

Filtronic

FY21 results

Cash generative in FY21 despite the pandemic

Filtronic's sales declined by 9% year-on-year during FY21 because of 5G roll-out delays and a slowdown in sales to the US public safety market during H121. This market began to recover during Q4. Nevertheless, the group was strongly cash generative during the year, putting it in a good position to invest in additional engineering resource and business development. This supports management's strategy of broadening the customer base and product range.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)
05/19	15.9	0.7	0.1	0.05	0.00	222
05/20	17.2	1.2	0.1	0.05	0.00	222
05/21	15.6	1.8	0.1	0.14	0.00	79.1
05/22e	18.0	2.0	0.7	0.34	0.00	33.0

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

H121 sales affected by COVID-19 – recovery in Q4

Group sales declined by 9% year-on-year during FY21 to £15.6m, in line with management guidance. Strong growth in defence sales partly offset a decline in sales of transceivers for 5G XHaul links and a slowdown in sales to the US public safety market during H121 as budget was diverted during the pandemic. Adjusted EBITDA increased from £1.2m in FY20 to £1.8m, also in line with management guidance. This improvement was attributable primarily to increased manufacturing efficiencies and a more favourable sales mix. Net cash (excluding IFRS 16 leases) increased from £0.4m at end FY20 to £1.9m at end FY21.

Rebound continues in FY22

We introduce FY22 estimates, which assume that the recovery noted in the critical communications markets during Q421 continues during FY22. (Maintaining the H221 run rate throughout the year would give annual revenues of £16.8m.) In addition, FY22 is likely to benefit from the £1.3m contract win from a new major UK defence customer for the supply of battlefield radio communications hardware announced in January 2021. This strong revenue growth will be accompanied by an increase in overheads as the company resumes physical meetings with potential customers and invests in additional engineering resource to support new customers and develop product for emerging communications frequencies such as W-band.

Valuation: Depends on growth trajectory post FY22

Filtronic's share price has risen by over 20% 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 sample mean with regards to both prospective EV/sales and EV/EBITDA. Our estimates show Filtronic's revenues growing more quickly than revenues for the companies in this sample during FY22. This suggests that a premium may be justified if Filtronic is able to maintain FY22 levels of revenue growth in subsequent years by continuing to broaden its customer base and product range.

Tech hardware & equipment

3 August 2021

Price 11.08p
Market cap £24m

Net cash (£m) at end May 2021 (excluding right of use property leases)	1.9
Shares in issue	214.4m
Free float	66.1%
Code	FTC
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(4.4)	22.2	22.9
Rel (local)	(4.7)	20.8	1.4
52-week high/low		12p	7p

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 events

AGM	28 October 2021
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FY21 performance

Strong defence sales partly offset weakness in communications markets

Filtronic remained fully operational throughout the coronavirus lockdowns, enabling it to keep core engineering developments on track against their respective milestone delivery plans and maintain product delivery schedules. The end-markets remained reasonably robust. While there was a slowdown in sales to the US public safety market during H121, which management believes was the result of public funds being diverted to COVID-19 support measures and the lead customer experiencing difficulties in accessing sites to install equipment, demand recovered during Q421 as COVID-19-related restrictions started to ease. Sales of transceivers for 5G XHaul links decreased year-on-year, partly because the lead customer had built up buffer stock towards the end of FY20, deployment of which was slower than it had expected, partly because the switch to Filtronic's next-generation Morpheus product was delayed because of technical challenges unrelated to the product itself. In contrast, sales to the defence and aerospace market grew by 24% year-on-year, supported by the investment in plant and machinery made during FY20, which automates processes for manufacturing electronic products containing unpackaged integrated circuits. This technique is critical for high-frequency applications. COVID-19-related travel restrictions adversely affected new business acquisition.

Group sales rose from £7.1m in H121 to £8.5m in H221. This resulted in a 9% year-on-year decline for the full year to £15.6m, which was in line with guidance given in the pre-close trading update

Improved EBITDA

Adjusted EBITDA increased from £1.2m in FY20 to £1.8m, also in line with management guidance. This improvement was attributable to increased manufacturing efficiencies, lower travel and marketing expenses and c £0.3m benefit from the UK furlough and US Paycheck Protection Program (PPP) schemes, together with a more favourable sales mix with a higher proportion of sales to the defence market where certain components are free-issued by the customer. There was a modest (£0.2m) increase in salary costs as the recruitment of additional engineering resource and reinstatement of a marketing function was offset by a reduction in the size of the manufacturing team following the investment in automation. EBITDA of £1.2m was generated in H221. Adjusted profit before tax was the same as FY20 at £0.1m, reflecting higher levels of depreciation following the prior year investments in plant and machinery and higher levels of amortisation following the launch of the new tower top amplifier and Morpheus transceiver products.

