1H2023 RESULTS BRIEFING

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Management Panel:

Gary Ho	Group Chief Executive Officer (“**Group CEO**”)
Kay Lim	Group Chief Financial Officer (“**Group CFO**”)
Gian Yi-Hsen	Group Chief Strategy Officer (“**Group CSO**”)
Ian Howe	Group Chief Commercial Officer (“**Group CCO**”)

Presentation Transcript

Duane Tan
Investor Relations
: Hi, good morning and welcome to our results brief for the first half of 2023. I'm Duane from investor relations and we are delighted to have you here this morning as we provide updates on our performance and initiatives.

Allow me to first introduce our speakers from management. We have Mr. Gary Ho, our Group CEO; Mr. Kay Lim, our Group CFO; Mr. Gian Yi-Hsen, our Group Chief Strategy Officer; and Mr. Ian Howe, our newly appointed Group Chief Commercial Officer. Given this is the first time that Ian is joining us for the results brief, I would invite him to give a short introduction. Ian, please.

Ian Howe
Group CCO
: Thank you, Duane. I'm the Group Chief Commercial Officer for Nanofilm Technologies, joining the Company this year in 2023. My primary focus is on leading the Company's commercial strategy and driving profitable growth going forward. Prior to Nanofilm, I have over 25 years’ experience in global management, always within the advanced materials and technology space. I have worked in industry segments such as industrial, automotive, medical, energy and semiconductor markets. And it’s a pleasure to be here today. Thank you.

Duane Tan
Investor Relations
: Thanks, Ian. For today's agenda, we will have Gary give us an overview before passing on to Kay to touch a little bit on our financials. Yi-Hsen would then give us some pertinent updates on the ESG front before we have Gary and Ian cap things off with the outlook. Without further ado, I will pass the time now to Gary. Gary, please.

Gary Ho
Group CEO
: Thanks, Duane. Good morning, ladies and gentlemen. Thank you for joining Nanofilm's first half results briefing. I will kick off today's presentation by providing you a business overview. The first half of 2023 was a challenging operating period for us due to a number of factors, including softer end

consumer demand, particularly in our 3C[1] segment, and the slower than expected post-reopening recovery of China.

These factors had a negative impact on the first half performance and we have taken the necessary measures to control costs. In light of this and ongoing macro uncertainty in the near term today, we are proposing an interim dividend of 0.33 cents per ordinary share and together with the share buyback executed, these reflect our strong confidence in the business.

I would emphasise to you all that the fundamentals of Nanofilm's core business remain sound. So does the strong appeal and competitive advantages of our deep tech. We are unwavering in our focus on pursuing our long-term growth objectives while driving operational efficiency and managing costs within the business to navigate near-term uncertainty.

Turning to the next slide, we want to give you a better picture of how our different business units have performed over the period. To varying degrees, these business units were impacted by combinations of softer consumer demand, lower seasonality, customer capex[2] tightening and weaker foreign exchange.

In the AMBU[3] 3C sub-segment in the first half, revenue fell 42% year-on-year, in a typical softer first half due to lower seasonality.

Comparative performance was impacted by a relatively stronger first half in 2022, lifted by the prior year's spillover production. This was compounded by a soft consumer electronics market resulting in inventory reduction in the supply chain. The foreign exchange translation from RMB[4] to Singapore dollar also had a 3% impact on the revenue. Despite this, there were more positive performances, in the AMBU's industrial and automotive sub-segments.

In the industrial sub-segment, which includes precision engineering and printing and imaging, our efforts yielded positive results in the first half, with 15% growth year-on-year, driven by successful execution of our growth strategy that focused on scalable commercial applications. Similarly, in the Automotive sub-segment, sales recovered and grew 25% year-on-year, led by a rebound in the commercial vehicle market.

In the NFBU[5], first half revenue fell 36% year-on-year, due to softer demand which resulted in pushback of the production ramp of micro lens array

[1] 3C refers Computer, Communication, and Consumer
[2] Capex refers to capital expenditure
[3] AMBU refers to Advanced Materials Business Unit
[4] RMB refers to renminbi
[5] NFBU refers Nanofabrication Business Unit

wearables components as the supply chain reduced inventory. In the IEBU[6], revenue fell 55% year-on-year in the first half, mainly driven by execution of brought forward order book which was soft, as customers tightened equipment capex spending.

