Progressive EQUITY RESEARCH

CML MICROSYSTEMS

TECHNOLOGY

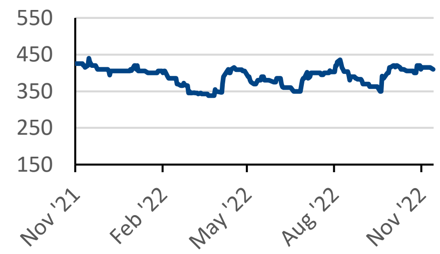
22 November 2022

CML.L

410p

Market Cap: £65.2m

SHARE PRICE (p)



12m high/low	440p/338p

Source: LSE Data (priced as at prior close)

KEY DATA	
Net (Debt)/Cash	£22.7m *(at 30/09/22)*
Enterprise value	£42.5m
Index/market	AIM
Next news	Trading update, Apr, '23
Shares in Issue (m)	15.9
Chairman	Nigel Clark
Chief Executive	Chris Gurry

COMPANY DESCRIPTION

CML is a semiconductor company focused on the next generation of wireless communications technologies

www.cmlmicroplc.com

CML MICROSYSTEMS IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Exceptionally strong results

CML's interim results for the six months ended 30 September 2022 have significantly exceeded management's own expectations. We do not publish half-year forecasts, but with revenue in the first half 22% ahead of H1 FY22, the Reported PBT result (£1.8m) was not far from our forecast for the full year (£2.1m). We have therefore raised our forecasts significantly for FY23 and FY24. CML's focus on wireless communications markets, working in non-consumer, high-performance applications where customer service allows it to differentiate, is clearly demonstrating its value.

- **Revenue growth.** Revenue increased 22% on H1 FY22 and 15% H1 on H2. In general, this strong improvement was seen across the customer base and end markets. The period-end order book increased, and extended beyond 12 months at the period end. However, supply chain disruptions do remain a feature of the market.
- **Strong revenues drive margins up.** The revenue improvement drove gross profit up from £6.1m in H1 FY22 to £7.6m, an increase in margin % terms from 74.5% to 75.9%. With operating costs little changed, most of the increase in gross profits dropped through; profit from operations was £1.75m (vs £0.5m in H1 FY22).
- **Strong cash generation and balance sheet.** Period-end cash and short-term deposits as at 30 September 2022 was £22.7m, in line with the year before (£22.6m), and £2.3m down on end FY22. This is after a net spend of £3.3m for share buybacks, £2.7m R&D investment and the final dividend payment of £0.8m. With this strong cash position, CML remains well placed to make acquisitions to supplement its impressive organic growth rate.
- **New products, new markets, new valuation.** New products continue to be an important part of CML's drive to build revenues. CML launched a number of new chips in H1, and further new product launches are expected in H2. Following the investment in new technologies, products and people, management believes that CML's annual addressable market now exceeds $1bn. These results are very impressive and demonstrate the value of CML management's strategy when applied in existing markets. Looking to next-generation wireless technologies – compound semiconductors, 5G, satellite communications and industrial internet of things – the investment case only gets better.

FYE MAR (£M)	2020	2021	2022	2023E	2024E
Revenue	15.0	12.5	17.0	20.5	23.3
Adj EBITDA	4.5	2.7	4.3	6.0	6.8
Fully Adj PBT	1.5	1.1	2.2	3.5	4.2
Fully Adj Dil EPS (p)	8.0	5.7	10.3	17.5	19.7
EV/Sales (x)	2.8x	3.4x	2.5x	2.1x	1.8x
EV/EBITDA (x)	9.5x	15.6x	9.9x	7.1x	6.3x
PER (x)	51.2x	71.6x	39.7x	23.4x	20.8x

Source: Company Information and Progressive Equity Research estimates.