Strong balance sheet supports future investment

Net cash (net of all lease obligations except right of use property leases) increased from £0.4m at end FY20 to £1.9m at end FY21. Cash generated from operations was £2.5m. Inventory levels reduced by £0.8m during the year as the company started to ship Morpheus transceivers and worked through stock of items with long lead times and inventory that it had built up ahead of Brexit. The reduction in inventory resulted in a £1.1m drop in trade and other payables as the company worked through stock that had previously been paid for. Trade and other receivables fell by £1.6m because of the large number of E-band transceivers for Xhaul that had been shipped in Q420. Investment in capital equipment was minimal (£0.2m) because the investment in the Sedgefield site completed in FY20. Capitalised development costs were substantially lower year-on-year (£0.1m versus £0.7m in FY20) because much of the development work during the year was paid for by customers. The strong balance sheet gives Filtronic a good base from which to continue investing

in additional engineering resource and business development during FY22, as well as securing component inventory to mitigate the impact of supply chain issues.

Introducing FY22 estimates

Management has not provided any formal guidance for FY22, other than noting the renewed commitment to 5G network roll-out, an anticipated recovery in investment in critical communications infrastructure and the current disruption to semiconductor supply chains. This disruption may directly affect Filtronic. In addition, since Filtronic's products are used in customer projects deploying sub-systems from multiple vendors, if any of these suppliers is directly affected by component shortages, this may have an indirect impact on Filtronic because its customers may experience delays in completing projects. Given the uncertain economic environment, we continue to provide only one year of forecasts and present FY22 estimates for the first time. These make the following assumptions:

- **Revenues:** we assume that the recovery noted in the critical communications markets during Q421 continues during FY22. We note that maintaining the H221 run rate throughout the year would give revenues of £16.8m. In addition, FY22 is likely to benefit from the contract win from a new major UK defence customer for the supply of battlefield radio communications hardware announced in January 2021. Final product delivery under the contract is scheduled to commence in calendar H221, so a high proportion of the revenues from this contract, which is valued at £1.3m, are likely to be recognised during FY22.
- **Cost of materials/sales:** we model this at FY21 levels, ie 45%, although the higher proportion of work for the defence sector may push cost of materials/sales lower.
- **Other costs:** we 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.
- **Working capital:** we model a £0.5m increase in inventory as the company rebuilds levels of long lead time items to address supply issues.
- **Investment activity:** we model £0.5m investment in equipment to support the development of W-band product for future 5G networks as E-band capacity becomes full. We also model £0.5m of capitalised R&D costs to reflect this development work.

Valuation

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 product 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.

Filtronic's share price has risen by over 20% 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 both prospective EV/sales and EV/EBITDA and at a significant premium to the mean with regards to P/E. 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. While we only have one year of estimates for Filtronic, the analysis suggests that if Filtronic is able to maintain the level of revenue growth we expect it to achieve in FY22 (15.5%) in subsequent years, this would merit an uplift in share price multiples. Such accelerated growth, if achieved would, we believe, be attributable to continued success in broadening the customer base and product range, as discussed in our June [initiation note](#). We note that the proposed growth in FY22 is against an unusually weak FY21.

Exhibit 1: Peer multiples

Name		Market cap (£m)	EV/sales 1FY (x)	EV/EBITDA 1FY (x)	P/E 1FY (x)	CAGR %
Aviat Networks	Microwave networking products including E-band radios	281	1.3	11.0	15.4	7.5%/3 years
Baylin Technologies	Microwave communications products up to Ka-band (26.5–40GHz)	34	0.9	49.1	N/A	7.4%/2 years
CommScope Holding Company	Microwave communications products including point-to-point antennae up to 11.7GHz and tower-mounted amplifiers	2,985	1.7	10.9	10.5	1.7%/3 years
Comtech Telecommunications	Microwave communications products including Ku-band (12–18 GHz) power amplifiers and block-up-converters	463	1.4	11.0	N/A	0.5%/3 years
Mean of RF specialists			1.3	11.0	13.0	
CML Microsystems	Developer of mixed-signal, RF and microwave semiconductors for global communication markets	77.1	3.2	14.7	53.4	16.8%/2 years
Kromek Group	Supplier of detection technology for medical, security screening and nuclear markets based on CZT (cadmium zinc telluride) material	79.6	5.2	N/A	N/A	44.9%/1 year
Mynaric	Developer of free space laser communications systems for deployment on space and airborne platforms	259.2	26.2	N/A	N/A	577%/3 years
Sivers Semiconductors	Developer of RF chips and antennae for 5G systems and semiconductor-based products for optical networking, optical sensors and optical wireless communication (Li-Fi)	335.0	30.6	N/A	N/A	114%/3 years
Trackwise Designs	Developer of novel technology based on flexible printed circuits for reducing weight of wiring harnesses	52.2	4.9	51.5	N/A	90.8%/2 years
Mean of companies with highly differentiated technology			16.3	33.1	53.4	
Filtronic		24	1.3	11.4	33.0	15.5%/1 year

Source: Refinitiv, Edison Investment Research. Note: Prices as at 29 July 2021.

