Acal

Interim results

Margin expansion on track

Industrial support services

Acal continues to make progress with its strategy to transform itself into an international supplier of differentiated customised electronic products. Recent acquisitions have increased the company's presence outside the eurozone and UK and increased the proportion of higher-margin design and manufacturing revenues. With new operating margin targets and a continued focus on acquisitions, we see scope for growth in revenues above market levels and continued margin expansion, supporting upside to the current share price.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/13**	177.4	5.6	11.3	6.18	18.6	2.9
03/14**	211.6	6.9	13.1	6.80	16.1	3.2
03/15e	269.0	11.6	14.9	7.55	14.1	3.6
03/16e	300.3	14.7	16.7	7.95	12.5	3.9

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

H115: Organic and acquisitive growth

As recently reported in its trading update, Acal achieved group revenue growth of 20% y-o-y in H115 (27% at constant exchange rates). The Custom Distribution business saw flat like-for-like revenues, whereas the Design & Manufacturing business grew like-for-like revenues 15% y-o-y. Group operating margin (Acal adjusted) expanded from 3.0% in H114 to 4.5% in H115, driving normalised EPS growth of 27.6% y-o-y.

Outlook and changes to forecasts

The company introduced key strategic indicators to measure its progress with the group strategy, in particular growing the proportion of design and manufacturing revenues and increasing the level of international business. Reflecting the recent acquisition of higher-margin Noratel, the company has revised up its operating margin targets, aiming to achieve 6-7% over the next three years, compared to the 4.5% reported in H115. Reflecting the continued weakness in the UK market and currency headwinds, we have reduced our revenue forecasts for FY15 and FY16 by 2.0% and 1.6% respectively. Stronger margins mean our FY15 EPS is unchanged, but higher depreciation and the impact of FX in FY16 reduces EPS by 5.2%.

Valuation: Specialist focus drives earnings growth

The stock is trading on a P/E of 14.1x in FY15e and 12.5x in FY16e; while this is in line with commodity distributors, Acal trades at a discount to manufacturing and specialist distribution peers. Recent PMI data point to stabilising demand in Europe; recent acquisitions have given the company increased geographic coverage and the potential for cross-selling and integration benefits, which could drive revenue growth above market levels and support expansion of operating margins. The stock is underpinned by a dividend yield approaching 4%.

4 December 2014

Price	**210.0p**
Market cap	**£132m**
Net debt (£m) at end H115	14.0
Shares in issue	63.0m
Free float	99%
Code	ACL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.4	(9.1)	(18.4)
Rel (local)	(2.7)	(7.1)	(20.87)
52-week high/low		292.90p	192.00p

Business description

Acal is a leading European specialist electronics supplier providing electronic and photonic products, manufacturing, marketing, engineering and design services to the industrial sector.

Next event

IMS	February 2015

Analysts

Katherine Thompson +44 (0)20 3077 5730

Dan Ridsdale +44 (0)20 3077 5729

tech@edisongroup.com

Edison profile page

Acal is a research client of Edison Investment Research Limited

Review of H115 results

Acal reported H115 revenue growth of 20.4% y-o-y, which at constant exchange rates (CER) reached 27%. Like-for-like revenues grew 3% with the remaining 24% growth from acquisitions. With the sale of the final part of the Supply Chain business completed in H115, the company announced a new divisional reporting structure that more accurately reflects the operations of the business. On an "as reported" basis, the Custom Distribution business was essentially flat y-o-y and Design & Manufacturing grew 111%. On a CER basis, Custom Distribution grew 5.5% y-o-y; like-for-like[1] sales were essentially flat. Design & Manufacturing like-for-like revenues grew 15%.

The group operating margin (excluding exceptionals and amortisation of acquired intangibles) grew to 4.5% from 3.0% a year ago, boosted by the acquisition of higher-margin Noratel (which contributed operating profit of £1.5m in H115), but also by better profitability in Custom Distribution. Exceptional costs totalled £3.6m, including £2.0m costs related to the acquisition of Noratel, £0.3m for the integration of YEG into Acal BFi (completed in May), £1.1m for the integration of the web platform into the main sales infrastructure in the UK and £0.2m accrual for earnouts for Myrra and Noratel. The tax rate increased y-o-y as Acal did not have the benefit of tax losses in H115 that were used in H114. This resulted in normalised EPS growth of 27.6%.

Net debt of £14m at the end of H115 reflected the use of credit facilities put in place at the time of the Noratel acquisition (average net debt over the period was c £20m).

