EDISON

XP Power

FY14 results

Bolstering the US opportunity

Tech hardware & equipment

XP reported FY14 results substantially in line with expectations. Strong order intake positions the company well for 2015 and increased investment in the US should support further growth from the blue chip client base. Manufacturing at the Vietnamese facility is ramping-up to plan, supporting further growth in profitability and increasing the company's self-sufficiency. We forecast steady growth in revenues and earnings and continued strong cash generation, providing support for the dividend policy and the funds to invest in further product development and M&A.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/13	101.1	22.9	95.1	55.0	16.4	3.5
12/14	101.1	24.3	101.1	61.0	15.4	3.9
12/15e	111.8	27.1	106.3	64.0	14.6	4.1
12/16e	116.6	28.4	111.6	65.0	13.9	4.2

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

FY14 results: Underlying growth

XP reported FY14 revenues in line with the recent trading update – revenues were flat y-o-y, although in constant currency grew 5%. Gross margin increased 50bp to 49.6% and operating margin by 120bp to 24.2%. A lower than expected tax rate resulted in diluted EPS of 101.1p versus our 99.8p forecast. The final Q4 dividend of 22p takes the full year dividend to 61p, versus our 59p. The company finished the year with a net cash position of £1.3m.

FY15 outlook positive; investing further in the US

Record order intake of £105m in FY14 provides the company with a strong backlog going into 2015. With stronger levels of demand in North America compared to Europe, the company has decided to increase investment in the US with extra sales and engineering resource. Management expects to see revenue growth in 2015, although this is helped by the weakening of sterling against the dollar.

Changes to forecasts and valuation

We have revised our estimates to take account of the stronger dollar versus sterling and the increased investment in the US. Our FY15 revenue forecast increases by 4% (y-o-y growth 10.6%) and we introduce an FY16 forecast for 4.2% growth. While we slightly increase our operating profit forecast for FY15, an increase in the tax rate results in a 2% reduction in our diluted EPS forecast. We forecast earnings growth of 5% in FY15 and FY16. XP is trading on a P/E of 14.6x FY15e and 13.9x FY16e normalised EPS, with a forecast dividend yield above 4% in FY15 and FY16. Based on XP's superior margins, we believe it is undervalued versus peers; competitor power converter companies trade at c 19x FY15e EPS on EBITDA margins of 17-21% versus XP's 27.7% forecast EBITDA margin, and the UK distributors trade at c 13.5x FY15e EPS, on a c 10% EBITDA margin. The company generates strong cash flows that should support further investment in growth, either through internal product development or through bolt-on acquisitions.

23 February 2015

Price	**1,556p**
Market cap	**£299m**
	$1.55:£1
Net cash (£m) at end FY14	1.3
Shares in issue	19.2m
Free float	79%
Code	XPP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	5.2	7.4	(11.4)
Rel (local)	0.5	2.8	(13.0)
52-week high/low		1,775p	1365p

Business description

XP Power is a developer and designer of power control solutions with production facilities in China and Vietnam; and design, service and sales teams across Europe, the US and Asia.

Next event

Q115 IMS	10 April 2015

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Edison profile page

XP Power is a research client of Edison Investment Research Limited

Investment summary

Company description: Power converter solutions

XP Power designs, manufactures and distributes power converter solutions to original equipment manufacturers (OEMs) in the healthcare, technology and industrial markets. The group has its headquarters in Singapore, and to remain close to its global customer base, has sales, design and engineering presence in the US, Europe and Asia. Unlike many in the industry, XP is vertically integrated – its manufacturing facilities in Asia allow the company to maintain quality control, improve flexibility, reduce product costs and minimise lead times.

Financials: Steady growth

XP's reported flat revenues in FY14 mask constant currency growth of 5%. The company managed to improve gross and operating profitability despite flat revenues, and slightly lower tax resulted in a small upside to our earnings forecast. We have factored in constant currency revenue growth of 4% for both FY15 and FY16 and a very gradual increase in gross margins over that period. We also take into account increased headcount in the US to support sales and engineering. While our FY15e operating profit increases, a higher tax rate (from 21% to 24%) results in a small cut to forecast EPS. We forecast earnings growth of 5% in FY15 and FY16.