Exhibit 2: Financial summary

Year end 31 May	£m	2019	2020	2021	2022e
INCOME STATEMENT					
Revenue		15.9	17.2	15.6	18.0
EBITDA		0.7	1.2	1.8	2.0
Normalised operating profit		0.2	0.4	0.6	0.8
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0
Exceptionals		0.0	(0.6)	0.1	0.0
Reported operating profit		0.2	(0.2)	0.6	0.8
Net Interest		(0.1)	(0.2)	(0.4)	(0.2)
Exceptionals		0.0	0.0	0.0	0.0
Profit Before Tax (norm)		0.1	0.1	0.1	0.7
Profit Before Tax (reported)		0.1	(0.4)	0.2	0.7
Reported tax		2.1	(0.1)	(0.2)	0.2
Profit After Tax (norm)		0.1	0.1	0.3	0.7
Profit After Tax (reported)		2.2	(0.5)	0.1	0.8
Discontinued operations		(3.5)	(1.4)	0.0	0.0
Net income (normalised)		0.1	0.1	0.3	0.7
Net income (reported)		(1.3)	(2.0)	0.1	0.8
Average Number of Shares Outstanding (m)		208	211	213	214
EPS - normalised (p)		0.05	0.05	0.14	0.34
EPS - diluted normalised (p)		0.05	0.05	0.14	0.33
EPS - basic reported (p)		1.08	(0.25)	0.03	0.40
Dividend (p)		0.00	0.00	0.00	0.00
Revenue growth (%)		N/A	7.8%	-9.5%	15.5%
EBITDA Margin (%)		4.2	6.8	11.4	11.2
Normalised Operating Margin		1.5	2.2	3.7	4.6
BALANCE SHEET					
Fixed Assets		4.3	7.5	6.2	6.0
Intangible Assets		1.2	1.8	1.7	1.9
Tangible Assets		1.0	3.8	3.3	2.8
Investments & other		2.0	1.9	1.2	1.2
Current Assets		14.0	9.8	8.4	9.1
Stocks		2.1	2.9	2.2	2.7
Debtors		4.2	4.8	3.3	3.4
Cash & cash equivalents		2.6	2.0	2.9	3.0
Other		5.0	0.0	0.0	0.0
Current Liabilities		(7.1)	(6.0)	(3.6)	(3.2)
Creditors		(2.3)	(3.5)	(2.4)	(2.0)
Short term borrowings including lease liabilities		(0.1)	(0.7)	(0.6)	(0.6)
Other		(4.7)	(1.8)	(0.6)	(0.6)
Long Term Liabilities		(0.1)	(2.0)	(1.7)	(1.7)
Long term borrowings		(0.0)	(2.0)	(1.6)	(1.6)
Other long-term liabilities		(0.1)	0.0	(0.1)	(0.1)
Net Assets		11.0	9.4	9.4	10.2
Minority interests		0.0	0.0	0.0	0.0
Shareholders' equity		11.0	9.4	9.4	10.2
CASH FLOW					
Op Cash Flow before WC and tax		0.7	1.2	1.8	2.0
Working capital		2.2	(2.4)	1.1	(1.0)
Exceptional & other		(2.7)	(2.7)	(1.0)	0.0
Tax		(0.1)	1.2	0.5	0.2
Net operating cash flow		(0.0)	(2.6)	2.5	1.2
Capex (including capitalised R&D)		(1.0)	(1.2)	(0.4)	(1.0)
Acquisitions/disposals		0.0	3.7	0.0	0.0
Net interest		(0.1)	(0.3)	(0.2)	(0.2)
Equity financing		0.1	0.3	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		(1.0)	(0.2)	1.9	0.1
Opening net debt/(cash)		(3.6)	(2.5)	0.7	(0.8)
FX		0.0	0.0	0.0	0.0
Other non-cash movements		0.0	(3.0)	(0.4)	(0.0)
Closing net debt/(cash) including lease liabilities		(2.5)	0.7	(0.8)	(0.8)
Property lease liabilities			1.1	1.2	1.2
Closing net debt/(cash) excluding lease liabilities		(2.5)	(0.4)	(1.9)	(2.0)

Source: Company accounts, Edison Investment Research

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