

discoverIE Group

Fully focused on Design & Manufacturing

With the proposed sale of Acal BFi, discoverIE is taking the final step to exit the Custom Supply business. Gross proceeds of £50m will be used to reduce debt, providing further headroom for Design & Manufacturing (D&M) acquisitions. We estimate that moving away from this lower-margin business will boost group underlying operating margins from 8.2% to 10.2% in FY22 and from 8.6% to 10.6% in FY23. The disposal leaves management fully focused on the growth of the D&M business and increases exposure to structural growth markets.

Year end	Revenue (£m)	PBT* (£m)	Diluted EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/20	297.9	27.3	25.1	3.0	40.3	0.3
03/21	296.6	27.0	22.3	10.2	45.3	1.0
0322e	358.2	33.5	25.9	10.7	39.0	1.1
03/23e	380.2	37.3	28.0	11.0	36.2	1.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. Continuing operations only (PBT and diluted EPS for FY20 and FY21 are Edison estimates until full disclosure is available).

Selling Acal BFi for £50m

discoverIE announced that it has agreed to sell Acal BFi, its electronics distribution business, to private equity buyers for £50m (£45m cash upfront and £5m deferred). The deal is subject to various consultation requirements and regulatory approvals and should complete by the end of FY22. Following the recent sale of the smaller Vertec SA business, this will complete the exit from the Custom Supply business. In FY21, Custom Supply generated 35% of group revenue and 13% of underlying operating profit contribution.

Estimates reflect D&M continuing operations

We have revised our estimates to treat Custom Supply as a discontinued business (both historicals and forecasts). Removing the lower-margin Custom Supply business (underlying operating margin 3.6% in FY21 and FY22e) results in the group underlying operating margin increasing from 8.2% to 10.2% in FY22 and from 8.6% to 10.6% in FY23. The company estimates that post disposal, pro forma gearing would reduce from 1.4x to 1.0x. By the end of FY22, we estimate that this will have reduced further to 0.8x, leaving ample headroom for further acquisitions based on management's target gearing range of 1.5–2.0x.

Valuation: Reflects D&M growth potential

The stock trades towards the upper end of its peer group on a P/E basis, in our view reflecting the group's potential to drive earnings growth through accretive acquisitions. The disposal of the Custom Supply business provides the company with resources to fund further acquisitions and frees up management to fully focus on the growth of the D&M business.

Sale of distribution business

Tech hardware & equipment

11 November 2021

Price **1,012p**

Market cap **£959m**

€1.17:\$1.35:£1

Net debt (£m) at end FY21 47.2

Shares in issue 94.8m

Free float 96%

Code DSCV

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (3.8) (5.1) 65.9

Rel (local) (7.0) (6.8) 40.3

52-week high/low 1,262p 560p

Business description

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

Next events

Interim results 30 November 2021

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Exit from Custom Supply

On 9 November, discoverIE announced that it has agreed the sale of Acal BFi, the electronics distribution business that makes up the bulk of Custom Supply revenues. The business is being sold to H2 Equity Partners, and the existing management team will remain with the business. discoverIE will receive gross proceeds of £50m (on a debt-free, cash-free basis), with £45m upfront and £5m deferred for three years (earning interest at 5% pa). Acal BFi will continue to sell discoverIE's D&M products. The deal is subject to certain consultation requirements and regulatory approvals, with completion expected by the end of FY22.

The company announced in early October that it had sold Vertec SA, the other business within Custom Supply, for ZAR25m/£1.25m. The sale of Acal BFi will conclude the exit from the Custom Supply business.

Moving away from lower-margin distribution

The company disclosed that Acal BFi generated revenue of £148.7m and PBT of £4.0m in FY21 and that the sale price valued the business at 7x average underlying operating profit pre-COVID. Custom Supply generated revenue of £168.5m in FY20 and £157.7m in FY21, with adjusted operating profit of £7.3m and £5.6m respectively. This equates to margins of 4.3% in FY20 and 3.6% in FY21 compared to Design & Manufacturing margins of 12.8% and 12.7% respectively. Custom Supply has always been a cyclical business, and with lower operating margins, had less room for manoeuvre in weaker economic environments.

We note that divisional profits are reported before taking into account central costs. In FY21, D&M alone (including central costs) would have generated an underlying operating margin of 10.0%, compared to the reported group operating margin of 7.7%.

Full focus on Design & Manufacturing business

Sale proceeds will be used to reduce net debt and to progress the design and manufacturing growth strategy. The company estimates that the disposals will result in pro forma gearing¹ of 1.0x as at the end of September (down from 1.4x reported), giving further headroom for acquisitions and allowing management to focus solely on the growth of the D&M business.

Increased exposure to structural growth markets

The company's strategy is unchanged:

- Grow sales well ahead of GDP over the economic cycle by focusing on structural growth markets that form discoverIE's target markets: renewable energy, medical, transportation and industrial & connectivity. While 75% of D&M revenue came from these markets in FY21, the contribution was only 50% for Custom Supply.
- Move up the value chain into higher-margin products, with group operating margin now above 10%.
- Acquire businesses with attractive growth prospects and strong operating margins. The company has acquired five businesses in the last 12 months, all with operating margins above 20%.
- Further internationalise the business by developing operations in North America and Asia. Post recent acquisitions, c 40% of D&M revenue comes from these regions.

