# SDI GROUP

INDUSTRIALS

30 July 2024

**SDI.L**

67p

Market Cap: £70m

**SHARE PRICE (p)**




12m high/low 138p/52p

*Source: LSE Data (priced as at prior close)*

**KEY DATA**

| | |
|---|---|
| Net (debt)/cash | £(13.2)m *(at 30/04/24)* |
| Enterprise value | £83.2m |
| Index/market | AIM |
| Next news | Trading statement, Sept |
| Shares in issue (m) | 104.6 |
| Chairman | Ken Ford |
| CEO | Stephen Brown |
| CFO | Amitabh Sharma |

**COMPANY DESCRIPTION**

SDI Group designs and manufactures analytical technology products for digital imaging, and sensing and control applications.

**www.sdigroup.com**

**SDI GROUP IS A RESEARCH CLIENT OF PROGRESSIVE**

**ANALYSTS**


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## Resilient FY24 and strategy refresh

**SDI's FY24 results, released this morning, confirm that while markets have experienced headwinds from inflationary pressures, and customer destocking issues linger, overall performance has been resilient. We note improving cash generation, with £3.8m of free cash flow in H2. Net debt was flat at £13.2m (FY23: £13.3m) after acquisition spend of £3.4m. Despite the unwinding of inflated Covid demand, SDI has made strategic and operational progress, with a strong team in place to support the next phase of growth. CEO Stephen Brown has conducted an operational review, addressing underperforming businesses and focusing on organic growth. This will be coupled with value-enhancing acquisitions, where the pipeline is strong. We remain confident for the long term given the track record demonstrated by SDI's 'buy and build' model. SDI has the finances in place and strong cash flow generation to support its growth plans.**

- **Unwinding of Covid demand but strong H2.** Revenue reduced by 2.7%, to £65.8m (FY23: £67.6m), however FY23 included £8.5m of 'one-off' Atik Covid revenue. Recent acquisitions generated lower margins than the existing portfolio, which, coupled with the loss of high-margin 'one-off' Covid revenue, has impacted short-term profitability. Adjusted operating profit reduced to £9.6m (FY23: £12.8m). However, given strategic actions and positive market dynamics in H2, several businesses delivered good profitability and others exceeded expectations by the year-end.
- **Strategy refresh and gross margin (on materials) maintained** at 63.1% (FY23: 63.3%), given improved performance of higher-margin businesses such as Astles and Chell. SDI is transitioning to a proactive sales culture. Price increases have been implemented to reflect supply chain pressures, and overheads have reduced on a like-for-like basis as part of cost-cutting measures, which will improve profitability going forward.
- **Cash flow strong and revised FY25E.** Cash from operations was £9.4m (FY23: £10.9m), with a FY25 FCF yield of 8.9%. Despite acquisition spend of £3.4m, year-end net debt was broadly unchanged at £13.2m (FY23: £13.3m). Revenue growth was higher than our estimate for FY24, however profitability was impacted by the headwinds described above. We therefore leave FY25E revenue unchanged at £69.0m with a lower adjusted EBITDA of £9.7m, down from £11.7m. We forecast FY25E net debt at £7.8m. We anticipate demand will pick up throughout FY25 given an end to destocking, and cost cutting will support margin growth.

| FYE APR (£M) | 2021 | 2022 | 2023 | 2024 | 2025E |
|---|---|---|---|---|---|
| Revenue | 35.1 | 49.7 | 67.6 | 65.8 | 69.0 |
| Adj EBIT | 7.7 | 12.1 | 12.8 | 9.6 | 9.7 |
| Fully Adj PBT | 7.4 | 11.8 | 11.8 | 8.0 | 8.3 |
| Fully Adj EPS (p) | 6.0 | 8.7 | 9.0 | 5.8 | 6.0 |
| EV/Sales (x) | 2.4x | 1.7x | 1.2x | 1.3x | 1.2x |
| EV/EBITDA (x) | 9.1x | 6.1x | 5.3x | 7.0x | 6.7x |
| PER (x) | 11.2x | 7.7x | 7.4x | 11.6x | 10.9x |

