EDISON

Windar Photonics

FY15 results

Chinese contract win points to future growth

Alternative energy

Windar's FY15 results were in line with our forecasts, but lower than the expectations at the time of the IPO in March 2015 because of issues with the distributor in China, which is a key market. These issues appear to have been resolved and we expect renewed activity in China to lead to a ramp-up in sales, beginning in H216. The subscription and factoring arrangement announced in May 2016 remove the funding gap identified in our previous note.

Year end	Revenue (€m)	EBITDA (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)
12/14	1.0	(1.5)	(2.0)	(0.05)	0.0	N/A
12/15	0.9	(2.8)	(3.3)	(0.08)	0.0	N/A
12/16e	6.4	0.1	(0.5)	(0.01)	0.0	N/A
12/17e	27.1	10.2	9.5	0.24	0.0	6.1

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

FY15 performance in line with revised estimates

FY15 revenues (€0.95m) were slightly below FY14 (€1.04m), but in line with our estimates. FY15 sales were broadly evenly distributed between North America, Europe and Asia, with a significant increase in activity in the European and North American markets. The distributor in China failed to achieve the required sales levels and has been given termination notice. Importantly, Windar received its first volume order to retrofit a wind park. This order, worth c US$0.9m, is from a US utility and is scheduled for delivery in FY16. EBITDA losses widened, reflecting increased sales and engineering activity and were in line with our estimates (€2.8m).

Chinese contract win points to FY16 sales ramp-up

In April 2016, Windar announced an order for 15 WindEYE LIDAR units for wind turbines in China. This indicates that the decision to sell direct in China is working, underpinning our estimates, which assume a ramp-up in sales from mid-2016 onwards. The Chinese contract award also illustrates how the group is expanding its portfolio in response to OEM requirements, strengthening this route to market. We make minor changes to our estimates to reflect the subscription and factoring facility arrangement in May.

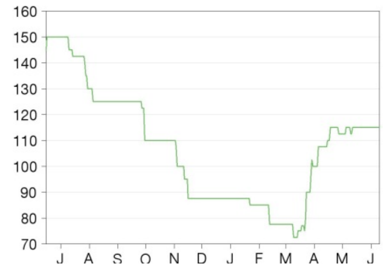
Valuation: Contract news to drive price upwards

Our valuation analysis is based on a DCF, reflecting a series of potential outcomes related to market penetration and consequent volume benefits. The share price has rallied from a low of 72.5p in early March, when the market cap (c £28m) was substantially below the lower bound of our indicative value range. The announcement of the subscription and factoring arrangement has eased investor concerns about the funding gap, while the announcement of the Chinese order has demonstrated that the new approach to winning sales in China is making progress. Receipt of further volume orders, especially from China, should give confidence that the ramp-up in sales modelled in our estimates is feasible, and act as a catalyst towards our mid-case fair value of £58.5m (was £57m) or 150p/share.

13 June 2016

Price	**115p**
Market cap	**£45m**
	€1.28/£
Net cash (€m) at end December 2015, excluding €1.2m raised through subscription in June 2016, long-term deposits and Growth Fund loan	0.6
Shares in issue	39.1m
Free float	38%
Code	WPHO
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	2.2	58.6	(23.3)
Rel (local)	2.6	56.1	(15.2)
52-week high/low		150p	72.5p

Business description

Windar Photonics is a UK-registered, Copenhagen-based developer and manufacturer of an innovative low-cost light detection and ranging (LIDAR) system. Approaching wind direction and speed is measured ahead of a wind turbine, allowing appropriate yaw alignment, increasing efficiency.

Next events

AGM	30 June 2016

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Market development

The primary reason why FY15 performance was substantially lower than anticipated by management at the time of the IPO in March 2015 was the inability of the Chinese distributor to convert interest from wind park operators and wind turbine manufacturers into sizeable orders. Despite being the largest market by far (see our March 2016 note for details), revenues from China were only slightly higher than those from either Europe or North America and were substantially lower than those generated from China in FY14. In January this year, management gave the Chinese distributor termination notice. Windar now has four employees in China and intends to gradually build up this number. The order for 15 WindEYE LIDAR units announced in April indicates that this direct approach to the market is succeeding.

Windar is also making good progress in North America and Europe. During FY15 it received its first volume order. This was worth c US$0.9m, for delivery during FY16, and is from a US utility to retrofit a windpark. So far in FY16, Windar has received LIDAR orders from two large-scale utilities in North America with an aggregate installed capacity of more than 3,500MW. Both orders are already installed in North America.

