

XP Power

Solid H1 performance

Interim results

XP reported revenue and order growth in H116, benefiting from the recent EMCO acquisition and the weakness in sterling. Despite Brexit uncertainty, the higher backlog supports management confidence in H216 growth. We have revised our forecasts to reflect the significantly weaker pound versus the dollar, resulting in EPS upgrades of 1.8% in FY16e and 2.6% in FY17e.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/14	101.1	24.3	101.1	61.0	15.8	3.8
12/15	109.7	25.7	104.3	66.0	15.3	4.1
12/16e	127.2	27.4	107.3	69.0	14.9	4.3
12/17e	136.4	30.5	119.5	73.0	13.4	4.6

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

H116: Revenue, order and profit growth

After a period of weaker demand from US customers in H215, XP saw good order growth in H116: +9% y-o-y/+14% h-o-h. Revenues grew 11.9% y-o-y (constant currency +7%), helped by the EMCO acquisition last November (£3.1m contribution in H116) and the weaker pound. Normalised operating profit of £13.2m grew 3.9% y-o-y, although the margin declined from 23.6% to 21.9% reflecting the recent investment in sales and engineering headcount and the lower profitability of EMCO. Net debt at the end of H116 increased to £6.0m from £3.7m at the end of FY15.

Outlook and changes to forecasts

Management expects to generate revenue growth in H216 as recent design wins move into production. The impact of the Brexit vote looks to be mixed for XP – the medium-term impact on customer demand is uncertain, but the weakness of sterling versus the dollar has a positive translational effect. Trade tariffs are unlikely to have a material impact due to XP's Asian manufacturing base and overseas subsidiaries. We have factored in the lower sterling rate versus the US dollar; while this results in a small upgrade to our earnings forecasts (+1.8% in FY16e, +2.6% in FY17e), it has a negative effect on our reported working capital and net debt forecasts.

Valuation: Recent investment supports growth

While the economic outlook is mixed, 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 14.9x FY16e and 13.4x FY17e normalised EPS, with a forecast dividend yield of 4.3% in FY16 and 4.6% in FY17. Competitor power converter companies are trading at around 21x FY16e EPS on EBITDA margins of c 16% versus XP's 25% forecast EBITDA margin. The UK distributors are trading on c 17x 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.

Tech hardware & equipment

25 July 2016

Price 1,599p

Market cap £307m

\$1.32:€1.20:£1

Net debt (£m) at end H116 6.0

Shares in issue 19.2m

Free float 85.6%

Code XPP

Primary exchange LSE

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	(0.7)	(1)	(0.3)
Rel (local)	(6.3)	(6.1)	(0.4)
52-week high/low	1733p	1421p	

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

Q3 trading update 7 October 2016

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Review of H116 results

XP Power has reported H116 revenue growth of 11.9%; on a constant currency basis growth was 7%. The majority of this growth came from the EMCO acquisition, which contributed revenues of £3.1m in H116 (5.8% of reported growth). This implies Q216 revenues of £31.3m, +11% y-o-y and 8.1% q-o-q.

At £61.6m, H116 order intake was 9% higher than a year ago (+4% in constant currency), with EMCO contributing £4.0m of the total. Book-to-bill for H116 was 1.02x and backlog at the end of H116 was £50.0m, compared to £48.0m at the end of FY15.

Gross margin was negatively affected by the move in the euro versus the dollar in 2015. The rate moved from 1.371 in H114 to 1.116 in H115, staying at that level in H116. As most input costs are in dollars, for those customers invoiced in euros there would have been a big hit to profits in H115. The company countered this with a combination of putting up prices for euro-based invoices and having the benefit of a €/£ currency hedge. In H116, the higher prices were still in place, but there was no corresponding currency hedge, putting pressure on the margin compared to H115. As EMCO is a lower-margin business than XP, the EBITDA margin fell to 25.2% from 26.9% a year ago and 27.0% for FY15.

Net debt at the end of H116 rose to £6.0m, mainly as a result of US dollar strength versus sterling. At the end of H116, XP had gross term debt of \$10.3m and a working capital facility of \$7.5m, translated at a rate of \$1.33/£ compared to \$1.44/£ for the majority of the period before 23 June. Translation of dollar-denominated working capital also saw the same effect, resulting in a higher than expected working capital outflow.