Looking to Sydrogen, revenue grew year-on-year in the first six months this year due to low base effect and there have been encouraging developments from bipolar plates coating customers either going through qualification, batch samples, or small batch production. We are also glad to share that Sydrogen has successfully qualified with several leading Chinese automotive customers. However, volumes are not meaningful in the immediate term due to a slowdown in the Chinese market.

To summarise, while macro head winds led to pressure on several of our key businesses that impacted performance, there were bright spots in our portfolio in the form of double-digit growth in the AMBU non-consumer sub-segments and positive momentum in Sydrogen. I will now pass the time to Kay for him to elaborate a little bit more on the financials. Kay, please.

Kay Lim
Group CFO
: Thank you, Gary. To start off with revenue, on your left you can find the Group's full year revenue, the top left chart followed by the bottom left charts where we have the BU revenue performance. And on the right bottom table, as per what we have disclosed to the market in how we group our end-markets, we would like to again point out that the industrial end-market is made up of AMBU printing and imaging, precision engineering, automotive and industrial equipment BU.

In the Group's first half of 2023, revenue saw a decline of 34% to S$73 million. With the factors earlier mentioned by Gary, we have both positives and negatives in revenue performance. While we saw weaknesses in consumer segment, our efforts in diversifying and growing non-consumer revenue streams are yielding positive results. We saw encouraging growth from both the AMBU's industrial and automotive sub-segments.

AMBU's industrial sub-segment grew 15% year-on-year, led by a rebound in printing and imaging, and increasing commercial adoption of precision engineering applications. And the automotive sub-segment grew 25% year-on-year driven by a rebound in commercial vehicle market and adoption of our coated piston rings.

Next, directing our attention to core expenses, we have both the above gross profit line, which is the COGS (cost of goods sold) on the left table, as well as the below gross profit, which make up mainly our operating expenses

[6] IEBU refers to Industrial Equipment Business Unit

administration and R&D[7] and Engineering expenses. For R&D and Engineering expenses, we have a separate slide in the next slide to actually go through in details, so let's focus on the opex[8] (administrative).

Before we touch on that, our focus on operational efficiency and cost management is ongoing. Given the weaker business performance, we have stepped up our pace in tightening costs, but at a pace without derailing our long-term business strategy. Referring to the top left chart, we saw a decline in cost of goods sold year-on-year as certain costs are lower due to lower sales.

Meanwhile, cost of goods sold as a percentage of revenue is higher year-on-year, mainly attributed to three factors. First, lower revenue base effect as a denominator, but partially mitigated by our ongoing cost reduction measures. Second, we have an increase of five percentage points in direct depreciation and amortisation fixed costs. And lastly, we have an increase of 4.6 percentage points in materials cost, mainly due to the relatively higher material content from AMBU's automotive sub-segment.

In the bottom left chart, the higher administrative opex year-on-year of S$3.4 million was mainly due to two factors. First, we have a higher depreciation and amortisation of S$1.2 million, mainly related to our Singapore HQ. Secondly, we have a higher professional fees of S$1.1 million mainly related to services provided for M&A[9] activities. Compared to second half, 2022 of higher admin opex of S$24 million year-on-year, as seen in the chart, the Group's ongoing cost reduction efforts have reduced administrative opex by 9% on a half-on-half basis. Our cost reduction efforts include delays in non-essential manpower hiring and prudency in spending non-essential expenses.

Following on to the R&D and innovation spending, we are seeing a higher portion of R&D and Engineering activities moving closer to commercialisation. And, why is that so? This is represented by a higher capitalisation rate of eligible R&D and engineering expenses on a year-on-year and half-on-half basis, which is a reflection of our higher quality R&D and Engineering activities that are closer to achieving commercial benefits.

We are a deep tech material science manufacturer that views R&D investments as essential to maintain our lead in innovation and technology. And to provide further context, our field of research includes expansion of advanced materials coating kinds, product development in fuel cell applications, and new advanced nanocomposite materials.

