

Filtronic

Improved H2 lifts earnings and year-end net cash

Filtronic's post-close trading update notes that management expects improved trading during H221 to result in FY21 revenues of c £15.6m, in line with our estimate. It expects a favourable sales mix at higher margins to generate c £1.8m EBITDA, which is slightly ahead of our previous estimate.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)
05/18	21.6	3.6	3.1	1.52	0.00	7.7
05/19	15.9	0.7	0.1	0.05	0.00	N/A
05/20	17.2	1.2	0.1	0.05	0.00	N/A
05/21e	15.6	1.8	0.2	0.07	0.00	N/A

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

Easing of lockdown helps US public safety sales

Filtronic remained fully operational throughout the coronavirus lockdowns and its end-markets remained reasonably robust. Importantly, demand for critical communications products to the public safety market in the US recovered during Q421 as COVID-19-related delays to new installations and system upgrades started to ease. Management expects the resultant improvement in trading during H2 after a softer H1 to deliver FY21 revenues of c £15.6m (FY20: £17.2m). This is in line with our previous £16.0m estimate. Moreover, management expects that a favourable sales mix at higher margins will deliver EBITDA of £1.8m (FY20: £1.2m), which is slightly ahead of our previous £1.6m estimate. Cash at end FY21 was £2.9m (end H121: £1.6m). Net cash (net of all lease obligations except right of use property leases) at end FY21 was £1.9m (end H121: £0.4m). This strong balance sheet gives Filtronic a good base to continue investing in additional engineering resource during FY22, as well as securing component inventory to mitigate the impact of supply chain issues.

Demand in all three sectors favourable going forward

While we will not be introducing FY22 estimates until the FY21 results are announced in August, we note that demand for Filtronic's products appears robust in each of the three sectors served: public safety communications, aerospace and defence and mobile communications backhaul links. However, 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.

Valuation: Leveraged model supports share price

Comparing Filtronic's multiples with those of its RF specialist peers, we note that it is trading at a premium to the mean of the sample on all metrics. This premium can be justified given Filtronic's surplus manufacturing capacity, which means that indirect costs would not increase as quickly as revenues if there were to be significant sales growth. This could potentially lead to EBITDA margins that are higher than the mean for the sample, justifying a share price premium.

Post-close trading update

Tech hardware & equipment

17 June 2021

Price 11.75p
Market cap £25m

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	30.6	34.3	51.6
Rel (local)	28.1	27.4	28.1
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 event

FY21 results	3 August 2021
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Changes to estimates

We have adjusted our FY21 estimates to reflect management's expectations as well as higher levels of capitalised R&D.

Exhibit 1: Revisions to FY21 estimates

£m	FY20		FY21e		Change
	Actual	Old	New		
Revenues	17.2	16.0	15.6		-2.5%
EBITDA	1.2	1.6	1.8		9.6%
EBITDA margin	6.8%	10.3%	11.6%		12.4%
Normalised PBT	0.1	0.3	0.2		-37.0%
Normalised basic EPS	0.05	0.12	0.07		-37.0%
Dividend per share	0.00	0.00	0.00		0.0%
Net debt/(cash) excluding lease liabilities	(1.8)	(1.4)	(1.9)		34.4%

Source: Edison Investment Research

Valuation

Exhibit 2: Peer multiples

	Market cap (£m)	EV/Sales 1FY (x)	EV/EBITDA 1FY (x)	P/E 1FY (x)	EBITDA margin 1FY (%)
Aviat Networks	312	1.5	12.4	16.8	11.7
Baylin Technologies	32	0.8	46.5	(4.5)	1.8
CommScope Holding Company	3,177	1.7	11.0	11.1	15.3
Comtech Telecommunications Corp	407	1.2	10.0	(7.5)	12.3
Mean		1.3	11.1	14.0	13.1
Filtronic	25	1.7	14.4	167.9	11.6

Source: Refinitiv, Edison Investment Research. Note: Prices as at 14 June 2021.

Filtronic's share price has increased by more than 30% since we initiated coverage on the stock in early June. Comparing Filtronic's multiples with those of its RF specialist peers, we note that it is trading at a premium to the mean of the sample on all metrics. As discussed in our [initiation note](#), this premium can be justified given Filtronic's surplus manufacturing capacity. While we do not have any estimates yet for FY22, this surplus manufacturing capacity means that indirect costs would not increase as quickly as revenues if there were to be significant sales growth during the year.

Moreover, the establishment of a network of sales agents in the US, mainland Europe and South Korea should help keep the increase of indirect costs relatively low as sales in these regions increase. Provided that indirect costs are kept under control, revenue growth of 10% or more would result in an improvement in EBITDA margin (see Exhibit 3). Depending on the scale of EBITDA margin improvement, Filtronic justifies trading on EV/Sales and EV/EBITDA multiples that are at a premium to the mean for our sample.

