Corrected Transcript

11-Aug-2021

Atotech Ltd. (ATC)

Q2 2021 Earnings Call

CORPORATE PARTICIPANTS

Sarah Spray
Vice President, 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

Joshua Spector
Analyst, UBS Securities LLC

Steve Byrne
Analyst, BofA Securities, Inc.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

John W. Pitzer
Analyst, Credit Suisse Securities (USA) LLC

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

David Silver
Analyst, C.L. King & Associates, Inc.

Laurence Alexander
Analyst, Jefferies LLC

Silke Kueck
Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Atotech's Second Quarter 2021 Earnings Conference Call. Today's speakers are Geoff Wild, Atotech's Chief Executive Officer; Peter Frauenknecht, Atotech's Chief Financial Officer; and Sarah Spray, the Head of Investor Relations.

After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions] We kindly ask that you limit yourself to one question and one follow up. 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 would now like to turn the call over to Ms. Spray. Please go ahead.

Sarah Spray

Vice President, Global Head-Investor Relations & Communications, Atotech Ltd.

Thank you, Catherine. Good morning, everyone, and thank you for joining Atotech's second quarter 2021 earnings call. 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 20-F filing for a list of factors that could cause our results to differ from those anticipated in any forward-looking statement. We undertake no obligation to publicly update or revise any forward-looking statements, except as required by law.

Please note that when we come to the Q&A at the end of this call, we will not be taking any questions relating to the MKS transaction. We ask that you limit your questions to aspects of our second quarter only.

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

Geoffrey Wild

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

Thank you, Sarah. Good morning, everyone, and welcome to our second quarter 2021 conference call. In our second quarter, as a public company, we are pleased to present an excellent set of results.

As you'll remember, from a global perspective, Q2 2020 was the quarter most affected by the pandemic lockdowns. Therefore, as we look at our Q2 results now and further into our outlook for the rest of the year, you will see the effect of the recovery from Q2 2020 trough, as well as the tempering of those very high growth rates as we move into the second half.

In the second quarter, we experienced organic growth of 9% for our Electronics chemistry. This is a strong result for a second quarter, in particular when you consider that by Q2 last year, China had already begun to recover from the pandemic. Thus, the demand we experienced is primarily driven by secular trends in which we continue to participate, especially 5G and millimeter wave, as well as advanced semiconductor packaging.

Some of these growth drivers were stronger than expected in Q2 and we believe they will support us well into the future. For example, we had previously expected that the work-from-home trends would start to abate in the second quarter of 2021, but the arrival of the Delta variant of COVID-19 meant that work-from-home-driven computer demand continues to be strong, particularly in Asia. In addition, the never-ending search for more server capacity and greater data volumes continue to drive computer demand and, therefore, our customers' demand for our products.

Now as Peter will review later, the record order level for Electronics equipment we saw in the first quarter of 2021 translated into very high levels of equipment revenue. And as always, these equipment sales are supportive of sustainable future chemistry revenues.

In quarter two last year, our General Metal Finishing segment experienced a deep trough in demand as a result of the pandemic, the rebound from which is clearly visible in the 59% organic revenue growth in chemistry. Although auto production worldwide remains below typical trends due to the well-known semiconductor shortages, our strong presence in China and differentiated offering helped us to grow ahead of the overall market.

Our strong revenue growth, coupled with the operating leverage inherent in our business model, provided us with a 63% increase in Adjusted EBITDA to a record result of $118 million. We generated adjusted free cash flow from operations of $86 million, returning to a very strong conversion rate from Adjusted EBITDA. As a result, we ended the quarter with net leverage of 3.2 times EBITDA. So we are well on track towards our targeted capital structure.

In this past quarter, we experienced a surge in demand for our sustainability-related products in both GMF and the Electronics segments. Atotech is uniquely well positioned to meet this demand, given of our decades of focus and investment on sustainable plating solutions.

For example, our Covertron pretreatment process for decorative plating is currently now up and running with two customers and in qualification with a further 15 customers. Our revolutionary patent-pending Fumalock solution is the world's first PFAS-free mist suppressant and, with it, we are in a unique position to help redefine the environmental footprint of the plating industry.