Product development

An important effect of this increasing customer engagement is a greater understanding of customer requirements. This has resulted in several new product introductions in recent months, as well as some significant improvements to the original WindEYE system that make it easier to install and less expensive and complex to manufacture. The product introductions include:

- 4-beam WindVision system that can measure wind shear. This improves pitch alignment, thus reducing the wear on turbine components, increasing their potential life and reducing maintenance costs.
- Turbine control system for direct retrofit to certain turbine models. Compared to the previous retrofit solution, WindTIMIZER, which only offered turbine yaw optimisation, the new system also supports blade load optimisation.
- Wake detection feature for load optimisation of wind turbine standing in the wake of other turbines. This has been added to both standalone and retrofit products.

Financial performance

FY15 revenues were slightly lower than FY14, but in line with our estimates (€0.95m). EBITDA losses widened, reflecting increased sales and engineering activity, and were in line with our estimates (€2.8m). Administrative costs included warrant expenses of €365k, which we include with the €223k costs associated with admission to AIM in exceptional items.

Net cash (excluding long-term deposits and the Growth Fund loan, which is not currently interest-bearing) reduced from €5.5m at end FY14 to €0.6m at end FY15. Inventory grew by €0.5m and trade receivables by €0.3m, while trade payables fell by €0.7m. Investment in intangible assets rose by 87% year-on-year to €0.6m as a result of the higher levels of product development discussed earlier. Investment in tangible assets was unusually high (€0.2m vs €0.02m FY14) because of the investment in a larger facility in Copenhagen.

Our March 2016 note identified a €1.3m funding gap, which we modelled as financed by debt, noting that this could be addressed by deploying factoring instead. The funding gap was resolved in

May through the combination of a subscription for 885,502 shares at 110p/share raising €1.2m and a factoring facility. The initial facility is for up to €0.4m, with an understanding to increase later in FY16 up to €1.5m as sales ramp up.

The news in April 2016 of the Chinese contract award gives us confidence in our estimates, which assume a substantial ramp-up in sales from mid-2016 onwards. Penetration of the Chinese market is key to achieving this growth. We therefore leave our estimates broadly unchanged, making minor modifications to reflect the possibility of factoring some of the sales. These affect the profitability metrics shown in Exhibit 1, but do not affect the revenue estimates. While the details of the factoring arrangement have not been disclosed, we assume fees are levied at an average rate of 4.5% of revenues factored. We also assume that the arrangement is only used in FY16 and FY17, as our model shows that cash levels in FY18 are sufficient not to require factoring.

Exhibit 1: Changes to estimates

	EPS* (€)			PBT* (€m)			EBITDA (€m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2015	(0.08)	(0.08)**	N/A	(3.0)	(3.3)**	-10.0	(2.8)	(2.8)**	N/A
2016e	(0.01)	(0.01)	N/A	(0.4)	(0.5)	-25.0	0.1	0.1	N/A
2017e	0.25	0.24	-4.0	9.6	9.5	-1.0	10.4	10.2	-1.9
2018e	0.59	0.58	-1.7	29.1	29.1	N/A	30.0	30.0	N/A

Source: Edison Investment Research. Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Actual. EPS estimates have been adjusted to reflect the shares issued as a result of the subscription in May 2016.

Valuation

We continue to use a DCF valuation out to 2025 based on a range of possible scenarios as our preferred valuation methodology. The base/medium case assumes the revenue development shown in our estimates. The low case models a more conservative level of sales based on small market share gains. The high case models an accelerated market penetration. (See our March 2016 note for more details.) We have updated our valuation to reflect the additional costs associated with factoring and the cash raised from the subscription in May. This gives a minor uplift to our indicative valuation: from £34.8m to £35.9m (92p/share) for the low case; from £56.5m to £58.5m (150p/share) for the base/medium case; and from £107.0m to £109.0m (279p/share) for the high case.

Exhibit 2: Edison DCF valuation (£m) using a range of forecast scenarios

		Low case				Base/medium case				High case		
		Discount rate				Discount rate				Discount rate		
		30.0%	40.0%	50.0%		30.0%	40.0%	50.0%		30.0%	40.0%	50.0%
Term growth	0.0%	35.7	35.7	35.7	0.0%	84.5	58.1	42.2	0.0%	161.8	108.4	76.9
	1.0%	35.8	35.8	35.8	1.0%	84.9	58.3	42.3	1.0%	162.4	108.7	77.0
	2.0%	35.9	35.9	35.9	2.0%	85.3	58.5	42.4	2.0%	163.0	109.0	77.2
	3.0%	36.1	36.1	36.1	3.0%	85.8	58.7	42.5	3.0%	163.6	109.3	77.3
	4.0%	36.2	36.2	36.2	4.0%	86.2	58.9	42.6	4.0%	164.3	109.6	77.5

Source: Edison Investment Research

The share price has rallied from a low of 72.5p in early March, when the market cap (c £28m) was substantially below the lower bound of our indicative value range. The announcement of the subscription and factoring arrangement has eased investor concerns about the funding gap, while the announcement of the Chinese order for 15 WindEYE units has demonstrated that the new approach to winning sales in China is working. Receipt of further volume orders, especially from China, should give confidence that the ramp-up in sales modelled in our estimates is feasible, and act as a catalyst towards our mid-case fair value of £58.5m (150p/share).