*Source: Company Information and Progressive Equity Research estimates.*


*This publication should not be seen as an inducement under MiFID II regulations.*

*Please refer to important disclosures at the end of the document.*

## Onwards with a strategy refresh

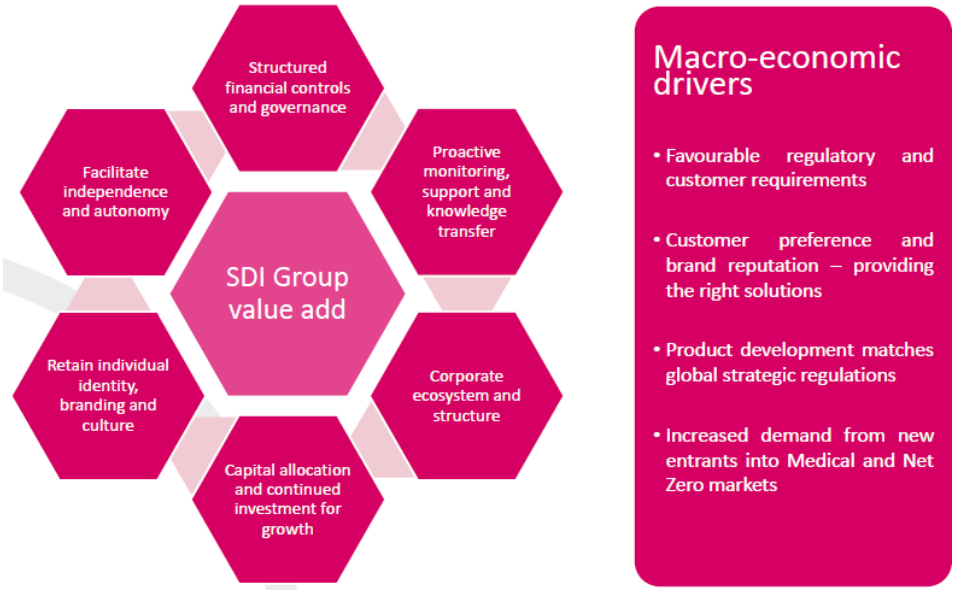
SDI's FY24 results were in line with revised guidance given at the interim results in December, which was reiterated at the full-year trading update in May. The group has successfully reflected and delivered on its stated intention to focus on organic delivery, overhead cost reduction and efficiency ahead of revenue growth, along with further cash flow generation, in FY24. The results also unveiled a refreshed and updated strategy to drive profitable growth in FY25, alongside the completion of the new board following the departure of longstanding director Mike Creedon.

The constitution of the board of directors is now as follows, with more detailed biographies available in the FY24 results presentation and report and accounts:

- Chairman: Ken Ford – joined the board in 2010, became Chairman in 2012.
- CEO: Stephen Brown – joined in September 2023 as COO, appointed CEO in January 2024.
- CFO: Amitabh Sharma – joined the board in 2022.
- NED, Senior Independent Director: David Tilston – joined the board in 2017.
- Non-Executive Director: Andrew Hosty – joined the board in August 2022.
- Non-Executive Director: Louise Early – joined the board in February 2023.

The following charts summarise the refreshed strategy, which looks to propel the group from the stabilised base achieved, driving profitable growth in FY25 and beyond.

