

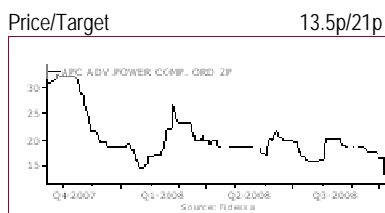


Advanced Power Components (APC)

BUY

Niche Consolidator

Share Price



Market Data

| | |
|-----------------------|-------------------------------------|
| Stock Code | APC.L |
| Listing | AIM |
| Sector | Electronic and Electrical equipment |
| Market Cap | £3.1m |
| Enterprise Value | £3.6m |
| 12-month high/low | 32.5/13.5p |
| Next results (finals) | January |

Company Statistics

| | |
|-----------------|-------|
| Shares in Issue | 22.3m |
| Net debt | 1.33m |
| Gearing | 82.6% |
| Interest cover | 9.5x |
| NAV per share | 21.9p |

Major holders

| | |
|--------------------------------|-------|
| Management | 7.9% |
| Robinson family trusts | 27.6% |
| J.A.Mitchell and family trusts | 20.3% |
| Hargreave Hale Ltd | 7.0% |

Research coverage

| | |
|------------------|----------|
| Initiation (BUY) | 15/10/08 |
|------------------|----------|

Company Description

Specialist component distributor
www.apc-plc.co.uk

Analyst

Simon Miller 020 7448 5997
 simon.miller@sthelenscapital.com

The company has reviewed a draft of this research note and factual changes have been made.

Please refer to the disclaimers at the back of this document.

APC distributes specialist electronic components via technically knowledgeable sales teams to an equally specialised customer base comprised of defence, aerospace, transport, medical and other industrial contractors. This reduces cyclicality, increases the likelihood of repeat business and allows decent margins. While APC can generate some organic growth it has also proved adept at acquiring small specialised businesses that are immediately earnings accretive and this forms a key part of management's growth strategy. On conservative growth assumptions APC trades on a PE of 5.2 times 2008/9 earnings.

Acquisitions form a key element of APC's growth strategy

APC made two earnings accretive acquisitions in 2008 which will lift revenues by around 40% in 2008/9. As these are both significantly more profitable businesses than APC's existing business, margins will also be lifted. Industry knowledge allows APC to identify a number of potential acquisitions which would be similarly earnings accretive and would have a material impact on a company of APC's size but which would be of no interest to the larger distributors. However, its ability to make such acquisitions will depend on market conditions.

Specialisation means a less cyclical business

The highly specialised nature of APC's business model means in turn a fairly specialised customer base; 37% defence and aerospace, 10% transport and 10% medical, with the remainder being industrial. As a consequence we believe APC is a less cyclical business than the larger component distributors.

Valuation

At the current price APC's is trading on a PE of 4.1x 2007/8 earnings and 5.2x 2008/9. These multiples and the £3.1m market cap seem unduly miserly for a business expected to turnover nearly £15m and earn pre tax profits of around £750,000 next year. Nor would the valuation seem to give APC much credit for either the two acquisitions it has made this year or their potential to significantly enhance earnings in the future. It is certainly not pricing in any further sales to the NHS by Contech despite a clear requirement from the NHS for further keyboards and an established sales channel.

| Performance | 08/07A | 08/08E | 08/09E | 08/10E |
|--------------------|--------|--------|--------|--------|
| Turnover (£m) | 9.741 | 12.115 | 14.814 | 15.386 |
| EBITDA (£m) | 0.792 | 0.992 | 0.926 | 1.116 |
| Adjusted PBT (£m) | 0.510 | 0.680 | 0.750 | 0.937 |
| Tax (%) | N/A | - | 22.0% | 28.0% |
| Adjusted EPS (p) | 2.6 | 3.3 | 2.6 | 3.0 |
| Operating CFPS (p) | 6.4 | 64.0 | 21.4 | 45.7 |
| Ratios | 08/07A | 08/08E | 08/09E | 08/10E |
| P/E (x) | 5.2 | 4.1 | 5.2 | 4.5 |
| EPS Growth (%) | | 26% | -21.2% | 15.4% |
| EV/EBITDA (x) | 3.7 | 3.9 | 3.3 | 2.9 |

Source: St.Helens Capital plc.

