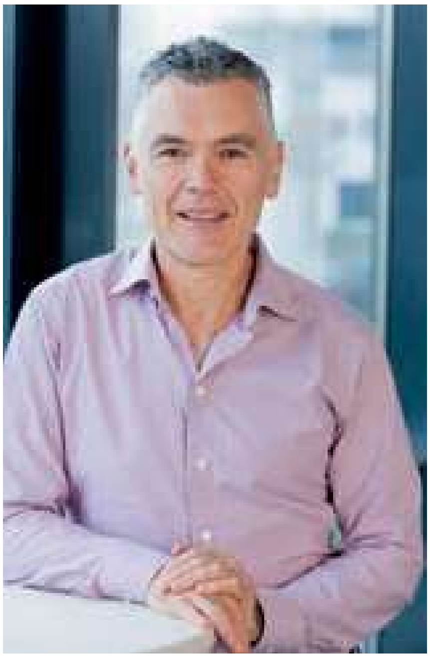
PERFORMANCE: OPERATIONAL REVIEW



DUNCAN PENNY
Chief Executive Officer

REVIEW OF OUR YEAR

The 2019 financial year presented several challenges to our business. A combination of cyclical weakness in the Semiconductor Equipment Manufacturing sector, which had begun in 2018, the trade dispute between China and the USA, the knock-on impact of the component price inflation we experienced in 2018, fluctuating Sterling to US Dollar exchange rates and some destocking in our distribution channels, combined to produce tougher business conditions.

Against this backdrop we continued to make good progress with the execution of our strategy, putting the business on a stronger footing to grow in the future by continuing to improve our product life cycle management procedures and upgrading our processes and systems in our sales organisations in Asia, Europe and North America.

We exited 2019 having delivered an ERP implementation, with Section 301 tariffs now being recovered from customers and a strong order book as the Semiconductor Equipment Manufacturing sector showed signs of recovery in the fourth quarter. We are making significant progress, in line with our vision of being the first-choice power solutions provider, delivering the ultimate experience to our customers and our people.

Our design wins were strong in 2019, boding well for future market share and revenue growth. We continued to move our product portfolio to higher power and technically more complex applications, and to expand the number of design wins with higher engineering solutions content.

We are one of the few companies that can offer its customers a full range of solutions across the voltage and power spectrum and provide the engineering services to package these together to provide a complete power solution, including communication with the customers' application through firmware. This is a powerful proposition which makes us an ideal partner for many of our target customers and greatly expands our addressable market.

MARKETPLACE

Demand and order intake in the Industrial Electronics, Healthcare and Technology sectors was robust throughout the year. In the Semiconductor Equipment Manufacturing sector, the cyclical weakness which had started in the second half of 2018 gathered pace in the first part of 2019, before starting to recover in the final quarter of the year.

Group order intake was up 8% on a reported basis to £214.9 million (2018: £198.4 million). In constant currency order intake increased by 4% and on a like-for-like basis, excluding Glassman, which was acquired at the end of May 2018, order intake growth was 2%. The resulting book-to-bill ratio was 1.08.

Overall revenues grew by 2% to £199.9 million (2018: £195.1 million) on a reported basis. Revenues were reduced by approximately £5 million due to the short-term issue with the implementation of a new ERP system in the fourth quarter of 2019, as discussed later in this review. In constant currency revenues reduced by 2% and by 4% on a like-for-like basis, excluding the acquisition of Glassman completed in May 2018.

The average exchange rate for US Dollar to Sterling was 1.28 in 2019 versus 1.34 in 2018, representing a 4% weakening. We discuss the impact of foreign exchange volatility in more detail in our Financial Review.

MARKETPLACE: SECTOR DYNAMICS

Revenues from Industrial Electronics customers grew by 7% to £89.2 million (2018: £83.7 million) representing 45% (2018: 43%) of overall revenues. Although Industrial Electronics is our largest sector, it is very diversified with few of these customers making it into our top 30 customer list. Applications in this sector vary significantly and are principally driven by new and emerging electronic technologies and high growth niches rather than traditional areas like industrial machinery, automotive or mining. Typical drivers for our revenues in this sector include renewable energy, analytical instruments, test and measurement equipment, displays, 3D printing, smart grid and industrial printing. Our Distribution business, which represents 11% of our overall business and is exposed to a very diverse range of end markets, is also included within the Industrial Electronics sector.

