EDISON

Acal

FY17 results

Strong start to FY18

Industrial support services

Acal saw a recovery in demand in H217 after a weak first half and finished the year with a solid order book. Continued strong demand in Q118 supports organic growth in FY18 and we again nudge our estimates upwards (+1.5% to FY18 eps) following a similar upgrade in April. The company's strategy to grow the design and manufacturing business is on track and we expect to see further acquisitions to broaden the product offering and geographical coverage. The stock continues to trade at a discount to its peer group.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/15	271.1	12.4	16.4	7.6	17.9	2.6
03/16	287.7	15.2	17.8	8.1	16.5	2.7
03/17e	338.2	17.8	19.9	8.5	14.8	2.9
03/18e	367.4	20.7	20.6	8.9	14.3	3.0
03/19e	381.1	22.1	21.7	9.3	13.5	3.1

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

FY17 results: Substantial recovery in H2

After a weak first half, Acal saw a return to organic growth in H217 (+6 y-o-y). The 1% decline in FY17 organic revenues was boosted by positive currency effects and acquisitions to generate reported revenue growth of 18% y-o-y. Underlying operating profit grew 22.7% y-o-y to a margin of 5.9% (vs 5.7% in FY16). Normalised EPS was 4.6% ahead of our forecast, growing 11.4% y-o-y. Acal reduced net debt significantly, from £38m at end FY16 to £30m at end FY17.

Positive outlook for FY18; expect more M&A

The group saw strong order intake in H217 (+3% in D&M and +11% in Custom Distribution (CD) on an organic basis) and has seen continued positive momentum in Q118. This positions Acal well for organic growth in FY18. The company should see the full £4m cost savings from the efficiency programme initiated in FY17. We have revised our forecasts to reflect FY17 performance: we increase our FY18 normalised EPS forecast by 1.5% and introduce an FY19 forecast for 5.3% EPS growth. With net debt reduced over the year, and funding in place, we expect the pace of M&A to pick up again in FY18, focused on companies with design and manufacturing capabilities with presence in Europe, the US and/or Asia.

Valuation: Discount persists despite positive outlook

Over the last year, the stock has gained 12%, although with the recovery in trading in H217, it is now 43% higher than the low of 206p reached in November 2016. Nevertheless, the stock continues to trade at a discount to the peer group average on EV/EBITDA and P/E multiples. The strong order book combined with good progress in the strategy to grow the Design & Manufacturing (D&M) side of the business provide confidence in both the near-term and longer-term outlook for the company. 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 above 3%.

19 June 2017

Price	**294.3p**
Market cap	**£208m**
	€1.15:NOK11.0:£1
Net debt (£m) at end FY17	30.0
Shares in issue	70.7m
Free float	96%
Code	ACL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	9.6	27.8	10.6
Rel (local)	10.4	26.1	(11.7)
52-week high/low		297.5p	204.5p

Business description

Acal is a leading international supplier of customised electronics to industry. It designs, manufactures and distributes customer-specific electronic products and solutions to 25,000 industrial manufacturers.

Next events

AGM & trading update	25 July 2017

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Edison profile page

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Investment summary

Company description: Supplier of customised electronics to industry

Acal is a leading international supplier of customised electronics to industry. Over the last eight years the company has broadened its product range, customer base and geographical presence via a series of acquisitions. The company offers design and manufacturing and value-added distribution services; the focus on differentiated products and expansion along the supply chain is helping the company to expand operating margins. The company intends to continue to grow organically and via acquisition while maintaining its focus on higher-margin business.

Financials: Outlook improving

FY17 revenues grew 18% y-o-y on a reported basis and 6% at constant exchange rates. On an underlying basis (pre-currency effects and acquisitions), the D&M business declined 1% and the ongoing business in CD was flat. Operating profit and normalised EPS came in ahead of our forecasts, with the underlying operating margin expanding from 5.7% in FY16 to 5.9% in FY17 and up to 6.2% for H2 17. Good working capital management reduced net debt by 21% over the year. We increase our FY18 EPS forecast by 1.5% and introduce a forecast for 3.7% revenue growth and 5.3% normalised EPS growth in FY19.

Exhibit 1: Changes to forecasts

	EPS (p)			PBT (£m)			EBITDA (£m)		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
2017	19.0	19.9	4.6	17.4	17.8	2.3	23.1	24.3	5.2
2018e	20.3	20.6	1.5	20.3	20.7	1.8	26.5	27.3	2.8
2019e	N/A	21.7	N/A	N/A	22.1	N/A	N/A	28.6	N/A

Source: Acal, Edison Investment Research

Valuation: Discount persists despite positive outlook

Over the last year, the stock has gained 6%, although with the recovery in trading in H217, it is now 36% higher than the low of 206p reached in November 2016. The stock continues to trade at a discount to the peer group average on EV/EBITDA and P/E multiples, with the discount slightly widening to c 35% from c 30% in April. As Acal increases the proportion of revenues generated from D&M, we would expect to see meaningful increases in operating margins, which should flow through to the earnings level. The stock is supported by a dividend yield above 3%.

