

discoverIE Group

High-margin acquisitions

discoverIE has made two acquisitions of design and manufacturing (D&M) businesses for a total of £77m in cash. This is in line with the company's strategy to grow the D&M division and provides scope for cross-selling as well as increasing access to non-European markets. Both acquisitions have high operating margins (20%+), helping the group in its quest to drive underlying operating margins towards its four-year target of 12.5% from last year's 7.7%. The acquisitions were part-funded by an over-subscribed placing that raised gross proceeds of £55m.

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	37.6	0.2
03/21	454.3	32.6	27.0	10.2	44.3	0.8
03/22e	523.8	39.8	30.8	10.7	38.8	0.9
03/23e	550.0	43.6	32.7	11.0	36.5	0.9

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

Further expansion of the D&M business

discoverIE has acquired two D&M businesses for a total cash consideration of £77m, funded from existing debt facilities. Together these businesses add c £29m in annual revenue with operating margins above 20% (compared to the FY21 D&M operating margin of 12.7%). The deals, together with the equity placing, are immediately accretive to EPS. US-based Beacon EmbeddedWorks is an embedded computing specialist and UK-headquartered Antenova specialises in radio frequency (RF) antennas. Both deals provide cross-selling opportunities and higher exposure to business outside of Europe.

Partially funded by over-subscribed placing

The company placed 5.35m shares at 1,028p per share (no discount) to raise gross proceeds of £55m, up from the originally planned £45m due to high demand. We have revised our forecasts to reflect the acquisitions and the placing. Our revenue forecasts increase by 3.2% in FY22 and 5.6% in FY23 and normalised diluted EPS by 4.8% in FY22 and 7.8% in FY23. We forecast gearing to increase from 1.3x to 1.5x at the end of FY22, still well within the company's target range of 1.5–2.0x and leaving headroom for further deals.

Valuation: Boosted by high-margin additions

The deals have been well received by the market, with the stock up 16% since the placing and acquisitions were announced. The stock now trades at a 13% premium to its peer group on an FY22e P/E basis, suggesting an expectation of further earnings upgrades. Aside from the ongoing 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 close to 1%.

Acquisitions and placing

Tech hardware & equipment

7 September 2021

Price **1,196p**

Market cap **£1,134m**

€1.17:\$1.38:£1

Net debt (£m) at end FY21 47.2

Shares in issue (from 7 September) 94.8m

Free float 96%

Code DSCV

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 10.7 45.9 99.3

Rel (local) 9.3 42.3 56.5

52-week high/low 1,250p 560p

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

H122 trading update October 2021

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Acquisition of two D&M businesses

discoverIE has acquired two businesses operating in the D&M segment and expects the deals, together with the equity placing, to be immediately earnings enhancing.

Beacon EmbeddedWorks: Embedded computing boards

discoverIE has acquired Logic PD, also known as Beacon EmbeddedWorks (Beacon) for \$80.5m/£58.8m on a debt-free, cash-free basis, funded from existing debt facilities. Beacon was founded in 2001 and is located in Minneapolis, Minnesota. Beacon designs, manufactures and supplies custom system-on-module (SOM) embedded computing boards and related software for the medical, industrial and aerospace & defence markets in the United States. Around 75% of sales are into the medical market, with more than 50% for critical care applications. The company sees potential for cross-selling with its existing Hectronic business.

In CY20, Beacon reported revenue of \$28.1m/£20.5m, underlying¹ EBITDA of \$6.8m/£5.0m (24.2% margin) underlying EBIT of \$5.9m/£4.3m (21.0% margin) and PBT of \$5.4m/£3.9m.

This values Beacon on trailing EV/sales of 2.9x and EV/EBIT of 18.7x. This compares to discoverIE's FY21 multiples of 2.1x EV/Sales and 26.6x EV/EBIT.

Antenova: Antennas and RF modules

discoverIE has acquired Antenova for £18.2m on a debt-free, cash-free basis, funded from existing debt facilities. UK-headquartered Antenova was founded in 1999 and has operations in Taiwan and the United States, with sales split evenly across Europe, the United States and Asia. Antenova designs and manufactures antennas and RF modules for industrial connectivity applications in medical and industrial markets.