I'd like to close with an update on our digitalization activities. The addition of software to our integrated offering is a further differentiator, and I'm very pleased to announce that we have signed our first contract with a high-end industry partner to implement an innovative combination of IIOT solutions and hardware optimization, which will enable our customer to reduce overall energy consumption and meet their climate-related goals.

Although today, the percentage of revenues from our sustainability products is relatively small, Atotech is a leader with a broad portfolio of products offering tangible benefits to our customers in terms of reducing the environmental footprint of their activities.

Now before I hand the presentation over to Peter, I'd be remiss if I didn't mention the acquisition agreement with MKS Instruments. As of July 1, the board of Atotech reached an agreement to join with MKS for a total equity value of $5.1 billion. MKS is a global leader of instruments, systems and process control solutions that measure, monitor, power and control critical parameters of advanced manufacturing processes, especially semiconductors.

Similar to Atotech, they have a strong focus on technology and our customer solutions are complementary for key advanced Electronics markets. The regulatory approval process for the merger is underway, and the transaction is expected to close in the fourth quarter of 2021. We expect that joining with MKS will provide additional opportunities for collaboration, innovation and continued groundbreaking solutions.

And with that, I'd like to hand it over to our Chief Financial Officer now, Peter Frauenknecht, for a review of our financial results, after which we'll take questions. And please note, as Sarah mentioned, we can't address questions pertaining to the MKS acquisition today. So, please – we would be grateful if you could please limit your questions to the subject of our quarterly results. Peter?

Peter Frauenknecht

Chief Financial Officer, Atotech Ltd.

Thank you, Geoff. Good morning, everyone. I'm very excited to review our Q2 as we achieved record financial results and continue to grow ahead of our end markets.

Let's start on slide 4. For the second quarter, our total revenue was $377 million, an increase of 44% over the prior year, including organic revenue growth for chemistry and equipment of 32% as well as an FX tailwind of 9% and a 3% benefit from palladium pass-throughs. Palladium price continued to rise and contributed $7 million to our top line, while a weaker US dollar positively impacted our sales by $24 million.

The key secular trends, which Geoff highlighted, remain the principal drivers behind our strong revenue growth. To a large degree, the high growth rates seen at GMF are a result of the recovery from last year's quarters, which were heavily affected by the COVID-related plant shutdowns, which I will address, but I will address our two segments in detail on the later slides.

Looking into our profitability, you can see the quality of our gross margin and the high operating leverage inherent in our business model as we increased our Adjusted EBITDA by 63% compared to the second quarter in 2020, adding 370 basis points to our Adjusted EBITDA margin. It's worth noting that our margin of 31% leads the industry despite the negative product mix effect from higher equipment sales as well as the dilution from the pass-through of higher palladium prices.

Similar to the first quarter of 2021, Q2 was also affected by supply chain disruption, elevated freight expenses and material inflation. However, as we anticipated in May, we were able to keep the impact on our gross margin to below 2% of sales.

Looking ahead to the third quarter 2021, although higher freight costs will begin to abate, we anticipate that the raw material costs will continue to be elevated. To counter these effects, we continue to work on procurement efficiency and will pass on persistent cost increases to our customers.

Diluted earnings per share was $0.15 for the second quarter. You can see the profound effect of analyzing the quarters most affected by the COVID-19 pandemic in the recovery versus the loss of $3.47 in the second quarter of 2020.

As announced in May, we're now publishing an adjusted EPS. We have taken the same adjustments as for our Adjusted EBITDA, with the addition of the elimination of the amortization expense stemming from the increase in book value associated with the acquisition by Carlyle. The adjusted EPS is pro forma for the prior year period based on the same number of shares as we had in the second quarter of 2021.

2021 adjusted EPS was $0.29 per share. And here too, you can see the effect of the rebound in our strong operating leverage. You will find a detailed explanation of the adjustments in the appendix slides of this presentation. Going forward, we will apply the same adjustments, which we believe present an accurate view of our earnings capacity.

Let's go to slide 5 for a deeper look into the Electronics results. Our performance in Electronics continued to be very strong in the second quarter with total revenue of $248 million, increased 33% year-over-year. This result included organic growth of 21%, a favorable palladium impact of 4% and an 8% benefit from FX translation.

Organic growth in chemistry revenue for Electronics was 9% in the quarter, underpinned by the strong growth in the smartphone market as well as sustained growth in the high-performance PCB and semiconductor-related businesses.

