

Transcript of
Materion Corp.
Materion Fourth Quarter and Full Year 2024 Earnings Conference Call
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Participants

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Jugal Vijayvargiya - President and Chief Executive Officer, Materion Corp.
Shelly Chadwick - Vice President and Chief Financial Officer, Materion Corp.

Analysts

Michael Harrison - Seaport Research Partners
Daniel Moore - CJS Securities
Philip Gibbs - KeyBanc Capital Markets
David Silver - C.L. King & Associates
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Presentation

Operator

Greetings, and welcome to the Materion's Fourth Quarter and Full Year 2024 Earnings Conference Call. At this time, all participants are on a listen-only mode and 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, Mr. Kyle Kelleher, Director, Investor Relations and Corporate FP&A. Sir, you may begin.

Kyle Kelleher - Director of Investor Relations & Corporate FP&A, Materion Corp.

Good morning, and thank you for joining us on our fourth quarter 2024 earnings conference call. This is Kyle Kelleher, Director, Investor Relations and Corporate FP&A. 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. Following Jugal, Shelly will review detailed financial results for the quarter and full year in addition to discussing expectations for 2025. We will then open up the call for questions.

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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, noncash charges and certain discrete income tax adjustments.

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

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

Thanks Kyle, and welcome everyone. It's nice to be with you today to discuss our fourth quarter and 2024 results and provide our initial outlook for 2025. Let's start with the fourth quarter. Sales developed about as we expected in the fourth quarter, with strong shipments in aerospace and defense and improved contribution from semiconductor and Precision Clad strip, muted by the continued softness across other end markets like Automotive and Industrial.

We delivered a record EBITDA with 240 basis points of margin expansion, thanks to the diligent work our teams have been driving to improve our operations and streamline our back-office functions. These actions will continue to pay dividends as we move through 2025 and beyond. Now for the full year. 2024 was a challenging year with notable achievements. Sluggish markets and inventory corrections may have dampened our organic growth, but this allowed us to demonstrate the strength of our company, the commitment of our team and the result of their hard work.

For the year, we delivered our fourth consecutive year of record EBITDA and EBITDA margins. After years of diligent efforts to improve performance and drive profitable growth while streamlining our organization, we delivered on our midterm EBITDA margin target of 20% for the first time for the full year of 2024.

We have been taking swift and consistent actions to optimize our footprint and address our cost structure, while continuing to invest for growth and strengthen our customer partnerships. Achieving this level of performance in a sluggish environment gives us confidence to look ahead and set new goals for the company. As our end markets strengthen and we deliver on our organic initiatives, we will continue to drive further operational improvements and generate even stronger levels of profitability.

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With this in mind, we're establishing a new midterm EBITDA margin target of 23%, expecting that our business can deliver an additional 300 basis points of improvement over the next several years. While our underlying markets struggled to find momentum in 2024, we advanced several strategic initiatives during the year. In aerospace and defense, our customers are developing new products and applications that require the highest level of performance reliability in harsh conditions. Earlier this year, a leading Aerospace and Defense customer agreed to invest approximately \$10 million in new capacity and capabilities at one of our existing sites in support of their growing demand. This project is well underway, and we expect to bring our new capabilities online mid-next year.

2024 also saw key new business wins in defense including the selection of our SupremEX lightweight composite material for use on the prototype for the U.S. Army's future tiltrotor long-range aircraft as Materion's products are uniquely suited for next-generation applications. The growth of commercial space has driven new opportunities for us as well, as Materion is well positioned to serve the needs of this expanding market. In the second quarter, we secured a \$150 million multiyear agreement to supply critical materials for space propulsion systems after proving ourselves to be a key critical supplier of these products.

In addition, AyontEX Alloy, one of our newest high-performance products was selected for a new telescope mirror that will be tested by NASA in its cryogenic test facility. In Semiconductor, the expansion of our portfolio to include ALD, or atomic layer deposition, products is allowing us to support the production of the most sophisticated semiconductor chips. We were pleased to receive an overall excellent supplier award after our team collaborated with a leading ALD customer to innovate multiple new materials, which will see expansion with the rapid growth of AI and the increasing demand for the most complex chips.

We also entered into an agreement to serve as the technology partner for a major global supplier of semiconductor processing equipment. We are supporting this customer in their development of a new deposition material that will pave the way for a wide range of next-generation consumer and automotive electronic devices. Aside from commercial advancements, we took steps to eliminate underperforming noncore businesses and optimize our footprint.

In the fourth quarter, we completed the sale of an Electronic Materials facility in Albuquerque, New Mexico, that produces coatings for architectural glass mainly used in commercial construction. We are also closing a related nearby facility. We're in the process of rightsizing two facilities in Asia, which should be completed in the first half of this year. As a result of some of the changes already made, our Electronic Materials business delivered roughly 20% EBITDA margins for the year, representing a 390 basis points improvement year-over-year.