[7] R&D refers to research and development
[8] Opex refers to operating expenditure
[9] M&A refers to mergers and acquisitions

To provide further clarity and context to our EBITDA[10] and PATMI[11], how we bridged against last year's numbers, the key differences were mainly caused by two factors. One, we have a lower revenue and that impacted the gross profits, followed by product mix changes, which is related to the automotive sub-segment’s contribution, that also impacted our gross margins. Coupled with a higher fixed cost attributable to fixed asset expansion and business initiatives, our profits were affected.

In capex, we continue to make investments of strategic priorities to support future growth. Our first half 2023 capex was mainly spent on infrastructure, plant, buildings build-up and renovation fittings. Our capex outlook for second half will be touched on by Gary later in the Outlook slide.

In terms of cashflow, despite a challenging environment, we have generated a positive operating cashflow of S$30 million. With this in first half, we have deployed our planned cash on long-term productive assets of S$17 million in capex spent and capital allocation of S$16 million into share buyback, with the objective of enhancing shareholder value. Total cash balance stood at S$127 million. We have also declared an interim dividend of 0.33 cents, in view of our first half performance and our full year outlook. With that, I will pass over to Yi-Hsen to cover ESG. Yi-Hsen, please.

Gian Yi-Hsen
Group CSO
: Thank you, Kay. Good morning, everyone. In this section, I would like to share with you some of Nanofilm's latest ESG efforts as well as a snapshot of one of our unique sustainable solutions.

Sustainability is really a vital part of Nanofilm's corporate strategy and for achieving long-term sustainable growth with, and for our people, our environment, and our society. As a responsible corporate citizen and a long-term partner to our top customers, we aim to keep our impact on the environment, especially in terms of our carbon footprint, to a minimum.

In the first half of 2023, we have made a major step towards this direction. Firstly, we have completed the installation and connection of our two solar installations in Shanghai's Plant 1 and Plant 2. Together, this system is rated at 2.4 megawatt peaks. Annually, this system is expected to generate over 3.8 gigawatt hour worth of electricity, translating to more than 1,800 tons of carbon abated in the Chinese context.

Secondly, we have also concluded a power purchase agreement with the state grid to purchase hydroelectricity for our other electricity needs for our Shanghai plant. With that, I'm pleased to say that our Shanghai facility is now fully powered by renewable energy. These developments are part of our

[10] EBITDA refers to earnings before interest, taxes, depreciation, and amortisation
[11] PATMI refers to profit after tax and minority interests

commitment to achieving our carbon footprint reduction and our 2030 carbon targets.

Moving on, I would like to share a prime example of our environmentally sustainable solution, our green plating series, which was developed to replace the pollutive electroplating process. Electroplating is a very traditional process, but we also know it as one that produces a lot of heavy metal liquid waste. As a result, many jurisdictions including China, EU, and Vietnam have already tried to limit the use of this process.

Companies are increasingly facing regulatory scrutiny and find it hard to move away from electroplating due to the lack of good substitutes till today. To address this need, Nanofilm is proud to bring to the market three different green plating series in the decorative, power, and power plus coating application. These coating solutions are based off our FCVA[12] and PVD[13] capabilities. They produce zero liquid discharge in the coating process and will deliver the strong anti-corrosion properties and high conductivity required for our customers' applications. In fact, we are even looking to replace precious metals such as gold in certain applications to reduce waste and cost.

Our offering goes beyond just the coating itself and includes our production capabilities where we have developed proprietary inline systems to deliver these coatings at scale and at affordable pricing. This is critical for the commercialisation of this solution. Our first target market is the Chinese EV battery connector market. This is done through ApexTech, our joint venture with Everwin. Gary and others will touch on their developments separately.

In future, we intend to bring this solution to other markets as well as other geographies. We are confident that our unique sustainable solution will be a key enabler for many customers and represent good commercial potential for us while pursuing a sustainable future for everyone. With that, I pass the time back to Gary to run through our business outlook. Thank you.

Gary Ho
Group CEO
: Thank you, Yi-Hsen. I will now like to take a moment to reemphasise our four core strategic priorities. The first is geographical expansion. This is in line with global trends that will allow us to penetrate more markets and serve more customers, while also becoming more resilient against the dynamic environment.

