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IPD Group (IPG)

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A Capital Allocation Play with Macro Tailwinds

Initiating Coverage

“It’s like they are operating in a different economy.” So declared an HVAC executive in admiration of the order books of his electrical sector peers. In about a dozen industry conversations in preparing this document, this observation was often repeated. The electrical industry is booming and there’s a strong argument we are still early innings for capital spending amidst a major infrastructure project upswing and a transition towards renewable energy systems.

IPD offers a ‘picks and shovel’ exposure to the booming electrical sector without taking on individual project or contract risks common to contractors and other listed players. But there are more strings to IPD’s bow than simply riding project cycles. Since listing they’ve expanded supplier and customer bases, entered new product categories, and have materially increased market share.

Management has an ambition to grow share to multiples of the current level and they are pursuing this with urgency and an acumen we’ve rarely encountered. Their capital allocation record is excellent, and there’s a long runway to deploy capital to match the market leader’s offering. Shareholder alignment is high with management owning around twenty per cent of the shares on issue.

The industry has attractive structural qualities including high brand equity, high entry barriers, and safety regulations that inhibit import competition. IPD’s balance sheet is modestly geared, and capex requirements are minimal beyond funding working capital. A policy of retaining 50 per cent of earnings and access to capital markets will provide ammunition for future M&A. In short, IPD has all the ingredients of a long duration compounder.

Valuation & Recommendation

Having outlined our positive view of the business, our enthusiasm for the investment case is more nuanced. IPD trades on an FY25e PE of roughly 15.4X and an EV/EBIT multiple of 10.2X, which is in line with distributor peers. Our DCF valuation of $5.00 per share is around 8 per cent above the current price.

Earnings risks are elevated presently given around one-third of FY25e earnings will be contributed from an acquisition, CMI. CMI has a cyclical record, profits near all-time highs and sales skew to unbranded product lines. It is larger than past bolt-ons and has a different risk profile compared to IPD’s core business. We understand the strategic fit and think synergies will positively surprise but this setup justifies some short-term caution, in our view.

An analysis based on current earnings power fails to capture the major value creation mechanism for IPD, which in our view is M&A. Past acquisitions have not only delivered growth and operating leverage, but also enhanced IPD’s capabilities and contributed to development of key supplier partnerships. We think this model is repeatable, and recent M&A looks set to replicate this model.

In our view shares are currently fairly valued on a discounted earnings power basis, but investors aren’t paying anything for the optionality of future capital allocation, or any potential growth inflection from the energy transition. We are betting these options will prove to be valuable.

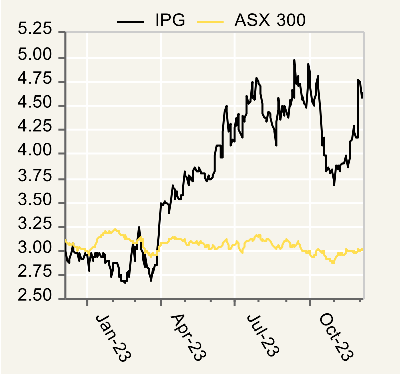
We initiate coverage on IPD Group with an Outperform recommendation and a $4.80 price target.

Recommendation: Outperform

Summary (AUD)

Market Capitalisation	**$480.0M**
Share Price	**$4.65**
12 Month Target Price	$4.80
52 week low	$2.48
52 week high	$5.08

Share price graph (AUD)



Key Financials (AUD)

	FY23A	FY24E	FY25E
Revenue ($m)	226.9	304.8	393.8
EBITDA ($m)	27.9	40.3	53.0
NPAT	16.1	23.7	31.2
EPS (c)	18.6	25.0	30.2
Growth (pcp)	18.0%	34.2%	20.9%
PE Ratio (x)	29.9	20.3	15.4
DPS (c)	4.7	7.0	7.6
Div Yield	2.0%	2.6%	3.2%
Franking	100%	100%	100%
EV ($M)	395.7	483.7	471.4
EV/EBITDA (x)	14.2	12.0	8.9
EV/EBIT (x)	16.8	14.0	10.2

IPD Group Limited - Summary of Forecasts

IPG-AU 4.65

PROFIT & LOSS SUMMARY (A$m)	FY23A	1H24E	2H24E	FY24E	FY25E
Revenue	226.9	127.0	177.9	304.8	393.8
Gross Profit	86.8	49.5	62.5	112.0	138.6
CODB	(59.1)	(33.7)	(38.3)	(72.0)	(85.9)
Adj. EBITDA	27.9	16.0	24.3	40.3	53.0
D&A	(4.4)	(2.6)	(3.1)	(5.7)	(6.7)
EBIT	23.6	13.4	21.2	34.6	46.3
Net interest income/(expense)	(0.4)	(0.2)	(0.6)	(0.8)	(1.7)
Significant income/ (expenses)	0.0	0.0	0.0	0.0	0.0
Pre-Tax Profit	23.2	13.3	20.6	33.9	44.6
Tax Expense	(7.1)	(4.0)	(6.2)	(10.2)	(13.4)
Reported Group NPAT	16.1	9.3	14.4	23.7	31.2
Minority Interest share	0.0	0.0	0.0	0.0	0.0
Reported Shareholder NPAT	16.1	9.3	14.4	23.7	31.2
Significant Items (post-tax)	0.0	0.0	0.0	0.0	0.0
Adj. Shareholder NPAT	16.1	9.3	14.4	23.7	31.2

BALANCE SHEET SUMMARY (A$m)	FY23A	1H24E	2H24E	FY24E	FY25E
Cash	20.8	84.3		21.3	18.6
Receivables	45.0	48.7		67.4	75.5
Inventory	42.3	42.4		63.4	69.9
Other	1.0	1.2		1.3	1.5
Total Current Assets	**109.1**	**176.6**		**153.4**	**165.6**
Property Plant & Equip	4.0	4.6		5.5	6.9
Intangibles	10.5	18.5		85.8	94.7
Right of use	12.3	12.0		13.8	13.3
DTA	3.8	4.2		4.7	5.6
Other	0.0	0.0		0.0	0.0
Total Non-Current Assets	**30.5**	**39.4**		**109.8**	**120.5**
TOTAL ASSETS	**139.6**	**216.0**		**263.2**	**286.0**
Accounts Payable	40.8	45.2		54.3	70.1
Tax liabilities	2.7	2.4		3.0	4.0
Borrowings	0.0	0.0		0.0	0.0
Lease Liabilities	3.0	2.8		2.8	3.4
Provisions	8.2	8.9		9.1	13.8
Other	0.0	0.0		0.0	0.0
Total Current Liab	**54.7**	**59.3**		**69.2**	**91.3**
Borrowings	0.0	0.0		25.0	10.0
Lease Liabilities	10.8	11.2		14.0	13.1
Provisions	0.5	0.5		0.6	0.8
Other	0.7	0.8		0.9	1.1
Total Non-Current Liab	**12.0**	**12.5**		**15.5**	**14.9**
TOTAL LIABILITIES	**66.7**	**71.7**		**84.7**	**106.2**
TOTAL EQUITY	**72.9**	**144.2**		**178.4**	**179.8**