The company announced a 22% increase in the interim dividend to 2.2p.

Exhibit 1: H115 results highlights

	H115	H114	y-o-y
Revenues	**120.9**	**100.4**	**20.4%**
Custom Distribution	82.3	82.1	0.2%
Design & Manufacturing	38.6	18.3	110.9%
Gross profit	**37.4**	**30.0**	**24.6%**
Gross margin	30.9%	29.9%	1.0%
Normalised operating profit			
Custom Distribution	3.1	2.9	6.9%
Design & Manufacturing	4.6	2.1	119.0%
Central costs	(1.9)	(1.7)	11.8%
Total normalised operating profit	**5.8**	**3.3**	**75.8%**
Normalised operating margin			
Custom Distribution	3.8%	3.5%	0.2%
Design & Manufacturing	11.9%	11.5%	0.4%
Total normalised operating margin	**4.8%**	**3.3%**	**1.5%**
Acal adj. operating profit*	5.5	3.0	
Acal adj. operating margin*	**4.5%**	**3.0%**	**1.6%**
Reported operating profit	1.0	3.2	
Reported op. margin	0.8%	3.2%	-2.4%
Normalised PBT	5.0	2.9	72.4%
Normalised net income	3.9	2.5	56.0%
Normalised EPS (dil) – continuing (p)	**7.0**	**5.5**	**27.6%**
Reported EPS (dil) – continuing (p)	(1.1)	5.5	n/m
Net debt	14.0	1.8	n/m

Source: Acal, Edison Investment Research. Note: *Includes share-based payments.

[1] Like-for-like: at CER and excluding acquisitions in last 12 months (YEG, RSG, Noratel).

Business update

Custom Distribution

The Custom Distribution division incorporates the Acal BFi (c 90% of divisional revenues) and Vertec businesses, which supply the industrial and medical markets respectively. The division saw improving demand across most countries, particularly Germany and Italy, although demand in the UK remained weak.

Management started restructuring the UK business in H115, in particular integrating the follow-up of sales leads from the marketing website with the UK's existing sales and marketing organisation. Management has also started a similar process in Germany. This incurred costs of £1.1m in H115 and will incur a further £0.5m in H215.

The company intends to drive revenue growth in this division from a combination of cross-selling initiatives and generating new leads from the marketing website. Management calculates that incremental revenues of £1.6m were generated from the combination of both initiatives in H115.

Design & Manufacturing

This division supplies products that are designed uniquely for a customer or specifically modified from an existing product. Most products are manufactured internally at facilities in China, India, Sri Lanka or Poland, with the remainder outsourced to third-party manufacturers. The division comprises seven businesses: Noratel, Myrra, RSG, Compotron's Design Solutions business, Stortech, MTC and Hectronic. All businesses delivered y-o-y revenue growth in H115. On an annualised basis, this division now makes up 40% of group revenues.

The growth strategy for this division is focused on cross-selling and expansion into new geographies. This is also an area where the company is considering acquisitions.

Progress of recent acquisitions

In the Custom Distribution division, the loss-making YEG was integrated with Acal BFi in early H115 and is already delivering sustainable profitability.

In the Design & Manufacturing division, both Noratel and RSG have performed well since acquisition. Cross-selling in the magnetics businesses is underway, with Myrra products already incorporated into a Noratel customer contract. There is also scope to benefit from shared purchasing and manufacturing across the magnetics businesses.

Outlook and changes to forecasts

The company previously had a "through-the-cycle" operating margin target of 5%. Once it acquired the higher-margin Noratel business, it committed to revise this target and is now working to achieve group operating margins in the range of 6-7% over a three-year period. The lower end of the range would correspond to moderate organic growth, and the upper end to stronger organic growth or bolt-on, higher-margin acquisitions.

The company laid out key strategic indicators (KSIs) that demonstrate how Acal is making progress on its growth strategy (see Exhibit 2). It is already making good progress on growing its custom product sales. The acquisition of Noratel made a significant difference to the proportion of revenues coming from Design & Manufacturing businesses – we would expect some progress towards the target with this division growing more quickly than Custom Distribution, but we also expect this type of business to be the focus of acquisitions. Growth in cross-selling and web-generated sales looks like a more challenging target, but recent and ongoing restructuring in sales and marketing should improve the focus on this route to organic growth. Acal has sized the addressable market for its solutions as £4bn in Europe, £6bn in the US and £2bn in Asia. The company already generates nearly £30m in annual sales from outside the eurozone and the UK (£14m from Asia and South Africa, £6m from North America and £8m from Turkey/Eastern Europe/Austria/Switzerland) and wants to increase this. On an organic growth basis, the company expects to achieve this through a combination of following European customers to their operations in North America and Asia, and setting up local sales offices in those regions. This is also likely to be a key focus for future acquisitions.