Sensitivities: Demand, currencies, acquisitions

Our estimates and Acal'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. **Currency:** with 90% of underlying profits outside the UK, Acal is exposed to the translation of euro and Nordic-denominated subsidiary results into sterling, which positively affected sales by 10% and profits by 14% in FY17. **Pricing:** Acal'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. **Acquisitions:** Acal may make further acquisitions, which could add integration risk and will require funding. **Pension deficit:** Acal has a £6.0m pension deficit and, as agreed with the pension trustees in 2009, has been making increased contributions since FY13 to reduce this (£1.6m in FY17).

Company description: Custom electronics supplier

Acal is a supplier of customised electronics to industry with operations throughout Europe and increasingly outside Europe. The last eight years have seen the integration of a series of acquisitions and a focus on growing the percentage of higher-margin specialist product, resulting in higher profitability. The company intends to continue to grow organically and via acquisitions while maintaining the focus on higher-margin business.

Company history

Acal 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, the company has, through its strategy of specialisation, transitioned to become a provider of customised electronic solutions with operations in Europe, Asia, North America and South Africa. Acquisitions include BFi Optilas in 2009, CompoTRON, Hectronic and MTC Micro Tech Components (MTC) in 2011, Myrra Group, Young Electronics Group and RSG in 2013, Noratel in 2014, Foss and Flux in 2015, Contour and Plitron in 2016 and Variohm in 2017. The company operates through two divisions: D&M (52% of FY17 revenues) and CD (48% of FY17 revenues), with 3,800 employees across 23 countries.

Group strategy

Management's aim is to transform the company into a technology-led provider of customised electronics for industrial applications with design, manufacturing and distribution capabilities. To achieve this, the company has set the following strategic objectives:

- **Move up the electronics value chain** into higher margin products. This includes growing revenues from the design and manufacture of own products, where operating margins tend to exceed 10%; optimising the performance of CD to achieve margins of 5%; and cross-selling D&M products.
- **Grow sales organically and well ahead of GDP** by focusing on structural growth markets that have an essential need for Acal products.
- **Acquire high quality businesses** that strengthen and develop the company's commercial offering.
- **Develop sales internationally by further expansion into North America and Asia,** both by supporting existing customers' international needs and by developing local market sales.

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 in this report. The company has also highlighted its priorities for the year ahead in order to generate earnings growth:

- drive organic revenue growth;
- optimise efficiency through production efficiencies, regional sales leadership structure and continued growth in cross-selling;
- integrate the Variohm acquisition; and
- make value-enhancing acquisitions.

Technical expertise adds value to specialist product range

Acal specialises in supplying technically demanding, bespoke electronics for industrial applications and has c 25,000 customers over a wide range of end-markets. The company estimates that the global niche electronic components market is worth £20bn annually. Acal mainly competes against small, privately owned, country-specific suppliers in one or multiple technology areas and expects to continue its active role in consolidating this fragmented market.

Mainly through acquisitions, the company has built up its **D&M** capability in four of the company's five technology areas (see Exhibit 2). From this division, Acal supplies custom electronic products either designed uniquely or modified from an existing product. More than 80% of products are manufactured in house (with principal facilities in China, India, Poland, Sri Lanka and Thailand) with the remainder manufactured by third-party contractors. Increasingly, these products are also distributed through Acal BFi.

The main business in **CD** is Acal BFi, a specialist electronics supplier that differentiates itself from high-volume distributors such as Arrow or Avnet by supplying niche components from leading manufacturers (often on an exclusive basis) in a wide range of electronic component areas. The products that the company supplies are often technically complex and therefore require more technical sales support, which Acal is able to provide (this is not always available from the product manufacturer or smaller local distributors). Acal solutions range from the recommendation and supply of a part, modification of an existing product or full design and development of a custom solution. A significant proportion of sales come from products that are either uniquely created for one customer and/or exclusively sourced.

Acal BFi supplies products from a selected group of manufacturers (including the D&M division), across five technology areas to more than 20,000 industrial customers (see Exhibit 2). It operates across Europe, with centralised warehousing, purchasing, finance, customer contact management and IT systems.