The second is new segments and product diversifications. Our large range of coatings and products allow us to expand into numerous applications across

[12] FCVA refers to filtered cathodic vacuum arc
[13] PVD refers to physical vapour deposition

many industrial value chains. The third is joint ventures / M&As, where we pursue synergistic value, and accretive partnerships and acquisitions.

And lastly is investment in R&D. As Kay mentioned, our business is defined by its ability to innovate and produce the highest quality technology. Only through continued investment can we sustain the edge. These four strategic pillars are designed to unlock greater opportunities and grow revenues. We remain focused on delivering against these objectives to generate long-term value for our shareholders.

If we start from the top right row, in terms of geographical expansion, it's more important than ever to get closer to our customers and meet their needs and embed ourselves in global supply chains in an ever-evolving environment. This means strengthening our presence in existing markets but also looking at future growth opportunities.

Our expansion to new sites in Vietnam and India is very much driven by 3C supply chain shifts beyond China. For our Vietnam expansion, it will be a multi-BU site. Phase one construction has commenced, with coating qualifications and initial small batch production are expected by Q1 2024. In India, we have incorporated an Indian subsidiary. We are exploring a factory-in-factory arrangement and also actively sourcing for a new site location. We are working towards qualification and initial small batch production by Q1 2024 as well. I will invite Ian to elaborate a little bit more on the European initiative in a while.

Going to the second row, each of our BUs has a clear focus on high growth new segments of products. For the AMBU, there are green plating of EV battery connectors, functional coatings of PCB[14] drills, semicon toolings. Meanwhile, the IEBU is focusing on completing the inline mass production green plating lines.

For the NFBU, we are focused on bringing projects from existing and new customers towards mass production. For Sydrogen, we are establishing our position as the key enabler of hydrogen as an energy source with our cutting-edge bipolar plates coating. For the JVs and M&As, we continue to explore and assess synergistic partnerships or M&A opportunities that can accelerate the pace and size of existing organic growth strategy and drive revenue. The exciting progress of ApexTech and the momentum we see in Sydrogen give us strong confidence to open more doors and drive growth in the future.

Last but not least, R&D remains a key pillar of our success. By the end of this year, we will add the Advanced Technology Research Center and Nanofab

[14] PCB refers to printed circuit board

Engineering Center to our HQ at Tai Seng Drive to further support the development of new applications and products for the AMBU and the NFBU.

For Sydrogen, we also continue to develop fuel cell systems and selected end product applications as a first mover in the exciting hydrogen space. I would now like to invite Ian to elaborate a little bit more on our European initiative. Ian, please.

Ian Howe
Group CCO
: Thank you, Gary. For Europe as part of the geographical expansion, we have a very significant market in excess of €400 million. There is clear potential and demand for our existing solutions within areas such as industrial, e-mobility, energy and new energy, medical, et cetera.

Subsequently, to the approval of the entrance strategy for Europe, we have been working diligently the last months. Legal entities are already established in Netherlands and in process is also the second one in Germany., We are considering several greenfield options as well as M&A opportunities.

Latest by quarter one 2024, we plan to initiate operations within the European Union and in parallel, we are currently hiring and onboarding key management and business development team members. Further updates will follow in due course. Thank you. Back to you, Gary.

Gary Ho
Group CEO
: Thanks, Ian. Next. I would like to finish by giving you some commentary on the business outlook.

In relation to the market environment, as we have mentioned, we are currently operating in a challenging business climate. This is particularly for the IEBU business where customers remain tight on capex spending and investment.

Within the 3C consumer business, encompassing the AMBU and the NFBU, inventory rebalancing is improving. Demand and production volume for second half peak season will be dependent on end-consumer interest for upcoming new product launches.

On the operational front, cost improvement measures while ongoing, will be balanced against the second half peak production requirements and new businesses initiatives. The Group anticipates strong operating leverage when the markets recover and the production volume returns. capex spending in second half for the Group will be directed more towards infrastructure and R&D investments.

In terms of market expansion, our decision to expand into Vietnam and India has been predominantly driven by customer supply chain shifts in the 3C market. Whereas in Europe, we do see opportunities in the functional coating space to expand our presence, as earlier elaborated by Ian.

