EDISON

discoverIE Group

H122 results

Record order book drives upgrades

Tech hardware & equipment

discoverIE reported strong organic growth in H122, up 8% compared to pre-COVID H120, and the underlying operating margin increased 0.8pp y-o-y to 10.3%. With the disposal of the distribution business agreed, the group is now solely focused on its design and manufacturing business and has revised key strategic targets to reflect this. Through its focus on structural growth markets, internationalisation and further higher-margin acquisitions, discoverIE expects to continue to grow the business and expand operating profitability to 13.5% by FY25.

Year end	Revenue (£m)	PBT* (£m)	Diluted EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/20	297.9	27.3	25.1	2.97	39.2	0.3
03/21	302.8	28.3	23.4	10.15	42.0	1.0
0322e	365.9	36.0	27.8	10.75	35.4	1.1
03/23e	388.1	38.6	28.9	11.15	34.0	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 are Edison estimates until further data are reported).

Strong H122 performance

discoverIE reported strong organic growth in H122, with revenue up 15% on a constant currency organic basis versus COVID-hit H121 and up 8% compared to the pre-COVID period of H120. The Design & Manufacturing (D&M) business achieved an underlying operating margin of 13.7% (H121: 12.2%) which, after central costs, resulted in a group underlying operating margin of 10.3%, up from 9.5% in H121. Orders increased on an organic basis by 64% y-o-y and by 34% versus H120. Net debt at the end of H122 was £75.6m; after adjusting for the imminent Custom Supply disposal, pro forma gearing was 0.9x at the end of H122. To reflect the strong performance in H122, we have raised our normalised EPS forecasts by 7.1% for FY22 and 3.4% for FY23.

Revising targets to reflect D&M focus

As previously announced, discoverIE has agreed to sell its lower-margin Custom Supply (CS) business, with the deal expected to complete by the end of FY22. discoverIE has updated its key strategic indicators to reflect the new group structure, lifting targets for operating margins and international sales. The higher proportion of D&M business focused on structural growth markets compared to CS supports the aim to grow revenue ahead of GDP and, with c £70m debt headroom, we expect higher-margin acquisitions to further bolster growth and profitability.

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 CS 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.

6 December 2021

Price	**983p**
Market cap	**£932m**
	$1.33:€1.18:£1
Net debt (£m) at end H122	75.6
Shares in issue	94.8m
Free float	96%
Code	DSCV
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(8.5)	(21.4)	75.5
Rel (local)	(6.8)	(20.2)	58.8
52-week high/low		1,262p	602p

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

Trading update	January/February 2022

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Edison profile page

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Investment summary

Designing and manufacturing innovative electronics for industry

discoverIE is a leading designer and manufacturer of components for electronic applications. Over the last 11 years, the company has broadened its product range, customer base and geographical presence via a series of acquisitions. It designs and manufactures differentiated products, and expansion along the supply chain is helping the company to expand operating margins. discoverIE intends to continue to grow organically and via acquisition while maintaining its focus on higher-margin business. To grow revenues well ahead of GDP, it is focused on four structural growth markets: renewable energy, transportation, medical and industrial & connectivity. Its capital-light business model supports strong cash flow generation, with the aim of increasingly self-funding acquisitions.

Financials: Upgrading on strong H122 performance

H122 results were the first to be reported under the new group structure, with CS treated as a discontinued operation. The D&M business, treated as continuing operations, reported strong organic revenue growth versus H121 (+15%) and pre-COVID H120 (+8%), resulting in 32% y-o-y growth in group underlying operating profit and an operating margin of 10.3%. The disposal of CS will provide c £40m in cash in H222, resulting in pro forma net debt/EBITDA of 0.9x at the end of H122, compared to the company's target range of 1.5–2.0x. On the back of strong H122 revenue and order performance, we have revised up our underlying EPS forecasts by 5.6% in FY22 and 3.0% in FY23 and our normalised EPS (excluding share-based payments) by 7.1% for FY22 and 3.4% for FY23. With debt headroom of c £70m, we expect the company to continue to make acquisitions in the D&M space, with a focus on higher-margin businesses operating in structural growth markets.

Valuation: Accretive acquisitions to accelerate earnings growth

The stock has gained 63% over the last year and now trades towards the upper end of its peer group on an EV/EBITDA and P/E basis. In our view, this reflects the group's potential to drive earnings growth through accretive acquisitions. The disposal of the CS 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.

Sensitivities: Economy, currency, pricing and acquisitions

Our estimates and discoverIE's share price will be sensitive to the following factors. **Customer demand:** demand will be influenced by the economic environment in Europe and increasingly in North America and Asia. **Supply chain:** raw materials and components are sourced globally so the company must manage around availability. **Currency:** with 89% of revenues generated in currencies other than sterling, discoverIE is exposed to the translation of euro, US dollar and Nordic-denominated subsidiary results into sterling, which had a small negative effect on sales and profits in FY21. **Pricing:** discoverIE's revenues and profitability are sensitive to its ability to include in price quotes engineering time spent on designing customer solutions. The company normally passes through supplier price increases and tariffs. **Acquisitions:** discoverIE expects to make further acquisitions, which could add integration risk, and larger deals may require equity funding.

