

# Trackwise Designs

FY20 results

Strategic progress in challenging environment

Trackwise Designs' FY20 results show a resilient response to the pandemic while management expanded IHT capacity to meet the requirements of a multi-million order from an undisclosed UK electric vehicle (EV) OEM. This OEM has recently extended its supply and manufacture agreement with Trackwise from three years to four, increasing the total value by £16m to up to £54m. We note that the volume ramp-up under this agreement has been delayed by a quarter to H122, so we have revised our FY21 estimates, taking EPS from 4.9p profit to 1.0p loss.

| Year end | Revenue (£m) | EBITDA (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) |
|----------|--------------|-------------|-----------|----------|---------|---------|
| 12/19    | 2.9          | 0.5         | 0.1       | 0.8      | 0.0     | N/A     |
| 12/20    | 6.1          | 0.8         | (0.4)     | 1.4      | 0.0     | N/A     |
| 12/21e   | 9.0          | 0.7         | (0.7)     | (1.0)    | 0.0     | N/A     |
| 12/22e   | 22.1         | 4.2         | 1.9       | 6.4      | 0.0     | 32.1    |

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

## Doubling in revenues following SCL acquisition

FY20 revenues increased by £3.2m year-on-year to £6.1m, reflecting the acquisition of Stevenage Circuits (SCL). SCL has become the group's centre for advanced printed circuit board (PCB) manufacture, freeing the Tewkesbury site for improved harness technology (IHT) production. However, concerns about the long-term economic impact of the pandemic caused a slowdown in new orders for both the advanced PCB and IHT divisions. After adjusting for exceptional costs and share-based payments, the group moved from an operating profit of £0.2m in FY19 to a £0.2m loss. The balance sheet benefited from fund-raising in March 2020 and December 2020 generating £18.5m (gross). Part of the proceeds was used to acquire SCL, and part is being used to purchase and equip a new site in Stonehouse, Gloucestershire, which will also be dedicated to IHT production.

## Additional IHT capacity for EV programme

The additional IHT capacity is needed to meet the requirements of the UK EV OEM with some surplus to accommodate the potential demand from the medical sector, which could lead to volume shipments from FY22 onwards. Since the group is already incurring some of the cost associated with the capacity increase, management expects that the quarter's delay in ramping up volumes for the EV programme is likely to result in an operating loss during FY21.

## Valuation: Addressing several high-potential sectors

While our peer multiples-based analysis shows Trackwise trading at a premium to its peers on all metrics, this approach fails to recognise the potential of the IHT business so we have augmented it with a scenario analysis, which is presented in our September [initiation note](#). This explores how each of the three key segments in which Trackwise has developed prototype IHT products for customers (EVs, medical devices and aerospace) has the potential to generate revenues of at least £100m at even relatively modest levels of market penetration.

Tech hardware &amp; equipment

29 June 2021

**Price** **205p**
**Market cap** **£58m**

Net cash (£m) at 31 December 2020 (excluding £2.6m IFRS 16 leases) 11.3

Shares in issue 28.4m

Free float 67.6%

Code TWD

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (14.6) (15.3) 145.1

Rel (local) (15.0) (19.3) 106.9

52-week high/low 370p 84p

### Business description

Trackwise Designs is a UK manufacturer of specialist products using printed circuit technology. These include a lightweight replacement for conventional wiring harnesses known as IHT and RF antennae. In FY20, 39% of revenues related to exports.

### Next event

AGM 14 July 2021

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## **FY20 performance indirectly affected by pandemic**

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### **Suppliers and customers adversely affected by pandemic**

Production continued at both the Stevenage and Tewkesbury sites throughout the coronavirus lockdowns, so the main impacts of the pandemic were indirect and related to how the pandemic affected both suppliers and customers. Group revenues increased by £3.2m year-on-year during FY20 to £6.1m, reflecting the acquisition of SCL which completed in April 2020. IHT revenues reduced by £0.3m to £0.6m because the pandemic delayed installation of equipment needed to complete product for a medical customer. This equipment was commissioned during H220 and samples were shipped (see below). Similarly, delays during H120 in installing equipment at the EV customer's site caused slippages to its production schedule and adversely affected call-offs. Concerns about the long-term economic impact of the pandemic resulted in a slowdown in new orders for both the advanced PCB and IHT divisions. This situation was exacerbated towards the year end by supply chain issues affecting its customers' ability to source electronic components, leading to them placing orders for lower volumes of circuits.