St Helen's Capital acts as broker to Advanced Power Components plc

Specialised distributor with reduced cyclical

Investment Summary

Component distributor APC concentrates on market niches that require specialist technical product knowledge and high levels of customer support, avoiding the wholesale end of the business. Consequently; it is a less cyclical business than the larger distributors, enjoys a degree of insulation from price based competition either from UK or offshore competitors, and can nevertheless continue to grow by adding new product lines and new activities. On 5.2x forecast 2008/9 earnings and 21% of 2008/9 sales, APC trades at a substantial discount to the larger quoted UK or US distributors. This discount reflects neither the progress that APC has made in recent years nor its growth potential.

APC is the least cyclical distributor

Avoiding the wholesale and consumer markets and concentrating instead on distributing specialised products that require a high degree of product knowledge and support to defence, aerospace, industrial and latterly health care customers makes APC a less cyclical business than the other quoted distributors. Defence and aerospace contractors are inherently conservative, are unlikely to move to offshore sourcing and value reliability and support over price.

APC continues to identify new products and new activities

As part of its strategy to deliver growth, APC continues to identify new product lines and new activities that fit with its specialist approach. Through the acquisition of Contech, APC has opened a sales channel to the NHS and is actively looking for further opportunities to sell through this channel. It has also identified Green technology as an area where a specialist approach might yield profitable sales and is negotiating an agreement to manufacture and distribute KVAR Energy's energy controller.

Growth to come from acquisitions

Acquisitions can deliver meaningful growth

The acquisitions of Novacom and Contech will increase turnover by about 40% with the full effect being felt in 2008/9. APC is of a size that gives it the opportunity to consider a number of small privately owned specialist businesses that are accretive to the APC business but would have no discernible impact on the likes of Premier Farnell.

Management

APC has an energetic management team with considerable experience of specialised component distribution. This team will be vital in both driving organic growth, identifying promising acquisition targets and in ensuring the smooth integration of those that are acquired.

Market Opportunity

A nimble specialist in a mature industry

If the dot-com boom and bust taught us anything it is that technology is enabling rather than an end in itself, so while new technology may exhibit rapid growth for a period as users upgrade, its long term growth remains linked to the economic activity it enables. So it is with electronic component distribution. Electronic component distribution is a mature cyclical business which is not currently showing any real growth. A glance at the Electrocomponents and Premier Farnell numbers would suggest that at the upper or wholesale end of the market there is a choice to be made between revenue growth and earnings growth. It is a highly competitive business, largely online and needs an expensive infrastructure. Furthermore, customers are increasingly able to source cheaper offshore. For companies this size, earnings accretive acquisitions are thin on the ground. In the space APC occupies life is rather different. There are opportunities for profitable growth both organically and via acquisitions.

It is important to make clear from the start that trading conditions remain tough everywhere, with the last three months being particularly grim and despite being less cyclical than the larger businesses APC is not immune. APC has to work hard for its organic growth.

Acquisitions

APC made two acquisitions in 2008 that will have a significant impact on the business both

in terms of scale, lifting group turnover to what we estimate will be c. £12.25m in the year to 31 August 2008 and about £14.8m in 2008/9 and the opportunity to develop new activities. At its present size, APC is still sufficiently small that it can identify a wealth of opportunities that allow the business to grow much faster than the underlying component distribution market. APC has the scope to consolidate small privately owned specialist distribution businesses, which at current, market levels are earnings accretive. Management is keen to make further acquisitions and has identified a number of promising targets although current conditions in both the equity and debt markets will inevitably influence timing.

New activities

In addition to acquisitions APC can identify new activities. These can often involve manufacturing or control of manufacturing processes for customers. APC has recently identified a clean tech opportunity. APC is negotiating an agreement with KVAR Energy Corporation whose patented energy controller can reduce electricity usage by between 6% and 30% depending on the type of load. As electricity prices climb further, interest in this product is expected to increase. APC will be the first company licensed to manufacture KVAR's product outside the USA. The product is soon to be launched in the UK.

Medical and health products

Through the recent acquisition of Contech, APC now has open sales channels into the NHS. The NHS is responsible for both primary care, through GP practices, dentists, pharmacists etc and secondary care such as hospitals. It either specifies or influences the purchase of medical devices and equipment. Although its budget is finite, it is not influenced by the general economic cycle. Contech has so far sold the NHS 15,000 medigenic, infection control keyboards but the NHS has an estimated 400,000 keyboards in clinical areas as well as other input devices which Contech will be looking to supply. APC is actively searching for possible new opportunities to supply the NHS.