CASH FLOW SUMMARY (A$m)	FY23A	1H24E	2H24E	FY24E	FY25E
NPAT	**16.1**	**9.3**	**14.4**	**23.7**	**31.2**
D&A	4.4	2.6	3.1	5.7	6.7
Net working capital movement	(13.0)	1.6	(5.8)	(4.2)	5.1
Operating Cash Flow	**7.4**	**13.4**	**11.7**	**25.2**	**43.0**
Capex (P&E)	(2.1)	(1.3)	(1.3)	(2.5)	(3.5)
Capex (Intangibles)	0.0	0.0	0.0	0.0	0.0
Lease Principal Repayment	(2.9)	(1.4)	(1.4)	(2.8)	(3.4)
Free Cash Flow	**2.5**	**10.8**	**9.1**	**19.9**	**36.2**
Acquisitions	0.0	(9.2)	(92.1)	(101.3)	(8.9)
Dividends Paid	(7.2)	(4.1)	(5.1)	(9.1)	(14.9)
Net Cash Flow	**(4.7)**	**(2.5)**	**(88.1)**	**(90.5)**	**12.3**
New debt issued/(repaid)	0.0	0.0	25.0	25.0	(15.0)
New equity issued/(repaid)	0.0	66.0	0.0	66.0	0.0
Net Cash Movement	**(4.7)**	**63.6**	**(63.1)**	**0.5**	**(2.7)**
Opening Cash	25.4	20.8	84.3	20.8	21.3
Cash at Period End	**20.8**	**84.3**	**21.3**	**21.3**	**18.6**

SEGMENT INFORMATION	FY23A	1H24E	2H24E	FY24E	FY25E
Product revenue	208.3	117.3	167.1	284.5	371.4
EBITDA	26.4	15.3	23.4	38.7	51.2
Margin %	12.7%	13.0%	14.0%	13.6%	13.8%
Services revenue	18.8	9.6	10.7	20.3	22.4
EBITDA	1.3	0.8	0.9	1.6	1.8
Margin %	6.9%	8.0%	8.0%	8.0%	8.0%

VALUATION MULTIPLES	FY23A	1H24E	2H24E	FY24E	FY25E
PER (x)	29.9	25.9	16.6	20.3	15.4
PER adj (x)	29.9	23.8	16.6	18.6	15.4
Dividend Yield (%)	2.0%	2.1%	3.0%	2.6%	3.2%
EV/EBITDA (x)	16.9	12.0	7.9	9.5	7.3
EV/EBIT (x)	20.1	14.3	9.1	11.1	8.3

PER SHARE DATA	FY23A	1H24E	2H24E	FY24E	FY25E
Reported EPS (c)	18.6	9.0	14.0	23.0	30.2
EPS adj (c)	18.6	9.8	14.0	25.0	30.2
Diluted EPS (c)	18.5	8.9	13.9	22.8	30.0
DPS (c)	9.3	4.9	7.0	11.9	15.1
Special DPS (c)	0.0	0.0	0.0	0.0	0.0
Dividend Franking	100.0%	100.0%	100.0%	100.0%	100.0%

RATIOS	FY23A	1H24E	2H24E	FY24E	FY25E
ROA (%)	12.2%	10.4%	13.4%	11.8%	11.4%
ROE (%)	23.6%	17.1%	20.0%	20.9%	19.3%
EBIT Interest cover (x)	n/m	n/m	23.5	24.8	19.5
Net Cash / (Debt) ($m)	20.8	84.3	(3.7)	(3.7)	8.6
Net Cash / (Debt) incl. Leases ($m)	6.9	70.4	(17.8)	(20.5)	(7.8)
Dividend Payout Ratio (%)	49.9%	50.0%	50.0%	50.0%	50.0%

MARGIN ANALYSIS	FY23A	1H24E	2H24E	FY24E	FY25E
Gross Profit	38.2%	39.0%	35.1%	36.7%	35.2%
EBITDA	12.3%	12.6%	13.7%	13.2%	13.5%
EBIT	10.4%	10.6%	11.9%	11.4%	11.8%
NPAT adj.	7.1%	7.3%	8.1%	7.8%	7.9%

GROWTH RATIOS	FY23A	1H24E	2H24E	FY24E	FY25E
Revenue	28.4%	14.5%	53.3%	34.3%	29.2%
Gross Profit	28.6%	18.8%	38.6%	29.1%	23.7%
Adj. EBITDA	27.6%	18.7%	68.4%	44.4%	31.4%
Adj. EBIT	28.8%	15.4%	77.6%	46.9%	33.8%
Adj. NPAT	31.5%	15.6%	79.0%	47.4%	31.7%
Adj. EPS	18.0%	5.3%	49.8%	34.2%	20.9%
DPS	151.4%	6.4%	48.6%	27.7%	27.1%
Product Sales	30.7%	15.0%	11.1%	13.0%	10.0%
Product EBITDA	40.7%	18.4%	13.2%	15.8%	6.6%
Services revenue	4.4%	8.0%	8.0%	8.0%	10.0%
Services EBITDA	(3.8)%	52.1%	7.6%	24.9%	10.0%

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Investment Thesis

The Australian electrical equipment and services industry is fragmented. Australian companies like IPD Group (IPD) play a crucial role helping (mostly) international suppliers localise and go-to-market. We see the market as a collection of niches, segmented by industry and sometimes geography, with a need to comply with strict safety regulations.

The requirement for qualified technicians in design and installation is a limiting factor to competition. Sales have unusual technical, compliance and even education requirements where often the equipment end users are not the customers. Entry barriers are high, but customer and counterparty power is also strong. Good operators, like IPD, can generate healthy profits and attractive returns on capital through-the-cycle. This remains a cyclical industry, in our view, albeit one in a long duration upswing.

IPD makes an interesting investment because the energy sector is all but certainly in a super-cycle, near term earnings power is underwritten by a major infrastructure project pipeline and management has an excellent track record for capital allocation. The operating record since listing shows an ability to integrate bolt-on acquisitions, deliver market share growth for vendors, and successfully navigate a challenging supply chain and inflationary environment.

Most of IPD's Australian peers are unlisted, but they are typically groups serving multiple segments, and often extending into adjacent markets like HVAC and communications. Even after the acquisition of CMI Electrical (CMI), IPD is materially smaller than their larger local competitors. There are still product gaps to be filled and we see recent supplier additions as encouraging on this front. We expect the energy capital cycle will support continuing organic growth and a fragmented industry will present opportunities to deploy capital for M&A.

The acquisition of CMI, in our view, also signals an intent to grow more aggressively making use of external funding. IPD's core distribution business generates attractive returns, but in our view double-digit organic growth rates were going to be hard to sustain with the existing product catalogue. EPS accretion and synergies from the CMI transaction underwrite EPS growth through FY25 and we expect further M&A once CMI is integrated.

Company Overview

History

Many of the leading electrical brands trace their origins to the early 1900's in Australia. Some of the international brands even have histories that predate the invention of the light bulb. IPD tracks its origins back to the 1950's and operated as the Australian arm for international conglomerates for most of its first fifty years. Its life as an independent company started with a management buyout (MBO) in 2005, with most of the team remaining as shareholders today, but many having retired. The current board and management own around 20 percent of shares outstanding.

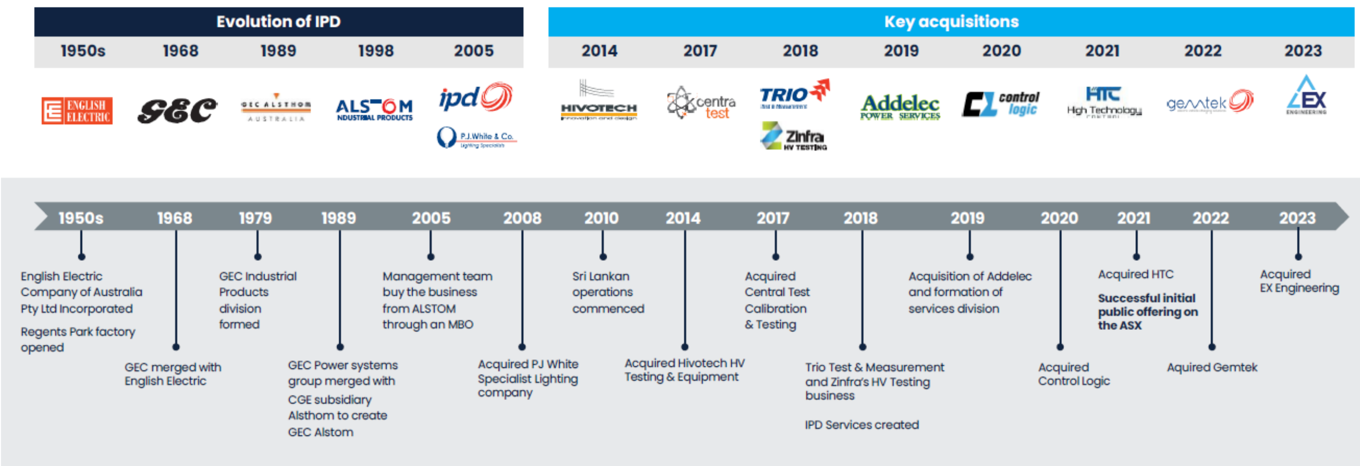
IPD listed on the ASX in December 2021 raising $40m at $1.20 per share, with 86.3m shares on issue. Around $20m was retained to fund growth. The team has a track record for executing and integrating acquisitions averaging one annually since 2014. Most of the growth and acquisition post-MBO was funded through retained earnings.

