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Atotech Ltd. (ATC)

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CORPORATE PARTICIPANTS

Paul Goldberg
Global Head-Investor Relations & Communications, Atotech Ltd.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

OTHER PARTICIPANTS

John P. McNulty
Analyst, BMO Capital Markets Corp.

Kieran de Brun
Analyst, Credit Suisse Securities (USA) LLC

David I. Begleiter
Analyst, Deutsche Bank Securities, Inc.

Joshua Spector
Analyst, UBS Securities LLC

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Laurence Alexander
Analyst, Jefferies LLC

Duffy Fischer
Analyst, Barclays Capital, Inc.

Benjamin Joseph Kallo
Analyst, Robert W. Baird & Co., Inc.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Atotech's Fourth Quarter 2020 Earnings Conference Call. Today's speakers are Geoff Wild, Atotech's Chief Executive Officer; Peter Frauenknecht, Atotech's Chief Financial Officer; and Paul Goldberg, the Head of Investor Relations. After the speaker's remarks, there will be a question-and-answer period. [Operator Instructions] As a reminder, this conference call is being recorded and your participation implies your consent to our recording this call. If you do not agree with these terms, please disconnect now. Thank you.

I will now turn the call over to Mr. Goldberg. Please go ahead, sir.

Paul Goldberg

Global Head-Investor Relations & Communications, Atotech Ltd.

Thank you, Sylvia. Good morning, everyone and thank you for joining Atotech's initial earnings call as a public company. A replay of this webcast will be available on our website for six months. Please note that Atotech provides non-IFRS information and reconciliations between IFRS and adjusted measures are included in our presentation materials, which are available on our website.

I'd like to remind everyone that our comments today contain certain forward-looking statements that are inherently subject to uncertainties and risks. We caution everyone to be guided in their analysis of Atotech by referring to our recent 20-F filing for a list of factors that could cause our results to differ from those anticipated in any such forward-looking statement. Also, we undertake no obligation to publicly update or revise forward-looking statements except as required by law.

And with that, I will turn the call over to Geoff.

Geoffrey Wild

President, Chief Executive Officer & Director, Atotech Ltd.

Thank you, Paul. And good morning or afternoon, and Happy Chinese New Year and the Year of the Ox to you all. Before we get started, I just want to let you know how excited we all are to begin our journey as a public company. Team members, customers and other partners have long been aware of the innovation and value we bring to our markets. We're delighted that we can now share our story with a wider audience and look forward to engaging with you on a regular basis.

With that, let's begin on slide 3, please. We're very pleased with our fourth quarter performance. We leveraged the continued strength in our electronics end markets, as well as the ongoing recovery in global automotive markets to deliver organic chemistry growth in both segments. Organic chemistry growth was complemented by strong growth in our electronics equipment business resulting in overall organic growth rate of 9%. We also grew adjusted EBITDA, improved free cash flow, and reduced leverage in the fourth quarter. Peter will share these details as well as our 2021 guidance later in this presentation.

But perhaps even more important than our strong finish to 2020 are the initiatives and decisions we took during the year and even before then which have well-positioned us for what we believe will be a very constructive market in 2021. All through 2020 and despite the challenges of the pandemic, we continue to invest in the long-term best interest of our business especially regarding our footprint and technology.

Now as we begin the new year, I'm happy to say that several initiatives are bearing fruit including our recently completed new production facility in Yangzhou, China which is now fully functional. This facility is our second chemistry plant in China. It will provide additional capacity to serve the large and growing Electronics and General Metal Finishing markets in the East, North and Center of China. It also creates important operational redundancy with our larger chemistry production site in Guangzhou.

The investments we've made in R&D and digitalization are also paying dividends, including our focus on delivering new and innovative solutions connected to next generation semiconductor packaging. As one example, our advanced Spherolyte copper UF3 chemistry has been developed for the specific needs of next generation fan-out wafer level packaging. Its superior purity ensures that our customers have the highest reliability with no cracks or microvoids. Volumes are ramping up for other UF3 chemistry applications as well.

Another example is our market leading Uniplate equipment line embedded in the semiconductor packaging supply chain. This equipment is used in ultra-thin production applications within the high end IC substrate manufacturing process, as well as for the production of leading edge smartphone components. And as we've communicated before, these installed lines will pull through our chemistry over an extended period.

Another important area of investment for Atotech is digitalization. Our 2020 acquisition of Visutech enabled us to quickly expand our digitalization capabilities, speed up production development time, and build a software-based business model. We are aggressively pushing towards commercializing a suite of tools that will enhance production quality, efficiency, and system availability for our customers while at the same time, reducing cost and creating stickier customer relationships for Atotech.

No one else in our industry is able to provide chemistry, equipment, software and leading edge global service and we believe this is a sustainable competitive advantage.