Specialisation can deliver growth

While the component distribution market as a whole is not growing, this is not a universal stagnation. APC has successfully identified a need in the defence, aerospace, transport, medical and other electronics industries for a distributor with specialised industry relevant product knowledge and design capabilities. In these specialist businesses individual component cost is of secondary importance to reliability, performance and continuing availability. APC aims to grow its business by continuing to identify customers and products fitting this philosophy. Management has set targets of 2.5% for organic growth, 2.5% for new product lines and a further 2.5% for new activities. These obviously represent a goal and it is good to see management setting them but also important to recognize that management is realistic and in the current environment any growth will be very hard to achieve.

Specialised distribution is less cyclical

By avoiding wholesale distribution and concentrating on supplying customers that are not consumer-facing APC is arguably a far less cyclical business than other quoted distributors. Two areas of APC's business stand out in this respect, Defence and Medical/Health. Both are subject to annual budget reviews but are not correlated to the business cycle and are both considered to be defensive sectors. Defence and Aerospace currently makes up around 37% of APC revenues, transport about 10% and medical about 10% and expected to grow, reducing APC's cyclicity still further.

Potential of the NHS contract not priced in

Overview

APC is an independent distributor of specialist electronic components, employing about 65 people and has been trading since 1982. It was admitted to the Official List of the London Stock Exchange in 1996 and transferred to AIM in November 2002 as part of a restructuring. While the history of APC is interesting in that it was a £100m market cap company in 2000, this probably says more about the mindset of investors in that period than it does about APC's business.

APC did take a diversion from the component distribution model in the 1990's by becoming a specialist manufacturer of products to service the telecommunications and the emerging broadband industries. At the end of the 1990's APC had built up manufacturing capacity and inventories to fulfil large order books. When the dot.com bubble burst in 2000 and the orders subsequently evaporated, APC was left exposed.

To save itself, APC was forced to slim down rapidly, disposing of the communication products division in January 2003 and returning to its core business as a specialist and often exclusive distributor. In the past five years APC has increased revenues by a compound 17.7%, returned to profitability, tidied up the balance sheet (following court approval to eliminate the holding company's accumulated loss) and bought back 25% of the equity.

APC today

APC is likely to report 2007/8 turnover of around £12m, up from £9.7m in 2006/7. With the full impact of recent acquisitions being felt in 2008/9 that figure is likely to be in the region of £14.8m. This makes it something of a minnow compared to the other quoted distributors, Abacus, which has just agreed to an offer of £42m from Avnet has turnover of £287m, Premier Farnell £745m and Electrocomponents £925m, While the US businesses Avnet and Arrow have sales of \$16bn and \$17bn respectively. With such a disparity in size comparisons with these businesses are fairly meaningless. It is more useful to focus on the specific characteristics of APC and how it differs from the larger businesses. The group operates through a number of divisions or brands, each one effectively being a specialist sales team with a specialist product and or market focus. With the recently acquired businesses there will be seven divisions.

Seven specialised divisions

hi-rel

This is where the business started back in 1982. hi-rel distributes specialized high reliability components; primarily to the defence, aerospace, transportation and industrial sectors where high component reliability, ability to operate in extreme environments, such as cold or heat etc, are critical to the customers. Typically these are high value components ordered in relatively low volumes. Products include power supplies, capacitors, memory, transformers etc.

Locator

Locator specialises in sourcing obsolete or discontinued components. Customers are primarily defence and aerospace contractors. This is a highly specialised business and as well as procurement would include testing, anti counterfeit verification and up-screening. This business is effectively linked to hi-rel with many of the same customers.

Hero

This division was formed following the acquisition of Hero Electronics in 2006. Another highly specialised business distributing, heat movement and pressure sensors, timers, opto-electronics, wireless connectivity, RF devices, LEDs etc. The approach to this market is engineering led, with specialised product managers offering "design-in" support to customers.

Displays+

This division specialises in all aspects of display technology, helping customers achieve their goal through correctly sourcing the most suitable components from cabling through to screens.

go!

go! operates as a purchasing resource for customers who prefer to concentrate on design, product development and marketing and outsource other aspects such as purchasing, testing and even manufacturing. go! can offer all these services including arranging a full turnkey manufacturing option if needed.

