PERFORMANCE: FINANCIAL REVIEW

GAVIN GRIGGS
Chief Financial Officer

"We continue to invest in our business and people, whilst still being able to deliver strong year-on-year profit growth."

REVIEW OF OUR YEAR

XP Power delivered a resilient performance in 2019. The business generated strong free cash flow due to good working capital management and continues to have a robust financial position.

STATUTORY RESULTS

On a statutory basis, revenue was £199.9 million (2018: £195.1 million), representing growth of 2%. Operating profit was £26.7 million (2018: £39.3 million), a decrease of 32% over the prior year, with operating margin at 13.4% (2018: 20.1%). Net finance costs were £2.7 million (2018: £1.7 million) resulting in profit before tax of £24.0 million (2018: £37.6 million) and an income tax expense of £3.2 million (2018: £7.2 million), equivalent to an effective tax rate of 13% (2018: 19%). Basic earnings per share were 107.0 pence (2018: 157.8 pence), a decrease of 32%.

ADJUSTED RESULTS

Throughout this results announcement, adjusted and other alternative performance measures are used to describe the Group's performance. These are not recognised under International Financial Reporting Standards (IFRS) or other generally accepted accounting principles (GAAP).

When reviewing XP Power's performance, the Board and management team focus in particular on adjusted results rather than statutory results. There are a number of items that are included in statutory results, but which are considered to be one-off in nature or not representative of the Group's performance and which are excluded from adjusted results. The tables on page 132 show the full list of adjustments between statutory operating profit and adjusted operating profit, between statutory profit before tax and adjusted profit before tax, as well as between statutory profit after tax and adjusted profit after tax at Group level for both 2019 and 2018.

REVENUE PERFORMANCE

The Group generated revenue growth of 2% during the year 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 elsewhere in this review. In constant currency revenues reduced by 2% and by 4% on a like-for-like basis, excluding the acquisition of Glassman.

The Group's revenue performance was impacted by the cyclical downturn in the Semiconductor Equipment Manufacturing sector, with revenue in this sector declining by 21% to £37.4 million (2018: £47.4 million). This was offset by growth all other sectors, with the Technology sector growing 34% to £27.4 million (2018: £20.4 million), the Industrial Electronics sector, increasing by 7% to £89.2 million (2018: £83.7 million) and the Healthcare sector, which grew 5% to £45.9 million (2018: £43.6 million).

Our North American region was impacted by the Semiconductor Equipment Manufacturing sector slowdown, which contributed to revenue declining by 8% to US$147.5 million from US$159.5 million. On a like-for-like basis, after excluding Glassman revenue of US$14.8 million North America decreased by 12%. Europe delivered growth of 5% to £64.4 million (2018: £61.1 million), driven by a good performance in the Nordics, up 22% and Central Europe, up 9%. Asia revenue grew by 29% to US$25.6 million (2018: US$19.9 million).

Order intake was up 8% on a reported basis to £214.9 million (2018: £198.4 million). Orders and revenue for 2019 represent a full year, book-to-bill ratio of 1.08 (2018: 1.02).

READ ABOUT OPERATIONAL PERFORMANCE ON PAGES 30 TO 35

READ ABOUT SUPPLY CHAIN PERFORMANCE ON PAGES 36 TO 37

GROSS PROFITABILITY

Gross margin decreased to 45.1% (2018: 47.3%), largely due to the impact of the Section 301 tariffs imposed on Chinese goods imported into the USA, the knock-on impact of the component price inflation experienced in 2018 and product mix.

ADJUSTED OPERATING EXPENSES AND MARGINS

The Group continued to invest in the business, which resulted in adjusted operating expenses increasing by 11% to £54.2 million (8% in constant currency and 4% on an organic constant currency basis). Investing in our people remains a focus and resulted in payroll and staff costs increasing by 20%. Headcount, excluding factories, increased by 5% compared to 2018 as we invested in our engineering and sales capabilities. Non-cash share-based payment charges amounted to £0.7 million (2018: £0.8 million) and related to a grant to senior management under the Long-Term Incentive Scheme during the year. Adjusted operating margin decreased to 18.0% (2018: 22.0%) due to the lower revenues and gross margin in 2019 combined with the annualization of increased investments in 2018.

FOREIGN EXCHANGE

The Group reports its results in Sterling, but the US Dollar continues to be our principal trading currency, with approximately 83% (2018: 84%) of our revenues denominated in US Dollars. The average Sterling to US Dollar exchange rate decreased by 4%, from 1.34 to 1.28. The Sterling to US Dollar exchange rate saw large movements during the year but ultimately the net impact on the Group's 2019 results was not significant.

FINANCE COST

Net finance cost increased to £2.7 million (2018: £1.7 million) due to increased average borrowings following the acquisition of Glassman in May 2018.