As mentioned in May, this growth has been anticipated, and we are pleased to see it unfold. That said, please keep in mind that 2020 saw some shifts in typical seasonality. Work-from-home created stronger demand for laptops in the third quarter and a well-known OEM shifted its product launch [ph] patent (00:12:58) into the fourth quarter. As we lap this quarter, the base effect may cause mathematically lower growth rates compared to what we reported in the first half of 2021.

Electronic equipment sales enjoyed another outstanding quarter with organic revenue up 115%. The demand stems from the sources we have outlined previously, the full transition to 5G for the smartphone manufacturers with a high demand for computing. Our next-generation machines are in high demand as OEMs and PCB manufacturers seek to meet consumer demand.

Electronics generated $85 million of Adjusted EBITDA in the quarter, a $23 million or 36% improvement over the prior year period, primarily driven by the strong organic volume growth and our lean cost structure.

Margin was 34.3% in the quarter, up 20 basis points, which is a reflection of the robust organic volume growth, partially offset by product mix effects from high equipment sales and the palladium pass-through.

Moving to slide 6 now. GMF total revenue grew 71% to $129 million in the second quarter, comprised of organic growth of 59%, a 1% positive impact from palladium and an 11% tailwind from FX. From a mix perspective, chemistry revenues grew organically at 59% and equipment revenue rose 48% from a low base.

As Geoff said, this rebound is partly a reflection of the annualization of the quarters heavily affected by the COVID-19 pandemic. We also observed that high-end automobile and construction applications were stronger than expected. Automotive producers are still operating below full capacity due to the semiconductor shortage, but the demand environment is intact. So we believe that demand is simply being pushed out possibly even into 2022.

In the meantime, we are also experiencing promising project wins outside the auto market and strong demand for our sustainability-focused solutions. As Geoff touched upon earlier, we have seen an increase in interest for our sustainability-related products. As CFO, it's worth noting that our preparation to meet this opportunity rests on many years of development and investment. For example, the cumulative spend on R&D for the Covertron system has been nearly $20 million, spread over more than a decade.

As we look to earnings, GMF Adjusted EBITDA hit $33 million in the quarter and the adjusted margin was 25.8%. The growth in Adjusted EBITDA reflects our strong operating leverage partially offset by the higher freight expenses as a result of the well-known supply chain disruptions and the mentioned higher material inflation. The recovery of the Adjusted EBITDA margin to 25.8% is thanks to similar effects, and it's worth noting that we're now back on the path to normalized margins.

Let's now move to slide 7. We generated strong free cash flow of $86 million before debt service, returning to adjusted cash flow conversion rate more in line with our long-term targets of greater than 60%. The strong cash flow was also a function of our efficient working capital management, with working capital at 16% of revenues in the second quarter as well as our efficient CapEx, which was 2% of revenue.

Please note that we have a typical seasonality to our CapEx, with the majority coming in the second half of the year. So, although the spend as a percentage of revenue was lower than our full year guidance, we're fully aligned with our internal expectations. As a result, at quarter-end, we had $245 million of cash and a revolving credit facility of $233 million available, so in total a liquidity of $478 million.

Cash repatriation at a holding level are proceeding as planned, supporting our balance sheet efficiency and financial flexibility, particularly when it comes to investing for future growth. Our net leverage improved to 3.2 times, a significant improvement versus our 3.7 times level at the end of the first quarter 2021.

This is partially due to our cash generation and also supported by the annualization of the quarters of 2020, which were affected by COVID. That said, taking our expected cash flows, we should further improve our net leverage by the end of 2021. We'll be well on our way to our targeted capital structure of 2 to 3 times net leverage.

Moving on to slide 8. Turning to our guidance. I'm pleased that our strong Q2 performance and the support of our underlying demand trends allow us to once again raise our guidance range. In the beginning of 2021, we expected a growth range of 10% to 12% for total revenue. And having raised that expected range in May, we are raising it yet again to 13% to 14%. As I mentioned earlier, please keep in mind that moving into the second half of the year, we start to lap some extremely strong quarters, particularly the fourth quarter 2020.