Novacom

APC acquired Novacom Microwave in April 2008, a specialist distributor of specialised microwave and RF products. This is likely to be a £2.5m p.a. business. Clients are

predominantly telecommunications businesses and defence contractors.

Contech

APC's second acquisition of 2008, Contech is also a £2m turnover business supplying specialist computer input devices, such as programmable keyboards, rugged keyboards, barcode scanners and especially an infection control medical keyboard. This latter in particular could have significant potential as the company has started to supply the NHS.

Business model

There are a number of common factors with these divisions, for a start none of them is consumer-facing, there is a high proportion of defence and aerospace contractors in the customer base, the customers are very specialised and servicing them requires a strong technical knowledge and in many cases an ability to help the customer select the correct component for a particular application. This is the basis of APC's business model.

Strategy for growth

It should be clear by now that APC is a very different animal from the other quoted electronic component distributors, Abacus, Premier Farnell and Electrocomponents in the UK, or Arrow and Avnet in the US. For a start it is a minnow by comparison and that to a large extent shapes its business model and approach to the market. APC has to adopt a totally different model to survive and grow as a distributor.

For APC to succeed and grow it has to;

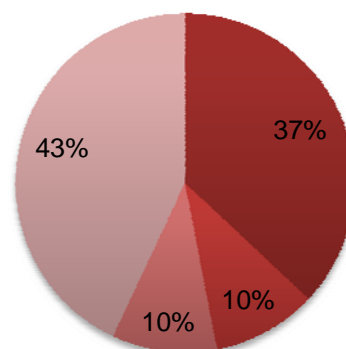
- Target a different customer base to the likes of Electrocomponents
- Offer a level of service that differentiates it from the mass market
- Specialise

The customer base

APC has deliberately chosen to service a highly specialised segment of the market. Most of its customers are specialised electrical or electronic engineering businesses. Around 37% of the current turnover is defence or aerospace related, 10% transport related, 10% medical and 43% other industrial. APC has no meaningful direct consumer facing business and this is probably also true for the majority of its customers. This gives it some distinct characteristics.

Breakdown of sales by industry

■ Defence and aerospace ■ Transport ■ Medical ■ Industrial and commercial



Source: Company

Industrial rather than consumer facing

A very defensive customer base

Significant customers

| Customer | Industry |
|--|---------------|
| Selex Sensors & Airborne Systems | Mil/Aero |
| Dell Corporation Ltd | Medical (NHS) |
| Alstom Transport Information Solutions | Transport |
| VETCO GRAY CONTROLS LIMITED | Industrial. |
| R S COMPONENTS | Industrial. |
| BAE SYSTEMS OPERATIONS LTD | Mil/Aero |
| Xaar Jet Limited | Industrial. |
| GE Aviation Systems LLC | Mil/Aero |
| Goodrich | Mil/Aero |
| ROTORK CONTROLS LIMITED | Industrial. |

Source: Company

- Defence customers are insulated from the normal business cycle and this confers a degree of such insulation on APC. Aerospace and other transportation customers also have a degree of such insulation but not to the same extent. Defence contractors are very particular in their supplier selection, don't tend to chop and change and are unlikely to go offshore for supplies. Reliability and security tend to be more important than price.
- The health and medical business acquired through the Contech acquisition is also largely independent of the economic cycle being government funded. The current medical business is highly specialised and targeting an area where the NHS is experiencing a very high profile problem, namely hospital acquired infections (MRSA).
- These customers will probably not be able to satisfy all their needs from the Premier Farnell and RS Components web sites. Interestingly RS Components is itself a significant APC customer.

APC's service

Highly knowledgeable sales teams

The divisions are effectively sales teams operating under different brands, with most logistics and finance functions being organised centrally. Each team is highly specialised and most of the salesmen are electronics or engineering graduates who can offer a high degree of technical support to customers. The teams understand the technology driving all the products they support, their applications and the businesses their customers operate in. This support might include help with component selection, design in capability, testing etc. APC focuses on providing customers with whatever support needed, whether it be a specific application of a product or a total solution.

APC's customer base and the type of service it has chosen to offer dictate that it specialises. When it comes to growing the business, this theme continues and the two acquisitions made in 2008 are themselves highly specialised businesses which fit very well with the APC philosophy and should present few if any cultural difficulties when integrating the businesses into APC as they effectively became divisions.