Company description: Innovative custom electronics

discoverIE designs and manufactures customised electronics for industry with operations throughout Europe and increasingly outside Europe. The last 11 years have seen the integration of a series of acquisitions and a focus on growing the percentage of higher-margin specialist products, resulting in higher profitability. The company recently agreed to sell its distribution business, leaving it fully focused on growing its higher-margin D&M business through a combination of organic investment and acquisitions.

Company history

discoverIE was founded in 1986 and was admitted to the official list of the LSE in 1994 as a pure distributor of electronic components. After a change in management in 2009, through its strategy of specialisation the company has transitioned to become a designer and manufacturer of customised electronics with operations in Europe, Asia and North America. The company has made a series of acquisitions since 2009 – we provide further detail on page 7. Until recently, discoverIE operated through two divisions, Design & Manufacturing (D&M) and Custom Supply (CS). As the disposal of the CS business should be completed by the end of FY22, it is now treated as a discontinued operation in the company's accounts. The remaining D&M business has 4,500 employees across 24 countries and our report focuses solely on the continuing operations.

Business model

discoverIE specialises in the design and manufacture of technically demanding, bespoke electronics for industrial applications and is focused on four target markets comprising 77% of group sales – renewables, electrification of transportation, medical and industrial & connectivity – all of which are long-term structural growth markets. The market for niche electronic components is very fragmented and discoverIE mainly competes against small, privately owned, country-specific manufacturers in one or two technology areas. The company expects to continue its active role in consolidating this market.

Diverse range of custom electronic products

Mainly through acquisition, discoverIE has built up its D&M capability in four areas of technology: sensors, magnetics, components and systems. discoverIE's custom electronic products are either designed uniquely or modified from an existing product. More than 80% of products are manufactured at 30 sites across 18 countries (principal facilities in China, India, Mexico, the Netherlands, Poland, Sri Lanka, Thailand and the UK), with the remainder manufactured by third-party contractors. discoverIE spends c 2% per annum on its manufacturing facilities and another 2% on R&D. As well as direct sales, some products are also distributed through the CS business, and this will continue post-disposal of CS.

Industrial focus leads to longer product cycles

discoverIE's components are used in both the design and production phases of a customer's product. discoverIE's engineers work with its customers throughout their product development process, from design concept to volume manufacturing. Once the new product moves into production, discoverIE supplies on a volume basis for the life of the product. We highlight that discoverIE is focused on industrial OEMs and does not serve the consumer electronics market (which tends to be highly commoditised with short lifetime products and often highly cyclical sales). A customer will typically take six to 24 months to move a product from design to production, at which point the company should earn revenues for the life of the product, typically five to seven years.

Group strategy

The group is focused on markets with sustainable growth prospects and increasing electronic content where there is an essential need for its products. It invests in initiatives and businesses that enhance design opportunities for customised products in targeted long-term structural growth markets.

Management has transformed the company into a technology-led provider of customised electronics for industrial applications with design and manufacturing capabilities. The company has the following strategic objectives:

- **Grow sales well ahead of GDP over the economic cycle** by focusing on the structural growth markets that form the company's target markets.
- **Move up the value chain** into higher-margin products**.**
- **Acquire businesses** with attractive growth prospects and strong operating margins.
- **Further internationalise the business** to align with its increasingly global customer base by developing operations in North America and Asia.
- **Generate strong cash flows** from a capital-light model and **deliver long-term sustainable returns.**

To track progress with these objectives, the company has set key strategic indicators (KSIs) and key financial performance indicators (KPIs), which we discuss in more detail later in this report.

Experienced board supports growth ambitions

To support its growth ambitions, discoverIE has constructed a board with substantial experience in acquisitions and international growth. Executive directors include Nick Jefferies (CEO since 2009 – biography on page 13) and Simon Gibbins (CFO since 2010 – biography on page 13). The board is chaired by Malcolm Diamond (previously non-executive chairman of Trifast (2017–19) and CEO (1984–2002)). Non-executive directors include Bruce Thompson (ex-Diploma CEO 1996–2018, non-executive chairman at Avon Rubber), Tracey Graham (also NED at Royal London, Ibstock and Link Scheme), Clive Watson (ex-group FD of Spectris 2006–19, NED at Breedon Group, Kier Group and Trifast) and Rosalind Kainyah (runs ESG consultancy Kina Advisory; previously VP External Affairs & CSR at Tullow Oil and various roles at De Beers).

Tracking strategic progress

Exhibit 1 summarises the steady progress discoverIE is making against its KSIs. These were updated with the FY20 results with new targets to run for five years, and more recently revised to reflect the disposal of the CS business. We discuss below how it is meeting its strategic objectives. As H121 was hit by the impact of COVID, the company compares H122 performance to the pre-COVID period H120. The table summarises group performance including D&M and CS for the years FY14 to FY21 and for H120. H122 and the new targets are for continuing D&M operations only.