Exhibit 2: Product range by technology

Product area	Key products	Design and manufacture businesses
Communication & Sensors	RF components, fibre optic components, frequency control, wireless modules and systems, sensors and transducers, sensor assemblies, rotary signal transmitters.	Foss, Variohm
Electromechanical	Cabling and assemblies, human interface components, military connectors, gaskets, EMC connector seals, springs, shields.	Contour, MTC, Stortech
Microsystems & Displays	Single board computers, server modules, system assemblies.	Hectronic
Imaging & Photonics	Infrared thermal imaging, radar, visible cameras, modules and software, lasers and diodes, optical-mechanics, optics, test and measurement.	
Power & Magnetics	Standard and customisable power designs, magnetic components, electromagnetic and thermal interface.	Flux, Myrra, Noratel, Plitron, RSG

Source: Acal

Additionally, the division has a separate medical business, Vertec, which supplies exclusively sourced medical imaging and radiotherapy products into medical and healthcare markets in the UK and South Africa.

Industrial focus leads to longer product cycles

Acal's solutions are used in both the design and production phases of a customer's product. The company works with R&D engineers to help them develop new products; once these move into production, Acal supplies on a volume basis for the life of the product. We highlight that Acal is focused on industrial OEMs and does not service the consumer electronics market (which tends to be highly commoditised with short lifetime products). Across both businesses, a customer will typically take six to 24 months to take 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.

Strategic progress update

Exhibit 3 summarises Acal's progress against its KSIs. We discuss below how the company is meeting its strategic objectives.

Exhibit 3: KSIs					
	FY14	FY15	FY16	FY17	Mid-term target*
Increase D&M revenue	18%	37%	48%	52%	75%
Increase underlying operating margin	3.4%	4.9%	5.7%	5.9%	8.5%
Build sales beyond Europe	5%	12%	17%	19%	30%

Source: Acal. Note: *three to five years.

Moving up the electronics value chain

Acal started life as a pure distributor of electronic components, but through a strategy of specialisation and acquisition has transitioned to become a provider of customised electronic solutions. Over the last six years, the company has acquired 10 businesses with design and manufacturing capabilities – these are significantly more profitable than the CD business. Consequently, while the **D&M** division generated more than half of FY17 revenues, it generated 80% of FY17 profits. In the **CD** division, Acal is focused on selling highly differentiated customised products. With D&M operating margins of 11.5% in FY17 compared to 3.2% for CD, as the company makes more D&M acquisitions, group operating margins should continue to expand.

Grow sales organically and well ahead of GDP

The company is taking a two-pronged approach to growing its revenues ahead of GDP on an organic basis:

- by targeting markets that are growing faster than GDP; and
- by promoting cross-selling within Acal BFi and across the rest of the group.

Targeting high growth markets

The World Bank is forecasting global GDP growth of 2.7% in 2017, and 2.9% in 2018 and 2019 (1.9%, 1.8% and 1.7% respectively for advanced economies). To generate growth ahead of GDP, the company is targeting end-markets that look set to benefit from population growth and long-term technology trends. In FY17, the business generated roughly half of its revenues from these four areas:

- **Transportation:** this includes road, rail and air travel. For example, the growth in electric vehicles is increasing demand for electronics – as a supplier to Tesla for its charging points, Acal is already benefiting from this trend. As automotive manufacturers work towards creating autonomous vehicles, the technology content of cars will increase even further.
- **Medical:** with an ageing population and growing levels of comorbidity, healthcare spending continues to rise, with increasing amounts of technology used in diagnosing, monitoring and controlling medical conditions.
- **Renewable energy:** the International Energy Authority forecasts that renewable energy will be the largest source of global power generation by 2030, mainly provided by solar, hydroelectric and wind technologies. Wind power is expected to account for 50% of the incremental power generated over this period. Through its Scandinavian acquisitions, Acal already has several wind turbine customers.
- **Industrial connectivity:** growth in device-to-device wireless connectivity (the internet of things) is driving demand for electronics for industrial applications such as smart meters, remote asset management and predictive maintenance.

Cross-selling strategy

Each of Acal's five technology groups has a team of specialist sales and support engineers and their role is to identify customer opportunities. The company has initiatives in place to increase the level of cross-selling to existing customers, with a particular focus on selling D&M products between group companies. Cross-selling generated sales worth £4.6m in FY17 (FY16: £3.0m).

Acquisitions core to growth strategy

Acal started the transformation of the business in 2009 with the acquisition of BFi Optilas, the next largest European specialist distributor after Acal. This increased Acal's presence in Germany, the UK, France and the Nordic region. Acal then proceeded to make a series of acquisitions (see Exhibit 4), the largest of which was Noratel for £73.5m in 2014, most with design and manufacturing capabilities. Acal has spent more than £160m on acquisitions over the last eight years.