Now let's talk about the current state of our markets in a little more depth. Within Electronics, demand for 5G infrastructure, networking equipment and service is very solid, driving demand for chemistry to manufacture high frequency PCBs and high performance semiconductors.

Additionally, the semi packaging space is extremely strong and we're benefiting from our focused investment in this area over the past few years. The evolution of semi packaging is leading to more plated layers at the wafer level and more plated layers at the IC substrate level, all of which are positive for Atotech in terms of content and chemistry value. The market is experiencing strong growth for GPU and CPU chips, which in turn is driving strong IC substrate growth. In fact, a recent forecast said semiconductors will grow about 8% annually from 2021 through 2024 and fan-in, fan-out and for 2.5D packages will grow around 10% annually over the same timeframe. 3D packages could grow over 20% annually.

Now regarding smartphones, Gartner recently forecasted that worldwide unit shipments are expected to be about 1.5 billion in 2021 or 11% growth over 2020. Within this total, 5G smartphone units are expected to reach [ph] over 540 million (07:26) units up from about 213 million in 2020. Atotech gets roughly 50% more revenue on a high-end 5G phone versus an average 4G phone. So, the growth in the market, compounded by the overall growth of 5G, is a great setup for us.

In addition, demand for electronic automotive products is rapidly improving despite temporary near-term chip shortages that are affecting OEM production schedules. We believe these problems created by surging demand will work themselves out in the coming quarters. In GMF, we're pleased that the global auto markets, led by China but broad-based, have continued to show sequential improvement from the pandemic-driven low point in the second quarter of 2020. As we begin 2021, we expect strong growth in virtually all our GMF served markets, but particularly in the global auto markets, reflecting a strong rebound off a low base but also from multiple secular drivers.

Among the more impactful trends are auto premiumization, electrification, and lightweighting and sustainability. On the premiumization front, we're seeing solid demand for our decorative and functional chemistries used in advanced exterior and interior design applications as well as in corrosion protection and wear resistance applications, all of which contribute to vehicle safety and longevity.

Regarding electrification and lightweighting we see some of the high value chemistry demand fueled by our OEM's growing use of new plastics and lightweight metals and related new challenges like contact corrosion. And with respect to sustainability, we expect secularly increasing demand for chrome (VI) free chrome plating processes driven by strict environmental regulations, such as REACH and continued global demand for new chrome colors enabled by chrome (VI) alternatives.

Here, Atotech's products like trichrome, blue chrome and Covertron address these customer needs and at the leading edge of technology for this space. Finally, we also expect very solid demand in other GMF markets like sanitary, household appliances, and construction. In addition, chemistry used in applications like solar panels and wind turbines should continue to grow as the world continues to evolve towards green energy.

So in summary, we see a very constructive demand environment across our portfolio and expect 2021 to be a good year of growth.

With that, let me hand it over now to Peter for a review of our financials and our 2021 guidance and I'll be back with some closing comments after he's finished. Peter, over to you.

Peter Frauenknecht

Chief Financial Officer, Atotech Ltd.

Thank you, Geoff. Good morning, everyone. I'm very excited to go through our strong Q4 financials with you the first time as a public company. Let's start in slide 4. As Geoff said, we were very pleased with our fourth quarter results and believe that we were once again able to outperform our underlying markets. Our teams did a great job of delivering results in dynamic markets, continuing to service our customers at the highest level while carefully managing costs.

For the fourth quarter, our total revenue was $365 million, an increase of 18% over the prior year including organic revenue growth for chemistry and equipment of 9% as well as an FX tailwind of 4% and a 5% benefit from palladium pass-throughs.

Organic chemistry revenue, a key performance indicator, increased 5% in the fourth quarter and reflect growth in both segments. Electronics was very strong and grew 14% organically. Secular drivers like 5G infrastructure, next generation smartphones, cloud computing and evolving technology in semiconductor packaging are propelling sustained growth as seen during the last few quarters. We'll go deeper into Electronics in a few minutes.

GMF posted revenue of $133 million, representing 7% growth over the prior year. We were pleased to see GMF return to growth after several quarters of year-over-year declines. GMF's organic revenue growth of 2% was largely driven by rapidly improving industrial production especially in the global automotive sector.

High palladium prices contributed $40 million to our top line, while a weaker US dollar positively impacted our sales with $12 million. Palladium continued to rise, was up about 25% in the fourth quarter 2020 over the fourth quarter 2019. As a reminder, changes in the price of palladium directly impact our chemistry sales as a straight pass-through to our customers but do not meaningfully affect EBITDA, resulting in some impact on reported relative margin mathematically.