Finally, in relation to our financial performance for second half of 2023, revenue is expected to be higher than first half of 2023, driven by seasonality peak production for consumer segment. However, the second half of 2023 will not be comparable to second half of 2022 due to an uncertain macro environment. The full year profitability of the Group is subject to the level of demand from end-consumers in the upcoming new 3C product launches and customers' capex expenditure not being further tightened. We remain focused on executing pipeline contracts and lean cost management.

Overall, as a management team, we remain confident of the mid to long-term prospects of the Group despite the near-term challenges facing the business. As we have mentioned, we remain laser focused on working towards our sustainable growth objectives. We are committed to taking necessary steps to optimise operations today and to further improve performance for when markets recover and volume returns.

We look forward to updating you on our progress. With this, I will conclude our presentation and move on to Q&A. We are happy to take on any questions. Thank you very much.

Q&A Transcript

Duane Tan
Investor Relations : Thanks, management team. As we proceed to our Q&A, I will request for participants to either use the raise hand function in Zoom or type your questions in the chat and we will get to your questions individually. With that, I will open the floor to any questions that you may have arising from our presentation.

We have one from Jame. Jame, if you would like to unmute yourself and ask your question.

Jame Osman
Citibank : Hi, everybody. Thanks for the presentation. Just a few questions from me please. The first one is on the customer mix for the first half. If you could share what the breakdown was between 3C as well as Industrial, and Automotive for the first half of FY23, that would be helpful.

Gary Ho
Group CEO : Thanks, Jame, for the questions. As I presented earlier on the first half results, particularly on the AMBU, we are impacted by the soft consumer demand and that very much impacted our 3C performance. But despite saying that, we are seeing very encouraging growth in our non-3C segments, which we have experienced a 15% year-on-year growth for industrial sub-segment and a 25% year-on-year growth for automotive sub-segment.

And, for IEBU we have experienced customers tightening their capex spending due to the uncertain macro environment. And for the NFBU, we are also impacted by the slowdown in consumer demand. Customers have been focused in the early part of this year on depleting the inventory balances.

For Sydrogen, we have a positive momentum building. In fact, we have been identified as a key player in the adoption of our proprietary technologies for the bipolar plate coatings. We have now been qualified by several key automotive OEMs[15], despite that the volume is still small at the moment.

Jame Osman
Citibank
: Thanks. Thanks, Gary. Then just on that, going to the gross margin side, I think like you mentioned for the automotive BU, the contribution requires more material. Maybe could you share a bit more from a technical standpoint, how it works versus 3C type products? What percentage more material are we talking about, the gross margin differential, et cetera.

Gary Ho
Group CEO
: Jame, as you may recall, for the automotive sub-segment, our solution is being applied in a couple of business models for both commercial and passenger vehicles. We are applying our proprietary FCVA solutions for the piston rings and supplying to our customers in China both as a coating as a service and also as a turnkey solution.

In the first half of 2023, we do see a rebound in the commercial vehicle market. And in that space, our solutions offering is a turnkey solution. That has incurred higher material costs, which resulted in product mix changes.

Jame Osman
Citibank
: Okay, I understand. And maybe just on equipment utilisation, it's come down to about 20%. Just wondering what sort of steady state utilisation level management will be targeting going to the second half or maybe even to next year?

Gary Ho
Group CEO
: You are right that in the first half, we were impacted by this slowdown in consumer demand, that has also impacted our utilisation in the first half. We have taken all the necessary measures to rationalise our capacity.

Firstly, we have taken measures to consolidate our workshops in our manufacturing facility in Shanghai and driving operational efficiency and cost improvement. As we are also expanding in other geographical locations, for example, our new site in Huizhou and the upcoming new site in countries like Vietnam and India.

We are looking at our overall capacity, we are rationalising and redeploying some of this capacity to these strategic locations. And that will help to mitigate the cost and the impact in this uncertain market environment.

[15] OEM refers to original equipment manufacturer

Jame Osman
Citibank
: I understand. Maybe just one last question from me. Just on the demand outlook into second half and beyond, especially on the ApexTech side, could you maybe share a bit more on how you are progressing there in terms of the expected ramp up? Thank you.