Exhibit 1: KSIs – updated targets

	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	H120	H122	Previous target	New target
Increase D&M revenue	18%	37%	48%	52%	57%	61%	64%	65%	63%	100%	>75%	100%
Increase underlying operating margin	3.4%	4.9%	5.7%	5.9%	6.3%	7.0%	8.0%	7.7%	7.6%	10.3%	12.5%	13.5%
Build sales beyond Europe	5%	12%	17%	19%	19%	21%	27%	28%	24%	38%	40%	45%
Sales from target markets	N/A	N/A	N/A	56%	62%	66%	68%	70%	66%	77%	85%	85%

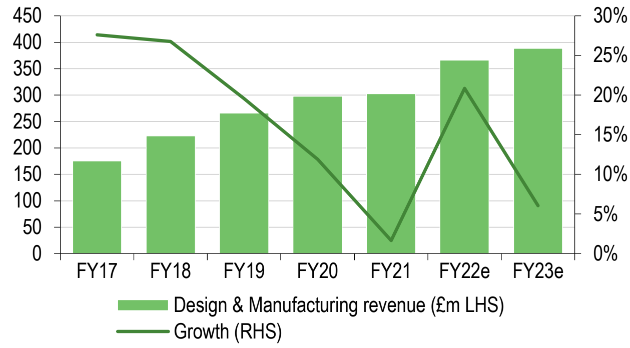
Source: discoverIE

Increasing D&M revenue; expanding operating margins

discoverIE started life as a pure distributor of electronic components, but through a strategy of specialisation and acquisition it has transitioned to become a designer and manufacturer of customised electronic solutions. Over the last 10 years, the company has acquired 19 businesses with design and manufacturing capabilities; these are typically much higher margin than the original distribution business, with recent acquisitions generating operating margins of 20%+.

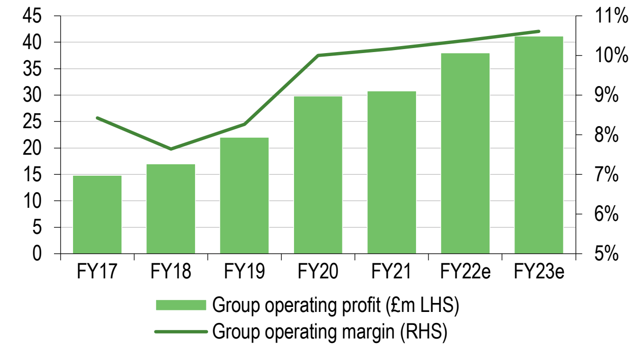
The charts below show the financial performance of the continuing business over the last five years and our forecasts for FY22-23. FY21 results were affected by pandemic-related demand weakness, although the underlying operating margin remained flat in FY21. In H122, growth rebounded and the group achieved 15% year-on-year organic revenue growth, 8% organic revenue growth versus H120 and a 10.3% underlying operating margin. The revised target is for a 13.5% underlying operating margin by FY25, to be achieved through a combination of organic growth and higher-margin acquisitions.

Exhibit 2: Revenue growth, FY17–23e



Source: discoverIE

Exhibit 3: Underlying operating profit, FY17–23e



Source: discoverIE

Build sales beyond Europe

Sales beyond Europe increased from 28% of total revenue in H121 to 38% in H122. Of this 10pp increase, 7pp was from the disposal of the CS business, which had a higher proportion of revenue from the UK and Europe, 2pp was from the five acquisitions over the last year and 1pp was due to strong organic growth in Asia. As the continuing operations already have 40% annualised sales from outside Europe, the FY25 target has been raised from 40% to 45%.

Targeting high-growth markets

As part of the group's goal to grow revenue well ahead of GDP on an organic basis, discoverIE is targeting higher-growth markets. These are markets that are exhibiting structural growth and depend on technology for product development, resulting in increasing electronic content. discoverIE aims to supply essential products to OEMs in these markets. With the increasing focus on ESG by investors and consumers alike, the company is keen that its target markets also align with the UN's Sustainable Development Goals (SDGs).[1]

The table below describes the four target markets, the growth prospects of each market and examples of products that discoverIE provides for each market. In H122, the business generated 77% of its revenues from these four areas (H121: 68%, H120: 66%) and is targeting this to grow to 85% over the next five years. Of the 9pp increase y-o-y, 5pp came from the disposal of CS, which had less exposure to the target markets. As business in the target markets tends to grow faster

1 UN SDGs: 17 goals adopted by all UN member states in 2015 as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030.

than other markets, and recent acquisitions have a higher weighting towards target markets, this accounted for the remaining 4pp of the increase.

Exhibit 4: Growth areas targeted by discoverIE

	Renewable energy	Transportation	Medical	Industrial & connectivity
Growth drivers	Decarbonisation and diversification	Decarbonisation and automation driving electrification and autonomous vehicles	Proactive and preventative medicine using artificial intelligence, sensing & analytics	Connectivity, automation, industrial Internet of Things (IoT)
Market data	International Energy Agency sustainable development scenario calls for renewable energy to make up 50% by 2030, from 27% in 2019.	Electric cars now 1% of global stock, target 13% by 2030 (IEA). Autonomous driving system (HW and SW) market to be worth $57bn by 2030 (IDTechEx).	Medical electronics market to grow by 8% pa 2018–2024 (TechSci Research)	Industrial IoT market to reach $111bn by 2025, CAGR of 7.5% 2017–2025 (Statista).
discoverIE products	Power inductors, turbine blade pitch control, airflow measurement	Charging, sensing systems, power control, cabin monitoring and control	Embedded diagnostics, interface device and cabling, power systems	Wireless telematics, fibre-optic connectivity, wireless robotics control, communication technologies, power control
UN SDG	7 AFFORDABLE AND CLEAN ENERGY; 13 CLIMATE ACTION	7 AFFORDABLE AND CLEAN ENERGY; 11 SUSTAINABLE CITIES AND COMMUNITIES; 13 CLIMATE ACTION	3 GOOD HEALTH AND WELL-BEING	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 11 SUSTAINABLE CITIES AND COMMUNITIES

Source: discoverIE. Note: HW = hardware, SW = software.

