EDISON

XP Power

FY15 results

Recent investment to drive FY16 growth

Tech hardware & equipment

XP reported better than expected FY15 earnings and expects further revenue growth in FY16. The recent acquisition of EMCO expands XP's product range and is in line with the company's strategy to support customers' complex power requirements. We expect the company to focus on driving cross-selling while continuing to seek out acquisitions to provide additional products and engineering expertise.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/14	101.1	24.3	101.1	61.0	14.6	4.1
12/15	109.7	25.7	104.3	66.0	14.1	4.5
12/16e	122.2	27.0	105.3	69.0	14.0	4.7
12/17e	129.6	29.8	116.6	73.0	12.6	5.0

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

FY15 results – revenue and profit growth

XP reported constant currency revenue growth of 4% for FY15 and reported EBITDA and EPS 2.7% and 6.6% respectively ahead of our forecasts. After paying £9.3m for two acquisitions, XP moved to net debt of £3.7m at year-end from net cash of £1.3m at the end of FY14. With both Asian manufacturing facilities fully operational for power converter and magnetics production, XP can provide the quality and reliability that customers require at a competitive price.

FY16 outlook positive

With a more positive order environment from Q415 and the recent EMCO acquisition, the company expects to achieve growth in FY16. We increase our FY16 revenue forecast by 3.8% (constant currency y-o-y growth of 8.6%, or 4.0% excluding EMCO) and introduce a 6% revenue growth forecast for FY17. Taking into account the impact of the EMCO cost base, 2015 hires and currency, our FY16 EPS forecast is substantially unchanged and we introduce a forecast for 10.6% growth in FY17. We forecast a shift to net cash of £1.8m by the end of FY16 rising to £8.1m by the end of FY17.

Valuation: Recent investment supports growth

While the economic outlook is mixed, with slower growth forecast in the US and China, we believe that XP should benefit from its recent investment in engineering and sales resource, as well as acquisitions in the US and South Korea. Strong forecast cash generation should enable the company to invest in further growth, either through internal product development or through the bolt-on acquisitions it continues to evaluate. XP now trades on a P/E of 14.0x FY16e and 12.6x FY17e normalised EPS, with a forecast dividend yield of 4.7% in FY16 and 5.0% in FY17. Competitor power converter companies are trading at around 18x FY16e EPS on EBITDA margins of c 17% versus XP's 25.6% forecast EBITDA margin. The UK distributors are trading on 10-16x FY16e EPS, on c 9% EBITDA margins. Based on XP's superior margins, the company is undervalued versus peers, and is further supported by its dividend yield.

22 February 2016

Price	**1,474p**
Market cap	**£280m**
	$1.44/£
Net debt (£m) at end FY15	3.7
Shares in issue	19.0m
Free float	85.6%
Code	XPP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.7)	0.1	(4.5)
Rel (local)	(1.7)	6.4	8.6
52-week high/low		1,733p	1,421p

Business description

XP Power is a developer and designer of power control solutions with production facilities in China, Vietnam and the US; and design, service and sales teams across Europe, the US and Asia.

Next events

AGM	1 April 2016
Q1 trading update	11 April 2016

Analysts

Katherine Thompson +44 (0)20 3077 5730

Dan Ridsdale +44 (0)20 3077 5729

tech@edisongroup.com

Edison profile page

XP Power is a research client of Edison Investment Research Limited

Investment summary

Company description: Power converter solutions

XP Power designs, manufactures and distributes power converter solutions to original equipment manufacturers (OEMs) in the healthcare, technology and industrial markets. The group has its headquarters in Singapore and, to remain close to its global customer base, has a sales, design and engineering presence in the US, Europe and Asia. Unlike many in the industry, XP is vertically integrated; its manufacturing facilities in Asia allow the company to maintain quality control, improve flexibility, reduce product costs and minimise lead times.

Financials: Strong FY15, positive FY16 outlook

XP reported revenue growth of 8.5% in FY15 (4% in constant currency) despite a weakening in orders in Q315; gross margin expanded 20bp to 49.8%. The planned increase in engineering and sales headcount meant that the EBITDA margin reduced slightly, but remained at a very high level of 27.0%, and EBITDA beat our forecast by 2.7%. After a slightly lower than expected tax rate, XP's normalised diluted EPS was 6.6% ahead of our forecast. We have raised our FY16 revenue growth forecast (partly due to currency), although at the EPS level our forecast is substantially unchanged. We forecast EPS growth of 10.6% in FY17.

