discoverIE Group

Accretive acquisition drives FY19 growth

Acquisition

Electronic & electrical equipment

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%.

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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