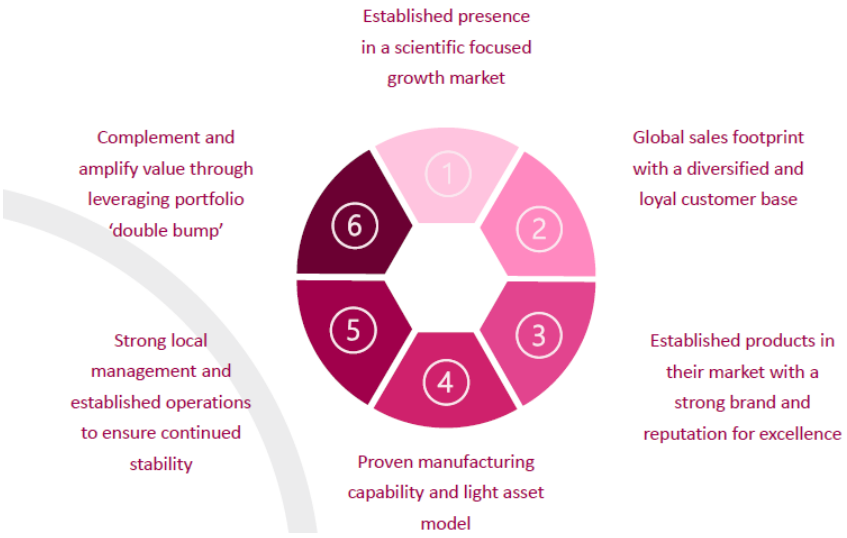
**Focused, Sustainable Organic Growth**




*Source: SDI Group*

### Targeting stability and growth potential

**Delivering Compounded Value – In-organic Growth**




*Source: SDI Group*

## Strategic actions drive strong second half

- **Growth initiatives for the portfolio (organic growth).** This includes product innovation, improving operational capacity, plus expansion into new geographic markets. There will be a stronger focus on repeat revenue streams through support and upgrades. Management is targeting a more proactive sales approach across both its stable, highly profitable and cash-generative businesses and its higher-growth potential businesses.
- **Value-enhancing acquisitions (inorganic growth).** Management has identified stringent criteria, targeting 'meaningful' acquisitions, that will either increase EBIT by c.£1m or will combine with an existing portfolio business to drive strong growth. Management believes that some businesses haven't achieved critical mass at multiples that will deliver ROCE given the current cost of debt.

SDI has made significant progress in H2 by focusing on organic growth and developing senior management. Portfolio businesses such as Scientific Vacuum Systems, Applied Thermal Control, Monmouth Scientific and Safelab Systems (among others) delivered exceptional performances to mitigate the lost Covid-related revenue.

The strategy is based on four key pillars:

1. Growth through acquisitions and internal development (buy and build) – focus on achieving both sustainable organic and inorganic growth.

2. Strong cash flow generation – enabling the delivery of its buy and build strategy.

3. Strategic acquisitions – prioritising impactful M&A that maximises value creation and where possible synergistic benefits.

4. Transparent shareholder engagement – commitment to deliver on its strategy and deliver shareholder value.

## Acquisitions a key part of the long-term strategic development

In FY24, revenue growth from acquisitions was 10.8%, with full-year contributions from LTE and FAST, which together delivered £6.3m in the first year and are currently trading ahead of expectations. Peak, acquired midyear, contributed £1m. Uniform, which was strategically divested at the end of February 2024, contributed £0.5m of external revenue over the period. The group has a strong acquisition track record, with 17 businesses acquired. The only business to experience a write-down has been Monmouth, where steps to address underperformance have produced a significant improvement in the second half.

