

# Filtronic

Interim results

## Recovery continues into H122

Filtronic's H122 results show a 12% growth in revenues accompanied by an 83% jump in EBITDA. The recovery in demand in the US public safety market first observed in Q421 has been sustained, more than offsetting a drop in sales of 5G XHaul transceivers caused by a supply chain issue. This issue was resolved during Q222, so we leave our FY22 estimates broadly unchanged and introduce estimates for FY23.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)
05/20	17.2	1.2	0.1	0.05	0.00	235.0
05/21	15.6	1.8	0.1	0.14	0.00	83.9
05/22e	17.4	2.0	0.8	0.40	0.00	29.6
05/23e	19.0	2.1	0.9	0.42	0.00	27.8

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

## Strong recovery during H122

Group sales rose by 12% year-on-year during H122 to £8.0m, broadly in line with internal forecasts. A sustained recovery in the US public safety market, where sales doubled year-on-year, offset a 35% fall in sales of XHaul transceivers caused by semiconductor component shortages. The pre-tax result (adjusted for exceptional items) moved from a loss of £0.1m in H121 to a profit of £0.6m in H122, reflecting a more favourable sales mix as well as higher revenues. Net cash (net of all lease obligations except right of use property leases) increased by £0.3m during the period to £2.2m at end H122, after £0.5m was absorbed in working capital.

## Rebound to continue through H222

Our FY22 estimates, which are broadly unchanged, assume that H222 revenues will be higher than H122. This is because XHaul sales picked up in Q222 when the supply chain issue was resolved. Management expects that, so long as there are no further supply chain issues, XHaul sales will remain at this higher level during H222 and into FY23. H222 revenues will also benefit from deliveries of the bulk of the production units for the battlefield communications contract, for which the initial deliveries were made in H122.

## Valuation: Premium for strong growth

Comparing Filtronic's multiples with those of its radio-frequency (RF) specialist peers, we note that it is trading broadly in line with the sample mean with regards to prospective EV/sales and at a premium with respect to EV/EBITDA and P/E multiples. However, our estimates show Filtronic's revenues growing more quickly than revenues for the companies in this sample during FY22 and FY23. This gives it a growth trajectory closer to the companies in our sample of companies offering a highly differentiated technology, which trade on higher multiples, suggesting that this premium may be justified.

### Tech hardware & equipment

8 February 2022

**Price** 11.75p  
**Market cap** £25m

Net cash (£m) at end November 2021 (excluding right of property leases) 2.2

Shares in issue 214.7 m

Free float 66.1%

Code FTC

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 2.2 0.0 48.7

Rel (local) 2.5 (1.4) 30.2

52-week high/low 13p 8p

### Business description

Filtronic is a designer and manufacturer of advanced RF communications products supplying a number of market sectors including mobile telecommunications infrastructure, public safety, defence and aerospace.

### Next event

FY22 results August 2022

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## H122 performance

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### Recovery in US public safety market offsets issues caused by supply chain shortages

Filtronic remained fully operational throughout the coronavirus restrictions, enabling it to keep its engineering developments for customers on track against their respective milestone delivery plans and maintain product delivery schedules. The recovery noted in the US public safety market during Q421 as COVID-19 related restrictions started to ease has been sustained because public funds are being redirected back into public infrastructure projects. As a result, the order flow for Filtronic's Tower Top Amplifier products, which were launched in May 2021, is finally meeting management's original expectations as the product is designed into major infrastructure projects in preference to more established brands. Segmental sales doubled year-on-year. Sales of transceivers for 5G XHaul links to the lead customer were held back during Q122 by supply chain shortages, which prevented Filtronic from meeting the customer's original requirements in full. However, the issue was resolved during Q222, supporting a recovery in sales to pre-pandemic levels by the end of the period. Sales to the lead customer in the defence and aerospace market were steady. In addition, segmental sales benefitted from the first deliveries of production units of battlefield radio communications hardware to a new major UK defence customer under the contract valued at £1.3m announced in January 2021 and several small development contracts from a large UK defence prime for the group's specialist filter technology. The latter follows the recent accreditation of the group's Leeds facility for certain defence work.

Group sales rose by 12% year-on-year during H122 to £8.0m in H221. This was broadly in line with internal forecasts.