Current year sales are expected to be c £8.0m with underlying EBITDA of c £2.3m (28.8% margin) and underlying EBIT of c £2.2m (27.5% margin). This values Antenova on current year EV/sales of 2.3x and EV/EBIT of 8.3x.

Rationale for acquisitions

The acquired companies fit well with discoverIE's growth strategy, providing the following benefits:

- Create further growth opportunities in the group's target markets, particularly medical and industrial & connectivity;
- Gain access to two companies with high levels of customised and unique products that are complementary to the existing D&M business;
- Expand the group's footprint in North America. The company estimates it will increase non-European revenue in the D&M division by 4pp to 40% and for the group by 3pp to 31% on a pro forma FY21 basis; and
- Both companies have operating margins above 20%, compared to D&M's 12.7% margin in FY21, so this will help with the expansion of the group's profitability towards the target of 12.5%. The company estimates an increase for both D&M and group operating profitability of 0.8pp on an FY21 pro forma basis.

¹ Excludes shareholder and associated costs.

Oversubscribed placing raises £55m

Via an accelerated bookbuild, the company has placed 5.35m shares at 1,028p per share (closing price on 2 September) to raise gross proceeds of £55.0m or £53.4m after costs. This equates to c 6% of outstanding shares prior to the placing. The company estimates that pro forma gearing (net debt/adjusted EBITDA annualised for acquisitions) at the end of FY21 would have increased from 1.25x (including the May acquisition of CPI) to 1.6x, well within the company's target range of 1.5–2.0x and leaving headroom for further deals.

Changes to forecasts

We have revised our forecasts to reflect consolidation of the two acquired businesses from the start of September. We estimate an increase in our normalised EPS forecasts of 4.8% for FY22 and 7.8% for FY23. Our group operating margin forecasts, on an underlying basis, increase from 7.6% to 8.2% in FY22 and from 7.8% to 8.6% in FY23. On the company's underlying diluted EPS basis, we estimate a 5.3% increase for FY22 and 8.5% for FY23. We forecast gearing at the low end of the company's target range by the end of FY22 and reducing further to 1.3x by the end of FY23.

Exhibit 1: Changes to forecasts

Year end March (£m)	FY22e old	FY22e new	Change	y-o-y	FY23e old	FY23e new	Change	y-o-y
Revenues	507.5	523.8	3.2%	15.3%	521.0	550.0	5.6%	5.0%
Design & manufacturing	337.7	354.0	4.8%	19.4%	347.0	375.9	8.3%	6.2%
Custom supply	169.8	169.8	0.0%	7.7%	174.1	174.1	0.0%	2.5%
Gross margin	33.8%	33.9%	0.1%	(0.3%)	33.8%	33.9%	0.1%	0.0%
EBITDA	53.0	57.3	8.1%	18.3%	55.0	62.4	13.4%	9.0%
EBITDA margin	10.4%	10.9%	0.5%	0.3%	10.6%	11.3%	0.8%	0.4%
Underlying operating profit	38.8	42.8	10.3%	21.5%	40.7	47.4	16.4%	10.8%
Underlying operating margin	7.6%	8.2%	0.5%	0.4%	7.8%	8.6%	0.8%	0.5%
Normalised operating profit	40.6	44.6	9.8%	22.8%	42.5	49.2	15.7%	10.4%
Normalised operating margin	8.0%	8.5%	0.5%	0.5%	8.2%	8.9%	0.8%	0.4%
Normalised PBT	36.3	39.8	9.6%	22.1%	38.0	43.6	14.7%	9.6%
Normalised net income	27.2	29.5	8.4%	18.6%	28.1	32.1	14.0%	8.8%
Normalised diluted EPS (p)	29.4	30.8	4.8%	14.2%	30.4	32.7	7.8%	6.3%
Underlying diluted EPS (p)	27.9	29.4	5.3%	13.0%	28.9	31.4	8.5%	6.7%
Reported basic EPS (p)	15.6	17.8	14.5%	31.8%	17.3	20.6	18.9%	15.5%
Dividend per share (p)	10.7	10.7	0.0%	5.4%	11.0	11.0	0.0%	2.8%
Net (debt)/cash	(60.0)	(82.1)	37.0%	74.0%	(52.3)	(72.1)	37.8%	(12.2%)
Net debt/EBITDA (x)	1.3	1.5			1.1	1.3		