Growth has accelerated materially since 2019 due to the contributions of acquisitions and from expanding distribution relationships with equipment manufacturers. More recently IPD has been investing in expanding its services capabilities and growing a national team of consultative salespeople. Recent capital allocation has bulked up assembly capabilities and established a position in the hazardous electrical segment.

The announced acquisition of CMI in November 2023 is IPD's largest and will be funded by raising $65m of new equity at $3.93 per share. The deal will also require debt funding via a $40m bank loan which will be mostly drawn at deal closure in January. We believe this is the first use of debt funding since the MBO and the board have conservatively set a gearing limit of 1X net debt to EBITDA.

Bolt-on Acquisitions

IPD have undertaken a series of small bolt-on acquisitions in the past decade but, in our view, their most consequential acquisitions pre-listing were made in 2019, 2020 and 2021. Addelec, Control Logic and HTC expanded the product range, customer set, enhanced solutions capability and introduced a service offering. We think the added scale from Control Logic and HTC were critical in establishing reliable earnings power on which the group could be floated.



Source: FY23 Results Presentation

We estimate Addelec, Control Logic and HTC together added roughly $11m of annual EBITDA to the pre-IPO business. We call out Control Logic in particular, since we estimate it was around half the size of IPD group prior to acquisition.

Material Acquisitions (pre-IPO)

We've started with an acquisitions analysis because we think capital allocation is central to the long-term IPD investment case. We hope the analysis below highlights a pattern where acquisitions are pursued to expand solutions capabilities and demonstrate to vendors a capacity to handle more of their local business.

- Addelec Power Services Pty Ltd (August 2019, undiscl.)
- Control Logic (acquired Oct 2020 for $11m, 60% scrip)
- High Technology Control Pty Ltd (HTC) (acquired October 2021 for $5.5m, roughly 50% scrip)

Since listing IPD has made two further bolt-ons:

- Gemtek (Intellectual Property Only, April 2022 for $0.4m), and
- EX Engineering (early FY24, paid $10.2m, incl. $1m scrip).

Combining Control Logic, HTC and IPD was formative towards establishing the ABB partnership

- Control Logic is a leading supplier of industrial, electrical and automation products and solutions. At the time of purchase they carried over 10,000 products, had a national presence and relationships with key global vendors including ABB and Red Lion.

- High Technology Control is a distributor with a strong presence in the HVAC sector. They focus on the industrial segment including electrical control and automation of machinery. Key categories included control products, electric motors, low voltage switchgear, encoders and variable speed drives. Key vendors include ABB, Fagor and Bei.

Combining Control Logic, High Technology Control and IPD gave the group an larger national presence with a broad catalogue and solutions capability. There was an opportunity to integrate the businesses physically, consolidating real estate footprint and leveraging buying power. It established IPD as the dominant Australian partner for ABB across important categories, and arguably contributed to ABB's decision to hand more of their direct sales business to IPD.

- Addelec was an NSW-centric business mostly servicing water and electric utilities. It was acquired by IPD after ABB acquired the GE industrial business for which IPD was a long-term partner. Through Addelec, IPD were able to offer full warranty, service and maintenance for ABB products, and extend Addelec's business into new geographies.

- Gemtek was a small, intellectual property only acquisition that extended IPD's technical solutions into the electric vehicle category. This deal followed IPD gaining the rights to ABB's AC electric vehicle charging products.

- EX Engineering (EX) is a Perth-based business specialising in design, distribution, modification, and repair of hazardous area equipment. Ex is an industry term for explosion-proof products. This deal followed an expansion of IPD's relationship with R Stahl Group to include hazardous area solutions being configured, engineered and assembled in Australia. Ex is designated as the "official Australian Stahl certified workshop" and their main electrical equipment supplier is DEXEN. There is an intention for IPD to extend EX's capabilities nationally.

This leads to the latest acquisition, CMI Electrical (CMI). We explore CMI in detail below, but we highlight the CMI Plugs division serves the same sector as EX but with a large east coast presence. We anticipate both cost and sales synergies between EX and Plugs, while also demonstrating an increased national solutions capability to R Stahl Group. EX currently favours one of the CMI's competitors as a Plugs supply partner.

Proposed acquisition of CMI Electrical (CMI)

At a $101m price (incl. earn out), earning $15.4m of trailing EBIT, CMI will be the largest acquisition that IPD has attempted by a factor of almost ten. We think it signals a change in capital allocation strategy and appetite for risk. IPD are paying roughly 6x trailing EBIT, albeit CMI's current profits are near all-time highs.

The deal has been structured with $92.1m upfront cash payment and up to $8.9m in deferred compensation payable in August 2024. Deferred compensation will be payable based on the extent FY24 EBIT exceeds the level achieved in FY23. IPD will pay a 6x multiple of excess EBIT with a ceiling of $8.9m. Deal close is targeted for mid-January 2024.

This acquisition requires external financing, and IPD are raising $65m of equity capital and $40m of debt financing. An underwritten equity raise at $3.93 has seen 16.5m new shares issued, increasing the share count by roughly 20%. Post-close IPD will have $30m of pro forma borrowings and the board have imposed a net debt limit of 1x EBITDA. We assume plans are to maintain the 50% payout ratio with retained earnings allocated towards debt reduction immediately post acquisition.

CMI's operations

CMI's parent company Excelsior Capital (ECL-ASX) is a reporting entity. We have tracked financial reporting back through the last infrastructure and mining cycles.

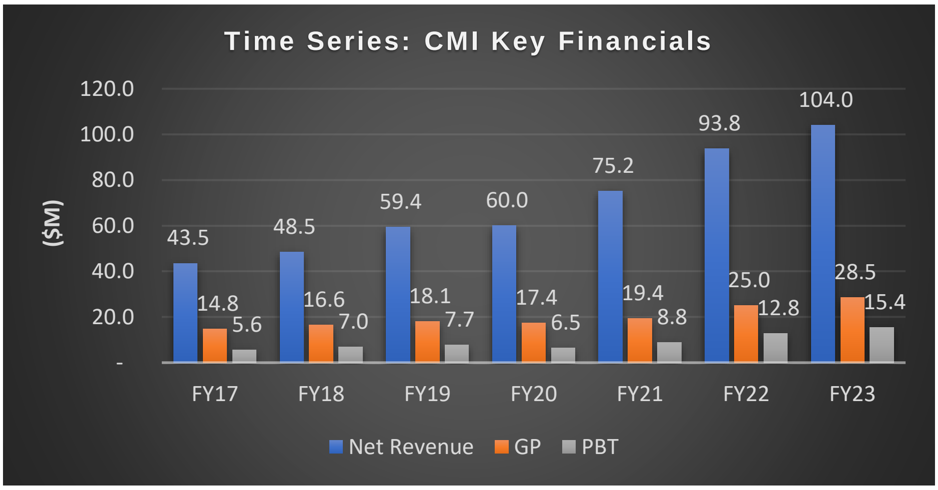
CMI was established in 1991 as a local manufacturer of electrical cables in QLD. Today they are primarily an importer of specialist electrical cables and their head office has shifted to Lidcombe, NSW where they manufacture Minto Industrial Products (Plugs). They have branches in Rockhampton, QLD, VIC and WA, serving roughly 500 customers with 60 employees.