The Semiconductor Equipment Manufacturing sector remains an important area for XP Power. Revenue from these customers reduced by 21% to £37.4 million (2018: £47.4 million) as a cyclical decline took hold in the latter part of 2018, before reaching a low point in the first half of 2019. We began to see signs of a recovery in this sector in our order intake in the fourth quarter of 2019. Revenue from Semiconductor Equipment Manufacturing sector customers represented 19% of overall revenue (2018: 24%). Our expansion into high-voltage and high-power products, combined with our engineering services offering, has made us an attractive supplier to this market. The new higher power and higher voltage products we now have allow us to service considerably more of the opportunities we see in this sector, significantly expanding our addressable market.

Despite the sector's cyclicality this market remains highly attractive due to its robust fundamentals, which are being driven by the proliferation of applications involving the internet of things (IoT), artificial intelligence (AI), autonomous vehicles, big data and the roll out of 5G technology. The latest generations of semiconductor logic and memory devices are becoming more capital intensive to manufacture as they become multilayer, and as dimensions continue to shrink. This plays to XP Power's strengths as one of few companies in the world that can offer the whole spectrum of power and voltage required for Semiconductor Equipment Manufacturing, making us a compelling partner to the manufacturers of these state-of-the-art tools.

Revenue from Healthcare customers grew by 5% to £45.9 million (2018: £43.6 million) representing 23% of overall revenues (2018: 22%). Healthcare remains another attractive market for XP Power given the breadth of our medical product range and high level of customer service. Healthcare customers are demanding in terms of quality and reliability, making our value proposition very attractive to them. We provide mission critical power solutions for numerous applications in the healthcare arena, from patient contact applications such as robotic surgery, to diagnostic equipment such as MRI and ultrasound, through to ventilators and laboratory equipment. We also understand the many special requirements and regulatory approvals that a medical power solution has to meet. Healthcare tends to be much less cyclical than the other sectors we address which adds resilience to our diversified business model.

Revenue from Technology customers grew 34% to £27.4 million (2018: £20.4 million) representing 13% of overall revenues (2018: 11%). The strong growth achieved in 2019 was partly due to a large programme for test equipment in Asia which had been dormant for several years. Other typical applications in technology include areas such as broadcast, high-end communications such as satellite and telecom base stations, and high-end computing. These programmes are often quite large but generally have much shorter lifetimes than the seven to eight years which are typical in the other market sectors we serve.

MARKETPLACE: NORTH AMERICA

North America revenue was US$147.5 million in 2019 (2018: US$159.5 million), a decrease of 8%. The decrease was 12% after excluding US$14.8 million of revenue from the Glassman business (2018: US$8.8 million) which was acquired at the end of May 2018. North America represented 58% of overall revenue (2018: 61%).

North America was adversely affected by the cyclical decline in the Semiconductor Equipment Manufacturing sector which began in 2018 and persisted throughout the majority of 2019, as discussed above.

EUROPE REPRESENTED
32%
OF OVERALL REVENUES
(2018: 31%)

ASIA REPRESENTED
10%
% OF OVERALL REVENUES (2018: 8%).