Exhibit 4: Acquisition timeline

Company	Date	Product areas	Operations	Sales	Cost (£m)
BFi Optilas	Dec 09	Speciality components, communication, photonic, imaging	Germany, France, UK, Spain, Italy, Sweden, Netherlands	Europe	13.4
CompoTRON	Jan 11	Electronic communications and fibre-optic components	Germany, UK, Denmark	Europe	7.1
Hectronic	Jun 11	Embedded computing	Sweden	Nordic region	1.2
MTC	Oct 11	Electro-magnetic shielding (own brand/manufacture)	Germany, South Korea	Europe and Asia	2.7
Myrra SAS	Apr 13	Transformers, coils, cores and inductors (own brand/manufacture)	France, Poland, China	Europe, Asia, North America, Africa	9.9
Young Electronics Group	Sep 13	Solid state lighting, electronic components, power supplies, power cords, custom cable assembly	UK, Ireland	UK, Ireland	1.7
RSG	Nov 13	Custom power solutions	Germany	Germany	2.7
Noratel	Jul 14	Low-, medium- and high-power transformers and inductors (own brand/manufacture)	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	UK, France, Germany, US	13.3
Total					**160.8**

Source: Acal

Acal's focus for future acquisitions is to target companies 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 and similar long-term growth drivers to Acal's focus markets.

Integration strategy – retain entrepreneurial approach

Many of the acquired businesses have been led by entrepreneurial managers, and Acal 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. Benefits of being part of the larger Acal group include:

- access to the wider Acal customer base and cross-selling initiatives;
- support for management development and succession planning;
- capital investment in manufacturing capacity and infrastructure;
- Acal's strong balance sheet;
- support for product development;
- efficiency improvements through access to the group's purchasing scale, processes, warehousing and freight; and
- centralised finance and administrative support.

D&M acquisition track record

The company has analysed the 10 D&M acquisitions it has made over the last six years. Six are currently generating a return on investment (ROI[1]) above Acal's target of 15% and 9 at above the company's WACC of 10%. On average, the whole group is generating an ROI above the target. Following a number of changes, management expects the one company currently operating below the company WACC to move above this threshold in the coming year. Management expects further improvements in the average ROI expected in FY18.

Exhibit 5: Acal D&M acquisition track record

Measure	Result
Weighted average organic revenue growth	4% pa
Weighted average organic operating profit growth	6% pa
FY17 ROI	16%
Target ROI	15%
WACC	10%
Number generating above target ROI / WACC	6 / 9
Number generating below target ROI / WACC	4 / 1

Source: Acal

Further acquisitions likely

Acquisitions remain a key part of the group strategy, with management considering 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 pace of acquisitions slowed over the last year, but with the appointment of a director responsible for M&A, Jeremy Morcom, we would expect the pace to re-accelerate. Jeremy is focused on sourcing new acquisition targets in Acal's key technological and geographical markets, ie companies with design and manufacturing capabilities in any of the group's five technology areas, located in Europe, North America or Asia.

The target for 75% of revenues to be generated from the D&M business in our view assumes a combination of good organic growth and a material level of M&A in that division, with no further acquisitions in the CD division.

At the end of FY17, the company had a net debt position of £30m, with gearing of 1.2x EBITDA below the target range of 1.5-2.0x. The company has a £120m syndicated bank facility (with a term lasting until July 2021) as well as a £30m accordion facility. Acal can use the syndicated facility for acquisitions and working capital. We estimate that the company has debt headroom of c £25m, based on a maximum 2x our FY18 EBITDA forecast and the end-FY17 net debt position.

Develop sales internationally

In FY17, 19% of revenues were generated outside of Western Europe (up from 17% in FY16). Acal's strategy is to support existing customers' business outside Western Europe and to make further acquisitions that expand the group's geographical coverage, such as the 2016 acquisition of Canadian-headquartered Plitron.

Financials

Review of FY17 results

After the April trading update, we upgraded our forecasts for FY17 and FY18 to reflect the stronger levels of demand the company was seeing. Acal reported FY17 revenues 0.7% ahead of our

1 ROI: measured as current year operating profit divided by acquisition costs (upfront cost plus earn-outs, expenses and integration costs).

revised forecasts. Gross margin was slightly lower than our forecast, impacted by higher input costs (euro and US dollar-based) in the UK business. Underlying operating profit beat our forecast by 2.6% and the underlying operating margin expanded 20bp compared to FY16. Better operating profitability resulted in normalised EPS 4.6% ahead of our forecast, growing 11.4% compared to FY16. Good working capital management resulted in net debt significantly below our forecast. The company announced a final dividend of 6.05p, for a full year dividend of 8.5p (+5.6% y-o-y, and above our forecast of 8.35p).

The company instigated an efficiency programme during FY17 and had flagged an expected exceptional charge of £8m – the programme actually only ended up costing £6.4m. In D&M, the company closed three Nordic manufacturing facilities and further integrated purchasing and production processes. In CD, management headcount was reduced, sales operations were regionalised, the Spanish business was closed and admin costs were reduced.