Gross margin declined by 9.6pp to 28.3%, reflecting low levels of equipment utilisation, particularly in H120. Excluding share-based payments and exceptional costs, administrative expenses increased by £1.0m to £1.9m because of the additional costs associated with SCL. After adjusting for exceptional costs and share-based payments, the group moved from an operating profit of £0.2m in FY19 to a £0.2m operating loss. Reported profit before tax benefited from £1.6m negative goodwill arising on the acquisition of SCL, partly offset by £0.3m acquisition expenses, resulting in a switch from a small £0.1m loss before tax in FY19 to £0.4m profit before tax in FY20. The group benefited from £0.5m enhanced research and development tax allowances.

### **Placings fund SCL acquisition, new Stonehouse site and working capital**

Net cash totalled £11.3m at end FY20 (excluding £2.6m IFRS 16 lease liabilities), compared with net debt at end FY19 of £0.3m (excluding £0.7m lease liabilities). A placing in March at the time of the SCL acquisition raised £5.9m (gross) at 80p/share and a placing and open offer in December 2020 collectively raised £12.6m at 200p/share. Part of the funds raised in March were used to finance the SCL acquisition (£1.6m net of cash), with the surplus allocated for capacity expansion at Stevenage and working capital as IHT series production ramps up. Other cash outflows during FY20 included payments on IHT production equipment for the Tewkesbury site, primarily the laser drill, direct imaging tool and clean room infrastructure (£0.4m capex net of new leases) and investment in IHT development (£2.2m capitalised R&D). The balance sheet had £13.9m cash at the end of December 2020.

## **Outlook**

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### **Uncertainty continues in the short term**

Management expects economic uncertainty in the UK and elsewhere to continue during most of FY21, depressing demand from new customers. In addition, supply chain shortages may lead to delays in fulfilling Advanced PCB orders for a major customer, although management expects to make up for that with other Advanced PCB business. Paradoxically, the supply chain shortages are encouraging existing customers to place larger orders than usual to ensure they have the circuits needed to cover a longer period of production, and SCL is recruiting additional staff to meet production demand. Revenues for the five months ended May 2021 totalled £3.1m (five months

ended May 2020: £1.9m), £0.3m of which was attributable to the IHT division. The order book at the end of May 2021 totalled £4.9m, of which £2.6m is scheduled for 2021 delivery. This includes £0.5m for the UK EV OEM programme, £0.2m for IHT development in the nuclear fusion field, £0.1m for IHT development in the space sector and £2.0m for the Advanced PCB division.

## **EV OEM ramp-up delayed but total contract value increased**

Trackwise has been working with its UK EV OEM customer on improvements to the products it will be producing in volume for it. As a result, management anticipates that the volume ramp-up for this programme will be delayed by a quarter and will now not commence until early FY22 rather than late FY21, removing c £5m in revenues from the FY21 delivery schedule. On the other hand, the EV OEM customer has extended the term of the manufacture and supply agreement from three to four years, raising the aggregate value for the contract by £16m to up to £54m. This potentially represents IHT revenues of £16–17m in FY23 and FY24. The level in FY22 will depend on the rate of ramp-up during Q122.

## **Volume IHT production for medical sector presents upside to FY22 estimates**

Trackwise is working with five medical catheter manufacturers. The samples for medical devices that Trackwise shipped in FY20 to its lead catheter company, which is a large US medical OEM, are working as designed in trials. Management expects to receive further development orders from this customer in FY21 ahead of potential production revenues in FY22. (We treat the production revenues as upside to our estimates.) As discussed in our May [flash note](#), Trackwise has signed a seven-year agreement with CathPrint, which has created a novel technique for manufacturing advanced catheters. Assuming the ongoing development project supplying IHT to CathPrint is successful, this potentially represents sales of significant volumes of IHT for medical applications for a five-year period from FY23 onwards.

## **Aerospace still expected to be largest sector longer term**

Trackwise is working with over 30 aerospace OEMs and suppliers including GKN on a system for preventing ice forming on aircraft wings, four developers of unmanned aerial mobility (UAM), two developers of business jets and two developers of high-altitude pseudo-satellites (HAPS). The GKN project is the most advanced. Management estimates that this could progress to production revenues within two to three years.