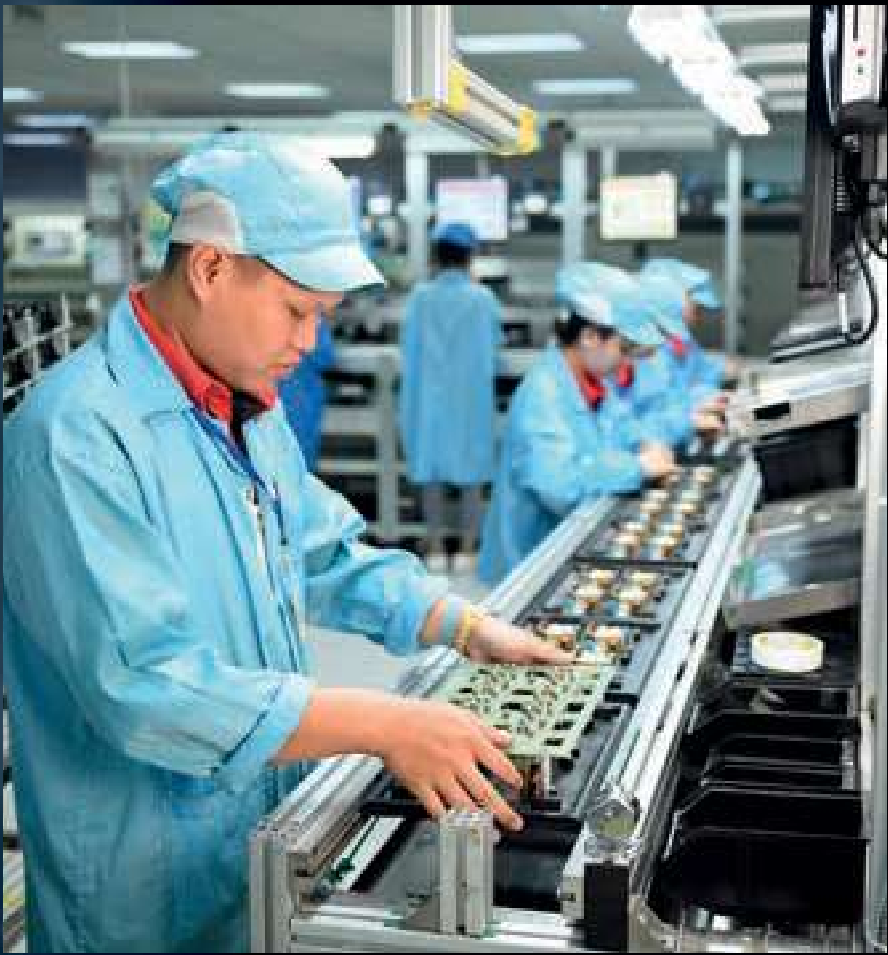
PERFORMANCE: OPERATIONAL REVIEW CONTINUED

We started to see signs of a recovery in the Semiconductor Equipment Manufacturing sector in the order intake in the last quarter of 2019, which appears to be predominately driven by increased demand for next generation technology tools and reduction in excess customer inventory. Notwithstanding the disappointing performance in the Semiconductor Equipment Manufacturing sector, the Industrial Electronics, Healthcare and Technology sectors all grew year on year.

Order intake in North America was US$161.7 million (2018: US$158.1 million), an increase of 2% resulting in a book-to-bill ratio of 1.10. After excluding the order intake from the Glassman acquisition of US$14.0 million (2018: US$9.4 million), orders reduced by 1%.

The Section 301 tariffs imposed by the US government on Chinese sourced products had an adverse impact on XP Power. From September 2018 a 10% tariff was imposed on power converters imported from China, where the Group has a manufacturing facility. In May 2019 the tariff was increased to 25%. The introduction of these tariffs necessitated the implementation of a process to recover this from customers to avoid a severe impact on our margins in North America. We recovered more than 90% of the Section 301 tariffs from customers in 2019. Whilst this shortfall is almost neutral to our reported absolute gross margin, it does reduce our reported gross margin percentage by approximately 60 basis points.

Our manufacturing facility in Vietnam presented an opportunity for the Group to shift production away from China to a location where the new tariffs did not apply. We had already started shifting production of our lower power products from China to Vietnam and the introduction of the Section 301 tariffs has caused us to accelerate this process. We are now able to produce over 2,000 different products in our Vietnam facility and the majority of these have been transferred from our China facility. Many customers have now qualified our Vietnam facility so they can begin to take product from Vietnam rather than China. We believe that our established production capabilities in Vietnam give us a significant advantage against competitors who primarily have a China only manufacturing footprint.



MARKETPLACE: EUROPE

Our European business grew revenue by 5% to £64.4 million (2018: £61.1 million) despite weakness in continental Europe. Growth was driven by Industrial Electronics and Healthcare, with Technology revenue being in line year on year. The European Industrial Electronics business remains highly fragmented, and comprises of many customers and numerous applications, but growth is being driven by areas such as analytical instruments, renewable energy, industrial printing and other niches rather than traditional industrial manufacturing equipment. Semiconductor Equipment Manufacturing was the only sector to decline but this makes up less than 1% of our European business. Europe represented 32% of overall revenues (2018: 31%).

Order intake in Europe was £65.0 million (2018: £64.6 million), an increase of 0.6%, resulting in a book-to-bill ratio of 1.01.