Exhibit 6: FY17 results highlights

£m	FY17e	FY17a	Change	y-o-y
Revenues	335.8	338.2	0.7%	17.6%
Gross margin	33.0%	32.8%	-0.2pp	0.6pp
EBITDA	23.1	24.3	5.2%	22.7%
EBITDA margin	6.9%	7.2%	0.3pp	0.3pp
Underlying operating profit*	19.5	20.0	2.6%	22.7%
Underlying operating profit margin*	5.8%	5.9%	0.1pp	0.2pp
Normalised operating profit	20.2	20.6	2.0%	21.2%
Normalised operating margin	6.0%	6.1%	0.1pp	0.2pp
Normalised PBT	17.4	17.8	2.3%	17.1%
Normalised net income	13.2	13.6	2.8%	14.6%
Normalised EPS (p)	19.0	19.9	4.6%	11.4%
Reported EPS (p)	1.7	5.3	210.6%	-53.0%
Net (debt)/cash	(36.7)	(30.0)	-18.3%	-21.3%
Net debt/EBITDA (annualised for acquisitions)	1.6x	1.2x		

Source: Acal, Edison Investment Research. Note: *underlying operating profit includes share-based payments.

Exhibit 7: Divisional performance

	FY17	FY16	FY16 CER	Reported y-o-y	CER y-o-y	Like-for-like
D&M revenues	175.6	137.6	154.4	27.6%	13.7%	-1.0%
CD revenues	162.6	150.1	166.1	8.3%	-2.1%	0.0%
Total revenues	**338.2**	**287.7**	**320.5**	**17.6%**	**5.5%**	**-1.0%**
Underlying operating profit						
D&M	20.2	16.5	18.4	22.4%	9.8%	
CD	5.2	4.7	5.6	10.6%	-7.1%	
Unallocated	-5.4	-4.9	-4.9	10.2%	10.2%	
Total operating profit	**20.0**	**16.3**	**19.1**	**22.7%**	**4.7%**	
Underlying operating margin						
D&M	11.5%	12.0%	11.9%	-0.5%	-0.4%	
CD	3.2%	3.1%	3.4%	0.1%	-0.2%	
Total operating margin	**5.9%**	**5.7%**	**6.0%**	**0.2%**	**0.0%**	

Source: Acal

The table above shows performance at a divisional level, and strips out the effect of exchange rate moves and acquisitions. D&M saw a 1% decline in organic constant currency revenues, although this masks the improvement in demand in the second half of the year (H117 -4%, H217 +3%). CD saw a similar profile, with flat organic revenues for FY17 (once the Spanish business discontinued in December 2016 is stripped out), made up of a 10% decline in H117 and 9% growth in H217.

D&M operating profitability was lower year-on-year, with a decline in profitability in H2 (H117: 12.2%, H217: 10.9%). A large proportion of input costs for the UK-based businesses are dollar or euro-denominated, and post-Brexit the weakness of sterling has pushed these costs up.

CD profitability was slightly higher year-on-year. The management changes, efficiency programme and closure of the Spanish business had a positive effect in H2, with underlying operating margins improving from 2.1% in H1 to 4.1% in H2.

Progress versus KPIs

The company continues to make good progress towards its medium term KPI targets. Due to the large number of acquisitions, the company decided to switch its return calculation from ROTCE to ROCE in order to include goodwill.

Exhibit 8: KPIs

	FY14	FY15	FY16	FY17	Three-year target (FY20)
Sales growth: CER	17%	36%	14%	6%	
Sales growth: organic	2%	3%	3%	(1%)	Well ahead of GDP
Increase cross-selling	£0.3m	£0.9m	£3.0m	£4.6m	£10m pa
Underlying EPS growth	20%	31%	10%	13%	>10%
ROCE	15.2%	12.0%	11.6%	13.0%	>15%
Operating cash flow generation	100%	104%	100%	136%	>85% of underlying profit

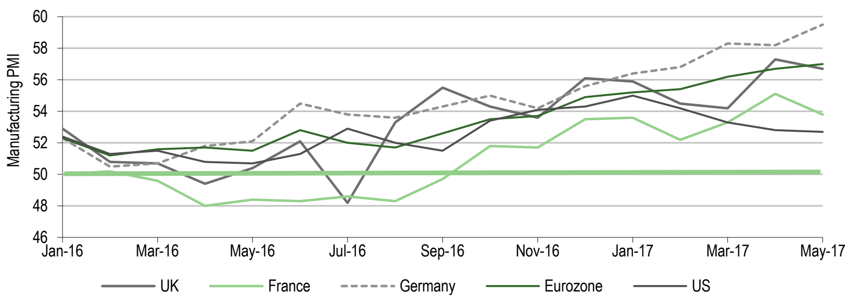
Source: Acal

Positive outlook

The company ended FY17 with an order book of £109m, which is 22% higher than a year ago on a constant currency basis, and 13% higher on an organic basis. This was helped by new project wins with an estimated lifetime value of £127m. Book-to-bill for the year was 1.04x (H1: 1.02x, H2: 1.05x). Within D&M, H2 orders rose 3% y-o-y on an organic basis and in CD, organic orders rose 11% y-o-y. The company has seen continued positive momentum in orders in Q118 to date.