Gary Ho
Group CEO
: Coming to the second half outlook, the market remains challenging and uncertain. Particularly in our IEBU, where we see that the customer's capex spending remained tightened. For the consumer segment, as we have seen inventory rebalancing is improving, especially now we are entering the peak season in the second half. For ApexTech, we are aggressively ramping up the facility in Zigong, Sichuan. We have completed the renovation of our facility. We are commissioning the newly installed batch systems and also working on qualification with our key customers.

Jame Osman
Citibank
: Okay. Understand. Thank you very much, that's all from me.

Duane Tan
Investor Relations
: Thanks, Jame, Gary. Se Chai, you have a question? Would you like to unmute yourself and ask your question?

Se Chai Ngoi
Oaklands Path Capital Management
: Hi. Good morning. The first question that I have is your 3C's volume dropped a lot more than other components makers in the 3C supply chains. Usually, we see those reported on in Taiwan, Hong Kong or China. They dropped 10% - 20% first half, more or less in line with the volume drop in 3C. And one of the big main customers of yours in the US, we look at the volume of their phones, watch, laptop. Or I mean laptop dropped more but the other two didn't drop that much. I can't really understand how your revenue from 3C drop just a whole lot more than the overall market. And also, I would really like to question on wallet share. Is it a result of just the market plus inventory adjustment or actually there are dual source or triple source now for some of the things that you do.

Gary Ho
Group CEO
: Thanks, Se Chai, for the questions. I would like to emphasise that we remain as the key solution provider in the 3C business segment. And the solutions we are providing remain at a high level of stickiness. On your question about this demand, I would say that it is not comparable as we are in the different segment of the supply chain.

Based on our analysis, product sales in the early part of the year were very much driven by the depletion of current inventory balances. Given the slowdown, we are taking necessary steps to optimise our operation efficiency while we are executing our long-term strategies and building a strong platform with strong operating leverage to further improve performance when the markets recover and volume returns.

Se Chai Ngoi
Oaklands Path Capital Management
: Okay. The next one on utilisation, specifically we can see that your main customer and, actually quite a few others as well, they are moving to India. And I can see that you are following as well, and Vietnam also. In China, it seems that many manufacturing plants, not just yours, are hollowing up because of this movement, so there is excess capacity. How do you go about balancing this thing because if you move the machines, okay, you can move some, those non-inline machines you can just move it over, but then the plant capacity will be in excess right? How do you do see this? And also the cost, because you used to have one facility and now you have three facilities in three different countries. So the overall cost level is going to be different as well.

Gary Ho
Group CEO
: We have mentioned that the shift in the supply chain, especially in the 3C segment to India and Vietnam is predominantly to support the customer's strategy. Having said that, Nanofilm remains as a key solution provider in this space and we are actively participating in this shift.

On this business, instead of consolidating in our current Shanghai mega site, moving forward, our solutions will be supplied in several locations. The good position about us is that the equipment is self-built and they are versatile. We are able to deploy all this capacity very easily to cope with the demand requirement.

And for the Shanghai new plant, this is a multi-BU site. Today, besides the 3C segment, we are also serving business in the non-consumer segment for the industrial applications, automotive, and Sydrogen and Nanofab are also co-located in this facility as well.

We are working very hard to continue to pursue new growth opportunities in all the different areas and I believe that some of the capacity deployment to other locations will be filled up by several of our other businesses.

Gian Yi-Hsen
Group CSO
: Maybe if I may add to Gary's response, I think Nanofilm is uniquely positioned in this shift of the supply chain because of our first mover advantage. For Vietnam, we have a pre-existing facility and team, which means that compared to any other player in the supply chain, we already have a team to leverage and a facility to quickly deploy as our customers move.

And with respect to India, for those who have been following the geopolitical tensions between China and India, there's been increasing difficulty for Chinese companies to access investments into India. As a result, again, Nanofilm as a non-Chinese company has an advantage in entering this market. We will have first mover advantage, which we are working very hard to capture today.

Se Chai Ngoi
Oaklands Path Capital Management
: Okay. All right. My last question is on Europe, do you have a system project or something there already, that is why you are going there?

Ian Howe
Group CCO
: Thanks for the question. Yes, absolutely. We have already existing demand especially on the functional coatings, so for the FCVA carbon-based coatings there is significant potential among others.