MARKETPLACE: ASIA

Asia revenues were US$25.6 million in 2019 (2018: US$19.9 million), an increase of 29%, with the strongest growth in Technology which benefited from a large customer programme for burn-in test equipment that was reinvigorated. Our Asia business is also benefitting from the RF and high-voltage high-power products brought into the product portfolio as a result of the Comdel and Glassman acquisitions. Prior to acquisition, these companies had minimal sales representation in Asia which presents a significant future opportunity for the Group. Asia represented 10% of overall revenues (2018: 8%).

Order intake in Asia was US$28.2 million (2018: US$21.4 million), an increase of 32%, resulting in a book-to-bill ratio of 1.10.

SUPPLY CHAIN

As previously announced, during the first half of 2018 we started to see a significant tightening of the supply chain for certain electronic components, which resulted in increased lead times, in some cases moving from 12 to 52 weeks, and component cost inflation. In response, we went into the market to increase our safety inventories of critical components, at prices beyond our standard costs, in order to ensure we could continue to meet our lead times to customers. The higher prices we had to pay for components were a drag on gross margins in the second half of 2018 and in 2019. As expected, we have seen an unwinding of this inventory position in 2019 which has resulted in a reduction in working capital in the period.

We remain vigilant and are keeping supply chain dynamics under close review given the advent of the COVID-19 outbreak in China, as we are now entering a period where demand for the next generation of semiconductor manufacturing equipment appears to be rising. We have already started to see the first signs of lengthening lead times for certain components such as multi-layer ceramic capacitors, purportedly driven by the roll out of 5G technology. Power semiconductor devices have also continued to be on long lead times throughout 2018 and 2019. We will continue to proactively manage our inventory to ensure continuity of supply but expect the levels to reduce further in 2020.

COVID-19 VIRUS

The situation regarding the COVID-19 virus outbreak in Wuhan, China in mid-December has been widely reported. We send our heartfelt thoughts to everyone affected by the virus outbreak, particularly our colleagues at our Kunshan manufacturing site, who we are providing with all necessary support. Our first priority is to ensure the safety of our people and we have taken epidemic prevention and control measures at both our Kunshan and Vietnam manufacturing facilities.

The Chinese authorities extended the Chinese Lunar New Year holiday and imposed a number of travel restrictions and operational restrictions on companies. These measures caused a two-week delay to the recommencement of production at our Kunshan facility, which re-opened on 17 February 2020. The difficulties our people have experienced in travelling back to work and the self-quarantine requirements also mean that we have been operating at a reduced level of capacity and do not expect to be operating at full capacity until mid-March at the earliest. Our local supply chain has experienced similar issues and we now have a backlog of production orders to catch up. There will be an inevitable slippage of revenues from the first quarter of 2020, but it is too early to determine whether this will have a material effect on our first half performance and to what extent the worldwide economic conditions will be affected by this situation.

Our Vietnamese facility recommenced production following the Lunar New Year holiday as planned on 1 February 2020 and is operating normally. We have been taking mitigating action by accelerating the transfer of more products and materials from China to Vietnam to maintain the supply of products to our customers.

ADAPTING TO THE MARKET AND THE COMPETITION

Over the last two decades XP Power has evolved from a specialist distributor of power conversion products to a designer, and then manufacturer, of power solutions for the Industrial Electronics, Healthcare, Semiconductor Equipment Manufacturing and Technology markets. Our product portfolio has moved up the power and voltage spectrum, and now also includes RF power conversion products.

We continue to perform well against our traditional established competition. Our broad range of standard products, now augmented by recent acquisitions, and excellent customer service, delivered by the largest direct sales force in our industry, is an attractive customer proposition. We are now one of very few power solutions providers who can supply our target customers with a portfolio of products from low to high-power and low to high voltage, including RF power. This capability, when combined with our engineering services offering, which can take standard products and tailor them to provide complete plug and play power systems, often incorporating custom firmware communications, makes us a compelling business partner as the equipment we power gets more sophisticated and connected.

Our low-cost Asian competitors continue to be competitive for low-power/ low-complexity products without demanding or critical applications and it is straightforward for customers to

source low-cost/low-power products directly through this channel. However, this market is not growing, with revenue from these products remaining stable. By contrast, engineering solutions of the type provided by XP Power are not easily managed remotely and work most effectively when situated close to the customer, so design discussions and design reviews can take place face-to-face. We continue to add significant value to our customers as we expand our engineering service groups across the globe and customers demand more connectivity and digital control of the power solutions that power their applications. These trends are driving our order and revenue growth.