**SDI Group's acquisition track record**

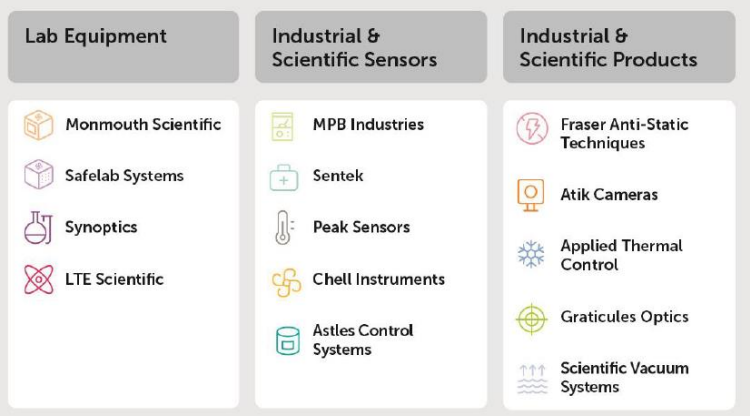
| Financial year | Month | Year | Company | Segment | Fair value net consideration | EBIT multiple |
|---|---|---|---|---|---|---|
| FY14 | February | 2014 | Opus Instruments | Digital Imaging | £1.0m | N/A |
| FY16 | October | 2015 | Sentek | Sensors and Control | £2.3m | 4.6x |
| FY17 | January | 2017 | Astles Control Systems | Sensors and Control | £4.8m | 4.1x |
| FY18 | August | 2017 | Applied Thermal Control | Sensors and Control | £1.1m | 5.1x |
| | February | 2018 | Quantum Scientific Imaging | Digital Imaging | US$0.3m | N/A |
| FY19 | September | 2018 | Fistreem | Digital Imaging | £0.7m | 3.4x |
| | February | 2019 | Thermal Exchange | Sensors and Control | £0.9m | 4.5x |
| | February | 2019 | Graticules Optics | Digital Imaging | £3.4m | 5.2x |
| | April | 2019 | MPB Industries | Sensors and Control | £1.5m | 4.9x |
| FY20 | November | 2019 | Chell Instruments | Sensors and Control | £5.2m | 6.6x |
| FY21 | December | 2020 | Monmouth Scientific | Sensors and Control | £5.8m | 5.8x |
| | February | 2021 | Uniform Engineering | Sensors and Control | £0.35m | 3.5x |
| FY22 | January | 2022 | Scientific Vacuum Systems | Sensors and Control | £4.9m | 5.0x* |
| | March | 2022 | Safelab Systems | Sensors and Controls | £7.7m | 7.2x** |
| FY23 | July | 2022 | LTE | Sensors and Controls | £4.2m | 6.4x** |
| | October | 2022 | Fraser Anti-Static | Sensors and Controls | £13.0m | 7.0x** |
| FY24 | October | 2023 | Peak | Sensors and Control | £2.4m | 7.0x |

*Source: Company data, Progressive Equity Research.*

**Based on estimated LTM EBIT (£1.1m for SVS). ** excl (Safelab property £1.2m, LTE £1.65m, FAST £1.76m).*

Management believes that there are many businesses ripe for consolidation that will deliver good levels of ROCE. Its strategy will be primarily focused in the UK, but also Europe and the US, particularly if it enables geographic expansion of existing businesses.

**Re-segmentation of the Portfolio – Promoting knowledge transfer & economies of scale**




*Source: SDI Group*

## FY24 – Financial highlights

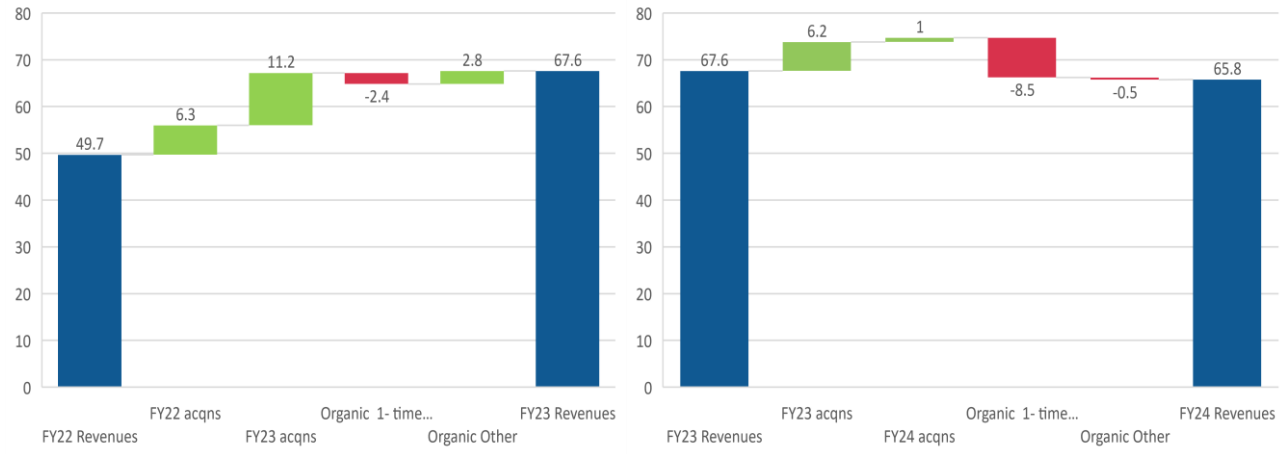
| SDI Group – Key performance metrics | FY24 (£m) | FY23 (£m) |
|---|---|---|
| Revenue | 65.8 | 67.6 |
| Adjusted operating profit | 9.6 | 12.8 |
| Reported operating profit | 7.3 | 6.8 |
| Adjusted PBT | 8.0 | 11.8 |
| Reported PBT | 5.7 | 5.8 |
| Adjusted Diluted EPS | 5.8 | 9.0 |
| Cash generated by operations | 9.4 | 10.9 |
| Net debt (includes acq in FY24 £3.4m) | 13.2 | 13.3 |