Around 80 per cent of sales are made to electrical/cable wholesalers. The business is project-sensitive, achieving excellent operating leverage during periods of healthy demand using a relatively fixed cost base. This partly explains a tripling of profits since FY16. Throughout the last project downturn CMI was still able to maintain healthy profits, albeit at a reduced level.

CMI has secured and supplied major projects in resources and commercial sectors over the past few years, and this has materially contributed to their organic growth record. Major project wins include Western Sydney Harbour Tunnel, Martin Place Metro, Cross River Rail, Olive Downs Coking Coal Complex, Hail Creek Mine and Camden Water Treatment Plant.

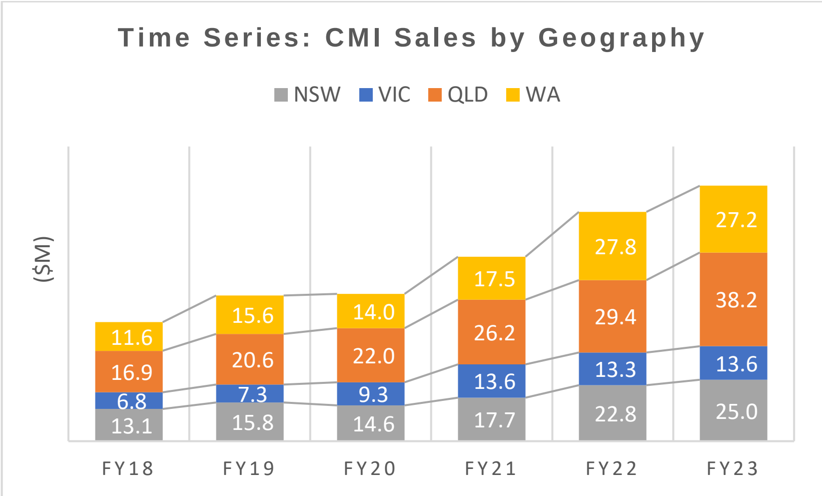
Manufacturing operations are not capital intensive, with an average annual P&E capex of less than $0.25m over the past five years. Head office and the other three branch sites are leased with annual outgoings of around $1.5m. Net working capital has roughly doubled from around $15m in FY17 to $35m in FY23. Sales also doubled over this period.

CMI certainly looks attractive with minimal reinvestment needs and the ability to generate ~$15m of EBIT on ~$35m of net working capital. We assume IPD will be looking for current profitability to be sustained for at least a few more years given the strong pipeline for major works.



Source: ECL-AU financials, TC Research

CMI generates most of its sales on east coast of Australia, but it also generates around one quarter of sales from WA. This reflects their branch locations, especially proximity to underground mining customers, and the concentration of major infrastructure works.

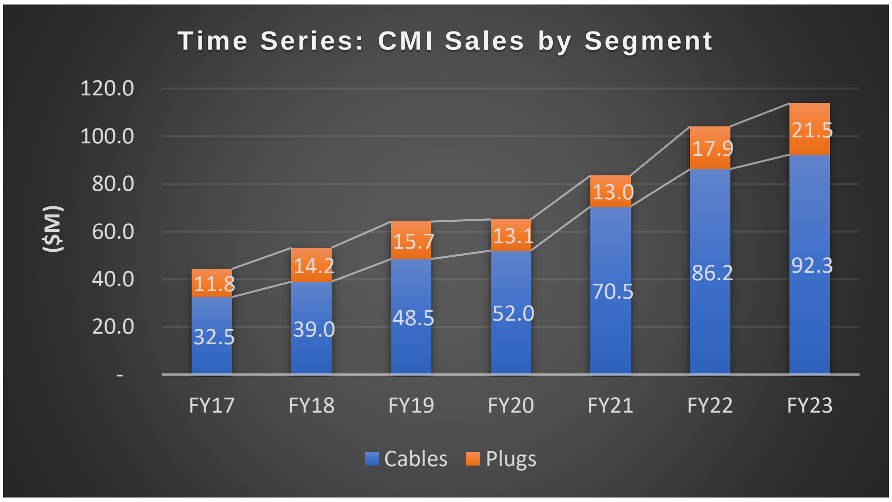


Source: ECL-AU financials, TC Research

CMI has two divisions, both serving electrical markets. Their largest division, Cables, supplies electrical cable to major construction infrastructure and renewables projects nationwide, targeting orders of between $0.25m and $10m. Cables has averaged around 80 per cent of gross sales over the past five years.

The Plugs division engineers, manufactures and sells couplers and receptacles to customers in hazardous environments. Core brand ‘Minto’ is the Australian market leader with export customers in Indonesia, Papua New Guinea, China and Mongolia.

Cables have been CMI’s fastest growing segment in recent years, but Plugs has shown strong growth since FY21.



Source: ECL-AU financials, TC Research

Cables:

The Australian cable market is estimated at roughly $2bn per annum, but this includes sales into the residential construction channel which CMI does not serve. Major competitors include multinationals with Australian manufacturing subsidiaries and importers. Imports have been growing market share and some cable categories attracted anti-dumping duties in the last decade.

Price is the main basis for competition and all suppliers in the market use price lists and have a rebate and discount structure for similar customer groups. Copper is a key input, and margins can fluctuate with the LME copper price and Australian dollar.

CMI's cable businesses mostly serves industrial niches. XPLE cables supplies electrical cables to the building and construction industry, Aflex provides bespoke solutions for switchboards, control systems and variable speed drives. These are end markets served by IPD and there should be synergy opportunities integrating CMI cables into solutions offered by IPD.

Products		
XLPE	• Power supply in low and medium voltage applications • Used in commercial and industrial sub-mains, factories, variable speed drive (VSD) motors and control systems in infrastructure projects	81% FY23A cables revenue
Aflex	• Flexible cables for use in applications where tight or difficult access is restrictive or where movement occurs • Supplied for switchboards, generators, sound & lighting, batteries, variable speed drive motors, submersible pumps and low voltage control systems	17% FY23A cables revenue
HARTLAND	• Leading range of audio, coaxial, control, data, instrumentation, UL approved connecting wire, copper braid, screened & unscreened multicore & multipair cables	2% FY23A cables revenue

Source: IPD 2023 AGM presentation

Plugs

The two key products in the Plugs division are Connectors and Receptacles/Couplers. The term 'plug' is an apt description for these products; they attach to cables and secure them to electrical equipment, such as control systems. CMI's main brand, Minto, engineers and manufactures plugs for hazardous environments such as underground mines and tunnels. Their main purpose is to seal and terminate electrical devices, but a secondary purpose is to protect equipment from dust and moisture.

Minto's main market is the eastern states' underground coal sector, but it also services copper and gold mines. Customers are primarily mine service providers and contractors. Plugs is a relatively small, mature industry with an oligopoly structure – we estimate around $60-80m market size in Australia. Minto is the dominant player and the other three major competitors each have around 15-30% market shares.

Plug sales are supported by an installed base and rapid replacement cycles. Once installed into a mine site, the branded plug is usually retained for the entire mine life. Safety standards and general wear and tear require replacement on a roughly three-to-five-year cycle. Replacement plugs and components represented more than half of Minto revenues in FY23.

Minto Two has been developed as a hybrid plug that can be sold into open cut and above ground projects, expanding the addressable market. To date the product has not enjoyed material commercial success and there may be an opportunity to accelerate traction by using IPD's sales resources.

