

IQE

Trading update

Outperformance in both wireless and photonics

IQE has announced that the strong performance in H120, which resulted in record first-half revenue, has continued into the second half. It has updated FY20 revenue guidance from at least £165m to over £170m, with adjusted EBIT guidance remaining at the mid-single-digit million level. We have updated our FY20 and FY21 forecasts accordingly, giving adjusted PBT upgrades of 34% and 10% for FY20 and FY21 respectively.

Year end	Revenue (£m)	EBIT* (£m)	PBT* (£m)	EPS (p)	DPS (p)	P/E (x)
12/18	156.3	16.0	14.0	1.38	0.0	45.7
12/19	140.0	(4.7)	(7.0)	(2.46)	0.0	N/A
12/20e	170.6	6.1	4.2	0.38	0.0	163.7
12/21e	183.3	13.1	12.0	1.16	0.0	54.4

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

Wireless boosted by 5G roll out

In [September](#) we noted that IQE's longstanding wireless customers had benefited from major design wins and investment in 5G infrastructure and handsets. This trend has continued. Earlier this month, Skyworks stated that it expected double-digit sequential revenue and earnings growth in the December quarter, driven by content gains and product ramps across multiple 5G-enabled smartphone platforms. Qorvo reported expanded module shipments across multiple tier-one smartphone OEMs and projected the robust end-market demand would continue into the December quarter.

Photonics benefiting from LiDAR

Production for IQE's major vertical cavity surface emitting laser (VCSEL) customer, which we have previously inferred is involved in the Apple supply chain, has been consistently strong throughout the year so far. Demand is benefiting from the launch of the iPhone 12 Pro, which includes a world-facing LiDAR scanner to improve augmented reality (AR) experiences. The ability to integrate more accurate information about a handset user's physical environment into the AR world will potentially catalyse the launch of 'must-have' AR apps. This would be beneficial for iPhone 12 Pro sales. It would also encourage Android handset manufacturers, several of which already use modest amounts of IQE's VCSEL epitaxy, to add LiDAR to their devices.

Valuation: Recovered ground lost in March

IQE's share price has more than recovered the ground lost during the panic selling in March. At current levels, IQE is trading at a discount to the mean EV/EBITDA multiples of the sample of companies engaged in manufacturing VCSEL epitaxy. Given IQE's broader product portfolio, we believe it is reasonable for IQE to trade on multiples that are at the upper bound of this sample. However, we believe share price improvement will require greater visibility of how handset demand will be affected by any pandemic related recession in 2021 and whether the switch to 5G and the availability of as yet unknown 'must-have' AR apps will be sufficient motivation for cash-strapped consumers to justify upgrading their handsets.

Tech hardware & equipment

25 November 2020

Price 63.0p

Market cap £504m

Net debt (£m) at end June 2020 (excluding £48.1m finance leases) 7.4

Shares in issue 800.1m

Free float 86.6%

Code IQE

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 15.2 9.1 46.9

Rel (local) 4.9 2.2 63.6

52-week high/low 64.5p 20.0p

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 and power electronics.

Next events

FY20 results March 2021

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Revisions to estimates

Exhibit 1: Estimate changes

	FY19	FY20e			FY21e		
	Actual	Old	New	% change	Old	New	% change
Revenue (£m)	140.02	165.55	170.62	3.1	178.16	183.31	2.9
Adjusted PBT (£m)	(7.02)	3.15	4.21	33.9	10.89	11.99	10.2
Adjusted EPS (p)	(2.46)	0.28	0.38	39.1	1.05	1.16	10.2
Capitalised R&D (£m)	9.97	6.00	6.00	0.0	6.00	6.00	0.0
Property, plant and equipment (£m)	31.86	10.00	7.00	-30.0	10.00	10.00	0.0
Net (cash)/debt excluding finance leases at year end (£m)	15.97	10.32	4.22	-59.1	(2.55)	(7.17)	180.6

Source: Edison Investment Research

We revise our estimates to reflect the following:

- Upgraded FY20 revenue guidance with outperformance in both the wireless and photonics segments. We assume the higher than previously expected growth in H220 continues into FY21 and raise our revenue estimates for FY21 as well.
- Lower levels of investment in capital equipment during FY20.

Valuation: Share price above pre-pandemic levels

We include a comparative valuation of IQE versus its broader (if imperfect) peer group below. Unlike some of its peers, IQE's share price has more than recovered the ground lost during the panic selling in March. At current levels, IQE is trading in line on an EV/EBITDA basis with regards to the mean of the larger sample and at a discount to the mean of the sample of companies engaged in manufacturing VCSEL epitaxy. It is trading above the upper bound of the sample of VCSEL peers with regards to P/E multiples.