¹ Net debt divided by underlying EBITDA (on pre-IFRS 16 basis, annualised for acquisitions).

Changes to forecasts

We have updated our estimates to treat Custom Supply as a discontinued operation, assuming the deal completes at the end of FY22. For clarity, this means Custom Supply is excluded from our normalised and underlying EPS forecasts and included on a net basis in our reported net income and EPS forecasts. For FY20 and FY21 historicals, we have estimated the split between the two divisions at the PBT and net income level – we will update this when the company reports financials on this new basis. We have factored in net sale proceeds of £40m in FY22, deal-related exceptional costs of £3m, debt/cash adjustments of c £2m and slightly higher central costs.

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	529.6	358.2	(32.4%)	(21.1%)	556.0	380.2	(31.6%)	6.1%
<i>Design & manufacturing</i>	358.2	358.2	0.0%	20.8%	380.2	380.2	0.0%	6.1%
<i>Custom supply</i>	171.4	0.0	(100.0%)	(100.0%)	175.8	0.0	(100.0%)	N/A
Gross margin	33.9%	33.9%	0.0%	(0.3%)	33.9%	33.9%	0.0%	0.0%
EBITDA	57.8	51.0	(11.7%)	19.1%	62.9	55.4	(11.9%)	8.7%
EBITDA margin	10.9%	14.2%	3.3%	4.8%	11.3%	14.6%	3.3%	0.4%
Underlying operating profit	43.3	36.5	(15.7%)	23.2%	47.9	40.4	(15.7%)	10.8%
Underlying operating margin	8.2%	10.2%	2.0%	3.7%	8.6%	10.6%	2.0%	0.5%
Normalised operating profit	45.1	38.3	(15.1%)	24.7%	49.7	42.2	(15.1%)	10.3%
Normalised operating margin	8.5%	10.7%	2.2%	3.9%	8.9%	11.1%	2.2%	0.4%
Normalised PBT	40.3	33.5	(16.8%)	24.1%	44.2	37.3	(15.6%)	11.2%
Normalised net income	29.9	24.8	(16.9%)	20.5%	32.5	27.4	(15.6%)	10.5%
Normalised diluted EPS (p)	31.2	25.9	(16.9%)	16.0%	33.2	28.0	(15.6%)	7.9%
Underlying diluted EPS (p)	29.8	24.5	(17.7%)	14.5%	31.8	26.6	(16.3%)	8.6%
Reported basic EPS (p)	18.2	15.3	(16.2%)	12.8%	21.0	15.7	(25.5%)	2.6%
Dividend per share (p)	10.7	10.7	0.0%	5.4%	11.0	11.0	0.0%	2.8%
Net (debt)/cash	(78.2)	(39.6)	(49.4%)	(16.1%)	(70.6)	(34.6)	(51.0%)	(12.7%)
Net debt/EBITDA (x)	1.4	0.8			1.3	0.7		

Source: Edison Investment Research

Valuation

The table below compares discoverIE's financial performance and valuation metrics to peers, which include electronics designers and manufacturers and acquisitive industrial companies. The stock trades towards the upper end of its peer group on a P/E basis, in our view reflecting the group's potential to drive earnings growth through accretive acquisitions. The disposal of the Custom Supply business provides management with resources to fund further acquisitions and frees up management to fully focus on the growth of the D&M business.

Exhibit 2: Peer financial and valuation metrics

	Share price	Market cap	Rev growth (%)		EBITDA margin (%)		EBIT margin (%)		EV/sales (x)		EV/EBITDA (x)		EV/EBIT (x)		P/E (x)		Div. yield (%)	
	(p)	(£m)	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
discoverIE	1,012	959	20.8	6.1	14.2	14.6	10.7	11.1	2.8	2.6	19.7	18.2	26.3	23.8	39.0	36.2	1.1	1.1
Diploma	3,200	3,986	42.9	8.7	21.1	20.8	19.0	19.0	5.5	5.1	26.0	24.3	28.9	26.6	38.3	35.3	1.2	1.3
Gooch & Housego	1,180	295	2.6	3.1	16.3	17.0	10.4	11.4	2.5	2.4	15.1	14.0	23.7	20.9	31.7	28.3	1.0	1.1
TT electronics	249.5	437	10.3	4.8	10.9	12.0	7.6	8.7	1.1	1.1	10.5	9.1	15.1	12.5	16.9	14.1	2.2	2.6
XP Power	5,440	1,069	4.6	5.2	24.1	25.0	19.1	20.4	4.5	4.3	18.6	17.0	23.4	20.9	28.1	26.0	1.7	1.7
Avon Rubber	1,944	603	17.4	30.0	17.0	21.3	10.6	15.3	2.6	2.0	15.2	9.3	24.3	12.9	36.6	19.6	1.7	2.1
Halma	2,990	11,355	12.0	7.1	24.7	25.1	20.8	21.3	7.9	7.3	31.8	29.2	37.8	34.4	47.7	43.2	0.6	0.7
Spectris	3,730	4,133	-0.9	2.9	20.1	21.1	16.1	17.3	2.9	2.9	14.6	13.6	18.3	16.5	25.5	22.9	1.9	2.0
Spirax-Sarco Engineering	16,275	11,984	13.6	5.6	29.2	29.2	24.9	24.9	9.0	8.5	30.9	29.3	36.2	34.2	49.7	47.1	0.8	0.9
Average			12.8	8.4	20.4	21.4	16.1	17.3	4.5	4.2	20.3	18.2	26.0	22.4	34.3	29.6	1.4	1.5

