

# IQE

## VCSEL growth underpins revenue upgrade

**IQE's pre-close trading update noted that management expects FY17 revenues to be ahead of market expectations. Noting that the upgrade is driven by delivery of volume epitaxy on a programme that we infer is the new iPhone X, a programme which will continue throughout FY18, we raise our revenue estimates for both FY17 and FY18, but keep EPS numbers unchanged as the proportion of licence revenues in the mix is lower.**

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	114.0	17.6	2.60	0.0	52.7	N/A
12/16	132.7	20.6	3.00	0.0	45.7	N/A
12/17e	150.1	23.7	3.26	0.0	42.0	N/A
12/18e	165.2	28.3	3.56	0.0	38.5	N/A

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

### Photonics revenues double, while wireless stable

Management expects volume VCSEL ramp-up during H217 to result in photonics revenues approximately doubling for FY17 as a whole. Our estimates model photonics revenues remaining at H217 levels throughout FY18. Management expects wireless revenues to be broadly flat year-on-year, with favourable FX rates balancing an inventory reduction. Our estimates model growth from this segment in FY18. IQE expects the increase in wafer sales to drive an expansion of wafer margins in FY17, an effect which we model as continuing through FY18. We revise our group revenue estimates from £145.3m to £150.1m for FY17 and from £160.3m to £165.2m for FY18. We also increase the FY17 cash tax payment by £4.2m to reflect settlement of a prior year tax liability.

### Potential for multiple VSCEL ramp-ups

Our revised estimates model growth from multiple volume VCSEL programmes related to the iPhone X. IQE is currently working on a range of other VCSEL programmes that have potential to become volume contracts in the future. We believe that some are for other phone manufacturers wanting to include Face ID functionality in their devices. Some are for other consumer applications including hand and body tracking, automotive applications, data comms and industrial applications, indium phosphide wafers for high-speed data networks and gallium nitride wafers for radio frequency and power applications. The acquisition of Quasi Photonic Crystal patents for \$0.5m will help IQE maintain its technology leadership in these applications and could lead to new growth markets beyond epitaxy.

### Valuation: Earnings upgrades priced in

The shares have performed extremely well in recent months, rising more than 3x from 37.75p a year ago, and are now trading on multiples that suggest that upgrades are already priced in. There remains potential for FY18 earnings to exceed current expectations, especially if other VCSEL programmes move into volume manufacture. Our September [outlook note](#) explores the impact of potentially faster rates of VCSEL roll-out on FY18 EPS.

## Pre-close trading update

### Tech hardware & equipment

2 January 2018

**Price** 137p  
**Market cap** £1,035m

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

Shares in issue 755.6m  
Free float 90.5  
Code IQE  
Primary exchange AIM  
Secondary exchange N/A

### Share price performance



%	1m	3m	12m
Abs	(16.3)	9.4	260.5
Rel (local)	(22.4)	5.4	234.1
52-week high/low		178.8p	37.8p

### 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

FY17 results 20 March 2018

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**Exhibit 1: Financial summary**

	£'000s	2015	2016	2017e	2018e
Year End 31 December		IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
Revenue		114,024	132,707	150,112	165,230
Cost of Sales (Inc D&A + SBP)		(81,585)	(96,292)	(110,344)	(120,790)
Gross Profit		32,439	36,415	39,769	44,440
EBITDA		29,001	31,730	35,461	40,288
Depreciation and Amortisation		(10,024)	(9,611)	(10,000)	(12,300)
Operating Profit (before amort. and except.)		18,977	22,119	25,461	27,988
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	21,134	23,661
Underlying interest		(1,403)	(1,489)	(1,725)	300
Exceptionals		(387)	(144)	0	0
Profit Before Tax (norm)		17,574	20,630	23,736	28,288
Profit Before Tax (FRS 3)		19,376	19,032	19,409	23,961
Tax		773	408	500	500
Profit After Tax (norm)		18,066	21,440	23,736	28,288
Profit After Tax (FRS 3)		20,149	19,440	19,909	24,461
Average Number of Shares Outstanding (m)		662.6	671.5	689.8	755.6
EPS - normalised (p)		2.60	3.00	3.26	3.56
EPS - (IFRS) (p)		3.00	2.87	2.89	3.24
Dividend per share (p)		0.0	0.0	0.0	0.0
<b>BALANCE SHEET</b>					
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	110,186	117,001
Stocks		21,215	28,498	36,521	40,472
Debtors		23,050	30,868	36,521	40,899
Cash		4,644	4,957	37,145	35,630
Other		0	0	0	0
Current Liabilities		(48,050)	(46,012)	(42,405)	(44,472)
Creditors		(44,809)	(38,360)	(42,405)	(44,472)
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	304,441	330,562
<b>CASH FLOW</b>					
Operating Cash Flow		20,971	22,463	25,831	34,024
Net Interest		(1,403)	(1,489)	(1,725)	300
Tax		(459)	(839)	(5,039)	(839)
Capex		(10,002)	(19,060)	(35,000)	(35,000)
Acquisitions/disposals		0	(11,250)	(373)	0
Financing		544	578	93,000	0
Dividends		0	0	0	0
Net Cash Flow		9,651	(9,597)	76,694	(1,515)
Opening net debt/(cash)		31,251	23,223	39,549	(37,145)
HP finance leases initiated		0	0	0	0
Other		(1,623)	(6,729)	0	0
Closing net debt/(cash)		23,223	39,549	(37,145)	(35,630)

Source: Company accounts, Edison Investment Research

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