

# XP Power

H117 results

## Broad based demand drives upgrade

XP reported a strong performance in H117 and is seeing good demand across its customer base. Based on the order intake in H1, management has a more positive outlook for FY17 and we have upgraded our forecasts accordingly. Our normalised EPS forecasts increase by 8% in FY17 and 3% in FY18. To support future growth, XP is investing in manufacturing capacity in Vietnam and engineering resource, and continues to look for suitable acquisitions.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	109.7	25.7	104.3	66.0	24.0	2.6
12/16	129.8	28.6	115.3	71.0	21.7	2.8
12/17e	155.8	33.2	133.5	75.0	18.7	3.0
12/18e	160.7	34.6	135.8	79.0	18.4	3.2

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

## H117 results reflect continued strength in Q2

XP grew revenues 33% y-o-y in H117, with constant currency growth of 18%. The company saw good demand from all end-markets and geographies, and closed H117 with a backlog that was 20% higher than at the end of FY16. Due to currency effects and cost reallocation, while gross profit increased 27.5% y-o-y, gross margin declined 2pp to 46.9%. Normalised operating profit increased 31.8% y-o-y to achieve a margin of 21.7%. Cash generation was strong in the period, with net cash growing to £8.0m at the end of H117 versus £3.7m at the end of FY16.

## FY17 results likely to be ahead of expectations

After the high level of order intake in H117, the company now anticipates that FY17 results will be ahead of its expectations. We have increased our underlying revenue growth assumption for FY17, resulting in an increase to our revenue forecast of 3.9% in FY17 and 2.5% in FY18. Taking into account a slightly lower gross margin, we increase our FY17e normalised EPS by 8.0% and FY18e by 3.4%. We view our underlying growth forecast of 5% for FY18 as conservative – if order intake continues at a similar pace in H217 we see scope for further upgrades. Despite the setback of the aborted deal in H1, the company continues to look for acquisitions to broaden its product offering and engineering resources.

## Valuation: Earnings growth to drive upside

The stock is trading on a P/E of 18.7x FY17e and 18.4x FY18e normalised EPS, in line with its power converter peers, but at a discount to UK electronics manufacturers, despite its better profitability. Evidence of accelerating earnings growth could reduce this discount. The forecast dividend yield of 3.0% in FY17 is ahead of its peers. Strong forecast cash generation should enable the company to invest in further growth, either through internal product development or bolt-on acquisitions, while maintaining its high level of profitability.

### Tech hardware & equipment

31 July 2017

**Price** **2,500p**
**Market cap** **£475m**

\$1.3:£1

Net cash (£m) at end H117 8.0

Shares in issue 19.0m

Free float 90.6%

Code XPP

Primary exchange LSE

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (9.1) (0.5) 55.3

Rel (local) (6.7) (0.1) 40.1

52-week high/low 2,680p 1,512p

### 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 9 October 2017

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## Review of H117 results

<b>Exhibit 1: Half-year results</b>			
<b>£m</b>	<b>H116</b>	<b>H117</b>	<b>y-o-y</b>
Revenues	60.3	80.2	33.0%
Gross profit	29.5	37.6	27.5%
<i>Gross margin</i>	48.9%	46.9%	(2.0%)
EBITDA	15.2	19.9	30.9%
<i>EBITDA margin</i>	25.2%	24.8%	(0.4%)
Normalised operating profit	13.2	17.4	31.8%
<i>Normalised operating margin</i>	21.9%	21.7%	(0.2%)
Reported operating profit	13.0	14.5	11.5%
<i>Reported operating margin</i>	21.6%	18.1%	(3.5%)
Normalised PBT	13.1	17.3	32.1%
Normalised PAT (after minority interest)	10.0	13.0	30.0%
Reported net income (after minority interest)	9.8	10.9	11.2%
Normalised diluted EPS (p)	52.1	67.3	29.1%
Reported basic EPS (p)	51.6	57.2	11.0%
Net debt/(cash)	6.0	(8.0)	N/A

Source: XP Power, Edison Investment Research

XP Power has reported a strong performance for H117, with revenue growth of 33% year-on-year. On a constant currency basis, revenues grew 18% y-o-y. Gross profit increased 27.5% y-o-y, although the margin declined two percentage points. This was for two reasons a) a 110bp hit from the currency impact of the higher proportion of costs of sale denominated in US dollars (c 90%) versus revenues (c 81%), and b) a 100bp hit from the reallocation of EMCO costs from operating expenses to costs of sale (c £0.8m). EBITDA increased 30.9% y-o-y with a small decline in the EBITDA margin. Underlying operating costs (including depreciation and amortisation) increased 24% y-o-y through a combination of inflationary increases, currency effects and higher headcount than a year ago. This was partially offset by £0.8m of EMCO costs being reallocated to cost of sales. XP continues to invest in engineering resources to address the more complex segment of the market, where there is less competition from Asian suppliers.