Moving to the P&L. We generated adjusted EBITDA of $106 million in the fourth quarter which exceeded our expectations heading into the quarter and was a $5 million increase over last year. Overall, our solid Q4 EBITDA result was driven by earnings and strong organic chemistry growth, stable pricing, productivity and our focus on cost management offset in part by increases in compensation accruals in the quarter reflecting our strong full year performance. We believe our positioning is a critical supply in the electronics value chain, and our focus on the high-end of our market will enable us to drive earnings growth moving forward. We also had a modest benefit from FX in the quarter.

Adjusted EBITDA margin was 29.1% in the fourth quarter. The margin was impacted by the mathematical impact of palladium pass-through, the mix of equipment versus chemistry and by the increased compensation accruals, partially offset by cost controls and productivity. Excluding palladium, product mix and the accrual increase, adjusted margin was essentially flat with last year. Our margin continues to be amongst the highest in the specialty chemical industry and illustrates the quality of our business.

Now, let's go to slide 5 for a deeper look into the electronic results. Our performance in electronics accelerated in the fourth quarter with total revenue of $232 million, increased 25% year-over-year. This very strong result included organic growth of 14%, a favorable Palladium impact of 5% and a 5% benefit from FX translation.

Organic chemistry revenue for Electronics grew 7% in the quarter, reflecting continued solid demand for our innovative electronic chemistry solutions. Customers are still gravitating towards our higher value-added chemistries as they continue to ramp up for 5G and for using complex PCPs, semiconductor packaging, IC substrates and even high-growth consumer variable applications.

Our market-leading broadened offering of plating lines including Uniplate and the recently introduced Polygon drove equipment revenue up 56% over the prior year. Quoting activity for electronics equipment remains quite strong and we are basically sold out for the first half of 2021. Encouragingly, we expect the second half to be busy too as we get the benefit of incremental chemistry pull-through as the equipment comes online.

Electronics generated $70 million of adjusted EBITDA in the quarter, a $6 million or 9% improvement over the prior-year period primarily driven by the higher organic revenue, stable pricing and tight cost control. Margin was 30.2% in the quarter, primarily reflecting the pass-through impact of palladium, product mix, the increased compensation accruals.

Regarding the product mix, we had strong growth in equipment which carries a lower margin [ph] by nature (16:40) but serves as an enabler for future high-margin chemistry revenue. Adjusting for this item, margin was largely consistent with last year. Our best-in-class margins for chemistry is sustainable and speaks to the strength of our business and the value we provide our customers.

Moving to slide 6 now. GMF total revenue grew 7% to $133 million in the fourth quarter, comprised of organic growth of 2%, 3% positive impact from palladium, and a 2% tailwind from FX. From a mixed perspective, organic chemistry grew 3% and equipment revenue was slightly down in the quarter. As already discussed, we were very pleased to see organic growth swing positive in the quarter after the market challenges we faced in light of the pandemic, especially in the second quarter of 2020. Our solid fourth quarter performance is mainly attributable to rapidly improving global automotive markets, continued constructive sanitary market and from growing interest in our sustainability-focused suite of solutions.

Turning from revenue to earnings, GMF adjusted EBITDA was $36 million in the quarter and adjusted margin was 27%. Adjusted EBITDA was flat with last year, reflecting earnings on organic growth essentially offset by the previously mentioned increased accruals. Adjusted margin excluding the impact of palladium and accruals was largely in line with the prior year period. These results are amongst the highest of all specialty chemical companies serving industrial markets. And we believe they will improve as our underlying markets continue to strengthen.

Let's now move to slide 7. 2020 was a good year for cash generation for Atotech. We generated adjusted free cash flow from operations before debt service of $120 million in the fourth quarter, up 15% and generated $262 million for the full year. This strong performance enabled us to repay $80 million of our Holdco notes in the fourth quarter. Also, at quarter-end, we had $549 million of liquidity and improved our net leverage to 5.1 times.

We believe this performance is very indicative for the company's ability to deleverage [ph] or under half a turn (19:29) per year going forward. We feel very good about the way we navigated through the pandemic which showed the stability of our business and our cash generation abilities. More important than how we finished the year is where we are now post the IPO. As you know, we completed the IPO on February 8 and sold 23.3 million shares at $17. The gross proceeds to Atotech were $498 million before deducting the underwriting discount and offering expenses. We used the net proceeds, some cash and borrowings under our revolver to completely pay off the $220 million balance of Holdco notes and the $220 million outstanding of Opco notes. As a reminder, the

Holdco notes carried an interest rate of 8.25% and the Opco notes interest rate was 6.25%. Post the IPO closing, pro forma net leverage was reduced to 3.9 times.

Now, as we move forward, we're actively engaged in a process to refinance our existing term loan facilities. We expect to take advantage of our lower leverage position, recent upgrades by S&P and Moody's, and our strong business outlook to lower our cost of borrowings. We do not have any details to share yet, but we will communicate them once the final transaction is complete.