Growth strategy

APC is still a small business and many of the customers it supplies are operating in relatively mature industries. So how does management intend to grow the business? Overall demand is probably growing at the rate of GDP or thereabouts. Management has set a target of 2.5% organic growth with further targets of 2.5% for the divisions to add new lines to their products and a further 2.5% is also sought through new activities. As mentioned earlier this is an ambition and in the current environment would be extremely hard won. We have not included any of these additional elements in our forecasts for 2008/9

The second leg of management's growth strategy is acquisition. It is fairly clear that APC has an ambitious and acquisitive management team. It has made two acquisitions in 2008. These are expected to add over £4m revenue to the group in their first full year. Therefore in 2008/9 group revenue should be around £14.8m.

The acquisition of Novacom Microwave in May 2008 was part of a plan to create a Microwave centre of excellence and the process identified a number of businesses spun out of the former English Electric Valve company.

Management's preference is clearly to continue to grow the APC business both organically

and through acquisition. The strategy as outlined so far is aggressive, or perhaps opportunistic might be more apt. The two 2008 acquisitions will increase turnover in 2008/09 by just under 40%, but they will leave the business with gearing.

There is something of a balancing act to be performed here; the current environment is creating acquisition or merger opportunities but APC has limited borrowing headroom and will probably not be able to fund its acquisition program with debt. On the other hand, with the current depressed stock price management is understandably reluctant to raise new equity. Until a degree of confidence returns to the markets we expect management to temper its desire to grow the business with a degree of caution.

Risks

Currency is possibly the most significant risk **Reliance on key personnel**

APC is a small growing business, to drive that growth it relies heavily on its management team and in particular on its CEO Mark Robinson. There can be no guarantee that APC will continue to enjoy the services of these key managers and this would pose a risk to APC's growth strategy.

Acquisition opportunities don't materialise

A central plank of management's growth strategy is acquisition. There are currently three businesses that management has identified as a good fit with the APC philosophy, and with the existing divisions. However, progress on this front is not likely to be without obstacles. APC has a good relationship with its bank but the credit crunch which is impacting corporate lending as well as mortgages could make further debt funding difficult. Similarly, APC's current low valuation and the depressed equity market are not particularly conducive to financing acquisitions. There is a risk therefore that acquisitions will be delayed at best but delays could result in the opportunities being lost.

Recent acquisitions take longer to integrate

APC has made two significant acquisitions and is keen to make more. Although APC is careful to select acquisitions on the basis of similar business logic, integration of any acquired business can have its pitfalls. Corporate culture in particular can sometimes be difficult to reconcile. There is therefore a risk that these businesses take longer than anticipated to assimilate into APC, with an attendant delay in realising cost savings and an additional load on management time.

Currency Exposure

Typically a significant proportion of the components APC distributes are priced in US\$ whereas virtually all APC's customers are UK based and are invoiced in GBP. This leaves APC exposed to potential currency risk. This is particularly acute when a currency moves violently as the US\$ has against sterling in the last month or so. APC has not historically hedged, but the violence of recent moves may prompt a rethink in this area.

Management

An experienced management team

Rex Thorne OBE, BSc, FIM, MCIM – Non-Executive Chairman

Rex has an extensive career background in the electronics and telecommunications industries extending over 50 years and has held a number of senior executive directorships with various companies including Standard Telephones and Cables Ltd, ITT Business Systems UK, EMI Industrial Electronics Ltd, Brandenburg Limited and Astec BSR plc. He is currently non-executive Chairman of Marcom and was appointed non-executive Chairman of APC in September 1996.

Mark Robinson - Chief Executive Officer

Mark joined the Company in 1985 as a sales engineer and was appointed to the Board in 1992. In June 2001, Mark Robinson was appointed Managing Director and then Chief Executive Officer in September 2004. He has been responsible for the expansion into new business areas for the Company and has overseen the efforts to enhance operating efficiencies and increase market penetration in recent years.

Rod Muir – Finance Director

Rod joined the Company in March 2004 as Interim Finance Controller and was appointed to the Board in April 2006. Rod has wide experience at Board level in the distribution, manufacturing and service sectors and also spent ten years as a management consultant working on major projects with companies such as Thames Water, Coty Manufacturing and Shepherd Neame. Over the last two years he has worked closely with other Board members to achieve the cost savings and efficiency gains which have played a significant role in improving APC's financial performance.