Acquisitions core to growth strategy

From 2011 discoverIE started to make a series of acquisitions of companies with design and manufacturing capabilities (see Exhibit 5 below). The company has a dedicated M&A team focused on developing and pursuing opportunities.

Criteria for acquisition targets

discoverIE's focus for future acquisitions is to target D&M companies with commercially viable technologies that can be applied to its target markets or with complementary product and/or geographical capability supplying common markets and customers. The preference is to buy businesses that are successful and profitable, with good growth prospects, good margins and similar long-term growth drivers to discoverIE's focus markets but need scaling up.

Integration strategy: Retain entrepreneurial approach

Many of the acquired businesses have been led by entrepreneurial managers and discoverIE is keen to retain this culture. To support this, acquired businesses typically continue to operate under their own brands and management, working towards agreed business plans. discoverIE has started to create technology clusters, where smaller businesses are taken under the wing of a larger business operating in the same product area. At the same time, they are able to take advantage of being part of the larger group, with access to the wider discoverIE customer base, support for product development and manufacturing, centralised finance and administrative support. Efficiency improvements are achieved through knowledge-sharing amongst the D&M businesses and group guidance on best practices. Where appropriate, manufacturing is rationalised to make the most efficient use of the group's network of manufacturing facilities.

D&M acquisition track record

The table below summarises the D&M acquisitions the group has made since FY12.

Exhibit 5: D&M acquisition timeline

Company	Date	Product areas	Operations	Sales	Cost (£m)
Hectronic	Jun 11	Embedded computing	Sweden	Nordic region, US	1.2
MTC	Oct 11	Electro-magnetic shielding	Germany, South Korea	Europe and Asia	2.7
Myrra SAS	Apr 13	Transformers, coils, cores and inductors	France, Poland, China	Europe, Asia, North America, Africa	9.9
Noratel	Jul 14	Low-, medium- and high-power transformers and inductors	Nordic region, China, US, India, Poland, Sri Lanka	Europe, Asia, North America	73.5
Foss	Jan 15	Customised fibre-optic solutions	Norway, Slovakia	Norway, Eastern Europe	12
Flux	Nov 15	Customised magnetic components	Denmark, Thailand	Denmark	4
Contour	Jan 16	Custom cable assemblies and connectors	UK	UK	17.5
Plitron	Feb 16	Custom toroidal transformers	Canada	North America	1.8
Variohm	Jan 17	Electronic sensors, switches and motion measurement systems	UK, Germany	UK, France, Germany, US	13.3
Santon	Feb 18	DC and AC switches and switchgear	Netherlands, UK	Europe, Asia, US	23.7
Cursor Controls Group	Oct 18	Human-to-machine interface technology	UK, Belgium	UK, Europe, North America, Asia	19.0
Hobart	Apr 19	Customised transformers, inductors, magnetics	US, Mexico	North America	11.7
Positek	Apr 19	Sensors	UK	UK, Europe, North America, Asia Pacific	4.2
Sens-Tech	Oct 19	Specialist sensing and data acquisition modules for X-ray and optical detection applications	UK	US, Europe, Asia, UK	58.0
Phoenix	Oct 20	Magnetically actuated sensors, encoders and related products	US	US	8.5
Limitor	Feb 21	Custom thermal safety components including temperature & current sensors, limiters and thermal switches	Germany, Hungary	Europe, US, Asia	13.2
CPI	May 21	Custom, rugged sensors and switches	US	US	8.1
Beacon EmbeddedWorks	Sep 21	Custom system-on-module embedded computing boards & related software	US	US	58.8
Antenova	Sep 21	Antennas and RF modules	UK, Taiwan, US	Europe, US, Asia	18.2
Total					**359.3**

Source: discoverIE

The company has analysed the D&M acquisitions it has made since 2011, excluding those it has not owned for at least two years, to calculate the return on investment (ROI: average operating profit since acquisition divided by acquisition cost, which includes acquisition costs, earn-outs and integration costs). These 13 businesses delivered an average ROI of 16% by FY21 over the life of the acquisitions, ahead of the company's 15% target, and nine of the 13 businesses are generating an average ROI of 15% or more.

Further acquisitions expected

After a brief halt at the height of the pandemic, discoverIE resumed its M&A strategy in October 2020 with the acquisition of Phoenix America (Phoenix). It has since made four more acquisitions and notes that it has a pipeline of deals under consideration.

Management considers two types of acquisition: 'platform' to create a new position in a technology and/or geography and 'bolt-on' to expand the position of an existing business. The company's M&A director is focused on sourcing new acquisition targets in discoverIE's key technological and geographical markets, namely companies with design and manufacturing capabilities in any of the group's technology areas, located in Europe, North America or Asia.