Moving on to slide 8. Now, let's quickly review our 2021 guidance. As Geoff mentioned before, we expect 2021 to be a year of strong organic chemistry revenue growth in both segments. Our expectation is that this will also result in double-digit EBITDA growth. Total organic revenue is expected to grow 10% to 12% in 2021 led by strong organic chemistry growth and double-digit equipment growth.

Organic chemistry revenue, our key performance indicator, is expected to be up 8% to 9% for the full year. Electronics is expected to be up about 6% to 7% on broad base secular strength. GMF is anticipated to increase approximately 11% driven by strong global automotive market and the low base in 2020.

Adjusted EBITDA is forecasted to be in the range of $405 million to $425 million, representing an increase of 14% over 2020 at the midpoint. This adjusted EBITDA guidance reflects leverage on organic chemistry growth, the benefits of operational improvements, as well as some FX translation gains which we expect in the first quarter 2020. CapEx is expected to be between 4.5% and 5% of total sales in 2021 with about [ph] $10 million (22:52) of this investment triggered by the build-out of our new Mexican manufacturing facility.

Normalized interest expense is anticipated to be between $70 million and $74 million for the year. This is based on our new capital structure but does not include our refinancing activities. Please note that the refinancing will trigger roughly $61 million in onetime costs connected with early liquidation of our Holdco and Opco notes, as well as financing fee amortization all of which will be recognized in the first quarter but is not reflected in our full year interest expense guidance. Finally, our effective tax rate, which includes income and withholding taxes, should be around 30% to 31%. This rate needs to be applied to our operating profit. In other words, please exclude the EBITDA adjustments and particular transaction expenses, restructuring programs, and noncash adjustments, as well as interest expense from earnings when you use this guidance. As a reminder, we do not have a meaningful tax [ph] shield (24:10) on interest expense and interest is, therefore for this purpose, excluded from taxable income.

With respect to the first quarter, we expect organic chemistry revenue to be in the low-double digits and for adjusted EBITDA growth to be before the positive impact of [indiscernible] (24:30) translation in the mid to high-teens [indiscernible] (24:34) the first quarter of 2020.

With that, allow me to hand back over to Geoff.

Geoffrey Wild

President, Chief Executive Officer & Director, Atotech Ltd.

Thank you very much. As Peter outlined, we're forecasting good revenue and earnings growth in 2021. We have the right technology to address advanced semiconductor packaging, the high density PCB market, and the rapidly changing requirements connected to sustainable processes in plating. We believe these secular trends combined with a strong cyclical recovery from the pandemic puts us in a great position for 2021.

With that, I suggest that we now take some questions from our listeners. And after that, I'll make some final comments. Operator, we're now ready to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And your first question comes from the line of John McNulty from BMO Capital Markets.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Yeah. Good morning. Thanks for taking my question and congratulations on a great set of results and guide just right out of the box. So, I guess the first question I had was regarding cash flows as we look to 2021, you ended the year really strong in 2020. I guess, are there – when you think about like the working capital side of things, should we be thinking about in general that moving with sales as we look through 2021 in terms of kind of the magnitude of change there or are there other levers you can pull to either squeeze out cash, or is there anything we should be thinking about the new facility in China? I guess how should we be thinking about like the working capital outlook as we look to 2021?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thanks, John, for the question. In fact, we had a great improvement in 2020 in terms of operating working capital. We expect to keep this very strong and efficient level going forward. And probably, we grow along with sales with these levels. But again, I think it was a great achievement by the end of 2020 and we're able just to maintain these levels going forward.

[indiscernible] (26:55)

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Sorry. Go ahead.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Just in relative terms to sale.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Got it. Okay. No, that's helpful. And then I guess just in general, when we look at your business in terms of seasonality, 1Q was always a little bit lighter than the rest of the year. I assume that's largely because of Chinese New Year. I guess, how should we be thinking about that this year both based on what's kind of going on with regard to Chinese New Year, also with regard to like the semi issues that we're seeing with autos? Like, is there is there going to be a little bit of a difference in terms of sequencing as we progress through the year or how should we be thinking about that?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Well, first of all, we have the impact, as you said, from holidays particularly Chinese New Year. At the beginning of the year in Electronics, you have the new product cycles coming from major smartphone producers, which affect, of course, all the demand. So, the first part of the year typically in the first quarter [indiscernible] (27:57) as well as the fourth quarter.

When we talk about 2021, of course, we need to look at the comps compared to 2020. And as you know, the second quarter in 2020 was particularly weak in GMF as COVID hit the Western world in the second quarter. So we'll have a significant recovery expected in the second quarter 2021.

John P. McNulty
Analyst, BMO Capital Markets Corp.

Q

Great. Thanks very much for the color.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: Your next question comes from Kieran de Brun from Credit Suisse.

