

The Mix Converted

We are raising our fair value on Richardson Electronics to \$23.75 from \$21.00 and maintaining our Buy rating. First quarter fiscal 2027 results were released after the close on October 7. Net sales grew 18.9% to \$64.9M with growth across all three business units, gross margin expanded to 34.6% from 31.0%, and backlog reached \$184.4M, up 36.9% year over year. Our fair value is set against a reference price of \$20.00, the October 7 close, which precedes any market reaction to the release. The company hosts its call on October 8 at 9:00 a.m. Central.

Our July note closed on a single question: whether the manufactured mix would convert into margin. We wrote that the market was pricing fiscal 2031 gross margin at 31.9%, the same level Richardson reached at the fiscal 2023 cycle peak, and that the disagreement was not about whether the company grows. The first quarter answered the question in one print.

Gross margin came in well ahead of our forecast. Reported gross margin of 34.6% included 1.7 percentage points from an IEEPA tariff refund, leaving roughly 32.9% underlying against 31.0% in the prior year quarter. PMT expanded to 35.4% from 31.3%, GES to 32.6% from 29.6% on product mix including new products, and Canvys to 33.0% from 30.9%. Our prior model carried 31.7% for the full year. We now forecast 32.5% in fiscal 2027, below the underlying first quarter figure, and we exclude the tariff refund from our estimates entirely.

We have restructured the margin forecast rather than simply raising it. Our prior model applied a flat 50 basis points of annual expansion. We now apply a declining curve of 130, 100, 75, 50 and 25 basis points across fiscal 2027 to fiscal 2031, reaching 34.9% consolidated. The shape reflects the mechanics of the shift: with manufactured product already at 55% to 60% of revenue, each incremental point of mix converts a progressively smaller distributed base. A constant rate of expansion would imply the opposite.

Operating expenses are now modeled as a function of revenue growth. First quarter operating expenses rose 8.8% against 18.9% sales growth, a flex of roughly 0.47 times, and fell to 26.8% of sales from 29.2%. We apply 0.50 times prospectively, replacing a flat 4% annual growth assumption. That is a more honest expression of the operating leverage argument than a fixed rate, and it is grounded in what the company just delivered.

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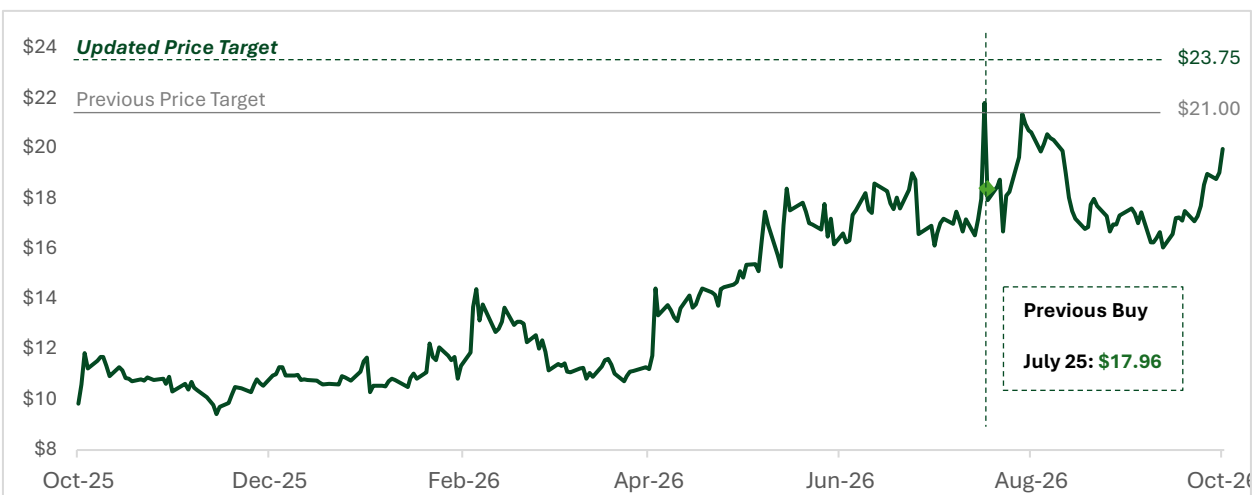
We model fiscal 2027 revenue of \$262.6M, up 14.9%, with PMT at 15%, GES at 24% and Canvys at 7%. Each sits below the first quarter growth rate, reflecting materially harder comparisons through the balance of the year. Fiscal 2031 EBITDA rises to \$48.6M from \$42.9M and fiscal 2027 EPS to \$0.79. Our fair value applies the same 10.0x exit multiple and 10.3% cost of capital as our prior note.

