

IQE

Six more VCSEL projects in mass production

IQE's post-H118 close trading update notes the group continues to trade in line with current market expectations. Importantly, it comments on a significant increase in photonics revenues from product qualifications, underpinning management's expectation of a photonics ramp-up in H218 and FY19. We raise our revenue estimates slightly but otherwise leave our forecasts unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16**	132.7	20.6	2.89	0.0	36.3	N/A
12/17	154.5	24.3	3.36	0.0	31.2	N/A
12/18e	178.1	32.8	3.62	0.0	29.0	N/A
12/19e	207.1	42.3	4.60	0.0	22.8	N/A

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

Revenue growth held back by currency headwinds

IQE expects H118 revenues to be c £73m compared with £70m H117, as double-digit sales growth on a constant currency basis in each of the three primary markets was offset by a 9.5% currency headwind. The segmental split was distorted by inventory management factors. During both H117 and H217, significant production capacity was allocated to the VCSEL ramp-up for a 3D sensing application. During H118, sales to the chip manufacturer servicing this application were similar to H117, as the supply chain absorbed inventory, enabling the group to replenish wireless inventory channels and start work on a significant number of VCSEL production qualifications. On a constant currency basis, wireless revenues grew by almost 11% year-on-year, photonics by 30% and infra-red by c 11%.

H218 photonics ramp-up already underway

The recent work on VCSEL product qualifications has resulted in IQE being in mass production with six VCSEL chip manufacturers and in final qualification stages with another six, with volumes already ramping up in H218. These are for mobile, sensing, automotive and datacom applications. We leave our estimates broadly unchanged, raising our FY18 revenue estimate from £174.9m to £178.1m and our FY19 revenue estimate from £203.8m to £207.1m.

Valuation: Discount to other VCSEL epitaxy providers

The share price has declined from the peak of 178.75p in November 2017. A comparison of IQE's FY18 P/E multiple against those of listed peers shows it trading at a premium (29.0x vs 23.2x). However, if we restrict the comparison to the three listed companies offering epitaxy for VCSELs (IntelliEPI, LandMark Optoelectronics and Visual Photonics), then IQE is trading close to the mean (27.8x vs 26.8x) and below Landmark (28.2x) and Visual Photonics (33.3x) despite being in a stronger market position than both. Taking this approach, the shares look fairly priced at current levels despite modelling fairly unambitious photonics revenue growth (40%) in our estimates.

H118 trading update

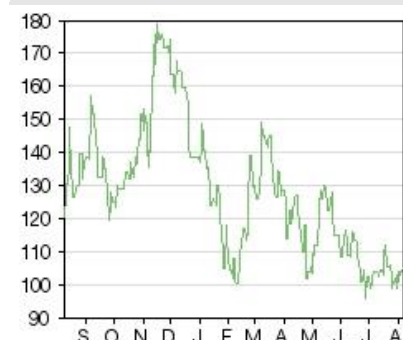
Tech hardware & equipment

7 August 2018

Price 104.9p
Market cap £798m

Net cash (£m) at end December 2017	45.6
Shares in issue	757.6m
Free float	95.2%
Code	IQE
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.9	(6.3)	(2.7)
Rel (local)	0.4	(7.4)	(4.8)
52-week high/low	178.8p	96.0p	

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

Interims	29 August 2018
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Analysts

Anne Margaret Crow	+44 (0)20 3077 5700
Dan Ridsdale	+44 (0)20 3077 5729

tech@edisongroup.com

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Exhibit 1: Financial summary

	£'000s	2016	2017	2018e	2019e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS		restated			
Revenue		132,707	154,480	178,078	207,095
Cost of Sales (Inc D&A + SBP)		(98,538)	(115,857)	(126,611)	(145,297)
Gross Profit		34,169	38,623	51,467	61,798
EBITDA		33,057	38,384	47,910	58,959
Depreciation and Amortisation		(10,938)	(12,025)	(15,166)	(16,699)
Operating Profit (before amort. and except.)		22,119	26,359	32,745	42,260
Acquired Intangible Amortisation		(1,374)	(1,429)	(1,429)	(1,429)
Exceptionals		1,962	(385)	0	0
Share based payments		(2,881)	(7,526)	(7,526)	(7,526)
Operating Profit		19,826	17,019	23,790	33,305
Underlying interest		(1,463)	(2,099)	100	0
Exceptionals		(26)	80	0	0
Profit Before Tax (norm)		20,630	24,340	32,845	42,260
Profit Before Tax (FRS 3)		18,363	14,920	23,890	33,305
Tax		(340)	(435)	(3,583)	(4,996)
Profit After Tax (norm)		20,692	24,823	29,261	37,265
Profit After Tax (FRS 3)		18,023	14,485	20,306	28,310
Average Number of Shares Outstanding (m)		671.5	689.5	758.7	760.8
EPS - normalised (p)		2.89	3.36	3.62	4.60
EPS - (IFRS) (p)		2.66	2.09	2.66	3.71
Dividend per share (p)		0.0	0.0	0.0	0.0
BALANCE SHEET					
Fixed Assets		214,043	224,836	243,241	253,114
Intangible Assets		103,972	108,513	108,418	106,791
Tangible Assets		85,001	90,875	109,375	120,875
Other		25,070	25,448	25,448	25,448
Current Assets		64,323	111,559	127,100	164,512
Stocks		28,498	33,707	40,267	46,865
Debtors		30,868	32,240	39,297	50,253
Cash		4,957	45,612	47,536	67,394
Other		0	0	0	0
Current Liabilities		(51,522)	(44,916)	(48,447)	(56,100)
Creditors		(43,870)	(44,916)	(48,447)	(56,100)
Short term borrowings		(7,652)	0	0	0
Long Term Liabilities		(39,021)	(666)	(666)	(666)
Long term borrowings		(36,854)	0	0	0
Other long term liabilities		(2,167)	(666)	(666)	(666)
Net Assets		187,823	290,813	321,229	360,860
CASH FLOW					
Operating Cash Flow		22,463	29,717	37,824	49,057
Net Interest		(1,489)	(2,125)	100	0
Tax		(839)	(5,844)	(1,000)	(1,200)
Capex		(19,060)	(28,190)	(35,000)	(28,000)
Acquisitions/disposals		(11,250)	0	0	0
Financing		578	94,912	0	0
Dividends		0	0	0	0
Net Cash Flow		(9,597)	88,470	1,924	19,857
Opening net debt/(cash)		23,223	39,549	(45,612)	(47,536)
HP finance leases initiated		0	0	0	0
Other		(6,729)	(3,309)	0	0
Closing net debt/(cash)		39,549	(45,612)	(47,536)	(67,394)

Source: Company data, Edison Investment Research

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