## **Stonehouse site provides capacity for high-volume/low-mix IHT**

In May 2021, Trackwise acquired a 6,947m<sup>2</sup> freehold property in Stonehouse, Gloucestershire, for £2.8m. The company is in the process of installing an automated roll-to-roll IHT production line at the site with the intention of it being fully operational by end FY21. The site has capacity for the installation of a second line in the future. Around £9m of the funds raised in December were allocated for purchasing the site and associated equipment. Once operational, the Stonehouse site will be used for high-volume/low-mix IHT work and the Tewkesbury site (1,812m<sup>2</sup>) for low volume development projects.

## **Revisions to estimates**

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We revise our FY21 estimates to reflect the delay in volume ramp-up for deliveries to the UK EV OEM. We introduce FY22 estimates, which make the following assumptions:

- **IHT revenues:** we model £13.0m revenues from deliveries to the UK EV OEM and £0.6m other IHT revenues, ie they exclude potential production revenues from the large US medical OEM.
- **Advanced PCB revenues:** we assume that any supply chain constraints have eased by this time and that the economic uncertainty deterring new customers from placing orders has disappeared, resulting in 5% year-on-year growth.
- **R&D tax credit:** we model a £0.3m tax credit.
- **Capital expenditure:** we assume that the major investment programme at Stonehouse completes by end FY21, so investment in property, plant and equipment (excluding finance leases) reduces from £4.8m (FY21) to £0.6m (FY22).
- **Capitalised development:** we assume that Trackwise continues to invest in IHT development, with capitalised development remaining at FY21 levels, ie £1.0m.

**Exhibit 1: Revisions to estimates**

| £m                       | 2020   |        |        | 2021e |       |        | 2022e |
|--------------------------|--------|--------|--------|-------|-------|--------|-------|
|                          | Est.   | Actual | Change | Old   | New   | Change | New   |
| Revenues                 | 6.1    | 6.1    | -0.9%  | 14.3  | 9.0   | -36.8% | 22.1  |
| EBITDA                   | 0.7    | 0.8    | 10.0%  | 2.7   | 0.7   | -74.4% | 4.2   |
| Normalised PBT           | (0.3)  | (0.4)  | 14.8%  | 1.3   | (0.7) | N/A    | 1.9   |
| Normalised basic EPS (p) | 0.35   | 1.42   | 307.0% | 4.86  | (1.0) | N/A    | 6.38  |
| Dividend per share (p)   | 0.00   | 0.00   | 0.0%   | 0.00  | 0.00  | 0.0%   | 0.00  |
| Net debt/(cash)*         | (11.2) | (8.8)  | -21.7% | (0.7) | 2.8   | N/A    | 2.3   |

Source: Edison Investment Research. Note: \*Including IFRS 16 leases.

## Valuation

### Peer multiples

**Exhibit 2: Peer multiples**

| Name                 | Market cap (\$m) | EV/Sales 1FY (x) | EV/Sales 2FY (x) | EV/EBITDA 1FY (x) | EV/EBITDA 2FY (x) | P/E 1FY (x) | P/E 2FY (x) | CAGR* | EBITDA margin 1FY (%) | EBITDA margin 2FY (%) |
|----------------------|------------------|------------------|------------------|-------------------|-------------------|-------------|-------------|-------|-----------------------|-----------------------|
| AT & S               | 1,674            | 1.4              | 1.2              | 5.9               | 4.7               | 18.0        | 14.8        | 17.4% | 23.7                  | 24.6                  |
| CMK                  | 249              | 0.5              | 0.5              | 6.8               | 5.4               | 21.9        | 11.9        | 7.6%  | 7.6                   | 9.1                   |
| Compeq Manufacturing | 1,801            | 0.8              | 0.7              | 4.2               | 3.8               | 9.8         | 8.5         | 7.5%  | 18.7                  | 19.0                  |
| Ibiden               | 7,503            | 2.3              | 2.1              | 7.7               | 6.4               | 23.9        | 19.2        | 13.9% | 29.3                  | 32.1                  |
| KCE Electronics      | 2,537            | 5.8              | 5.1              | 24.0              | 19.9              | 39.8        | 31.9        | 17.6% | 24.0                  | 25.4                  |
| Meiko Electronics    | 777              | 1.1              | 1.0              | 9.1               | 8.2               | 14.0        | 12.1        | 7.6%  | 12.1                  | 12.5                  |
| Tripod Technology    | 2,525            | 1.0              | 0.9              | 5.2               | 4.7               | 11.0        | 10.0        | 9.1%  | 18.6                  | 19.2                  |
| TTM Technologies     | 1,541            | 0.9              | 0.8              | 6.9               | 6.3               | 11.5        | 9.8         | 4.4%  | 12.7                  | 13.3                  |
| Unimicron Technology | 6,959            | 2.2              | 1.9              | 11.2              | 8.5               | 24.0        | 17.8        | 12.4% | 19.7                  | 22.5                  |
| Zhen Ding Technology | 3,633            | 0.8              | 0.7              | 4.2               | 3.7               | 10.6        | 9.1         | 11.5% | 18.3                  | 19.2                  |
| Mean                 |                  | <b>1.7</b>       | <b>1.5</b>       | <b>8.5</b>        | <b>7.2</b>        | <b>18.4</b> | <b>14.5</b> |       | <b>18.5</b>           | <b>19.7</b>           |
| Trackwise Designs    | 81               | 5.2              | 2.1              | 66.9              | 11.2              | (213.4)     | 32.1        | 90.9% | 7.8                   | 18.9                  |

