll be talking to you at some point that defines what we think we can be in three to five years from now. And that's something we're looking forward to and perhaps having that discussion during '24.

Q: Look forward to it. Thank you again.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Thanks, Dan.

Operator
Thank you. The next question is coming from Mike Harrison from Seaport Research Partners. Mike, your line is live.

Q: Hi, good morning.

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

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Good morning, Mike.

Q: Jugal, I was wondering if you could – maybe, I'm looking at Slide 7 here that shows your end market performance. And it's kind of striking that of the seven key end markets that you called out, five of them are showing dramatic declines, right, double-digit declines. Is this an indication of what's going on in the underlying market, or is there some de-stocking going on, or timing issues, maybe just give us a little bit more color? I think we understand what's going on in Semiconductor, but if you could talk in a little more detail about Industrial, Energy, Automotive, I guess those three and what's driving those big declines in the fourth quarter?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. I think, Mike, it's important to note, and you highlighted the keyword, I think, here, which is the fourth quarter. If you look at, of course, the full year, the numbers are much less, right, declines on a full-year basis, but much higher declines in the fourth quarter. And I can tell you that it is the underlying market/destocking going on in these markets. We've done extensive reviews with our teams on where are we in terms of share growth, new business wins, and we know that we have good growth and good business wins to have confidence that '24, as the markets turn around will have the right growth in '24 and into '25.

So this is clearly – this is really, clearly a market/destocking. And I can kind of walk through each market, of course, be able to help understand that and help talk through that. As we look at '24, I would see the Industrial market, I think we do have one sort of special thing going on in the Industrial market, and that's related to our beryllium nickel sprinkler systems or the sprinkle that we provide for those. In there, I see that as more of a one-time correction. I think that's going to happen probably during the '24 timeframe. But other than that, I really do see this as a market situation and just destocking, and would expect that during '24 these markets are turning around for us.

The one thing that I'll note is, despite these reductions in Q4, you see our performance. The team has done a fantastic job of driving performance across the company, whether it's price, whether it's mix related improvements, operational performance in the plants, our SG&A cost control, targeted cost actions, all those things that we should be doing, the team has done really a fantastic job of driving those. So to me, this is a – I think this is a temporary situation that we would see turning around. As we indicated earlier, that we expect about a mid-single-digit growth, really heavily weighted towards the back half of the year.

Q: All right, thanks for that. And maybe on a brighter note, the Aerospace and Defense market has been extremely strong here. You noted the $60 million of additional orders that you've secured. I know that the Defense market in particular can have some lumpiness to it. So I'm just

curious, is some of the strength that you're seeing just timing-related or are you optimistic that you're seeing a sustained pick-up in opportunities and applications within that market?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. Well, first of all, let's take that market and just appeal it a little bit, right? And then there's three major components I would say that we should talk about. One is the Commercial Aerospace market, the other one is the Defense market, and then the third is the very emerging Space market. Let me start with that emerging space market. That's been a fantastic market for us. We indicated about $90 million of new business orders. Today, we announced this fourth order of $36 million for supplying for space propulsion systems. This is the fourth order.

If you kind of look at what's happened over the last year or so and look at the first three orders, add that up, that's roughly about $70 million of orders just in the Space market. Combine that with our ToughMet business in the Space market, our Optical Assistance business in the space market, and we're looking at roughly about $90 million. So very good, strong market for us in '23, growing, accelerating market for us in '24, and we would hope that, that can continue beyond that.

The Aerospace market, the Commercial Aerospace market, we've gained content, 25% more content on average on planes now versus pre-pandemic, just in the last few years, both at the Boeing side as well as the Airbus side. So good content growth as well as, as, you know, the build rates continue to increase. Temporary situation on the Boeing side, as we all are aware of, but in general, the build rates continue to increase for the airplane. So we would expect our material content to continue to increase.

And on the Defense side, the team's done a fantastic job of getting our materials more and more ingrained into the defense applications. And I would expect that even though there's lumpiness, and I agree with you completely, that there's lumpiness on the Defense orders, we would expect a good market and good growth for Defense overall for the year. So I think all three components of the Aerospace and Defense market, we feel really good about for '24 and positioning well for '25 and beyond.

Q: All right. Very helpful. And then just a couple of quick ones. The Electronic Materials business in the margin or EBITDA commentary, you mentioned some one-time unfavorable items hitting that business. Can you give a little more color on what those items were and maybe how we should think about the EBITDA margin progression in 2024 in that EM business?

