

discoverIE Group

Acquisition

Accretive acquisition drives FY19 growth

discoverIE has further expanded its design and manufacturing business with the acquisition of Santon, a Dutch DC switch manufacturer, for initial consideration of €27m/£23.7m. The deal nearly doubles discoverIE's sales into the renewables sector as well as increasing the level of business from Asia. Management expects the deal to be earnings accretive in FY19. We forecast that the acquisition will increase FY19e normalised EPS by 9% and will result in a net debt/EBITDA ratio of 1.7x by the end of FY19.

| Year end | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|---------|---------|-----------|
| 03/16 | 287.7 | 15.2 | 17.8 | 8.1 | 21.0 | 2.1 |
| 03/17 | 338.2 | 17.8 | 19.9 | 8.5 | 18.9 | 2.3 |
| 03/18e | 391.0 | 21.6 | 21.6 | 9.0 | 17.4 | 2.4 |
| 03/19e | 427.6 | 25.0 | 24.6 | 9.5 | 15.3 | 2.5 |

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

Acquisition of Dutch DC switch manufacturer

discoverIE has acquired Santon Group, a designer and manufacturer of custom switches for electronic applications. Its DC switches are used to isolate electrical circuits; for example, they are used in solar panel systems to isolate the power-generating solar panels from the AC network (ie the grid). Santon is headquartered in Rotterdam, the Netherlands, where it also has its manufacturing facility and it has sales offices in Wales and Germany. discoverIE is paying €27m/£23.7m initial consideration (€26m/£22.8m cash plus €1m/£0.9m from the issue of 0.22m shares) and will also reimburse the vendor €2.5m/£2.2m for a recently undertaken manufacturing automation project. Contingent consideration of €22.5m/£19.9m is payable over three years, subject to achieving growth targets. The deal was funded using the existing debt facility.

Earnings accretive from FY19

Santon generated CY16 revenues of €24.4m/£20.0m and grew in CY17. CY16 normalised operating profit (excluding finance charges, exceptional items and shareholder costs) was €3.2m/£2.6m (13.1% margin vs FY17 group margin of 5.9% and D&M margin of 11.5%). We have revised our forecasts, with revenues up 0.8% in FY18 and 6.2% in FY19. While FY18 normalised EPS is unchanged, we lift our FY19 forecast by 8.9%. We forecast end-FY19 net debt to increase from £24.4m to £58.6m, which equates to a net debt/EBITDA ratio of 1.7x, within the company's target gearing range of 1.5-2.0x.

Valuation: Still trading at a discount

On our revised forecasts, the stock is trading on an FY19e P/E of 15.3x, at a c 23% discount to the peer group average. Continued growth in the proportion of revenue generated from design and manufacturing should support operating margin expansion, and should help to reduce the valuation discount. The stock is also supported by a dividend yield of more than 2%.

Electronic & electrical equipment

5 February 2018

Price 375p

Market cap £266m

€1.14:NOK10.92:£1

Net debt (£m) at end H118 37.6

Shares in issue 70.9m

Free float 96%

Code DSCV

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 0.8 15.3 64.5

Rel (local) 3.7 17.1 56.2

52-week high/low 398p 213p

Business description

discoverIE (formerly Acal plc) is a leading international designer and manufacturer of customised electronics to industry, supplying customer-specific electronic products and solutions to 25,000 industrial manufacturers.

Next events

Capital markets day 15 March 2018

FY18 trading update April 2018

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Changes to forecasts

The table below summarises the changes to our estimates.