*Source: Company information, Progressive Equity Research*

### Unwinding of Covid-related orders continued into FY24

Throughout Covid, SDI experienced a ramp-up in product ordering, partly influenced by, and contributing to shortages of components across the supply chain. However, the surplus ordering has prompted certain OEMs to reduce their stocks as they readjust to a more normalised economic environment. As previously flagged Atik Cameras received substantial, high-margin, 'one-off' orders due to Covid, for cameras designed into an OEM's PCR equipment. FY24 is the first year not to comprise this Covid-related revenue, with £8.5m received in FY23. Therefore, overall revenue for FY24 reduced by 2.7%, to £65.8m (FY23: £67.6m). The organic revenue decline was 13.2% given the tough prior-year comparator. However, excluding 'one-off' Covid-related revenue, the organic revenue decline was only 0.5%, highlighting the resilience of the portfolio.

**SDI Group – Revenue bridge (£m)**



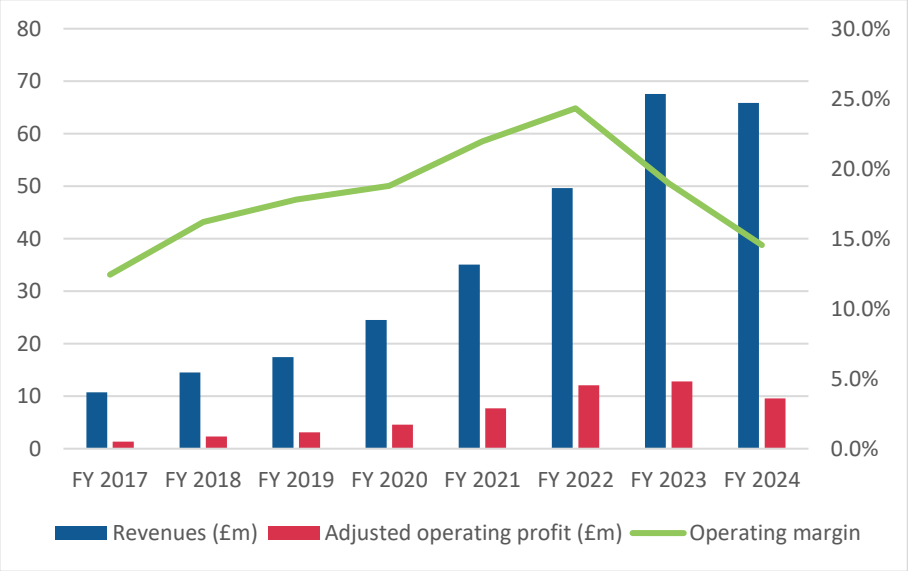

*Source: Company data, Progressive Equity Research*

## Gross margins maintained

Gross profit (on materials only) reduced to £41.6m (FY23: £42.8m). The gross margin was broadly held at 63.1% (FY23: 63.3%) and on a like-for-like basis (including prior-year acquisitions) gross margins were actually ahead. Overheads have reduced on a like-for-like basis due to cost-cutting measures. Adjusted operating profit reduced 25% to £9.6m (FY23: £12.8m). Adjustments made are for share-based payments, acquisition costs, loss on disposal of subsidiary undertakings, reorganisation costs, the impairment charge (for Monmouth and Uniform in FY23 of £3.5m) and amortisation of acquired intangible assets. Reported operating profit increased to £7.3m (FY23: £6.8m). Management estimates a loss £5.6m in gross margin due to the end of the Covid contract.

For FY25, we forecast an adjusted operating margin of 14.1%, which we note brings margins into line with the historical norm following three years of exceptional revenue growth due the one-off Covid demand, which spiked both margins and cashflow.