### Strong growth in EBITDA

Adjusted EBITDA jumped by 83% year-on-year to £1.1m, also in line with management guidance. This improvement was attributable to a more favourable sales mix, with a higher proportion of sales to the critical communications and defence markets and the final phases of work on some long-term development programmes. The cost of goods sold (COGS) actually declined by 4%, even though revenues increased. The reduction in COGS helped offset a 12% rise in overheads primarily related to the cessation of the UK furlough scheme and the US Paycheck Protection Program (PPP), as well as increased sales and marketing expenditure as tradeshows started up again and some engineering recruitment costs. The jump in EBITDA, together with lower depreciation charges and a £0.2m reduction in net finance costs resulted in a shift from a pre-exceptional pre-tax loss of £0.1m in H121 to a pre-exceptional pre-tax profit of £0.6m in H122. Finance costs were artificially high in H121 because of the revaluation of an inter-company loan. The reported H122 pre-tax result of £0.7m benefitted from the release of a £0.1m warranty provision related to the antennae business, which was sold in January 2020.

### Strongest net cash position for four years

Net cash (net of all lease obligations except right of use property leases) increased from £1.9m at end FY21 to £2.2m at end H122. Cash generated from operations was £0.6m, reflecting a £0.5m increase in working capital related to the upswing in 5G XHaul links towards the end of the period. As in H121, investment in capital equipment was minimal (£0.1m) because the investment in the Sedgefield site completed in FY20. There were no capitalised development costs (£0.1m in H121) as the bulk of development undertaken was paid for by customers, with the rest expensed. The

strong balance sheet gives Filtronic a good base from which to continue investing in additional engineering resource and business development activities during H222 and FY23.

## Outlook: Third consecutive year of EBITDA growth

### Adjustments to FY22 estimates

Management has not provided any formal guidance for FY22, other than noting that it expects the group will achieve a third consecutive year of EBITDA growth despite the supply chain disruption caused by global semiconductor shortages. We make the following adjustments to our FY22 estimates, which have the net effect of leaving EBITDA unchanged and raising other profit metrics:

- **Revenues:** we assume that the recovery observed in the critical communications markets is maintained throughout FY22. In addition, H222 is likely to benefit from completion of deliveries for the battlefield radio communications hardware contract. However, since Filtronic is not able to make up for the lower 5G XHaul sales during H2, we reduce our total revenue estimate by £0.6m to £17.4m.
- **Cost of materials/sales:** we previously modelled this at FY21 levels (ie 45%). Since 5G XHaul sales were depressed during H122, the proportion of work for the defence sector will be higher for the year as a whole, so we have reduced our estimate for cost of materials/sales.
- **Other costs:** we continue to model an increase in staffing costs in comparison with FY21 to reflect investment in engineering, as well as an increase in marketing expenditure as COVID-19 related travel restrictions ease and the absence of any benefit from furlough or PPP schemes. However, we have reduced the rate of increase.
- **Depreciation:** we have reduced this in line with H122 levels.
- **Working capital:** we continue to model a year-on-year reduction in payables at the end of FY22 but have made the reduction smaller to reflect the increase in payables during H122.
- **Investment activity:** we continue to model £0.5m in investment in equipment to make development work more efficient. We also continue to model £0.5m of capitalised R&D costs to reflect this development work, as resource should be redeployed to this now that the development phases of both the battlefield communications and 5G test equipment projects have been completed.

#### Exhibit 1: Changes to estimates

£'m	FY21 Actual	FY22e			FY23e New
		Old	New	Change	
Revenues	15.6	18.0	17.4	-3.0%	19.0
EBITDA	1.8	2.0	2.0	0.0%	2.1
EBITDA margin (%)	11.4%	11.2%	11.6%	3.1%	11.0%
Normalised PBT	0.1	0.7	0.8	24.1%	0.9
Normalised basic EPS (p)	0.14	0.34	0.40	18.1%	0.42
Dividend per share (p)	0.00	0.00	0.00	N/A	0.00
Net debt/(cash)	(1.9)	(2.0)	(2.3)	16.6%	(2.7)

Source: Company accounts, Edison Investment Research

### Introduction of FY23 estimates

One side-effect of the supply chain shortages is that customers generally in the electronics industry are placing longer orders to secure capacity and help their suppliers procure components. (We commented on this trend in our recent [IQE note](#).) Given the better order book visibility, we are introducing FY23 estimates. These make the following assumptions:

- **Revenues:** we assume that sales to the US public safety market will remain at FY22 levels and that 5G Xhaul deliveries will remain at the higher level reached at the end of H122. In addition,

we assume that the bulk of the \$0.8m (£0.6m) revenues from the contract announced in October 2021 to manufacture pilot phase production units of over-the-air 5G mmWave modules for the 5G test equipment market will be received during the year. We assume that the group will secure new contracts to replace revenues from the battlefield communications contract.