Coming to our key performance indicator of organic revenue growth in the chemistry, we increased expectations for Electronics chemistry to 7% to 8% and moved the expectations for GMF up to the high end of the range at 12% to 13%. This allows a forecast of approximately 10% in organic chemistry revenue growth, a full 1 percentage point more compared to our previous guidance.

We take our Adjusted EBITDA guidance for the full year from between $415 million to $435 million to a range of $435 million to $450 million, adding to the midpoint an additional 3 percentage points of growth. This now represents 20% earnings growth for the full year and reflects our confidence in our revenue growth potential as well as our cost discipline and operational improvements.

Our underlying assumptions for our guidance are the same as noted on the slide. Our CapEx guidance remains unchanged at approximately 4.5% to 5% of total sales in 2021. We're in line with our full year expectations. Our major investments are focused on our new Mexican facility, digitalization initiatives and customer-specific projects.

As we communicated to you in May, our guidance for interest expenses already anticipated the refinancing activities. Therefore, we confirm that the range for normalized interest expense is anticipated to be between $70 million and $74 million for the year. This is based on our new capital structure and does not include one-time costs related to our refinancing activities.

Finally, our income tax rate, which includes income and withholding taxes, should be unchanged at around 30% to 31% of our adjusted operating profit.

Looking forward to the third quarter of 2021 and keeping the effects of pandemic recovery in mind, we feel confident in expecting organic total revenue growth and Adjusted EBITDA growth in the high single-digit growth range.

With that, I think we can open the floor for questions, operator.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] And our first question comes from John (sic) [Josh] (00:22:02) Spector with UBS. Your line is open.

Joshua Spector
Analyst, UBS Securities LLC

Q

Hey, guys. This is Josh, Josh Spector. So just curious if you could provide some granularity on the sequential sales change and EBITDA change in Electronics. So chemistry sales were only up around $6 million. I assume a decent portion of that is metals. But EBITDA was up $9 million. So we haven't heard about costs decreasing sequentially across the space much at all to date. So curious what was the driver of the increase in EBITDA sequentially for Electronics?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Josh, thanks. Let me just take this question first. So first of all, we nicely converted our growth into profit, maintained pricing stability, had good mix effects. In addition, we continue to run a very lean cost structure and the initially expected cost increases didn't materialize. So in other words, we haven't had much travel expenses and we were able just to continue to drive the cost measures we had initially planned.

Joshua Spector
Analyst, UBS Securities LLC

Q

Okay. Thanks for that. And just – yeah. No. That's helpful. And I guess just thinking broadly on your strategy, you guys have been pretty clear about your equipment plus chemistry driving the strategy, the combination with MKSI further drives that. I'm not asking you to specifically comment on MKSI, but just thinking generally, when you go to win new business in Electronics, how often are other ancillary equipment providers involved in that conversation when you're trying to get spec into that additional application? Is that something that's common or unique? Or could you just kind of characterize how that develops?

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

A

Yes. Thanks. I think at the lower end, there is usually some competition of its generic plating equipment. A lot of our sales have been for areas like Uniplate, which is at the leading edge of semiconductor packaging. And the sales have been predominantly in those areas and particularly in Asia.

Those sales have been driven by two factors. One is that the Uniplate gives a lot of environmental advantages to our customers, like a reduction in wastewater treatment and costs. But secondly, it enables the customer to use the advanced plating chemistry and meet the very fine line and space requirements that are inherent in the advanced semiconductor packaging.

So at that end, there is – we have very high market share, and there is less opportunity for other suppliers of equipment to come in and compete, which is why we have a very high percentage of chemistry and equipment mix at that part of the market. I hope that clarifies, Josh.

Joshua Spector
Analyst, UBS Securities LLC

Q

Yeah. Thank you.

Operator: Thank you. Our next question comes from Steve Byrne with Bank of America. Your line is open.

Steve Byrne
Analyst, BofA Securities, Inc.

Q

Yes. Thank you. I'd be really curious to hear your view on what you're expecting trends in auto use of metallic coatings to go to from here. Is that a trend that you expect to increase or decrease from here? And perhaps that depends on the region of the world, the price of the vehicle, where on the vehicle, interior, exterior and ICE versus EV. If you could comment on that, we would appreciate that.

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

A

Thank you. In general, we see more use of metallic coatings at the higher end of the market because of the attractive finishes of things like satin chrome, which provide a good luxurious finish to the automobile. So we do better at that end of the market.