Exhibit 2: Key strategic indicators (KSIs)

	FY10	FY14	With Noratel*	Mid-term (3-5 yr) target
Increase custom product sales	c 30%	c 42%	50%	65%
Increase Design & Manufacturing revenue	c 5%	18%	40%	65%
Increase cross-selling & web generated sales	0%	c 2%	c 1%	4-5%
Build sales outside Europe	0%	5%	10%	20%

Source: Acal. Note: *Approximately annualised.

As discussed in the recent trading update, group orders were up 19% y-o-y CER, although like-for-like orders were down slightly when excluding a large one-off order received in H114. Excluding UK distribution, like-for-like orders were up 4% y-o-y. Backlog as at the end of H115 was £80m (up 33% y-o-y).

Changes to forecasts

To take into account weakness in the UK market and the impact of currency, we have reduced our revenue forecasts for H215 and FY16. As H115 gross margins were stronger than expected, we have increased our gross margin forecasts for both years. Our operating profit forecast for FY15 is substantially unchanged. A slightly higher depreciation forecast and the impact of FX reduces our FY16 operating profit forecast by £0.4m, which results in a 5.2% reduction in normalised EPS. Reported EPS for FY15 and FY16 benefits from lower than previously forecast amortisation of acquired intangibles.

Exhibit 3: Changes to estimates

£m	FY15e old	FY15e new	Change (%)	FY16e old	FY16e new	Change (%)
Revenues	274.5	269.0	(2.0)	305.3	300.3	(1.6)
Gross margin	30.2%	30.9%	0.7	30.5%	30.9%	0.4
Normalised operating profit	13.4	13.4	0.7	17.2	16.8	(2.0)
Normalised operating margin	4.9%	5.0%	0.1	5.6%	5.6%	0.0
Normalised PBT	11.6	11.6	0.8	15.2	14.7	(2.9)
Normalised net income	9.0	9.0	0.0	11.7	11.1	(5.2)
Normalised EPS (p)	14.9	14.9	0.0	17.7	16.7	(5.2)
Reported EPS (p)	2.1	4.8	123.4	11.4	12.1	5.8
Net (debt)/cash	(20.3)	(19.1)	(5.8)	(18.3)	(18.2)	(0.3)