Exhibit 1: Changes to forecasts

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2015	97.9	104.3	6.6	25.0	25.7	2.9	28.9	29.7	2.7
2016e	105.2	105.3	0.1	26.8	27.0	0.6	31.1	31.2	0.5
2017e	N/A	116.6	N/A	N/A	29.8	N/A	N/A	34.2	N/A

Source: XP Power, Edison Investment Research

Valuation: Recent investment to drive growth

While the economic outlook is mixed, with slower growth forecast in the US and China, we believe that XP should be able to take advantage of its recent investment in engineering and sales resource, as well as acquisitions in the US and South Korea. Our forecasts assume a steady increase in bookings as XP integrates recent acquisitions and continues to win market share, particularly in healthcare. Strong forecast cash generation should enable the company to invest in further growth, either through internal product development or through the bolt-on acquisitions it continues to evaluate. XP now trades on a P/E of 14.0x FY16e and 12.6x FY17e normalised EPS, with a forecast dividend yield of 4.7% in FY16 and 5.0% in FY17. Competitor power converter companies are trading at around 18x FY16e EPS on EBITDA margins of c 17% versus XP's 25.6% forecast EBITDA margin. The UK distributors are trading on 10-16x FY16e EPS, on c 9% EBITDA margins. Based on XP's superior margins, the company is undervalued versus peers, and is further supported by its dividend yield.

Sensitivities: End-market demand, currency

XP Power has cyclical exposure to global industrial, technology and healthcare markets and is therefore sensitive to end-demand and product development expenditure in these markets. Visibility of customer volumes is limited and, as such, individual customer orders can be volatile. With the majority of XP's revenues, manufacturing costs and opex US dollar-denominated, currency will continue to add volatility to XP Power's reported revenues, although it will have less impact at the net income level. XP also has more limited exposure to the euro/sterling exchange rate; to minimise this, the company enters into forward contracts. Recent acquisitions add integration risk.

Company description: Power conversion solutions

XP Power designs, manufactures and distributes power converter solutions to OEMs in the industrial, healthcare and technology markets. Power converters take the high-voltage alternating current output from the mains supply and convert it into various lower-voltage, stable direct current outputs that are required to drive most electronic equipment. Over the last 13 years, the company has transitioned from being a distributor to designing and manufacturing the majority of its products. In 2015, the company made two acquisitions, EMCO and a South Korean distributor, for a total cost of £9.1m. The group has its headquarters in Singapore and has volume manufacturing facilities in China and Vietnam and specialist high-voltage product manufacturing in the US. To provide customers with high-quality service and support, it has design, engineering and sales functions in the US, Europe and Asia. FY15 revenues were generated in North America (51%), Europe (41%) and Asia (8%).

Background: Specialist designer and manufacturer

XP Power was formed as a specialist distributor of power converters in 1988 (based in Pangbourne, UK). Subsequently, the business merged with Foresight (California, US) and IPS (New England, US) on flotation in 2000 to form a distributor with more than $100m of sales. In 2002, the board decided to begin developing its own IP and designs, and bought Switching Systems International (California, US), which designed its own configurable power converters with an outsourced manufacturing model. Since then the group has continued to develop its own products and brand, built out manufacturing capacity in China and Vietnam and completed the transition from distributor to designer and manufacturer. The company sells through 27 sales offices and multiple distributors across Europe, Asia and North America. XP has engineering service functions in Northern California, Germany and the UK.

Growth strategy

XP's strategy to drive revenue and profitability growth and to continue to gain market share is as follows:

- Increase contribution of own-design products.
- Manufacture own products.
- Develop a strong pipeline of leading-edge products.
- Target key customer accounts.
- Increase penetration of existing key accounts.
- Expand high-efficiency ('green') product offering and lead the industry on environmental matters.

We discuss the progress XP has made in each of these areas below.

Own-IP products drive margin progression

XP Power's business splits along three business lines:

- Own-manufactured product (68% of FY15 revenues). Products designed by XP, ownership of 100% of the IP and manufactured in its Shanghai or Vietnam facility. This includes engineered solutions where XP power supplies are customised for specific customer end-product design requirements, ie designing and engineering additional casings, metalwork, circuitry, connectors.
- Labelled products (28%). Customer requirements identified and product design specified by XP, but products sourced from third-party manufacturers and labelled under the XP brand.
- Distribution (4%). Supply of third-party products.

XP's decision to move from distribution to design and manufacture of its own products has paid dividends in terms of margin growth: gross margins grew from 31.9% in 2002 to 49.8% in FY15, and over the same period operating margins grew from 3.9% to 23.6%. The company's long-term target is to generate 75% of sales from own-designed product, compared to 68% achieved in 2015 (up from 66% in FY14).

In-house manufacturing well-established

The company manufactures power converters and magnetic components in two locations, China and Vietnam, with smaller US facilities acquired as part of the EMCO deal. In FY15, the company has re-engineered the manufacturing process to reduce lead times and freight costs.

China: Main power converter facility

XP built a manufacturing facility in China and started production there in 2006. The company now has two adjacent factories in Kunshan (near Shanghai). By the end of 2015, the Chinese facilities were operating at c 80% capacity. In FY15, this facility produced 1.2m power converters.

In addition to making power converters at this facility, XP introduced small-scale production of magnetic components (these are components that go into the end-product and were previously bought in from third parties). This gives XP more control over the manufacturing process (important for some customers) and assists the design teams by shortening design cycles. At this facility, magnetic components are mainly produced for prototyping and short lead-time contracts.

Vietnam: Magnetics and less complex power converters

To reduce XP's exposure to rising Chinese labour costs and gain more control over the manufacturing process, XP expanded manufacturing into Vietnam, at a site near Ho Chi Minh City. The first phase (which is approximately the same size as the Chinese facility) was completed in December 2011. The second phase, of equivalent size to the first, will be constructed as demand dictates. The first product to be manufactured at this facility was magnetic components – these have a high labour component, hence the decision to manufacture them in a lower labour cost country. XP started producing magnetics at this facility in 2012, with the facility breaking even in 2013. XP now manufactures virtually all of its magnetics requirements in house. In FY15, XP manufactured 4.3m magnetic components (+18% y-o-y), with 0.5m produced in December.

In H214, the company also started manufacturing power converters in this facility. It started with some of the less complex converters and, once qualified, their production was shifted entirely from China to Vietnam. The facility continues to qualify additional converter products, and runs production in parallel with the Chinese facility until it achieves acceptable yields on those products. This process is freeing up capacity in China for more complex product. In FY15, this facility manufactured more than 172k power converters, more than 10% of XP's total converter output in the year.

Recent acquisition adds US manufacturing capacity

The EMCO acquisition has added manufacturing capacity in the US. EMCO has two facilities (in Nevada and California) where it manufactures its high-voltage DC-DC converters. EMCO also uses outsourcing partners for some manufacturing. As EMCO converters are typically more complex than XP's products (and therefore higher value), it makes sense to retain the specialist expertise of the US-based manufacturing facilities.

Product development

XP aims to have the most comprehensive and up-to-date product range in its target markets. The company introduced 22 new products in 2015 (versus 26 in 2014 and 31 in 2013). In 2015, XP spent £6.7m on R&D (before capitalisation and amortisation), up 17.5% compared to 2014; during the year the company added engineering resource in the US to support growth of the larger customer base, and also added a new design centre in Northern California via the EMCO acquisition.

Developing more custom capability

The company splits its R&D activities between developing new standard products and developing modifications to existing products to meet specific customer requirements. With emerging competition tending to come from Asian manufacturers of low-complexity converters, the company is focused on serving customers with more complex requirements and is now starting to engage in custom design work for large customers.

Expanding the product range

Before the EMCO acquisition, XP's products could supply voltages up to 120V, with the majority of products sold supplying 24V. EMCO's high-voltage, low-power DC-DC converters can supply voltages up to 40kV, with the majority of products in the 5-12kV range. The company continues to consider acquisitions to further expand the product range and engineering expertise.

Long product life cycles

Products in each end-market have very different life cycles. For example, a medical device could have a product life cycle of 10 years or more. Once a power converter is designed into this product, it is likely to remain in it for the full life of the product. Conversely, technology-related products such as routers have much shorter lives, sometimes as short as two years. On average, product life cycle is five to seven years. XP's balanced mix of end-customers means it has a fairly high level of revenues that are recurring in nature and exposure to multiple end-markets mitigates the risk of individual industry cyclicality.

Targeting key accounts – new and existing

XP Power has more than 5,000 direct active customers, of which no customer makes up greater than 7% of revenues. In 2015, the top 30 customers made up 44% of revenues. XP Power supplies power converters to three key markets: industrial, healthcare and technology (see Exhibit 2).

Exhibit 2: End-market breakdown

Sector	FY15 revenue split	Selected customers	Types of products
Industrial	44%	ABB, Agilent, Danaher	Factory automation, automated test equipment, industrial control, 3D printing, test & measurement, instrumentation, hazardous environments, defence, avionics.
Healthcare	31%	GE, Medtronic, Philips, Siemens, Stryker	Medically approved power solutions for use in patient vicinity applications and in the lab environment, including homecare devices, highly efficient convection-cooled designs for low-noise patient area devices and defibrillator-proof DC-DC converters for applied part applications.
Technology	25%	Applied Materials, Lam Research	Semiconductor production equipment, audio visual broadcast equipment, mobile & wireless communications, computing and data processing.