We are also seeing more metallic coatings in areas where the vehicle needs lightweighting as we move from hybrid into EV, electronic vehicles. For example, the components that might have been metal in the past are now becoming plastic, coated plastic components due to lightweighting and that increases the metal content as well.

In general, we're expecting about 30% more chemistry on EV versus ICE, and that's driven by the number of fasteners and connectors and electronic additive components as well as the surface finishing that we're involved with. So there is a general good trend toward increased metallization, particularly at the premium end of the market.

Steve Byrne
Analyst, BofA Securities, Inc.

Q

And Geoff, you mentioned this PFAS-free mist suppressant. I have – it begs the question about your legacy mist suppressants. What would be your revenues from these products that do contain PFAS? And maybe more specifically, is the unit operation that they're used in by your customer, does it generate wastewater?

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

A

I can't give you the precise percentage at the minute, and we've been helping customers with auxiliary equipment for wastewater treatment for some time. But just to be clear, we have strictly adhered to the Stockholm convention on Persistent Organic Pollutants and derived regulations. So we're not really responsible for the way that our customers handle the treatment of the materials.

But I'm very pleased that we're now able to move on to a really new range of mist suppressants where none of these materials are required. The one I mentioned in the text, the Fumalock solution, is the world's first PFAS-free mist suppressant. And we're currently, therefore, on track to eliminate all sales of materials containing short-term PFAS, which is being very well received by the customer base as they seek to move – to meet upcoming regulations.

Steve Byrne
Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: Thank you. Our next question comes from Arun Viswanathan with RBC Capital Markets. Your line is open.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question. I guess I just wanted to get a little bit more on the markets here. So obviously, there's automotive exposure in GMF and maybe that was some of the – that drove some of the performance. Was that segment kind of below your expectations? And was it due to automotive?

And similarly, in Electronics, you guys had a pretty robust quarter there. You talked about the cost. But just thinking about the demand, did demand materialize a little bit better? And if so, what would you highlight on that front? I know you talked about COVID, but anything else? Thanks.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Why don't I start, Arun, and Geoff can chip in later on. So again, I think we saw a very nice rebound of the automotive business, good growth rates all around in all the regions. We saw that China is performing very well. But we also see that markets outside automotive have shown good growth rates. And this was very encouraging and contributed nicely to the great performance of GMF in the second quarter.

When we look at Electronics, we also saw that the performance was better than we initially expected because many markets continue to grow strongly. And it's a broad-based growth. We see strong growth in smartphones. We also see that work-from-home-driven laptops, computing, cloud services, all of that drives demand.

And even though the smartphone cycle moved by a quarter, and as you know that one of the key OEMs moved their cycle to fourth quarter and ending their cycle in the first quarter, we continue to see good growth rates and good demand in China. So all in all, it's a broad-based growth, which we benefited in the second quarter.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Okay.

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

A

I'd only add to that, I think we're seeing good drivers on 5G penetration, starting millimeter wave penetration. You've seen upgrades by some of the major smartphone manufacturers in their outlook, which has come through into the supply chain, which has given us better growth than expected and a better outlook as well for the second half than we expected ahead of their anticipated launch for the first quarter of next year.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great. Thanks. And then just – also just wanted to get your thoughts on the equipment business. It's somewhat unique to you guys. Are you seeing more orders there? And does that give you visibility into next year as well? Thanks.

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

A

Yes. We – still strong on equipment. Our factories are pretty much fully loaded now. We're dealing with some supply chain stock shortages as well on some components and I think managing that quite nicely.

Our factories in both Germany and China are pretty much full up and we've got a good order book and visibility out, I think, to the second half – to the first – to the end of the first half of next year. So it's mostly driven in by Electronics, mostly then driven by semiconductor packaging and HDI. But we are starting to see some interesting inquiries as well for the GMF business, which we believe should recover next year as well.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Thanks.

Operator: Thank you. Our next question comes from David Begleiter with Deutsche Bank. Your line is open.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Good morning, Geoff and Peter. Just looking at Q4 guidance, can you comment on the somewhat wide range? And it looks like at the low end it could be down year-over-year. What factors would cause Q4 to be down year-over-year? Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah. I think we have a pretty good visibility for the third quarter. And there are various factors driving the fourth quarter market trends. And if you look at market estimations and the key marketing firms, they see a probably rather stable or slightly declining market for the automotive market in the fourth quarter.

