

# XAAR TECHNOLOGY

20 September 2022

## XAAR.L

220p

Market Cap: £172.6m

### SHARE PRICE (p)



12m high/low

273p/145p

Source: LSE Data (priced as at prior close)

### KEY DATA

Net (Debt)/Cash	£12.7m (at 30/06/22)
Enterprise value	£159.9m
Index/market	LSE
Next news	Trading update, Jan.'23
Shares in Issue (m)	78.4
Chairman	Andrew Herbert
Chief Executive	John Mills
CFO	Ian Tichias

### COMPANY DESCRIPTION

Xaar manufactures specialist industrial and commercial digital printheads, used in a variety of applications.

<https://www.xaar.com>

XAAR IS A RESEARCH CLIENT OF PROGRESSIVE

### ANALYSTS

Ian Robertson

+44 (0) 20 7781 5318

[irobertson@progressive-research.com](mailto:irobertson@progressive-research.com)



[www.progressive-research.com](http://www.progressive-research.com)

## Strong results; stronger underlying progress

The interim results for the six months ended 30 June 2022, released today, provide further evidence that Xaar is back on a growth path. H1 22 revenue was up 39% on H1 21 and 11% on H2 21. Organic growth was a very impressive 14% H1 on H1. These figures actually mask even stronger underlying progress, as the Printhead business was significantly constrained by the continued Covid-19 lockdown restrictions in China. Xaar is on track to launch its new aqueous printhead product in Q4 2022. The recent FFEI and Megnajet acquisitions are performing well, and all business units delivered positive adjusted EBITDA in the period.

- China Covid frustrations hide real progress.** Printhead revenue growth of 2% H1 on H1 was constrained by the 22% H1 on H1 decline in sales in China as a result of Covid-19 restrictions. The Printhead business in the US and EMEA regions enjoyed strong growth and there was good progress in the Coding & Marking and Additive Manufacturing sectors.
- Aqueous printhead on track for Q4 launch.** The results statement confirms that the new aqueous printhead that has been developed on Xaar's ImagineX platform is on track for Q4 launch. This should allow Xaar to address a number of exciting growth markets, not least of which are Packaging and Textiles.
- FFEI, Megnajet and even EPS performing.** Xaar's recent acquisitions, FFEI and Megnajet, are performing well and management actions have turned around the profitability and prospects of EPS, Xaar's US-based product printing systems business.
- Further actions to reduce costs (and increase capacity).** Management's commitment to driving down costs, as well as improving revenues, is made clear with the news that its plans for the Huntingdon facility will involve a short shutdown to upgrade and modernise its capabilities.

**Xaar has good technology, strong management and a clear strategy. It has grown its position in its core markets, and with new products and working to its core technological strengths Xaar has the opportunity to grow significantly in the short, medium and long term. The short-term valuation metrics show that the market recognises the achievements of management to date, with the real fruits of the ongoing labours likely to show through in 2023 and beyond.**

FYE DEC (£M)	2019	2020	2021	2022E	2023E
Revenue	49.4	48.0	59.3	73.3	81.6
Adj EBITDA	-4.9	0.1	3.2	5.6	8.8
Fully Adj PBT	-8.0	-3.9	-0.6	1.4	4.4
Fully Adj Dil EPS (p)	-15.1	-5.2	-0.1	1.7	5.6
EV/Sales (x)	3.2x	3.3x	2.7x	2.2x	2.0x
EV/EBITDA (x)	-32.9x	2578.7x	50.2x	28.4x	18.2x
PER (x)	N/A	N/A	N/A	126.9x	39.0x

Source: Company Information and Progressive Equity Research estimates.

This publication should not be seen as an inducement under MiFID II regulations.

Please refer to important disclosures at the end of the document.

## Strong results with even stronger underlying progress

The interim results for the six months ended 30 June 2022 provide further evidence that Xaar is back on a growth path. H1 22 revenues were up 39% on H1 2021 and 11% on H2 2021. Stripping out the acquisition of FFEI and Megnajet, the organic growth was a still very impressive 14% H1 on H1. This figure actually masks even stronger underlying progress, as the Printhead business was significantly constrained by the continued Covid-19 lockdown restrictions in China. Group adjusted PBT for H1 2022 was £1.4m, a significant step forward from the adjusted LBT of £1.6m in H1 21.