| Exhibit 1: Changes to forecasts | | | | | | | | |
|---|----------------------|----------------------|---------------|--------------|----------------------|----------------------|---------------|--------------|
| £m | FY18e old | FY18e new | Change | y-o-y | FY19e old | FY19e new | Change | y-o-y |
| Revenues | 388.0 | 391.0 | 0.8% | 15.6% | 402.6 | 427.6 | 6.2% | 9.4% |
| Design & manufacturing | 217.1 | 220.1 | 1.4% | 25.4% | 228.0 | 253.0 | 11.0% | 14.9% |
| Custom supply | 170.8 | 170.8 | 0.0% | 5.1% | 174.6 | 174.6 | 0.0% | 2.2% |
| Gross margin | 32.2% | 32.2% | 0.0% | (0.6%) | 32.4% | 32.4% | 0.0% | 0.2% |
| EBITDA | 28.6 | 29.0 | 1.4% | 19.3% | 29.9 | 34.4 | 15.0% | 18.6% |
| EBITDA margin | 7.4% | 7.4% | 0.0% | 0.2% | 7.4% | 8.0% | 0.6% | 0.6% |
| Underlying operating profit* | 23.9 | 24.2 | 1.0% | 20.8% | 24.9 | 28.4 | 14.0% | 17.4% |
| Underlying operating profit margin* | 6.2% | 6.2% | 0.0% | 0.3% | 6.2% | 6.6% | 0.5% | 0.5% |
| Normalised operating profit | 24.5 | 24.8 | 1.0% | 20.2% | 25.7 | 29.2 | 13.6% | 17.8% |
| Normalised operating margin | 6.3% | 6.3% | 0.0% | 0.2% | 6.4% | 6.8% | 0.4% | 0.5% |
| Normalised PBT | 21.6 | 21.6 | 0.0% | 21.5% | 22.9 | 25.0 | 9.1% | 15.5% |
| Normalised net income | 16.2 | 16.2 | 0.0% | 19.5% | 17.1 | 18.7 | 9.2% | 15.5% |
| Normalised EPS (p) | 21.6 | 21.6 | (0.0%) | 8.7% | 22.6 | 24.6 | 8.9% | 13.7% |
| Reported EPS (p) | 13.6 | 12.1 | (11.1%) | 126.8% | 17.7 | 13.9 | (21.2%) | 14.9% |
| Net (debt)/cash | (29.9) | (56.2) | 87.9% | 87.3% | (24.4) | (58.6) | 140.3% | 4.3% |
| Net debt/EBITDA (x) | 1.0 | 1.7 | | | 0.8 | 1.7 | | |
| Source: Edison Investment Research. Note: *Includes share-based payments. | | | | | | | | |

