

IQE

Placing

Funds raised to support VCSEL ramp-up

IQE has announced its intention to raise up to £95.1m (gross) through a placing of up to 67.9m new shares at 140p/share. The funds will enable IQE to expand capacity to support multiple VCSEL volume ramp-ups from FY19 onwards. We expect the share issue to be earnings neutral in the near term, and are encouraged by this signal of confidence from management as it prepares for the next step change in output.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	114.0	17.6	2.60	0.0	65.4	N/A
12/16	132.7	20.6	3.00	0.0	56.7	N/A
12/17e	145.3	23.7	3.26	0.0	52.1	N/A
12/18e	160.3	28.3	3.57	0.0	47.6	N/A

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

Getting ready for multiple VCSEL ramp-ups

The funds raised will be used to purchase an additional 40-60 new MOCVD reactors over the next three to five years (IQE currently has around one hundred, but these are used for a different mix of epitaxies). The reactors will be used to make epitaxy for multiple VCSEL programmes as they move into volume production. Towards the end of H117 IQE began to deliver volume VCSEL epitaxy, which we infer was for the new iPhone X. It is currently working on a range of programmes that have potential to become volume contracts in future. Some are for other phone manufacturers wanting to emulate the capabilities of the new iPhone. Some are for other consumer applications including hand and body tracking, automotive applications, data comms and industrial applications such as heating, InP (indium phosphide) wafers for high-speed data networks and GaN (gallium nitride) wafers for radio frequency and power applications.

Share issue earnings neutral

We have updated our estimates to reflect the proposed placing. Since there is a 12-month lead time for MOCVD reactors, the first units funded by the placing will not be delivered and start producing epitaxy until FY19, so there is no change to our near-term revenue and earnings estimates. The near-term dilutive impact of the new shares, which represent up to 9.9% of the existing shares in issue, is offset by a reduction in finance charges; there should be a positive impact on EPS from FY19 onwards as new capacity comes online. We have raised our capex estimates, which include capitalised R&D and equipment, for both FY17 and FY18.

Valuation: Earnings upgrades priced in

The shares have performed extremely well in recent months, rising more than 4x from 29.5p a year ago, and are now trading on multiples that suggest that upgrades in earnings are already priced in. While noting that there remains uncertainty regarding Q417 deliveries, management recognises potential for FY17 earnings to exceed current expectations. Our September [outlook note](#) explores the impact of potentially faster rates of VCSEL roll-out on FY17 and FY18 EPS.

Tech hardware & equipment

14 November 2017

Price **170p**
Market cap **£1168m**

 Net debt* (£m) at end June 2017 41.9
 *Prior to placing raising up to £95.1m gross

 Shares in issue* 686.8m
 *Prior to Placing

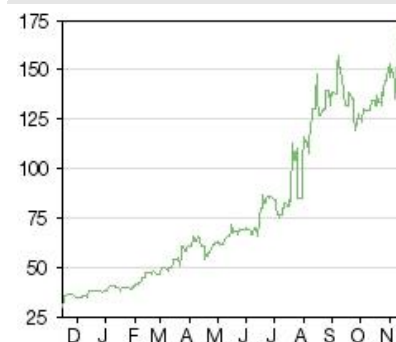
Free float 88.5%

Code IQE

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	26.9	30.5	471.4
Rel (local)	29.0	28.7	414.7

52-week high/low	170.0p	29.5p
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Business description

IQE is the leading supplier of epitaxial compound semiconductor wafers globally. The principal applications include radio frequency semiconductors, devices for optical networks, vertical cavity lasers, infrared semiconductors, power electronics and CPV solar cells.

Next events

Prelims	March 2018
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Exhibit 1: Financial summary

	£'000s	2015	2016	2017e	2018e
Year End 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		114,024	132,707	145,346	160,303
Cost of Sales (Inc D&A + SBP)		(81,585)	(96,292)	(105,303)	(115,664)
Gross Profit		32,439	36,415	40,043	44,639
EBITDA		29,001	31,730	35,462	40,287
Depreciation and Amortisation		(10,024)	(9,611)	(10,000)	(12,300)
Operating Profit (before amort. and except.)		18,977	22,119	25,462	27,987
Acquired Intangible Amortisation		(1,208)	(1,327)	(1,327)	(1,327)
Exceptionals		5,398	1,915	0	0
Share based payments		(2,001)	(2,042)	(3,000)	(3,000)
Operating Profit		21,166	20,665	21,135	23,660
Underlying interest		(1,403)	(1,489)	(1,725)	300
Exceptionals		(387)	(144)	0	0
Profit Before Tax (norm)		17,574	20,630	23,737	28,287
Profit Before Tax (FRS 3)		19,376	19,032	19,410	23,960
Tax		773	408	500	500
Profit After Tax (norm)		18,066	21,440	23,737	28,287
Profit After Tax (FRS 3)		20,149	19,440	19,910	24,460
Average Number of Shares Outstanding (m)		662.6	671.5	689.8	754.8
EPS - normalised (p)		2.60	3.00	3.26	3.57
EPS - (IFRS) (p)		3.00	2.87	2.89	3.24
Dividend per share (p)		0.0	0.0	0.0	0.0
BALANCE SHEET					
Fixed Assets		174,207	215,154	238,827	260,200
Intangible Assets		86,843	103,972	113,645	116,518
Tangible Assets		65,154	85,001	99,001	117,501
Other		22,210	26,181	26,181	26,181
Current Assets		48,909	64,323	113,275	119,748
Stocks		21,215	28,498	34,214	38,755
Debtors		23,050	30,868	34,278	39,163
Cash		4,644	4,957	44,784	41,830
Current Liabilities		(48,050)	(46,012)	(40,921)	(42,645)
Creditors		(44,809)	(38,360)	(40,921)	(42,645)
Short term borrowings		(3,241)	(7,652)	0	0
Long Term Liabilities		(28,032)	(39,021)	(2,167)	(2,167)
Long term borrowings		(24,626)	(36,854)	0	0
Other long term liabilities		(3,406)	(2,167)	(2,167)	(2,167)
Net Assets		147,034	194,444	309,015	335,136
CASH FLOW					
Operating Cash Flow		20,971	22,463	28,897	32,585
Net Interest		(1,403)	(1,489)	(1,725)	300
Tax		(459)	(839)	(839)	(839)
Capex		(10,002)	(19,060)	(35,000)	(35,000)
Acquisitions/disposals		0	(11,250)	0	0
Financing		544	578	93,000	0
Dividends		0	0	0	0
Net Cash Flow		9,651	(9,597)	84,333	(2,954)
Opening net debt/(cash)		31,251	23,223	39,549	(44,784)
HP finance leases initiated		0	0	0	0
Other		(1,623)	(6,729)	0	0
Closing net debt/(cash)		23,223	39,549	(44,784)	(41,830)

Source: Company accounts, Edison Investment Research

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