Source: Edison Investment Research

Exhibit 4: Financial summary

£m	2009	2010	2011	2012	2013	2014	2015e	2016e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	165.4	181.6	264.8	257.8	177.4	211.6	269.0	300.3
Cost of Sales	(121.5)	(131.5)	(189.6)	(179.9)	(123.0)	(148.6)	(185.8)	(207.5)
Gross Profit	43.9	50.1	75.2	77.9	54.4	63.0	83.2	92.8
EBITDA	2.3	0.9	9.1	10.2	7.4	9.1	16.1	19.9
Operating Profit (before am, SBP and except.)	0.4	(0.5)	7.7	8.7	6.1	7.7	13.4	16.8
Operating Profit (before am. and except.)	0.2	(0.7)	7.4	8.1	5.5	7.1	12.7	16.0
Amortisation of acquired intangibles	0.0	(0.1)	(0.3)	(0.8)	(0.7)	(1.0)	(1.9)	(2.4)
Exceptionals	(27.7)	(4.7)	(4.6)	(3.4)	(3.4)	(0.9)	(5.1)	(1.1)
Share-based payments	(0.2)	(0.2)	(0.3)	(0.6)	(0.6)	(0.6)	(0.7)	(0.8)
Operating Profit	(27.5)	(5.5)	2.5	3.9	1.4	5.2	5.8	12.5
Net Interest	0.5	(0.2)	(0.3)	(0.9)	(0.5)	(0.8)	(1.8)	(2.1)
Profit Before Tax (norm)	0.9	(0.7)	7.4	7.8	5.6	6.9	11.6	14.7
Profit Before Tax (FRS 3)	(32.6)	(6.3)	1.9	2.7	0.7	4.2	3.7	10.1
Tax	(4.4)	(0.3)	(0.2)	(0.6)	1.4	(0.5)	(0.9)	(2.5)
Profit After Tax (norm)	(0.6)	(1.3)	5.8	6.4	4.6	6.0	9.0	11.1
Profit After Tax (FRS 3)	(37.0)	(6.6)	1.7	2.1	2.1	3.7	2.8	7.6
Average Number of Shares Outstanding (m)	36.3	37.1	39.1	39.2	39.2	43.1	57.7	63.0
EPS - normalised & diluted (p)	(1.7)	(3.4)	14.2	15.7	11.3	13.1	14.9	16.7
EPS - IFRS basic (p)	(101.8)	(17.8)	4.3	5.4	(4.8)	3.0	4.8	12.1
EPS - IFRS diluted (p)	(101.8)	(17.4)	4.2	5.1	(4.7)	2.8	4.6	11.5
Dividend per share (p)	5.1	5.1	5.4	5.8	6.2	6.8	7.6	8.0
Gross Margin (%)	26.5	27.6	28.4	30.2	30.7	29.8	30.9	30.9
EBITDA Margin (%)	1.4	0.5	3.4	4.0	4.2	4.3	6.0	6.6
Operating Margin (before am, SBP and except.) (%)	0.2	-0.3	2.9	3.4	3.4	3.6	5.0	5.6
BALANCE SHEET								
Fixed Assets	22.3	22.6	27.7	32.5	30.9	33.1	105.1	102.9
Intangible Assets	15.0	16.0	21.1	25.7	24.2	25.5	97.7	95.9
Tangible Assets	4.7	3.9	3.8	3.5	3.1	3.5	3.3	2.9
Deferred tax assets	2.6	2.7	2.8	3.3	3.6	4.1	4.1	4.1
Current Assets	97.8	94.9	98.3	86.8	81.8	92.7	102.9	108.8
Stocks	24.7	23.7	25.3	25.7	19.3	19.4	25.8	28.8
Debtors	39.5	53.7	59.3	48.8	44.7	48.3	61.2	68.3
Cash	33.2	17.3	13.6	12.3	17.8	18.1	15.9	11.8
Current Liabilities	(53.7)	(56.6)	(63.9)	(58.8)	(50.9)	(58.3)	(70.4)	(76.9)
Creditors	(45.1)	(53.2)	(58.8)	(53.6)	(46.6)	(51.5)	(60.4)	(66.9)
Short term borrowings	(8.6)	(3.4)	(5.1)	(5.2)	(4.3)	(6.8)	(10.0)	(10.0)
Long Term Liabilities	(7.8)	(9.0)	(10.8)	(11.4)	(10.3)	(19.0)	(34.3)	(29.3)
Long term borrowings	(0.1)	0.0	(1.8)	(0.8)	(1.7)	(9.5)	(25.0)	(20.0)
Other long term liabilities	(7.7)	(9.0)	(9.0)	(10.6)	(8.6)	(9.5)	(9.3)	(9.3)
Net Assets	58.6	51.9	51.3	49.1	51.5	48.5	103.3	105.6
CASH FLOW								
Operating Cash Flow	(2.4)	5.2	0.5	9.1	5.7	6.1	(0.2)	14.7
Net Interest	0.6	(0.2)	(0.3)	(0.9)	(0.6)	(0.8)	(1.8)	(2.1)
Tax	(3.4)	(3.1)	0.5	(1.1)	(1.4)	(0.9)	(0.9)	(2.5)
Capex	(1.4)	(1.1)	(1.3)	(1.4)	(1.3)	(1.4)	(3.1)	(3.3)
Acquisitions/disposals	10.9	(10.3)	(4.4)	(3.9)	(0.5)	(9.2)	(64.1)	(1.1)
Financing	0.0	0.1	0.0	0.3	5.7	0.1	52.7	0.0
Dividends	(4.8)	(1.6)	(2.0)	(2.2)	(2.3)	(2.7)	(3.5)	(4.8)
Net Cash Flow	(0.5)	(11.0)	(7.0)	(0.1)	5.3	(8.8)	(20.9)	0.8
Opening net cash/(debt)	25.6	24.5	13.9	6.7	6.3	11.8	1.8	(19.1)
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	(0.6)	0.4	(0.2)	(0.3)	0.2	(1.2)	0.0	0.0
Closing net cash/(debt)	24.5	13.9	6.7	6.3	11.8	1.8	(19.1)	(18.2)

Source: Acal, Edison Investment Research

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand