

Filtronic

FY22 results

Third consecutive year of EBITDA growth

Filtronic's FY22 results show revenues growing by 10% while adjusted EBITDA jumped by 58% despite the challenges posed by global supply chain shortages. Our estimates look for continued revenue growth in FY23 as the group executes on its strategy of expanding into adjacent markets where its specialist radio frequency (RF) skills command a premium.

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	292.8
05/21	15.6	1.8	0.1	0.14	0.00	104.6
05/22	17.1	2.8	1.5	0.54	0.00	27.1
05/23e	19.0	2.1	0.9	0.42	0.00	34.9

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

Product mix boosts FY22 profits

As flagged in the post-close trading update, group sales rose by 10% year-on-year during FY22 to £17.1m. The recovery noted in the US public safety market during Q421 as COVID-19-related restrictions started to ease was sustained throughout the year, but supply chain issues prevented Filtronic from fulfilling demand for 5G transceivers during H122. While this was resolved in Q222, the US public safety customer was itself affected by supply chain issues in H222. A higher proportion of sales to the critical communications and defence markets benefited gross margin, resulting in adjusted EBITDA climbing by 58% year-on-year to £2.8m.

Investing for further growth in FY24 and FY25

We leave our FY23 estimates, which are underpinned by a growing orderbook for 5G XHaul transceivers, unchanged. Since gross margins are likely to be lower year-on-year in FY23 because of the higher proportion of Xhaul transceivers, which are price-sensitive, and overheads are likely to be higher because of continued investment in engineering personnel, we model a year-on-year drop in EBITDA (though a substantial increase compared with FY21) even though revenue growth is modelled at 11.5%. Management intends that this investment will result in stronger revenue and profit growth during FY24 and FY25 as the group diversifies into adjacent markets, such as private low-latency links and broadband communications networks based on networks of multiple high altitude pseudo satellites (HAPS) and low Earth orbit (LEO) satellites.

Valuation: Uplift for successful diversification

Our DCF analysis shows that if management's diversification strategy delivers double-digit year-on-year revenue growth through to FY27, while holding year-on-year growth in indirect costs at 5.0% or less from FY24 onwards, further uplift in Filtronic's share price can be justified. Announcements of further contract awards, such as the recent orders from a 5G test equipment company and a quantum computing company, will indicate how successful management is being in winning additional work outside its three core areas, which is key to achieving this growth.

Tech hardware and equipment

2 August 2022

Price 14.64p
Market cap £31m

Net cash (£m) at end May 2022 (excluding right of property leases) 3.1

Shares in issue 214.8m

Free float 66.1%

Code FTC

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	26.0	33.0	34.6
Rel (local)	21.0	35.8	33.3
52-week high/low	16.8p	9.0p	

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

AGM 27 October 2022

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FY22 financial performance

Supply chain issues still present challenges

As flagged in the post-close trading update, group sales rose by 10% year-on-year during FY22 to £17.1m. The recovery noted in the US public safety market during Q421, when COVID-19-related restrictions started to ease, was sustained throughout the year, as public funds were redirected back into public infrastructure projects. However, Filtronic's customer was adversely affected by supply chain issues during H222, which restricted its ability to build complete solutions, resulting in some orderbook rescheduling. Nevertheless, segmental sales grew by 23% year-on-year. Sales to the lead customer in the defence and aerospace market were steady. In addition, segmental sales benefited from deliveries of production units of battlefield radio communications hardware and several small development contracts from a large UK defence prime for the group's specialist filter technology. As a result, segmental sales grew by 27% 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. Although the issue was resolved during Q222, supporting a return to pre-pandemic levels of sales that was maintained throughout H222, segmental sales fell by 12% year-on-year.

EBITDA benefits from product mix

Adjusted EBITDA jumped by 58% year-on-year to £2.8m. Operating costs were at similar levels to FY21. Salary-related costs increased slightly as although prior year investments in automation meant that fewer manufacturing personnel were required, the company recruited additional engineers to help support an enlarged customer base. The increase in salary-related costs were partly offset by a reduction in travel costs in the first part of the year, which were linked to coronavirus related restrictions. Cost of sales and revenues were unusually low during the year (33.1% in FY22 vs 35.1% in FY21 and 47.0% in FY20) because the lower sales of 5G transceivers resulted in a higher than usual proportion of sales to the critical communications and defence markets. Gross margins in these markets are higher than average because certain components are free issued by the customer. Finance costs were artificially high in FY21 because of the revaluation of an inter-company loan. The reported FY22 pre-tax result of £1.9m benefited from the release of a £0.4m provision related to the antennae business, which was sold in January 2020.