Interest cover (EBITDA as a multiple of net interest expense as defined by our Revolving Credit Facility) was 17 times (2018: 32 times) which is well in excess of the four times minimum required in our banking covenants. Net debt to EBITDA at the year-end was comfortable at 0.92 (2018: 1.07). The covenant level for net debt to EBITDA is a maximum of three times.

The Company renewed its financing facilities with effect from 8 November 2019, increasing the revolving credit facility by US$15m to US$120m, with a US$60m accordion option. The facility is provided by HSBC UK Bank PLC, J.P. Morgan Securities PLC and DBS Bank Ltd on similar terms to the previous arrangements, with a four-year term up to November 2023.

ADJUSTED PROFIT BEFORE TAX

The Group generated adjusted profit before tax and specific items of £33.2 million, down 19% compared to last year, due to the higher direct costs incurred.

SPECIFIC ITEMS

Specific items are excluded from management's assessment of profit because by either their size, or their nature they are non-repetitive and therefore could distort the Group's underlying earnings.

In 2019, the Group incurred £9.2 million (2018: £3.6 million) of specific items, predominantly related to £3.2 million for amortisation of intangible assets due to business combination (2018: £2.8 million), costs associated with acquisitions of £0.9 million (2018: £0.6 million) and ERP implementation costs of £2.2 million (2018: £0.2 million). In addition, the Group incurred legal costs of £1.9 million (2018: £Nil) related to a non-customer related legal dispute in North America and restructuring costs of £1.0 million (2018: £Nil) related to the transfer of the manufacturing of all our low-power, high-voltage DC-DC modules to our Vietnamese facility.

TAXATION

The effective tax rate on adjusted profit before tax decreased by 790bps to 9.6% (2018: 17.5%). The lower effective tax rate was due to one-off credits related to prior year tax assessments in the United States.

The effective tax rate on profit before tax decreased by 580 bps to 13.3% (2018: 19.1%). Going forward, XP Power expects the effective tax rate to be approximately 18-20% depending predominantly on the regional mix of profits.

"Revenue growth has translated into earnings growth

REVENUE INCREASES **2%**

CASH FROM OPERATIONS INCREASES **72%**

NET DEPT DECREASES **21%**

PERFORMANCE: FINANCIAL REVIEW CONTINUED

ADJUSTED EARNINGS PER SHARE

Basic and diluted adjusted earnings per share from continuing operations before specific items both decreased by 16% to 148.3 pence and 145.5 pence respectively (2018: 176.1 pence and 172.8 pence).

CASH FLOW

The Group generated £46.2 million net cash from operations compared with £26.7 million in the previous year. The higher level of operating cash flows was largely a result of improved working capital management, specifically related to a £12.4 million reduction in inventory levels.

Free cash flow before acquisitions, dividends and repayment of borrowings was £26.2 million (2018: £10.9 million).

NET DEBT AND DIVIDENDS

We finished 2019 in a net debt position of £41.3 million (2018: £52.0 million), with the decrease due to improved cashflow generation and foreign exchange movements. The Group continued its progressive dividend policy which meant returning £16.7 million (2018: £15.3 million) to shareholders in the form of dividends.

The attractive cash flow generated by the XP Power business model has enabled the Company to pursue a progressive dividend policy over a sustained period of time.

This year's cash flow performance has enabled us to recommend a final dividend of 36 pence per share for the fourth quarter of 2019. This dividend will be payable to members on the register on 27 March 2020 and will be paid on 28 April 2020. When combined with the interim dividends for the previous three quarters, the total dividend for the year will be 91 pence per share (2018: 85 pence), an increase of 7%.

The policy is to increase dividends progressively whilst maintaining an appropriate level of dividend cover. Dividend cover for the year was 1.2 times (2018: 1.9 times). We expect dividend cover to re-build based on strong long-term prospects.

FIXED ASSETS

We continue to invest in our business with the majority of the spend being on manufacturing and supporting our future sales growth. We plan to invest circa £8 million during the new financial year, in line with 2019. This investment is principally related to upgrading our ERP system.

FINANCIAL INSTRUMENTS

The Group's financial instruments consist of cash, money market deposits, and various other items such as trade receivables and trade payables that arise directly from its business operations.

The Group uses forward currency contracts to hedge highly probable forecast transactions. The instruments purchased are denominated in the currencies of the Group's principal markets. The Group had no forward currency contracts outstanding at 31 December 2019 (2018: £10.8 million).

BREXIT

In terms of the broader economic impacts of Brexit on our business, we do not consider that they will be material. Our products are made in Asia and are already imported into Europe where we have warehouses in both Germany and the United Kingdom and hence, we could ship our product destined for the European Union directly into Germany or another appropriate location. Plans are in place that will help minimise any logistical issues that may arise following the United Kingdom's exit from the European Union.

GAVIN GRIGGS

Chief Financial Officer

READ ABOUT MARKETPLACE ON PAGES 12 TO 15

READ ABOUT SUPPLY CHAIN PERFORMANCE ON PAGES 36 TO 37