**SDI Group – Operating margin progression**




*Source: Company Information, Progressive Equity Research estimates*

## Cash and balance sheet still strong

Cash generated from operations reduced to £9.4m in FY24 compared with £10.9m in the same period last year, however cash generation improved significantly in the second half, with free cash flow of £3.8m generated in H2. The increase in working capital, amounting to £2.0m, was driven by a £2.7m decrease in customer advances; £1.4m of this reduction was due to Scientific Vacuum Systems Limited (SVS) shipping equipment in October, £0.7m from Astles as it delivered chemical dosing equipment, and LTE experienced a £0.5m reduction due to an environmental test chambers project for a major OEM.

Analysing cashflow at SDI has been made more complicated by orders in its Atik division being boosted during the COVID pandemic. As the table below shows the group's working capital benefited from upfront payments from Chinese customers in 2021 and 2022 but this reversed in 2023 and 2024 causing large cash outflows.

### Continued strong cash generation

We've analysed average cashflows over the last four years. Changes in working capital were small, at £0.4m. Interest and taxes went up due to increased debt and capital expenditure was relatively steady. We calculate average free cashflow for the last four to be £7.8m, which gives a FCF yield of 11.5% at the current share price.

**SDI Group – Four year average cashflow**

| £000s | 2021 | 2022 | 2023 | 2024 | Average |
|---|---|---|---|---|---|
| Op cashflow before working capital | 8,913 | 13,198 | 14,843 | 11,387 | 12,085 |
| Movement in working capital | 2,797 | 1,490 | (3,970) | (2,000) | (421) |
| Interest and taxes paid | (1,453) | (1,585) | (3,131) | (3,552) | (2,430) |
| Capital expenditure and R&D | (967) | (1,775) | (1,324) | (1,675) | (1,435) |
| **Free cashflow** | **9,290** | **11,328** | **6,418** | **4,160** | **7,799** |
| **FCF Yield** | | | | | **11.5%** |

*Source: Company Information, Progressive Equity Research estimates*

Net debt as at 30 April 2024 was £13.2m, at a similar level to the end of April 2023 (£13.3m). This equates to a net debt to EBITDA ratio of 1.07x based on a rolling last 12 months calculation. Despite recent acquisitions, SDI has maintained a strong financial position with £10.4m headroom within its £25m committed loan facility with HSBC and a £5m accordion. Management has said that headroom has increased to £11.5m by the end of June 2024

## Estimate changes

Management has guided that following the conclusion of the strategic review, the continued investment in the portfolio for future growth and the uncertain timing of a higher margin contract, adjusted EBIT guidance for FY25 has been revised.

Revenue growth was higher than our estimate for FY24, however, profitability was impacted by the headwinds described. We leave FY25E revenue unchanged at £69m with a lower adjusted EBITDA of £9.7m, down from £11.7m. This is due to lingering destocking leading to a less favourable product mix going into FY25 and uncertain timing on larger contracts. We forecast FY25E net debt £7.8m. We anticipate demand will pick up in FY25 as destocking unwinds, and cost cutting will support margin growth.

**SDI – Estimate changes**

| | FY23A | FY24A | | | FY25E | | |
|---|---|---|---|---|---|---|---|
| £m unless stated | | Est | Act | Change (%) | Old | New | Change (%) |
| Revenue | 67.6 | 64.8 | 65.8 | 2% | 69.0 | 69.0 | 0% |
| Adj EBITDA | 15.8 | 11.8 | 11.9 | 1% | 13.8 | 12.2 | -12% |
| Adj EBIT | 12.8 | 9.5 | 9.6 | 1% | 11.5 | 9.7 | -16% |
| Reported PBT | 5.8 | 5.6 | 5.7 | 2% | 7.9 | 6.0 | -24% |
| Fully adj PBT | 11.8 | 7.9 | 8.0 | 1% | 11.0 | 8.3 | -24% |
| Reported EPS (p) | 3.7 | 3.6 | 4.0 | 11% | 5.2 | 3.9 | -26% |
| Fully adj EPS (p) | 9.0 | 5.7 | 5.8 | 2% | 7.3 | 6.0 | -18% |

*Source: Progressive Equity Research estimates*

## Outlook & conclusion

SDI's refreshed strategy to drive organic growth across the portfolio, coupled with continuing its track record of value-enhancing acquisitions, should drive revenue growth and profitability. We expect FY25 to be a reset year for the business, providing a base on which to build. However, with the new management team in place and a focus on three complementary global end-markets, we see a return to longer-term organic growth of 5%-8% and margins tracking towards 15%, supported by a FCF yield of 8.9% on FY25 estimates.