Duane Tan
Investor Relations
: Thanks, Se Chai. Lee Keng, you have a question? Would you like to unmute yourself?

Lee Keng Ling
DBS
: Hi, yes, I would just like to get a bit more colour on the GP[16] margin. Other than the 5% increase in fixed costs and also the 4.6% in materials cost, is there any other reason that caused this big drop in the GP margin?

Kay Lim
Group CFO
: I think one of the key reasons, Lee Keng, is that we do have both variable and fixed cost components. The fixed cost, as you correctly point out, is the depreciation and amortisation. But there will be semi-fixed cost as well. What do we mean by semi-fixed costs? These will be the likes of our indirect labour, such as our production manager, production leaders, and our QA (Quality Assurance). These are what we call more skilled labour in the production workshops that basically drive planning, supervision and execution to drive a smooth operation.

Then we have variable components such as our direct labour. Direct labour will basically have a direct relationship with revenue activity. Then if you stack everything together, including our manufacturing overheads, the likes of security, our consultancy fees, et cetera, these are costs that have certain lagging effects.

Yes, we actually saw the weakness in our business and henceforth, the ongoing active tightening of our costs. But during this process, there is a certain lagging effect. And coupled by a lower revenue that is not able to generate enough GP, effectively this caused a decline in terms of GP margin.

Lee Keng Ling
DBS
: Okay. What kind of GP margin can we expect for second half this year?

Kay Lim
Group CFO
: We are expecting an improvement in GP margin, but it will be not comparable to last year. For the very reason, until we have visibility as we mentioned in the outlook, it is subject to end-consumer demand for the new upcoming product launches in the 3C market, as well as the outlook of capex spending in the industrial equipment segment.

[16] GP refers to gross profit

But what we are doing actively, which we have control over, is on cost. We continue to embark on the ongoing cost optimisation, without sacrificing or compromising our long-term business initiatives. Certain costs would still be incurred. For example, what we have been mentioning, our expansion in the various sites of strategic nature, India, Vietnam, as well as Europe. Those are the areas that we will not enjoy revenue contributions in a meaningful manner this year. That will only come next year.

All in all, to stack up, GP margin will improve because of the peak seasonality that right now we are seeing a better situation when it comes to rebalancing of inventory in the supply chain. Coupled with our ongoing momentum that we are seeing in the AMBU's industrial applications, automotive, as well as basically the costs that we mentioned in the tightening, we should expect to see better margins in second half.

Lee Keng Ling
DBS
: Yeah, okay. Thank you. My second question is what's the split in the product mix for your key customer?

Kay Lim
Group CFO
: We continue to offer basically a full range of solutions in all categories. Just to recap, these are the communication sub-segment, which we term as smartphones. The wearables and accessories sub-segment, we term as the smart watches as well as accessories associated with the watches and the wireless earphones et cetera, followed by the computer sub-segment, which is portable tablets.

All in all, our solutions are found across these. But in terms of product mix within this customer, more was allocated towards communication, i.e., smartphones in the first half. I think that is not something surprising. We saw a bigger drawback when it comes to the wearables, accessories as well as basically the computer sub-segments.

Lee Keng Ling
DBS
: Okay. On the phone, is it 50%?

Kay Lim
Group CFO
: It's close to that range.

Post-result brief clarification - revenue split that is closer to the 50% range is the computer sub-segment. The communication sub-segment contributed approximately slightly more than one-third of 3C.

Lee Keng Ling
DBS
: Yeah. Okay, got it. Thank you.

Duane Tan
Investor Relations
: Thanks, Kay. Thanks, Lee Keng. We are about 10 minutes away from being on the hour. If you have any more questions, we can probably take about one or two more. Se Chai, you have another question?

Se Chai Ngoi
Oaklands Path Capital Management
: Talking about Europe, what kind of application is that? Is it automotive or what?

Ian Howe
Group CCO
: Yeah, I can answer that question. Thanks for the question. I think the biggest market starting will be in the general industry application area. And that can be a very broad range. They are the first applications we will focus on, but absolutely, the future will also be on e-mobility and new energy and so on.