Regarding our cost structure, we took a series of decisive actions to streamline our organization and position us for greater efficiency. Over the last year, we reduced over 150 positions through targeted reductions and optimizing back-office

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operations while controlling discretionary spending. At the same time, we remain focused on investing for the future. Our R&D spend in 2024 was at an all-time high as we focus on partnering with our customers to deliver next-generation products and solutions.

Even through periods of market softness, we have remained focused on investing for the future, further aligning the business to high-growth opportunities supported by global megatrends. Across our plants, we're improving yields and profitability through process and technical innovations and continuous improvement initiatives.

In Precision Optics, we took meaningful steps to drive the early stages of transformation, starting with appointing a new President, Jason Moore. Despite the challenges the business has faced, we believe the long-term fundamentals remain strong. Jason is quickly working with his team to adjust the cost structure and optimize the footprint to ensure we're maximizing the value of that critical business and prioritizing the growth opportunities the business is developing.

The number of careful and deliberate actions we've undertaken allowed us to deliver record performance in 2024 and have set the stage for even stronger performance in the future. As we look ahead to 2025, we're cautiously optimistic about a stronger macro environment as we move through the year. We expect to continue to see solid growth in Aerospace and Defense, where healthy end market demand will be compounded by outgrowth from our organic wins. We're seeing some gradual recovery in Semiconductor. And while our customers are providing mixed outlooks for 2025, we expect to see mid-single-digit growth year-on-year.

Industrial, where our largest application is the beryllium nickel spring for commercial construction, should see growth in 2025 as the inventory correction is nearly complete, and we are seeing orders returning to near normal levels. We're planning for other end markets to show low single-digit growth with the exception of Automotive, which is poised to remain weak.

With regard to Precision Clad strip, we're expecting meaningful headwinds in 2025. Our customer's indicated that the inventory correction that started in the back half of '24 will carry through in '25, resulting in lower volumes year-on-year. After working diligently to ramp volumes and fill their supply chain over the past couple of years, PMI finds themselves in a position to lean out their inventory levels despite the continued success of their IQOS products rollout. Our Phase 2 capacity is complete and online, ready to serve their increased demand, which is expected in 2026.

As we head into '25, I'm confident that we will continue to deliver the strong performance you have come to expect from Materion. I would like to thank our global team for their unwavering commitment to innovating for our customers while managing costs and delivering record performance.

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

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Shelly Chadwick - Vice President 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 13. In the fourth quarter, value-added sales, which exclude the impact of pass-through precious metal costs were \$296.1 million, up 2% from prior year and up 12% sequentially. This year-over-year increase was driven by continued strength in Space and Defense and gradual improvement in Semiconductor, partially offset by market headwinds across Automotive, Industrial and Energy. When looking at earnings per share, we delivered record quarterly adjusted earnings of \$1.55, up 10% from prior year.

Moving to Slide 14. Adjusted EBITDA was a quarterly record at \$61.5 million or 20.8% of value-added sales, up 15% with 240 basis points of margin expansion from the prior year. This marks the third consecutive quarter delivering margins above our midterm target of 20%. The increase was driven primarily by strong cost management and operational performance.

Moving to Slide 15. Let me now review fourth quarter performance by business segment. Starting with Performance Materials, value-added sales were \$195.8 million, a quarterly record and up 5% as compared to prior year. This year-over-year increase was largely driven by continued strength across Space and Defense and the Consumer Electronics end market. EBITDA, excluding special items was a record \$53.6 million or 27.4% of value-added sales, up 17% compared to the prior year period with 270 basis points of year-over-year margin expansion. This increase was driven by higher volume, strong price mix and operational performance, including higher production credit benefit year-on-year.

Moving now to the 2025 outlook. We expect continued strength across Aerospace and Defense with improving market conditions in Energy and Industrial. We expect the Automotive market to remain challenged with market contraction for a second straight year. Precision Clad strip sales to Philip Morris will be down year-on-year, given the continued inventory correction that Jugal mentioned earlier. We expect to deliver another year of strong bottom-line results, driven by operational performance and cost management.

Next, turning to Electronic Materials on Slide 16. Value-added sales were \$78.6 million, a 1% increase year-on-year driven by improving semiconductor sales specifically across logic and memory and data storage technology. When adjusting for the divested Albuquerque large area target sales, the growth was 4% for the quarter. EBITDA, excluding special items was \$14.7 million or 18.7% of value-added sales in the quarter, up 460 basis points versus the prior year. This increase was driven by improved mix, strong operational performance and cost management. As we look out to 2025, we expect the Semiconductor market to improve as the year progresses, particularly in logic and memory and data storage devices.