Exhibit 3: FY22 EBITDA margin (%) as a function of revenue and cost development

	Year-on-year revenue growth				
	3.0%	5.0%	10.0%	15.0%	20.0%
Incremental indirect costs as a % of additional sales	11.2%	11.2%	13.7%	15.9%	17.9%
	5.0%	9.3%	11.8%	14.1%	16.2%
	7.0%	7.4%	10.0%	12.4%	14.6%

Source: Edison Investment Research

Exhibit 4: Financial summary

31-May	£m	2018	2019	2020	2021e
INCOME STATEMENT					
		Restated			
Revenue		21.6	15.9	17.2	15.6
EBITDA		3.6	0.7	1.2	1.8
Normalised operating profit		3.2	0.2	0.4	0.6
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0
Exceptionals		0.0	0.0	(0.6)	0.0
Reported operating profit		3.2	0.2	(0.2)	0.6
Net Interest		(0.1)	(0.1)	(0.2)	(0.4)
Exceptionals		(0.5)	0.0	0.0	0.0
Profit Before Tax (norm)		3.1	0.1	0.1	0.2
Profit Before Tax (reported)		2.7	0.1	(0.4)	0.2
Reported tax		0.1	2.1	(0.1)	0.0
Profit After Tax (norm)		3.1	0.1	0.1	0.2
Profit After Tax (reported)		2.7	2.2	(0.5)	0.2
Discontinued operations		(1.5)	(3.5)	(1.4)	0.0
Net income (normalised)		3.1	0.1	0.1	0.2
Net income (reported)		1.2	(1.3)	(2.0)	0.2
Average Number of Shares Outstanding (m)		207	208	211	214
EPS - normalised (p)		1.52	0.05	0.05	0.07
EPS - diluted normalised (p)		1.49	0.05	0.05	0.07
EPS - basic reported (p)		1.31	1.08	(0.25)	0.07
Dividend (p)		0.00	0.00	0.00	0.00
Revenue growth (%)		N/A	-26.3%	7.8%	-9.2%
EBITDA Margin (%)		16.8	4.2	6.8	11.6
Normalised Operating Margin		14.8	1.5	2.2	3.9
BALANCE SHEET					
Fixed Assets		6.3	4.3	7.5	6.5
Intangible Assets		3.9	1.2	1.8	1.6
Tangible Assets		1.4	1.0	3.8	3.0
Investments & other		1.0	2.0	1.9	1.9
Current Assets		12.3	14.0	9.8	8.9
Stocks		2.1	2.1	2.9	2.4
Debtors		6.4	4.2	4.8	3.7
Cash & cash equivalents		3.8	2.6	2.0	2.9
Other		0.0	5.0	0.0	0.0
Current Liabilities		(6.1)	(7.1)	(6.0)	(3.8)
Creditors		(5.1)	(2.3)	(3.5)	(1.3)
Short term borrowings		(0.1)	(0.1)	(0.7)*	(0.7)*
Other		(1.0)	(4.7)	(1.8)	(1.8)
Long Term Liabilities		(0.3)	(0.1)	(2.0)	(2.2)
Long term borrowings		(0.1)	(0.0)	(2.0)*	(2.2)*
Other long-term liabilities		(0.2)	(0.1)	0.0	0.0
Net Assets		12.2	11.0	9.4	9.5
Minority interests		0.0	0.0	0.0	0.0
Shareholders' equity		12.2	11.0	9.4	9.5
CASH FLOW					
Op Cash Flow before WC and tax		3.6	0.7	1.2	1.8
Working capital		(0.7)	2.2	(2.4)	(0.5)
Exceptional & other		(1.2)	(2.7)	(2.7)	0.0
Tax		0.1	(0.1)	1.2	0.0
Net operating cash flow		1.8	(0.0)	(2.6)	1.3
Capex		(1.0)	(1.0)	(1.2)	(0.3)
Acquisitions/disposals		0.0	0.0	3.7	0.0
Net interest		(0.1)	(0.1)	(0.3)	(0.4)
Equity financing		0.0	0.1	0.3	0.0
Dividends		0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0
Net Cash Flow		0.7	(1.0)	(0.2)	0.6
Opening net debt/(cash)		(2.6)	(3.6)	(2.5)	0.7
FX		0.0	0.0	0.0	0.0
Other non-cash movements		0.3	0.0	(3.0)	0.0
Closing net debt/(cash) including lease liabilities		(3.6)	(2.5)	0.7	0.0
Lease liabilities				2.5	1.9
Closing net debt/(cash) excluding lease liabilities		(3.6)	(2.5)	(1.8)	(1.9)

Source: Company data, Edison Investment Research. Note: *Including lease liabilities.

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