- **Costs:** we model cost of materials/sales as higher than FY22 to reflect the higher proportion of 5G XHaul sales. We model a further year-on-year increase in staffing costs to reflect investment in engineering resource to accelerate the development of W-band (75–110GHz) and Q-band (33–50GHz) communications links. This investment depresses EBITDA margin short term, as well as PBT and EPS growth, but management intends that it will result in stronger revenue and profit growth during FY24 and FY25.
- **Investment activity:** we model investment in capital equipment at FY22 levels as the group works on the development of W-band product for future 5G networks once existing E-band capacity becomes full. We maintain investment in development activity at FY22 levels.

## Management changes

Following the retirement of Reg Gott at the group's AGM in October 2021 after 15 years of service, Jonathan Neale became the new non-executive chairman in November 2021. Jonathan was previously chief operating officer of McLaren Group. Prior to that he was the CEO of McLaren Racing F1 and managing director of Hawk Military Aircraft at BAE Systems, UK.

## Valuation

When preparing a peer group, we found that there are very few other listed companies specialising in high-power mmWave communications products, not just in the UK, but also across mainland Europe, Israel and North America. While this emphasises the uniqueness of Filtronic's skill set, it makes it more difficult to create a sample of peers to use as the basis of a peer multiples comparison. We have created two sample sets. The first consists of companies that, like Filtronic, offer niche products used for transmitting data at mmWave frequencies. The second is a sample set of European companies that, like Filtronic, offer a highly differentiated technology based on hard-to-find skill sets.

**Exhibit 2: Peer multiples**

Name	Market cap (£m)	EV/sales FY1 (x)	EV/sales FY2 (x)	EV/EBITDA FY1 (x)	EV/EBITDA FY2 (x)	P/E FY1 (x)	P/E FY2 (x)	CAGR* (%)
Aviat Networks	244	1.0	0.9	7.7	7.0	11.4	10.2	6.6%
Baylin Technologies	41	1.0	0.8	(6.8)	16.2	(1.1)	(6.4)	2.4%
CommScope Holding Company	1,359	1.4	1.4	11.0	10.0	7.2	5.7	1.5%
Comtech Telecommunications	383	1.2	1.1	9.4	8.5	35.9	24.0	3.6%
<b>Mean of RF specialists</b>		<b>1.1</b>	<b>1.1</b>	<b>9.4</b>	<b>10.4</b>	<b>18.1</b>	<b>13.3</b>	
CML Microsystems	67.6	2.9	2.6	12.3	10.2	36.4	33.9	18.4%
Kromek Group	68.9	4.6	3.9	520.6	110.6	(17.6)	(17.3)	31.9%
Mynaric	137.3	12.9	2.5	(6.7)	(35.2)	(6.3)	(18.6)	852.1%
Sivers Semiconductors	215.5	24.0	8.3	(26.9)	(65.7)	(23.0)	(48.6)	80.1%
Trackwise Designs	30.2	3.7	1.4	35.3	7.5	(49.4)	24.4	88.0%
<b>Mean of companies with highly differentiated technology</b>		<b>11.1</b>	<b>4.3</b>	<b>189.4</b>	<b>42.8</b>	<b>36.4</b>	<b>29.1</b>	
Filtronic	25	1.3	1.2	11.6	11.1	29.6	27.8	10.5%

Source: Refinitiv, Edison Investment Research. Note: Prices as at 7 February 2022. \*FY0 to FY2.

Filtronic's share price has risen by over 30% since we [initiated coverage](#) in June 2021. Comparing Filtronic's multiples with those of its RF specialist peers, we note that it is trading broadly in line with the mean of the sample with regards to prospective EV/sales and at a premium to the mean with regards to both EV/EBITDA and P/E multiples. Since several of the companies in the second



sample set are not profitable yet, the data are limited. However, consensus estimates show companies in this sample growing substantially more quickly than those in the first, thus commanding higher multiples. Our estimates show Filtronic also growing more quickly than the companies in the first sample set during FY22, suggesting that a premium to the multiples of this sample is justified.