From 2020 to 2023 SDI was trading on a growth multiple of circa 20x. With revenue of £17.4m in the year to April 2019 it was able to acquire businesses that added a material amount to turnover, with revenue of £67.6m by the year ending April 2023.

However, revenue was flattered by exceptional Covid related sales, which were high margin and cash positive. Despite the unwinding of these contracts and a tougher economic environment, revenue in FY24 has been broadly maintained and margins have returned to more normal levels, yet the shares trade on a PER of 10.9x FY25 EPS.

Cashflow remains strong, there is sufficient financial headroom and debt is being repaid quickly. SDI is well placed to continue to grow via its buy and build strategy, with scope to add more meaningful acquisitions than they have in the past, focusing on a 'double bump' of driving synergies and geographic expansion of the existing portfolio.

Solid FY24 performance underpins our confidence that management is successfully executing on its strategy. We welcome the strategic review with SDI emerging post pandemic on a strong footing, with a portfolio of quality niche businesses. We note that the appointment of Stephen Brown, as CEO is starting to bear fruit given his strong background in engineering, as well as in operational improvement. We look forward to further positive developments as the year progresses.

## Financial Summary: SDI Group

**Year end: April (£m unless shown)**

| PROFIT & LOSS | 2021 | 2022 | 2023 | 2024 | 2025E |
|---|---|---|---|---|---|
| Revenue | 35.1 | 49.7 | 67.6 | 65.8 | 69.0 |
| Adj EBITDA | 9.1 | 13.7 | 15.8 | 11.9 | 12.2 |
| Adj EBIT | 7.7 | 12.1 | 12.8 | 9.6 | 9.7 |
| Reported PBT | 5.6 | 9.9 | 5.8 | 5.7 | 6.0 |
| Fully Adj PBT | 7.4 | 11.8 | 11.8 | 8.0 | 8.3 |
| NOPAT | 7.4 | 10.1 | 9.8 | 8.4 | 8.6 |
| Reported EPS (p) | 4.6 | 7.2 | 3.7 | 4.0 | 3.9 |
| Fully Adj EPS (p) | 6.0 | 8.7 | 9.0 | 5.8 | 6.0 |
| Dividend per share (p) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

| CASH FLOW & BALANCE SHEET | 2021 | 2022 | 2023 | 2024 | 2025E |
|---|---|---|---|---|---|
| Operating cash flow | 11.7 | 14.7 | 10.9 | 9.4 | 11.1 |
| Free Cash flow | 9.3 | 11.3 | 6.4 | 4.2 | 6.1 |
| FCF per share (p) | 9.0 | 10.9 | 6.1 | 4.0 | 5.8 |
| Acquisitions | (4.1) | (11.0) | (21.1) | (2.4) | 0.0 |
| Disposals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Shares issued | 0.2 | 0.7 | 0.9 | 0.1 | 0.0 |
| Net cash flow | (1.3) | 1.3 | (2.5) | (1.3) | (0.2) |
| Overdrafts / borrowings | (0.5) | (4.0) | 0.0 | 0.0 | 0.0 |
| Cash & equivalents | 3.8 | 5.1 | 2.7 | 1.4 | 1.4 |
| Net (Debt)/Cash | 0.8 | (6.3) | (13.3) | (13.2) | (7.8) |