Exhibit 1: Changes to forecasts

	EPS			PBT			EBITDA		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2014	99.8	101.1	1.3	24.4	24.3	(0.3)	27.8	27.6	(0.6)
2015e	108.5	106.3	(2.0)	26.5	27.1	2.2	29.9	30.9	3.4
2016e	N/A	111.6	N/A	N/A	28.4	N/A	N/A	32.5	N/A

Source: XP Power, Edison Investment Research

Valuation: Dividend provides strong support

The stock has declined 13% over the last 12 months as the mixed economic environment prevented revenue and earnings upgrades, although we note that the company achieved underlying revenue growth and grew gross and operating margins over the year. XP now trades on a P/E of 14.6x FY15e and 13.9x FY16e adjusted EPS, with a forecast dividend yield of 4.1% in FY15 and 4.2% in FY16. Competitor power converter companies are trading at around 19x FY15e EPS on EBITDA margins of 17-21% versus XP's 27.7% forecast EBITDA margin. The UK distributors are trading on c 13.5x FY15e EPS, on a c 10% EBITDA margin. Based on XP's superior margins, the company is undervalued versus peers, and is further supported by its dividend yield. Our forecasts assume a steady increase in bookings as XP benefits from its US investment and market share wins elsewhere. 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.

Sensitivities: End-market demand, currency

XP Power has cyclical exposure to global industrial, technology and healthcare markets and is therefore sensitive to end-demand and product development expenditure in these markets. Visibility of customer volumes is limited and, as such, individual customer orders can be volatile. With the majority of XP's revenues, manufacturing costs and opex US dollar-denominated, currency will continue to add volatility to XP Power's reported revenues, although it will have less impact at the net income level. XP also has more limited exposure to the euro/sterling exchange rate; to minimise this, the company has hedged estimated euro-denominated income in 2015.

Company description: Power conversion solutions

XP Power designs, manufactures and distributes power converter solutions to OEMs in the industrial, healthcare and technology markets. Power converters take the high-voltage alternating current output from the mains supply and convert it into various lower-voltage, stable direct current outputs that are required to drive most electronic equipment. Over the last 12 years, the company has transitioned from being a distributor to designing and manufacturing the majority of its products. The group has its headquarters in Singapore and has manufacturing facilities in China and Vietnam. To provide customers with high-quality service and support, it has design, engineering and sales functions in the US, Europe and Asia.

Background: Specialist designer and manufacturer

XP Power was formed as a specialist distributor of power converters in 1988 (based in Pangbourne, UK). Subsequently, the business merged with Foresight (California, US) and IPS (New England, US) on flotation in 2000 to form a distributor with over $100m of sales.

In 2002, the board decided to begin developing its own IP and designs, and bought Switching Systems International (California, US), which designed its own configurable power converters with an outsourced manufacturing model. Since then the group has continued to develop its own products and brand. From 2005, management started building in-house manufacturing capacity in China and, more recently, in Vietnam (discussed further on page 4).

The company sells through 27 sales offices and multiple distributors across Europe, Asia and North America. Direct sales presence was added in Israel and Japan in 2014. XP has engineering service functions in Northern California, Germany and the UK.

Growth strategy

XP's strategy to drive revenue and profitability growth and to continue to gain market share is as follows:

- Increase contribution of own-design products.
- Manufacture own products.
- Develop a strong pipeline of leading-edge products
- Target key blue chip customer accounts.
- Increase penetration of existing key accounts.
- Further expand high-efficiency ('green') product offering.

We discuss the progress XP has made in each of these areas below.

Own-IP products drive margin progression

XP Power's business splits along three business lines:

- Own-manufactured product (66% of FY14 revenues). Products designed by XP, ownership of 100% of the IP and manufactured in its Shanghai or Vietnam facility. This includes engineered solutions where XP power supplies are customised for specific customer end-product design requirements, ie designing and engineering additional casings, metalwork, circuitry, connectors.
- Labelled products (28%). Customer requirements identified and product design specified by XP, but products sourced from third-party manufacturers and labelled under the XP brand.
- Distribution (6%). Supply of third-party products.

XP's decision to move from distribution to design and manufacture of its own products has paid dividends in terms of margin growth: gross margins grew from 31.9% in 2002 to 49.6% in FY14, and over the same period operating margins grew from 3.9% to 24.2%. The company's long-term target is to generate 75% of sales from own-designed product, compared to 66% achieved in 2014.

In-house manufacturing reaches critical mass

XP used to outsource manufacturing, but in 2005 it decided to build in-house capacity. Management formed a joint venture with Fortron Source to manufacture power converters in Kunshan (near Shanghai) in China. The joint venture, Fortron XP Power (Hong Kong), started production in 2006. In 2008, management bought out the remaining 50% of the joint venture manufacturing facility and built a new factory on the same site adjacent to the existing facility. This quadrupled XP Power's manufacturing capacity when it became operational in 2009. By the end of 2014, the Chinese facilities were operating at c 80% capacity. The company previously used a sub-contractor for a proportion of own-design products, but phased this out through 2012, bringing the manufacture of 200 products in-house. In 2014, two-thirds of product sold was manufactured internally and this will grow further as utilisation of the Chinese facility increases.