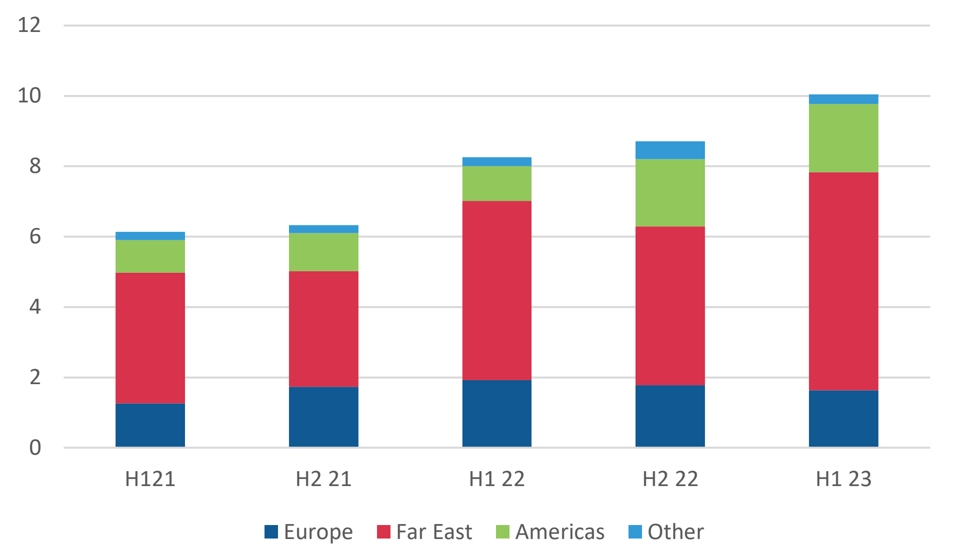
Exceptionally strong results

The interim results have significantly exceeded management's own expectations. We do not publish half-year forecasts, but suffice to say that with revenues in the first half 22% ahead of H1 FY22, the Reported PBT result of £1.8m was not far from our forecast for the full year (£2.1m). We have therefore raised our forecasts significantly for FY23 and FY24. CML's focus on wireless communications markets, working in non-consumer, high-performance applications where customer service allows it to differentiate, is clearly demonstrating its value.

Very strong revenue growth

Revenues increased 22% on H1 FY22 and 15% H1 on H2. In general, this strong improvement was seen across the customer base and end markets. There was a near doubling of revenue from the Americas, a 21% increase from Asia but a 15% decline in Europe, where CML saw lower demand from one of its main voice communications customers. We believe that this European customer works within the safety/security private mobile radio market. We note that this market is often driven by lumpy contract wins with large public sector customers, so we don't regard this as a long-term concern.

Revenue progression by region (£m)



Source: Progressive Equity Research

The period-end order book increased, and extended beyond 12 months at the period end. However, supply chain disruptions do remain a feature of the market, although not to the extent they have been.

The strength in the US dollar was a contributing factor to the rise in revenue, but we note that the impact of foreign exchange is seen across the income statement, so the impact upon final profit is less significant.

Revenue increases help drive margins up

The revenue improvement drove gross profit up from £6.1m in H1 FY22 to £7.6m, an increase in margin % terms from 74.5% to 75.9% – somewhat above the 70%-75% that management refer to as a normal range. This was driven by a combination of both product mix and selling through of the inventory build. The Chairman's statement strikes a tone of caution by emphasising that some of the improvement has been derived from one-off gains.

With operating costs little changed, most of the increase in gross profit dropped through; profit from operations was £1.75m (vs £0.5m in H1 FY22). The improvement in Reported PBT is not as dramatic (£1.8m vs £1.0m) because CML no longer receives rental income at the other income line (H1 FY22 £4k vs H1 FY21 £427k). There is a small tax credit in the period relating to prior-year issues and, given CML's high levels of development investment in the UK, we do not anticipate significant tax charges in the short term.

The Group MD's statement confirms that, despite generally tight labour markets, CML has been successful in recruiting across the business, including within engineering, operations and sales. That said, we expect CML to see cost inflation, principally due to staff and energy, in the second half.

Strong balance sheet and underlying cash generation

Year-end cash and short-term deposits as at 30 September 2022 was £22.7m, in line with the year before (£22.6m), and £2.3m down on end FY22. This decline in cash is after a net spend of £3.3m for share buybacks, £2.7m R&D investment and the final dividend payment of £0.8m. The board is recommending an interim dividend of 5.0p per share (H1 FY22: 4.0p). With this strong cash position, CML remains well placed to make acquisitions to supplement its impressive organic growth rate.

End markets all good places to be

Within the Land Mobile Radio / Private mobile radio markets, the end markets continue to grow. With several of the major equipment suppliers as customers, CML is taking market share through its well-established strategy of developing the product further and through product integration. Within data-centric markets, the use of and interest in 'smart everything' continues to build, and the strategic shift towards next-generation wireless technology appears increasingly astute.