Xaar is on track to launch its new aqueous printhead product in Q4 2022. The recent FFEI and Megnajet acquisitions are performing well, and the Product Print Systems business has responded very positively to recent management attention.

Xaar's turnaround is clearly heading in the right direction, as demonstrated by the fact that all business units delivered positive adjusted EBITDA in the period.

### Revenue growth by business unit

£m	H1 2022	H1 2021	Change %	H2 2021	Change %
Printhead	20.7	20.2	2%	19.9	4%
EPS	9.2	6.1	51%	7.8	18%
<b>Organic growth H1 2022 vs H1 2021</b>	<b>29.9</b>	<b>26.3</b>	<b>14%</b>	<b>27.7</b>	
FFEI	6.1			5.3	15%
<b>Organic growth H1 2022 vs H1 2021</b>	<b>36.0</b>	<b>26.3</b>		<b>33.0</b>	<b>9%</b>
Megnajet	0.6				
<b>Total</b>	<b>36.6</b>	<b>26.3</b>	<b>39%</b>	<b>33.0</b>	<b>11%</b>

Source: Xaar

### Printhead – China Covid-19 frustration masks global progress

#### Printhead business unit revenues (£m)



Source: Xaar

The 2% headline growth in the Printhead business is a frustration to all. The Covid-19 lockdown restrictions in China was the primary reason for the decline in Printhead sales in Asia, from £5.8m in H1 21 to £4.5m in H1 22. As can be seen in the chart above, this decline comes after two years of consistently strong growth.

In North America, the printhead business saw revenue growth of 26% H1 22 on H1 21, and in EMEA the figure was 7% growth. Within these regions' revenue figures, there was notable growth in both the Coding & Marking and the Additive Manufacturing sectors.

The Chinese Covid-19 restrictions have had major impact across the supply chain for Xaar's Ceramics and Glass printer customers in the region, so even if customers are able to obtain Xaar's printheads they may struggle to obtain other key printer components. As an additional frustration, management notes that this has impacted not only immediate demand but has also impeded work to develop and install printers. The restrictions continue and we expect this to remain a challenge to both Xaar and its customers (and for that matter its competitors). However, we regard this as more a shifting of sales to the right rather than sales lost completely.

### **Gross margin improvement**

An important feature of these results, as noted above, is the gross margin improvement, principally as a result of the increase in gross profit margin within the Printhead business unit from 35% to 41% (£7.1m and £8.5m, respectively), helped by revenue growth, volume increases and management efforts to reduce the cost base. The basic fact that this is a high contribution margin, high fixed cost business with an existing facility that has significant manufacturing capacity, both latent and potential, should not be forgotten.

### **FFEI acquisition – delivering growth and new products**

FFEI, acquired in July 2011 for £3.7m initial and £5.4m deferred consideration, as part of Xaar's strategy to better address the UDI (User Developer Integrator) customers, generated revenue of £6.1m – organic growth of 15% on H2 21. During the period, FFEI successfully launched its new print engine product, the Xaar Versatex.

### **Megnajet acquisition ahead of initial expectations**

Megnajet, the ink systems business acquired in March 2022 for £3.6m initial and £0.4m deferred consideration, made only limited contribution to these results. However, management reports that the business has already been integrated into the wider Xaar and that it is operating well, with the £0.6m it did contribute to revenues being ahead of management's expectations at the time of acquisition.

### **EPS returns to profitability – more to come**

Management efforts to restore the Product Print Systems business (EPS) are evidently making progress. The overall revenue growth of 51% came from a mix of factors, most notably the increase in sales of digital machines and peripherals, and the business has returned to profitability. With an improving order book and pipeline, management is 'confident the business is now well placed to continue to growth profitably'.

### **New products – Q4 aqueous printhead launch on plan**

While FFEI and Megnajet bring new products and product opportunities to the group, the key driver remains the Printhead business. It is therefore very encouraging to hear that Xaar remains on plan for the launch of its new aqueous printhead product in Q4 2022, the latest to be powered by its ImagineX platform. Management believes that this, as yet unnamed, product will help to open up new sectors, most notably Packaging and Textiles, thanks to its superior reliability to the incumbents' products.