Source: Refinitiv, Edison Investment Research. Note: Prices at 28 June 2021. \*CAGR is compound average growth in revenue between year 0 and year 2.

Although Trackwise's share price fell by 16% on the day that the delay to the UK EV OEM programme was announced, overall the share price has doubled since the announcement of the series production order for the EV manufacturer in September 2020. At current levels, our peer multiples-based analysis shows Trackwise's shares trading at a premium to the sample means on all metrics. However, based on our estimates, Trackwise is expected to grow revenues much more strongly than any of the sample between FY20 and FY22. Moreover, the IHT business has the potential to deliver growth that is faster than the average for our sample – not just for the period covered by our estimates, but for at least several years beyond that, so the peer multiples-based approach fails to recognise the potential of the IHT activity in the longer term. Although we do not present detailed FY23 estimates, we provisionally estimate that expansion could support FY23

revenues of at least £33m. We therefore supplement the peer multiples approach with a scenario analysis.

### **Scenario analysis**

In our [September note](#), we presented a scenario analysis that looked at the potential revenues achievable if the company was successful in penetrating specific target markets. This approach showed that the three key segments in which Trackwise has developed prototype IHT products for customers (EV, medical devices and aerospace) each has the potential to generate revenues of at least £100m at relatively modest levels of market penetration. The contract with the EV manufacturer announced in September is the first demonstration of uptake of the technology at scale. This means that the share price is very sensitive to any news regarding the relationship with this customer.

