PERFORMANCE: FINANCIAL REVIEW

Johan Olivier
Acting Chief Financial Officer

> The Group delivered excellent financial results in 2020 against the backdrop of the unprecedented challenges of COVID-19, reflecting the resilience of the Group and our people.

STATUTORY RESULTS

Revenue was £233.3 million (2019: £199.9 million), representing growth of 17%. Statutory operating profit was £37.4 million (2019: £26.7 million), an increase of 40% over the prior year, with operating margins at 16.0% (2019: 13.4%). Net finance costs were £1.7 million (2019: £2.7 million), resulting in profit before tax of £35.7 million (2019: £24.0 million) and an income tax expense of £4.0 million (2019: £3.2 million), equivalent to an effective tax rate of 11% (2019: 13%). Basic earnings per share were 163.0 pence (2019: 107.0 pence), an increase of 52%.

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 on adjusted results rather than statutory results. There are a number of items that are included in statutory results, but are considered to be one-off in nature or not representative of the Group's performance, and are excluded from adjusted results. The tables in Note 2 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 2020 and 2019.

REVENUE PERFORMANCE

The Group's revenue performance was driven by growth in the Semiconductor Manufacturing Equipment sector, which increased 86% to £69.6 million (2019: £37.4 million). The Healthcare sector grew 51% to £69.3 million (2019: £45.9 million), which includes the COVID-19 related shipments. This was partially offset by a decline in the Industrial Technology sector down 19% to £94.4 million (2019: £116.6 million).

Our North American region benefited from growth in the Semiconductor Manufacturing Equipment sector, increasing by 28% to US$188.1 million from US$147.5 million in 2019. Europe delivered growth of 1% to £65.0 million (2019: £64.4 million), as growth from Healthcare customers was offset by a decrease in the Industrial Technology sector. Asia revenue grew by 5% to US$26.8 million (2019: US$25.6 million), driven by good growth in the Healthcare sector.

OTHER INCOME

Included in other income are £0.6 million received related to the COVID-19 pandemic, primarily from the Singaporean government as part of the Jobs Support Scheme (JSS). The JSS was extended to all active employers in Singapore.

"Excellent financial results despite a challenging environment, reflecting the resilience of the Group and our people"

GROSS PROFITABILITY

Gross margin increased to 47.2% (2019: 45.1%), benefiting from production efficiency gains at our manufacturing facilities due to the increased demand and the transition of production from Minden to Vietnam. This more than offset the incremental COVID-19 related costs of £0.9 million incurred by the Group during the year, predominantly related to additional safety measures at our manufacturing facilities.

ADJUSTED OPERATING EXPENSES AND MARGINS

The Group continued to invest in the business, which resulted in adjusted operating expenses increasing by 16% to £64.2 million. In addition to investment in people we have also invested in our IT infrastructure, specifically related to the ERP implementation. Due to COVID-19, travel was severely restricted from early March leading to a decline in travel costs of £2.0 million compared to 2019. Adjusted operating margin increased to 19.7% (2019: 17.5%) due to volume leverage on higher revenue

FINANCE COST

Net finance cost decreased by 37% to £1.7 million (2019: £2.7 million). The lower interest expense was a result of lower interest rates and borrowing levels.

ADJUSTED PROFIT BEFORE TAX

The Group generated adjusted profit before tax and specific items of £44.3 million, an increase of 37% compared to last year.

SPECIFIC ITEMS

In 2020, the Group incurred £8.6 million (2019: £8.3 million) of specific items, predominantly related to £3.2 million for amortisation of intangible assets due to business combination (2019: £3.2 million), costs associated with acquisitions of £0.3 million (2019: £0.9 million) and ERP implementation costs of £1.9 million (2019: £2.2 million). In addition, the Group incurred legal costs of £0.4 million (2019: £1.9 million) related to a non-customer related legal dispute in North America, restructuring costs of £2.3 million (2019: £1.0 million) related to the closure of a UK design centre and the production facility in Minden, Nevada, and fair value loss on currency hedges of £0.5 million (2019: gain of £0.9 million).

The ERP implementation will continue through 2021 and costs related to the project and amortisation of intangible assets due to business combinations will continue to be classified to specific items.

LEGAL

On 11 September 2020, Comet Technologies USA Inc., Comet AG, and YXLON International (collectively "Comet") filed a lawsuit against XP Power LLC in the U.S. District Court for the Northern District of California, alleging trade secret misappropriation relating to RF match and generator technology (Comet Technologies USA Inc., Comet AG, and YXLON International v. XP Power LLC, Case No. 5:20-cv-6408 (N.D. Cal.)).

The Group believes there is no merit to this lawsuit and intends to vigorously defend against any claims brought against us by Comet.

The Group expects to incur further legal costs until this matter is resolved, the magnitude of which cannot currently be estimated with any certainty. The Group incurred legal costs of £0.4 million in 2020 (2019: £1.9 million) related to this matter which are treated as specific items and excluded from management's assessment of profit as they are non-repetitive and therefore could distort the Group's underlying earnings.