XP incurred an exceptional charge of £2.8m for aborted acquisition costs. Excluding this cost, normalised operating profit increased 31.8% y-o-y and normalised operating margin declined marginally to 21.7% from 21.9%. The reported tax rate of 22.2% was lower than our 24% forecast for the year; for adjusted earnings the company used a rate of 23%, again below our forecast. The company expects a future tax rate of 22-24%.

The company increased its net cash position from £3.7m at the end of FY16 to £8.0m at the end of H117.

A dividend of 16p has been proposed for Q217, in line with our forecast. It will be paid on 12 October to shareholders as at 15 September.

### Continued strong order intake

The company is benefiting from a recovery in the capital equipment market and new design wins entering into production.

- Order intake reached £93.4m for H117 (+52% y-o-y, +35% constant currency), split out as £47.0m in Q117 (+55.1% y-o-y, +26.7% q-o-q) and £46.4m in Q217 (+49.2% y-o-y, -1.3% q-o-q). Around half of the growth in order intake was from existing programmes and the remainder from new programmes entering production in the last year.
- Book-to-bill was 1.16x in H117, split out as 1.19x in Q117 and 1.14x in Q217.
- Order backlog was £70.9m at the end of H117, up from £59.1m at the end of FY16.

## Business update

The company has seen strengthening demand across all end-markets and geographies. The Technology vertical showed the strongest growth, driven by a near doubling in sales to semiconductor equipment manufacturers (\$15.3m in H117, +99% y-o-y). This was followed by the Healthcare vertical with 36% growth y-o-y. Although the company has approvals from the top three companies in this market, it was the next tier of healthcare equipment companies that generated most of the growth. The Industrial sector grew 19% y-o-y which, once currency effects are removed, represented steady demand across the diverse customer base.

**Exhibit 2: Revenues by end market and geography (£m)**

Healthcare	H117	H116	y-o-y	Industrial	H117	H116	y-o-y	Technology	H117	H116	y-o-y
North America	14.4	10.7	34.6%	North America	13.3	11.2	18.8%	North America	16	8.9	79.8%
Europe	7.7	6.0	28.3%	Europe	17.5	14.8	18.2%	Europe	4.2	3.8	10.5%
Asia	1.7	0.8	112.5%	Asia	3.5	2.8	25.0%	Asia	1.9	1.3	46.2%
<b>Total</b>	<b>23.8</b>	<b>17.5</b>	<b>36.0%</b>	<b>Total</b>	<b>34.3</b>	<b>28.8</b>	<b>19.1%</b>	<b>Total</b>	<b>22.1</b>	<b>14.0</b>	<b>57.9%</b>

Source: XP Power

Own-design product made up 75% of revenues, up from 72% in H116 and 73% in FY16. 14 new products were introduced in H117 compared to 27 a year ago. A large number of new products were introduced in 2016 as XP added a new labelled product supplier for DC-DC converters. The sale of ultra-high efficiency “green” products grew slightly slower than the group average to make up 23% of total revenues (H116: 24%).

## Manufacturing update

As previously announced, XP is planning to break ground on a second facility in Vietnam in H217 (Vietnam II). It expects the facility to cost \$6.5m in total, with \$1.9m to be spent in H217 and \$4.6m in FY18.

As a reminder, the China facility in Kunshan is used to make power converters. The Vietnam I building manufactures less complex power converters (259 part numbers qualified to date, up from 113 in H116) as well as magnetics that are used in the manufacture of power converters. Vietnam II will be also be used to manufacture both magnetics and power converters, and is planned to be a larger facility than Vietnam I.

**Exhibit 3: Manufacturing capacity**

	Revenue capacity* (\$m)	Current utilisation
China	100	100%
Vietnam I	70	60%
Vietnam II - to be built	130	N/A

Source: XP Power. Note: \*Based on current product mix.

In H117, the company manufactured 693,000 power converters (+26% y-o-y), with 60% of them produced in the Vietnam I facility. The company continues to transfer production of power converters from China to Vietnam, leaving the most complex and higher power products in China.

## Outlook and changes to forecasts

The company now anticipates that FY17 results will come in materially ahead of its expectations. We have revised our forecasts as follows:

- Revenues:** underlying growth increased for FY17 to reflect stronger order intake. We have adjusted our US\$/£ currency forecasts: FY17 from 1.27 to 1.28 and FY18 from 1.27 to 1.30. Overall our FY17 revenue forecast increases by 3.9% and FY18 by 2.5%. We note we are only

forecasting modest underlying growth of 5% in FY18 – if order intake remains strong through H217 there is potential for us to upgrade this number.