Products		
MINTO	• Market leader when power and safety are required in a complex and extremely hazardous environment • Minto has a global reputation, with exports to mining installations in Indonesia, Papua New Guinea, and Mongolia • Manufactured locally in Sydney, the plant operates to international quality standards	84% FY23A plugs revenue
Minto 2	• Launched in March 2023 • Electrical plug compliant for use in non-coal underground mining, tunnelling and infrastructure projects, as well as above ground mining applications	1% FY23A plugs revenue
Components	• In addition to finished plugs, CMI markets and sells a range of components suited to plug refurbishment, providing re-occurring revenue	15% FY23A plugs revenue

Source: IPD-AU presentations

IPD has identified synergy opportunities for internal cable sourcing and in bundling ABB and Minto products in solutions for hazardous environments. IPD currently spends around $1.5m annually sourcing from CMI's cable competitors and they have estimated there is around $1m of sales synergies for a Minto/ABB bundle. It's expected there could be more cross selling synergies but these were unquantified. CMI will operate as a stand alone business, with no current integration plans.

Our thoughts on the deal

What stands out with this acquisition is the difference between CMI's cable business and IPD's existing product division.
Around 80 per cent of CMI's revenues are for specialist cabling. Whilst these are niche specialist cables, they are still an unbranded, substitutable, price-elastic product. Cables sales are significantly skewed towards commercial wholesalers and gross margins appear to be in the low 20% range net of wholesaler rebates.

While cables achieve a goal of diversifying the supplier and customer base, we sense a major attraction of the CMI acquisition was the smaller Plug division, which forms part of a broader push into the hazardous market. IPD recently expanded their distribution agreement with R Stahl Group for hazardous products, and they acquired EX Engineering, a West Coast Stahl-certified workshop. Minto sells into the same customer base as EX, and they currently seem to favour non-IPD brands for electrical equipment and plugs in their design and distribution operations.

Owning the CMI's Plug division extends IPD's assembly/customisation capability for Stahl into Rockhampton in addition to Wetherill Park and the Perth workshop acquired with EX. Stahl has a broad product catalogue for Ex electrical equipment and in our view, would be a complementary equipment supplier to IPD's existing brands, without much overlap. We speculate IPD is courting Stahl to take on a greater Australian distribution role, as they did with ABB a few years ago.

Our hunch is synergies for the combined group have been materially understated. We believe there are additional opportunities, including, but not limited to:

- A cable offering complements IPD's busbar offering in the data centre segment,
- CMI bulks up their IPD's catalogue in the wholesale channel, and give scale for negotiating better freight and rebate structures, or better product representation in branches,
- Cables enable IPD to engage earlier in certain conversations which fits with their strategy of educating specifiers / contractors in earlier phases of construction, and
- Minto above ground plugs should benefit from IPD's sales force and contractor relationships.

Where could the CMI transaction go wrong? In our view, CMI's two main vulnerabilities the threat of import competition, which may have been unnaturally subdued over the past couple of years due to supply chain backlogs, and a high indirect exposure to commodity prices, particularly coal.

Core Operations

IPD headquarters are in Wetherill Park, NSW including offices and a 10,000 sqm main warehousing and assembly facility. They also maintain a 40-person switchboard assembly team at Wetherill Park, which provides value-added solutions for switchboards of specific voltages. They have a national footprint comprising ten warehouses/branches and more than 20,000 sqm in total. The acquisition of CMI adds four more branches plus two third-party distributors in states lacking a direct presence and export distributor relationships.

The group employes around 450 staff with Australian operations complemented by teams in Sri Lanka and the Philippines which provide technical and back-office functions. Offshore teams enhance responsiveness and help keep cost-to-serve low. The acquisition of CMI adds around 60 new staff.

Most products sold are imported as finished goods from manufacturing plants in Asia and Europe, which is where many of IPD's suppliers are headquartered. The long supply chain requires advanced inventory forecasting and risk management. Customers require just-in-time fulfilment and logistical capability is a key factor for competition. IPD have a reputation for responsiveness in fulfilment and believe their logistics are a competitive advantage. Outbound freight is coordinated with third-party logistics providers and IPD's delivery promise is same-day dispatch for orders placed before 3pm.

Most of IPD's manufacturer/ supplier relationships are arranged on an exclusive basis. Exclusive supply relationships are usually contracted for multi-year terms, with the manufacturer possessing an option to terminate with notice. We view termination risks as low given interdependencies and the high fixed costs for the manufacturer to maintain a direct sales and warehousing presence.

Why do global vendors use local distributors?

This is a common question for distributors. In the electrical industry there is also a crucial requirement to meet Australian standards and to package solutions that involve multiple products/brands. This requires a qualified labour force.

Competitor Schneider Electric discusses their relationship with distributors in the following note, and we think this is typical for equipment manufacturers:

> We are a key partner to distributors worldwide, who account for around 50% of our total sales (70% of product sales) and offer a network of 13,000 sales outlets. This close relationship allows us to offer customers levels of service and efficiency that truly set us apart from our rivals. Distributors provide a single point of access for customers and can combine products into packages. In addition, they use their own sales forces to negotiate individual transactions, freeing up the Schneider Electric sales team to concentrate on promoting solutions and servicing customers' general needs. (TC emphasis added).

Source: Schneider Electric Annual Report

Key Segments

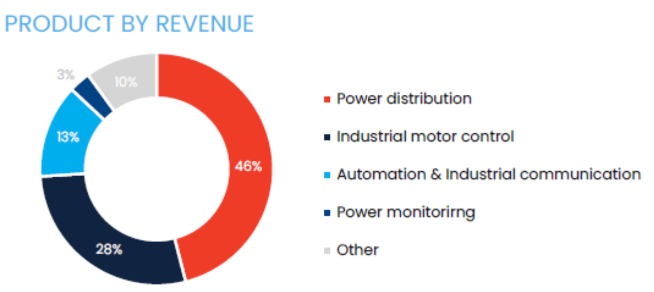
IPD operates primarily as a value-added products distributor with a focus on ‘the sale of electrical infrastructure products.’ A services offering was introduced with the acquisition of Addelec in 2019 as part of a strategy to become an end-to-end solutions provider. Currently more than 90 percent of revenue and more than 95 percent of group EBITDA is generated from product sales, and this is set to increase following the acquisition of CMI.

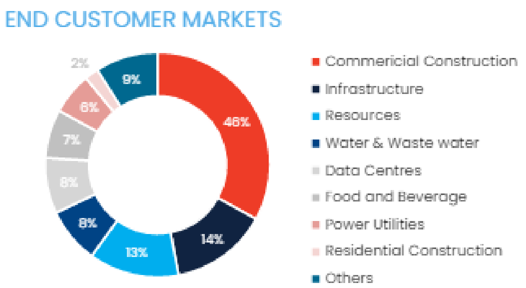
FY22 pro forma revenue split	Description	Brands	Customer types	End users/industries	Locations	Revenue model
Products 92%	Sale and distribution of a range of electrical Infrastructure products and solutions	ipd, EX	Switchboard manufacturers, OEMs and system integrators, electrical wholesalers, electrical contractors and power utilities	Commercial construction, residential construction, infrastructure, mining, power utilities, healthcare and education	Sydney, Brisbane, Melbourne, Adelaide and Perth	Sale of products and solutions
Services 8%	Specialist provider of low and high voltage electrical services	gemtek, addelec	EV charging infrastructure, Data centres, healthcare, power generation, utilities, industrial, mining, roads and rail infrastructure		Brisbane, Sydney, Melbourne, Perth, Bendigo and Burnie (Tasmania)	Project management, labour and materials

Source: FY23 Results presentation

Products distributed are crucial to powering industrial equipment and buildings safely. Prior to the acquisition of CMI, there were five key product categories:

- Power distribution,
- Industrial and motor control,
- Automation and industrial communication,
- Power monitoring, and
- Electric vehicle solutions

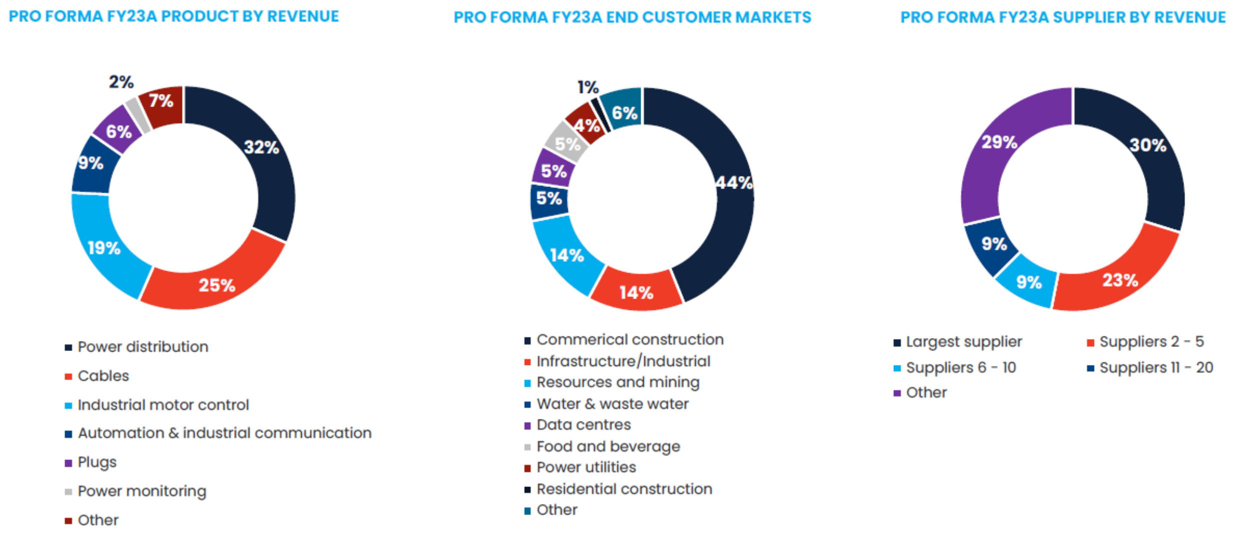




Source: FY23 results presentation

A combined IPD/CMI Electrical business will benefit from a more diversified product catalogue, supplier base and end market exposures. On a pro forma basis cables and plugs will comprise around 25 per cent and 6 per cent of sales, respectively. ABB falls from roughly 40 per cent of sales to under 30 per cent.

While not illustrated in the charts below, CMI's customer base is concentrated among electrical wholesalers. We estimate the combined group will generate around 40 per cent of sales from the electrical wholesale channel. While the high channel concentration presents risks, we think there could be opportunities to use their enlarged catalogue to negotiate better terms with wholesalers and logistics providers.



Source: FY23 results presentation

The Services divisions includes calibration, testing, installation and commissioning, maintenance, refurbishment, and repairs. Proximity and speed is crucial to the service business, especially for maintenance and repair issues where a break down occurs. Clients value proximity and quick response times above price in many cases, since the cost of lost operation usually dwarfs the remedial costs.

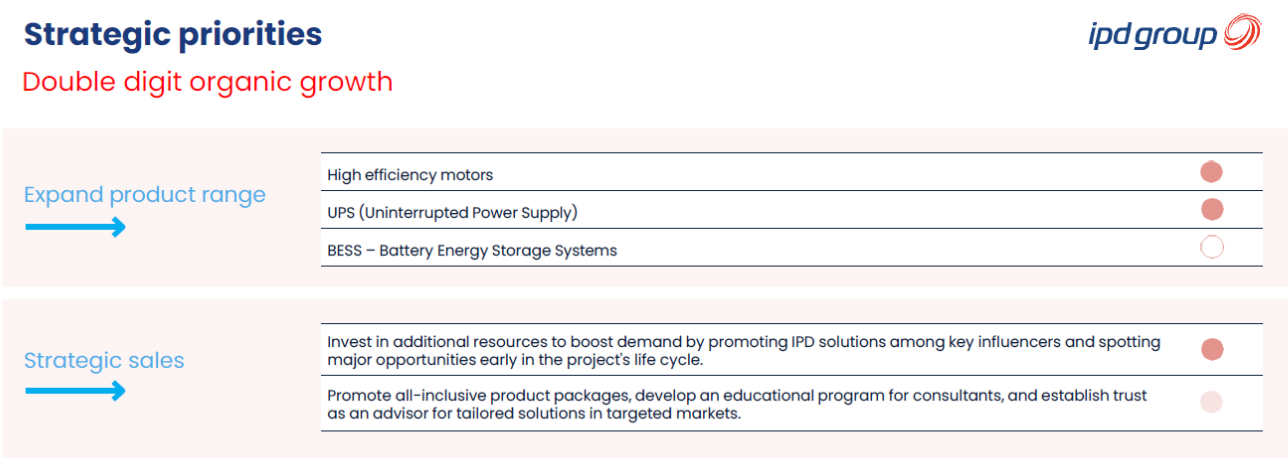
We see IPD's services offering as mostly strategic to provide an end-to-end solution for manufacturers and for end customers. Access and retention of skilled labour, in the right locations will be a key element to scaling service operations to complement the core products division.

Strategy

Short term strategies have concentrated on product range expansion and enhanced sales capability. In FY24 IPD are targeting double digit organic growth through an expanded product range and sales force. Progress has already been made towards these objectives including:

- The expansion of the ABB supply range to include HVAC products in May 2023,
- A new distribution partnership with Delta for Uninterrupted Power Supply (UPS), and
- A new distribution partnership with R Stahl Group for equipment in hazardous environments.

IPD has been building out a national sales team with a focus on engaging earlier with specifiers and consultants. Specifiers are a key bottleneck for market share, since equipment specified in the design phase flows through to the procurement phase. With education and improved relationships IPD are hoping to drive up market share for distributed brands.



Source: FY23 presentation materials

Qualified labour, and the role of Consultants/Specifiers

Electrical equipment distribution has a high reliance on a labour force with electrical trade or engineering qualifications. The need for qualified labour arises from the Electricity Safety Act and other general regulations. This regulatory environment places demands strict adherence for complex electrical installations including compliance with standards, procedural documentation, supervision, and reporting.

Take the example of a switchboard assembly at IPD's Wetherill Park facility. Although IPD aren't the original equipment manufacturer, under Australian Standards they take on the de facto role of the 'assembly manufacturer.' IPD's assembly team must prepare the switchboard layout in accordance with project diagrams, conduct design verification (including component and device selection choices) and prepare full assembly documentation.

By the time contractors put out tender documents, in most case equipment vendors have already been specified. This specification process is undertaken by design and engineering firms, consultants, architects and systems specialists. These 'specifiers' are important gatekeepers and IPD's investment in sales is targeting this channel.

It can be difficult to substitute devices that are not specified in the original tender designs. Standards require the substitute device to perform as well as or better than the originally prescribed device, which can be difficult to prove without access to manufacturer data.

Key Suppliers

At the initial public offering, IPD's three largest suppliers were ABB Group (ABB), Elsteel and Emerson and there were a handful of other suppliers each accounting for 2 – 3 per cent of gross revenues. The three largest suppliers were responsible for nearly 40 per cent of gross revenue. Most of the top ten supply partners have more than ten-year tenures with IPD.

Since IPO, new and expanded supply relationships have been announced for:

- ABB Motion for variable HDD Drives in the HVAC sector (a separate division from electrification products),
- Powerduct for busway systems into data centres,
- Delta Systems for uninterrupted power supply products (UPS) into data centres, and
- R Stahl Group equipment for hazardous environments, including assembly at Wetherill Park.