Cash conversion ran ahead of our model and we have left the assumption unchanged. We forecast a cash burn in fiscal 2027 and the first quarter generated \$4.2M of free cash flow, with cash rising to \$36.9M from \$31.8M. We continue to hold receivable and inventory intensity at fiscal 2026 levels, which produces negative \$6.8M of unlevered free cash flow for the year and a cash trough of \$24.0M. One quarter of better conversion is not sufficient to loosen a working capital assumption, but the gap is wide and we expect to revisit it after the second quarter.

A perpetuity growth terminal value gives \$18.97 and we continue to report it as a cross-check only. At the reference price the two methods bracket the shares closely. Readers who prefer the perpetuity approach should treat Richardson as fully valued here. Our 10.0x exit multiple now implies 4.7% perpetuity growth, against 4.9% in our prior note.

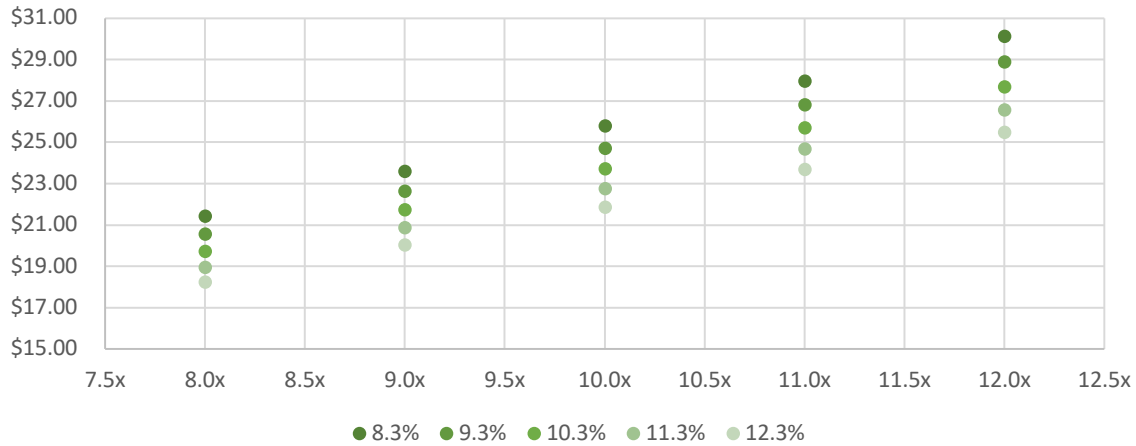
Three of our four downgrade conditions are resolving in the company's favor. Gross margin expanded well above the 20 basis point threshold we set. Operating cash flow exceeded net income. Backlog grew while the company shipped a near-record quarter, with book to bill at 1.31 times, which argues against the extended lead time explanation. The fourth, PMT concentration, is unresolved and has grown rather than diminished: the segment's margin expansion is being driven by semiconductor wafer fabrication equipment, a capital spending cycle Richardson does not control. We would also note that Green Energy Solutions growth is now attributed in part to Battery Energy Storage Systems, the first revenue attribution to a product line we previously carried as unvalued optionality.

Stock Chart (1 Year)

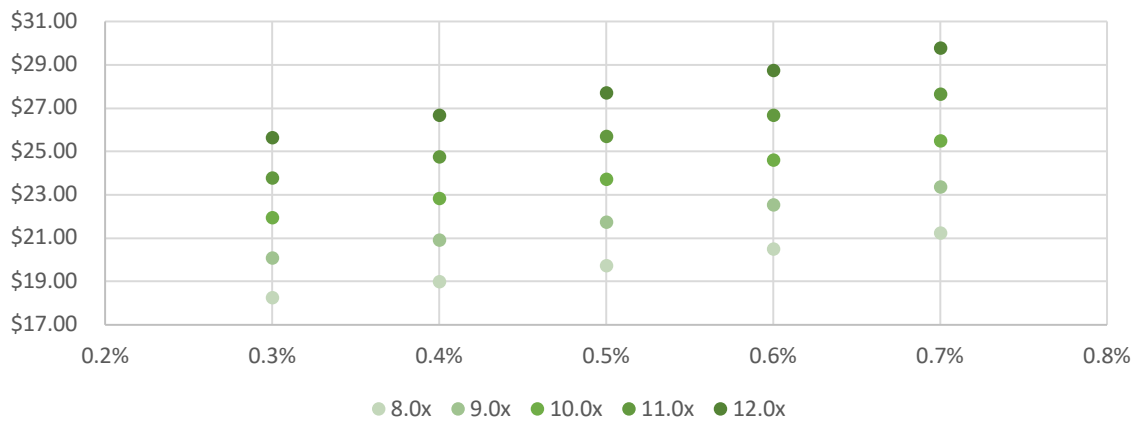


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Exit Multiple & WACC
Sensitivity