This improvement is expected to be greater in the second half. On the flip side, we expect our power semi business to remain challenged with high level of inventories

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remaining at our customers and weak end use demand in markets like Automotive and Industrial. We expect improved bottom line results driven by the stronger demand, strong cost management and operational performance.

Turning to Precision Optics on Slide 17. Value-added sales were \$21.7 million, down 17% compared to the prior year. This decrease was driven by market weakness in several end markets, offset by strength in the Space and Semiconductor markets. EBITDA, excluding special items was a loss of \$1.1 million or minus 5% of value-added sales. This decrease was largely driven by reduced volume, unfavorable product mix and some operational challenges. As part of the initiatives underway to transform this business, our new business president continues to review and adjust the portfolio, footprint and cost structure, setting the stage for dramatically improved results that will start this year.

While we are optimistic about the future of Precision Optics, we did take a noncash goodwill and intangible impairment charge that impacted our GAAP results in the fourth quarter. This write-down is expected to be a one-time accounting adjustment and does not reflect our commitment to this business as a key part of the Materion portfolio.

Moving to Slide 18, let me comment on the full year. Value-added sales were approximately \$1.1 billion, a 3% decrease from prior year due to market weakness in key end markets, including Industrial, Energy and Automotive. This decrease was partially offset by strength in Space and Defense and Precision Clad strip. Despite the slight decline in VA sales, we delivered our fourth consecutive year of record adjusted EBITDA and EBITDA margins with adjusted EBITDA of \$221.2 million for the year or 20.2% of value-added sales, up 2% from the prior year with margin expansion of 90 basis points.

We are very pleased to have delivered our targeted EBITDA margins of 20% for the year for the first time in our company's history. This significant margin performance was driven by strong price mix and improved operational performance, despite the softer top line. Adjusted earnings per share was \$5.34 for the year, down 5% as compared to the prior year, with a \$0.16 headwind due to higher interest expense.

Moving now to cash, debt and liquidity on Slide 19. We ended the quarter with a net debt position of approximately \$425 million and approximately \$169 million of available capacity on the company's existing credit facility. We generated strong free cash flow of \$57 million in the quarter and ended the year with leverage at 1.9x, down from 2.2x at the end of Q3. Free cash flow remains an important focus, and we expect to generate stronger cash flows in 2025.

Lastly, let me transition to Slide 20 and address the full-year outlook for the company. After a challenged macro environment in 2024, we remain cautiously optimistic about the market dynamics as we enter 2025, expecting mid-single-digit top line growth from our businesses, excluding Precision Clad strip. The clad strip inventory correction is expected to continue through 2025, returning to growth in 2026.

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Despite the clad strip inventory correction, we expect earnings growth in 2025 from market outperformance, continued operational excellence, cost management and portfolio optimization actions despite very modest top line growth. With this, we are guiding to the range of \$5.30 to \$5.70 for the full-year 2025 adjusted earnings per share, an increase of 3% from prior year at the midpoint.

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

Operator

Thank you. At this time, we will be conducting our question-and-answer session. [Operator Instructions]. Thank you. Our first question is coming from Mike Harrison with Seaport Research Partners. Your line is live.

Q: Hi, good morning.

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

Good morning, Mike.

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

Good morning, Mike.

Q: Was just looking for a little bit more clarification on the Precision clad strip business and the inventory actions that your customer is taking there. How should we think about the magnitude of that volume decline that you're expecting in 2025? And I guess we should assume that, that decline is probably most pronounced in Q1 and Q2 and then maybe levels out in the second half? And then you have that consumer electronics business listed as a market that should grow low-single-digits in 2025 on the outlook slide. Is that excluding the PCS business? Or are there pieces within consumer electronics that should offset the decline that you're expecting in Precision clad strip?

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

Yes. Mike, let me address that part of it first. That is excluding our Precision Clad strip business. This is just general Consumer Electronics market. I would say, small turnaround, right, small growth on a year-over-year basis on the remaining Consumer Electronics business. With regard to the Precision Clad strip, as you know, we've supported the customer from day one. I mean, we are their development partner. We have been on a number of different things that we've developed with them. And we have, I think, extremely good relationship with them as they have launched this. We've supported them really in every country that they have gone and launched.

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I think the situation is in line with kind of what we talked about at the end of last year, which is the ramp-up that we had was significantly more as they were filling the channel than I would say the rollout that they have had. So they have excess inventory. They have a significant initiative in the company to delever. As part of that, they've made many initiatives, one of them being inventory and getting their supply chain aligned to the actual sales and actual demands. And as a result of that, we would see '25 to be that down. So probably looking at roughly about maybe around a 20-ish type of percent year-over-year decline in that business.