- **Gross margins:** we have tweaked down our gross margin forecasts to reflect the currency impact on higher revenues.
- **Net cash:** despite the £2.8m exceptional charge for aborted M&A incurred in H117, we raise our net cash forecast for both years to reflect higher profitability and better working capital management.

<b>Exhibit 4: Changes to forecasts</b>									
£m	2017e				2018e				
	Old	New	Change	y-o-y	Old	New	Change	y-o-y	
Revenues	150.0	155.8	3.9%	20.0%	156.9	160.7	2.5%	3.2%	
Gross profit	71.1	73.2	3.0%	18.1%	74.4	75.7	1.7%	3.4%	
Gross margin	47.4%	47.0%	(0.4%)	(0.8%)	47.4%	47.1%	(0.3%)	0.1%	
EBITDA	36.9	38.6	4.4%	16.8%	39.3	40.4	2.9%	4.8%	
EBITDA margin	24.6%	24.7%	0.5%	(0.7%)	25.0%	25.1%	0.1%	0.4%	
Normalised operating profit	31.8	33.5	5.1%	16.2%	33.8	34.9	3.4%	4.3%	
Normalised operating profit margin	21.2%	21.5%	0.2%	(0.7%)	21.5%	21.7%	0.2%	0.2%	
Reported operating profit	31.4	30.3	(3.7%)	8.1%	33.4	34.5	3.4%	14.1%	
Reported operating margin	21.0%	19.4%	(1.5%)	(2.2%)	21.3%	21.5%	0.2%	2.1%	
Normalised PBT	31.5	33.2	5.1%	15.9%	33.5	34.6	3.4%	4.4%	
Reported PBT	31.1	30.0	(3.8%)	7.7%	33.1	34.2	3.4%	14.2%	
Normalised net income	23.7	25.6	8.0%	15.9%	25.2	26.0	3.4%	1.7%	
Reported net income	23.4	22.5	(3.8%)	5.7%	24.9	25.7	3.5%	14.4%	
Normalised basic EPS	124.9	135.0	8.0%	16.1%	132.7	137.2	3.4%	1.7%	
Normalised diluted EPS	123.6	133.5	8.0%	15.8%	131.3	135.8	3.4%	1.7%	
Reported basic EPS	123.3	118.6	(3.8%)	5.9%	131.1	135.7	3.5%	14.4%	
Dividend per share	75.0	75.0	0.0%	5.6%	79.0	79.0	0.0%	5.3%	
Net debt/(cash)	(3.6)	(5.7)	55.5%	53.0%	(7.7)	(10.1)	30.4%	77.6%	