**Exhibit 3: Financial summary**

|   | £'m | 2019   | 2020   | 2021e  | 2022e  |
|---|-----|--------|--------|--------|--------|
| 31-December   |     | IFRS   | IFRS   | IFRS   | IFRS   |
| <b>INCOME STATEMENT</b>                             |     |        |        |        |        |
| Revenue   |     | 2.9    | 6.1    | 9.0    | 22.1   |
| Cost of Sales                                       |     | (1.8)  | (4.4)  | (5.9)  | (14.3) |
| Gross Profit  |     | 1.1    | 1.7    | 3.1    | 7.9    |
| EBITDA  |     | 0.5    | 0.8    | 0.7    | 4.2    |
| Normalised operating profit                         |     | 0.2    | (0.2)  | (0.5)  | 2.4    |
| Amortisation of acquired intangibles                |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Exceptionals  |     | (0.0)  | (0.1)  | 0.0    | 0.0    |
| Share-based payments                                |     | (0.2)  | (0.2)  | (0.3)  | (0.3)  |
| Reported operating profit                           |     | (0.1)  | (0.5)  | (0.8)  | 2.1    |
| Net Interest  |     | (0.1)  | (0.2)  | (0.2)  | (0.5)  |
| Exceptionals  |     | 0.0    | 1.1    | 0.0    | 0.0    |
| Profit Before Tax (norm)                            |     | 0.1    | (0.4)  | (0.7)  | 1.9    |
| Profit Before Tax (reported)                        |     | (0.1)  | 0.4    | (1.0)  | 1.6    |
| Reported tax  |     | 0.1    | 0.8    | 0.3    | 0.3    |
| Profit After Tax (norm)                             |     | 0.1    | 0.3    | (0.3)  | 1.8    |
| Profit After Tax (reported)                         |     | (0.0)  | 1.2    | (0.7)  | 1.9    |
| Basic average number of shares outstanding (m)      |     | 14.7   | 20.7   | 28.4   | 28.4   |
| EPS - normalised (p)                                |     | 0.8    | 1.4    | (1.0)  | 6.4    |
| EPS - diluted normalised (p)                        |     | 0.8    | 1.4    | (0.9)  | 6.2    |
| EPS - basic reported (p)                            |     | (0.3)  | 6.0    | (2.5)  | 6.6    |
| Dividend (p)  |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Revenue growth (%)                                  |     | (16.2) | 108.8  | 48.5   | 145.5  |
| Gross Margin (%)                                    |     | 37.9   | 28.3   | 34.6   | 35.5   |
| EBITDA Margin (%)                                   |     | 17.8   | 12.7   | 7.8    | 18.9   |
| Normalised Operating Margin                         |     | 6.9    | N/A    | N/A    | 10.8   |
| <b>BALANCE SHEET</b>                                |     |        |        |        |        |
| Fixed Assets  |     | 6.8    | 14.7   | 24.7   | 24.5   |
| Intangible Assets                                   |     | 4.3    | 6.5    | 7.3    | 8.0    |
| Tangible Assets                                     |     | 2.5    | 8.2    | 17.3   | 16.4   |
| Investments & other                                 |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Current Assets                                      |     | 3.1    | 18.5   | 12.8   | 16.9   |
| Stocks  |     | 0.6    | 2.0    | 2.2    | 3.6    |
| Debtors   |     | 1.7    | 1.8    | 2.0    | 4.2    |
| Cash & cash equivalents                             |     | 0.6    | 13.9   | 7.7    | 8.2    |
| Other   |     | 0.3    | 0.8    | 0.8    | 0.8    |
| Current Liabilities                                 |     | (1.4)  | (3.0)  | (2.3)  | (4.1)  |
| Creditors   |     | (1.0)  | (2.0)  | (1.2)  | (3.0)  |
| Tax and social security                             |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Short term borrowings (including lease liabilities) |     | (0.3)  | (1.1)  | (1.1)  | (1.1)  |
| Other   |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Long Term Liabilities                               |     | (2.5)  | (5.3)  | (10.7) | (10.7) |
| Long term borrowings (including lease liabilities)  |     | (1.3)  | (4.1)  | (9.5)  | (9.5)  |
| Other long term liabilities                         |     | (1.3)  | (1.2)  | (1.2)  | (1.2)  |
| Net Assets  |     | 6.0    | 24.9   | 24.5   | 26.6   |
| Minority interests                                  |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Shareholders' equity                                |     | 6.0    | 24.9   | 24.5   | 26.6   |
| <b>CASH FLOW</b>                                    |     |        |        |        |        |
| Op Cash Flow before WC and tax                      |     | 0.5    | 0.8    | 0.7    | 4.2    |
| Working capital                                     |     | 0.1    | (0.6)  | (1.2)  | (1.9)  |
| Exceptional & other                                 |     | 0.0    | (0.6)  | 0.0    | 0.0    |
| Tax   |     | 0.0    | 0.7    | 0.3    | 0.3    |
| Net operating cash flow                             |     | 0.6    | 0.3    | (0.2)  | 2.6    |
| Capex   |     | (2.7)  | (3.2)  | (5.8)  | (1.6)  |
| Acquisitions/disposals                              |     | 0.0    | (1.6)  | 0.0    | 0.0    |
| Net interest  |     | (0.1)  | (0.2)  | (0.2)  | (0.5)  |
| Equity financing                                    |     | 0.0    | 17.3   | 0.0    | 0.0    |
| Dividends   |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Other   |     | 0.2    | 0.1    | 0.0    | 0.0    |
| Net Cash Flow                                       |     | (2.0)  | 12.7   | (6.2)  | 0.5    |
| Opening net debt/(cash)                             |     | (2.3)  | 1.0    | (8.8)  | 2.8    |
| FX  |     | 0.0    | 0.0    | 0.0    | 0.0    |
| Other non-cash movements                            |     | (1.3)  | (2.9)  | (5.4)  | 0.0    |
| Closing net debt/(cash) including lease liabilities |     | 1.0    | (8.8)  | 2.8    | 2.3    |
| Lease liabilities                                   |     | 0.7    | 2.6    | 8.0    | 8.0    |
| Closing net debt/(cash) excluding lease liabilities |     | 0.3    | (11.3) | (5.2)  | (5.6)  |

Source: Edison Investment Research

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