And -- however, we would see that then coming back to growth in the '26 time frame. I think at this time, I probably would say that, that year-over-year decline is spread across the full-year. So not necessarily heavily -- more heavily weighted in the first half than in the second half. But of course, we will continue to monitor this, and we'll continue to work with the customer. I mean, if we see that they're starting to have alignment to their inventory goals, then we may see perhaps higher volumes in the second half of the year.

But our plan is not necessarily based on that. We expect this product to continue to be a very strong product for us. Even with the year-over-year headwind, it's still a great contributor product for us for this year, and we would expect it to continue that way over the next several years, I mean, as we continue to be their development partner. So that's how I see it.

Q: All right. Thank you for that. And then on the Electronics business, I was hoping you could just give us a little more color on your expectations for the semiconductor business? It sounds like you're expecting maybe some acceleration in the pace of recovery as we get further into the year. But are you seeing some green shoots in any of the more mainstream portions of the market? Or is this mostly an advanced application driven recovery, I guess, that you're baking into your '25 guidance for now?

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

Yes. As you know, the Semiconductor business, the market, of course, our business has been extremely challenging over the last six to eight quarters as the market has gone through a significant downturn. The expectations certainly were that the market recovery was going to start last year in '24. In fact, some expectations were that it would even start at the back half of '23, but that has continued to get pushed out.

We have seen in the back half of '24 that the logic and memory segment was starting to recover, primarily driven by the advanced nodes, the 3-nanometer, 5-nanometer, 7-nanometer type of advanced nodes that are used in AI applications or other high-performance computing applications, associated memory applications, so high-bandwidth memory applications associated with that, have also contributed to a little bit of a turnaround.

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We're starting to see a little bit of a turnaround on the data storage side, considering the increased use of data and data processing. So we are starting to see maybe a little bit of recovery on that. At the same time, Mike, I mean, I'm sure you know, and we've all seen the reports, the power semiconductor is extremely challenged, right? All the key players of the power semiconductor business have had tough quarters, tough guide for Q1 and I think they're projecting challenging year, a challenging year in '25. But we have a fairly balanced portfolio. So when you kind of balance out the challenges on the power semiconductor side with the expected increases on the advanced nodes, especially with our contribution on the ALD or atomic layer deposition growth that we're trying to push with the high-end memory applications, we believe that especially in the second half of the year, this market could be a mid-single-digit type of a growth market.

Q1 will be a very, very challenging quarter in this market. Every earnings call that I've heard from the chip manufacturers is a sequential down, in many cases, a year-over-year down. There's normal seasonality that happens in the chip industry, but I think they have perhaps a little bit more than a normal seasonality, as I said, particularly in the power segment. But we do see that during the year, particularly in the areas that I highlighted, maybe a little bit of an uptick and then more of an uptick in the back half of the year, leading to about a mid-single-digit type of growth. And that's what we have included in our model.

Q: All right. Very helpful. And then last question for me is on the \$73 million of impairments in the Precision Optics business. I'm curious, was that the Balzers Optics business that you acquired about four years ago? And if so, can you give us a sense of maybe how that has progressed differently than you expected when you acquired it? And if it's not, maybe just help us understand what it is that was written down and how that helps to establish you going forward for better performance?

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

Mike, why don't I start on that one and then we'll see if Jugal has comments to add. Every year, we need to do an assessment of the intangibles. It's an accounting exercise. Precision Optics itself is a whole reporting unit. So it gets measured at the segment level, which does have goodwill beyond Optics Balzers. But if you think about what has happened in that business over the last several years, certainly, that was a large acquisition in 2020 with very strong prospects. We did see a major setback with the loss of a very large customer, which the business has struggled to recover from completely.

We still see that business fulfilling our vision. But in the meantime, the forecast had gotten as such that we couldn't support the value that was on our books. It's not a -- it's not something we choose or don't choose. It's really model-driven from the accounting side. So we took the adjustment. It goes into our GAAP results. It's a one-time item, and we move forward from here to build back that business.

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

Yes. And Mike, what we're excited about going forward is, I think one, leadership change. We've made a leadership change in the back half of last year. We're really, really excited to have Jason Moore on. He has traveled to the various sites, met with the people, understood the technology, the footprint that we have, I would say, a significant number of changes that we drove already in Q4, and it's our expectation to continue to drive both cost optimization, footprint optimization and, of course, top line growth and deliver a meaningful year-over-year improvement from '24 to '25. That's included in our plan.

And we want this business to be an equal contributor to our 23% margin objective that we have for a midterm. So our goal is to have a meaningful improvement from '24 to '25 and then continue that going forward beyond that.

Q: Sounds good. Thank you very much.