Figure 3.4: FY21 pro forma gross revenue by supplier[2]

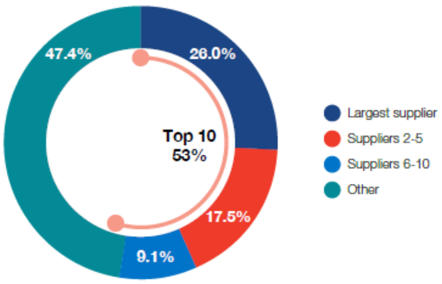


Figure 3.5: FY21 top 10 supply partners – tenure

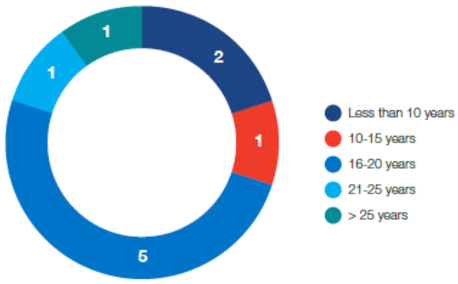


Table 3.4: Overview of top 10 supply partners

#	Supply partner	Length of relationship[3]	Product types	% of FY21 pro forma gross revenue	Headquartered
1	ABB	> 28 years	Circuit protection, motor control, electric vehicle chargers	~26%	Switzerland
2	ELSTEEL	> 22 years	Modular enclosures for switchboards	~8%	Sri Lanka
3	EMERSON	> 16 years	Automation PLCs	~5%	USA

Source: IPD Prospectus

IPD looks for exclusive distribution arrangements with suppliers so they can avoid price-based with other distributors representing a brand. IPD's product/brand catalogue has been assembled to be complementary in their solutions offering, so supplier partners aren't in competition for components within systems. With this structure IPD and their distributed brands are aligned to grow and IPD can go to market with packaged solutions spanning multiple brands.

For example, in a fictitious project IPD could assemble a switchboard system with an Elsteel enclosure, fitted with ABB components, powering ABB motor control equipment, connected with CMI-sourced XPLE cables, terminated by Minto plugs with uptime redundancy powered by a Delta UPS.

We expect IPD will look to replicate the ABB relationship with other Suppliers.

We believe the expending relationship with ABB has delivered much of the organic revenue growth achieved since listing. By FY23 ABB had grown to around 40 per cent of gross revenues, and we estimate around $50m of this was previously ABB direct business transitioned to IPD.

We think this is a template IPD will look to replicate with other suppliers. It took more than two years for ABB to be confident in fully outsourcing its distribution of power management and control products. To achieve this outcome, IPD made several bolt-ons to consolidate ABB supply and increase after-sales support resources.

July 2019

IPD was appointed distributor for electrification products for the 415V switchboard manufacturer channel. IPD could also provide ABB low voltage power distribution solutions to major electrical contractors but all other channels were still serviced directly by ABB.

August 2020

IPD and ABB announced a ‘strategic partnership.’ From Sept 2020 IPD was the preferred distributor for low voltage power distribution and control products to the electrical wholesale market. IPD also provided ABB with distribution board assembly whilst ABB’s direct sales force continued to support some customers and facilitate others through IPD.

September 2021

The partnership was expanded to remainder of the market for electrification products including up to 1,000V equipment in addition to control products and AC EV chargers.

May 2023

IPD entered a master distribution agreement with ABB’s Motion business for the supply and sale of ABB variable speed HVAC drives.

IPD all but doubled ABB’s market share in Australia since commencing the distribution partnership. Management still believes there is significant upside with ABB in Australia, and they cite a single-digit market share compared to some European markets where ABB enjoys 30 – 40 per cent share.

We speculate IPD are looking to grow their catalogues with recently added vendors including Stahl and Delta Group, who both possess sizeable product ranges. High efficiency motors and Battery Energy Storage are two desirable product categories where these vendors have solutions and where IPD are looking to expand.

Customers (two key channels)

IPD serves more than 4,200 customer accounts, including switchboard manufacturers, electrical wholesalers, electrical contractors, power utilities and OEMs. Of these customer segments, switchboard and electrical contractors are particularly fragmented, whilst electrical wholesale, power utilities and OEMs have high degrees of concentration. These customers in turn service a diverse range of end markets.

We divide the market into two, with electrical wholesalers mainly servicing the small job/electrician channel and the remaining customer segments servicing medium and large-sized commercial and engineering projects. Customers are distributed nationally, mostly mirroring the distribution of project activity.

Figure 3.6: FY21 pro forma gross revenue by customer type[4]

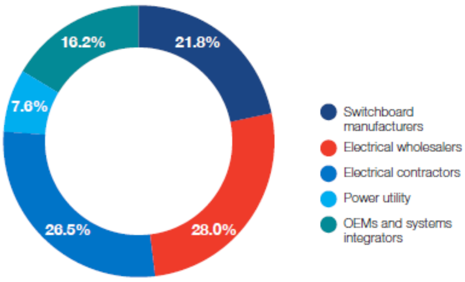
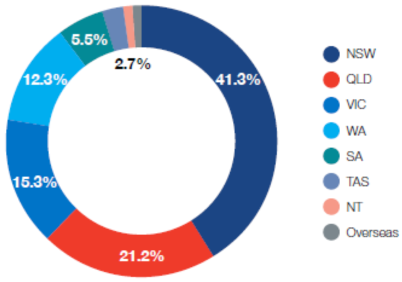


Figure 3.7: FY21 pro forma gross revenue by geography[5]

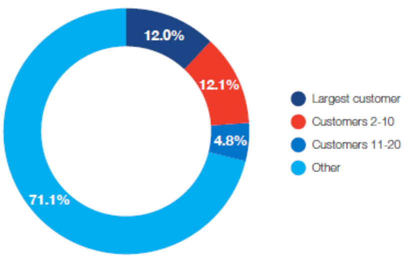


Source: IPD Prospectus

Electrical Wholesaler Channel

In FY21 IPD's top five customers were electrical wholesalers, with the largest responsible for 12 per cent of gross revenue. The wholesale channel is reasonably fragmented, with the largest three networks operating 400+, 150+ and 130+ branches respectively.

Figure 3.8: Pro forma gross revenue concentration by customer[7]



Source: IPD Prospectus

Wholesaler branch networks serve as a de facto inventory warehouse for electricians who might visit two or three times daily to acquire parts for jobs. E-commerce wholesalers are an emerging channel but they cannot match the daily service and proximity advantages of a branch network. Wholesalers offer small contractors and electricians product range, aftersales service, and credit terms. They place a high value on suppliers having strong logistics capabilities and reliable product supply.

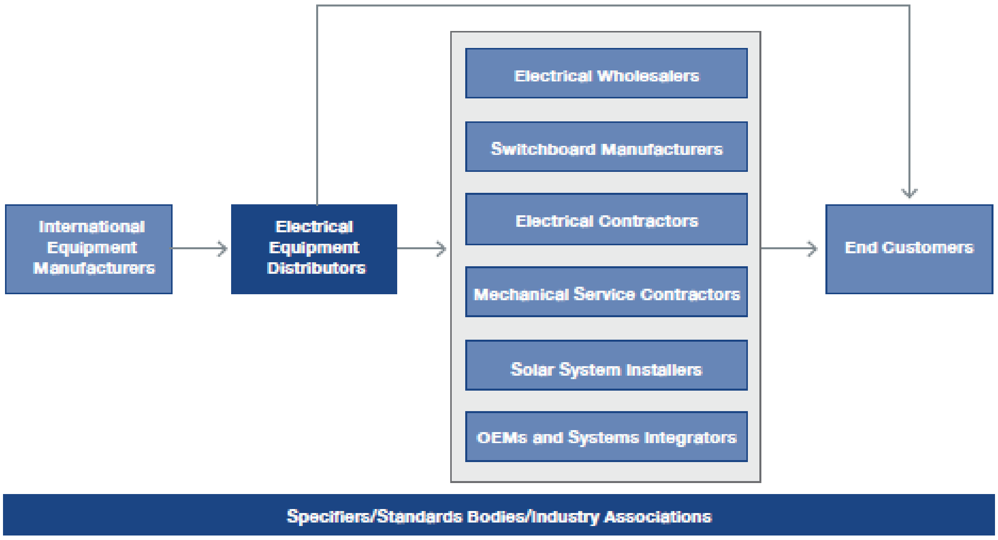
Electrical wholesalers range mostly leading brands of low voltage electrical SKUs with a bias towards products used in residential and light commercial buildings. They also direct source their own private label products for certain categories. Suppliers (including distributors like IPD) negotiate annually with wholesalers to determine trading terms including rebate rates.