Kieran de Brun
Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning and again congratulations on your first quarter as a public company. I guess you've just touched briefly on this and John just asked something along these lines. But can you just speak to any impact that you saw in January and February that's resulting from automotive production delays due to semiconductor shortages? And if you view this impacting -- I mean we've talked a little bit about the cadence. I understand that 2Q is your easiest comp but do you see any of that demand now getting pushed out into the second half particularly like a little bit of a weaker 1Q and 2Q or is that just a near-term -- very near term temporary delay that you're expected to flow through in the second quarter as well? Thank you.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Yeah. Thank you, Kieran. I'd say the chip shortage is primarily affecting the global auto markets. For Electronics, for us, it's in the related PCB business, and in GMF, it's more kind of surface-finishing related. We think the shortage will probably reduce auto production by about 1 million units in Q1 and perhaps another [ph] 250,000 (29:46) or so in Q2. So it'll affect those quarters. Based on the feedback we're getting from our customers, however, we think the shortage which, as you know, is driven by high demand, will largely wash itself by the year-end. So our full-year growth plans, which Peter touched on [indiscernible] (30:02) remain intact.

That being said, yeah, we think the shortage may put some type of cap on how fast high auto production could possibly grow. So we're watching it very closely. But offsetting that as far as our GMF business is concerned is we're seeing good growth in other areas like sanitary where you may recall the automobile is only about half of GMF business.

Kieran de Brun
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. And then I guess on the equipment side, you had a very strong quarter within Electronics, but there's still slight weakness within the GMF equipment business. Can you discuss the backlog that you have within the GMF business? And just on a high level, how we should think about incremental chemistry sales in both Electronics and GMF as your equipment is installed at the OEM facilities? Peter mentioned from pull-through of demand in the second half in Electronics due to new equipment base. So any color you can give there would be appreciated.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Thanks. So as we've [indiscernible] (31:03), the growth on the backlog is mostly on the Electronics side [indiscernible] (31:07). That's because there's enough capacity in areas like plating on plastics for our GMF and some large equipment that was installed in 2019 going into 2020. So most of the sales at the [indiscernible] (31:20) around and the orders are Electronics which is very good going into an order book for the first half of 2021.

In turn, that Electronics growth is driven particularly by semiconductor packaging, our Uniplate lines are selling particularly well because that's what's needed for production of high-density interconnect and semiconductor packaging. So the bulk of the orders going forward will be on the Electronics side. However, we're seeing good interest in some of our new GMF equipment such as DynaSmart. We've launched this in the last 12 months and we're seeing strong interest for sales starting to come through now.

In terms of chemistry, it's not easy to give a straightforward answer because when we sell a piece of equipment, it might pull something through like $300,000 of chemistry to gear up to almost $1 million. And so the mix makes a tremendous difference. But in virtually all cases and particularly in the Electronics side, we typically get some contracts and that come through along with the chemistry equipment that we sell. But I can't be more specific in terms of the actual pull-through on the average, but I hope that helps you, Kieran.

Kieran de Brun
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah. No, that's great. Thank you and congratulations again.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Thank you very much.

Operator: Your next question comes from David Begleiter from Deutsche Bank.

David I. Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Geoff, on that same line of questioning, can you quantify the impact in Q1 do you think from the auto – lower auto production?

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Yeah. And I think, as I said, that it will be 1 million units or something in terms of auto. It will affect us by a 1% or 2% possibly on GMF business in the first quarter. But that still gives us very healthy growth about in double digits. So it's not really material to us and we think even that loss will be picked up going into the second quarter and certainly by the end of the year.

David I. Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. And, Peter, just on the cost side, can you discuss any cost headwinds and tailwinds you're seeing in 2021 versus 2020 i.e. incentive comp or some temporary costs that are coming back in the business? Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah. David, as you said earlier, we face the typical inflationary impact in 2021 when wage inflation is kicking in again. We had some cost containment activities which might not repeat itself and we started some growth initiatives. We ramped up our Indian development facility as well as our second Chinese chemistry plant. Being said that we still believe that a major part of the additional margin is being converted into profit and this gives us a nice improvement in 2021.

David I. Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: Your next question comes from Josh Spector from UBS.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah. Hey, guys. Thanks for taking my question and congrats again on the achievement here. Just broadly on the margin side, again, kind of a follow-up to a prior question I guess, when I look at the incremental EBITDA into 2021, on your organic guidance, the margin there is around 50% almost. When I include FX, it's kind of in the mid-30s. I guess what do you consider normal? Is 2021 a normal EBITDA leverage that you're seeing or would you think that there's something different that we should expect more in medium term, longer term?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

So, overall, I think it's important to look at our margin mix that we have a very strong margin on the chemistry side of close to 60% and we converted nicely to profits. The assumption is and we have shown that we were able to offset wage inflation every year by sustainable cost measures. And I see that's also valid going forward. We might invest part of the incremental EBITDA into growth initiatives which we do in 2021. We might do also going forward. But still this gives you a nice leverage and a nice conversion of our margins into EBITDA.