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

Thanks, Mike.

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

Thanks.

Operator

Thank you. Our next question is coming from Daniel Moore with CJS Securities. Your line is live.

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

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

Good morning, Dan.

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

Good morning, Dan.

Q: Maybe to start with the new long-term target of 23% adjusted EBITDA margin, obviously, really strong performance to get to your prior target in a difficult environment. How do you think about kind of a reasonable time frame? And maybe more importantly, what type of organic top line growth we would need to achieve it?

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

Yes. Well, first of all, Dan, it has been a heavy lift, but I think a lift that our team took on and has delivered. I'm really, really proud about I think what our team has accomplished over the last five years in this regard. We've gone from roughly about a 15% EBITDA margin in the '20 time frame to delivering a full-year 20% EBITDA margin. I think ahead of our plan, ahead of our expectations and taking our EBITDA from roughly about \$100 million of EBITDA to well over \$200 million of EBITDA in this time frame. So more than doubling the EBITDA, really proud of, I think what the team has accomplished.

And that gives us the confidence that, frankly, that we believe we can continue this trajectory and reach a 23% midterm EBITDA margin. It involves, of course, organic growth, but we believe and we've indicated this, I think, all along that we always want to be growing ahead of our underlying markets, so perhaps maybe a 200 to 300 basis point type of growth beyond the underlying markets. It could involve some bolt-on M&As. We've done those over the last few years. And so perhaps maybe there is -- that could happen over the next several years.

And then the continued disciplined execution that we have delivered, I think in the company, with the commercial excellence, with the cost management, operational excellence, and I think continuing to drive a leaner, more efficient organization. And then with the changes that we've driven in '24, especially during this a little bit of a downturn, I think those changes will certainly carry through into the next few years as well. We talked about Precision Clad and how that can be a turnaround factor in the '26 and beyond years and that would be a contributing factor.

So I think all of those things that we have done to get from the 15% to 20% today, and then building on that, I think gives us the confidence that over the next several years, we believe we can continue to march towards that 23% EBITDA margin. So we're quite excited about this now -- new initiative and sort of new benchmark that we've set for ourselves. And of course, we're happy to share the progress with you as we go along.

Q: Very helpful. And then in the prepared remarks, you teased -- well, in the discussion of new products and new opportunities you teased the new deposition material. What, if anything, can you say about that relative to your current tantalum and/or precious metals and what type of applications and anything in terms of market opportunity? Thanks.

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

Yes. So we're actually quite involved with a leading equipment manufacturer on that. As you know, the type of deposition technologies that we're involved in today are PVD, so physical vapor deposition is a core part of what we do, and that involves our precious metals targets, tantalum targets, other nonprecious metals targets. We have the emerging ALD or atomic layer deposition technology that we're involved in.

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And we now have a relationship or a partnership with a leading equipment manufacturer who is investigating a sort of next-generation deposition technology that can be used in certain applications. We're fortunate enough to have that relationship with them, and we're supporting them.

So provided that this is something that could become successful over the next couple of years, we would expect to have a good meaningful growth in that -- after that. So we're very much looking forward to continue to do the development with them and see where this takes us.

Q: All right. Appreciate the color. I will jump back. Thanks.

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

Thanks, Dan.

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

Thanks, Dan.

Operator

Thank you. Our next question is coming from Phil Gibbs with KeyBanc. Your line is live.

Q: Hey, good morning.

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

Good morning, Phil.

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

Good morning, Phil.

Q: As you all have thought about the tariff environment and what could be or will be or won't be, where are some spots that may be of concern or where are some spots that may be of an opportunity as you look across your supply chain and customers?

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

Well, as we know, Phil, I mean, this is a very evolving situation, right? Just this morning, for example, there is some report about possible tariffs on pharma, semi, autos. There's been talk of, of course, Canada, Mexico reversal, China. I mean, so it's a very, very evolving situation. So we're, of course, keeping sort of a daily track on it to understand the ins and outs and how we can be properly positioned to operate in this environment.

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First of all, when we look at the buy side, so we do certainly have buy from Canada, from Mexico, from China. We've looked at what those buys are, the dollar values, the suppliers that we're buying from. We have evaluated where we have second source opportunities and where we could potentially shift our buy to those countries, if there was action that was taken.

We've also made sure that -- and we have this because we've used it during COVID time. We've used it in general situations, and that we have a very disciplined robust process on any cost increases that we would get whether it's tariffs or any other type of things that we work with our customers to process those increases.

