

discoverIE Group

FY21 results

Back in growth mode

discoverIE's FY21 results confirmed that measures taken to manage the business through the pandemic minimised the impact on profitability and reduced gearing significantly. Strong order intake in H221 has returned the business to organic growth and the company continues to make higher-margin acquisitions in the Design & Manufacturing (D&M) business. We lift our underlying EPS forecast by 5.3% for FY22.

Year end	Revenue (£m)	PBT* (£m)	Diluted EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/20	466.4	34.6	31.8	3.0	27.0	0.3
03/21	454.3	32.6	27.0	10.2	31.8	1.2
03/22e	498.0	35.3	28.6	10.7	30.0	1.2
03/23e	513.0	37.2	29.7	11.0	28.8	1.3

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

FY21 beats forecasts

discoverIE beat our recently upgraded forecasts for FY21, with underlying operating profit and EPS ahead by 3.9% and 6.9% respectively due to higher-than-expected gross margin, and lower-than-expected finance costs and tax. Measures taken during H121 combined with higher-margin D&M acquisitions in H221 helped limit the operating margin decline to only 0.3pp despite a 2.6% revenue decline for FY21. Net debt reduced by £14m in the year as a result of cost control (opex and capex) and lower working capital, after paying £21m for two acquisitions in H2.

Upgrading estimates

Order momentum started to improve in H221 and discoverIE returned to organic revenue growth in the last two months of H2. So far this year, the company is trading ahead of the same period in FY20 and FY21 on an organic basis. We have revised our forecasts to reflect the post year-end acquisition of CPI for £8m and higher revenue in both divisions. We raise our FY22 underlying EPS forecast by 5.3% (4.1% y-o-y growth) and introduce a forecast for EPS growth of 4.4% in FY23.

Valuation: D&M key to margin growth

The stock is trading at a c 7% discount to its peer group on an FY22e P/E basis – the discount has widened from 2% when we last wrote in [April](#). Aside from the continuing recovery in customer demand, we view the key trigger for earnings and share price upside to be progress in increasing the weighting of the business towards the higher-growth, higher-margin D&M business (organically and via acquisition), which in turn should move the company closer to its 12.5% medium-term operating margin target. The stock is supported by a dividend yield of 1.2%.

Tech hardware & equipment

9 June 2021

Price **857.5p**
Market cap **£767m**

€1.16:\$1.42:£1

Net debt (£m) at end FY21 47.2

Shares in issue 89.5m

Free float 96%

Code DSCV

Primary exchange LSE

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	11.1	28.2	62.7
Rel (local)	11.4	20.7	43.7

52-week high/low 859p 463p

Business description

discoverIE is a leading international designer, manufacturer and supplier of customised electronics to industry, supplying customer-specific electronic products and solutions to original equipment manufacturers.

Next events

Q122 trading update 29 July 2021

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Review of FY21 results

Exhibit 1: FY21 results highlights

£m	FY21e	FY21a	diff	y-o-y
Revenues	453.6	454.3	0.2%	(2.6%)
Design & manufacturing	298.8	296.6	(0.7%)	(0.4%)
Custom supply	154.7	157.7	1.9%	(6.4%)
Gross margin	33.7%	34.2%	0.5%	0.6%
EBITDA	47.9	48.4	1.1%	(4.9%)
EBITDA margin	10.6%	10.7%	0.1%	(0.3%)
Underlying operating profit	33.9	35.2	3.9%	(5.1%)
Underlying operating margin	7.5%	7.7%	0.3%	(0.2%)
Normalised operating profit	35.5	36.3	2.3%	(6.7%)
Normalised operating margin	7.8%	8.0%	0.2%	(0.4%)
Normalised PBT	31.5	32.6	3.4%	(5.8%)
Normalised net income	23.6	24.9	5.2%	(10.0%)
Normalised diluted EPS (p)	25.6	27.0	5.2%	(15.2%)
Underlying diluted EPS (p)	24.3	26.0	6.9%	(13.8%)
Reported basic EPS (p)	14.0	13.5	(3.3%)	(20.6%)
Dividend per share (p)	10.4	10.2	(2.4%)	241.8%
Net (debt)/cash	(53.7)	(47.2)	(12.0%)	(23.0%)
Net debt/EBITDA (x)	1.2	1.1		

Source: discoverIE, Edison Investment Research

We recently upgraded our forecasts on the back of the year-end trading update in April. FY21 results came in marginally higher than forecast at the revenue level and 4% ahead at the underlying operating profit level. H221 revenue increased 10% half-on-half and returned to organic growth for the last two months of the year.