Source: Edison Investment Research

**Exhibit 5: Financial summary**

	£m	2012	2013	2014	2015	2016	2017e	2018e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>								
Revenue		93.9	101.1	101.1	109.7	129.8	155.8	160.7
Cost of Sales		(49.0)	(51.5)	(51.0)	(55.1)	(67.8)	(82.6)	(85.0)
Gross Profit		44.9	49.6	50.1	54.6	62.0	73.2	75.7
EBITDA		23.3	26.0	27.6	29.7	33.0	38.6	40.4
Normalised operating profit		21.0	23.3	24.5	25.9	28.8	33.5	34.9
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	(0.4)	(0.4)	(0.4)
Exceptionals		0.0	0.0	0.0	(0.3)	(0.4)	(2.8)	0.0
Share-based payments		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit		21.0	23.3	24.5	25.6	28.0	30.3	34.5
Net Interest		(0.8)	(0.4)	(0.2)	(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	0.0
Exceptional & other financial		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)		20.2	22.9	24.3	25.7	28.6	33.2	34.6
Profit Before Tax (reported)		20.2	22.9	24.3	25.4	27.8	30.0	34.2
Reported tax		(4.5)	(4.5)	(4.8)	(5.5)	(6.3)	(7.2)	(8.2)
Profit After Tax (norm)		15.7	18.4	19.5	20.2	22.3	25.9	26.3
Profit After Tax (reported)		15.7	18.4	19.5	19.9	21.5	22.8	26.0
Minority interests		(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)
Discontinued operations		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)		15.5	18.2	19.4	20.0	22.1	25.6	26.0
Net income (reported)		15.5	18.2	19.4	19.7	21.3	22.5	25.7
Basic average number of shares outstanding (m)		19	19	19	19	19	19	19
EPS - basic normalised (p)		81.67	95.84	102.12	105.28	116.22	134.95	137.24
EPS - diluted normalised (p)		81.35	95.05	101.07	104.32	115.33	133.55	135.81
EPS - basic reported (p)		81.67	95.84	102.12	103.70	112.02	118.62	135.66
Dividend (p)		50	55	61	66	71	75	79
Revenue growth (%)		(9.4)	7.7	0.0	8.5	18.3	20.0	3.2
Gross Margin (%)		47.8	49.1	49.6	49.8	47.8	47.0	47.1
EBITDA Margin (%)		24.8	25.7	27.3	27.0	25.4	24.7	25.1
Normalised Operating Margin		22.4	23.0	24.2	23.6	22.2	21.5	21.7
<b>BALANCE SHEET</b>								
Fixed Assets		52.8	53.3	56.1	65.4	73.2	76.9	80.7
Intangible Assets		38.1	39.1	40.5	48.2	53.0	54.2	55.2
Tangible Assets		13.2	12.7	14.4	16.1	19.1	21.6	24.4
Investments & other		1.5	1.5	1.2	1.1	1.1	1.1	1.1
Current Assets		39.3	42.2	47.0	53.5	65.7	72.1	78.4
Stocks		19.8	20.4	25.2	28.7	32.2	38.5	39.6
Debtors		14.2	15.4	16.0	17.5	21.5	24.8	25.5
Cash & cash equivalents		4.1	5.0	3.8	4.9	9.2	6.1	10.5
Other		1.2	1.4	2.0	2.4	2.8	2.8	2.8
Current Liabilities		(20.2)	(22.4)	(18.6)	(19.8)	(25.7)	(26.6)	(25.5)
Creditors		(11.1)	(12.7)	(14.4)	(14.6)	(16.0)	(22.5)	(21.4)
Tax and social security		(1.6)	(1.1)	(1.7)	(1.2)	(3.3)	(3.3)	(3.3)
Short term borrowings		(7.3)	(8.5)	(2.5)	(4.0)	(5.5)	(0.4)	(0.4)
Other		(0.2)	(0.1)	0.0	0.0	(0.9)	(0.4)	(0.4)
Long Term Liabilities		(10.6)	(3.7)	(4.2)	(10.0)	(6.2)	(6.2)	(6.2)
Long term borrowings		(7.4)	0.0	0.0	(4.6)	0.0	0.0	0.0
Other long term liabilities		(3.2)	(3.7)	(4.2)	(5.4)	(6.2)	(6.2)	(6.2)
Net Assets		61.3	69.4	80.3	89.1	107.0	116.1	127.3
Minority interests		(0.2)	(0.2)	(0.1)	(0.8)	(0.9)	(1.0)	(1.1)
Shareholders' equity		61.1	69.2	80.2	88.3	106.1	115.1	126.2
<b>CASH FLOW</b>								
Op Cash Flow before WC and tax		23.3	26.0	27.6	29.7	33.0	38.6	40.4
Working capital		4.2	(0.3)	(4.1)	(4.6)	(6.2)	(3.0)	(3.0)
Exceptional & other		0.4	(0.5)	1.9	0.6	5.2	(2.8)	0.0
Tax		(4.3)	(5.0)	(3.6)	(4.7)	(4.1)	(7.2)	(8.2)
Net operating cash flow		23.6	20.2	21.8	21.0	27.9	25.5	29.2
Capex		(4.7)	(3.2)	(5.8)	(5.4)	(6.8)	(9.2)	(9.7)
Acquisitions/disposals		(1.6)	0.1	0.1	(8.3)	0.1	(0.5)	0.0
Net interest		(0.5)	(0.3)	(0.1)	(0.1)	(0.2)	(0.3)	(0.3)
Equity financing		(0.5)	0.1	(0.2)	0.0	0.2	0.5	0.0
Dividends		(9.1)	(10.1)	(11.0)	(12.2)	(13.1)	(14.1)	(14.8)
Other		0.5	0.2	0.1	0.2	0.0	0.0	0.0
Net Cash Flow		7.7	7.0	4.9	(4.8)	8.1	2.0	4.4
Opening net debt/(cash)		18.6	10.6	3.5	(1.3)	3.7	(3.7)	(5.7)
FX		0.3	0.1	(0.1)	(0.2)	(0.5)	0.0	0.0
Other non-cash movements		0.0	0.0	0.0	0.1	(0.2)	0.0	0.0
Closing net debt/(cash)		10.6	3.5	(1.3)	3.7	(3.7)	(5.7)	(10.1)

Source: XP Power, Edison Investment Research

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