

discoverIE Group

Boosting North American presence

discoverIE has acquired two high-margin design & manufacturing (D&M) businesses for initial consideration of £15.9m, and raised £28m net from the issue of 7.3m shares at 400p per share. The acquired businesses strengthen discoverIE's position in the magnetics and sensor markets, increase presence in North America and open up organic growth opportunities in the group's target markets. The placing brings the group's gearing down and provides headroom for further acquisitions.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/17	338.2	17.8	19.9	8.5	21.7	2.0
03/18	387.9	22.6	23.0	9.0	18.7	2.1
03/19e	438.5	27.0	26.9	9.5	16.0	2.2
03/20e	465.4	30.6	27.6	10.0	15.6	2.3

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

Acquiring magnetics and sensor businesses

discoverIE has acquired two D&M companies, Hobart Electronics and Positek, for total initial cash consideration of £15.9m. Operating in the magnetics and sensor markets respectively, the acquisitions enhance the group's international operations, add cross-selling potential, and bring higher operating margins to the group. The company has placed 7.3m shares at 400p per share to raise net proceeds of £28m, which will be used to reduce debt and for general working capital. The company expects the combined acquisitions and placing to be neutral to EPS in FY20 (it would have been c 2% accretive on a 100%-equity funded basis).

Positive trading update; estimates revised up

The company saw strong trading in Q419 to close the year with reported revenue growth of 13% (ahead of our forecast). Constant currency organic growth in orders of 9% for D&M and 5% for Custom Supply in Q419 positions the company well for growth in FY20. We have revised our forecasts to reflect the two acquisitions, the placing and the strong trading update for FY19. We lift our FY20 revenue forecast by 4.5% and, as both acquisitions have higher operating margins than the existing D&M division, group operating margin expands slightly in FY20. We have cut our net debt forecasts and now expect a net debt/EBITDA ratio of 1.3x by the end of FY20, down from our previous 1.8x estimate.

Valuation: Growth strategy supports upside

For FY20e, the stock is trading on an EV/EBITDA of 10.4x (at an 8% discount to its peer group) and at an 8% discount on a P/E basis. With continuing growth and higher margins, further progress in increasing the weighting of business towards D&M (including accretive acquisitions), combined with good control over the profitability of the CS business, should help to close the valuation gap. The stock is also supported by a dividend yield of more than 2%.

Year-end trading update

Electronic & electrical equipment

23 April 2019

Price **431p**

Market cap **£348m**

€1.15:NOK11.05:£1

Net debt (£m) at end H119 62.6

Shares in issue 80.7m

Free float 96%

Code DSCV

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 7.2 9.3 0.2

Rel (local) 3.5 1.5 (0.3)

52-week high/low 455p 325p

Business description

discoverIE (formerly Acal) 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

FY19 results 4 June 2019

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Two D&M acquisitions; one placing

discoverIE has made two acquisitions in the D&M business, Hobart Electronics and Positek, with initial consideration totalling £15.9m funded through debt. It has also placed 7,309,867 shares at 400p (at a 3.85% discount to the 416p closing price on 15 April) to raise gross proceeds of £29.2m and net proceeds of £28m. This represents 9.96% of the shares outstanding prior to the placing. Proceeds will be used to reduce debt and for general working capital purposes.

The company expects the combination of the two acquisitions and the placing to have a neutral impact on EPS in FY20. If the acquisitions had been 100% equity-funded, the combined deal would have been EPS enhancing by c 2%.

Hobart Electronics – boosting US magnetics presence

Coil-Tran Corporation, which is trading as Hobart Electronics, is based in Hobart, Indiana, and designs, manufactures and supplies customised transformers, inductors and magnetic components for niche applications. It has four manufacturing facilities: two in the US (Tempe, Arizona and Hobart, Indiana) and two in Mexico, and employs c 260 people in the US and Mexico.

The business is currently run by the founder's son, Mr Gary Kriadis, who is also the sole shareholder of the company. Mr Kriadis and his management team will stay with the business, which will retain its brand identity within the Noratel division.

In CY18, the business generated revenues and profits as per Exhibit 1. In 2015, Hobart acquired a business called Imag, and since then has doubled revenues. The organic revenue growth rate is c 6%. 94% of revenues are generated in North America and c 74% of sales are into the energy infrastructure and industrial markets.

Exhibit 1: Financial performance of Hobart Electronics			
CY18		\$m	£m
Revenues		13	10
EBITDA		2.1	1.6
<i>EBITDA margin</i>		16%	16%
Operating profit		2.0	1.5
<i>Operating margin</i>		15%	15%
PBT		2.0	1.5
Gross assets		6.9	5.3
Source: discoverIE			

Management's rationale for the deal includes:

- building the group's position in North America. Adding Hobart's revenues will double the amount generated in North America by the group's magnetics business;
- addition of a strong management team; and
- addition of manufacturing facilities in Mexico, which should support expansion of the North American business.