Exhibit 2: Peer valuation

Name	YTD performance (%)	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)
Epitaxy								
GCS Holdings Inc	(26.7)	162	2.4	2.3	N/A	N/A	(280.6)	(26.7)
IntelliEPI (Cayman)	(20.1)	66	2.6	2.2	18.8	13.3	125.4	30.2
LandMark Optoelectronics	(9.1)	900	10.7	8.2	21.5	15.9	46.6	30.1
Soitec	48.9	5,496	7.6	5.8	25.6	18.7	53.7	33.8
Visual Photonics Epitaxy	(22.7)	591	6.6	5.7	17.6	14.9	31.4	25.0
WIN Semiconductors	13.8	4,973	5.7	5.2	12.4	11.7	21.0	20.4
Opto-electronics								
II-VI	92.4	6,719	2.6	2.4	10.6	9.5	19.0	16.8
EMCORE	38.5	124	0.9	0.8	1,309.1	13.1	(23.0)	35.1
Lumentum Holdings	5.1	6,293	3.2	2.9	9.1	8.4	13.5	12.2
Mean – Epitaxy and Opto-electronics			4.7	3.9	16.5	13.2	44.4	25.5
IntelliEPI Inc (Cayman)	(20.1)	66	2.6	2.2	18.8	13.3	125.4	30.2
LandMark Optoelectronics	(9.1)	900	10.7	8.2	21.5	15.9	46.6	30.1
Visual Photonics Epitaxy	(22.7)	591	6.6	5.7	17.6	14.9	31.4	25.0
Mean – VCSELS			6.6	5.4	19.3	14.7	67.8	28.4
IQE	23.1	\$672m	3.0	2.8	17.1	13.5	163.7	54.4

Source: Refinitiv, Edison Investment Research. Note: Prices at 23 November 2020. Grey shading indicates exclusion from mean. IQE's EBITDA includes losses from JV.

IQE has a broader product portfolio than its VCSEL peers. In addition, it can manufacture on multiple sites, which gives it relative resilience to US-China trade disputes. For these reasons, we believe it is reasonable for IQE to trade on EV/EBITDA and P/E multiples that are at the upper end of the VCSEL sample. However, we believe that further share price improvement will require

greater visibility of how handset demand will be affected by any potential pandemic-related recession in FY21 and whether the switch to 5G and the availability of as yet unknown 'must-have' AR apps will be sufficient motivation for cash-strapped consumers to justify upgrading their handsets.

Exhibit 3: Financial summary					
	£'000s	2018	2019	2020e	2021e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS		restated			
Revenue		156,291	140,015	170,621	183,307
Adjusted Cost of Sales		(119,536)	(119,145)	(134,000)	(138,427)
Adjusted Gross Profit		36,755	20,870	36,621	44,880
EBITDA		26,404	16,246	30,281	38,209
Depreciation and Amortisation		(12,882)	(22,289)	(24,468)	(25,418)
Operating Profit (before amort. and except.)		16,040	(4,676)	6,113	13,091
Acquired Intangible Amortisation		0	0	0	0
Exceptionals		(8,424)	(14,897)	(9,346)	0
Share based payments		1,044	771	(550)	(550)
Operating Profit		8,660	(18,802)	(3,783)	12,541
Underlying interest		(66)	(1,606)	(1,600)	(800)
Exceptionals and losses from JVs		(1,847)	(4,540)	(300)	(300)
Profit Before Tax (norm)		13,974	(7,019)	4,213	11,991
Profit Before Tax (FRS 3)		6,747	(24,948)	(5,683)	11,441
Reported tax		(5,558)	(10,180)	1,826	(2,278)
Profit After Tax (norm)		11,229	(19,010)	3,413	9,713
Profit After Tax (FRS 3)		1,189	(35,128)	(3,857)	9,163
Average Number of Shares Outstanding (m)		761.8	787.2	797.2	800.1
EPS - normalised (p)		1.38	(2.46)	0.38	1.16
EPS - (IFRS) (p)		0.13	(4.51)	(0.53)	1.10
Dividend per share (p)		0.0	0.0	0.0	0.0
BALANCE SHEET					
Fixed Assets		267,476	300,047	288,579	279,161
Intangible Assets		121,775	118,456	116,648	114,240
Tangible Assets		124,520	136,557	126,897	119,887
Other		21,181	45,034	45,034	45,034
Current Assets		94,531	72,533	93,469	116,809
Stocks		35,709	30,668	33,189	40,177
Debtors		38,015	33,065	39,734	44,697
Cash		20,807	8,800	20,546	31,935
Other		0	0	0	0
Current Liabilities		(48,893)	(32,646)	(39,001)	(40,932)
Creditors		(48,893)	(27,529)	(33,884)	(35,815)
Short term borrowings*		0	(5,117)	(5,117)	(5,117)
Long Term Liabilities		(3,836)	(69,491)	(69,491)	(69,491)
Long term borrowings*		0	(67,631)	(67,631)	(67,631)
Other long term liabilities		(3,836)	(1,860)	(1,860)	(1,860)
Net Assets		309,278	270,443	273,556	285,547
CASH FLOW					
Operating Cash Flow		16,988	8,948	26,346	28,189
Net Interest		(66)	(671)	(1,600)	(800)
Tax		(665)	(151)	0	0
Capital expenditure and capitalised R&D		(42,362)	(41,834)	(13,000)	(16,000)
Acquisitions/disposals		0	10	0	0
Financing		813	712	0	0
Dividends		0	0	0	0
Net Cash Flow		(25,292)	(32,986)	11,746	11,389
Opening net debt/(cash)*		(45,612)	(20,807)	63,948	52,202
HP finance leases initiated		0	0	0	0
Other		487	(51,769)	0	0
Closing net debt/(cash)*		(20,807)	63,948	52,202	40,813
Closing net debt/(cash) excluding finance leases		0	15,970	4,224	(7,165)

Source: Company data, Edison Investment Research. Note: *Including finance leases from FY19 onwards.

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