At the end of H122, the company had a net debt position of £75.6m and gearing of 1.3x EBITDA. Taking into account the soon to be completed CS disposal, pro-forma gearing was 0.9x at the end of H122. The company has a £180m revolving credit facility (RCF) due in June 2024, and also has access to a £60m accordion facility; it can be used for acquisitions and working capital. The company targets a gearing range of 1.5–2.0x, suggesting c £70m headroom for further acquisitions.

Setting out ESG targets

At the start of 2020, the board and group executive committee initiated a review of the company's approach to ESG matters, with the aim of further improving the group's approach to sustainability. As a result of this, the company has committed to spending £3m over the next five years to resource and deliver its ESG strategy. From a governance perspective, the company has appointed a new non-executive director, Rosalind Kainyah, with ESG experience, and has set up its first external board evaluation. Each member of the group executive committee has a specific ESG responsibility and targets within their personal objectives relating to ESG, with a proportion of annual bonus dependent upon achievement of those targets.

After the review, the company set three primary aims:

- minimise negative impact on the environment;
- keep staff safe and happy; and
- ensure the reliability and quality of products.

The table below shows the targets set to work towards achieving each aim, and progress to date.

Exhibit 6: Specific ESG targets

Aim	How measured	Targets	Progress
Minimise negative impact on the environment	Carbon intensity	50% reduction against 2019 emissions (11.45 tCO_2e/£m turnover)	CY19: 22.91 tCO_2e/£m turnover, CY20: 21.54 tCO_2e/£m turnover
	ISO14001 accreditations	>80% of group's operations to be covered by an ISO14001 accreditation by 2025	31% by end FY21
	Energy audits conducted at group sites	>80% of all group sites to have been subject to an energy audit within the last five years	11% by end FY21
	Company cars	50% to be electric or hybrid by 2025	9% by end CY20
Keep staff safe & happy	Proportion of workforce covered by ISO45001 compliant occupational health & safety (H&S) system	>80% to be covered by 2025	6% by end FY21
	No. of H&S representatives and trained H&S staff across the group	Maintain a ratio of at least 1:50 trained H&S staff to total employees	1:47 at end CY20
	Staff turnover	Unplanned staff turnover ≤15% pa	<10% in CY20
Ensure the quality and reliability of products	Share of group products covered by an ISO9001 system	Ensure that at least 80% of all products are built in accordance with ISO9001 accredited processes	88% in CY20

Source: discoverIE

Financials

Review of H121 results

Exhibit 7 summarises the performance of the continuing operations in H122 and H121. Reported revenue increased 21% y-o-y or 24% at constant exchange rates (CER). On an organic, CER basis revenue increased 15% y-o-y, or 8% compared to H120. Underlying operating profit increased 32% y-o-y and the margin expanded from 9.5% to 10.3%. Underlying EPS increased 37% y-o-y.

The company recorded one-off acquisition-related charges totalling £3.3m in H122, including £1.6m for the three acquisitions made during the period, £1.3m for accrued contingent consideration and £0.4m for integration of an earlier acquisition. Amortisation from acquired intangibles increased to

£6.4m in H122 from £5.3m in H121, reflecting the acquisitions made over the last 12 months. Overall, this resulted in reported EPS increasing by 14% y-o-y.

Exhibit 7: H122 results highlights

£m	H122	H121	H121 CER*	Reported y-o-y	CER y-o-y	Organic y-o-y
Revenues	**174.3**	**143.8**	**140.5**	**21%**	**24%**	**15%**
Underlying operating profit						
Design & manufacturing	23.9	17.5	17.3	37%	38%	
Unallocated	(5.9)	(3.9)	(3.9)	51%		
Total underlying operating profit	**18.0**	**13.6**	**13.4**	**32%**	**34%**	
Total underlying operating margin	***10.3%***	***9.5%***	***9.5%***	***0.9%***		
Reported operating profit	8.3	7.5		11%		
Underlying EPS** (p) - diluted	13.0	9.5		37%		
Reported EPS (p) - diluted	6.6	5.8		14%		
Net debt	75.6	42.1		80%		

Source: discoverIE Group. Note: *CER = constant exchange rates. **Continuing operations only.

Making good progress versus KPIs

The table below shows discoverIE's KPIs and we discuss the performance below.

Exhibit 8: Key performance indicators

Key performance indicators	FY14	FY15	FY16	FY17	FY18	FY19	FY20	H120	H122*	Target
Sales growth: constant exchange rates	17%	36%	14%	6%	11%	14%	8%	9%	20%	Well ahead of GDP
Sales growth: continuing organic	3%	9%	3%	(1%)	11%	10%	5%	7%	8%	
Underlying EPS growth	20%	31%	10%	13%	16%	22%	11%	11%	18%	>10%
Dividend growth	10%	11%	6%	6%	6%	6%	N/A***	6%	6%	Progressive
ROCE**	15.2%	12.0%	11.6%	13.0%	13.7%	15.4%	16.0%	15.8%	14.8%	>15%
Operating cash flow generation+	100%	104%	100%	136%	85%	93%	106%	101%	124%	>85% of underlying operating profit
Free cash flow generation+	24%	22%	64%	101%	58%	94%	104%	104%	125%	>85% of underlying profit after tax
Carbon emissions										50% reduction vs CY19

Source: discoverIE. Notes: *Continuing operations only; growth rate is versus H120. **Calculated as underlying operating profit (acquisitions annualised) as a percentage of net assets plus net debt; in H122 excludes Beacon & Antenova. ***Only interim dividend paid to preserve cash. +Half-year performance based on trailing 12 months.