Strong net cash position supports future growth

Net cash (net of all lease obligations except right-of-use property leases) increased from £1.9m at end FY21 to £3.1m at end FY22. Cash generated from operations was £2.3m after absorbing a £0.8m increase in working capital caused by a strong finish to Q422. As in FY21, 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 FY21) 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 FY23.

Outlook

Our FY23 estimates, which were not changed in our June or July updates and remain unchanged, 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 c £0.7m revenues attributable to the contract announced in June 2022 for 5G test equipment, the £0.5m revenues attributable to the contract announced in July 2022 from a UK defence customer for the design, manufacture and delivery of a modular, programmable reference system for testing RF equipment and £0.4m revenues attributable to a contract for switched filter bank products will all be received during the year.
- **Cost of materials/sales:** we model an increase from 33.1% in FY22 to 40.9% in FY23 to reflect the higher proportion of 5G XHaul sales.
- **Other costs:** we model a further year-on-year increase in staffing costs during FY23 to reflect continued investment in engineering resource to accelerate the development of W-band links. This investment will hold back improvements in EBITDA margin in the short term (11.0% in FY23), 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 £0.5m in investment in capital equipment. We also model £0.5m of capitalised R&D costs as resource should be redeployed on the development of W-band technology now that the development phases of both the battlefield communications and 5G test equipment projects have been completed.

Given the uncertainty created by continuing supply chain challenges, we are not introducing FY24 estimates yet and aim to do so when the H123 results are announced. Exhibit 1 presents a scenario analysis for FY24 EBITDA, which explores the impact of delivering double-digit revenue growth with only single-digit increases in indirect costs.

Valuation

Exhibit 1: DCF analysis

FY24e EBITDA (£m)						
		Year-on-year sales growth FY24–27e				
		9.0%	10.0%	11.0%	12.0%	13.0%
Indirect cost growth	3.0%	2.4	2.5	2.6	2.7	2.8
	3.5%	2.3	2.4	2.6	2.7	2.8
	4.0%	2.3	2.4	2.5	2.6	2.7
	4.5%	2.2	2.4	2.5	2.6	2.7
	5.0%	2.2	2.3	2.4	2.5	2.6
Indicative value (p/share)						
		Year-on-year sales growth FY24–27e				
		9.0%	10.0%	11.0%	12.0%	13.0%
Indirect cost growth	3.0%	15.7	17.2	18.6	20.1	21.6
	3.5%	15.1	16.6	18.0	19.5	21.0
	4.0%	14.5	15.9	17.4	18.9	20.4
	4.5%	13.9	15.3	16.8	18.3	19.8
	5.0%	13.2	14.7	16.1	17.6	19.1

Source: Edison Investment Research

As discussed in our [July note](#), given the volatility in EBITDA margin and lack of direct peers, we prefer a discounted cash flow (DCF) approach for valuing Filtronic. This models the impact on EBITDA and indicative valuation if Filtronic is able to deliver sustained double-digit revenue growth (9.0% to 13.0% year-on-year between FY24 and FY27) without adding significantly to indirect costs after FY23 (3.0% to 5.0% year-on-year between FY24 and FY27). The calculation uses a WACC of 10.0% and a terminal growth rate of 3.0%. Costs of sales and revenues is modelled at 43.1%, reflecting a higher percentage of 5G Xhaul revenues than FY21, FY22 or FY23. Investment in



intangible assets is maintained at FY23 levels but investment in tangible assets is reduced to £0.2.m each year, which is similar to FY22 levels.

The analysis shows that if management's diversification strategy delivers double-digit year-on-year from FY24 through to FY27, while holding year-on-year growth in indirect costs at 5.0% or less from FY24 onwards, further uplift in the share price should be justified. For example, Exhibit 1 shows that if Filtronic can deliver 12% revenue growth each year between FY24 and FY27, coupled with only 4% year-on-year cost growth over the same period, our DCF would produce an indicative value per share of 18.9p, 29% higher than the current level.