Source: XP Power

Leverage approved supplier status

XP's in-house manufacturing has helped the company to sign up blue-chip companies, particularly in the medical equipment and semiconductor equipment markets. Stable and secure power supply is so crucial to the operation of these customers' products that they demand complete control over their supply chain and product manufacture to ensure quality. XP has achieved approved or preferred supplier status at a large number of customers, including all of the main healthcare equipment companies, and is now working to expand its share of business at each customer.

Improvements to internal processes (upgraded CRM platform, SAP rolled out globally – including at EMCO) are helping the company to share information internally more effectively and to provide better customer service. In December 2015, the company launched its redesigned website – the site is now mobile optimised with improved user experience to provide better information and encourage more interaction.

Cross-selling from acquisitions

EMCO's customer base has limited crossover with XP's existing customer base. As XP's AC-DC converters often provide the DC input for high-voltage DC-DC converters, there is good cross-selling potential. The acquisition of Hanpower, a distributor, adds new customers in South Korea, a country to which XP has not previously had direct access. In addition, Hanpower has engineering services capability that enables it to customise power solutions.

High-efficiency products support 'green' credentials

XP is a full member of the Electronic Industry Citizenship Coalition (EICC), has adopted the EICC's Code of Conduct and is an active member of the Environmental Sustainability and Water working groups. In 2011 XP was included in the FTSE4Good Index. XP incorporated green technologies into the Vietnamese facility, and received the Gold Plus rating by the Singapore Building and Construction Authority (BCA) for non-residential buildings in tropical climates. This is the first BCA Green Mark industrial facility in Vietnam and is the industry's most environmentally friendly building.

Having manufacturing facilities and products that meet high environmental standards helps XP to win approved supplier status with large OEMs, but its main ongoing contribution to sustainability is to design ever-more efficient power converters. For example, a 95% efficient product such as the CCM250 only wastes 5% of the input energy, thereby requiring a lower power input to achieve the same output as a device operating at a lower efficiency. The wasted power is often converted to heat, which in turn requires additional power or physical heat sinks to provide cooling, adding to the upfront and running costs of the product. In FY15, sales of 'green' (ie high-efficiency) products grew 27% to make up 22% of revenues, compared to 18% in FY14 and, of the 22 new products introduced in the year, 17 were high efficiency designs.

Market outlook

Exhibit 3 shows the split of revenues by geography and end-market over the last two years. On a sector basis, **Industrial** is the most fragmented. Areas where the company is seeing demand include 3D printing, industrial printing, LED lighting, smart grid and test & measurement. In FY15, this segment was particularly weak in North America, with some growth in Europe and Asia. The **Healthcare** business saw strong growth in all regions in FY15, benefiting from gains at the big three companies, but also seeing increasing demand from the next tier of companies. The **Technology** business rebounded to growth of 28% after a decline of 10% in 2014. Semiconductor equipment companies made up nearly a third of the division's revenues, growing 12% y-o-y.

Exhibit 3: Divisional and geographic split of revenues (£m)

Healthcare	FY14	FY15	y-o-y	Industrial	FY14	FY15	y-o-y	Technology	FY14	FY15	y-o-y
North America	19.5	21.3	9.2%	North America	19.9	17.6	-11.6%	North America	11.9	16.8	41.2%
Europe	10.2	11.3	10.8%	Europe	25.5	27.1	6.3%	Europe	6.5	6.7	3.1%
Asia	1.3	1.7	30.8%	Asia	3.7	3.9	5.4%	Asia	2.6	3.3	26.9%
Total	**31.0**	**34.3**	**10.6%**	**Total**	**49.1**	**48.6**	**-1.0%**	**Total**	**21.0**	**26.8**	**27.6%**

Source: XP Power

Competitive position

XP Power operates in a market that was estimated to be worth c £1.75bn in 2014 (source: Micro-Tech Consultants). The market is fragmented, with no player having more than a 10% global share.

Based on Micro-Tech Consultants' market statistics, XP Power estimates its global market share stands at 6.3%, with 11.6% market share in Europe, 9.0% in North America and 1.2% in Asia. XP Power does not operate in the high-volume, low-value commodity power converter markets that supply products such as PCs, laptops and cell phone chargers, or in the market for inverters used for renewable energy. Key players in the power converter market are described in Exhibit 4. XP competes most often with TDK-Lambda, and with SL Industries in healthcare.