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yeah. Thanks for that question. They did see some items, but there weren't one-time items. There was nothing that was really big that stood out, a couple of accrual adjustments, a couple of expenses that just came in at the end of the year. We do expect that from a quarter-on-quarter, we will see a positive move in the margins as we enter into '24. So we think Q4 was a bit impacted just by those one-time items, and we'll see things kind of pick up in '24.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation

Yeah. And Mike, to add to that, if you look at our Q2 and Q3 results, we were on 17%, 18% EBITDA margins in the Q2, Q3 timeframe. Certainly in Q4, we had the impact of the one-time items that Shelley mentioned, but also there was a significant impact based on the mix for memory devices.

And, you know, what's happened at the memory side, particularly in the last year, so that was a mixed hit for us. But we would expect, and we see this, I think, happening during the year, as Shelley indicated, that those one-time items are behind us and we would expect continued progression back towards the Q2, Q3 type margins and then pushing those forward after that.

Q: All right. And then last one for me is, you called out $5.6 million worth of startup costs and scrap costs for the second phase of this precision clad strip project. Is that all the startup costs or is that just a portion that you guys considered unusual? I guess, I'm just looking for a little more clarity on how we should be modeling those startup costs through late 2024, if you could provide some more detail there?

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yeah, sure. Thanks for that. As you probably know, when we were working through the initial phases of the ramp of the clad strip facility, we did not special out any of those ramp costs. We took them to the P&L and we discussed and disclosed what they were.

Once we were at kind of full run rate in that facility, and we had some process tweaks and some formulation tweaks that we were working on with the customer, we did incur some additional charges that we would assume or we would call unusual, and we didn't want that to mask the performance of the business. So we called them out and we specialed those charges in '22.

Similarly, we're doing a little of that again, and we did that in Q4, where we had some process runs and things that were for qualifications that needed to be scrapped. And so a lot of it is there, in addition to some resources that we've brought in just to make sure the ramp goes well. So now that we're really fully running, we don't want to have the business results skewed by up and down on those startup costs. So if we have unusual costs, we will continue to special them, so that you don't have to worry about, hey, is that margin going to come down, come up during the year.

Q: So I guess as we're thinking about the Performance Materials business on an adjusted basis going forward, we should assume that there's not start-up cost in there, that those are going to be specialed out or are there still going to be some headwinds, I guess, as that's ramping?

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yeah. You should have –

Q: On an adjusted basis.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yes, on an adjusted basis, you should assume that those will be specialed out. And as we've talked about, the ramp of that will start late in '24 of the sales related to that.

Q: Right. Right. Understood. Okay. Thank you very much for all the help.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Sure.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Thanks, Mike.

Operator
Thank you. The next question is coming from David Silver from C.L. King. David, your line is live.

Q: Okay. Thank you. Good morning.

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

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Good morning, David.

Q: Yeah. I apologize if I'm going to make you repeat yourself, but I wanted to maybe just talk about the softness on the Electronic Materials side initially. So correct me if I'm wrong, but I think maybe last quarter or so, Jugal, I think your commentary was the fourth quarter, we would see an inflection point or reach an inflection point at some point in the fourth quarter on the electronic material side.

And I think the tone of it, I guess the stabilization that you had been, maybe indicating got pushed out to the right a little bit. I know there's a number of issues that have been pressuring that group for many quarters, but was there something in particular that maybe has led you to delay, maybe the upturn – your expectations of an upturn in that group, maybe by two, three quarters?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. David, if we actually go back a couple of quarters, I know, you highlighted fourth quarter, I think the world was thinking, and we were thinking that this market, Semi market was going to bottom out in Q2 and start to see an uptick in Q3. And then, as we noticed from all the major Semi companies, the recovery got a bit delayed, bit delayed, bit delayed.

And now the most recent information is that Q1 is expected to be the low point and then slight recovery in Q2, but then really more of the recovery happening in the back half of this year. So – and that's just a combination of the usage around the world as well as the inventory de-stocking that was happening at all of the Semi companies. So I think that clearly impacts us as we are a key supplier into that value chain.

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The recovery for us will be slightly later than what the Semi companies will recover, just based on the cycle and kind of where we fit in the value chain, but we'll follow that recovery as it happens. So I think really it's a very much, David associated with sort of the market dynamics and what we were hearing from the various Semi producers.

The one item that was more specific I think to us, which again is a market-dependent item is the memory mix issue that I mentioned, where we did have some specific product portfolio, which we count on every quarter, and we had a significant drop just based on inventory correction that our customers are going through.

And as a result, that created a negative – a heavy negative mix for us for the quarter. But we would expect that to start to recover in Q1 and into Q2 and so on. So I think we're lined up extremely well to be able to hit the ground running as the Semi producers start to produce more and get the recovery going.