We believe that we outperform the market, but still the fourth quarter 2020 was a very strong automotive quarter where we are not sure with the supply chain shortages, how the trend is going to be.

On the Electronics side, we continue, despite the fact that, as I said, one of the key top OEMs started their smartphone cycle in the fourth quarter. We continue to see strong demand. We continue to see growth in

Electronics again. But the comps are getting a lot more difficult with the automotive market returns in the fourth quarter 2020.

And also the Electronics, particularly the smartphone market, performing very, very well in the fourth quarter last year. So again, we see that we definitely perform at that level, but the growth rates are dependent on various factors, and that's what we put into our focus.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

And just commenting on the first half of the quarter right now, are you ahead or in line or behind your forecast for top line and EBITDA growth for Q3?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Well, as I guided, you saw that we improved our guidance for the full year. So what we mentioned over the last calls as well, we were quite cautious going into the year. We see a strong confirmation of our growth trends. We see a strong confirmation of our project wins. And with that, we were able just to increase the guidance for the full year and we were able just to increase our guidance for organic chemistry growth rate as well as equipment growth rate. So all in all, I think we're able just to confirm a more optimistic view for the year.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: Thank you. Our next question comes from John Pitzer with Credit Suisse. Your line is open.

John W. Pitzer
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah. Good morning, guys. Congratulations on the strong results. Thanks for letting me ask the question. Peter, I apologize if I missed this, but as you think about your total growth expectation for the full year on an organic basis, can you help us kind of parse out how you're thinking about second half palladium pricing and FX impacts?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Well, I think we applied the FX rates as of June and similarly that for the full year. So again any change might also impact our total numbers or forecast. But again, just please use the June FX rates as we applied them for the rest of the year.

On the growth rates, we continue to see good growth rates for our business. However, as I mentioned before, the comps are getting more difficult. The second half of the year – China returned to growth June 2020 in our business. So you see that the comps changed there. But we also saw, as I mentioned before, that the automotive market returned strongly in the fourth quarter last year.

All of that needs to be taken into account. So we continue to see a very strong performance of our business. We continue to see good demand in automotive. And we see continued demand, strong demand for all of our latest technologies on smartphones and also in all the other areas.

John W. Pitzer
Analyst, Credit Suisse Securities (USA) LLC

Q

And then, Geoff, as my follow-up, I'm wondering if you could just comment a little bit on the Electronics equipment business and the prospects for sustainability. I mean how much of this do you think is cyclically motivated? How much do you think of this is kind of structural share gain on your behalf?

And I guess as you answer the question, I'd be curious as to whether or not you expect to see any impact from the CHIPS Act. I think a lot of people view that as helping front-end capacity in semiconductor. But I kind of get the sense that you're going to have to see some back-end capacity perhaps migrate into different geographies over time. Are you seeing that yet? And is that something that you expect to see in the future that could sustain growth here?

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

A

Yes. We have started to see some of the equipment move outside traditional areas like China. We had some very good orders during the quarter from some other areas of Southeast Asia with some new customers. It's being driven by advanced packaging. It's being driven, as I mentioned, by some sustainability requirements. It's being driven by addition of capacity, but also the wafer-level fan-out type of applications.

So we're seeing customers, that because of those front-end requirements and expansion you're talking about, are now starting to add back-end capacity in anticipation of that, driven as well by tighter requirements for areas like smartphone and 5G packaging.

I'm also pleased to see that that penetration was always good at the leading smartphone manufacturers. But as market share has been growing in China by some of the other smartphone manufacturers, we're starting to see these packaging trends flow into those areas as well, which is also helping demand for our plating equipment and thus, the chemistry that comes with it.

John W. Pitzer
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you very much.

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

A

Thank you.

Operator: Our next question comes from Ben Kallo with Baird. Your line is open.

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

Q

Hey. Congratulations. Could you talk about the sustainable solutions and the momentum there? And anything you're doing in battery recycling through as well? Thank you.

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

A

Thank you, Ben. On sustainable solutions, we're seeing increasing interest, obviously, from our customers. We have a broad range of auxiliary equipment that can help our customers with recycling and with reducing any wastewater emissions.