Exhibit 2: Financial summary

Year end 31 May	£m	2020	2021	2022	2023e
INCOME STATEMENT					
Revenue		17.2	15.6	17.1	19.0
EBITDA		1.2	1.8	2.8	2.1
Operating profit (before amort. and excepts.)		0.4	0.6	1.6	1.1
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0
Exceptionals		(0.6)	0.1	0.4	0.0
Reported operating profit		(0.2)	0.6	2.0	1.1
Net Interest		(0.2)	(0.4)	(0.1)	(0.2)
Exceptionals		0.0	0.0	0.0	0.0
Profit Before Tax (norm)		0.1	0.1	1.5	0.9
Profit Before Tax (reported)		(0.4)	0.2	1.9	0.9
Reported tax		(0.1)	(0.2)	(0.4)	0.2
Profit After Tax (norm)		0.1	0.3	1.2	0.9
Profit After Tax (reported)		(0.5)	0.1	1.5	1.1
Discontinued operations		(1.4)	0.0	0.0	0.0
Net income (normalised)		0.1	0.3	1.2	0.9
Net income (reported)		(2.0)	0.1	1.5	1.1
Average Number of Shares Outstanding (m)		211	213	215	215
EPS - normalised (p)		0.05	0.14	0.54	0.42
EPS - diluted normalised (p)		0.05	0.14	0.53	0.42
EPS - basic reported (p)		(0.25)	0.03	0.68	0.51
Dividend (p)		0.00	0.00	0.00	0.00
Revenue growth (%)		7.8	-9.5	9.6	11.5
EBITDA Margin (%)		6.8	11.4	16.5	11.0
Normalised Operating Margin		2.2	3.7	9.3	5.6
BALANCE SHEET					
Fixed Assets		7.5	6.2	5.4	5.1
Intangible Assets		1.8	1.7	1.5	1.7
Tangible Assets		3.8	3.3	3.0	2.7
Investments & other		1.9	1.2	0.9	0.7
Current Assets		9.8	8.4	11.1	11.0
Stocks		2.9	2.2	2.6	2.9
Debtors		4.8	3.3	4.5	3.5
Cash & cash equivalents		2.0	2.9	4.0	4.7
Other		0.0	0.0	0.0	0.0
Current Liabilities		(6.0)	(3.6)	(4.0)	(2.8)
Creditors		(3.5)	(2.4)	(3.0)	(1.8)
Short term borrowings including lease liabilities		(0.7)	(0.6)	(0.5)	(0.5)
Other		(1.8)	(0.6)	(0.5)	(0.5)
Long Term Liabilities		(2.0)	(1.7)	(1.4)	(1.4)
Long term borrowings		(2.0)	(1.6)	(1.3)	(1.3)
Other long term liabilities		0.0	(0.1)	(0.1)	(0.1)
Net Assets		9.4	9.4	11.0	12.0
Minority interests		0.0	0.0	0.0	0.0
Shareholders' equity		9.4	9.4	11.0	12.0
CASH FLOW					
Op Cash Flow before WC and tax		1.2	1.8	2.8	2.1
Working capital		(1.7)	1.1	(0.8)	(0.5)
Exceptional & other		(3.3)	(1.0)	0.3	0.0
Tax		1.2	0.5	0.0	0.2
Operating Cash Flow		(2.6)	2.5	2.3	1.8
Capex (including capitalised R&D)		(1.2)	(0.4)	(0.3)	(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	1.9	0.7
Opening net debt/(cash)		(2.5)	0.7	(0.8)	(2.2)
FX		0.0	0.0	0.0	0.0
Other non-cash movements		(3.0)	(0.4)	(0.5)	(0.0)
Closing net debt/(cash) including lease liabilities		0.7	(0.8)	(2.2)	(2.8)
Property lease liabilities		1.1	1.2	1.0	1.0
Closing net debt/(cash) excluding property lease liabilities		(0.4)	(1.9)	(3.1)	(3.8)

Source: company data, Edison Investment Research

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