In addition to making its end-products at this facility, XP has started integrating vertically with the small-scale production of magnetic components. This gives XP more control over the manufacturing process (important for some customers) and assists the design teams by shortening design cycles.

Expanding manufacturing into Vietnam

To reduce XP's exposure to rising Chinese labour costs and gain more control over the manufacturing process, XP expanded manufacturing into Vietnam. The company purchased land close to Ho Chi Min City in Vietnam, which could ultimately triple the expected output from the Chinese factory. Construction of the first phase (which is approximately the same size as the Chinese facility) was completed in December 2011. The second phase, of equivalent size to the first, will be constructed as demand dictates.

Magnetic components require a high labour component, hence the decision to manufacture them in a lower labour cost country. XP started producing magnetic components at the Vietnamese facility in Q112, with the facility breaking even in June 2013. By the end of 2014, XP was manufacturing virtually all of its magnetics requirements in-house, with the target of being completely self-sufficient by the end of H115. In H214, the company also started manufacturing power converters in the Vietnam facility. The facility started with some of the less complex converters, and once qualified, their production was shifted entirely from China to Vietnam. The facility continues to qualify additional converter products, and will run production in parallel with the Chinese facility until it achieves acceptable yields on those products. This process should free up capacity in China for more complex product. Management expects the facility to produce power converters with a sales value of c $6m in 2015.

Targeting blue chip customer base

Mixed customer base provides stability in revenues

XP Power has over 5,000 direct active customers, of which no customer makes up greater than 6% of revenues. In 2014, the top 30 customers made up 40% of revenues. XP Power supplies power converters to three key markets: industrial, healthcare and technology (see Exhibit 2).

Exhibit 2: End-market breakdown

Sector	FY14 revenue split	Selected customers	Types of products
Industrial	49%	ABB, Agilent, 3DSystems, Danaher	Factory automation, automated test equipment, industrial control, 3D printing, test & measurement, instrumentation, hazardous environments, defence, avionics.
Healthcare	31%	Philips, GE, Stryker	Medically approved power solutions for use in patient vicinity applications and in the lab environment, including homecare devices, highly efficient convection-cooled designs for low-noise patient area devices and defibrillator-proof DC-DC converters for applied part applications.
Technology	20%	Applied Materials, Lam Research	Semiconductor production equipment, audio visual broadcast equipment, mobile and wireless communications, computing and data processing.

Source: XP Power

Exhibit 3: Geographical split by end-market

Healthcare	FY13	FY14	y-o-y	Industrial	FY13	FY14	y-o-y	Technology	FY13	FY14	y-o-y
N. America	19.7	19.5	(1.0%)	North America	19.0	19.9	4.7%	North America	11.3	11.9	5.3%
Europe	9.4	10.2	8.5%	Europe	25.3	25.5	0.8%	Europe	9.1	6.5	(28.6%)
Asia	1.1	1.3	18.2%	Asia	3.2	3.6	12.5%	Asia	3.0	2.7	(10.0%)

Source: XP Power

Exhibit 3 shows the split of revenues by geography and end-market over the last two years. In North America, the company benefited from design wins with several larger blue chip companies, with reported growth of 2.5% and US dollar growth of 8.3%. The European market was the most challenging: in the UK, where XP has a mature market share, business was slow; conversely business in Germany and Southern Europe was better than expected considering the economic environment, with XP gaining market share. Revenues grew 4.1% in Asia, or 9.6% on a US dollar basis, helped by the addition of direct sales presence in Japan. On a sector basis, **Industrial** is the most fragmented. Areas where the company is seeing demand include 3D printing, industrial printing, LED lighting, smart grid and test & measurement. The **Healthcare** business saw strong growth in Europe in 2014. Although North America shows a reported revenue decline, the company saw growth on a constant currency basis, and made gains with the top three healthcare companies. The **Technology** business declined 3% in 2013 (as semiconductor equipment customers cut orders in response to weak demand from their customers) and a further 10% in 2014. While semiconductor equipment customers returned to order growth in 2014 (at 7.6% of FY14 revenues), this was more than offset by weaker demand in the UK as several products went end-of-life. In Asia, the company partially compensated for a large customer's product going end-of-life with several smaller wins from other customers.

Blue chips attracted by in-house production

XP's in-house manufacturing helps the company to sign up new blue chip companies, particularly in the medical equipment and semiconductor equipment markets. Stable and secure power supply is so crucial to the operation of these customers' products that they demand complete control over their supply chain and product manufacture to ensure quality. With the ramp-up of in-house manufacturing capacity, XP Power continues to gain healthcare design wins.