We are building a broad and compelling product offering supported by an excellent engineering services capability which makes us an increasingly attractive partner for leading companies in the Industrial Electronics, Healthcare, Semiconductor Equipment Manufacturing and Technology sectors to choose to power their mission-critical applications.

STRATEGIC PROGRESS

We have followed a consistent strategy which has enabled us to produce strong results over a sustained period of time. The fundamental essence of this strategy is targeting key accounts where we can add value and gain more of the available business in those accounts, combined with moving the product line up in power, voltage and complexity. Although this strategy continues to remain appropriate and effective, we constantly challenge and refine it, as we have done again in 2019.

Our strategy can be summarised as follows:

- Develop a market leading range of competitive products, organically and through selective acquisitions;
- Target accounts where we can add value;
- Increase vertical penetration of target accounts;
- Build a global end to end supply chain that balances high efficiency with market leading customer responsiveness; and
- Lead our industry on environmental matters.

We continue to make significant progress against each of these strategic objectives. We believe we have the broadest, most up-to-date portfolio of products, many of which are class-leading in terms of efficiency and low stand-by power. We continue to move our product portfolio up in power and voltage to expand our addressable market and protect our margins. We are also enhancing our proposition to our target customers by expanding our engineering services capabilities. This allows us to combine our products into one complete power solution to power a customer's application.

The executive leadership team undertook an in-depth critical review of our strategy during 2019 which was presented and challenged by the Board. The key outcomes of this review were:

- Upgrade key talent so we have the capabilities to profitably scale the business, particularly in developing an end to end global supply chain;
- Ensure product development resources are focused on the appropriate product segments. This is resulting in more internal resources being focused on higher power products and away from the low-voltage/low-complexity market which we can address via third parties. As a result of this, we have closed our low-voltage design centre in Fyfield in the UK;
- Enhance product life cycle management from capture of requirements, through concept and feasibility, development, production and eventually end of life; and
- Upgrade systems and processes using our new ERP system as a platform for robust control and excellent customer service and responsiveness.

TASK FORCE FOR CLIMATE RELATED FINANCIAL DISCLOSURES

We are cognisant of the increasing concerns our people, customers, suppliers and shareholders have around climate change. We consider that we have taken a lead in our industry in developing and promoting high efficiency products which consume less energy and therefore help reduce carbon emissions over the lifetime of the equipment that our products power. The Task Force for Climate Related Financial Disclosures ("TCFD") encourages us to provide financial guidance to investors regarding the risks and opportunities that climate change might have on our business.

In general, we regard the continuing emphasis and concern over climate change as a positive for our business as our customers have embraced our high efficiency "Green" XP Power products. These generated revenues of £43.2 million in 2019 (2018: £42.1 million) representing 22% of total revenue. The Company is committed to leading the industry in this area. We believe that legislation regarding the efficiency requirements for power conversion will become more and more stringent and the standards currently in place for higher volume consumer applications, such as external power supplies, will spread to industrial and healthcare applications where we will be well positioned. Concerns over climate change should lead to an increasing emphasis by our customers of efficiency and more revenue opportunities to power renewable energy systems and controllers – smart grid being a prime example where we have already been successful.

Our geographic footprint is diverse, and we do not generally operate in locations that could be exposed to sea level rises or are particularly vulnerable to dramatic swings in weather patterns. We are continually reviewing the potential primary impacts on the business. The secondary effects of measures to combat climate change could also impact the Group. However, if more stringent legislation regarding power conversion efficiency were introduced, we believe we are well positioned to take advantage of such changes.

NEW ERP SYSTEM

Efficient and robust systems are essential for us to manage an international business and supply chain with a highly diverse customer base. The Group had operated a global Customer Relationship Management system across its businesses, which allowed it to collaborate, share information and provide efficient and effective customer service. In our 2017 Annual Report, we announced a project to implement the latest version of SAP's ERP software across our entire global supply chain. Priority would be given to our sales companies in Asia, Europe and North America, which were already running an older version of SAP, with our China and Vietnam manufacturing facilities and our recent acquisitions to follow.

The implementation of the new system will have significant benefits in terms of factory planning and customer responsiveness, and it will give us significant operational advantages, with our factory systems running on the same platform as our sales companies. Further gains will be realised when we migrate the acquired Comdel and Glassman businesses to the new platform.