Positek – strengthening the Variohm sensor business

Positek is a UK-based designer and manufacturer of rugged, high-accuracy linear, rotary, tilt and submersible sensors. Roughly 60% of sales are into the industrial sector. On a geographic basis, 15% of sales are generated in the UK, 50% in Europe, 20% in North America and the remainder in Asia Pacific. In the year to 31 August 2018, the company reported revenues of £1.5m, underlying EBITDA of £0.6m (40% margin) and reported PBT of £0.4m. Gross assets at this date were £1.3m. Positek will operate within the Variohm division and retain its own brand identity.

Initial cash consideration of £15.9m for both deals

For Hobart, discoverIE is paying initial cash consideration of \$15.2m/£11.7m and contingent cash consideration of up to \$4.0m/£3.1m subject to achieving certain profit and integration targets in the next 18 months.

For Positek, discoverIE is paying initial cash consideration of £4.2m and contingent cash consideration of up to £0.4m subject to achieving certain profit and integration targets in the next 18 months

The table below shows the enterprise value (EV) multiples for each acquisition and the same multiples for discoverIE based on our forecasts and the share price at close on 15 April.

Exhibit 2: Valuation multiples			
	Hobart	Positek	discoverIE
EV £m	11.7	4.2	372
EV/Sales (x)	1.2	2.8	0.9
EV/EBITDA (x)	7.3	7.0	10.5
EV/EBIT (x)	7.8	7.6	12.6

Source: Edison Investment Research

Positive FY19 trading update

The company also provided a trading update for the quarter and year just ended, with growth in revenues and orders as per Exhibit 3. In Q419, organic growth remained strong in both divisions, as did order intake. We note that our FY19 revenue forecast prior to this update was for growth of 10.5% on a reported basis.

Exhibit 3: Revenue and order growth rates				
	Revenues		Orders	
	FY19	Q419	FY19	Q419
Group growth				
Reported	13%	12%		
Constant exchange rates (CER)	14%	14%		
Organic*	8%	8%	7%	8%
D&M organic	10%	9%	11%	9%
Custom Supply organic	5%	7%	3%	5%

Source: discoverIE. Note: *Organic growth is on a CER basis and excludes Santon and Cursor Controls acquisitions.

The company also noted that cash generation was good during Q4 and that net debt at the end of the year was lower than expected, with net debt/EBITDA of 1.8x (1.5x when factoring in acquisitions and placing), compared to our forecast of 2.0x.

Changes to forecasts

We have revised our forecasts to take account of the better than expected trading in Q419, the two acquisitions and the placing. In FY20e, D&M revenues as a proportion of total revenues move up from 61.9% to 62.7%, and the share of operating profit from D&M moves from 80.3% to 80.9%. On the basis of stronger trading in H219, we lift our FY19 normalised EPS forecast by 2.4% and FY20 by 0.3%.

We note that our estimate for net debt/EBITDA reduces to 1.3x from 1.8x by the end of FY20. The company commented that while no further acquisitions were imminent, they would continue to consider acquisition targets and now have more financing headroom to fund this.

Exhibit 4: Changes to estimates

£m	FY19e old	FY19e new	Change	y-o-y	FY20e old	FY20e new	Change	y-o-y
Revenues	428.5	438.5	2.3%	13.0%	445.4	465.4	4.5%	6.1%
Custom supply	168.0	171.9	2.3%	4.0%	169.7	173.7	2.3%	1.0%
Design & manufacturing	260.5	266.5	2.3%	19.7%	275.7	291.7	5.8%	9.4%
<i>Gross margin</i>	33.0%	33.0%	0.0%	0.4%	33.0%	33.0%	0.0%	0.0%
EBITDA	35.3	35.8	1.5%	22.1%	37.4	39.7	6.2%	10.9%
EBITDA margin	8.2%	8.2%	(0.1%)	0.6%	8.4%	8.5%	0.1%	0.4%
Underlying operating profit	29.4	29.9	1.8%	22.2%	31.6	33.8	6.8%	12.9%
<i>Underlying operating margin</i>	6.9%	6.8%	(0.0%)	0.5%	7.1%	7.3%	0.2%	0.4%
Normalised operating profit	30.4	30.9	1.7%	22.8%	32.5	34.7	6.6%	12.1%
<i>Normalised operating margin</i>	7.1%	7.1%	(0.0%)	0.6%	7.3%	7.5%	0.2%	0.4%
Normalised PBT	26.4	27.0	2.4%	19.7%	28.0	30.6	9.5%	13.2%
Normalised net income	19.8	20.3	2.4%	18.4%	20.8	22.8	9.5%	12.5%
Normalised EPS (p)	26.3	26.9	2.4%	16.8%	27.5	27.6	0.3%	2.6%
Reported EPS (p)	14.9	15.6	4.3%	(6.5%)	17.9	18.8	5.1%	20.9%
Net (debt)/cash	(72.7)	(66.7)	(8.2%)	27.3%	(65.7)	(51.0)	(22.4%)	(23.5%)
Net debt/EBITDA (x)	2.0	1.8			1.8	1.3		