Increase penetration in existing accounts

Wide product range, with focus on customer-specific requirements

XP aims to have the most comprehensive and up-to-date product range in its target markets. In 2014, XP spent £5.7m on R&D (before capitalisation and amortisation), up 7.5% compared to 2013. The company introduced 26 new products in 2014 (versus 31 in 2013 and 19 in 2012). The company splits its R&D activities between developing new standard products and developing modifications to existing products to meet specific customer requirements. Currently, over half of products sold have been modified from the original standard product. The company is adding engineering resource in the US to support growth of the larger customer base.

Cross-selling opportunities

In many blue chip companies, XP needs to seek approval from a corporate purchasing team before any engineer can use XP product. This means that once approval has been obtained, XP has the potential to sell into all the businesses within that company. In some cases, the distinction is made between approved and preferred suppliers. XP's goal is to get onto the preferred supplier list, and availability of in-house manufacturing capability is helping this process. XP has received corporate approvals from all of the main healthcare equipment companies and consequently expects to see higher growth rates in this market in the medium term as it expands its share of business at each customer.

XP recently implemented a new CRM platform across the business to ensure fast and efficient communication company-wide to support customers' global operations. The company also rolled out SAP ERP software to its North American operations, the last region to have access to this technology.

Varied product lifecycles improve visibility

Products in each end-market have very different life cycles. For example, a medical device could have a product life cycle of 10 years or more. Once a power converter is designed into this product, it is likely to remain in it for the full life of the product. Conversely, technology-related products such as routers have much shorter lives, sometimes as short as two years. On average, product life cycle is five to seven years. XP's balanced mix of end-customers means it has a fairly high level of revenues that are recurring in nature.

High efficiency products support 'green' credentials

XP established an Environmental Committee in 2009 with the goal of becoming the industry leader on environmental issues. XP is a full member of the Electronic Industry Citizenship Coalition (EICC), has adopted the EICC's Code of Conduct and is an active member of the Environmental Sustainability and Water working groups.

XP incorporated green technologies into the new Vietnamese facility, and received the Gold Plus rating by the Singapore Building and Construction Authority for non-residential buildings in tropical climates. This is the first BCA Green Mark industrial facility in Vietnam and is the industry's most environmentally friendly building. As a result, in 2011 XP was included in the FTSE4Good Index.

Having manufacturing facilities and products that meet high environmental standards helps XP to win approved supplier status with large OEMs, but its main ongoing contribution to sustainability is to design ever more efficient power converters. For example, a 95% efficient product such as the CCM250 only wastes 5% of the input energy, thereby requiring a lower power input to achieve the same output as a device operating at a lower efficiency. The wasted power is often converted to heat, which in turn requires additional power or physical heat sinks to provide cooling, adding to the upfront and running costs of the product. In 2014, XP launched two new high efficiency products, the CCB200 and CCL400, neither of which requires fan cooling.

In FY14, sales of 'green' (ie high-efficiency) products grew 36% to make up 18.4% of revenues, compared to 13.6% in FY13.

Market outlook

XP Power has slowly been winning share in a large, fragmented market. We believe the company will continue to grow share with its combination of in-house design and manufacturing.

Strong competitive position in the power market

XP Power operates in a market that was estimated to be worth c £1.7bn in 2013 (source: Micro-Tech Consultants). The market is fragmented, with no player having more than a 10% global share. Based on Micro-Tech Consultants' market statistics, XP Power estimates its global market share stands at 6%, with a joint top position in Europe at 11% market share and the top position in the US with 8% market share. XP's share in Asia (the largest geographical market at £650m in 2013) stands at only 1%, but the company's presence in Singapore, China and Vietnam represents an opportunity for XP to grow this.

XP Power does not operate in the high-volume, low-value commodity power converter markets that supply products such as PCs, laptops and cell phone chargers, or in the market for inverters used for renewable energy. Key players in the power converter market are described in Exhibit 4. XP competes most often with TDK-Lambda, Power-One and in healthcare, SL Industries.