We transitioned to the new SAP ERP system in mid-October 2019. However, during the system migration and in the first few weeks of operation as the teams across the Group went up the learning curve with the new processes, we experienced some short-term disruption to the implementation which led to shipments temporarily falling behind expected run rates. This resulted in approximately £5 million of scheduled order backlog moving from the fourth quarter of 2019 into 2020.

We are confident that the new SAP ERP system will deliver significant long-term benefits to the Group's ability to run its global business and supply chain.

In 2019, the Group capitalised £3.4 million (2018: £1.1 million) of development costs and incurred £2.2 million (2018: £0.2 million) of other project related costs in respect of this project. In 2020, we expect to capitalise a further £2.5-3.0 million and the other project related costs will be circa £1.0 million.

MANUFACTURING

In October 2017, we commenced construction of a second manufacturing facility in Vietnam on our existing site near Ho Chi Minh City. Construction was completed in early 2019. Our existing manufacturing facility in China and our first Vietnam facility have an annual revenue capacity of US$170 million. Vietnam II conservatively adds an additional US$130 million of capacity, bringing our total Asian manufacturing capacity up to US$300 million per annum.

This additional capacity is necessary to accommodate our growth trajectory. It also gives us the opportunity to transfer production from China to Vietnam, thereby saving the costs of the Section 301 Tariffs currently imposed on Chinese goods by the USA authorities. We have transferred over 2,000 different products to Vietnam from China and are also well advanced in transferring production of our high-voltage/low-power DC-DC modules from Minden, Nevada to Vietnam. We believe this will give us a cost advantage over many of our competitors with Chinese based manufacturing.

Our end objective is to have the flexibility to be able to build all products in either China or Vietnam to provide flexibility and robust business continuity planning.

RESTRUCTURING OF LOW-POWER, HIGH-VOLTAGE MANUFACTURING AND TRANSFER TO VIETNAM

In order to take advantage of our expanded Vietnam capacity, competitive labour rates and excellent quality, in August 2019 we announced that we would be transferring the manufacture of all our low-power, high-voltage DC-DC modules to our Vietnamese facility. Our manufacturing facility in Minden, Nevada will close by June 2020. We expect that this will result in annualised cost savings of approximately £4.0 million. Approximately £1-2 million of these cost savings will be reinvested back into the business to expand and strengthen our new product introduction team. The enlarged team will facilitate further transfers of existing engineering services production from our facility in Sunnyvale, California to Vietnam, as well as new standard products as they are introduced, resulting in additional future savings. We expect to incur approximately £1-2 million in costs associated with the full closure of the Minden site over the next 12 months which will be excluded from adjusted results.

ENGINEERING SOLUTIONS

As well as expanding our product offering, we have continued to expand our engineering solutions groups particularly in Asia and North America. As we continue to move our capabilities up to higher power and higher voltages, we are becoming an increasingly attractive partner for customers whose applications are becoming more and more demanding. These demands include not only power delivery and management, but also sophisticated connectivity involving software and firmware which enable the customer's application to control the power solution and the power solution to communicate back to the application. As the world becomes more connected and the fourth industrial revolution gains traction, we expect this trend to gather pace. Customers place a high value on our engineering solutions capabilities which differentiate us from many of our competitors, who focus only on providing standard products with little additional value added.

Our engineering solutions groups work closely with the customer's engineering teams to provide these customised solutions. Speed and proximity to the customer are critical as the power solution is often one of the last parts of the system to be designed, so is invariably one of the gating items to get the end product to market. This is an area where XP Power adds significant value to its customers, and we are seeing increasing demand for these services.

RESEARCH AND DEVELOPMENT

We have continued to invest in research and development to further expand our portfolio of products and the size of our addressable market opportunity. We released 32 new product families in 2019 (2018: 27) and 25 of these can be classified as "Green" XP Power products having ultra-high efficiency and/or low standby power (2018: 20).

We continue to move our product portfolio up in power and voltage range and away from our traditional low-power/low-voltage offering, to protect our margins and expand our addressable market. As part of this process we took the decision to close our design centre in Fyfield, UK which was focused on low-power, low-voltage product. RF power is a significant long-term opportunity and is a market which contains many interesting and significant niches. We have therefore directed more of our internal product development resources away from low-power/low-voltage and are supplementing the low-power area with more third-party products designed to our specifications and quality standards while expanding the RF development resources.

2019 STRATEGIC REPORT

Our Strategic Report on pages 12 to 62 has been reviewed and approved by the Board.

DUNCAN PENNY
Chief Executive Officer