Exhibit 4: Competitors

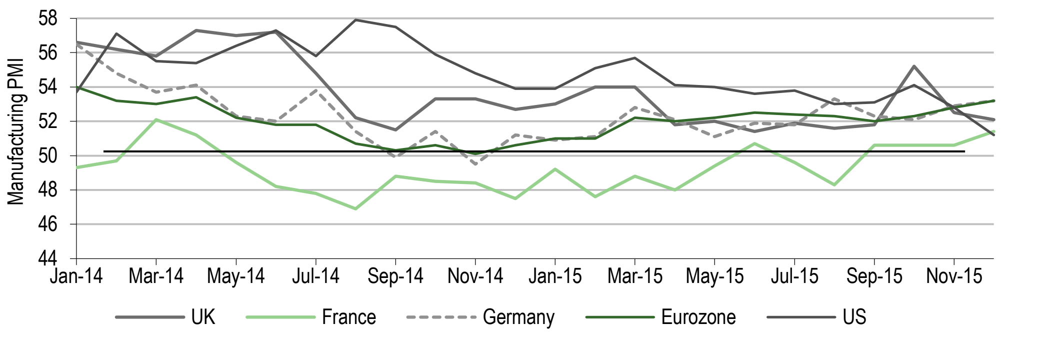
Company	Corporate HQ	Market cap	Comment
GE	US	$294bn	Bought private equity-owned Lineage Power in Jan 2011. Lineage itself was made up of the acquisitions of Tyco Electronics Power Systems and Cherokee in 2008 and PECO II in 2010, with revenues of $450m in 2010.
Emerson	US	$30bn	Emerson offers a vast array of electronic components including power converters. Network Power division had $6.2bn revenues in FY13, of which c $1.2bn was from embedded power & computing (EPC). In November 2013 51% of EPC (now called Artesyn) was sold to Platinum Equity for $300m.
Delta Electronics	Taiwan	$10.6bn	Diversified supplier of custom power supplies, components and systems. Revenues of $6.1bn in FY15 (+2% y-o-y), of which Power Electronics c $3.4bn.
TDK Corporation	Japan	$6.3bn	Subsidiary TDK-Lambda is a power supply specialist covering multiple end-markets. Key competitor to XP in Europe and US.
Vicor	US	$0.3bn	Broad range of power components and complete power systems. Revenues $230m in 12 months to September 2015 (+4% y-o-y). Competes with XP in the military market.
Cosel	Japan	$0.3bn	Specialist in compact, low-profile power supplies. Revenues of $192m in FY15 (+10% y-o-y). Competes with XP in Europe and the US.
Mean Well	Taiwan	-	Standard off-the-shelf switching power modules.
Volgen	US	-	Focus on ultra-small power supplies; division of Kaga Electronics.
SL Industries	US	$0.1bn	Power Electronics division (made up of Ault and Condor businesses) competes with XP in healthcare market. Power Electronics divisional revenues $72m in 12 months to September 2015 (-3% y-o-y).

Source: Edison Investment Research

Short-term outlook

The strength of the industrial market will depend on the health of the global economy. In 2015, manufacturing PMI data remained above 50 (the level that implies expansion rather than contraction) in Germany, the UK, US and eurozone, with only France moving into positive territory towards the end of 2015.

Exhibit 5: Manufacturing PMI data



Source: Markit

Healthcare performance was mixed in 2015 – the two main European healthcare equipment suppliers saw good growth, even in constant currency, whereas GE was weaker. In CY15, GE Healthcare saw a 4% decline in equipment orders and revenues. Philips's healthcare revenues grew 19% in CY15 (or 4% in constant currency), with constant currency orders up 5%. Siemens's healthcare business saw constant currency revenue and order growth of 3% in FY15, accelerating to order growth of 8% and revenue growth of 11% in Q116 (calendar Q415), providing positive momentum going into CY16.

The technology market declined in 2015, although forecasts are for a return to growth in 2016. According to Gartner, global IT spending fell 5.8% in 2015, and is forecast to show minimal growth in 2016 (+0.6%). We note that these forecasts include telecom services. Forecasts from Forrester estimate that the global technology hardware market declined 7.6% in 2015 and will grow 2.4% in 2016 and 5.3% in 2017. SEMI estimates that the semiconductor equipment market declined marginally by 0.6% in 2015 after growth of 19% in 2014. SEMI is forecasting growth of 1.4% in 2016.

Long-term growth drivers

Key drivers of market growth include:

- the environment: legislation and consumer pressure are driving OEMs to reduce the power consumption of their products. Legislation also extends to the efficiency of power converters, driving demand for new products. XP's new products are designed to maximise efficiency – for example, the CCM250 has an efficiency of up to 95%;
- healthcare: as the population ages, while continuing to grow overall, people are living longer with chronic diseases, driving overall healthcare spending;
- emerging technology: alternative technologies are evolving for lighting (eg LEDs) and power generation (eg solar), which all have specific power conversion needs; and
- innovation: customers increasingly need to differentiate their products from the competition. XP's in-house design capabilities enable it to develop products for niche applications.

Sensitivities

XP Power is a global electronics company supplying a broad range of end-markets. The company is not immune to economic slowdown, but diversification and the low-cost structure affords the company some earnings resilience versus competitors.