Exhibit 1: Half-yearly results highlights

£m	H116	H115	y-o-y
Revenues	60.3	53.9	11.9%
Gross profit	29.5	26.6	10.9%
Gross margin	48.9%	49.4%	-0.4%
EBITDA	15.2	14.5	4.8%
EBITDA margin	25.2%	26.9%	-1.7%
Normalised operating profit	13.2	12.7	3.9%
Normalised operating margin	21.9%	23.6%	-1.7%
Reported operating profit	13.0	12.7	2.4%
Reported operating margin	21.6%	23.6%	-2.0%
Normalised PBT	13.1	12.6	4.0%
Normalised PAT	10.2	9.6	6.3%
Reported net income	9.8	9.6	2.1%
Normalised diluted EPS (p)	52.1	50.1	4.1%
Reported basic EPS (p)	51.6	50.5	2.0%
Net debt	6.0	0.4	1400.0%

Source: XP Power

Business update

Divisional revenues

The table below shows the H116 revenue split by end-market and geography. The **healthcare** business generated minimal growth y-o-y. Considering the strong dollar, this implies a small decline in underlying revenues. Management is confident that recent design wins moving into production will drive growth in the medium term. The **technology** business saw 11% growth y-o-y with stronger demand from semiconductor and broadcast customers. The **industrials** business saw the largest increase at 20% y-o-y, with a strong performance in Europe, a recovery in the US after a weak

2015 and a full six months' contribution from EMCO. The majority of EMCO revenues are reported in the industrial segment, with small amounts in the healthcare and technology segments. Around half of EMCO's revenues are generated in the US, with the next largest amount in Europe and the remainder in Asia.

Exhibit 2: Geographical revenue split by end-market (£m)

Healthcare	H115	H116	y-o-y	Industrial	H115	H116	y-o-y	Technology	H115	H116	y-o-y
North America	10.6	10.7	0.9%	North America	8.6	11.2	30.2%	North America	7.7	8.9	15.6%
Europe	6.0	6.0	0.0%	Europe	13.7	14.8	8.0%	Europe	3.5	3.8	8.6%
Asia	0.7	0.8	14.3%	Asia	1.7	2.8	64.7%	Asia	1.4	1.3	-7.1%
Total	17.3	17.5	1.2%	Total	24.0	28.8	20.0%	Total	12.6	14.0	11.1%

Source: XP Power

Manufacturing progress

The company continues to increase the level of power converter manufacturing in the Vietnam facility. The total number of converters produced across the China and Vietnam facilities was 550,000, of which 140,000 were made in Vietnam (25.5%). This compares to production in 2015, which split out as 590,000 in H115 (4.1% in Vietnam) and 810,000 in H215 (18.3% in Vietnam). The company continues to transfer products over to Vietnam, freeing up capacity in China for more complex products.

The level of own-design product increased by 20% to £43.4 (72% of total revenues) in H116 versus 67% in FY15. This was partly helped by the addition of EMCO, which is 100% own design.

Product development

The company accelerated new product introductions in H116 to 27 from 13 in H115 and 22 for FY15. This was partly due to the introduction of a new labelled product supplier for DC/DC converters. Of the 27 new products, 18 were "green", ie high efficiency.

"Green" product revenues made up 24% of the H116 total compared to 21% in FY15, as customers seek out high-efficiency, high-reliability products.

Outlook and changes to forecasts

Outlook considering Brexit impact

Management is conscious of the uncertainty brought about by the Brexit vote, with the possibility that it could reduce customer demand, particularly in the UK. However, the weakness of sterling versus the dollar has a positive translational effect for XP as roughly three-quarters of revenues are invoiced in US dollars. In addition, the weak pound may increase the attractiveness of UK customers' exports. In the UK (20% of sales), roughly two-thirds of sales are invoiced in sterling; the company is currently reviewing pricing for the sterling-based invoices.

As the majority of product is manufactured in Asia, it can be shipped to customers without passing through the UK, thereby avoiding any tariffs that may be put in place between the UK and the EU.

Although the capital goods markets remain subdued, the company expects to grow revenues in H216 as recent design wins move into production. Management also highlighted its strong balance sheet in the context of considering further acquisitions to widen its product offering and engineering capabilities.

Changes to forecasts

We have factored in the weaker sterling versus dollar rate (1.39 for FY16 and 1.35 for FY17). This has a positive impact at the revenue level, but as the company has a high level of natural hedging, the impact at the operating profit level is lower. We have factored in higher capex and a higher level of working capital, resulting in a higher net debt forecast at the end of FY16 and lower net cash at the end of FY17. Overall, we forecast a 1.8% increase in normalised EPS in FY16 and 2.6% in FY17.