We are also, as you may know, we've spent, as Peter mentioned, a decade or more of research into moving from Chrome VI to trivalent solutions. And we've got about 17 customers now either using or actively involved in evaluating this, which has some major advantages in moving away from things like chromic acid into much safer chrome alternatives.

Around 57% of our R&D today is designed toward sustainable solutions driven by this strong customer demand. And I think it provides a healthy tailwind, both for our equipment and for our chemistry business, going out in the future. That's true both for the GMF business and for Electronics.

On your latter point, we are not involved in battery recycling today, although we have commented in the past that we have a number, in fact, five different R&D projects ongoing to look at materials that will go into batteries because it's a fertile area for surface finishing solutions and the core competencies that we have in this area. So it's at R&D stage at the moment, with nothing really to talk about on battery recycling.

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

Q

Thank you.

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

A

Thank you.

Operator: Our next question comes from David Silver with C.L. King. Your line is open.

David Silver
Analyst, C.L. King & Associates, Inc.

Q

Yeah. Hi. One thing I noticed during the quarter was the sequential revenue trend by geography. So Asia was certainly up strongly, but I think there were sequential declines in both Europe and the Americas. And in particular, I was curious about Europe, just given I think there would be a positive currency effect on top of the underlying business trends. So maybe if you wouldn't mind commenting on the sequential revenue declines outside of Asia. Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Overall, we continue – again, [ph] it's like (00:42:00) we continue to see growth rates in all regions. We were able just to grow. There were some specific country-focused topics. But overall, we continue to see growth rates, both in Europe as well as in the US.

Please keep in mind that the recovery was not as strong as anticipated as supply chain issues prevented customers to ramp up their factory and their production as planned. So some customers had one to two-week shutdowns and additional holidays in order to cope with the semiconductor shortages. But overall, we continue to see growth rates in all regions.

David Silver
Analyst, C.L. King & Associates, Inc.

Q

Okay. And maybe just to follow up on your comments a tiny bit. I was wondering if you could maybe just elaborate somewhat more on the automotive end market. So earlier this year, when a number of producers were taking downtime, I mean there were various sources of it, and COVID was one, the chip shortage was another. Logistics, port availability was cited also and a couple of others.

But from your perspective, when you look to the second half of the year, I mean how do you see the various impediments that the industry is facing to a return of more normal production and shipping schedules? I mean how do you see that developing from your perspective? Thank you.

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

A

We see it returning, according to our customers, more to normal. I mean the COVID effects are not so pronounced now. The chip shortage is still, as Peter mentioned, significant. We have customers still [ph] with us biting (00:43:57) and we might expect production to be pushed out even into 2022.

The logistics have, for ourselves and for our customers, mostly returned to normal. We are seeing some shortages of raw materials, not just chip shortages though, but certain plastic and raw materials that are affecting production, both for our customers and theirs. So we're seeing a mixed pattern. Generally, the GMF business has been stronger than we expected so far in the quarter. And I think we're confident of outperforming the market still going forward. But there are still those disruptions that you mentioned.

David Silver
Analyst, C.L. King & Associates, Inc.

Q

Okay, great. I appreciate that. Thank you very much.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Thank you.

Operator: Thank you. And we have a question from Laurence Alexander with Jefferies. Your line is open.

Laurence Alexander
Analyst, Jefferies LLC

Q

Hi there. Can you give us a sense for just how much – because of the kind of price/mix effects, just how much sort of a normalization tailwind is flowing through into 2022? And also, how we should think about incremental margins on that volume when it comes back?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

I think if you look at our business in GMF, we're back to 2019 levels. So I think we show a slight growth if you compare ourselves to 2019 levels. So I think the recovery is going on quite nicely. But if you look to IHS, they probably modeled the market to be back to 2019 levels by 2024.

So there might be a continued recovery of the market and where we benefit of good growth rates in the automotive market over the next years. So again, I think that's probably what I can say. In Electronics, as we experienced over the last two, three years, we're continuously growing quarter-by-quarter and show a very nice, good, strong growth rate. And this will continue also for – in our expectation, over the next years.

The second question was on conversion?

Sarah Spray
Vice President, Global Head-Investor Relations & Communications, Atotech Ltd.