- **Economic sensitivity:** the group has cyclical exposure to global industrial, technology and healthcare markets. Therefore, any slowdown in end-demand in these markets or cutbacks in product development expenditure will have an impact on XP's revenues.
- **Order book visibility:** the group has around four months of order book visibility at any one time. However, it is essentially a tier two supplier to the electronics industry and still has a small proportion of distributor revenues. Therefore, visibility of customer volumes is limited and, as such, individual customer orders can be volatile.
- **Currency:** around 80% of XP's revenues, c 90% of cost of sales and c 60% of opex are US dollar-denominated. XP Power reports in sterling, exposing the company's results to fluctuations in the US$/£ exchange rate. While moves in the exchange rate will have an impact on reported revenues, the overall impact of currency at the net income level is much less pronounced. XP is also exposed to fluctuations in the euro versus sterling (c 10% of revenues and c 15% of operating costs are euro-denominated). To minimise the impact, the company enters into forward contracts.
- **Large competitors:** competition ranges from significantly larger players with big balance sheets through to smaller innovative companies. The deeper pockets of large competitors may make it more difficult for XP Power to keep pace with product development.
- **Acquisitions:** XP has recently made acquisitions and continues to assess potential targets, adding integration risk.

Financials

Review of FY15 results

Exhibit 6: Actual versus forecast results for FY15

£m	2015e	2015a	Difference
Revenues	108.5	109.7	1.1%
Gross profit	53.8	54.6	1.4%
Gross margin	*49.6%*	*49.8%*	*0.1%*
EBITDA	28.9	29.7	2.7%
EBITDA margin	*26.6%*	*27.0%*	*1.6%*
Normalised operating profit	25.1	25.9	3.1%
Normalised operating profit margin	*23.2%*	*23.6%*	*0.5%*
Reported operating profit	25.1	25.6	1.9%
Reported operating margin	*23.2%*	*23.3%*	*0.2%*
Normalised PBT	25.0	25.7	2.9%
Reported PBT	25.0	25.4	1.7%
Normalised net income	18.8	20.0	6.5%
Reported net income	18.8	19.7	4.9%
Normalised basic EPS (p)	98.9	105.3	6.4%
Normalised diluted EPS (p)	97.9	104.3	6.6%
Reported basic EPS (p)	98.9	103.7	4.8%
Dividend per share (p)	64.0	66.0	3.1%
Net debt	3.9	3.7	-5.2%

Source: XP Power, Edison Investment Research

XP grew revenues 9% in FY15 (4% in constant currency), beating our forecast by 1.1%. This included a $0.8m/£0.5m contribution from EMCO (acquired on 25 November 2015). Gross margin of 49.8% was marginally higher than our forecast, helped by power converter production in Vietnam breaking even during H215. EBITDA was 2.7% ahead of our forecast, helped by the revenue and gross profit beat. This combined with a lower than expected tax rate (21.7% versus our 24% forecast) resulted in normalised diluted EPS 6.6% ahead of our forecast. The company reported exceptional costs of £0.3m relating to acquisitions. A final dividend of 24p per share will be paid on 4 April 2016 to shareholders on 11 March 2016, making a full year dividend of 66p (+8% y-o-y).

Debt refinanced

The company has a working capital facility from the Bank of Scotland based on the Bank of England base rate plus 1.5%. This was renewed in September 2015 to $12.5m ($0.9m/£0.6m used at year-end), stepping down to $10m on 1 January 2016, $7.5m on 1 April 2016 and $5m on 1 July 2016.

To finance the EMCO deal, the company took out a $12m term loan with Bank of Scotland at Libor plus 0.95%. The loan is repayable in quarterly instalments of $1.7m starting in June 2016 until December 2017.

Outlook and changes to forecasts

In FY15, XP received orders worth £110.5m, +5% y-o-y and +1% in constant currency. After a weak Q3 order intake, Q4 orders picked up (+26% q-o-q), providing positive momentum going into FY16. Despite the mixed economic outlook, the company expects to show growth in 2016. We have assumed that the company is able to grow organically, boosted by a full 12 months of the EMCO acquisition. We have revised our forecasts for FY16 and introduce forecasts for FY17 (see Exhibit 7). We have adjusted our $/£ exchange rate assumptions to reflect the continued strength of the dollar. While this has a positive impact at the revenue level, it has minimal impact at the operating profit level. We have increased our dividend forecasts to reflect growth on an annual basis.

