

IQE

Optimising its MBE footprint

Singapore site closure

Tech hardware & equipment

1 October 2021

Price 47.55p
Market cap £381m

Net cash (£m) at end June 2021 (excluding £52.6m lease liabilities) 0.9

Shares in issue 802.2m

Free float 88.1%

Code IQE

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (9.5) (0.4) (7.0)

Rel (local) (8.3) (1.5) (24.8)

52-week high/low 88.3p 43.3p

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 surface emitting lasers and infrared semiconductors.

Next event

FY21 results March 2022

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IQE has announced that it will be closing its Singapore site by mid-2022 and transferring activity to its sites in North Carolina and Taiwan. The move will generate estimated annualised cash cost savings of c £4.8m so we have revised our FY22 estimates, raising adjusted EPS by 8%. Importantly it helps create an optimised platform for pursuing volume opportunities for MBE epitaxy used for long-wavelength VCSELs and healthcare applications.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)
12/19	140.0	16.2	(7.0)	(2.46)	0.00	N/A
12/20	178.0	29.9	3.2	0.29	0.00	164.0
12/21e	169.5	27.4	0.1	(0.04)	0.00	N/A
12/22e	182.4	39.5	7.3	0.68	0.00	69.9

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

Creating an MBE centre of excellence

IQE's Singapore operation manufactures epiwafers for photo detectors and radio frequency applications using molecular beam epitaxy (MBE) systems but is relatively underutilised. Following the site closure, most of its MBE reactors will be moved to IQE's North Carolina site, and the remainder to its facility in Taiwan. By 2024 all of the MBE reactors at IQE's Pennsylvania site will be moved to the North Carolina facility as well, creating an operation with the scale to take advantage of the opportunities for using MBE to make long-wavelength vertical cavity surface emitting lasers (VCSELs) that can be used below OLED screens in mobile devices, thus dispensing with the 'notch', and in eye-safe vehicle LiDAR as well as sensors for healthcare applications (see our [thematic piece on laser diodes](#) for details.)

Annualised cash cost-savings of c £4.8m

Management estimates that revenues will drop by £3m during FY22 because of the transition but the closure will save annualised cash costs of around £4.8m. Part of these costs are rent payments. Since the value of the lease had already been impaired under IFRS 16 rules, none of these rent payments currently go through the P&L. Combining this effect with the loss of revenues means that the annualised profit increase will be c £1m. Management expects that the cash costs associated with the closure will be c £2.5m, which we treat as an exceptional item.

Valuation: Recovery dependent on 5G roll-out

IQE's share price has fallen by over 30% since the FY20 results 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, giving potential for share price improvement. We believe that investors will welcome the profitability enhancement arising from the Singapore site closure. However, in our view share price recovery will require greater visibility of the timing of 5G infrastructure roll-out and of how well the recently launched iPhone 13 models with world-facing time of flight (ToF) functionality sell.

Changes to estimates

We adjust our FY22 estimates in line with the announcement, reducing both revenues and operating costs. The cost savings are applied for half a year as these commence after the site is closed. The impact of these changes is summarised below.

Exhibit 1: Revisions to estimates							
	FY20	FY21e			FY22e		
	Actual	Old	New	% change	Old	New	% change
Revenue (£m)	178.0	169.5	169.5	0.0%	185.4	182.4	-1.6%
Adjusted PBT (£m)	3.2	0.1	0.1	0.0%	6.8	7.3	7.4%
Adjusted EPS (p)	0.3	(0.0)	(0.0)	0.0%	0.6	0.7	7.9%
Capitalised R&D (£m)	5.4	8.0	8.0	0.0%	6.0	6.0	0.0%
Property, plant and equipment (£m)	5.0	25.0	25.0	0.0%	10.0	10.0	0.0%
Net (cash)/debt excluding finance leases at year end (£m)	(1.9)	11.5	11.5	0.0%	(3.9)	(3.7)	-3.7%

Source: IQE accounts, Edison Investment Research

Valuation: Share price recovery dependent on the pace of 5G infrastructure deployment

We include a comparative valuation of IQE versus its broader (but imperfect) peer group below. At current levels, IQE is trading at a discount to the average of the larger sample for year one and year two EV/sales and year two EV/EBITDA and at a discount to the average of the sample of companies engaged in manufacturing VCSEL epitaxy for EV/sales and EV/EBITDA in both year one and year two. The shares are trading above the upper bound of both samples with regards to P/E multiples. 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 share price recovery will require greater visibility of the timing of 5G infrastructure roll-out, which will determine when GaN-on-SiC epitaxy sales start to pick up. It will also depend on sales of iPhone 13 phones with world-facing ToF functionality and when Android phones start adopting the technology, as these factors could potentially boost demand for VCSEL epitaxy.