I mean you've heard us say this a lot, we don't want to be the sponge, right? And so if there are any cost impacts from the buy side, we're going to work very openly and transparently with our customers and be able to share that with them and process that. So I think that's the -- I'll call it the buy side. You're right. On the sell side, I mean, we have roughly a third of our business that goes into Europe. China is a relatively small sales arm for us, probably mid-single digits, I think, in terms of our share there. But really, I would say it's the European side. So if there are any tariffs that are imposed for material going into Europe, certainly, we'll have to work through that and understand what the implications are and how we work with our customers on that.

We're also looking at initiatives where we can take advantage of what can we do from the very large footprint that we have in the U.S. As you know, we have a very important and meaningful footprint in the U.S. So where can we take advantage of perhaps competitor situations where we can do local manufacturing here in the U.S. We're also looking at China. As you know, there's a lot of talk about what gets produced in China. Can we produce outside? We have footprint in Asia that's not in China. And so we're also working towards those initiatives. At the same time, we're working on a number of different materials that perhaps could be exempted from tariffs just based on the national security importance of those materials.

And so we're working with the right people in Washington to highlight those. So they understand that there are certain materials that are important to the national security of the country, and therefore, they perhaps should be exempt from the tariffs. So I can tell you that this is a topic that certainly is getting a lot of attention on our side, and we'll continue to monitor it and continue to manage it in a very effective way.

Q: Thank you. And then as you look at your 300 basis point margin improvement expectations, just kind of, I guess, over the next three to five years, how much of that is getting some meat or profit back in Precision Optics versus anything else you could be doing over the portfolio? Because I would imagine, obviously, moving from a negative EBITDA to a positive EBITDA situation, there is obviously going to do a lot to get you a decent way of the amount there. But maybe some thoughts around what are the big moving pieces.

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

Yes. Well, I think Precision Optics clearly has to be an important contributor, right? We've said this all along that all three of our businesses need to contribute equally to our top line profile as well as our bottom line profile. Precision Optics has not done that. And so we're making the changes, the necessary changes so that it can. I would remind all of us that if we just go back four, five years, I mean, this business was a 20% plus EBITDA contributor to the company. It's a smaller base than the other two businesses, clearly, but it's still an important contributor.

And it was a 20%-plus EBITDA business. And of course, our objective to the new leadership is that they're both back. How do we get that business back to that level? So we are looking forward to that business contributing. But at the same time, we want to make sure that we can keep pushing our Electronic Materials business to move and deliver north of 20% EBITDA margins and continue to drive both the top line and bottom line in the rest of our company.

Q: Thank you for that. And I guess staying with the Precision Optics, you mentioned earlier in the call that your R&D budget was very strong last year. Is there a decent bid in the R&D budget to rejuvenate that business in particular?

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

Yes. First of all, at the company level, I mean, we spent nearly \$30 million on R&D. I mean I remember the time when we were spending less than \$20 million in R&D in this company. So I think we've continued to make the right investments for R&D spending at the company level. And we've made sure that as we have looked at the Precision Optics business, and we have made cost improvements and cost changes in that business, we've actually taken the R&D organization and frankly, almost kind of isolated it to create a single R&D organization that can be working to support that business globally.

So it is, I think targeted at making sure that the right projects are being funded and then the markets that we're focused on in that business are going to be focused on. So I think we're well positioned to ensure that we've got the resources to fund that business as it kind of goes on this turnaround over the next several years.

Q: Then I've got a couple of small ones. I appreciate the giving me the time to ask these. I know tantalite prices have been moving up. There's been some supply disruptions in Africa. How much does that impact you guys one way or the other? And how are you managing through some potential cost inflation there?

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

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Yes. So first of all, I think we've got a very good diverse supply base for tantalum. So if there's disruptions in one part of the world, I think we have good supply base and good balance across the world sort of to be able to make sure that overall, we're not being disrupted on the supply side. On the pricing side, you may recall, Phil, there was a time a couple of years ago where prices did go up. And unfortunately, we had to eat some of those prices just because of the way our contracts were structured when we had taken over the business.

We work very diligently to restructure the contracts so that we could make sure that there are some clauses in there to have a price recovery for cost changes on the tantalum side. I think we've got a fairly good feel for that. And so we have a good relationship, kind of a cost price relationship with our customers on that. Would there still be some impact, it could be, but it would be more from a timing standpoint to make sure that we've got the supply side and the sell side aligned. But overall, I think we've got a fairly good feel or how to handle the supply and the price side for tantalum.

Q: Thanks. And then lastly for me, just the working capital side, did a good job in the fourth quarter there, particularly on the inventory reduction as you got some of the higher-value shipments out the door in defense and space, I'm sure. But looking ahead, how should we think about how you're thinking about working capital management in 2025 in terms of a use or a source? And then any internal metrics that you all have over the next three to five years in terms of where you want your efficiency measures to be? Thanks.