Joshua Spector
Analyst, UBS Securities LLC

Q

Okay. Thanks. And just on free cash flow, I mean you're pretty clear in your tax guidance in terms of how to treat that and put that on operating income. I guess in light of your view of refinancing, I know you can't give a specific number but how much room is there to improve on that over the next year? And how meaningful can that be to a free cash flow [indiscernible] (36:20) versus what you're expecting now?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Well, our current term loan has 300 basis points plus LIBOR and 100% – 100 basis point floor. So it's virtually running at 4%. When you look at our lower leverage and the recent upgrades we received by S&P and Moody's, I just expect that we're able to shave off a decent amount of debt levels which I just said and can build in some more efficiency into our capital structure. As soon as tI have some more news and we completed the transaction, I will let you know.

Joshua Spector
Analyst, UBS Securities LLC

Q

I guess if I could just try to clarify just -- so in terms of the tax rate though and the cash taxes, would refinancing benefit that or is there something structural which wouldn't have an impact there?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Well, we do not have much tax shield on the interest so there's a limited impact on the taxes.

Joshua Spector
Analyst, UBS Securities LLC

Q

Okay. Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: Your next question comes from Jeff Zekauskas from JPMorgan.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Thanks very much. You had very, very nice revenue growth in the fourth quarter in your businesses. And in describing it, you said if you adjust for palladium and product mix, compensation, the EBITDA margin was largely unchanged. Why wasn't it higher? Was there some negative pricing effects or what helped it down? Why are your incremental returns the same as your average returns?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah. Jeff, as you said, we grew 5% organically with our chemistry business on an organic level. We also we're able to improve EBITDA by 5%. Embedded here is the increase of the compensation accrual in the fourth quarter, which related to the full year and which had a negative impact. If you take that out, the increase in profits would have been higher.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

So, then as my follow-up, do you have a target for your normalized EBITDA margin? That is do you think in three years it will be the same or lower or higher or higher by how much or lower by how much assuming you hit your revenue target?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah. I think, first of all, just a reminder that if we see increasing palladium prices, you will see some kind of dilution.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

No, excluding that. Yeah.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah. If I exclude that, we convert the growth into profits and this will lead to improved margins over time.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Great. Thank you so much.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: Your next question comes from P.J. Juvekar from Citi.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Yes. Hi, good morning or I should say good afternoon.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Good morning.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Good evening, Geoff. On the 5G rollout, that's going to benefit you both from the handset side and the 5G infrastructure side. What innings would you say you were in in this 5G rollout and how much benefit can continue in 2022 and beyond?

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

P.J., thank you for the question. I would say that we've got a tailwind of several years. On infrastructure, it's well advanced in China with another two years to go of some infrastructure build-outs and still starting in America, and of course, in Europe. And this is before sub-6 millimeter wave starts to be installed as well, which gives us some momentum beyond that.

In terms of 5G rollout, we're looking at about 20% of the handsets that are sold today will be 5G. And that'll increase to about 80% on current forecast by 2024. So we've got about three years of increasing 5G penetration in handsets. And as I mentioned earlier, it does provide a good tailwind for us because of the increasing complexity and extra layers that are required on these high frequency boards and the penetration of new semiconductor packaging technology wafer level fan-out packaging as well. So the combined effect of that is we get about 50% more in a 5G phone compared to an average 4G phone. So we're going to see the continued effects of this I think until 2024 at least.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Great. And just related to that, another question, what – how much share gain do you have in 5G versus 4G? And then I'm sure your competition is not standing still and they're innovating as well. So, can you talk about your competitive dynamic and sort of why that favors you? Thank you.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Certainly. We made a decision several years ago to concentrate our R&D particularly on this packaging space, driven by the decision that as Moore's Law was running out of speed on the wafer, the density would have to move to chiplets in the packaging. And so it has proved. And so for the last five years or so, we've particularly been concentrating on putting our chemistry towards the fine lines and spaces that are required particularly for the interposer on which these chiplets sit and are then packaged to get high-density in the overall integrated package.

So, this is a complex chemistry. It required multiple years of qualifications with the OEMs. It also requires some new equipment which is why as I referred to earlier, Uniplate lines are selling particularly well. So I think our competitive advantage here is OEM qualifications. We [ph] have (42:24) plan of record. We have a very strong position in this particular area. We have a good equipment sales, good chemistry follow through in this area and really strong customer support and technical service support in those areas which are important for production, particularly Greater China. So I think that is the summary of our competitive advantage.

P.J. Juvekar
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you very much.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Thank you.

Operator: Your next question comes from Laurence Alexander from Jefferies.