Exhibit 2: Peer valuation							
Name	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							
LandMark Optoelectronics	738	8.1	6.4	15.2	11.9	32.0	23.2
Soitec	7,241	7.6	6.1	24.3	19.0	46.2	35.9
Visual Photonics Epitaxy Co	783	5.8	5.0	14.8	13.1	23.8	19.9
WIN Semiconductors	4,718	5.4	4.6	12.9	10.4	25.0	18.8
Opto-electronics							
II-VI	6,293	2.2	1.9	8.4	7.5	16.1	13.3
EMCORE	277	1.3	1.2	7.2	6.0	10.9	9.6
Lumentum Holdings	6,105	3.1	2.8	9.1	8.5	14.4	12.6
Mean – Epitaxy and Opto-electronics		4.8	4.0	13.1	10.9	24.1	19.0
LandMark Optoelectronics	738	8.1	6.4	15.2	11.9	32.0	23.2
Visual Photonics Epitaxy Co	783	5.8	5.0	14.8	13.1	23.8	19.9
Mean – VCSELS		7.0	5.7	15.0	12.5	27.9	21.5
IQE	\$515m	2.2	2.1	13.9	9.6	N/A	69.9

Source: Refinitiv, Edison Investment Research. Note: Prices at 30 September 2021.

Exhibit 3: Financial summary

	£'000s	2019	2020	2021e	2022e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		140,015	178,016	169,475	182,444
Adjusted Cost of Sales		(119,145)	(144,689)	(140,444)	(146,727)
Adjusted Gross Profit		20,870	33,327	29,031	35,717
EBITDA		16,246	29,919	27,374	39,455
Depreciation and Amortisation		(22,289)	(24,533)	(25,500)	(30,000)
Operating Profit (before amort. and except.)		(4,676)	5,386	1,874	9,455
Acquired Intangible Amortisation		0	0	0	0
Exceptionals		(14,897)	(10,638)	0	(2,500)
Share based payments		771	(265)	(1,500)	(1,500)
Operating Profit		(18,802)	(5,517)	374	5,455
Underlying interest		(1,606)	(2,165)	(1,800)	(2,200)
Exceptionals and losses from JVs		(4,540)	3,788	0	0
Profit Before Tax (norm)		(7,019)	3,221	74	7,255
Profit Before Tax (FRS 3)		(24,948)	(3,894)	(1,426)	3,255
Reported tax		(10,180)	1,001	(14)	(1,378)
Profit After Tax (norm)		(19,010)	2,702	60	5,876
Profit After Tax (FRS 3)		(35,128)	(2,893)	(1,440)	1,876
Average Number of Shares Outstanding (m)		787.2	797.2	801.6	802.2
EPS - normalised (p)		(2.46)	0.29	(0.04)	0.68
EPS - (IFRS) (p)		(4.51)	(0.41)	(0.22)	0.19
Dividend per share (p)		0.0	0.0	0.0	0.0
BALANCE SHEET					
Fixed Assets		300,047	277,161	284,661	270,661
Intangible Assets		118,456	105,772	106,272	104,772
Tangible Assets		136,557	126,229	133,229	120,729
Other		45,034	45,160	45,160	45,160
Current Assets		72,533	94,125	78,995	101,437
Stocks		30,668	30,887	30,645	34,989
Debtors		33,065	38,575	37,145	39,988
Cash		8,800	24,663	11,205	26,460
Other		0	0	0	0
Current Liabilities		(32,646)	(48,545)	(44,016)	(46,503)
Creditors		(27,529)	(37,546)	(33,017)	(35,504)
Short term borrowings (including lease liabilities)		(5,117)	(10,999)	(10,999)	(10,999)
Long Term Liabilities		(69,491)	(62,306)	(57,306)	(57,306)
Long term borrowings (including lease liabilities)		(67,631)	(58,765)	(53,765)	(53,765)
Other long term liabilities		(1,860)	(3,541)	(3,541)	(3,541)
Net Assets		270,443	260,435	262,334	268,288
CASH FLOW					
Operating Cash Flow		8,948	35,457	26,342	33,455
Net Interest		(671)	(1,142)	(1,800)	(2,200)
Tax		(151)	(993)	0	0
Capital expenditure and capitalised R&D		(41,834)	(10,402)	(33,000)	(16,000)
Acquisitions/disposals		10	(1,363)	0	0
Financing		712	240	0	0
Dividends		0	0	0	0
Net Cash Flow		(32,986)	21,797	(8,458)	15,255
Opening net debt/(cash) including lease liabilities		(20,807)	63,948	45,101	53,559
HP finance leases initiated		0	0	0	0
Other		(51,769)	(2,950)	0	0
Closing net debt/(cash) including lease liabilities		63,948	45,101	53,559	38,304
Closing net debt/(cash) excluding finance leases		15,970	(1,923)	11,535	(3,720)

Source: Company accounts, Edison Investment Research

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