- **Sales growth**: the continuing business has shown strong organic growth since FY18, well ahead of GDP (excluding COVID-19 affected FY21).
- **EPS growth:** excluding FY21, the company has grown underlying EPS at or ahead of its target rate over the measurement period. In H122, EPS grew 37% versus H121, which in turn declined 14% versus H120, resulting in a net increase of 18% versus H120.
- **Dividend growth:** aside from FY20 when the company did not pay a final dividend to preserve cash, discoverIE has grown the dividend every year. The interim dividend of 3.35p for H122 was ahead of our 3.2p forecast.
- **ROCE:** this dipped below the 15% target in H122 due to recent larger acquisitions and the discontinuation of CS, although was 2.5pp higher than the 12.3% achieved in H121.
- **Operating cash conversion:** 124% of underlying operating profit was converted into cash over the last 24 months: 95% over the last 12 months and 159% in the 12 months prior to that, reflecting the change in working capital requirements over the course of the pandemic. Conversion has been consistently ahead of the 85% target.
- **Free cash flow conversion**: 125% of underlying profit after tax was converted into cash over the last 24 months: 95% over the last 12 months and 174% in the 12 months prior to that. Again, conversion has been consistently ahead of the 85% target. The company set this metric to help it work towards its target of self-funding acquisitions.
- **Carbon emissions reduction:** this is set as an annual test compared to CY19 emissions. For CY20, emissions reduced by 19%; when adjusted to factor in reduced activity because of the pandemic, emissions fell 6% on an underlying basis. The company also targets that within the

first five years of ownership, new acquisitions generate at least 50% of their energy from renewable sources. During H122, the company invested in projects to reduce emissions at its manufacturing facilities, including solar panel installations in Sri Lanka and an air source heat pump in Poland.

Outlook and changes to forecasts

H122 orders increased 75% y-o-y CER to £221.2m and by 64% y-o-y on an organic basis. Compared to H120, orders were 49% higher CER and 34% higher on an organic basis. Book-to-bill for H122 was 1.27x, versus 1.16x in H221, 0.9x in H121 and 1.02x in H120. The order book at end H122 of £198m was 71% higher year-on-year on an organic basis and 54% higher than at the end of H120. Design wins with an estimated lifetime value of £145m in H122 were 56% ahead of the prior year, with 80% of wins in target markets. A year ago, customers were placing short-term orders at normal levels but were more reluctant to place longer-term frame orders. Normal ordering behaviour resumed in H221; c 80% of the order book is due for delivery in the next 12 months.

Management noted that the second half has started well with continued order and sales growth over the same period last year and two years ago. The group is on track to deliver full year earnings for the continuing operations ahead of the board's previous expectations, despite ongoing supply chain and foreign exchange headwinds.

We have revised our forecasts to reflect H122 performance and order intake, lifting our underlying diluted EPS forecasts by 5.6% in FY22 and 3.0% in FY23 and our normalised EPS (which excludes share-based payments) by 7.1% in FY22 and 3.4% in FY23

Exhibit 9: Changes to forecasts

£m	FY22e old	FY22e new	Change	y-o-y	FY23e old	FY23e new	Change	y-o-y
Revenues	**358.2**	**365.9**	**2.1%**	**20.8%**	**380.2**	**388.1**	**2.1%**	**6.1%**
Gross margin	33.9%	38.0%	4.1%	(0.0%)	33.9%	38.0%	4.1%	0.0%
EBITDA	51.0	52.0	2.0%	18.1%	55.4	56.5	1.9%	8.7%
EBITDA margin	14.2%	14.2%	(0.0%)	(0.3%)	14.6%	14.6%	(0.0%)	0.3%
Underlying operating profit	**36.5**	**38.0**	**4.1%**	**23.3%**	**40.4**	**41.2**	**1.9%**	**8.5%**
Underlying operating margin	10.2%	10.4%	0.2%	0.2%	10.6%	10.6%	(0.0%)	0.2%
Normalised operating profit	**38.3**	**40.4**	**5.5%**	**26.5%**	**42.2**	**43.2**	**2.3%**	**7.0%**
Normalised operating margin	10.7%	11.0%	0.3%	0.5%	11.1%	11.1%	0.0%	0.1%
Normalised PBT	33.5	36.0	7.4%	27.2%	37.3	38.6	3.6%	7.3%
Normalised net income	24.8	26.6	7.3%	23.4%	27.4	28.4	3.6%	6.7%
Normalised diluted EPS (p)	**25.9**	**27.8**	**7.1%**	**18.6%**	**28.0**	**28.9**	**3.4%**	**4.3%**
Underlying diluted EPS (p)	**24.5**	**25.9**	**5.6%**	**15.1%**	**26.6**	**27.4**	**3.0%**	**5.9%**
Reported basic EPS (p)	15.3	15.1	(1.2%)	11.5%	15.7	13.3	(15.1%)	(11.9%)
Dividend per share (p)	10.7	10.8	0.5%	5.9%	11.0	11.2	1.4%	3.7%
Net (debt)/cash	**(39.6)**	**(42.8)**	**8.2%**	**(9.3%)**	**(34.6)**	**(38.8)**	**12.2%**	**(9.4%)**
Net debt/EBITDA (x)	0.8	0.9			0.7	0.8		

Source: Edison Investment Research

Valuation

Exhibit 10 shows financial metrics for discoverIE's peer group and Exhibit 11 shows the valuation metrics. For the peer group, we use companies active in the electronics market and acquisitive industrial companies. After a gain of 63% over the last 12 months, the stock is trading at the upper end of its peer group on EV/EBITDA and P/E multiples. The company is growing revenue at a faster rate than peers but is below the average in terms of profitability. Management has set a new underlying operating margin target of 13.5% by FY25, which we expect to be achieved through a combination of organic growth and higher-margin acquisitions.