Gross margin was 0.5pp higher than forecast and 0.6pp higher year-on-year, mainly due to higher-margin acquisitions, resulting in gross profit 1.6% higher than forecast. This was partially offset by slightly higher than forecast operating expenses, resulting in an underlying operating profit margin 0.2pp ahead of our forecast. In response to the pandemic, the company reduced operating costs by 2% on an organic basis and 4% compared to the H220 run rate.

One-off costs of £3.4m included £2.0m for acquisitions and a £1.4m one-off charge for the legacy pension fund. Net finance costs of £3.7m were below our £4.0m forecast. The tax rate of 29.4% on a reported basis compared to our 25% forecast, higher due to acquisition-related costs that do not attract tax relief. On underlying PBT, the tax rate of 23.7% was slightly below our 25% forecast. Overall, this resulted in underlying diluted EPS 6.9% ahead of our forecast and normalised diluted EPS 5.2% ahead.

Year-end net debt reduced 23% y-o-y to £47.2m, reflecting strong operating cash flow conversion of 141%, due to lower working capital requirements and a lower ratio of working capital to sales (13.1% vs 14.4% in FY20), cost cutting and reduced spending on manufacturing facilities (maintenance only). Year-end gearing declined to 1.1x, well below the target range of 1.5–2.0x, even after spending £21.2m on the acquisitions of Phoenix and Limator in H2.

The company announced a final dividend of 7.0p, resulting in a 10.15p dividend for the full year, marginally below our 10.4p forecast, and 6% higher than the full year dividend for FY19.

Divisional performance

Performance by division is shown in Exhibit 2. The D&M division reported flat revenue y-o-y and a 1% decline on a constant currency basis. Stripping out the effects of the Phoenix and Limator acquisitions, the division saw an organic constant currency revenue decline of 4%. The underlying

margin of 12.7% was marginally lower than the 12.8% reported in FY20 and flat y-o-y on a constant currency basis. Organic order intake declined 18% y-o-y in H121 and rebounded to growth of 10% y-o-y in H221, resulting in a 4% decline y-o-y for FY21. On a regional basis, Germany and Rest of Europe saw organic growth (3% and 1% respectively), while the UK was down 15%, the Nordics were down 8% and North America was down 17%.

The CS division reported a 6% revenue decline y-o-y, or 8% on a constant currency organic basis. The underlying operating margin declined from 4.3% in FY20 to 3.6% in FY21. On a half-yearly basis, organic CER revenue was down 10% y-o-y in H121 improving to a 6% decline in H221. Orders of £173m were flat y-o-y with a book-to-bill of 1.09:1; H121 orders declined 16% y-o-y and rebounded to 16% growth in H221, up 40% h-o-h.

Exhibit 2: Performance by division

£m	FY21	FY20	FY20 CER	Reported y-o-y	CER* y-o-y	Organic CER y-o-y
Design & manufacturing (D&M)	296.6	297.9	299.7	0%	(1%)	(4%)
Custom distribution (CS)	157.7	168.5	171.3	(6%)	(8%)	(8%)
Total revenues	454.3	466.4	471.0	(3%)	(4%)	(6%)
Underlying operating profit						
Design & manufacturing	37.7	38.1	38.2	(1%)	(1%)	
Custom distribution	5.6	7.3	7.4	(23%)	(24%)	
Unallocated	(8.1)	(8.3)	(8.3)	(2%)	(2%)	
Total operating profit	35.2	37.1	37.3	(5%)	(6%)	
Underlying operating margin						
Design & manufacturing	12.7%	12.8%	12.7%	(0.1%)	(0.0%)	
Custom distribution	3.6%	4.3%	4.3%	(0.8%)	(0.8%)	
Total operating margin	7.7%	8.0%	7.9%	(0.2%)	(0.2%)	

Source: discoverIE. Note: *Constant exchange rate.

Review of KSI and KPIs

In the exhibits below, we summarise the company's performance according to its key strategic and performance indicators.

