

# XP Power

Acquisition

## Entering the RF power supply market

XP has acquired Comdel, a US-based RF power supply company, for \$23m/£17m. This marks the entry into a new market for XP and gives it the potential to expand the amount it sells to a sub-sector of its customer base. We have revised our forecasts to reflect both the acquisition and the strengthening pound versus the dollar. We increase our normalised EPS forecast by 1.2% in FY17 and 1.7% in FY18

Year end	Revenue (£m)	PBT* (£m)	Dil. EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	109.7	25.7	104.3	66.0	26.6	2.4
12/16	129.8	28.6	115.3	71.0	24.1	2.6
12/17e	159.2	33.6	135.1	75.0	20.5	2.7
12/18e	170.0	35.9	138.1	79.0	20.1	2.8

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

## Deal funded by new debt facility

XP has acquired Comdel for \$23m/£17m using a new \$40m revolving credit facility. The deal is on a debt free/cash free basis with no deferred or contingent elements. The management team will remain with XP and the business will operate as part of XP's newly created RF Power division. With revenues of \$16.5m/£13.0m in FY16, this adds c 10% to XP's revenues on a pro-forma basis.

## Expanding the product range

The deal marks XP's entry into the radio frequency (RF) power supply market – this requires engineering expertise at a much higher power range than for XP's existing products. The acquisition will increase XP's exposure to the semiconductor manufacturing industry – XP and Comdel have several customers in common in this market. We expect XP to target selling more to its existing semiconductor customers; Comdel also brings new customers that XP could sell to. As Comdel's product is more specialist, we expect XP to train its salesforce to take a targeted approach to sales. XP also has the potential to improve manufacturing efficiencies, with the use of its Asian facilities a consideration for new product designs.

## Forecasts and valuation: small EPS upgrades

We have revised our forecasts to incorporate Comdel from 1 October 2017. We have also reflected the weakening dollar versus the pound in FY18 – this reduces reported revenues although has a smaller impact on profitability due to natural hedging. Our revenue forecasts increase by 2.2% in FY17 and 5.8% in FY18, with normalised EPS increasing 1.2% in FY17 and 1.7% in FY18. We forecast a swing from a net cash position of £5.7m at the end of FY17 to net debt of £12.1m. On our revised forecasts, XP is trading on 20x FY18 EPS. This is in line with its UK electronics peer group and at a premium versus international power supply peers. Cross-selling and a reduction in manufacturing costs for Comdel have the potential to provide upside to our forecasts.

Tech hardware & equipment

2 October 2017

**Price** 2776p

**Market cap** £527m

\$1.34:£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 6.8 15.4 64.9

Rel (local) 6.0 14.5 53.3

52-week high/low 2776p 1655p

### 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

Trading update 9 October

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## **Entry into the RF power supply market**

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XP Power has acquired the business and assets of Comdel, a Massachusetts, US-based designer and manufacturer of RF power supplies. XP has paid \$23m/£17m funded from a new \$40m revolving credit facility. The deal is on a debt free/cash free basis and there is no deferred or contingent consideration. Comdel will continue to operate on a stand-alone basis and its management team will remain with the business. Scott Johnson (current Comdel CEO) will head up XP's newly created RF Power division.

### **Adding RF power to the product range**

This acquisition marks the entry into a new product area for XP. Comdel designs RF power supplies, DC power supplies, impedance matching networks, multi-channel synthesisers and electrostatic chuck power supplies. It supplies standard, modified and custom products – due to the complexity of the products we understand that there is a higher proportion of custom work compared to XP's product range. Its RF power supplies are sold to the semiconductor production equipment (SPE), thin film, photovoltaics and induction heating industries.

RF power supplies are commonly used to control plasma processes. Plasma is created when an electromagnetic force is applied to a gas – this creates ions which can be used to either deposit materials onto a surface (deposition) or to remove particles from a surface (for etching and cleaning). Plasma is used in a large number of semiconductor production processes – plasma enhanced chemical vapour deposition (PECVD), etching (creating circuit patterns by removing unwanted material on the surface of the wafer) and cleaning.

In the industrial market, RF power supplies are used for plasma welding, dielectric heating (used particularly in food manufacturing for uniform drying) and induction heating (used for example in metal component manufacturing).