Source: Edison Investment Research, Refinitiv (at 8 November)

Exhibit 3: Financial summary

	£m	2020	2021	2022e	2023e
Year end 31 March		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		297.9	296.6	358.2	380.2
Cost of Sales		(197.8)	(195.2)	(237.0)	(251.3)
Gross Profit		100.1	101.4	121.3	128.9
EBITDA		43.6	42.8	51.0	55.4
Operating Profit (before am, SBP and except.)		31.6	30.7	38.3	42.2
Operating Profit (before am. and except.)		29.8	29.6	36.5	40.4
Amortisation of acquired intangibles		(9.0)	(11.1)	(11.6)	(11.6)
Exceptionals		(4.3)	(3.4)	(7.0)	(3.6)
Share-based payments		(1.8)	(1.1)	(1.8)	(1.8)
Operating Profit		16.5	15.1	17.9	25.2
Net Interest		(4.3)	(3.7)	(4.8)	(5.0)
Profit Before Tax (norm)		27.3	27.0	33.5	37.3
Profit Before Tax (FRS 3)		12.2	11.4	13.0	20.2
Tax		(3.3)	(3.4)	(3.4)	(5.3)
Profit After Tax (norm)		21.8	20.6	24.8	27.4
Profit After Tax (FRS 3)		8.9	8.0	9.6	14.8
Discontinued operations		5.4	4.0	4.5	0.0
Net income (norm)		21.8	20.6	24.8	27.4
Net income (FRS 3)		14.3	12.0	14.1	14.8
Ave. Number of Shares Outstanding (m)		84.0	88.8	92.6	94.8
EPS - normalised & diluted (p)		25.1	22.3	25.9	28.0
EPS - underlying, diluted (p)		23.5	21.4	24.5	26.6
EPS - IFRS basic (p)		17.0	13.5	15.3	15.7
EPS - IFRS diluted (p)		16.5	13.0	14.7	15.1
Dividend per share (p)		3.0	10.2	10.7	11.0
Gross Margin (%)		33.6	34.2	33.9	33.9
EBITDA Margin (%)		14.6	14.4	14.2	14.6
Operating Margin (before am, SBP and except.) (%)		10.6	10.4	10.7	11.1
discoverIE adjusted operating margin (%)		10.0	10.0	10.2	10.6
BALANCE SHEET					
Fixed Assets		236.4	245.0	280.2	269.9
Intangible Assets		182.2	191.2	225.0	213.8
Tangible Assets		46.3	45.9	47.3	48.2
Deferred tax assets		7.9	7.9	7.9	7.9
Current Assets		197.4	183.6	211.2	222.1
Stocks		68.4	67.7	78.5	83.3
Debtors		90.1	84.9	99.1	105.2
Cash		36.8	29.2	31.8	31.8
Current Liabilities		(103.6)	(107.8)	(126.0)	(133.1)
Creditors		(94.0)	(102.2)	(120.4)	(127.5)
Lease liabilities		(5.3)	(4.8)	(4.8)	(4.8)
Short term borrowings		(4.3)	(0.8)	(0.8)	(0.8)
Long Term Liabilities		(129.7)	(112.0)	(98.1)	(85.0)
Long term borrowings		(93.8)	(75.6)	(70.6)	(65.6)
Lease liabilities		(14.7)	(16.7)	(16.1)	(15.5)
Other long-term liabilities		(21.2)	(19.7)	(11.4)	(3.9)
Net Assets		200.5	208.8	267.3	274.0
CASH FLOW					
Operating Cash Flow		48.0	56.8	41.8	49.6
Net Interest		(3.7)	(3.1)	(4.2)	(4.4)
Tax		(6.4)	(7.2)	(8.7)	(9.8)
Capex		(6.3)	(3.9)	(8.5)	(8.5)
Acquisitions/disposals		(73.6)	(20.5)	(50.1)	(5.0)
Financing		53.9	(6.6)	46.7	(6.7)
Dividends		(8.1)	(2.8)	(9.5)	(10.1)
Net Cash Flow		3.8	12.7	7.6	5.0
Opening net cash/(debt)		(63.3)	(61.3)	(47.2)	(39.6)
HP finance leases initiated		0.0	0.0	0.0	0.0
Other		(1.8)	1.4	0.0	0.0
Closing net cash/(debt)		(61.3)	(47.2)	(39.6)	(34.6)

Source: discoverIE, Edison Investment Research. Note: Treats Custom Supply as a discontinued operation; FY20 and FY21 historicals are Edison estimates until full disclosure is available.

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