Source: Edison Investment Research

Exhibit 2: 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	523.8	550.0
Cost of Sales		(261.2)	(293.9)	(309.7)	(299.0)	(346.5)	(363.5)
Gross Profit		126.7	145.0	156.7	155.3	177.3	186.4
EBITDA		29.3	37.0	50.9	48.4	57.3	62.4
Operating Profit (before am, SBP and except.)		25.2	31.8	38.9	36.3	44.6	49.2
Operating Profit (before am. and except.)		24.5	30.6	37.1	35.2	42.8	47.4
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	27.2	32.2
Net Interest		(2.6)	(3.4)	(4.3)	(3.7)	(4.8)	(5.6)
Profit Before Tax (norm)		22.6	28.4	34.6	32.6	39.8	43.6
Profit Before Tax (FRS 3)		14.6	19.3	19.5	17.0	22.3	26.5
Tax		(4.0)	(4.7)	(5.2)	(5.0)	(5.8)	(7.0)
Profit After Tax (norm)		17.1	21.5	27.6	24.9	29.5	32.1
Profit After Tax (FRS 3)		10.6	14.6	14.3	12.0	16.5	19.5
Ave. Number of Shares Outstanding (m)		70.8	73.0	84.0	88.8	92.6	94.8
EPS - normalised & diluted (p)		23.0	28.4	31.8	27.0	30.8	32.7
EPS - underlying, diluted (p)		22.3	27.2	30.2	26.0	29.4	31.4
EPS - IFRS basic (p)		15.0	20.0	17.0	13.5	17.8	20.6
EPS - IFRS diluted (p)		14.2	19.4	16.5	13.0	17.2	19.9
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	33.9	33.9
EBITDA Margin (%)		7.6	8.4	10.9	10.7	10.9	11.3
Operating Margin (before am, SBP and except.) (%)		6.5	7.2	8.3	8.0	8.5	8.9
discoverIE adjusted operating margin (%)		6.3	7.0	8.0	7.7	8.2	8.6
BALANCE SHEET							
Fixed Assets		136.4	149.2	236.4	245.0	320.2	309.9
Intangible Assets		107.2	119.7	182.2	191.2	265.0	253.8
Tangible Assets		23.4	24.4	46.3	45.9	47.3	48.2
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	171.6	185.6
Stocks		58.1	66.2	68.4	67.7	78.6	82.6
Debtors		84.6	88.7	90.1	84.9	101.9	107.0
Cash		21.9	22.9	36.8	29.2	(10.7)	(5.7)
Current Liabilities		(94.0)	(96.0)	(103.6)	(107.8)	(121.7)	(127.2)
Creditors		(87.6)	(94.3)	(94.0)	(102.2)	(116.1)	(121.6)
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)	(98.9)	(85.8)
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)	(12.2)	(4.7)
Net Assets		126.8	134.7	200.5	208.8	271.2	282.6
CASH FLOW							
Operating Cash Flow		21.7	30.0	48.0	57.2	40.9	56.9
Net Interest		(2.6)	(3.4)	(3.7)	(3.1)	(4.2)	(5.0)
Tax		(3.7)	(3.8)	(6.4)	(7.2)	(10.3)	(11.5)
Capex		(4.3)	(5.4)	(6.3)	(3.9)	(8.5)	(8.5)
Acquisitions/disposals		(25.4)	(22.4)	(73.6)	(20.5)	(90.1)	(5.0)
Financing		(1.5)	0.1	53.9	(6.6)	46.7	(6.7)
Dividends		(6.2)	(6.7)	(8.1)	(2.8)	(9.5)	(10.1)
Net Cash Flow		(22.0)	(11.6)	3.8	13.1	(34.9)	10.0
Opening net cash/(debt)		(30.0)	(52.4)	(63.3)	(61.3)	(47.2)	(82.1)
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)	(82.1)	(72.1)

Source: discoverIE, Edison Investment Research

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