Phil Lancaster – Operations Director

Phil joined the Company in 1995 as a product manager and in June 2000 was appointed General Manager of APC's distribution business. He was responsible for developing APC as a dominant technically based sales presence in the UK's military and aerospace markets. Phil was appointed to the board in September 2003 and then to Operations Director in April 2006. He has been responsible for improving operating efficiencies and for the successful integration of the Company's acquisitions.

Amanda Parker - Sales & Marketing Director

Amanda joined the Company in April 2006 with responsibility for Sales & Marketing covering all group activities and was appointed to the Board in September 2006. Amanda has significant experience in the sale of electronic components. Prior to joining Advanced Power Components plc, she worked for Abacus Electronics plc as Sales Director with overall responsibility for sales in the UK and Republic of Ireland.

Will David - Non-Executive Director

Will has more than 20 years' experience working in corporate advisory and broking roles for small and mid cap companies. During his professional career he has worked on over 20 flotations for clients across a range of sectors. His experience also includes acquisitions and disposals, public takeovers and secondary fundraisings and provision of advice on corporate governance matters. Will is Non-Executive Chairman of Cello plc and Chairman of its Audit Committee. He is also Non-Executive Chairman of Orca Interactive Limited and has worked at Investec Henderson Crosthwaite, PricewaterhouseCoopers, Hoare Govett & Co and The London Stock Exchange.

Forecasts

Acquisitions boosting revenues and earnings

2008 acquisitions will lift 2008/09 revenues

APC made two significant acquisitions in 2008 and further acquisitions are an integral part of management's growth strategy. The two completed acquisitions will contribute in full in 2008/09. Novacom reported sales of £2.3m and pre-tax profit of £220k in the year to 31 December 2007 and has been performing ahead of this in 2008. Contech reported sales of £1.26m and pre-tax profit of £154k in the eight months to 31 March 2008. With no progress at all from these run rates the two businesses would be adding £4m to revenues and around £425k to pre tax profit. On this basis we expect total revenue to be in the region of £14.8m for 2008/9. Going forward we take no account of possible future acquisitions in our forecasts which are based on the current business.

Trading statement

APC issued a trading statement on 10 September in which it reaffirmed that it expected to report revenues and pre-tax profit in line with guidance given in May at the time of its H1 results. The statement confirmed that trading in July and August had been tough but that Contech had performed well ahead of expectations.

2007/8 forecast

We forecast a profit before tax for 2007/8 of £680,000 on revenues of just over £12m. As outlined in the trading statement July and August were difficult months and the new acquisitions and in particular Contech provided a helping hand in the last month.

2008/9 outlook - first half likely to be weak

Although management is still setting growth targets and a large part of the business is perhaps less cyclical than other distributors, the current trading environment is nevertheless very difficult and it is unlikely that the core businesses will deliver any growth in the coming year. Order input in the summer was disappointing and the current banking crisis will have had and will continue to have an effect on business levels among APC's industrial customers. Although order input has since recovered considerably, December is traditionally a weak month. In view of this we believe it is likely that APC's first half of 2008/9 will be weaker than hitherto anticipated. We have accordingly reflected this in our forecast for the full year, of £14.81m revenues and £750k profit before tax. That said we have adopted a conservative approach and our forecasts have not reflected possible upside from Contech which recently won an initial £1m order from the NHS for 15,000 medigenic keyboards. The NHS has an ongoing battle against hospital acquired infections and these keyboards are proven to carry far less bacteria than conventional keyboards. The NHS controls over 1,600 hospitals, and has an estimated 400,000 keyboards in clinical areas, 15,000 keyboards would seem to be merely scratching the surface of the potential market in the UK alone.

Margins continued to recover in 2007/8 but will slip in 2008/9

APC has mostly recovered from the bursting of the tech bubble at the start of the decade, shedding its manufacturing operations and its telecoms business. Margins have also recovered and APC is currently averaging a gross margin level of 33%. The pre tax margin in 2007/8 based on our forecasts is about 5.6% and management is ultimately targeting 10%, although that is likely to take a few years. Notwithstanding the two acquisitions made in 2008 pre tax earnings are likely to come in around £750,000 due to a reduced contribution from the existing businesses, which means pre-tax margins slipping to around 5.2%. Novacom's gross margin is probably a shade more than the group average while Contech's are about six percentage points lower, but they do provide an increased contribution to overheads.

