

# Featured Companies Update - Advanced Power Components

Advanced Power Components (APC) issued their final results for the year to 31 August 2008 on 27 January. The results were in line with forecasts and showed a profit before tax of £732,000. However, issues with exchange rates will probably mean that the Group will miss their forecasts for the current year. We have included the Current Trading and Outlook paragraphs from the results below:

## Current Trading

'The deterioration of trading conditions both within the electronic component distribution sector, and in the wider global economy has been well publicised and predicting future performance is difficult. However, our strategy of focusing on designing relatively specialist components into a wide cross section of technical applications is, so far, insulating the Company from the worst of the downturn. Order input was lower than anticipated through the early summer months and this resulted in sales in the first quarter of the current financial year being below expectations. Appropriate steps were taken and order input since August has recovered, gross margins have been maintained and overheads controlled well within budget. However, the rapid and significant depreciation of the value of sterling against the US Dollar and the Euro has had a considerable adverse impact on an otherwise strong operational performance. Whilst the Board is considering options to avoid future vulnerability to rapid exchange rate fluctuations, the likely effect is that profits will be reduced to a small loss in first half of 2008/9. Assuming no further unanticipated foreign exchange losses, and taking account of recent strong operational performance backed by a record order book, we expect a substantially more profitable second half. However, it is unlikely that the anticipated second half performance will entirely offset the foreign exchange losses in the first half of the financial year, and accordingly net profit before tax for the year as a whole is likely to be below market expectations.'



**APC's Chief Executive, Mark Robinson**

## Outlook

'In the Board's view the strength of the Company's strategy is becoming increasingly apparent as the electronic component distribution market continues to consolidate into relatively few large distribution organisations. The focus within these organisations is clearly on logistical excellence at the expense of the level of technical support provided to all but a relatively small number of key accounts. As a result the majority of customers and component manufacturers are facing an increasingly narrow choice of distributors with the technical expertise needed to assist with their design process. This is particularly apparent in relation to comparatively specialist, technical components which is the niche in which APC continues to operate. Accordingly the Board is continuing to invest in the Company's infrastructure accepting that whilst this may hold back short term profitability, it will result in the Company attaining an even stronger position as the markets recover.'

On the day that the results were issued we forwarded some questions to APC's Chief Executive, Mark Robinson. Here are our questions and Mark's answers:

- 1. The results quote 25% revenue growth. Some of this is from acquisitions. What is the growth rate from the existing businesses?**

The revenue from the existing business was almost exactly the same as in the previous year, although the mix across our different areas of activity obviously changed a little. It should be noted that the electronic component distribution market in the UK shrank by 15-20%+ during the year compared to the previous year, so we are very pleased with ourselves for maintaining the turnover which effectively increased our market share quite significantly.

**2. Could you explain a bit more detail about the exchange rate issues and what the company are considering to mitigate the problem?**

The main problem has been caused by the movement in exchange rates between the time we are invoiced by our suppliers in the US and Europe, and the time we buy the foreign currency to make payments – typically a period of around 60 days. The rapid depreciation of sterling from \$1.95 in September to \$1.45 in December meant that we lost \$0.50 for every £1.00 we spent buying \$US. Fortunately, our underlying performance has been strong and we are currently looking at what future risks there might be and what we can do in the long term to avoid any further issues. We will not be rushing to implement a hedging mechanism now, as sterling is already very weak and to do so could exacerbate the problem.

**3. With a loss forecast for H1 and increased investment, will FY 2009 be profitable?**

Yes, we will be profitable this year. Based on current trading and the strength of our order book, we even feel it is possible, though unlikely, that we might still hit previous full year 2009 market forecasts despite the exchange rate issues.

**4. Are APC still very optimistic about Contech? And might there be more large contracts in 2009 for this subsidiary?**

We are very encouraged by the positive progress made by both Contech and Novacom and both are working on a number of potentially large contracts.

**5. The Outlook statement mentions investment in infrastructure. Could you give an example of where such investment is being considered?**

Investment in people has taken place with four new management positions created in the last 3 months. These are Quality Systems Manager, Business Systems Manager, Accounts Manager and Group Marketing Assistant. These new positions strengthen the foundations of the Company and provide a platform for further expansion over the next couple of years.

On the day the results were issued APC's Broker, St Helen's Capital, issued a note with a Buy recommendation. St Helens reduced their 2009 forecast pre-tax profit from £0.8 to £0.5 million. The broker forecasts the 2010 pre-tax profit to come in at £0.9 million. These forecasts put APC's 2010 P/E ratio at just 4.8.

Finally, we should also mention that earlier in January APC announced a licensing agreement with US-based KVAR Corporation. KVAR specialise in energy saving products which reduce electricity consumption.

'Under the terms of the licensing agreement, APC will be responsible for the manufacture and distribution of KVAR's product range in all markets outside North and South America. APC has redesigned the products to comply with CE requirements and the business strategy for the deployment of the technology, into both commercial and domestic markets, is in the final stages of development. The initial roll-out is to be focused on Europe, the Middle East and Australasia. APC has set up a new division, APC KVAR, to manage this operation.'

### **Aimzine Comment**

We found Mark's answers to our questions encouraging. It would seem that the currency issue is unlikely to repeat itself unless we see further rapid deterioration in the pound. The share did drop by 1.5 to 11 pence on the day the results were issued but the long term story still seems very encouraging to us. The KVAR agreement provides yet further potential - the broker forecasts do not make any allowance for APC KVAR.