Competitors in this market include Advanced Energy Industries (Nasdaq-listed, market cap \$3.2bn), COMET PCT (owned by Swiss-listed COMET Group, market cap SFr1.1bn) and MKS Instruments (Nasdaq-listed, market cap \$5.1bn).

### **Some customer overlap, but no product overlap**

Currently the majority of Comdel's revenues are generated from sales to SPE manufacturers, with a smaller amount of business from industrial customers. XP already supplies the SPE market – for H117 SPE customers contributed c 15% of revenues, and this acquisition will increase its exposure to that market. XP and Comdel have some customers in common, but they do not overlap in terms of products sold.

### **Potential to take advantage of XP's Asian manufacturing**

Comdel has a 60,000 square feet manufacturing facility in Gloucester, Massachusetts. The component manufacturing for Comdel's products is outsourced within the US and final assembly and test is performed in the Comdel facility. We would expect XP to consider shifting some component production for new designs to Asia to reduce the manufacturing cost and to enable the supply of higher volume programmes.

### **Adding c 10% to revenues**

In FY16 (year to 31 December), Comdel generated revenues of \$16.5m/£13.0m and profit before tax of \$1.8m/£1.4m (margin 11%) and had gross assets worth \$10.9m/£8.5m. Based on XP's FY16

results, Comdel would have contributed an additional 10% to revenues and 5% to PBT (XP's PBT margin was 22%). XP expects the acquisition to be earnings enhancing in FY18. The acquisition values Comdel at 12.8x trailing PBT and 1.4x trailing revenues, compared to 18x and 4x respectively for XP, reflecting Comdel's lower profitability.

## Changes to forecasts

We have added Comdel revenues of \$4.4m for Q417 and \$18.9m for FY18. We have used a gross margin of 30% to reflect the company's more expensive manufacturing costs in the US as well as additional engineering resources required for custom products. We have assumed an EBITDA margin of 15% for Comdel's business. We note that the operating cost base prior to acquisition by XP included a management charge by Comdel's parent company, Indel – this will no longer be payable.

As XP has used its new debt facility to fund the deal, we have increased our interest expense forecast accordingly. We have applied a slightly higher group tax rate in FY18 to reflect the higher rate incurred in the US.

At the same time, we have revised our underlying XP forecasts to reflect the strong pound versus the dollar. We are now using a US\$/£ rate of 1.34 in FY18 compared to the previous rate of 1.30.

**Exhibit 1: Changes to forecasts**

£'m	17e		17e		18e		18e		
	Old	New	Change	y-o-y	Old	New	Change	y-o-y	
Revenues	155.8	159.2	2.2%	22.7%	160.7	170.0	5.8%	6.8%	
Gross profit	73.2	74.2	1.4%	19.7%	75.7	77.6	2.5%	4.5%	
Gross margin	47.0%	46.6%	(0.4%)	(1.1%)	47.1%	45.6%	(1.5%)	(1.0%)	
EBITDA	38.6	39.1	1.3%	18.4%	40.4	42.1	4.3%	7.9%	
EBITDA margin	24.7%	24.5%	(0.8%)	(0.9%)	25.1%	24.8%	(0.4%)	0.2%	
Normalised operating profit	33.5	33.9	1.4%	17.8%	34.9	36.4	4.4%	7.5%	
Normalised operating profit margin	21.5%	21.3%	(0.2%)	(0.9%)	21.7%	21.4%	(0.3%)	0.1%	
Reported operating profit	30.3	30.7	1.5%	9.7%	34.5	36.0	4.5%	17.3%	
Reported operating margin	19.4%	19.3%	(0.1%)	(2.3%)	21.5%	21.2%	(0.3%)	1.9%	
Normalised PBT	33.2	33.6	1.2%	17.3%	34.6	35.9	3.7%	7.0%	
Reported PBT	30.0	30.4	1.3%	9.2%	34.2	35.5	3.7%	16.9%	
Normalised net income	25.6	25.9	1.2%	17.3%	26.0	26.5	1.7%	2.2%	
Reported net income	22.5	22.8	1.3%	7.1%	25.7	26.2	1.7%	14.8%	
Normalised basic EPS (p)	135.0	136.6	1.2%	17.5%	137.2	139.6	1.7%	2.2%	
Normalised diluted EPS (p)	133.5	135.1	1.2%	17.2%	135.8	138.1	1.7%	2.2%	
Reported basic EPS (p)	118.6	120.2	1.3%	7.3%	135.7	138.0	1.7%	14.8%	
Dividend per share (p)	75.0	75.0	0.0%	5.6%	79.0	79.0	0.0%	5.3%	
Net debt/(cash)	(5.7)	12.1	(313.6%)	(426.8%)	(10.1)	9.5	(194.8%)	(21.2%)	