Laurence Alexander
Analyst, Jefferies LLC

Q

Good morning. Just a couple of things. First, can you give a sense by your key businesses so the electronics, the automotive and then the other industrial, the degree of actual visibility you have and how quickly you see inflections in demand or in order rates? And then secondly, when you build new plants for example the new Chinese capacity, how long does it normally take to fill out a plant?

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Thank you, Laurence. In terms of visibility, it's variable and particularly at the minute because our customers are not always able to give us the amount of impact for example on the semiconductor shortages. We have 14 factories operating around the world. And the reason we have them close to our customers is because in many cases we can do same day delivery or certainly same week delivery.

So, we work closely with the customers and have pretty good visibility, about four to six weeks ahead on actual demand. This is also augmented because in many cases we're supporting and maintaining the parts for our customers.

On the electronics side, because of the longer lead times on semiconductors and particularly on frontend of the work, we get much better visibility in the region of one to two to three months depending on the actual process.

In terms of manufacturing and our ability to scale up, we have plenty of capacity in the factories. As I mentioned, we've augmented this with the new factory in China. We're building a new one in Mexico. When we need additional capacity, we can add in general extra shifts. And we're not currently impacted by many raw material shortages, although it's getting a little bit tighter in one or two areas. So, we're not too worried about the capacity of our factories. And they're also fungible in the sense that if we did have a problem at one, the same products are often qualified at different factories, so we can move product around.

Laurence Alexander
Analyst, Jefferies LLC

Q

I guess maybe if you don't mind elaborating the – my impression was that capacity utilization is kind of a less useful metric for your business because of the way the plants work. So, when you decide to add new capacity, for example the plant in China, is it new functionality or new product lines that are tied to a particular industry or new skill sets that you're importing into a region? I mean, can you just characterize what the point is of a new plant?

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Thank you. Yes. I'd be happy to, Laurence. Thank you. When we made the decision to be in the Yangzhou, we had enough capacity at our Guangzhou plant in the south. We were however worried that for one of our largest sales areas we'd only got one plant. So, on grounds of redundancy initially, we decided that we would build an extra plant up in case either environmental regulations or local restrictions put pressure on us – the plant in the south.

So, we went ahead. And over the last four or five years, we've completed the plant in Yangzhou. Now that we have, we are accelerating the qualification with customers because the capacity is needed both because of growth of customers in the Shanghai region, which is strong for us but also because coronavirus regulations at the minute are meaning that we can't do multipoint deliveries for example from our delivery trucks out of the factory in the south. They have to make point-to-point deliveries, which is limiting our ability in some particular areas.

So, it's really a matter of redundancy plus local service. China being such a massive country, we wanted to have a factory very close to our emerging new customer base in the Shanghai Delta region.

Laurence Alexander
Analyst, Jefferies LLC

Q

Great. Thanks.

Operator: Your next question comes from Duffy Fischer from Barclays.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Yes. Good morning. The first question is, can you just tell us what the new net debt number is pro forma for the IPO? And then in your comment where you said you're going to pay down about a half turn of net debt ratio per year based on free cash flow. The math of that would say you're going to convert one-half of your EBITDA to free cash. Is that a valid number as well?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

So let me just see [ph] what I get to (47:36) give you that debt net number. Again, I think that the leverage by the time of IPO was 3.85. I need to pull out the net debt number, the final net debt number and provide that to you later on.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Okay. Fair enough. But the 50% conversion of EBITDA to free cash flow, is that a fair number?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

If you talk the adjusted free cash flow as we have defined it in the attachment, we see a 60% conversion of our adjusted EBITDA into free cash flow.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Okay.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

And then...

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

And then off your guided adjusted EBITDA number, what's the D&A that's embedded in that number for this year?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

I think it's – the ongoing depreciation, amortization excluding the extraordinary write-off we had last year, it's around $180 million but again, I think if you go into our 20-F, you see the numbers excluding the extraordinary write-off we have taken last year into the...

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

No, no. I'm just – in your guidance of $405 million to $425 million, I'm just trying to understand what's the embedded D&A in that number?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

It's EBITDA excluding depreciation and amortization.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

No. What I'm trying to get to is, what is EBIT? So, if you give us guidance of $405 million to $425 million, I just want to understand what's the embedded D&A number that's in that?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

I think if you take the – just reference to 2020 excludes the extraordinary write off, that there might be some FX effect to be seen in 2021. But probably then you come pretty close to the number when you calculate that what you need to know for your reconciliation.

Duffy Fischer
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you, guys.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

A

Thank you, Duffy.

Operator: Your next question comes from Ben Kallo from Baird.

Benjamin Joseph Kallo
Analyst, Robert W. Baird & Co., Inc.