A

Incremental margin.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Incremental margin.

Laurence Alexander
Analyst, Jefferies LLC

Q

So I guess...

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah.

Laurence Alexander
Analyst, Jefferies LLC

Q

...yeah, when the automotive industry comes back, it sounds like there's no top line multiplier effect, but what's the incremental margin on the recovery of that volume?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

I think similar to all the other market segments, we have very healthy margins. Particularly on the chemistry side, we have a very strong margin quality, convert any sales increase to a margin gain. So with that, I think we're well positioned. And we see with the recovery of the automotive market and the corresponding sales increases, we expect a nice margin improvement as well for GMF.

Laurence Alexander
Analyst, Jefferies LLC

Q

Thank you.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.
A

Thank you.

Operator: And we have another question from Silke Kueck with JPMorgan. Your line is open.

Silke Kueck
Analyst, JPMorgan Securities LLC
Q

Good morning. How are you?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.
A

Hi, Silke. Good. How are you?

Silke Kueck
Analyst, JPMorgan Securities LLC
Q

Did you say that your equipment business was mostly booked through the first half of like next year? And was that comment meant for the Electronics business or for the GMF business or for both?

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

It was mostly meant for the Electronics business, which is more built in-house. We have additional capacity for GMF. But yes, I said that we are pretty much booked up now on capacity through the first half of 2022.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.
A

But it's a typical lead time. It doesn't mean that the volume breaks up and we don't see much volume in the second half of the year. Typically, it's just the lead time that we can – we have good visibility up to the next – second – up to the first half of 2022.

Silke Kueck
Analyst, JPMorgan Securities LLC
Q

Okay. That's helpful. And secondly, how much of your palladium is sourced from China versus other regions?

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

[ph] Can't (00:48:31) tell you that. We source from the three main regions, South Africa, from Russia and from China, and that varies depending on the source and the demand for it within our operations. So we source from all three.

Silke Kueck
Analyst, JPMorgan Securities LLC
Q

Okay. Do you do any type of like hedging to manage the cost or you don't?

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

No. We don't do hedging. We have a very efficient pass-through, eliminate the cost for us as we pass on the price of the purchase directly to our customers.

Silke Kueck
Analyst, JPMorgan Securities LLC

Q

Okay. And lastly, I was wondering whether you can just give an update on capital projects that remain to be completed in 2021. There was like a Mexico plant that was to shift to like some tech centers. So just wondering whether you can give an update as to what the CapEx spend is for and where those projects stand.

Peter Frauenknecht
Chief Financial Officer, Atotech Ltd.

A

Yeah. So again, I think, as I mentioned in the text previously, we are on track of completing all the planned capital expenditure projects. A key project for us is moving our factory away from Mexico City to Carretero. This is progressing as planned and we are geared to finalize by the end of this year, just beginning of next year.

The key focus for us is digitalization as well. Geoff mentioned that IIOT is a big value, which we are able to provide to our customers. Here, we invest. We invest for internal capabilities as well as for external. And the other part is the customer-oriented projects, which help us to immediately gain chemistry contracts.

All of that is being planned. And as I said, we're a little bit second half year-loaded. So a lot of projects are being completed by the second half of the year. And we continue to see that we are going to be in the range of 4.5% to 5% of sales.

Silke Kueck
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks.

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

And I think, operator, there's no more questions. So if that's the case, I'd just like to thank everybody on the call very much for your questions, your attention and for your interest in Atotech.

Summarizing the key points from today's call, as in quarter one, supportive end markets and the continuous investment we've made in our technology and products led to yet another record quarter. Our lean cost structure and inherent operating leverage allows strong conversion of our revenue growth into profits and cash flow, providing financial flexibility and the ability to invest for further growth.

In closing, I'd like to thank all members of the Atotech team worldwide. Despite the challenges presented by the pandemic, cyclical swings and supply chain disruptions, we've demonstrated the strength and resilience of our business model over the last year. Our focus on anticipating and meeting the needs of our customers has not wavered, whether we were on-premises or virtual.

Just as in previous downturns, I believe we are emerging stronger and better prepared to meet the future, including being part of the MKS family, an event to which we are all looking forward.

With that, we'll end the call, and thank you very much for listening.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.