Se Chai Ngoi
Oaklands Path Capital Management
: Oh, okay. Speaking of the revenue and your utilisation, your revenue level of 70 over million, actually just two, three years ago, your revenue was also 70 over million for the first half of 2020, I think. But then the margin was something like 30%-ish. I understand that you have expanded quite a bit in the past two, three years, post-IPO. But if the revenue level continues to be rather subsided because of the overall environment, let's say the overall economy slows down further next year and overall demands peak and all these. Is it possible to at least improve the overall profitability of your company to somewhat close to … it cannot be at the same because the size is bigger right? But I'm just wondering how agile are you in terms of operational planning, production planning, and also costs for planning ahead as well? Thank you.

Gary Ho
Group CEO
: Se Chai, thanks for the question. I will probably take your questions and perhaps Ian, Kay, Yi-Hsen can chime in. I would like to emphasise that Nanofilm is in a strong position to capture future growth opportunities with our differentiated solutions. Our deep tech platform allows us to expand into numerous applications across a wide span of industries.

We are working hard to execute our strategies to expand into high growth segments and products, diversifying our customer base and geographical coverage. We are also investing in R&D to cement our technological and innovative edge. I think despite these short-term headwinds, we have taken all the necessary steps to optimise operational efficiency and exercise cost management throughout the Group in order to strengthen the foundation for future growth.

What we are looking at is to drive sustainable long-term growth in our business. This challenging market condition has impacted our short-term results. But we would like to remain focused in executing our strategic objectives. And we believe that with this, our Company's fundamental strengths and all these efforts that we have put in ensures that we are able to build a solid platform for us to grow our business in a sustainable manner when the market recovers and the volume returns.

Kay Lim
Group CFO
: I would like to add what would provide everyone some context. 2020 is basically a result of what we deem as the operating leverage or maximising the operating leverage. Why do we say that? Because in 2020, we were just operating in Shanghai Plant 1 if you recall. Then we built Shanghai Plant 2 with the expansion. Then following on, these few years that we continued to build different sites of a strategic nature.

These sites are not meant to just solely focus on 3C market. Even within 3C, we are diversifying, expanding our revenue stream into components-making modules, through Nanofabrication. Then coming back to what we meant by basically going into different revenue streams, which evidently some of these efforts are paying off such as our industrial, automotive growth that we have seen in first half this year despite a weak macro environment. Why? Because of the adoption of our technology, which is basically differentiated compared to our peers. I think the key thing next is how do we penetrate such markets.

Beyond this, we have our green plating solution to address the electric vehicles' batteries components. And as we stack up Sydrogen fuel cell applications, stack up industrial expansion as we see in basically various parts including our new Europe site and Japan. Then as we stack this, what is actually causing Nanofilm's weaker financial results today is because of the lack of operating leverage and because of the seasonality of our sales which we saw for so many years in terms of first half results. What we are trying to fix this, our deep technology solutions will take time for the market to absorb, to adopt.

What we are trying to say is that as we stack up this revenue like a portfolio basis, it will be more diversified and we will be enjoying the utilisation of our equipment to smoothen that out throughout the year. With that in mind, we are able to then achieve or at least reap the benefits of our operating leverage.

And when that day comes, which is in the next few years, we expect that to basically again bring us back to the margin profile that we previously are in. In terms of where we will land, would it be basically the same margins profile as we see in the past? We are not going to commit to that level because of the uncertain market. But that direction is a direction we are actually moving towards with the strategic plans that we have or are executing.

Duane Tan
Investor Relations
: Thanks, Gary and Kay. We will just take one more question in the chat from Patrick. He's asking when will the JV for the EV green plating be operational. He's referring to ApexTech.

Gary Ho
Group CEO
: Our ApexTech new site has completed the renovation. At the moment, we are commissioning the batch system that we have installed, and we are in the process of working on the qualifications of our green plating solution with our

customers. Our IEBU is also working on the mass production inline system, ready in 2024.

Duane Tan
Investor Relations
: Thanks, Gary. As we conclude today's session, I would just like to emphasise our lines of communication remain open. Should you have questions or require further clarifications, please do not hesitate to reach out to us. We will be happy to take it offline. Thank you, once again, for your time and attention this morning. With that, I would like to bring this session to a close and have a wonderful day ahead. Thank you.

END.