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

Yes. Sure, Phil. I'll take that one. So working capital is a very important initiative to us. We've, I think, had some really good success in bringing inventory down in some places. And then we've had places where we needed to add inventory, whether it's for new space business, whether it's for clad strip. So we had a base that was kind of increasing and decreasing at the same time. Hitting a more steady state, we're now working on bringing that down, getting to levels that we think are more appropriate for where we're at in time and space and you saw that come through in Q4.

Typically, we don't have the best working capital performance in Q1. So I don't expect to see a sequential improvement quarter-on-quarter, but I do expect a very strong year for cash flow for '25. So I think you're going to see the best cash flow performance that we've put up in a couple of years, as we -- we still have good organic spend, still a relatively high level of CapEx, but not adding that working capital, really controlling that area. And with good cash earnings, I think we're going to have good performance there.

Q: Thank you.

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

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You're welcome.

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

Thanks, Phil.

Operator

Thank you. Our next question is coming from David Silver with C.L. King. Your line is live.

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

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

Good morning.

Q: I have a couple of kind of smaller questions or smaller topics and then maybe a bigger topic. Firstly, I'm just looking on the -- I guess, it's Slide 20 from your deck full-year guidance. And I was wanted to hone in on the \$25 million that you called out from your CapEx budget for HCS. I was just wondering, is that the outlays required to complete the previously announced capacity expansion? Or is there something else, something newer going on there?

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

Yes. I mean, as you know, that's been an important part of our growth initiative, right, as we acquired that business. And we have made sure that we are investing in that business to capture the full growth not only in the Semiconductor space, but in the Industrial, Space and the Aerospace and Defense space. As you remember that business, we -- it was about a 70% to 75% semiconductor business, but we've made significant strides in the Industrial space and the Aerospace and Defense side to grow that business.

We have had a number of investments that we've highlighted over the '24 time frame that we made. And so I would say majority of that spend is related to investments that we have announced and that we're putting in not only additional capacity, but more cost-effective capacity in many cases that we're doing. So that's what that is, and it will continue into '25 as we finish that out. But that's a business that I think we're going to continue to look to figure out how we can keep funding and take full advantage of the opportunities that are there in aero, defense, industrial and semi.

Q: Interesting. Thank you very much for that color. Next question relates to your nonrecurring items this period. So you were asked earlier about the large \$73 million or so impairment and write-down of goodwill. But there was also a \$7.4 million charge here, I guess, under the term or listed as M&A related. And I'm just wondering,

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were those some costs that were capitalized maybe from the Balzers transaction? Or is that related to kind of ongoing M&A spend that maybe the project it was targeted for has been dropped off the list? But maybe just some comment on the M&A-related charge this quarter, please?

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

Sure. So I'll take that one, David. As you probably know, in the M&A line, we also have divestitures. And so a lot of that cost was related to finalizing the divestiture of the Albuquerque large area targets business that we've talked about as well as related to the facility closure of -- the nearby facility closure that we've been working on. So that's really kind of divestiture related versus acquisition-related.

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

Yes. And as we've talked, with the number of changes that we have driven in the company over the last 12 to 18 months, making sure that our portfolio is stronger going forward, right, has been an important initiative. And I think this move that we announced at the end of last year and then we've executed, gives us a stronger, more profitable portfolio for '25 and beyond.

Q: Okay. Great. And this next question, I'll stipulate in advance, I'm going to just take a little time to introduce it. But I'm going to ask you a question about your Performance Materials group and try to relate it to an element of your strategy within Electronic Materials. So within Electronic Materials, Jugal, you've highlighted a number of times that your company works with each of the top 15 chip makers.

And I always thought that was an important kind of positioning to have, particularly, I mean if you think about how the list of the top 15 maybe has changed over time. I was wondering -- I was trying to draw an analogy there to your Performance Materials and in particular, A&D portion of that, which seems to be driving a tremendous amount of growth in the past year or two and likely going forward.

So maybe this is a marketing strategy or marketing approach question. But within the space, aerospace and defense, there are -- just like in many industries, there's a couple of bigger, more dominant players, but then there's a lot of new business, new investment, new approaches, both in this country and outside. I was wondering if you might be able to talk about your approach to kind of exploiting your very strong positioning on the A&D side.

Is this the case where your Beryllium products are kind of a must-have and you're brought into the discussions by some of the emerging players in space or related areas? Or is this the case where you're trying to lock up a big business with a handful of leading companies? So as you think about your multiyear approach to taking full advantage of your strong positioning there. I mean, what is the goal? Do you want to be a top 15 supplier? Or do you want to be the exclusive supplier to #1 or #2 in the industry? Thank you.