Q: Okay, very good. I'm going to ask you to parse one comment you made in your opening remarks. But again on Electronic Materials, I believe you indicated that the order book that you're seeing is kind of indicating maybe early signs of stabilization, I think was your wording.

And when I think about an order book in your Electronic Materials business, I kind of think, well, are the orders that you're seeing, are they reflective of maybe legacy products in which case maybe it's indicating the customer inventory liquidation is nearing an end? Or alternatively, is it for more leading-edge or newer applications, which kind of points to the rollout or the ramp-up of new customer facilities? Is there some way you could maybe parse the order book that you're seeing and maybe read the tea leaves there a little bit?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation

Yeah. I think it's a combination from what you just indicated. So, for example, when you talk about the leading edge, we indicated that we launched two new ALD materials for these advanced memory applications and AI applications. We're starting to – as we're having discussions with our customers, we're starting to feel that they are going to start to put orders in that then will translate into sales in the Q2, Q3 timeframe.

So I think that's an example of where there's newer products that we believe are going to contribute to a sales uptick. And at the same time, I think on the legacy products, as you know, we have a lot of precious metals business, non-precious metals business, we're watching the inventory levels very closely with our customers.

And then from what we can see, the last few weeks, I mean the orders have – there's not been a decline, let's put it that way. So we feel good about, I think, the fact that, okay, maybe we're bottoming out and we would expect to see over the next few weeks a slight uptick in the order rate for those legacy products.

So that's kind of where our commentary is coming from, and that's where we feel that there would be a slight uptick in Q2, but really a bigger uptick in Q3, Q4. And I think we're hearing

that, right, also from the various other earnings calls or other announcements that the Semi producers are making as well.

Q: Okay. And then you did mention the two new ALD materials, and please don't tell me anything you shouldn't tell me. But should I assume that the new materials are tantalum-related, the new ALD materials? Or is this kind of new, new materials something beyond kind of the tantalum-based products and activities – development activities that you have ongoing?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. So our ALD portfolio that we have is not a tantalum-based ALD portfolio. It is not something that we created as part of the acquisition that we made from H.C. Starck. ALD is something that we've been working on for a number of years. It's an organic activity that we started to invest in when we started to see that this was an emerging area.

And so, over the last four or five years, we've been developing, and we're now up to a total of five materials. And so really advanced chemicals is what the category is that we put it in internal to the company. So they're not tantalum-related. They're really much more advanced materials that, as they said, end up in the next-generation memory applications, which then will end up in the various AI applications that we would see.

Q: Very interesting. So, sounds like Milwaukee, not Newton. So thank you for that. Okay. I just wanted to switch over, maybe, we don't really talk too much about your Optical segment. But you've done a lot of restructuring work there, and I'm just wondering if you maybe have an outlook for 2024 for that segment? I mean, is the time when that group finally resumes organic growth? And if so, what would you say would be kind of the one or two leading sources of that turnaround?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. Well, I think, first of all, that business, despite the sales drop that happened, has done a really nice job of managing the performance and the cost management of that business. Various cost control activities that we put in. We've now had three consecutive quarters of – three quarters, I should say, Q2, Q3, Q4, where we've had EBITDA improvement.

It's our expectation that we'll continue to drive improvement in that business on the bottom line throughout '24. And then on the top line, if you look at the last time that we did an earnings call, which was the Q3 earnings call, we talked about Space and Defense related orders, in the Optic space, today we're talking about contract and the LIDAR technology for autonomous vehicles.

And so I think those are the type of areas that are going to contribute. So Automotive is going to be a contributor in this thing. Defense, the Space market, is going to be a contributor, I think, to the growth here in '24, and then, of course, longer term as well, in '25 and '26. So our expectation is that this business is going to be a topline contributor in '24, as well as continued bottom line contributor as it has done over the last couple of quarters.

Q: Okay. And then just last one for me, not the biggest issue, but there was a commentary – a comment or two regarding your share repurchase authorization and whatnot. And this is just my

opinion, but I don't necessarily think your typical investor is demanding that kind of activity on your part. But just remind me, is your authorization there to offset dilution? Is it for handling options-related issuance? I mean, what – how do you anticipate your share repurchase activity fitting into your overall capital structure and cash deployment strategy?

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yeah. I'll take that one. Thanks. We think a lot about capital allocation and where we want to invest our money. We do have the $8 million available on the share repurchase program that was last authorized, but we haven't had any activity on that in a couple of years. And really the reason is because we're more focused on that organic growth.