GPM Expansion and Multiple



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Income Statement

	Historical			Forecast				
	2024	2025	2026	2027	2028	2029	2030	2031
Revenue	196.46	208.91	228.56	262.64	288.82	312.01	335.01	355.16
% growth	-25.2%	6.3%	9.4%	14.9%	10.0%	8.0%	7.4%	6.0%
Cost of Goods Sold	140.80	144.11	157.22	177.31	192.13	205.24	218.73	231.03
Gross Profit	55.66	64.80	71.35	85.33	96.69	106.77	116.28	124.13
	28.3%	31.0%	31.2%	32.5%	33.5%	34.2%	34.7%	34.9%
SG&A	55.24	62.17	65.72	70.62	74.14	77.11	79.95	82.36
Operating Income	0.42	2.63	5.63	14.72	22.56	29.66	36.33	41.77
Non-operating Income	-0.26	-4.16	1.85	0.87	0.96	1.32	1.89	2.69
Pre-tax Income	0.16	-1.53	7.48	15.59	23.52	30.98	38.21	44.46
Taxes	0.10	-0.39	1.10	3.74	5.65	7.43	9.17	10.67
Consolidated Net Income	0.06	-1.14	6.38	11.85	17.88	23.54	29.04	33.79
Shares Outstanding			15.0	15.0	15.1	15.2	15.3	15.3
EPS				\$ 0.79	\$ 1.18	\$ 1.55	\$ 1.90	\$ 2.20

Balance Sheet

Cash & Equivalents	24.26	35.90	31.78	24.02	26.46	36.26	51.83	73.79
Accounts Receivable	24.85	24.12	33.16	38.11	41.90	45.27	48.61	51.53
Inventories	110.15	102.80	103.02	118.38	130.18	140.63	151.00	160.08
Other Current Assets	2.40	3.07	4.77	4.77	4.77	4.77	4.77	4.77
Total Current	161.65	165.89	172.73	185.27	203.32	226.93	256.20	290.17
Net PP&E	23.44	20.63	20.39	20.60	20.82	21.07	21.33	21.61
Intangible Assets	1.64	0.35	0.29	0.29	0.29	0.29	0.29	0.29
Deferred Tax Asset	5.50	8.74	8.35	8.35	8.35	8.35	8.35	8.35
Other Assets	0.21	0.23	0.26	0.26	0.26	0.26	0.26	0.26
Total Assets	192.45	195.84	202.02	214.76	233.03	256.89	286.42	320.67
<i>Liabilities</i>								
Accounts Payable	15.46	21.34	19.59	22.10	23.94	25.58	27.26	28.79
Other Current	15.40	14.28	15.99	15.99	15.99	15.99	15.99	15.99
ST Debt	1.17	1.17	0.79	0.79	0.79	0.79	0.79	0.79
Total Current	32.03	36.79	36.37	38.87	40.72	42.35	44.03	45.57
LT Debt	1.59	1.11	0.60	0.60	0.60	0.60	0.60	0.60
Other Liabilities	0.78	1.20	1.17	1.17	1.17	1.17	1.17	1.17
Deferred Tax Liability	0.09	0.08	0.18	0.18	0.18	0.18	0.18	0.18
Total Liabilities	34.49	39.18	38.32	40.82	42.67	44.30	45.98	47.52
Equity	157.95	156.66	163.70	173.94	190.37	212.59	240.44	273.15
Total Liabilities & Equity	192.45	195.84	202.02	214.76	233.03	256.89	286.42	320.67

Cash Flow Statement

Net Income	0.06	-1.14	6.38	11.85	17.88	23.54	29.04	33.79
D&A	4.31	4.00	3.79	5.05	5.55	6.00	6.44	6.83
Tax Credit	-1.00	-3.26	1.06					
Other Funds	2.00	6.18	1.26					
SBC		1.55	1.62	1.86	2.05	2.21	2.38	2.52
Increases in WC	1.16	4.77	-11.73	-17.80	-13.75	-12.18	-12.02	-10.48
Operating Cash Flow	6.52	10.55	0.76	0.96	11.72	19.57	25.84	32.66
Capex	-4.04	-2.81	-4.38	-5.25	-5.78	-6.24	-6.70	-7.10
Other Sources	0.00	6.83	0.00					
Sale of Fixed Assets	0.00	0.01	1.30					
Investing Cash Flow	-4.04	4.02	-3.08	-5.25	-5.78	-6.24	-6.70	-7.10
Cash Dividends Paid	-3.38	-3.41	-3.44	-3.47	-3.50	-3.53	-3.57	-3.60
Change in Capital Stock	0.59	0.32	0.99					
Other Funds	-0.12	-0.16	-0.10					
Financing Cash Flow	-2.91	-3.25	-2.54	-3.47	-3.50	-3.53	-3.57	-3.60
Exchange Rate Effect	-0.30	0.31	0.74					
Net Change in Cash	-0.72	11.64	-4.12	-7.76	2.45	9.80	15.57	21.96

Pre-tax income includes interest income on cash balances

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