Central overhead

At least part of the rationale for growth through acquisitions is that APC has the necessary corporate and logistics infrastructure to manage a significantly larger business. The aim with both recent acquisitions and with proposed future acquisitions is that finance functions will be handled centrally and wherever possible logistics, i.e. inventory management, warehousing and dispatch will also be handled from a centralised location. Sweating the corporate overhead and other central costs harder should lead to a higher PBT margin.

Working capital management

At the half year stage inventory levels were approximately 40 days sales down from 41 days at the end of 2007. This is not a particularly high level of inventory. APC provides £10k per month for inventory obsolescence but as inventory is very rarely ordered without a customer order the history of obsolescence is low. Debtors were at 84 days, down from 91 at the end of 2007. Although debtor days have come down in 2008, they are still high at almost three months, but subject to variation throughout the year. In the current business environment with credit hard to find it may be seen as a cost of doing business but nonetheless APC is keen to keep reducing the level of debtors. APC has a credit facility from HBOS secured

Disappointing summer order input will lead to a weaker first half

against invoices (invoice discounting). Management reports no problem with bad debts.

EPS

Ignoring potential future acquisitions and therefore any increase in equity our EPS calculation is based on share capital of £0.782m and 22.324m shares in issue, with a weighted average of 20.725m for 2007/8. Forecast EPS for 2007/8 are 3.3p and for 2008/9 2.6p, the fall in EPS for 2008/9 is primarily due to a higher tax charge in that year as the loss carry forwards that have been keeping the tax charge low in previous years are mostly spent. The tax rate in 2008/9 is likely to be about 22% compared to 0% in 2007/8.

Dividend

APC has not paid a dividend since it moved to Aim at the end of 2002. APC has tidied up its balance sheet obtained court approval in October 2006 to eliminate the holding company's accumulated deficit which would allow APC to resume dividend payments. That said we do not expect APC to pay a dividend in the next couple of years. APC is in the midst of an expansion phase and is using its cash flow to fund acquisitions and provided these are earnings accretive, using the cash flow to grow the business is probably a more efficient use of capital.

Valuation

Along with the majority of Aim stocks and indeed full list stocks, APC's share price is at depressed levels. APC peaked this year on 26 February at 27p and was trading at 32p last November. In part the fall in the share price reflects general market malaise with the AIM all share having fallen 48% over a similar period.

An undemanding PE ratio

Based on consensus forecasts APC is trading on 5.2x 2008/09 earnings. This is far below the PER for the market and less than half the PER of the admittedly far larger quoted comparables. Clearly there is a discount for APC's size, the lack of liquidity, the lack of a robust institutional shareholder base and the lack of a dividend. That said this discount looks unduly harsh, gives APC no credit for the progress made in the last five years or for potential earnings enhancement from the acquisitions made in the last year. In particular we believe there is virtually nothing in the price to reflect the potential for substantial earnings improvements due to the NHS keyboard orders.

Price to sale also showing a large discount

Quite how valuable the price to sales ratio is as an indicator for a distributor is open to question but with a market cap of less than half 2008 revenue APC is once again trading at a substantial discount to Premier Farnell on 1.5x revenue and Electrocomponents on 0.75x. Once again there is a discount for lack of liquidity and dividend but operationally APC's margins would seem to be on a par with these companies'. APC's PBT margin is lower than the two market leaders but management's target of 10% seems on the money.

Price doesn't reflect earnings potential of NHS keyboard contract

Profit and Loss (£000's)