TAXATION

The effective tax rate on adjusted profit before tax decreased by 210 bps to 11.5% (2019: 13.6%). The lower effective tax rate was due to deductions for employee share option awards, the utilisation of tax losses and research and development tax credits.

The effective tax rate on statutory profit before tax decreased by 210 bps to 11.2% (2019: 13.3%).

Going forward, XP Power expects the effective tax rate to be approximately 16–18% depending predominantly on the regional mix of profits.

"Adjusted profit before tax grew by 37%, benefitting from good revenue growth, strong gross margins and lower finance costs"

PERFORMANCE: FINANCIAL REVIEW
CONTINUED

RESEARCH AND DEVELOPMENT (R&D)

Gross R&D expenditure was £15.9 million, an increase of 22% on 2019 or 7% of revenue. R&D investment is a key part of the Group's strategy and is expected to continue to grow as the Group expands its engineering capabilities. The Group is particularly focused on our RF and high-power, high-voltage product development activities.

The Group capitalised £7.7 million of R&D costs (2019: £8.0 million), which reflects the continued development of new products as the Group expands its product portfolio.

CAPITAL EXPENDITURE

The Group continued to invest in its infrastructure, with particular focus on the upgrade of our ERP system and capital investment at our manufacturing facilities to expand capacity and improve operational performance. £7.2 million (2019: £8.3 million) was incurred on capital expenditure during 2020.

We plan to invest c.£11 million during the new financial year, with the main investments related maintenance and expansion of our manufacturing facilities and the upgrade of our ERP system.

ADJUSTED EARNINGS PER SHARE

Basic and diluted adjusted earnings per share increased by 40% to 201.8 pence and 198.4 pence respectively (2019: 144.1 pence and 141.4 pence).

CASH FLOW

The Group continues to be highly cash generative with net cash from operations of £45.6 million (2019: £46.2 million) representing cash conversion of 122% (2019: 173%). The slightly lower level of operating cash flows was largely a result of investing in working capital to meet

the increased demand from customers, specifically related to a £12.3 million increase in inventory. This was partially offset by good cash collections which saw trade and other receivables decrease by £2.7 million despite the 17% revenue increase.

Free cash flow before acquisitions, dividends and repayment of borrowings was £31.3 million (2019: £26.2 million).

The Group finished 2020 with net debt of £17.9 million (2019: £41.3 million), comprising cash and cash equivalents of £13.9 million and gross debt of £31.8 million. The decrease in net debt during 2020 was a result of the strong free cash generation, offset by £7.3 million paid in dividends during the year.

DEBT FACILITY

The Group's debt is sourced from a Revolving Credit Facility ("RCF") provided by HSBC UK Bank PLC, J.P. Morgan Securities PLC, and DBS Bank Ltd. The Group has exercised an option in the RCF agreement in October 2020 to extend the facility expiry date by a year to November 2024. The Group also converted US$30 million of accordion option to committed facilities, increasing the committed facility to US$150 million (£110 million at year-end exchange rate), with a further US$30 million accordion option.

The Group is subject to two financial covenants, which are tested quarterly. These covenants relate to the leverage ratio between adjusted EBITDA and net debt and the interest cover ratio between adjusted EBITDA and finance costs.

Interest cover was 46 times (2019: 17 times), which is well in excess of the four times minimum required in our banking covenant. Leverage ratio at the year-end was comfortable at 0.32 times (2019: 0.91). The covenant level for net debt to EBITDA is a maximum of three times.

CAPITAL ALLOCATION

The Group will continue its disciplined approach to capital allocation, prioritising the maintenance of a strong balance sheet, and sufficient committed facilities, while continuing to focus on investing in the business to drive organic growth. The Group continues to seek out and review acquisition opportunities that are in line with the Group's strategy and that meet management's strict acquisition criteria to deliver value creation to Shareholders.

Due to the uncertainties caused by COVID-19, the Board took the difficult decision to cancel the final dividend for 2019 and the first quarter dividend for 2020. Dividend payments were resumed from the second quarter of 2020.

The strong finish to the year's cash flow performance and continued good liquidity has enabled the Board to recommend a final dividend of 36 pence per share for Q4 of 2020. This dividend will be payable to members on the register on 26 March 2021 and will be paid on 28 April 2021. When combined with the interim dividends for the previous three quarters, the total dividend for the year will be 74 pence per share (2019: 55 pence).

The Group plans to operate in a range of between 1–2 times net debt to Adjusted EBITDA in the medium term. Given the impact of COVID-19 on the global economic environment, the Board is comfortable with the current leverage of 0.32 in the short term.

FOREIGN EXCHANGE

The Group reports its results in Sterling, but the US Dollar continues to be our principal trading currency, with approximately 85% (2019: 83%) of our revenues denominated in US Dollars. The average Sterling to US Dollar exchange rate remained in line with 2019 at 1.28, meaning that constant currency results are in line with reported results.

Johan Olivier
Acting Chief Financial Officer

117%
Adjusted operating cash conversion

-56%
Change in net debt