Source: Edison Investment Research

**Exhibit 2: 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	159.2	170.0
Cost of Sales		(49.0)	(51.5)	(51.0)	(55.1)	(67.8)	(85.0)	(92.4)
Gross Profit		44.9	49.6	50.1	54.6	62.0	74.2	77.6
EBITDA		23.3	26.0	27.6	29.7	33.0	39.1	42.1
Normalised operating profit		21.0	23.3	24.5	25.9	28.8	33.9	36.4
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	30.7	36.0
Net Interest		(0.8)	(0.4)	(0.2)	(0.2)	(0.2)	(0.4)	(0.6)
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	33.6	35.9
Profit Before Tax (reported)		20.2	22.9	24.3	25.4	27.8	30.4	35.5
Reported tax		(4.5)	(4.5)	(4.8)	(5.5)	(6.3)	(7.3)	(9.0)
Profit After Tax (norm)		15.7	18.4	19.5	20.2	22.3	26.2	26.7
Profit After Tax (reported)		15.7	18.4	19.5	19.9	21.5	23.1	26.4
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	25.9	26.5
Net income (reported)		15.5	18.2	19.4	19.7	21.3	22.8	26.2
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	136.55	139.56
EPS - diluted normalised (p)		81.35	95.05	101.07	104.32	115.33	135.13	138.11
EPS - basic reported (p)		81.67	95.84	102.12	103.70	112.02	120.22	137.98
Dividend (p)		50	55	61	66	71	75	79
Revenue growth (%)		(9.4)	7.7	0.0	8.5	18.3	22.7	6.8
Gross Margin (%)		47.8	49.1	49.6	49.8	47.8	46.6	45.6
EBITDA Margin (%)		24.8	25.7	27.3	27.0	25.4	24.5	24.8
Normalised Operating Margin		22.4	23.0	24.2	23.6	22.2	21.3	21.4
<b>BALANCE SHEET</b>								
Fixed Assets		52.8	53.3	56.1	65.4	73.2	93.8	97.4
Intangible Assets		38.1	39.1	40.5	48.2	53.0	71.2	72.2
Tangible Assets		13.2	12.7	14.4	16.1	19.1	21.5	24.1
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	73.0	80.7
Stocks		19.8	20.4	25.2	28.7	32.2	39.6	43.1
Debtors		14.2	15.4	16.0	17.5	21.5	25.3	27.0
Cash & cash equivalents		4.1	5.0	3.8	4.9	9.2	5.3	7.9
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)	(44.1)	(43.9)
Creditors		(11.1)	(12.7)	(14.4)	(14.6)	(16.0)	(23.0)	(22.8)
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)	(17.4)	(17.4)
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	116.4	128.1
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	115.4	127.0
<b>CASH FLOW</b>								
Op Cash Flow before WC and tax		23.3	26.0	27.6	29.7	33.0	39.1	42.1
Working capital		4.2	(0.3)	(4.1)	(4.6)	(6.2)	(4.1)	(5.5)
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)	(7.3)	(9.0)
Net operating cash flow		23.6	20.2	21.8	21.0	27.9	24.8	27.6
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	(17.5)	0.0
Net interest		(0.5)	(0.3)	(0.1)	(0.1)	(0.2)	(0.4)	(0.6)
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	(15.8)	2.6
Opening net debt/(cash)		18.6	10.6	3.5	(1.3)	3.7	(3.7)	12.1
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)	12.1	9.5

Source: XP Power, Edison Investment Research

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