Exhibit 4: Competitors

Company	Corporate HQ	Market cap	Comment
GE	US	$248bn	Bought private equity-owned Lineage Power in Jan 2011. Lineage itself was made up of the acquisitions of Tyco Electronics Power Systems and Cherokee in 2008 and PECO II in 2010, with revenues of $450m in 2010.
ABB	Switzerland	$48bn	Bought Power-One in July 2013; integrated into Discrete Automation division. Power-One is a US-based power management & power converter manufacturer for a wide range of applications. Revenues were $1.02bn in FY12, of which $280m Power Solutions.
Emerson	US	$40bn	Emerson offers a vast array of electronic components including power converters. Network Power division had $6.2bn revenues in FY13, of which c $1.2bn was from embedded power & computing (EPC). Nov 2013 - 51% of EPC (now called Artesyn) sold to Platinum Equity for $300m.
Delta Electronics	Taiwan	$15.0bn	Diversified supplier of custom power supplies, components and systems. Revenues of $6.0bn in FY14 (+8% y-o-y), of which Power Electronics $3.4bn.
TDK Corporation	Japan	$8.2bn	Subsidiary TDK-Lambda is a power supply specialist covering multiple end markets. Key competitor to XP in Europe and US.
Vicor	US	$0.4bn	Broad range of power components and complete power systems. Revenues of $220m in 12 months to Sept 14 (+13% y-o-y). Competes with XP in the military market.
Cosel	Japan	$0.4bn	Specialist in compact, low-profile power supplies. Revenues of $174m in FY14. Competes with XP in Europe and the US.
Mean Well	Taiwan	-	Standard off the shelf switching power modules.
Volgen	US	-	Focus on ultra-small power supplies; division of Kaga Electronics.
SL Industries	US	$0.2bn	Power Electronics division (made up of Ault and Condor businesses) compete with XP in Healthcare market. Power Electronics divisional revenues $74m in 12 months to Sept 14 (-5% y-o-y).

Source: <Insert Source or Notes>

In recent years, the trend has been for large engineering conglomerates such as Emerson and GE to buy up smaller power converter companies. However, after several years of poor performance from its Embedded Power & Computing (EPC) division (weak demand in 2012, which weakened further in 2013), in 2013 Emerson sold a 51% stake in EPC to Platinum Equity for $300m. It remains to be seen if the remaining 49% will eventually be sold. In 2013, ABB acquired Power-One for access to its solar inverter product line, an area in which XP does not have (and does not plan to have) a presence.

Short-term outlook mixed

The healthcare market appears to be relatively stable. In Q414, GE Healthcare saw 2% growth in equipment orders, while equipment revenues were flat y-o-y. Equipment revenues for FY14 grew 1% y-o-y. Philips' healthcare revenues and equipment orders declined 2% in FY14, although much of this was due to internal manufacturing issues. Siemens' healthcare business saw a revenue and order decline of 1.5% in FY14, but saw order intake and revenues up 2% y-o-y (constant currency) in Q115 (CQ414). Against this backdrop, XP appears to have gained market share with 7% constant currency growth in 2014.

The strength of the industrial market will depend on the health of the global economy. In 2014, manufacturing PMI data has remained above 50 (the level that implies expansion rather than contraction) in the UK, US and eurozone, although the data have shown a slight downward trend through the year.

The technology market saw better growth in 2014. According to Gartner, global IT spending grew 1.9% in 2014, up from only 0.4% in 2013, and is forecast to show stronger growth in 2015 (+2.4%). We note that these forecasts include telecom services. Forecasts from Forrester exclude telecom services and estimate that the global technology market grew 2.4% in 2014, and will grow 4.1% in 2015 and 6.3% in 2016. SEMI estimates that the semiconductor equipment market returned to growth in 2014 (+19%) after two years of declines (-15% 2012, -13% 2013). SEMI is forecasting another strong year in 2015 (+15%) before growth levels off in 2016 (-1%).

Long-term growth drivers

Key drivers of market growth include:

- The environment: legislation and consumer pressure are driving OEMs to reduce the power consumption of their products. Legislation also extends to the efficiency of power converters, driving demand for new products. XP's new products are designed to maximise efficiency – for example, the CCM250 has an efficiency of up to 95%.
- Healthcare: as the population ages, while continuing to grow overall, people are living longer with chronic diseases, driving overall healthcare spending.
- Emerging technology: alternative technologies are evolving for lighting (eg LEDs) and power generation (eg solar), which all have specific power conversion needs.
- Innovation: customers increasingly need to differentiate their products from the competition. XP's in-house design capabilities enable it to develop products for niche applications.

From a company-specific perspective, we expect the continued ramp-up of in-house manufacturing capacity to attract more blue chip customers in the technology and healthcare markets. XP's in-house design capabilities in Asia position the company to win business from the Asian design centres of existing European and North American customers, as well as from Asian companies producing for the Asian and export markets. The increase in own-designed and own-manufactured product should continue to drive margin growth.

Sensitivities

XP Power is a global electronics company supplying a broad range of end-markets. The company is not immune to economic slowdown, but diversification and the low-cost structure affords the company some earnings resilience versus competitors.