Design activity tends to be technology-driven, whereas production activity is more geared to general economic conditions. The manufacturing PMI indices are useful indicators of the health of the industrial sector. Exhibit 9 shows the movement in the manufacturing PMI for the eurozone, France, Germany, the UK and the US since the start of 2016. Confidence has improved in all regions over the course of 2016 and year-to-date, with Germany currently looking particularly strong.

Exhibit 9: PMI data, January 2016 to May 2017



Source: Markit Economics

Changes to forecasts

Following a 3% revenue upgrade in April, we have nudged up our FY18 revenue by 0.9% forecast to reflect stronger than expected CD revenues. This results in a small increase in underlying operating profit, which translates to a 1.5% increase in our normalised EPS forecast. We have increased our FY18 dividend forecast by 4.7% to 8.9p.

Exhibit 10: Changes to forecasts

£m	FY18e old	FY18e new	Change	y-o-y	FY19e new	y-o-y
Revenues	364.3	367.4	0.9%	8.6%	381.1	3.7%
CD	165.1	168.0	1.7%	3.3%	171.7	2.2%
D&M	199.2	199.5	0.2%	13.6%	209.4	5.0%
Gross margin	33.0%	32.5%	-0.5%	-0.3%	32.5%	0.0%
EBITDA	26.5	27.3	2.8%	12.3%	28.6	4.6%
EBITDA margin	7.3%	7.4%	0.1%	0.2%	7.5%	0.1%
Underlying operating profit	22.5	22.8	1.1%	13.9%	24.0	5.1%
Underlying operating profit margin	6.2%	6.2%	0.0%	0.3%	6.3%	0.1%
Normalised operating profit	23.3	23.6	1.1%	14.5%	24.9	5.4%
Normalised operating margin	6.4%	6.4%	0.0%	0.3%	6.5%	0.1%
Normalised PBT	20.3	20.7	1.8%	16.2%	22.1	6.6%
Normalised net income	15.4	15.5	0.5%	14.2%	16.5	6.7%
Normalised EPS (p)	20.3	20.6	1.5%	3.9%	21.7	5.3%
Reported EPS (p)	12.8	12.1	-5.2%	126.7%	16.5	36.0%
Net (debt)/cash	(35.0)	(29.9)	-14.4%	-0.2%	(25.4)	-15.1%
Net debt/EBITDA	1.3	1.1			0.9	

Source: Edison Investment Research

Valuation

Exhibit 11 shows valuation metrics for Acal's peer group and Exhibit 12 shows their financial performances. Over the last year, the stock has gained 12%, although with the recovery in trading in H217, it is now 43% higher than the low of 206p reached in November 2016. Nevertheless, the stock continues to trade at a discount to the peer group average on EV/EBITDA and P/E multiples. As Acal increases the proportion of revenues generated from D&M, we would expect to see meaningful increases in operating margins, which should flow through to the earnings level. D&M made up 52% of FY17 revenues; absent any acquisitions we forecast this will increase to 54% in FY18 and the company is targeting this to reach 75% over the next three to five years.

Exhibit 11: Peer group financial performance

	Gross margin			EBITDA margin			EBIT margin			Revenue growth			EPS growth		
	Last year	This year	Next year	Last year	This year	Next year	Last year	This year	Next year	Last year	This year	Next year	Last year	This year	Next year
Acal	32.8%	32.5%	32.5%	7.2%	7.4%	7.5%	6.1%	6.4%	6.5%	17.6%	8.6%	3.7%	11.4%	3.9%	5.3%
Specialist and high service distributors															
Diploma	35.9%	35.9%	35.9%	18.3%	18.3%	18.4%	17.2%	16.0%	16.2%	14.6%	14.8%	4.9%	9.7%	14.6%	6.5%
Solid State	31.8%	27.9%	28.3%	11.6%	9.1%	9.1%	10.2%	N/A	N/A	20.6%	(10.9%)	4.3%	41.0%	(38.1%)	2.8%
Electrocomponents	43.4%	43.9%	43.9%	10.7%	11.4%	12.0%	8.8%	9.4%	10.1%	17.1%	5.2%	4.5%	66.7%	13.3%	11.3%
D&M															
Gooch & Housego	37.5%	39.0%	38.7%	20.5%	18.5%	19.7%	16.6%	15.0%	16.4%	9.3%	25.9%	8.3%	7.2%	12.5%	15.8%
TT Electronics	19.0%	18.7%	18.9%	9.6%	9.6%	9.9%	5.5%	5.6%	5.9%	11.8%	5.6%	2.2%	36.4%	13.3%	10.3%
XP Power	47.8%	47.4%	47.4%	25.4%	24.6%	25.0%	22.2%	21.2%	21.5%	18.3%	15.5%	4.6%	10.6%	7.2%	6.2%
Average	**35.9%**	**38.8%**	**38.8%**	**16.0%**	**15.3%**	**15.7%**	**13.4%**	**13.4%**	**14.0%**	**15.3%**	**9.4%**	**4.8%**	**28.6%**	**3.8%**	**8.8%**