| NAV AND RETURNS | 2021 | 2022 | 2023 | 2024 | 2025E |
|---|---|---|---|---|---|
| Net asset value | 26.8 | 35.8 | 41.3 | 45.4 | 49.9 |
| NAV/share (p) | 26.0 | 34.3 | 39.4 | 43.2 | 47.0 |
| Net Tangible Asset Value | 4.1 | 4.1 | 8.2 | 8.2 | 8.3 |
| NTAV/share (p) | 4.0 | 3.9 | 7.8 | 7.8 | 7.8 |
| Average equity | 23.4 | 31.3 | 38.5 | 43.4 | 47.7 |
| Post-tax ROE (%) | 31.7% | 37.6% | 30.7% | 18.3% | 17.5% |

| METRICS | 2021 | 2022 | 2023 | 2024 | 2025E |
|---|---|---|---|---|---|
| Revenue growth | 43.2% | 41.6% | 36.1% | (2.6%) | 4.7% |
| Adj EBITDA growth | 52.5% | 50.7% | 15.0% | (24.5%) | 2.1% |
| Adj EBIT growth | 67.3% | 56.8% | 6.1% | (25.2%) | 1.1% |
| Adj PBT growth | 70.5% | 58.9% | 0.5% | (32.8%) | 5.0% |
| Adj EPS growth | 74.0% | 45.7% | 3.6% | (36.0%) | 3.4% |
| Dividend growth | N/A | N/A | N/A | N/A | N/A |
| Adj EBIT margins | 22.0% | 24.3% | 19.0% | 14.5% | 14.0% |

| VALUATION | 2021 | 2022 | 2023 | 2024 | 2025E |
|---|---|---|---|---|---|
| EV/Sales (x) | 2.4 | 1.7 | 1.2 | 1.3 | 1.2 |
| EV/EBITDA (x) | 9.1 | 6.1 | 5.3 | 7.0 | 6.7 |
| EV/NOPAT (x) | 11.3 | 8.3 | 8.5 | 10.0 | 9.4 |
| PER (x) | 11.2 | 7.7 | 7.4 | 11.6 | 10.9 |
| Dividend yield | N/A | N/A | N/A | N/A | N/A |
| FCF yield | 13.5% | 16.2% | 9.1% | 5.9% | 8.9% |

*Source: Company information and Progressive Equity Research estimates*

30 July 2024

**Disclaimers and Disclosures**

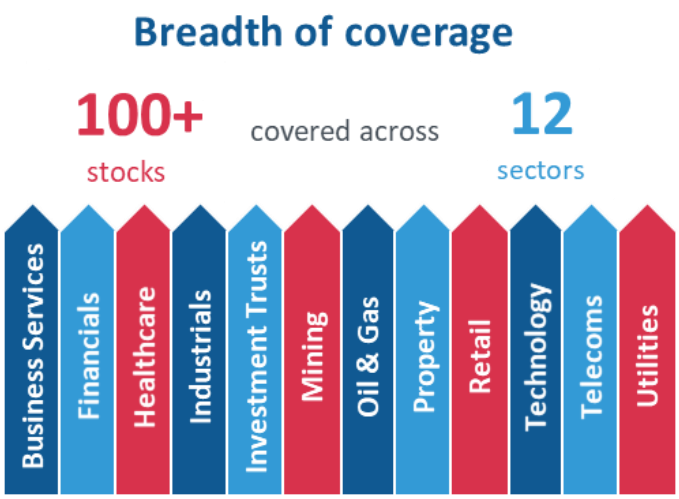
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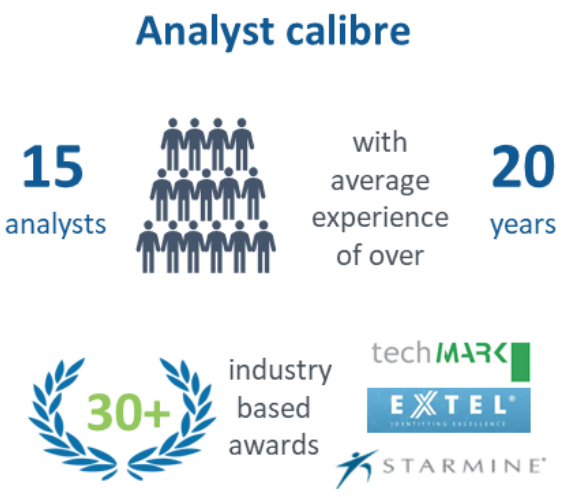
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