Source: Edison Investment Research

Exhibit 5: Financial summary

	£m	2015	2016	2017	2018	2019e	2020e
Year end 31 March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		271.1	287.7	338.2	387.9	438.5	465.4
Cost of Sales		(186.7)	(195.1)	(227.2)	(261.2)	(293.7)	(311.7)
Gross Profit		84.4	92.6	111.0	126.7	144.8	153.7
EBITDA		16.6	19.8	24.3	29.3	35.8	39.7
Operating Profit (before am, SBP and except.)		14.0	17.0	20.6	25.2	30.9	34.7
Operating Profit (before am. and except.)		13.4	16.3	20.0	24.5	29.9	33.8
Amortisation of acquired intangibles		(2.1)	(2.8)	(3.9)	(4.9)	(5.9)	(6.0)
Exceptionals		(5.2)	(2.1)	(8.4)	(1.1)	(4.8)	(3.2)
Share-based payments		(0.6)	(0.7)	(0.6)	(0.7)	(1.0)	(0.9)
Operating Profit		6.1	11.4	7.7	18.5	19.2	24.6
Net Interest		(1.6)	(1.8)	(2.8)	(2.6)	(3.9)	(4.1)
Profit Before Tax (norm)		12.4	15.2	17.8	22.6	27.0	30.6
Profit Before Tax (FRS 3)		4.3	9.4	4.8	15.8	15.1	20.3
Tax		(1.4)	(2.2)	(1.3)	(4.0)	(3.8)	(5.2)
Profit After Tax (norm)		10.0	11.8	13.6	17.1	20.3	22.8
Profit After Tax (FRS 3)		2.9	7.2	3.5	11.8	11.4	15.1
Average Number of Shares Outstanding (m)		57.6	63.3	65.4	70.8	72.9	80.3
EPS - normalised & diluted (p)		16.4	17.8	19.9	23.0	26.9	27.6
EPS - IFRS basic (p)		5.0	11.4	5.3	16.7	15.6	18.8
EPS - IFRS diluted (p)		4.8	10.9	5.1	15.8	15.0	18.3
Dividend per share (p)		7.6	8.1	8.5	9.0	9.5	10.0
Gross Margin (%)		31.1	32.2	32.8	32.7	33.0	33.0
EBITDA Margin (%)		6.1	6.9	7.2	7.6	8.2	8.5
Operating Margin (before am, SBP and except.) (%)		5.2	5.9	6.1	6.5	7.1	7.5
BALANCE SHEET							
Fixed Assets		88.6	108.4	122.2	136.0	148.3	157.8
Intangible Assets		69.9	88.2	100.7	106.8	119.8	129.6
Tangible Assets		13.8	14.7	16.0	23.4	22.7	22.4
Deferred tax assets		4.9	5.5	5.5	5.8	5.8	5.8
Current Assets		127.3	128.3	148.4	168.4	186.1	213.1
Stocks		39.8	42.9	50.1	60.6	72.1	76.5
Debtors		60.2	65.5	77.3	84.6	90.1	102.0
Cash		26.7	19.9	21.0	21.9	22.6	33.3
Current Liabilities		(62.1)	(61.7)	(78.1)	(93.6)	(105.5)	(111.3)
Creditors		(61.9)	(60.9)	(77.1)	(87.2)	(99.1)	(104.9)
Short term borrowings		(0.2)	(0.8)	(1.0)	(6.4)	(6.4)	(6.4)
Long Term Liabilities		(61.1)	(73.1)	(68.7)	(81.5)	(93.5)	(88.5)
Long term borrowings		(45.5)	(57.2)	(50.0)	(67.9)	(82.9)	(77.9)
Other long term liabilities		(15.6)	(15.9)	(18.7)	(13.6)	(10.6)	(10.6)
Net Assets		92.7	101.9	123.8	129.3	135.3	171.0
CASH FLOW							
Operating Cash Flow		6.6	14.6	20.5	21.7	27.9	27.4
Net Interest		(1.6)	(1.8)	(2.8)	(2.6)	(3.9)	(4.1)
Tax		(3.3)	(4.3)	(3.0)	(3.7)	(5.8)	(7.8)
Capex		(2.5)	(2.3)	(3.4)	(4.3)	(4.0)	(4.6)
Acquisitions/disposals		(37.3)	(19.8)	(11.8)	(25.4)	(22.0)	(15.9)
Financing		52.7	0.0	13.6	(1.5)	0.0	28.0
Dividends		(3.6)	(4.9)	(5.2)	(6.2)	(6.6)	(7.3)
Net Cash Flow		11.0	(18.5)	7.9	(22.0)	(14.3)	15.7
Opening net cash/(debt)		1.8	(19.0)	(38.1)	(30.0)	(52.4)	(66.7)
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0	0.0
Other		(31.8)	(0.6)	0.2	(0.4)	0.0	(0.0)
Closing net cash/(debt)		(19.0)	(38.1)	(30.0)	(52.4)	(66.7)	(51.0)

Source: discoverIE, Edison Investment Research

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