So deploying our capital to our organic growth is more important to us right now than kind of offsetting dilution or bringing that share count down. And we think we're delivering really well, the returns are very good. So we've got that lever there, should we choose to use it, but right now, it's something we're not very active on.

Q: Makes perfect sense. Okay. Thank you very much. I'll get back in queue.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Okay. Thanks, David.

Operator
Thank you. The next question is coming from Samuel McKinney from KeyBanc Capital Markets. Samuel, your line is live.

Q: Hey, good morning. It's Phil Gibbs. How are you?

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Hi Sam.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Hey, good morning, Phil.

Q: Thanks for talking about the Aerospace and Defense and Space market, and thinking about those buckets kind of leads me into the question that I had. How much is space right now as a percentage of that total bucket, and I would think that includes satellites and commercial space?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. Well, it's becoming a much larger part, right. As you know, Phil, you've been following our company for quite a while, and Space was relatively small component of our business, more related to government-type activity or just large projects such as the James Webb or something like that. And now space has become a much larger part of our component.

Defense has continued to grow, the Commercial Aerospace is continuing to grow, but I'd say – I'd say it's – probably, we're looking at maybe about a quarter to a little less than third is probably the Space component, but I would expect to continue to see growth in that business.

Q: Thank you. And then a lot of questions on margins on Electronic Materials, but hoping to just simplify it a little bit. Obviously, the mix wasn't ideal in the quarter, and it sounds like you're shipping under your production rates, which impacts absorption greatly when you think about that type of business. If you were shipping in line with your production rates and if your mix was, let's just call it average or something more ideal, where should margins have been?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Well, look, we've said all along that we need this business to be contributing positively to our goal of 20% EBITDA margins for the company. So I expect this business to be able to deliver those types of margins. We saw what this business was able to do in Q2 and Q3, when it had decent mix, even though we had a little bit of a sales challenge in Q2 and Q3. So I expect this business to be able to deliver favorably towards our 20% EBITDA target.

Q: And the last one for me on the H.C. Starck acquisition from late '21. There was a little sliver in that business that was non-tantalum based. I think some of that was going to be directed toward clean energy. Any thoughts or comments that you can make along those lines? Thanks so much.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah. You're absolutely right. And your memory is correct. I mean, we did, and I can tell you that that business is doing extremely well. Both the tantalum side, by the way of non-Semi application, I'll say, as well as non-tantalum business, where we have pursued other markets and have grown in other markets. So I can tell you that, that business has done extremely well over the last year and a half or so with our team, and I expect continued growth in that business over the next few years.

Q: Thanks. Best of luck.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Thank you.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Thanks, Phil.

Operator
Thank you. The next question is coming from Dave Storms from Stonegate. Dave, your line is live.

Q: Good morning.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Good morning, Dave.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Good morning, Dave.

Q: I appreciate you taking the question. Just kind of wanted to know, looking at the general market this year versus last year, kind of what does the general customer acquisition and contracting environment look like?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah, I think the acquisition and contracting environment has been good even though the markets, the actual sales in '23 were challenged in some of the markets as we've talked about. New business activity and new product development activity has continued to be strong.

And as a result, we're seeing some of those things already convert into new business wins, but we would expect more of that to happen during '24. So I think what's been positive is that customers did not really slow down new development, new R&D activities, therefore working with us. And so we would look for those to materialize and contribute towards our one to three-year sales window.

Q: That's perfect. Great color. And just kind of sticking with those business wins, obviously, as we've discussed, you're very well aligned with some really cutting edge technologies, the LIDAR, the AI, clean energy. Are there any of these technologies that you see as having like particularly strong potential to take a leap and scale up over these next 18 to 36 months?

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Well. I mean, there's a number of things I would say that have contributed and I expect them to continue. For example, the Space activity that we have talked about, I just indicated to Phil that we used to be just a small player in the Space market, mostly government, some of the larger projects, and here we are talking about $90 million of new business orders, for example in Space in the '23 calendar year. That's an incredible level of growth that we've been able to drive.

Now when you look at, for example, the Semi market, we have a number of things going on, ALD being one of them. So we do look for ALD as those materials are adopted more and more, as more and more advanced chips come out, as more and more AI applications happen. We expect that to grow.

When I look at LIDAR, autonomous vehicles, there are different levels of autonomous vehicles, but as we see more and more autonomous vehicles come out that have LIDAR technology, we would expect that business to continue to then grow. So I think we are excited about the megatrends that are out there, and I think our alignment to those megatrends with our portfolio, as you know, we love talking about that in these calls and other venues.