The long-term investment case for Xaar is built not just upon management's (now proven) ability to grow market share in Ceramics, and Coding & Marking. It is therefore encouraging to see that Xaar continues to explore ways in which to exploit its core technological advantages – in ink recirculation, high laydown and ultra-high viscosity inks – in other end markets.

### **Inventory build – reasoning becoming clearer**

Management has been clear with its policy on building inventories in recent periods, having done so in order to ensure Xaar's ability to deliver products to customers. The period has seen a material increase from £18.8m at the year-end to £24.6m at the end of June. Management believes that Xaar's ability to offer shorter lead times is enabling it to win customers from its competitors. The principal driver to this group increase has been the £3.2m increase in materials and finished goods seen in the Printheads business.

The high inventories could prove to be a partial shield against inflation, but their greatest use is now evident in the comments made with regard to the Huntingdon facility, where the printheads are made.

### **Huntingdon facility – improving capacity and efficiency**

Management continues to assess the manufacturing potential for its Huntingdon facility and is finalising plans for further investment, the first part of which will be an upgrade and modernisation that will require a factory closure for two months. We believe that the requirement for capital spend is limited in the short term and we expect that much of the work will be in moving equipment, debottlenecking and improving space and energy utilisation. We expect this work to be undertaken sometime early in 2023.

### **Inflation – management taking action**

With regard to the issue of inflation, Xaar's management has worked to address this and continues to do so. Xaar's electricity unit costs are fixed into H2 2023 and there has been significant investment in raw materials.

Management reports that some cost increases have already been passed on to customers.

### **Robust balance sheet**

The cash balance, £12.7m net (exc. leases), down from £15.3m at the start of the 2021, has been impacted by the inventory build and, of course, there has been the acquisition of Megnajet plus some investment spend at both FFEI and Megnajet. We do not anticipate significant acquisitions in the short term, nor, as alluded to above, any requirement for major capex spend.

### **No changes to forecasts or positive view**

The outlook statement is confident in tone and, with H1 having been in line with expectations, management sees the outcome for the full year as being in line with market expectations. We are not changing our forecasts following these results.

The issues of cost inflation and Covid-19 restrictions still affect Xaar, but we do not regard these as impacting the medium- to long-term story. We retain our enthusiasm for what management has achieved to date and what it looks set to achieve as it makes progress in the second stage of its strategy: building on growth in Xaar's core markets and exploiting the group's strengths with more reliable products that can lay down greater volumes of fluid and handle difficult and higher viscosity fluids (inks) than those of its competitors.

**Xaar has good technology, strong management and a clear strategy. It has grown its position in its core markets, and with new products and working to its core technological strengths Xaar has the opportunity to grow significantly in the short, medium and long term. The short-term valuation metrics show that the market recognises the achievements of management to date, with the real fruits of the ongoing labours likely to show through in 2023 and beyond.**

**Financial Summary: Xaar**

Year end: December (£m unless shown)