- **Economic sensitivity:** The group has cyclical exposure to global industrial, technology and healthcare markets. Therefore, any slowdown in end-demand in these markets or cutbacks in product development expenditure will have an impact on XP's revenues.
- **Order book visibility:** The group has around four months of order book visibility at any one time. However, it is essentially a tier 2 supplier to the electronics industry and still has a small proportion of distributor revenues. Therefore, visibility of customer volumes is limited and, as such, individual customer orders can be volatile.
- **Currency:** Around 70% of XP's revenues, c 90% of cost of sales and c 60% of opex, are US dollar-denominated. XP Power reports in sterling, exposing the company's results to fluctuations in the US$/£ exchange rate. While moves in the exchange rate will have an impact on reported revenues, the overall impact of currency at the net income level is much less pronounced. XP is also exposed to fluctuations in the euro versus sterling (c 10% of revenues and c 15% of operating costs are euro-denominated). To minimise the impact, the company has hedged all of its estimated euro income in 2015.

- **Large competitors:** Competition ranges from significantly larger players with big balance sheets through to smaller innovative companies. The deeper pockets of large competitors may make it more difficult for XP Power to keep pace with product development.

Valuation

The stock has declined 13% over the last 12 months as the mixed economic environment prevented revenue and earnings upgrades, although we note the company achieved underlying revenue growth and grew gross and operating margins over the year. XP now trades on a P/E of 14.6x FY15e and 13.9x FY16e adjusted EPS, with a forecast dividend yield of 4.1% in FY15 and 4.2% in FY16. Competitor power converter companies are trading at around 19x FY15e EPS on EBITDA margins of 17-21% versus XP's 27.7% forecast EBITDA margin. The UK distributors are trading on c 13.5x FY15e EPS, on a c 10% EBITDA margin. Based on XP's superior margins, the company is undervalued versus peers, and is further supported by its dividend yield.

Our forecasts assume a steady increase in bookings as XP benefits from its US investment and market share wins elsewhere. 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.

Financials

Review of FY14 results

As previously guided, XP reported flat revenues in FY14 versus FY13, although in constant currency, the company achieved revenue growth of 5% (see Exhibit 5). Improved factory loading and the impact of the strengthening of the US dollar versus sterling drove a 50bp increase in gross margin. Operating profit increased 5%, benefiting from currency effects, to drive a 120bp increase in the operating margin. The tax rate of 19.8% was lower than our 21% estimate, resulting in a slightly higher adjusted EPS than forecast.

Exhibit 5: FY14 results highlights

£m	FY13a	FY14e	FY14a	Difference	Y-o-Y
Revenues	101.1	101.1	101.1	0.0%	0.0%
Gross profit	49.6	50.1	50.1	0.1%	1.0%
Gross margin	49.1%	49.5%	49.6%		0.5%
EBITDA	26.0	27.8	27.6	(0.6%)	6.2%
EBITDA margin	25.7%	27.5%	27.3%		1.6%
Adj. Operating profit	23.3	24.6	24.5	(0.3%)	5.2%
adj. Operating Profit margin	23.0%	24.3%	24.2%		1.2%
Adj. PBT	22.9	24.4	24.3	(0.3%)	6.1%
Adj. Net income	18.2	19.1	19.4	1.6%	6.6%
Adj. EPS (p)	95.1	99.8	101.1	1.3%	6.3%
Reported EPS (p)	95.8	100.6	102.1	1.5%	6.5%
Net cash/(debt)	(3.5)	1.1	1.3	21.4%	N/A

Source: XP Power, Edison Investment Research

Term debt fully repaid

XP moved to a net cash position of £1.3m from net debt of £3.5m at the end of FY13. The company made its final term debt repayment in September and does not currently need another term facility. Also in September, it renewed its working capital facility at $15m, of which £2.5m/$3.9m was used at the end of FY14. The facility stepped down to $12.5m on 1 January this year and will step down to $7.5m from 1 July 2015. This facility is priced at the Bank of Scotland base rate plus 1.75%. We believe the company would have no problem securing a term loan to fund acquisitions.

Dividend growth 11% y-o-y

XP has a policy of paying dividends quarterly. In January, the company guided that the full year dividend would be at least 60p – the final dividend of 22p has been announced, taking the full year dividend to 61p (+11% y-o-y). This represents a payout ratio of 60%; we expect the payout ratio to remain around this level in FY15 and FY16.