New products enable growth and increase addressable market

New products continue to be an important part of CML's drive to build revenues. In H1, CML launched a number of new chips including a 28Ghz power amplifier for wide-band wireless applications. Further new product launches are expected in H2. Following the investment in new technologies, products and people, management believes that CML's annual addressable market now exceeds $1bn.

Outlook positive – forecasts raised

The outlook statement is positive, with guidance for revenue to increase H2 on H1. However, in line with our comments above, the guidance is for distribution and administration expenses to rise too. We have raised our forecasts for revenue and profit significantly for F23E and FY24E, with much of the improvement flowing through to increases in cash, as shown in the table below.

Forecast revisions

	FY23E			FY24E		
£m unless stated	Old	New	Change (%)	Old	New	Change (%)
Revenue	18.2	20.5	13%	20.5	23.3	14%
Adj EBITDA	5.0	6.0	20%	5.8	6.8	17%
Fully adj PBT	2.5	3.5	40%	3.3	4.2	27%
Fully adj Dil EPS (p)	12.1	17.5	45%	14.9	19.7	32%
Net (Debt)/Cash	19.0	20.2	6%	17.1	19.1	12%

Source: Progressive Equity Research

Property issues

A significant event in the period that has not yet impacted the financials was the application for planning permission for the development of CML's Oval Park site. As can be seen from the image below (CML's current offices and design, development and test facilities in the forefront), this is a substantial development. CML is not intending to undertake the project for itself but has signed contracts for the sale if permission is granted to two local firms that intend to occupy the two buildings in the back left and right of the image. This is part of a series of actions management has taken in recent years to realise and maximise the value of the group's excess assets. Management expects that the application will be considered in H1 CY23.

The remaining unused property in Hampshire remains held for sale.

We note that the timing and scale of these transactions are not factored into our valuation considerations, nor are they a basis for our investment case.

Oval Park proposed development

Source: CML

CML investment case goes beyond the semiconductor cycle

Wider newsflow from other semiconductor companies suggests that some of the supply constraints / demand issues that have beset the industry and impacted CML in recent years may be receding. The recent announcements from the likes of Intel, Qualcomm, Micron and AMD suggest that the semiconductor cycle may have moved forward.

This cooling elsewhere in the semiconductor industry could well be an operational and financial positive for CML as it could relieve the pressure on the wider semiconductor materials, foundry, and packaging and test markets that has challenged CML, its customers and competitors in the last few years.

While in sentiment terms the news from the majors may cast a shadow across the Atlantic, CML has a tight focus on different end markets with no consumer exposure and, furthermore, the CML investment story is about the longer term beyond the few years of an industry cycle, driven by next-generation wireless technologies – compound semiconductors, 5G, satellite communications etc. There has been no sign of any diminution in expectations for these technologies or the markets they may enable, and no reason to alter the long-term investment case.

Financial Summary: CML Microsystems

Year end: March (£m unless shown)