Exhibit 3: Changes to estimates

£m	2016e			2017e		
	Old	New	Change	Old	New	Change
Revenues	122.2	127.2	4.0%	129.6	136.4	5.3%
Gross profit	61.1	62.6	2.4%	65.0	67.4	3.6%
Gross margin	50.0%	49.2%	-0.8%	50.2%	49.4%	-0.8%
EBITDA	31.2	32.0	2.3%	34.2	35.3	3.3%
EBITDA margin	25.6%	25.1%	-1.6%	26.4%	25.9%	-1.9%
Normalised operating profit	27.2	27.7	1.6%	30.1	30.8	2.4%
Normalised operating profit margin	22.3%	21.8%	-0.5%	23.2%	22.6%	-0.6%
Reported operating profit	27.2	27.4	0.5%	30.1	30.6	1.8%
Reported operating margin	22.3%	21.5%	-0.8%	23.2%	22.4%	-0.8%
Normalised PBT	27.0	27.4	1.4%	29.8	30.5	2.3%
Reported PBT	27.0	27.1	0.3%	29.8	30.3	1.6%
Normalised net income	20.2	20.6	1.8%	22.4	22.9	2.6%
Reported net income	20.2	20.3	0.3%	22.4	22.7	1.7%
Normalised basic EPS	106.5	108.4	1.8%	117.78	120.8	2.6%
Normalised diluted EPS	105.3	107.3	1.8%	116.56	119.5	2.6%
Reported basic EPS	106.5	106.8	0.3%	117.78	119.7	1.7%
Dividend per share	69.0	69.0	0.0%	73.0	73.0	0.0%
Net debt/(cash)	(1.8)	2.1	-220.0%	(8.1)	(3.9)	-52.1%

Source: Edison Investment Research

Exhibit 4: Financial summary

	£m	2012	2013	2014	2015	2016e	2017e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue		93.9	101.1	101.1	109.7	127.2	136.4
Cost of Sales		(49.0)	(51.5)	(51.0)	(55.1)	(64.5)	(69.1)
Gross Profit		44.9	49.6	50.1	54.6	62.6	67.4
EBITDA		23.3	26.0	27.6	29.7	32.0	35.3
Normalised operating profit		21.0	23.3	24.5	25.9	27.7	30.8
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	(0.2)	(0.2)
Exceptionals		0.0	0.0	0.0	(0.3)	(0.1)	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	27.4	30.6
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	27.4	30.5
Profit Before Tax (reported)		20.2	22.9	24.3	25.4	27.1	30.3
Reported tax		(4.5)	(4.5)	(4.8)	(5.5)	(6.5)	(7.3)
Profit After Tax (norm)		15.7	18.4	19.5	20.2	20.9	23.2
Profit After Tax (reported)		15.7	18.4	19.5	19.9	20.6	23.0
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	20.6	22.9
Net income (reported)		15.5	18.2	19.4	19.7	20.3	22.7
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	108.39	120.80
EPS - diluted normalised (p)		81.35	95.05	101.07	104.32	107.26	119.54
EPS - basic reported (p)		81.67	95.84	102.12	103.70	106.81	119.74
Dividend (p)		50	55	61	66	69	73
Revenue growth (%)		(9.4)	7.7	0.0	8.5	15.9	7.3
Gross Margin (%)		47.8	49.1	49.6	49.8	49.2	49.4
EBITDA Margin (%)		24.8	25.7	27.3	27.0	25.1	25.9
Normalised Operating Margin		22.4	23.0	24.2	23.6	21.8	22.6
BALANCE SHEET							
Fixed Assets		52.8	53.3	56.1	65.4	66.9	67.7
Intangible Assets		38.1	39.1	40.5	48.2	49.4	50.5
Tangible Assets		13.2	12.7	14.4	16.1	16.4	16.1
Investments & other		1.5	1.5	1.2	1.1	1.1	1.1
Current Assets		39.3	42.2	47.0	53.5	58.4	63.1
Stocks		19.8	20.4	25.2	28.7	32.7	35.0
Debtors		14.2	15.4	16.0	17.5	20.2	21.7
Cash & cash equivalents		4.1	5.0	3.8	4.9	3.1	4.0
Other		1.2	1.4	2.0	2.4	2.4	2.4
Current Liabilities		(20.2)	(22.4)	(18.6)	(19.8)	(23.3)	(19.5)
Creditors		(11.1)	(12.7)	(14.4)	(14.6)	(16.9)	(18.2)
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)	(5.2)	(0.1)
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	96.5	105.9
Minority interests		(0.2)	(0.2)	(0.1)	(0.8)	(0.9)	(1.0)
Shareholders' equity		61.1	69.2	80.2	88.3	95.6	104.9
CASH FLOW							
Op Cash Flow before WC and tax		23.3	26.0	27.6	29.7	32.0	35.3
Working capital		4.2	(0.3)	(4.1)	(4.6)	(4.4)	(2.5)
Exceptional & other		0.4	(0.5)	1.9	0.6	(0.1)	0.0
Tax		(4.3)	(5.0)	(3.6)	(4.7)	(6.5)	(7.3)
Net operating cash flow		23.6	20.2	21.8	21.0	21.0	25.5
Capex		(4.7)	(3.2)	(5.8)	(5.4)	(6.0)	(5.5)
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)	1.6	6.0
Opening net debt/(cash)		18.6	10.6	3.5	(1.3)	3.7	2.1
FX		0.3	0.1	(0.1)	(0.2)	0.0	0.0
Other non-cash movements		0.0	0.0	0.0	0.1	0.0	0.0
Closing net debt/(cash)		10.6	3.5	(1.3)	3.7	2.1	(3.9)
Source: Company accounts, Edison Investment Research							

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