Outlook and changes to forecasts

The company enters 2015 with a strong backlog, after receiving record orders worth £105.1m in FY14 (+1% y-o-y/+6% in constant currency). The company is seeing stronger demand in the US and Asia than in Europe, where the economic environment is more uncertain. The backlog combined with recent design wins and the stronger US dollar should drive revenue growth in FY15.

As the company sees an encouraging outlook in North America, it has decided to increase investment in the region and plans to add to the sales team (four hires) and engineering resources (five hires across power systems, firmware, value-add and R&D).

We have updated our forecasts to reflect the US/£ exchange rate year to date, using a rate of $1.55/£ for FY15 and FY16. We forecast constant currency revenue growth of 4% in FY15 and FY16. We have factored in the increase in headcount in the US and a higher tax rate (24% in FY15/16 versus our previous forecast of 21% in FY15 and company guidance of 23-24.5%). We have increased our dividend forecast for FY15 from 63p to 64p and introduce a forecast of 65p for FY16.

Exhibit 6: Changes to estimates

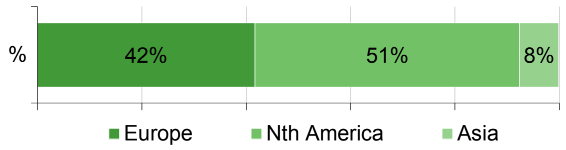
£m	FY15e old	FY15e new	Change	Y-o-Y	FY16e new	Y-o-Y
Revenues	107.6	111.8	4.0%	10.6%	116.6	4.2%
Gross profit	53.3	55.7	4.5%	11.2%	58.2	4.5%
Gross margin	*49.6%*	*49.8%*		*0.3%*	*49.9%*	*0.1%*
EBITDA	29.9	30.9	3.4%	12.1%	32.5	4.9%
EBITDA margin	*27.8%*	*27.7%*		*0.4%*	*27.9%*	*0.2%*
Adj. Operating profit	26.6	27.2	2.2%	11.0%	28.5	4.9%
adj. operating profit margin	*24.8%*	*24.3%*		*0.1%*	*24.5%*	*0.1%*
Adj. PBT	26.5	27.1	2.2%	11.5%	28.4	4.9%
Adj. Net income	20.8	20.4	(1.7%)	5.1%	21.4	4.9%
Adj. EPS (p)	108.5	106.3	(2.0%)	5.2%	111.6	4.9%
Reported EPS (p)	109.3	107.5	(1.7%)	5.2%	112.8	4.9%
Net cash	8.4	7.0	(17.5%)	434.8%	14.5	108.6%