Source: Bloomberg, Edison Investment Research

Exhibit 12: Peer group multiples

	EV/Sales			EV/EBITDA			P/E			Dividend yield		
	Last yr	This yr	Next yr	Last yr	This yr	Next yr	Last yr	This yr	Next yr	Last yr	This yr	Next yr
Acal	0.7	0.6	0.6	9.8	8.7	8.3	14.8	14.3	13.5	2.9%	3.0%	3.1%
Specialist and high service distributors												
Diploma	3.3	2.9	2.7	17.9	15.6	14.8	26.8	23.4	22.0	1.7%	2.0%	2.2%
Solid State	0.8	0.9	0.9	6.9	9.8	9.4	8.0	12.9	12.6	2.9%	2.9%	3.0%
Electrocomponents	1.8	1.7	1.7	16.9	15.2	13.7	28.4	25.1	22.5	2.1%	2.1%	2.2%
D&M												
Gooch & Housego	3.9	3.1	2.8	18.8	16.6	14.4	33.4	29.7	25.6	0.6%	0.7%	0.8%
TT Electronics	0.7	0.7	0.6	7.2	6.9	6.5	17.4	15.4	14.0	2.7%	2.8%	2.9%
XP Power	3.7	3.2	3.0	14.5	12.9	12.2	21.7	20.2	19.0	2.8%	3.0%	3.2%
Average	**2.4**	**2.1**	**2.0**	**13.7**	**12.8**	**11.8**	**22.6**	**21.1**	**19.3**	**2.1%**	**2.3%**	**2.4%**

Source: Bloomberg (as at 8 June), Edison Investment Research

Sensitivities

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

- **Customer demand:** demand for the company's products will be influenced by the economic environment in Europe. It will also be sensitive to the gain or loss of major customers, although in FY17 no customer made up more than 3.5% of sales.
- **Currency:** translational – with 90% of profits outside the UK, Acal is exposed to the translation of euro and Nordic-denominated subsidiary results into sterling, which positively affected sales by 10% and profits by 14% in FY17. Transactional – Acal sells mainly in euros, sterling and Nordic currencies and purchases mainly in US dollars and euros. Acal hedges with forward contracts to the extent that the exposure cannot be passed to the customer.
- **Pricing:** Acal'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 tends to pass through supplier price increases, with very few fixed-price contracts.
- **Acquisitions:** the company may make further acquisitions, which could add integration risk and will require funding (we estimate Acal has c £25m headroom in its debt facility).
- **Pension deficit**: the company has a £6.0m pension deficit and increased the level of contributions from FY13 by 3% a year (FY17: £1.6m contribution) as part of the plan agreed with trustees back in 2009 to try to eliminate it. The pension fund was closed to new entrants in 1999 and further service accruals in 2000.
- **Supply chain:** any major disruption of the supply chain could make it difficult for the company to satisfy customer demand and therefore affect revenues.