Exhibit 7: Changes to forecasts

	2016e			2017e
£m	**Old**	**New**	**Change**	**New**
Revenues	117.8	122.2	3.8%	129.6
Gross profit	59.1	61.1	3.5%	65.0
Gross margin	*50.2%*	*50.0%*	*-0.1%*	*50.2%*
EBITDA	31.1	31.2	0.5%	34.2
EBITDA margin	*26.4%*	*25.6%*	*-0.8%*	*26.4%*
Normalised operating profit	27.1	27.2	0.6%	30.1
Normalised operating profit margin	*23.0%*	*22.3%*	*-0.7%*	*23.2%*
Reported operating profit	27.1	27.2	0.6%	30.1
Reported operating margin	*23.0%*	*22.3%*	*-0.7%*	*23.2%*
Normalised PBT	26.8	27.0	0.6%	29.8
Reported PBT	26.8	27.0	0.6%	29.8
Normalised net income	20.2	20.2	0.1%	22.4
Reported net income	20.2	20.2	0.1%	22.4
Normalised basic EPS (p)	106.3	106.5	0.1%	117.8
Normalised diluted EPS (p)	105.2	105.3	0.1%	116.6
Reported basic EPS (p)	106.3	106.5	0.1%	117.8
Dividend per share (p)	65.0	69.0	6.2%	73.0
Net debt/(cash)	(1.2)	(1.8)	51.1%	(8.1)

Source: Edison Investment Research

Valuation

The stock has declined 6% over the last 12 months, although the stock went as high as 1,733p in August before the full effect of the weaker Q3 order environment became evident. XP now trades on a P/E of 14.0x FY16e and 12.6x FY17e normalised EPS, with a forecast dividend yield of 4.7% in FY16 and 5.0% in FY17. Competitor power converter companies are trading at around 18x FY16e EPS on EBITDA margins of c 17% versus XP's 25.6% forecast EBITDA margin. The UK distributors are trading on 10-16x FY16e EPS, on c 9% EBITDA margins. Based on XP's superior margins, the company is undervalued versus peers, and is further supported by its dividend yield.

While the economic outlook is mixed, with slower growth forecast in the US and China, we believe that XP should be able to take advantage of its recent investment in engineering and sales resource as well as acquisitions in the US and South Korea. Our forecasts assume a steady increase in bookings as XP integrates recent acquisitions and continues to win market share, particularly in healthcare. Strong forecast cash generation should enable the company to invest in further growth, either through internal product development or through the bolt-on acquisitions it continues to evaluate.