Source: Edison Investment Research

Exhibit 7: Financial summary

£m	2011	2012	2013	2014	2015e	2016e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	103.6	93.9	101.1	101.1	111.8	116.6
Cost of Sales	(52.7)	(49.0)	(51.5)	(51.0)	(56.1)	(58.4)
Gross Profit	50.9	44.9	49.6	50.1	55.7	58.2
EBITDA	27.5	23.3	26.0	27.6	30.9	32.5
Operating Profit (before am. acq. Intang & except.)	25.3	21.0	23.3	24.5	27.2	28.5
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Operating Profit	25.3	21.0	23.3	24.5	27.2	28.5
Net Interest	(1.0)	(0.8)	(0.4)	(0.2)	(0.1)	(0.1)
Profit Before Tax (norm)	24.3	20.2	22.9	24.3	27.1	28.4
Profit Before Tax (FRS 3)	24.3	20.2	22.9	24.3	27.1	28.4
Tax	(3.6)	(4.5)	(4.5)	(4.8)	(6.5)	(6.8)
Profit After Tax (norm)	20.7	15.7	18.4	19.5	20.6	21.6
Profit After Tax (FRS 3)	20.7	15.7	18.4	19.5	20.6	21.6
Average Number of Shares Outstanding (m)	18.9	19.0	19.0	19.0	19.0	19.0
EPS - normalised (p)	107.1	81.7	95.8	102.1	107.5	112.8
EPS - normalised fully diluted (p)	106.4	81.3	95.1	101.1	106.3	111.6
EPS - FRS 3 (p)	107.1	81.7	95.8	102.1	107.5	112.8
Dividend per share (p)	45.0	50.0	55.0	61.0	64.0	65.0
Gross Margin (%)	49.1	47.8	49.1	49.6	49.8	49.9
EBITDA Margin (%)	26.5	24.8	25.7	27.3	27.7	27.9
Operating Margin (before GW and except.) (%)	24.4	22.4	23.0	24.2	24.3	24.5
BALANCE SHEET						
Fixed Assets	52.7	52.8	53.3	56.1	57.2	58.1
Intangible Assets	37.7	38.1	39.1	40.5	41.4	42.2
Tangible Assets	12.9	13.2	12.7	14.4	14.6	14.8
Investment in associates	2.1	1.5	1.5	1.2	1.2	1.2
Current Assets	46.9	39.3	42.2	47.0	54.8	63.6
Stocks	22.0	19.8	20.4	25.2	26.7	27.1
Debtors	16.0	14.2	15.4	16.0	17.7	18.4
Cash	6.3	4.1	5.0	3.8	8.5	16.0
Other	2.6	1.2	1.4	2.0	2.0	2.0
Current Liabilities	(28.2)	(20.2)	(22.4)	(18.6)	(19.1)	(19.8)
Creditors	(14.8)	(12.9)	(13.9)	(16.1)	(17.6)	(18.3)
Short term borrowings	(13.4)	(7.3)	(8.5)	(2.5)	(1.5)	(1.5)
Long Term Liabilities	(15.6)	(10.6)	(3.7)	(4.2)	(4.2)	(4.2)
Long term borrowings	(11.5)	(7.4)	0.0	0.0	0.0	0.0
Other long term liabilities	(4.1)	(3.2)	(3.7)	(4.2)	(4.2)	(4.2)
Net Assets	55.8	61.3	69.4	80.3	88.6	97.7
CASH FLOW						
Operating Cash Flow	21.2	27.9	25.2	25.4	29.3	31.9
Net Interest	(0.8)	(0.5)	(0.3)	(0.1)	(0.1)	(0.1)
Tax	(5.0)	(4.3)	(5.0)	(3.6)	(6.5)	(6.8)
Capex	(7.7)	(4.7)	(3.2)	(5.8)	(4.9)	(4.9)
Acquisitions/disposals	(0.1)	(1.6)	0.1	0.1	0.0	0.0
Financing	(0.8)	(0.5)	0.1	(0.2)	0.0	0.0
Dividends	(7.8)	(9.1)	(10.1)	(11.0)	(12.2)	(12.5)
Other	0.8	0.5	0.2	0.1	(.0)	0.0
Net Cash Flow	(0.2)	7.7	7.0	4.9	5.7	7.6
Opening net debt/(cash)	18.4	18.6	10.6	3.5	(1.3)	(7.0)
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0
Other	(0.0)	0.3	0.1	(0.1)	0.0	0.0
Closing net debt/(cash)	18.6	10.6	3.5	(1.3)	(7.0)	(14.5)

Source: XP Power, Edison Investment Research

Contact details	Revenue by geography
401 Commonwealth Drive Lobby B #02-02, Haw Par Technocentre Singapore, 149598 Phone: +65 64116900 www.xppower.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 12-16e	8.2%	ROCE 15e	25.8%	Gearing 15e	N/A	Litigation/regulatory	○
EPS 14-16e	5.1%	Avg ROCE 12-16e	25.3%	Interest cover 15e	N/A	Pensions	○
EBITDA 12-16e	8.7%	ROE 15e	23.0%	CA/CL 15e	2.9	Currency	◖
EBITDA 14-16e	8.5%	Gross margin 15e	49.8%	Stock days 15e	87	Stock overhang	◖
Sales 12-16e	5.6%	Operating margin 15e	24.3%	Debtor days 15e	58	Interest rates	◖
Sales 14-16e	7.4%	Gr mgn / Op mgn 15e	2x	Creditor days 15e	52	Oil/commodity prices	○

Management team

CEO: Duncan Penny

Duncan qualified as an accountant with Coopers & Lybrand and from 1980 to 1990 held a senior financial management position with LSI Logic and Dell Computer Corp. He joined XP in 2000 as group FD. In February 2003, he was appointed as CEO.

CFO: Jonathan Rhodes

Jonathan joined XP in 2008 as European financial controller and was appointed to the CFO role in 2011. Before that he spent nine years with JCDecaux in various senior financial positions, including head of financial reporting. Previously, he spent three years with Mills & Allen.

Chairman: James Peters

James has over 25 years' experience in the industry with Marconi and Coutant Lambda, before joining Powerline in 1980. In 1988, he founded XP Power. In 2000, he was appointed as European MD. In 2003, he was appointed as deputy chairman and in 2014, became chairman.

Principal shareholders	(%)
James Peters	10.8
Aberdeen Asset Managers	10.1
Standard Life Investments	9.3
Mawer Investment Management	8.3
Generation Investment Management LLP	5.0
Artemis Investment Management LLP	4.8
Hargreave Hale	4.4

Companies named in this report

ABB (ABBN), Cosel (6905), Delta Electronics (2308), Emerson (EMR), GE (GE), SL Industries (SLI), TDK Corporation (6762)