Exhibit 10: Peer group financial metrics

	Year-end	Share price (p)	Market cap (£m)	Revenue growth (%)		EBITDA margin (%)		EBIT margin (%)	
				CY	NY	CY	NY	CY	NY
DiscoverIE	**31-Mar**	**983**	**932**	**20.8**	**6.1**	**14.2**	**14.6**	**11.0**	**11.1**
Diploma	30-Sep	3266	4075	9.3	5.4	20.7	20.8	18.8	18.9
Gooch & Housego	30-Sep	1105	277	4.1	3.3	17.0	17.5	11.4	12.2
TT electronics	31-Dec	236	413	10.4	5.4	10.7	11.9	7.4	8.7
XP Power	31-Dec	5120	1007	4.2	5.8	23.9	24.8	18.8	20.3
Avon Rubber	30-Sep	1083	336	17.4	26.0	17.0	21.1	11.6	15.3
Halma	31-Mar	3035	11538	13.2	7.3	24.8	25.2	21.0	21.3
Spectris	31-Dec	3569	3960	-1.0	2.6	20.1	21.0	16.1	17.2
Spirax-Sarco Engineering	31-Dec	15860	11691	13.3	6.1	29.3	29.0	24.9	24.7
Average				**8.9**	**7.7**	**20.4**	**21.4**	**16.3**	**17.3**

Source: Edison Investment Research, Refinitiv (as at 2 December)

Exhibit 11: Peer group valuation metrics

	EV/sales (x)		EV/EBITDA (x)		EV/EBIT (x)		P/E (x)		Div yield (%)	
	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
DiscoverIE	**2.7**	**2.5**	**18.8**	**17.3**	**24.3**	**22.7**	**35.4**	**34.0**	**1.1**	**1.1**
Diploma	5.0	4.7	24.2	22.9	26.6	25.1	35.5	33.2	1.4	1.4
Gooch & Housego	2.2	2.2	13.1	12.4	19.6	17.7	26.5	23.7	1.2	1.2
TT electronics	1.1	1.0	10.2	8.8	14.7	12.0	16.5	13.4	2.3	2.7
XP Power	4.2	4.0	17.7	16.2	22.5	19.7	26.9	24.8	1.8	1.9
Avon Rubber	1.5	1.2	8.9	5.7	13.0	7.9	20.4	11.3	3.0	3.9
Halma	7.9	7.4	31.9	29.2	37.7	34.6	47.9	43.3	0.6	0.7
Spectris	2.8	2.7	14.0	13.0	17.4	15.9	24.5	21.9	2.0	2.1
Spirax-Sarco Engineering	8.8	8.3	30.1	28.6	35.3	33.6	48.3	46.0	0.8	0.9
Average	**4.2**	**3.9**	**18.8**	**17.1**	**23.4**	**20.8**	**30.8**	**27.2**	**1.6**	**1.9**

Source: Edison Investment Research, Refinitiv (as at 2 December)

Sensitivities

Our estimates and the discoverIE share price will be sensitive to the following factors:

- **Customer demand:** Customer demand will be influenced by the economic environment in Europe and, increasingly, the United States and Asia-Pacific. It will also be sensitive to the gain or loss of major customers, although in FY21 no customer made up more than 8% of sales.
- **Supply chain:** The company buys raw materials and components from suppliers around the world and will be affected by the availability of these supplies as well as the cost and availability of freight to transport them.
- **Currency:** Translational – with 89% of revenues in non-sterling currencies, discoverIE is exposed to the translation of euro, US dollar and Nordic-denominated subsidiary results into sterling, which reduced growth in sales by 1pp and underlying operating profit by 0.3pp in FY21. Transactional – discoverIE sells mainly in euros, US dollars, sterling and Nordic currencies, and purchases mainly in US dollars and euros. discoverIE hedges with forward contracts to the extent that the exposure cannot be passed to the customer.
- **Pricing:** discoverIE's revenues and profitability are sensitive to the company's ability to include within price quotes engineering time spent on designing customer solutions. The company aims to pass through supplier price increases and tariffs, with very few fixed-price contracts.
- **Acquisitions:** The company is likely to make further acquisitions, which could add integration risk and will require funding.
- **Defined benefit pension scheme**: The company's pension liability reduced by £1.2m over the last year, moving from a deficit of £1.1m at the end of H121 to a surplus of £0.1m at the end of H122. This defined benefit scheme was closed to new entrants in 1999 and further service accruals in 2000. The company has increased the level of contributions since FY13 by 3% a

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year (FY21: £1.8m contribution) as part of the plan agreed with trustees to try to eliminate the deficit.