Exhibit 8: Financial summary

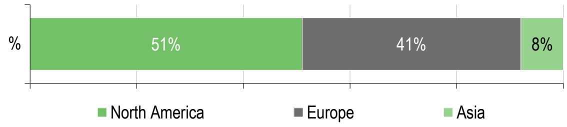
	£m	2012	2013	2014	2015	2016e	2017e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue		93.9	101.1	101.1	109.7	122.2	129.6
Cost of Sales		(49.0)	(51.5)	(51.0)	(55.1)	(61.1)	(64.6)
Gross Profit		44.9	49.6	50.1	54.6	61.1	65.0
EBITDA		23.3	26.0	27.6	29.7	31.2	34.2
Normalised operating profit		21.0	23.3	24.5	25.9	27.2	30.1
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals		0.0	0.0	0.0	(0.3)	0.0	0.0
Share-based payments		0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit		21.0	23.3	24.5	25.6	27.2	30.1
Net Interest		(0.8)	(0.4)	(0.2)	(0.2)	(0.3)	(0.3)
Joint ventures & associates (post tax)		0.0	0.0	0.0	0.0	0.0	0.0
Exceptional & other financial		0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)		20.2	22.9	24.3	25.7	27.0	29.8
Profit Before Tax (reported)		20.2	22.9	24.3	25.4	27.0	29.8
Reported tax		(4.5)	(4.5)	(4.8)	(5.5)	(6.5)	(7.2)
Profit After Tax (norm)		15.7	18.4	19.5	20.2	20.5	22.7
Profit After Tax (reported)		15.7	18.4	19.5	19.9	20.5	22.7
Minority interests		(0.2)	(0.2)	(0.1)	(0.2)	(0.3)	(0.3)
Discontinued operations		0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)		15.5	18.2	19.4	20.0	20.2	22.4
Net income (reported)		15.5	18.2	19.4	19.7	20.2	22.4
Basic average number of shares outstanding (m)		19	19	19	19	19	19
EPS - basic normalised (p)		81.67	95.84	102.12	105.28	106.45	117.78
EPS - diluted normalised (p)		81.35	95.05	101.07	104.32	105.34	116.56
EPS - basic reported (p)		81.67	95.84	102.12	103.70	106.45	117.78
Dividend (p)		50	55	61	66	69	73
Revenue growth (%)		(9.4)	7.7	0.0	8.5	11.4	6.0
Gross Margin (%)		47.8	49.1	49.6	49.8	50.0	50.2
EBITDA Margin (%)		24.8	25.7	27.3	27.0	25.6	26.4
Normalised Operating Margin		22.4	23.0	24.2	23.6	22.3	23.2
BALANCE SHEET							
Fixed Assets		52.8	53.3	56.1	65.4	66.3	67.1
Intangible Assets		38.1	39.1	40.5	48.2	49.0	49.7
Tangible Assets		13.2	12.7	14.4	16.1	16.2	16.3
Investments & other		1.5	1.5	1.2	1.1	1.1	1.1
Current Assets		39.3	42.2	47.0	53.5	58.2	62.8
Stocks		19.8	20.4	25.2	28.7	30.1	31.8
Debtors		14.2	15.4	16.0	17.5	18.8	19.9
Cash & cash equivalents		4.1	5.0	3.8	4.9	6.9	8.7
Other		1.2	1.4	2.0	2.4	2.4	2.4
Current Liabilities		(20.2)	(22.4)	(18.6)	(19.8)	(22.6)	(19.0)
Creditors		(11.1)	(12.7)	(14.4)	(14.6)	(16.3)	(17.2)
Tax and social security		(1.6)	(1.1)	(1.7)	(1.2)	(1.2)	(1.2)
Short term borrowings		(7.3)	(8.5)	(2.5)	(4.0)	(5.1)	(0.6)
Other		(0.2)	(0.1)	0.0	0.0	0.0	0.0
Long Term Liabilities		(10.6)	(3.7)	(4.2)	(10.0)	(5.4)	(5.4)
Long term borrowings		(7.4)	0.0	0.0	(4.6)	0.0	0.0
Other long term liabilities		(3.2)	(3.7)	(4.2)	(5.4)	(5.4)	(5.4)
Net Assets		61.3	69.4	80.3	89.1	96.4	105.4
Minority interests		(0.2)	(0.2)	(0.1)	(0.8)	(0.9)	(1.0)
Shareholders' equity		61.1	69.2	80.2	88.3	95.5	104.4
CASH FLOW							
Op Cash Flow before WC and tax		23.3	26.0	27.6	29.7	31.2	34.2
Working capital		4.2	(0.3)	(4.1)	(4.6)	(1.0)	(1.9)
Exceptional & other		0.4	(0.5)	1.9	0.6	0.0	0.0
Tax		(4.3)	(5.0)	(3.6)	(4.7)	(6.5)	(7.2)
Net operating cash flow		23.6	20.2	21.8	21.0	23.7	25.2
Capex		(4.7)	(3.2)	(5.8)	(5.4)	(4.9)	(4.9)
Acquisitions/disposals		(1.6)	0.1	0.1	(8.3)	0.0	0.0
Net interest		(0.5)	(0.3)	(0.1)	(0.1)	(0.3)	(0.3)
Equity financing		(0.5)	0.1	(0.2)	0.0	0.0	0.0
Dividends		(9.1)	(10.1)	(11.0)	(12.2)	(13.1)	(13.7)
Other		0.5	0.2	0.1	0.2	0.0	0.0
Net Cash Flow		7.7	7.0	4.9	(4.8)	5.5	6.3
Opening net debt/(cash)		18.6	10.6	3.5	(1.3)	3.7	(1.8)
FX		0.3	0.1	(0.1)	(0.2)	0.0	0.0
Other non-cash movements		0.0	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)		10.6	3.5	(1.3)	3.7	(1.8)	(8.1)

Source: XP Power, Edison Investment Research

Contact details

401 Commonwealth Drive
Lobby B #02-02, Haw Par Technocentre
Singapore, 149598
+65 64116900
www.xppower.com

Revenue by geography



Management team

CEO: Duncan Penny	**CFO: Jonathan Rhodes**
Duncan qualified as an accountant with Coopers & Lybrand and from 1980 to 1990 held a senior financial management position with LSI Logic and Dell Computer Corp. He joined XP in 2000 as group FD. In February 2003, he was appointed as CEO.	Jonathan joined XP in 2008 as European financial controller and was appointed to the CFO role in 2011. Before that he spent nine years with JCDecaux in various senior financial positions, including head of financial reporting. Previously, he spent three years with Mills & Allen.
Chairman: James Peters	
James has over 25 years' experience in the industry with Marconi and Coutant Lambda, before joining Powerline in 1980. In 1988, he founded XP Power. In 2000, he was appointed as European MD. In 2003, he was appointed as deputy chairman and in 2014 became chairman.	

Principal shareholders	(%)
Aberdeen Asset Investments	11.4
James Peters	10.8
Hargreave Hale	10.3
Mawer Investment Management	9.5
Standard Life Investments	7.8
Artemis Investment Management	4.7

Companies named in this report

Cosel, Delta Electronics, Emerson, GE, SL Industries, TDK Corporation