Exhibit 2: Financial summary

| | £m | 2013 | 2014 | 2015 | 2016 | 2017 | 2018e | 2019e |
|---|----|---------|---------|---------|---------|---------|---------|---------|
| Year end 31 March | | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS |
| PROFIT & LOSS | | | | | | | | |
| Revenue | | 177.4 | 211.6 | 271.1 | 287.7 | 338.2 | 391.0 | 427.6 |
| Cost of Sales | | (123.0) | (148.6) | (186.7) | (195.1) | (227.2) | (264.9) | (289.1) |
| Gross Profit | | 54.4 | 63.0 | 84.4 | 92.6 | 111.0 | 126.1 | 138.6 |
| EBITDA | | 7.4 | 9.1 | 16.6 | 19.8 | 24.3 | 29.0 | 34.4 |
| Operating Profit (before am, SBP and except.) | | 6.1 | 7.7 | 14.0 | 17.0 | 20.6 | 24.8 | 29.2 |
| Operating Profit (before am. and except.) | | 5.5 | 7.1 | 13.4 | 16.3 | 20.0 | 24.2 | 28.4 |
| Amortisation of acquired intangibles | | (0.7) | (1.0) | (2.1) | (2.8) | (3.9) | (4.9) | (7.4) |
| Exceptionals | | (3.4) | (0.9) | (5.2) | (2.1) | (8.4) | (3.9) | (3.2) |
| Share-based payments | | (0.6) | (0.6) | (0.6) | (0.7) | (0.6) | (0.6) | (0.8) |
| Operating Profit | | 1.4 | 5.2 | 6.1 | 11.4 | 7.7 | 15.4 | 17.7 |
| Net Interest | | (0.5) | (0.8) | (1.6) | (1.8) | (2.8) | (3.1) | (4.2) |
| Profit Before Tax (norm) | | 5.6 | 6.9 | 12.4 | 15.2 | 17.8 | 21.6 | 25.0 |
| Profit Before Tax (FRS 3) | | 0.7 | 4.2 | 4.3 | 9.4 | 4.8 | 12.1 | 13.3 |
| Tax | | 1.4 | (0.5) | (1.4) | (2.2) | (1.3) | (3.5) | (3.5) |
| Profit After Tax (norm) | | 4.6 | 6.0 | 10.0 | 11.8 | 13.6 | 16.2 | 18.7 |
| Profit After Tax (FRS 3) | | 2.1 | 3.7 | 2.9 | 7.2 | 3.5 | 8.6 | 9.9 |
| Average Number of Shares Outstanding (m) | | 39.2 | 43.1 | 57.6 | 63.3 | 65.4 | 70.7 | 70.9 |
| EPS - normalised & diluted (p) | | 11.3 | 13.1 | 16.4 | 17.8 | 19.9 | 21.6 | 24.6 |
| EPS - IFRS basic (p) | | (4.8) | 3.0 | 5.0 | 11.4 | 5.3 | 12.1 | 13.9 |
| EPS - IFRS diluted (p) | | (4.7) | 2.8 | 4.8 | 10.9 | 5.1 | 11.4 | 13.0 |
| Dividend per share (p) | | 6.2 | 6.8 | 7.6 | 8.1 | 8.5 | 9.0 | 9.5 |
| Gross Margin (%) | | 30.7 | 29.8 | 31.1 | 32.2 | 32.8 | 32.2 | 32.4 |
| EBITDA Margin (%) | | 4.2 | 4.3 | 6.1 | 6.9 | 7.2 | 7.4 | 8.0 |
| Operating Margin (before am, SBP and except.) (%) | | 3.4 | 3.6 | 5.2 | 5.9 | 6.1 | 6.3 | 6.8 |
| BALANCE SHEET | | | | | | | | |
| Fixed Assets | | 30.9 | 33.1 | 88.6 | 108.4 | 122.2 | 147.9 | 141.5 |
| Intangible Assets | | 24.2 | 25.5 | 69.9 | 88.2 | 100.7 | 126.6 | 118.8 |
| Tangible Assets | | 3.1 | 3.5 | 13.8 | 14.7 | 16.0 | 15.8 | 17.3 |
| Deferred tax assets | | 3.6 | 4.1 | 4.9 | 5.5 | 5.5 | 5.5 | 5.5 |
| Current Assets | | 81.8 | 92.7 | 127.3 | 128.3 | 149.6 | 164.6 | 170.7 |
| Stocks | | 19.3 | 19.4 | 39.8 | 42.9 | 50.1 | 57.8 | 63.3 |
| Debtors | | 44.7 | 48.3 | 60.2 | 65.5 | 77.3 | 86.8 | 94.9 |
| Cash | | 17.8 | 18.1 | 26.7 | 19.9 | 22.2 | 20.0 | 12.6 |
| Current Liabilities | | (50.9) | (58.3) | (62.1) | (61.7) | (78.4) | (95.2) | (101.6) |
| Creditors | | (46.6) | (51.5) | (61.9) | (60.9) | (77.1) | (89.9) | (96.3) |
| Short term borrowings | | (4.3) | (6.8) | (0.2) | (0.8) | (1.3) | (5.3) | (5.3) |
| Long Term Liabilities | | (10.3) | (19.0) | (61.1) | (73.1) | (69.6) | (93.3) | (86.5) |
| Long term borrowings | | (1.7) | (9.5) | (45.5) | (57.2) | (50.9) | (70.9) | (65.9) |
| Other long term liabilities | | (8.6) | (9.5) | (15.6) | (15.9) | (18.7) | (22.4) | (20.6) |
| Net Assets | | 51.5 | 48.5 | 92.7 | 101.9 | 123.8 | 124.1 | 124.2 |
| CASH FLOW | | | | | | | | |
| Operating Cash Flow | | 5.7 | 6.1 | 6.6 | 14.6 | 20.3 | 19.2 | 27.1 |
| Net Interest | | (0.6) | (0.8) | (1.6) | (1.8) | (2.8) | (3.1) | (4.2) |
| Tax | | (1.4) | (0.9) | (3.3) | (4.3) | (3.0) | (5.4) | (6.3) |
| Capex | | (1.3) | (1.4) | (2.5) | (2.3) | (3.4) | (3.7) | (6.2) |
| Acquisitions/disposals | | (0.5) | (9.2) | (37.3) | (19.8) | (11.8) | (27.0) | (6.4) |
| Financing | | 5.7 | 0.1 | 52.7 | 0.0 | 13.6 | 0.0 | 0.0 |
| Dividends | | (2.3) | (2.7) | (3.6) | (4.9) | (5.2) | (6.2) | (6.5) |
| Net Cash Flow | | 5.3 | (8.8) | 11.0 | (18.5) | 7.7 | (26.2) | (2.4) |
| Opening net cash/(debt) | | 6.3 | 11.8 | 1.8 | (19.0) | (38.1) | (30.0) | (56.2) |
| HP finance leases initiated | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | | 0.2 | (1.2) | (31.8) | (0.6) | 0.4 | 0.0 | 0.0 |
| Closing net cash/(debt) | | 11.8 | 1.8 | (19.0) | (38.1) | (30.0) | (56.2) | (58.6) |

Source: discoverIE, Edison Investment Research

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