Q: That's perfect. Thank you. And then just one more for me, if I could. Shelly, I know you just mentioned that you're very focused on organic growth. Just curious as to how you see this in relation to any M&A activity that you think about on your horizon.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Yeah, sure. So organic has been our focus, as you know, since we did our last acquisition at the end of '21, which Jugal, just referred to on the main tantalum business. We are always open for

business, if you will, looking at opportunities to expand our portfolio, expand our geographic footprint, but the opportunities that we have that are more near-term and certain have been coming up to be organic. So we love the returns on organic projects. We're continuing to focus there, but we're not closed off to the idea of M&A should the right thing come along.

Q: That's very helpful. Thank you both, and congrats on the strong 2023.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Thank you.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Great. Thanks.

Operator
Thank you. And the next question is a follow-up coming from David Silver from C.L. King. David, your line is live.

Q: Okay. Thank you for that. Just one more question and I'll stipulate this might be a little unfair. But I had a question, maybe about your view of the Industrial economy. So it is a meaningful end market, and other than electronics-related end markets, it was kind of the weakest in 2023.

And then I'll just say, like, over the last 24 hours, I guess, both Japan, which might be a proxy for Asia, Japan, their economy contracted in the fourth quarter, and this morning the UK announced their economy contracted in the fourth quarter as well. So maybe a sign for continued weakness in Europe.

But from your perspective, I mean, what are you hearing from your Industrial customers in terms of end market demand? And maybe are things still declining there, or are there some signs of stabilization? And then more to the point, in your fiscal year 2024 full-year guidance, you know, what kind of improvement or what kind of change in the Industrial end markets you serve is kind of built-in there? Thank you.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah, David, great question, because that is a large market for us and one that as you can imagine, we're very focused on. If you look at just the general industrial market and one metric that we look at, for example is PMI. The last time PMI was north of 50 was September of '22.

So a long time ago. And since then it's below 50, which implies that there's contraction. When you look at our Slide 10 and kind of what we have indicated for our Industrial market, we believe the Industrial market will continue to be a challenge market in the '24 timeframe and that's why we sort of indicate that it's less than 0%.

Now in our case, as I indicated earlier, we have a specific product that also is impacted and that's related to non-residential construction with our beryllium nickel product. But setting that aside, which is really a one-time specific item, we expect Industrial market to continue to be challenged

throughout ‘24. What’s great about I think our company is, we’re very well diversified. So clearly, Industrial, we expect to be a challenged market.

But we’ve got – if you look at our Chart 10, we’ve got all of our markets showing positive, except Automotive and Industrial. And that’s why we’re able to, I think, say that we would have about a mid-single-digit year-over-year growth led by Semi, led by Aerospace, Commercial Space, Defense, and some of the other things that we have going on as well.

So I think we’re kind of excited about where we’re headed despite the fact that we have these headwinds for Industrial PMI index being below 50 for a long time and not sure when that’s going to turn and kind of cross 50 again. The organic growth projects that we continue to drive, we highlighted a number of them on our Slide 6 and we’ll continue to make sure that we’re staying above market on all the areas that we’re playing in.

Q: Okay. And I’m going to just finish with an observation. So this was a record year for your company. I want to say Kyle, I think set a record this quarter with the most pages in the quarterly earnings slide deck. So there’s a lot to go through here. Maybe send it out a little earlier. My brain doesn’t work that fast in the morning. But anyway, a lot of good information here, but another record-setting element to the quarter.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Yeah.

Q: All right, thanks very much. I appreciate that.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Thank you.

Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corporation
Well, I know that was a comment, but I’ll just add to that. This is our third year in a row of record sales, record EBITDA, record margin, and record EPS, ‘21, ‘22, and ‘23. Our team has done just a fantastic job of delivering both on the top line and the bottom line, even during challenged times, which we experienced in ‘23. And I think we’re extremely well-positioned to continue that into ‘24 and have ‘24 be another record year for us.

Q: Very good. Thank you.

Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corporation
Thanks, David.

Operator
Thank you. And this does conclude today’s question-and-answer session. I would now like to hand the call over to Kyle Kelleher for closing remarks.

Kyle Kelleher - Manager, Investor Relations

Thank you. This concludes our fourth quarter 2023 earnings call. Recorded playback of this call will be available on the company's website, materion.com. I'd like to thank you for participating on this call and your interest in Materion. I will be available for any follow-up questions. My number is (216) 383-4931. Thank you again.

Operator

Thank you. This does conclude today's conference. You may disconnect your lines at this time. Thank you for your participation.