Exhibit 13: Financial summary

£m	2013	2014	2015	2016	2017e	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	367.4	381.1
Cost of Sales	(123.0)	(148.6)	(186.7)	(195.1)	(227.2)	(248.0)	(257.2)
Gross Profit	54.4	63.0	84.4	92.6	111.0	119.4	123.8
EBITDA	7.4	9.1	16.6	19.8	24.3	27.3	28.6
Operating Profit (before am, SBP and except.)	6.1	7.7	14.0	17.0	20.6	23.6	24.9
Operating Profit (before am. and except.)	5.5	7.1	13.4	16.3	20.0	22.8	24.0
Amortisation of acquired intangibles	(0.7)	(1.0)	(2.1)	(2.8)	(3.9)	(4.6)	(4.6)
Exceptionals	(3.4)	(0.9)	(5.2)	(2.1)	(8.4)	(3.5)	(0.6)
Share-based payments	(0.6)	(0.6)	(0.6)	(0.7)	(0.6)	(0.8)	(0.9)
Operating Profit	1.4	5.2	6.1	11.4	7.7	14.7	18.8
Net Interest	(0.5)	(0.8)	(1.6)	(1.8)	(2.8)	(2.9)	(2.8)
Profit Before Tax (norm)	5.6	6.9	12.4	15.2	17.8	20.7	22.1
Profit Before Tax (FRS 3)	0.7	4.2	4.3	9.4	4.8	11.6	15.8
Tax	1.4	(0.5)	(1.4)	(2.2)	(1.3)	(3.0)	(4.1)
Profit After Tax (norm)	4.6	6.0	10.0	11.8	13.6	15.5	16.5
Profit After Tax (FRS 3)	2.1	3.7	2.9	7.2	3.5	8.6	11.7
Average Number of Shares Outstanding (m)	39.2	43.1	57.6	63.3	65.4	70.7	70.7
EPS - normalised & diluted (p)	11.3	13.1	16.4	17.8	19.9	20.6	21.7
EPS - IFRS basic (p)	(4.8)	3.0	5.0	11.4	5.3	12.1	16.5
EPS - IFRS diluted (p)	(4.7)	2.8	4.8	10.9	5.1	11.4	15.3
Dividend per share (p)	6.2	6.8	7.6	8.1	8.5	8.9	9.3
Gross Margin (%)	30.7	29.8	31.1	32.2	32.8	32.5	32.5
EBITDA Margin (%)	4.2	4.3	6.1	6.9	7.2	7.4	7.5
Operating Margin (before am, SBP and except.) (%)	3.4	3.6	5.2	5.9	6.1	6.4	6.5
BALANCE SHEET							
Fixed Assets	30.9	33.1	88.6	108.4	122.2	117.3	112.4
Intangible Assets	24.2	25.5	69.9	88.2	100.7	96.0	91.3
Tangible Assets	3.1	3.5	13.8	14.7	16.0	15.8	15.6
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	159.6	164.2
Stocks	19.3	19.4	39.8	42.9	50.1	54.4	56.4
Debtors	44.7	48.3	60.2	65.5	77.3	84.0	87.1
Cash	17.8	18.1	26.7	19.9	22.2	21.3	20.8
Current Liabilities	(50.9)	(58.3)	(62.1)	(61.7)	(78.4)	(90.0)	(91.4)
Creditors	(46.6)	(51.5)	(61.9)	(60.9)	(77.1)	(84.7)	(86.1)
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)	(63.0)	(58.0)
Long term borrowings	(1.7)	(9.5)	(45.5)	(57.2)	(50.9)	(45.9)	(40.9)
Other long term liabilities	(8.6)	(9.5)	(15.6)	(15.9)	(18.7)	(17.1)	(17.1)
Net Assets	51.5	48.5	92.7	101.9	123.8	123.9	127.2
CASH FLOW							
Operating Cash Flow	5.7	6.1	6.6	14.6	20.3	19.6	24.6
Net Interest	(0.6)	(0.8)	(1.6)	(1.8)	(2.8)	(2.9)	(2.8)
Tax	(1.4)	(0.9)	(3.3)	(4.3)	(3.0)	(5.2)	(5.5)
Capex	(1.3)	(1.4)	(2.5)	(2.3)	(3.4)	(3.4)	(3.4)
Acquisitions/disposals	(0.5)	(9.2)	(37.3)	(19.8)	(11.8)	(2.0)	(2.0)
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)	(6.1)	(6.4)
Net Cash Flow	5.3	(8.8)	11.0	(18.5)	7.7	0.0	4.5
Opening net cash/(debt)	6.3	11.8	1.8	(19.0)	(38.1)	(30.0)	(29.9)
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)	(29.9)	(25.4)

Source: Acal, Edison Investment Research

EDISON

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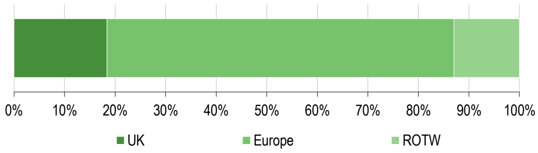
Revenue by geography



Management team

CEO: Nick Jefferies

Nick joined Acal 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).

CFO: Simon Gibbins

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 Acal in November 2015 and became non-executive chairman in April 2017. He is also non-executive chairman of Trifast Plc and Flowtech Fluidpower. Prior to being appointed executive chairman, Malcolm was chief executive of Trifast and, among other previous appointments, was senior non-executive director of Dechra Pharmaceuticals and a non-executive director of Unicorn AIM VCT.

Principal shareholders	(%)
Aberdeen Group	12.5
Hargreave Hale Investment Management	12.1
Unicorn Asset Management (UK)	7.4
Legal & General Investment Management Ltd (UK)	6.7
Chelverton Asset Management	5.2
BlackRock Inc	4.6
AXA SA	4.2
Franklin Resources	3.7

Companies named in this report

Diploma (DPLM), Electrocomponents (ECM), Gooch & Housego (GHH), XP Power (XPP)