**Exhibit 3: Financial summary**

31-May	£m	2020	2021	2022e	2023e
<b>INCOME STATEMENT</b>					
Revenue		17.2	15.6	17.4	19.0
EBITDA		1.2	1.8	2.0	2.1
Normalised operating profit		0.4	0.6	1.0	1.1
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0
Exceptionals		(0.6)	0.1	0.0	0.0
Reported operating profit		(0.2)	0.6	1.0	1.1
Net Interest		(0.2)	(0.4)	(0.2)	(0.2)
Exceptionals		0.0	0.0	0.0	0.0
Profit Before Tax (norm)		0.1	0.1	0.8	0.9
Profit Before Tax (reported)		(0.4)	0.2	0.8	0.9
Reported tax		(0.1)	(0.2)	0.2	0.2
Profit After Tax (norm)		0.1	0.3	0.9	0.9
Profit After Tax (reported)		(0.5)	0.1	1.0	1.1
Discontinued operations		(1.4)	0.0	0.0	0.0
Net income (normalised)		0.1	0.3	0.9	0.9
Net income (reported)		(2.0)	0.1	1.0	1.1
Average Number of Shares Outstanding (m)		211	213	215	215
EPS - normalised (p)		0.05	0.14	0.40	0.42
EPS - diluted normalised (p)		0.05	0.14	0.39	0.42
EPS - basic reported (p)		(0.25)	0.03	0.47	0.51
Dividend (p)		0.00	0.00	0.00	0.00
Revenue growth (%)		7.8%	-9.5%	12.0%	9.1%
EBITDA Margin (%)		6.8	11.4	11.6	11.0
Normalised Operating Margin		2.2	3.7	5.6	5.6
<b>BALANCE SHEET</b>					
Fixed Assets		7.5	6.2	6.0	5.7
Intangible Assets		1.8	1.7	1.9	2.0
Tangible Assets		3.8	3.3	3.1	2.8
Investments & other		1.9	1.2	1.1	0.9
Current Assets		9.8	8.4	9.2	10.0
Stocks		2.9	2.2	2.6	2.9
Debtors		4.8	3.3	3.3	3.5
Cash & cash equivalents		2.0	2.9	3.3	3.7
Other		0.0	0.0	0.0	0.0
Current Liabilities		(6.0)	(3.6)	(3.3)	(3.0)
Creditors		(3.5)	(2.4)	(2.2)	(1.8)
Short term borrowings including lease liabilities		(0.7)	(0.6)	(0.6)	(0.6)
Other		(1.8)	(0.6)	(0.6)	(0.6)
Long Term Liabilities		(2.0)	(1.7)	(1.7)	(1.7)
Long term borrowings		(2.0)	(1.6)	(1.6)	(1.6)
Other long term liabilities		0.0	(0.1)	(0.1)	(0.1)
Net Assets		9.4	9.4	10.2	11.1
Minority interests		0.0	0.0	0.0	0.0
Shareholders' equity		9.4	9.4	10.2	11.1
<b>CASH FLOW</b>					
Op Cash Flow before WC and tax		1.2	1.8	2.0	2.1
Working capital		(2.4)	1.1	(0.7)	(0.8)
Exceptional & other		(2.7)	(1.0)	0.0	0.0
Tax		1.2	0.5	0.2	0.2
Operating cash flow		(2.6)	2.5	1.5	1.5
Capex (including capitalised R&D)		(1.2)	(0.4)	(1.0)	(1.0)
Acquisitions/disposals		3.7	0.0	0.0	0.0
Net interest		(0.3)	(0.2)	(0.2)	(0.2)
Equity financing		0.3	0.0	0.0	0.0
Dividends		0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0
Net Cash Flow		(0.2)	1.9	0.4	0.4
Opening net debt/(cash)		(2.5)	0.7	(0.8)	(1.1)
FX		0.0	0.0	0.0	0.0
Other non-cash movements		(3.0)	(0.4)	(0.0)	(0.0)
Closing net debt/(cash) including lease liabilities		0.7	(0.8)	(1.1)	(1.5)
Property lease liabilities		1.1	1.2	1.2	1.2
Closing net debt/(cash) excluding lease liabilities		(0.4)	(1.9)	(2.3)	(2.7)

Source: Company accounts, Edison Investment Research

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