Exhibit 12: Financial summary

£m	2020	2021	2022e	2023e
Year end 31 March	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	297.9	302.8	365.9	388.1
Cost of Sales	(197.8)	(187.7)	(226.9)	(240.6)
Gross Profit	100.1	115.1	139.1	147.5
EBITDA	43.6	44.0	52.0	56.5
Operating Profit (before am, SBP and except.)	31.6	31.9	40.4	43.2
Operating Profit (before am. and except.)	29.8	30.8	38.0	41.2
Amortisation of acquired intangibles	(9.0)	(11.1)	(14.5)	(16.5)
Exceptionals	(4.3)	(2.6)	(7.8)	(3.0)
Share-based payments	(1.8)	(1.1)	(2.4)	(2.0)
Operating Profit	16.5	17.1	15.7	21.7
Net Interest	(4.3)	(3.6)	(4.4)	(4.6)
Profit Before Tax (norm)	27.3	28.3	36.0	38.6
Profit Before Tax (FRS 3)	12.2	13.5	11.3	17.1
Tax	(3.3)	(4.0)	(2.9)	(4.5)
Profit After Tax (norm)	21.8	21.6	26.6	28.4
Profit After Tax (FRS 3)	8.9	9.5	8.4	12.6
Discontinued operations	5.4	2.5	5.6	0.0
Net income (norm)	21.8	21.6	26.6	28.4
Net income (FRS 3)	14.3	12.0	14.0	12.6
Ave. Number of Shares Outstanding (m)	84.0	88.8	92.6	94.8
EPS - normalised & diluted (p)	25.1	23.4	27.8	28.9
EPS - underlying, diluted (p)	23.5	22.5	25.9	27.4
EPS - IFRS basic (p)	17.0	13.5	15.1	13.3
EPS - IFRS diluted (p)	16.5	13.0	14.5	12.8
Dividend per share (p)	3.0	10.2	10.8	11.2
Gross Margin (%)	33.6	38.0	38.0	38.0
EBITDA Margin (%)	14.6	14.5	14.2	14.6
Operating Margin (before am, SBP and except.) (%)	10.6	10.5	11.0	11.1
discoverIE adjusted operating margin (%)	10.0	10.2	10.4	10.6
BALANCE SHEET				
Fixed Assets	236.4	245.0	278.4	263.1
Intangible Assets	182.2	191.2	223.2	207.0
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	211.8	221.9
Stocks	68.4	67.7	80.2	85.1
Debtors	90.1	84.9	101.3	107.4
Cash	36.8	29.2	28.6	27.6
Current Liabilities	(103.6)	(107.8)	(128.5)	(135.6)
Creditors	(94.0)	(102.2)	(122.9)	(130.0)
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)	(97.0)	(82.7)
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)	(10.3)	(1.6)
Net Assets	200.5	208.8	264.8	266.6
CASH FLOW				
Operating Cash Flow	48.0	56.8	41.4	50.6
Net Interest	(3.7)	(3.1)	(3.8)	(4.0)
Tax	(6.4)	(7.2)	(9.4)	(10.2)
Capex	(6.3)	(3.9)	(8.5)	(8.5)
Acquisitions/disposals	(73.6)	(20.5)	(52.7)	(7.0)
Financing	53.9	(6.6)	46.7	(6.7)
Dividends	(8.1)	(2.8)	(9.5)	(10.2)
Net Cash Flow	3.8	12.7	4.4	4.0
Opening net cash/(debt)	(63.3)	(61.3)	(47.2)	(42.8)
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)	(42.8)	(38.8)

Source: discoverIE, Edison Investment Research

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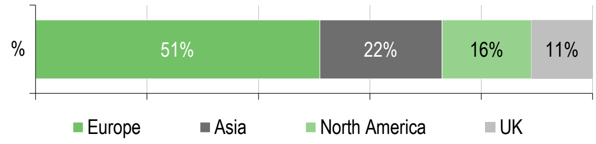
2 Chancellor Court, Occam Road, Surrey Research Park, Guildford GU2 7AH +44 (0)1483 544500 www.discoverieplc.co.uk	

Management team	
CEO: Nick Jefferies	**CFO: Simon Gibbins**
Nick joined discoverIE as group chief executive in January 2009. He has held senior positions for over 15 years with leading international distributors of electronic components and computer products, such as Electrocomponents and Arrow Electronics. He originally trained as an electronics design engineer with Racal Defence (now part of Thales).	Simon was appointed as group finance director in July 2010. A chartered accountant, he was previously global head of finance and deputy CFO at Shire. Before joining Shire in 2000, he spent six years with ICI in various senior finance roles, both in the UK and overseas. His earlier career was spent with Coopers & Lybrand in London.
Chairman: Malcolm Diamond	
Malcolm was appointed as a non-executive director of discoverIE in November 2015 and became non-executive chairman in April 2017. He was previously non-executive chairman of Trifast and before that chief executive of Trifast. Other previous appointments include senior non-executive director of Dechra Pharmaceuticals and non-executive director of Unicorn AIM VCT.	

Principal shareholders	(%)
Aberdeen Standard Investments	12.3
BlackRock Inc	6.8
Kempen Capital Management NV	5.4
Montanaro Group	4.3
Impax Asset Management	4.1
Legal & General Investment Management	3.5
Swedbank Robur	3.0

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