Exhibit 3: Financial summary

€000s	2013	2014	2015	2016e	2017e	2018e
Year-end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	74	1,039	946	6,436	27,110	62,596
Cost of Sales	(44)	(678)	(679)	(3,325)	(13,008)	(27,459)
Gross Profit	30	361	267	3,110	14,102	35,137
EBITDA	(1,044)	(1,514)	(2,821)	105	10,202	29,962
Operating Profit (before amort. and except.)	(1,358)	(1,841)	(3,217)	(385)	9,562	29,212
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	0	(669)	(588)	0	0	0
Other	0	0	0	0	0	0
Operating Profit	(1,358)	(2,510)	(3,805)	(385)	9,562	29,212
Net Interest	(94)	(175)	(100)	(100)	(100)	(110)
Profit Before Tax (norm)	(1,451)	(2,015)	(3,318)	(485)	9,462	29,102
Profit Before Tax (FRS 3)	(1,451)	(2,684)	(3,906)	(485)	9,462	29,102
Tax	118	70	121	0	0	(6,402)
Profit After Tax (norm)	(1,333)	(1,945)	(3,197)	(485)	9,462	22,699
Profit After Tax (FRS 3)	(1,333)	(2,614)	(3,785)	(485)	9,462	22,699
Average Number of Shares Outstanding (m)	38.2*	38.2*	38.2*	38.7	39.1	39.1
EPS - normalised (€)	(0.03)	(0.05)	(0.08)	(0.01)	0.24	0.58
EPS - normalised fully diluted (€)	(0.03)	(0.05)	(0.08)	(0.01)	0.24	0.58
EPS - (IFRS) (€)	(0.03)	(0.07)	(0.10)	(0.01)	0.24	0.58
Dividend per share (€)	0.0	0.0	0.0	0.0	0.0	0.3
Gross Margin (%)	40.3	34.7	28.3	48.3	52.0	56.1
EBITDA Margin (%)	N/A	N/A	N/A	1.6	37.6	47.9
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	35.3	46.7
BALANCE SHEET						
Fixed Assets	1,285	1,195	1,363	1,373	1,733	2,283
Intangible Assets	1,257	1,148	1,120	1,150	1,400	1,800
Tangible Assets	17	32	144	124	234	384
Investments	11	15	98	98	98	98
Current Assets	640	6,656	2,632	3,638	13,040	35,939
Stocks	147	248	770	1,370	2,320	3,270
Debtors	239	845	1,072	1,822	2,922	7,422
Cash	249	5,549	594	249	7,601	25,050
Other	5	14	197	197	197	197
Current Liabilities	(320)	(1,034)	(488)	(788)	(1,088)	(1,838)
Creditors	(320)	(1,034)	(483)	(783)	(1,083)	(1,833)
Short-term borrowings	0	0	(4)	(4)	(4)	(4)
Long-Term Liabilities	(1,436)	(717)	(827)	(827)	(827)	(827)
Long-term borrowings	0	0	(25)	(25)	(25)	(25)
Other long-term liabilities	(1,436)	(717)	(801)	(801)	(801)	(801)
Net Assets	170	6,100	2,681	3,396	12,858	35,557
CASH FLOW						
Operating Cash Flow	(1,095)	(2,142)	(4,923)	(945)	8,452	25,262
Net Interest	(1)	(175)	(14)	(100)	(100)	(110)
Tax	95	118	70	0	0	(6,402)
Investment in intangible & tangible assets	(8)	(230)	(484)	(500)	(1,000)	(1,300)
Acquisitions/disposals	(55)	0	0	0	0	0
Financing	0	7,071	0	1,200	0	0
Dividends	0	0	0	0	0	0
Net Cash Flow	(1,064)	4,643	(5,351)	(345)	7,352	17,449
Opening net debt/(cash)	(508)	(249)	(5,549)	(564)	(219)	(7,571)
HP finance leases initiated	0	0	0	0	0	0
Other	805	657	367	0	0	0
Closing net debt/(cash)	(249)	(5,549)	(564)	(219)	(7,571)	(25,021)

Source: Company accounts, Edison Investment Research. Note: *Based on number at admission to AIM.

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