| Year Ending August 31 | 2007A | 2008E | 2009E | 2010E | 2011E |
|---|--------------|---------------|---------------|---------------|---------------|
| Group Sales | 9,741 | 12,115 | 14,814 | 15,386 | 16,155 |
| Cost of Sales (Reported) | (6,277) | (7,973) | (9,926) | (10,308) | (10,743) |
| Gross Profit | 3,464 | 4,142 | 4,889 | 5,077 | 5,412 |
| Other Operating Costs | (2,672) | (3,150) | (3,961) | (3,961) | (4,159) |
| Total Costs | (8,949) | (11,123) | (13,887) | (14,270) | (14,902) |
| EBITDA | 792 | 992 | 928 | 1,116 | 1,253 |
| Depreciation | (174) | (190) | (85) | (87) | (89) |
| EBIT | 582 | 760 | 801 | 987 | 1,121 |
| Net Interest | (72) | (80) | (51) | (50) | (16) |
| Pre-Tax Profits, pre Goodwill & Exceptionals | 510 | 680 | 750 | 937 | 1,105 |
| Pre-Tax profits pre Goodwill | 510 | 680 | 750 | 937 | 1,105 |
| Pre-Tax Profits | 510 | 680 | 750 | 937 | 1,105 |
| pt% | 5.2% | 5.6% | 5.1% | 6.1% | 6.8% |
| Tax | 15 | 0 | -165 | -262 | -310 |
| Tax Rate (%) | | 0% | -22% | -28% | -28% |
| Reported Profits pre Minorities | 525.0 | 680.3 | 584.7 | 674.8 | 795.9 |
| EPS p (undiluted) | 2.6 | 3.2 | 2.6 | 3.0 | 3.6 |
| EPS p (fully diluted, pre g/will and excepts) | 2.4 | 3.1 | 2.3 | 2.6 | 3.1 |
| Number of Shares at Year End (Fully Diluted) | 22322 | 21931 | 25502 | 25502 | 2502 |
| Number of Shares at Year End (Undiluted) | 20136 | 20725 | 22324 | 22324 | 22324 |

Source: St Helen's Capital

Cashflow (£000's)

| Year Ending August 31 | 2007A | 2008E | 2009E | 2010E | 2011E |
|---|--------------|----------------|------------------|----------------|----------------|
| EBIT | 582.0 | 760.3 | 800.7 | 987.0 | 1,121.4 |
| Depreciation | 174.0 | 190.0 | 84.9 | 87.1 | 89.3 |
| share based payments | 36.0 | 42.0 | 42.0 | 42.0 | 42.0 |
| Increase in Inventories | (183.0) | (131.2) | (244.1) | (47.8) | (54.3) |
| Decrease in Debtors | (944.0) | 177.6 | (449.9) | (95.2) | (128.2) |
| Increase / (Decrease) in Creditors | 463.0 | 288.0 | 244.1 | 47.8 | 54.3 |
| Total Operating Cashflows | 128.0 | 1,326.7 | 477.7 | 1,020.9 | 1,124.5 |
| Tax | 16.0 | - | (165.3) | (262.4) | (309.5) |
| Interest | (72.0) | (80.0) | (50.7) | (49.9) | (16.0) |
| Capex | (75.0) | (1,454.0) | (760.0) | (179.1) | (98.3) |
| Free Cash Flow | (3.0) | (207.3) | (498.3) | 529.6 | 700.7 |
| Net Cash Flow before Financing | (3.0) | (207.3) | (498.3) | 529.6 | 700.7 |
| Capital Increase/Decrease | (1,085.0) | 379.6 | - | - | - |
| New borrowings | 1,221.0 | 691.8 | (666.6) | (83.3) | - |
| Net Cash Flow after Financing | 133.0 | 864.1 | (1,164.9) | 446.3 | 700.7 |
| (Net Debt)/Net Cash at Start of Year | 549 | 682 | 1546 | 381 | 827 |
| Net Cash Flow During Year | 133 | 864 | -1165 | 446 | 701 |
| (Net Debt)/Net Cash at End of Year | 682 | 1546 | 381 | 827 | 1528 |

Source: St Helen's Capital

| Sales | | Disclosure checklist | see key below | |
|--|---------------|--|---------------|-------------------|
| Andy Allen | 020 7448 5982 | Company | Code | Disclosure |
| Andy.Allen@sthelenscapital.com | | Advance Power Components plc | APC | 2,3,6 |
| Katie Ratner | 020 7448 5983 | Electrocomponents, Premier Farnell, Abacus | ECM, PFL, ABU | 3 |
| Katie.Ratner@sthelenscapital.com | | | | |

Sebastian Wykeham (Head) 020 7448 5979
Sebastian.Wykeham@sthelenscapital.com

Research

Pooja Daramci 020 7448 5968
Pooja.Daramci@sthelenscapital.com

Andy Hanson 020 7448 5985
Andy.Hanson@sthelenscapital.com

David Johnson (Head) 020 7448 5962
David.Johnson@sthelenscapital.com

Simon Miller 0207 448 5997
Simon.Miller@sthelenscapital.com

Shunil Roy-Chaudhuri 0207 448 5987
Shunil.Roy-Chaudhuri@sthelenscapital.com

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5. The Company holds more than 5% of the securities of St Helen's Capital and/or its affiliates.
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