Exhibit 3: Key strategic indicators (KSIs)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY25 target
Increase Design & Manufacturing revenue	37%	48%	52%	57%	61%	64%	65%	>75%
Increase underlying operating margin	4.9%	5.7%	5.9%	6.3%	7.0%	8.0%	7.7%	12.5%
Build sales beyond Europe	12%	17%	19%	19%	21%	27%	28%	40%
Sales from target markets	N/A	N/A	56%	62%	66%	68%	70%	85%

Source: discoverIE

The company made progress in FY21 towards three of the KSI targets. D&M continued to increase as a percentage of total revenue. We expect further D&M acquisitions will be required to achieve the 75% target in FY25; post year-end, the company acquired Control Products Inc (CPI), a US-based sensors business, for £8m on a debt-free, cash-free basis. Sales from target markets increased to 70% of total revenue and 75% of D&M revenue. The company estimates that target markets declined 3% in FY21 compared to a 9% decline for other markets. This helped the group to limit the organic group decline to 6%. Despite the effect of COVID-19, particularly in H121, the underlying operating margin only declined 0.3pp in FY21 and we expect it to expand again from FY22. In H121, the margin declined to 7.3% before recovering to 8.2% in H221.

Exhibit 4: Key performance indicators (KPIs)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21	Target
Sales growth: CER	36%	14%	6%	11%	14%	8%	(4%)	
Sales growth: D&M organic	9%	3%	-1%	11%	10%	5%	(4%)	
Sales growth: organic	3%	3%	-1%	6%	8%	2%	(6%)	Well ahead of GDP
Underlying EPS growth	31%	10%	13%	16%	22%	11%	(14%)	>10%
Dividend growth	11%	6%	6%	6%	6%	N/A - only interim paid	6%	Progressive
ROCE*	12.0%	11.6%	13.0%	13.7%	15.4%	16.0%	14.5%	>15%
Operating cash flow generation	104%	100%	136%	85%	93%	106%	141%	>85% of underlying operating profit
Free cash flow generation	22%	64%	101%	58%	94%	104%	157%	>85% of underlying profit after tax
Carbon emissions							(6%)	50% reduction to CY25

Source: discoverIE. Note: *Underlying operating profit as a percentage of net assets plus net debt, annualising acquisitions.

We discuss revenue, dividend and operating cash flow performance above. Underlying EPS declined 14% from a combination of higher share count (equity issued in H220), the impact of COVID-19 and higher tax rates.

ROCE fell below the target for the year, but on a half-yearly basis recovered to 15.6% in H221 from 12.7% in H121.

Strong operating cash flow conversion generated strong free cash flow. The company is aiming to become self-funding for acquisitions. The pause in M&A in H121 contributed to the reduction in gearing at year-end.

Carbon emissions declined 19% in CY20 on a like-for-like basis excluding acquisitions made in CY20. Adjusted to normalise for the impact of COVID-19, carbon emissions reduced by 6%.

Outlook and changes to forecasts

The company closed the year with an order book of £181m (c 80% due for delivery within 12 months), up 15% CER and 11% on an organic basis. H121 orders declined 18% y-o-y, with a book-to-bill of 0.91:1. In H221, orders were 12% higher y-o-y on an organic basis and 40% higher h-o-h, resulting in a book-to-bill of 1.19:1 for H2 and 1.05:1 for FY21. Design wins declined 15% y-o-y, with H121 down 19% y-o-y and H221 down 12% y-o-y but up 3% h-o-h. Design wins in target markets made up 90% of D&M wins and 60% of CS wins.

Management noted that FY22 has started well with organic sales growth ahead of the same period in FY21 and FY20, and orders running ahead of sales across all territories.

We have revised our forecasts to reflect the CPI acquisition and stronger revenue in FY22, which results in an upgrade to our underlying operating profit and EPS forecasts of 5.2% and 5.3% respectively. Factoring in the CPI acquisition and assuming that working capital requirements grow with revenue and expansion investment in manufacturing facilities is resumed, we forecast net debt of £59.4m by the end of FY22, equivalent to gearing of 1.3x.