	2019	2020	2021	2022E	2023E
<b>PROFIT &amp; LOSS</b>					
Revenue	49.4	48.0	59.3	73.3	81.6
Adj EBITDA	(4.9)	0.1	3.2	5.6	8.8
Adj EBIT	(7.9)	(3.7)	0.6	1.6	4.7
Reported PBT	(10.9)	(4.3)	1.0	0.9	3.9
Fully Adj PBT	(8.0)	(3.9)	(0.6)	1.4	4.4
NOPAT	(2.9)	(3.1)	0.0	1.1	3.6
Reported EPS (p)	(18.7)	(5.7)	0.9	1.1	5.0
Fully Adj Dil EPS (p)	(15.1)	(5.2)	(0.1)	1.7	5.6
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
<b>CASH FLOW &amp; BALANCE SHEET</b>					
Operating cash flow	(13.2)	(4.3)	(2.2)	(3.4)	6.5
Free Cash flow	(9.8)	(2.8)	(2.1)	(3.4)	6.5
FCF per share (p)	(12.5)	(3.6)	(2.6)	(4.4)	8.3
Acquisitions	(0.6)	(0.6)	(1.4)	(9.6)	(6.3)
Disposals	0.0	0.0	9.2	0.0	0.0
Shares issued	0.0	0.0	0.2	0.0	0.0
Net cash flow	0.3	(4.7)	5.1	(13.0)	0.2
Overdrafts / borrowings	(4.0)	(2.6)	(9.7)	(8.7)	(7.3)
Cash & equivalents	24.8	18.0	25.1	12.0	12.2
Net (Debt)/Cash	20.8	15.4	15.3	3.3	4.9
<b>NAV AND RETURNS</b>					
Net asset value	70.3	56.2	68.8	70.2	74.6
NAV/share (p)	89.8	71.7	87.8	89.6	95.2
Net Tangible Asset Value	41.0	29.6	44.4	43.3	44.7
NTAV/share (p)	52.3	37.8	56.7	55.3	57.1
Average equity	101.1	63.2	62.5	69.5	72.4
Post-tax ROE (%)	(112.8%)	(28.0%)	17.8%	1.2%	5.3%
<b>METRICS</b>					
Revenue growth		(2.8%)	23.5%	23.7%	11.4%
Adj EBITDA growth		(101.3%)	5033.9%	76.9%	56.2%
Adj EBIT growth		(52.7%)	(115.3%)	180.6%	191.6%
Adj PBT growth		(50.8%)	(85.4%)	(337.7%)	225.7%
Adj EPS growth		(65.3%)	(98.5%)	(2267.0%)	225.7%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		(7.8%)	1.0%	2.2%	5.7%
<b>VALUATION</b>					
EV/Sales (x)	3.2	3.3	2.7	2.2	2.0
EV/EBITDA (x)	-32.9	2578.7	50.2	28.4	18.2
EV/NOPAT (x)	-54.8	-51.6	-5315.2	145.4	44.6
PER (x)	N/A	N/A	N/A	126.9	39.0
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	(5.7%)	(1.6%)	(1.2%)	(2.0%)	3.8%

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

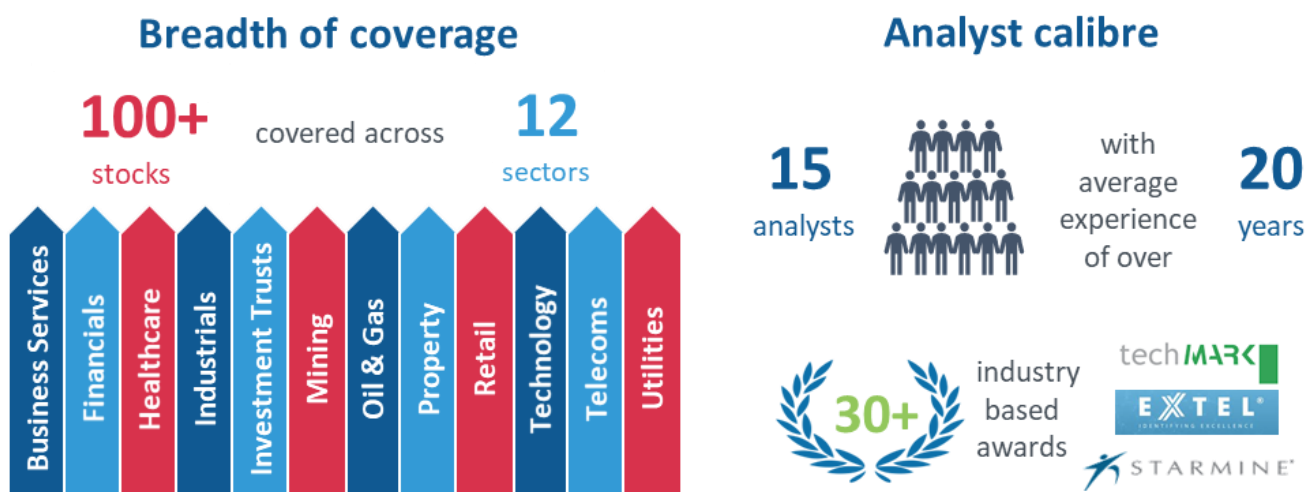
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To arrange a meeting with the management team, or for further information about Progressive, please contact:

Keith Hodgskiss  
+44 (0) 20 7781 5300  
khodgskiss@progressive-research.com