PROFIT & LOSS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Revenue	15.0	12.5	17.0	20.5	23.3
Adj EBITDA	4.5	2.7	4.3	6.0	6.8
Adj EBIT	1.3	0.8	1.9	3.1	3.9
Reported PBT	1.2	0.0	1.7	3.1	3.8
Fully Adj PBT	1.5	1.1	2.2	3.5	4.2
PAT	1.4	0.8	1.2	3.1	3.6
Reported EPS (p)	8.0	4.8	7.4	19.2	22.7
Fully Adj Dil EPS (p)	8.0	5.7	10.3	17.5	19.7
Dividend per share (p)	4.0	52.0	9.0	10.8	13.5
CASH FLOW & BALANCE SHEET	**2020**	**2021**	**2022**	**2023E**	**2024E**
Operating cash flow	6.5	7.7	3.0	6.9	6.5
Free Cash flow	7.0	8.2	3.9	6.9	6.3
FCF per share (p)	40.9	48.9	23.5	43.2	39.7
Acquisitions	(9.8)	(7.7)	(4.0)	(5.2)	(5.6)
Disposals	0.0	33.3	1.8	0.0	0.0
Shares issued	0.0	(1.6)	0.3	(4.5)	0.0
Net cash flow	(4.8)	23.0	(7.3)	(4.5)	(1.1)
Overdrafts / borrowings	(1.1)	(0.7)	(0.5)	(0.4)	(0.3)
Cash & equivalents	8.5	32.2	25.0	20.5	19.4
Net (Debt)/Cash	7.4	31.5	24.6	20.2	19.1
NAV AND RETURNS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Net asset value	42.4	53.4	49.9	47.0	49.1
NAV/share (p)	246.8	310.9	290.0	295.4	308.3
Net Tangible Asset Value	12.9	35.9	30.0	24.5	24.2
NTAV/share (p)	75.1	208.9	174.6	154.2	151.9
Average equity	42.4	47.9	51.7	48.4	48.0
Post-tax ROE (%)	(12.0%)	(12.1%)	(0.8%)	2.4%	4.0%
METRICS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Revenue growth		(16.7%)	36.0%	21.0%	13.5%
Adj EBITDA growth		(39.1%)	57.7%	39.4%	12.7%
Adj EBIT growth		(35.1%)	131.0%	65.9%	24.0%
Adj PBT growth		(30.3%)	110.2%	55.3%	21.6%
Adj EPS growth		(28.5%)	80.7%	69.3%	12.6%
Dividend growth		1200.0%	(82.7%)	20.0%	25.0%
Adj EBIT margins		6.5%	11.1%	15.2%	16.6%
VALUATION	**2020**	**2021**	**2022**	**2023E**	**2024E**
EV/Sales (x)	2.8	3.4	2.5	2.1	1.8
EV/EBITDA (x)	9.5	15.6	9.9	7.1	6.3
EV/NOPAT (x)	31.0	53.0	34.4	13.9	11.8
PER (x)	51.2	71.6	39.7	23.4	20.8
Dividend yield	1.0%	12.7%	2.2%	2.6%	3.3%
FCF yield	10.0%	11.9%	5.7%	10.5%	9.7%

Source: Company information and Progressive Equity Research estimates

22 November 2022

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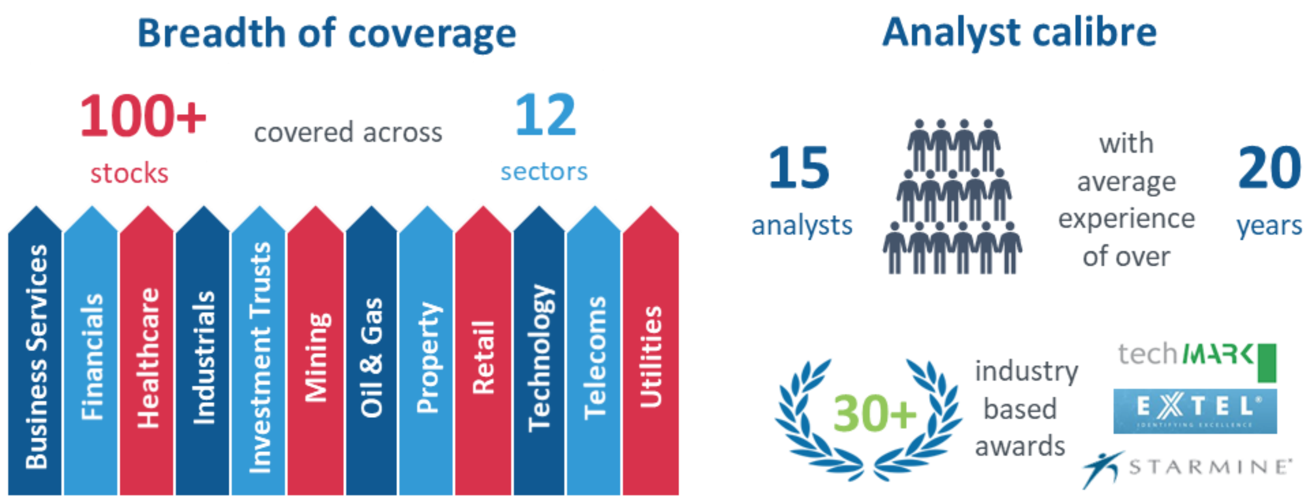

To arrange a meeting with the management team, or for further information about Progressive, please contact us at:
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