Q

Hey. Thank you, guys and congrats again on the first quarter. Maybe can we just touch on the opportunity in sustainability, if you can group it like that. And then maybe just on the auto side, the opportunity there for both lightweighting and anything in the higher electronic components per vehicle, how do you see that? And if you could give dollar terms or any type of data about who you're talking to or where those conversations are going, that would be great. Thank you very much.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.
A

Thank you, Ben. Yeah. On sustainability, you will be hearing a lot more for us by the way because obviously until a month ago we were a private company and we'll now be putting out some sustainability reports now we're a public company and upgrading our communication in this area. In terms of sustainability and auto if I understand what you're doing -your question. We are seeing generally about 30% improvement in Atotech sales as we move towards hybridization, and hybrid vehicles and electric vehicles. That's driven a lot by the electric components, but it's also driven by things like lightweighting where we're getting increased sales of things like plated plastics, ABS components that would have been or could have been metal before. We're seeing good improvements in some battery plating technologies that we have available. We're seeing some good improvements and some premiumization versus the chrome on the interior and exterior. This coming along nicely and differentiating some electric vehicles. So, overall we see about a 30% tailwind as we move into this area. It helps us on several other areas on the electrification as well.

Benjamin Joseph Kallo
Analyst, Robert W. Baird & Co., Inc.
Q

Great. Thank you.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.
A

Thank you, Ben.

Operator: Your final question comes from Arun Viswanathan from RBC Capital Markets.

Arun Viswanathan
Analyst, RBC Capital Markets LLC
Q

Great. Thanks for taking my question. Congrats on the results. I guess, the first question I had was obviously we're early in the year and so it's expected to provide a range. But maybe you can just kind of give us some factors that would push you to the upper or lower-end of the guidance range for the full year, the $405 million? What's embedded in the $405 million and kind of what's embedded in the $425 million? Thanks.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.
A

Yeah. Thanks, Arun for the question. So overall, we believe that there are opportunities to outperform the market if the market remains constructive. Again, I think it's a matter of volumes at the first place where we see strong volume growth at the first part of the year. And we're more cautious in the second part of the year. But also, the second part is that we might be able to outperform if costs do not come back to our business as fast as we have modeled it. This relates, to one extent, to travel where we just planned for a certain travel budget. With the travel restrictions, we might need to see when they are being lifted and when cost comes back to the business.

And lastly, I think, just to mention we also see on the interest side, as I indicated, through the refinancing and opportunity to improve our efficiency and reduce the interest expense going forward. So I think that's three areas where we see ourselves to have some opportunity in order to be able just to be on the upper end of the range.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Okay. And then, thanks for that. And then on the leverage, now you're below four turns. So you've indicated that you'll likely be in a position to de-lever about half a turn a year. So, yeah, maybe you can just reiterate what you think target leverage is for the business and what you will do with cash to get there? And then – I'm sorry, what you will do with the cash once you get there? Thanks.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thanks, Arun. So, again I think a clear commitment on our side is to de-lever as fast as possible. We have shown in the past that we are able to de-lever around a half a turn every year. With the strong growth and profit improvements we expect in 2021, we are able to convert that into additional cash as well. So we'll be close to nearing 3 times leverage by the end of the year. And on the capital allocation rules, nothing has changed. Our focus is on supporting the organic business, de-lever, and in mid-term, having some small bolt-on acquisitions as we have communicated that. I think that's the capital allocation rules we have set ourselves, they very much remain intact as well.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Okay, great. Thanks a lot.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: There are no further questions at this time. I will now turn the call back to Mr. Geoff Wild for any closing remarks.

Geoffrey Wild
President, Chief Executive Officer & Director, Atotech Ltd.

Well, thank you, operator. And I'd like to thank everybody for the questions today. We've got to close the call here as we're running out of time. But to finish, I'd reiterate a few key points from this call. Our Electronics business has grown throughout 2020 and is poised to continue growing with secular trends like 5G infrastructure, 5G smartphone, replacement cycles, and growth in IC substrates and semicon packaging accelerate. Our leading technology and comprehensive solutions are key enablers in the Electronics value chain.

Further, as GMF markets are quickly improving and our focus on delivering sustainability enabling solutions will offer us a multiyear tailwind. Together, these secular trends not only provided a constructive backdrop in the fourth quarter, they also present a multiyear opportunity to grow our business, expand share and deliver strong returns to our shareholders.

And finally, may I say to our teams around the world, I'd like to say thank you for continuing to stay safe and for staying focused on our customers. Your dedication and flexibility have enabled us to manage successfully through the pandemic, become a public company, and have positioned us very well for the future. I expect our hard work to pay strong dividends as we move forward. So thank you all for being on the call today. And we look forward to speaking with you again at our next call.

Operator, that ends the session. Thank you.

Operator: Ladies and gentlemen, this concludes today's conference. We thank you for your participation. You may now all disconnect.