Exhibit 5: Changes to forecasts

£m	FY22e old	FY22e new	Change	y-o-y	FY23e new	y-o-y
Revenues	489.0	498.0	1.8%	9.6%	513.0	3.0%
Design & manufacturing	325.0	330.5	1.7%	11.4%	341.3	3.3%
Custom supply	164.0	167.5	2.2%	6.2%	171.7	2.5%
Gross margin	33.8%	33.8%	0.0%	(0.4%)	33.8%	0.0%
EBITDA	50.3	52.1	3.7%	7.7%	54.2	3.9%
EBITDA margin	10.3%	10.5%	0.2%	(0.2%)	10.6%	0.1%
Underlying operating profit	36.1	37.9	5.2%	7.8%	39.9	5.1%
Underlying operating margin	7.4%	7.6%	0.2%	(0.1%)	7.8%	0.2%
Normalised operating profit	37.9	39.7	5.0%	9.5%	41.7	4.9%
Normalised operating margin	7.7%	8.0%	0.2%	(0.0%)	8.1%	0.1%
Normalised PBT	33.4	35.3	5.6%	8.2%	37.2	5.5%
Normalised net income	25.1	26.5	5.6%	6.3%	27.5	4.1%
Normalised diluted EPS (p)	27.2	28.6	5.0%	5.9%	29.7	4.1%
Underlying diluted EPS (p)	25.7	27.1	5.3%	4.1%	28.3	4.4%
Reported basic EPS (p)	14.2	14.7	3.8%	8.8%	16.7	13.2%
Dividend per share (p)	10.7	10.7	0.0%	5.4%	11.0	2.8%
Net (debt)/cash	(54.9)	(59.4)	8.3%	25.9%	(52.6)	(11.5%)
Net debt/EBITDA (x)	1.3	1.3			1.1	

Source: Edison Investment Research

Valuation

Exhibit 6: Peer valuation metrics

	EV/sales (x)		EV/EBITDA (x)		EV/EBIT (x)		P/E (x)		Dividend yield (%)	
	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
discoverIE	1.7	1.6	15.9	15.3	20.8	19.9	30.0	28.8	1.2	1.3
Diploma	5.0	4.6	24.0	22.4	27.8	25.5	35.0	32.5	1.3	1.4
Electrocomponents	2.2	2.1	16.1	14.3	19.6	17.1	25.5	22.2	1.6	1.8
Gooch & Housego	2.9	2.8	18.0	16.4	27.4	23.3	38.5	33.0	0.9	0.9
TT electronics	1.2	1.1	10.4	9.1	16.4	12.9	17.9	14.5	2.2	2.5
XP Power	4.4	4.2	17.9	16.6	22.9	20.7	27.7	26.1	1.7	1.8
Avon Rubber	3.4	2.7	14.7	11.1	21.2	14.9	33.2	24.4	1.1	1.4
Halma	7.8	7.4	31.7	29.1	37.7	34.2	47.3	42.8	0.7	0.7
Spectris	2.8	2.7	14.2	13.0	18.3	16.5	23.4	20.8	2.2	2.3
Spirax-Sarco Engineering	7.3	6.9	25.8	24.3	30.3	28.6	41.2	38.7	1.0	1.1
Average	4.1	3.8	19.2	17.4	24.6	21.5	32.2	28.3	1.4	1.5
Premium/(discount) to average (%)	(59.6)	(57.9)	(17.2)	(11.9)	(15.4)	(7.7)	(6.7)	1.8	(10.6)	(16.7)

Source: Edison Investment Research, Refinitiv (as at 7 June)

The stock is trading at a c 7% discount to its peer group on an FY22e P/E basis – the discount has widened from 2% when we last wrote in April. Aside from the continuing recovery in customer demand, we view the key trigger for earnings and share price upside to be progress in increasing the weighting of the business towards the higher-growth, higher-margin D&M business (organically and via acquisition), which in turn should move the company closer to its 12.5% medium-term operating margin target. The stock is supported by a dividend yield of 1.2%.