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

Great question. And let me just talk a little bit about that Aerospace and Defense market because really, I think I can break it up into actually three subsegments of that market. And in this market, there doesn't tend to be sort of the top 15 because I think there's a little bit lesser number of players in each of these key areas that I'm going to talk about. So when you think about Aerospace, there's obviously the two big players, right, one in North America, one in Europe and then an emerging player in China. We have a very strong position, and I would say, almost kind of an equal base with both the North America and the European customer. We have an extremely good relationship with both our copper beryllium business, but also our ToughMet business, which is a material that's used across both the narrow-body and the wide-body planes.

We have established, and credit to our team in China as well as our team here in North America, a solid relationship with the emerging customer in China, with equal, I would say, amount of waiting in terms of the content that we have as they're starting to build the narrow-body planes and then down the road, the widebody planes. So I think on the commercial Aerospace side, we're well positioned with those three major customers.

When I think about the commercial Space side, I mean, there's obviously one very large customer -- company around the world, and then there is a number of different smaller companies on both the government as well as the private side. Without getting into specifics because I can't talk about customer names, I can tell you that we are well positioned with the customers in this space, whether it's on the commercial Space side as well as the government side.

So we have a history of working with the U.S. government. We also have the European Space Agency that we work with. We work with the Indian Space Agency. And I would say other agencies around the world. So I think we're well diversified on the Space side of it. When you look at Defense, certainly our materials, whether it's about beryllium based materials, non-beryllium based materials are extensively used in the Defense market. We have a strong relationship with all the top defense contractors without going into again, names, I mean, every one of them, I think we supply our materials to. We also supply our optics materials to the Defense industry.

We've had a strong focus over the last couple of years to go global on our Defense side. So we've established relationships with Korea, with Japan, with the European customers. We've actually leveraged our commercial excellence and some external partners to help us identify defense opportunities outside the U.S. that, of course, are approved and allowed by the U.S. side.

And so I think we have a good diversified defense business in North America. But I would say an emerging growing business outside of North America with the number of things that are going on in the world. So I think when you look at the three areas

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of sort of commercial Aerospace, the Space side, both commercial space as well as the government space, as well as the defense, both North America as well as global, this has been a very focused targeted activity for us, particularly in the last two to three years to make sure that we are taking advantage of all the growth opportunities that are there.

We're looking forward to actually the commercial aerospace business turning around in '25. As you know, airplane deliveries were down roughly 10% in '24 due to the number of issues that some customers had, but we're looking forward to turnaround in '25 that's built into our plan when we talk about some of the growth activities. So great question. I think it's an area that we're very focused on, and we're going to continue to stay focused on.

Q: That's great. I really appreciate all the detail there. Thank you.

Operator

Thank you. [Operator Instructions]. Our next question is coming from Dave Storms with Stonegate. Your line is live.

Q: Good morning.

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

Good morning.

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

Good morning, Dave.

Q: Just two quick questions for me here. Any estimates on the remaining beryllium nickel inventory correction time line? And I guess how are you thinking about industrial post correction? Is it fair to say that growth in industrial may be a little more back half weighted this year?

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

Yes. So I think on the beryllium nickel side, I would say the inventory correction is nearly complete. Feedback from our key customers is that they look to start to place orders. They started to place some orders in the back half of last year. We would see more orders in the first half. And so I think we're getting through that, and we would see normalcy in that by midyear as we continue to make improvement on those orders.

With regard to Industrial, as you know, the PMI Index has been below 50 for a number of quarters, but it hit 50% in the last report that came out. So maybe there's a little bit of a positive sign that Industrial as a market may perhaps be turning

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around. But I would see slow growth throughout the year for Industrial is how I would put it. Yes, certainly, more growth in the back half of the year, but we hope Industrial is something that -- where the inventory levels have worked through in general, and we can have a slight growth in the first half with a little bit more growth in the second half.

Q: Understood. That's very helpful. Thank you. And then I just wanted to ask one follow-up question around the divestiture-related costs. With the mentioned rightsizing of the facilities in Asia, should we expect divestiture-related cost per facility to be similar to the New Mexico charge? Or are there other variables here that we should be aware of?

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

Yes. Good question. So nothing to that magnitude, right? Any time we make facility changes, you're going to see a little bit of cost related to that, but really nothing to the magnitude of the \$7 million that we took on the Albuquerque and the related facility closure.

Q: That's very helpful. Thank you for taking my questions.

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

Okay, thank you.

Operator

Thank you. We have reached the end of our question-and-answer session. So I will turn the call back over to Mr. Kelleher for closing remarks.

Kyle Kelleher - Director of Investor Relations & Corporate FP&A, Materion Corp.

Thank you. This concludes our fourth quarter 2024 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 this call and your interest in Materion. I'll be available for any follow-up questions by numbers 216-383-4931. Thank you again.

Operator

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

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