Exhibit 7: Financial summary

	£m	2018	2019	2020	2021	2022e	2023e
Year end 31 March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		387.9	438.9	466.4	454.3	498.0	513.0
Cost of Sales		(261.2)	(293.9)	(309.7)	(299.0)	(329.7)	(339.6)
Gross Profit		126.7	145.0	156.7	155.3	168.3	173.4
EBITDA		29.3	37.0	50.9	48.4	52.1	54.2
Operating Profit (before am, SBP and except.)		25.2	31.8	38.9	36.3	39.7	41.7
Operating Profit (before am. and except.)		24.5	30.6	37.1	35.2	37.9	39.9
Amortisation of acquired intangibles		(4.9)	(5.9)	(9.0)	(11.1)	(11.6)	(11.6)
Exceptionals		(2.3)	(2.0)	(4.3)	(3.4)	(4.0)	(3.6)
Share-based payments		(0.7)	(1.2)	(1.8)	(1.1)	(1.8)	(1.8)
Operating Profit		17.3	22.7	23.8	20.7	22.3	24.7
Net Interest		(2.6)	(3.4)	(4.3)	(3.7)	(4.5)	(4.5)
Profit Before Tax (norm)		22.6	28.4	34.6	32.6	35.3	37.2
Profit Before Tax (FRS 3)		14.6	19.3	19.5	17.0	17.8	20.1
Tax		(4.0)	(4.7)	(5.2)	(5.0)	(4.6)	(5.2)
Profit After Tax (norm)		17.1	21.5	27.6	24.9	26.5	27.5
Profit After Tax (FRS 3)		10.6	14.6	14.3	12.0	13.2	14.9
Ave. Number of Shares Outstanding (m)		70.8	73.0	84.0	88.8	89.5	89.5
EPS - normalised & diluted (p)		23.0	28.4	31.8	27.0	28.6	29.7
EPS - underlying, diluted (p)		22.3	27.2	30.2	26.0	27.1	28.3
EPS - IFRS basic (p)		15.0	20.0	17.0	13.5	14.7	16.7
EPS - IFRS diluted (p)		14.2	19.4	16.5	13.0	14.2	16.1
Dividend per share (p)		9.0	9.6	3.0	10.2	10.7	11.0
Gross Margin (%)		32.7	33.0	33.6	34.2	33.8	33.8
EBITDA Margin (%)		7.6	8.4	10.9	10.7	10.5	10.6
Operating Margin (before am, SBP and except.) (%)		6.5	7.2	8.3	8.0	8.0	8.1
discoverIE adjusted operating margin (%)		6.3	7.0	8.0	7.7	7.6	7.8
BALANCE SHEET							
Fixed Assets		136.4	149.2	236.4	245.0	243.5	233.9
Intangible Assets		107.2	119.7	182.2	191.2	188.0	176.8
Tangible Assets		23.4	24.4	46.3	45.9	47.6	49.2
Deferred tax assets		5.8	5.1	7.9	7.9	7.9	7.9
Current Assets		165.9	179.1	197.4	183.6	185.4	192.4
Stocks		58.1	66.2	68.4	67.7	74.8	77.0
Debtors		84.6	88.7	90.1	84.9	96.9	99.8
Cash		21.9	22.9	36.8	29.2	12.0	13.8
Current Liabilities		(94.0)	(96.0)	(103.6)	(107.8)	(114.9)	(118.0)
Creditors		(87.6)	(94.3)	(94.0)	(102.2)	(109.3)	(112.4)
Lease liabilities		0.0	0.0	(5.3)	(4.8)	(4.8)	(4.8)
Short term borrowings		(6.4)	(1.7)	(4.3)	(0.8)	(0.8)	(0.8)
Long Term Liabilities		(81.5)	(97.6)	(129.7)	(112.0)	(99.2)	(86.2)
Long term borrowings		(67.9)	(84.5)	(93.8)	(75.6)	(70.6)	(65.6)
Lease liabilities		0.0	0.0	(14.7)	(16.7)	(16.1)	(15.5)
Other long-term liabilities		(13.6)	(13.1)	(21.2)	(19.7)	(12.5)	(5.1)
Net Assets		126.8	134.7	200.5	208.8	214.8	222.1
CASH FLOW							
Operating Cash Flow		21.7	30.0	48.0	57.2	37.8	50.1
Net Interest		(2.6)	(3.4)	(3.7)	(3.1)	(3.9)	(3.9)
Tax		(3.7)	(3.8)	(6.4)	(7.2)	(8.8)	(9.7)
Capex		(4.3)	(5.4)	(6.3)	(3.9)	(8.5)	(8.5)
Acquisitions/disposals		(25.4)	(22.4)	(73.6)	(20.5)	(13.1)	(5.0)
Financing		(1.5)	0.1	53.9	(6.6)	(6.7)	(6.7)
Dividends		(6.2)	(6.7)	(8.1)	(2.8)	(9.1)	(9.6)
Net Cash Flow		(22.0)	(11.6)	3.8	13.1	(12.2)	6.8
Opening net cash/(debt)		(30.0)	(52.4)	(63.3)	(61.3)	(47.2)	(59.4)
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0	0.0
Other		(0.4)	0.7	(1.8)	1.0	0.0	(0.0)
Closing net cash/(debt)		(52.4)	(63.3)	(61.3)	(47.2)	(59.4)	(52.6)

Source: discoverIE, Edison Investment Research

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