We estimate IPD's share of gross revenues from electrical wholesalers will approach 40 per cent after completing the CMI acquisition.

The Value Chain excluding Electrical Wholesalers

The industry structure image below comes from the IPD prospectus. IPD mainly sits between International Equipment Manufacturers (IEMs) and a handful of different customer counterparties involved in delivering an electrical system solution. In our view this image oversimplifies the industry and is best considered for how the market looks from the perspective of the IEM.

Figure 2.1: Electrical equipment industry structure, Australia, 2021



Source: Frost & Sullivan cited in IPD Group Prospectus 2021

We prefer to think about the industry value chain in terms of project workflow, as illustrated in the image below.

Source: TC Research

In this model, instead of the customer groups sitting between distributors and end customers, they are engaged with intermediaries and contractors at different points of the construction process. IPD as a value-add distributor needs to be able to deal with different customer segments from project initiation through to service and support.

For larger projects, contractors/integrators are often working with complex electrical systems that have been designed by engineers. Equipment is usually required to be shipped to site on one or two days notice, with electrical work being completed towards the end of the job. There is a material safety and compliance burden that needs to be met.

With an import-reliant supply chain, forecasting and ordering of this type of inventory is a key competency, since some equipment cannot be air freighted. For remote sites, a local branch presence is an advantage for distributors since they can act as a de facto warehouse for the project. IPD also offer assembly capabilities across multiple sites as an additional value-add service, and this has appeal for IEM partners lacking a large Australian presence.

There are important relationships 'touch points' to service larger projects with key gatekeepers including design/engineering consultants, EPC contractors, electrical contractors, switchboard manufacturers etc. We've seen a tendency for certain upstream counterparties to favour vendors or customers based on familiarity, reputation or even relationship.

For example, a design consultant might be familiar with the technical properties of ABB and Elsteel products and will prefer to design systems using those brands. Or an EPC will look favourably upon an electrical contractor who they've work on for past projects and has demonstrated an ability to handle complex designs and deliver reliably.

We highlight this relationship/reputation dynamic to emphasise a few points:

1) Procurement is price-sensitive, but there are other commercial factors at play in securing contracts,

2) Relationships are crucial, especially with upstream counterparties who can be gatekeepers for product selection. Technical support and education are an important sales function requiring qualified staff.

3) Service and after-sales support can be an important factor in brand/product selection upstream, since the electrical systems and assets might have a 20 – 30 year expected life. Experience, spare parts stores, and technician responsivity are all considerations in equipment selection.

Equipment voltages and regulation influence market structure

Electricity needs to be converted from high voltages (where transportation is safest and most efficient), into lower voltages for industrial and consumer use. Safety risks are highest at higher voltages and so is regulation.

Voltage classifications differ by country. Australian standards classify electricity above 1,000V AC and 1,500V DC to be high voltage. Below this figure is considered low voltage.

In industry parlance, there's a middle 'medium voltage' category that seems to apply between 1,000V and 35,000V AC equipment. This captures many systems deployed in industrial, mining, and commercial applications. Medium voltage systems might include lighting, electric motors, and the powering of machines.

In our industry discussions, high voltage electrical systems and equipment usually referred to utility customers and/or transmission infrastructure, where bulk energy is transported between 66,000V and 500,000V AC.

We think it makes sense to stratify end customer markets for large projects as:

- Industrial/commercial/mining (medium voltage systems)
- Utilities/energy transmitters (high voltage systems)

Customers, regulations, compliance burden and system complexity different materially between low / medium / high voltage applications. Compliance is not a box-ticking exercise but can require complex engineering calculations to be demonstrated.

Product quality, reliability and reputation will differ across equipment and end market application. Likewise, the reliance on third party expertise, specification and installation will also be linked to the end market.

Customer concentration, bargaining and even competitive dynamic changes across different voltage end markets. For example, there are fewer utility customers that are best served by one-to-one relationship sales. On the other hand, there are tens of thousands of electricians that are best served through wholesale partners.

Customer fragmentation seems to increase as voltage decreases. Likewise, product and service substitution are higher as voltages (and compliance requirements) get lower. For example, private label shares are relatively low, occurring only in the electrical wholesaler channel, where safety regulations are lower and product standardisation is highest.

Qualified labour is all but mandatory throughout the value chain, but the level of technical skills and specialisation increases when working with higher voltages. We observe an increasing role of 'specifiers' or specialised design/engineering consultants that are involved in the project design phase.

Design competency requires a familiarity and even proximity to manufacturers to understand the technical properties of products, which isn't always widely available information. Likewise, we've also noticed a tendency for mechanical service providers to specialise in solutions of a small number of equipment manufacturers.

Competitors

Two decades ago, Schneider Electric (Schneider), one of IPD's listed peers, segmented their global competitors into the following three categories:

- Large non-specialist manufacturers with diversified business bases, including ABB, General Electric, Mitsubishi Electric and Siemens,
- Multinational specialist manufacturers, including Omron and Rockwell Automation, and
- Smaller companies – primarily in electrical distribution – with a more regional presence, including Eaton, Hager and Legrand.

We see it is an important industry feature that Schneider's competitor list is largely unchanged twenty years later.

The list is almost identical to the key competitors IPD included in their Prospectus, albeit some of the manufacturers above are substituted for local distributors.

- Schneider Electric, NHP Electrical Engineering Products (Terasaki/Rockwell aligned distributor), APS Industrial (Siemens aligned distributor), Eaton, Legrand and Hager Electrical.

The combination of dominant brands with relatively stable market positions creates high barriers to entry. Global manufacturers have product advantages because they can spread research and development costs across a global sales footprint.

Global manufacturers have tended to either acquire or partner with independent distributors in markets where they do not have a strong presence. Where independent Australian brands have maintained a strong position, it is usually in niche markets (like Minto) or for low margin commodity lines like certain types of cables.

The Australian electrical equipment market is dominated by Schneider, which acquired local brand Clipsal and has a diverse product range. They operate a vertical structure including development, manufacturing, marketing, distribution, and service.

In 2003 the ACCC estimated the merged Schneider/Clipsal's national market share at 30-35% and the concentration of the top four industry players at 45-50%. We think Schneider's current market share has since risen to around 40 per cent, of an addressable market of roughly $5bn. IPD's ~$350m of pro forma sales (including CMI) equates to less than 10 per cent market share, although they serve fewer segments than Schneider.

Schneider's Australian revenues have been reported to be above $2bn but this includes a large presence in the residential segment and a broader catalogue including lighting, solar, data/communications and HVAC. Schneider benefits from a long-established reputation, relationships and a large marketing presence. They also have a reputation for best-in-class logistics.

NHP Electrical Engineering are another Australian distributor reporting >$500m in annual sales and around 800 employees. They are focused on similar segments to IPD including power management and motor control products, but they distribute throughout the South Pacific.

Compared to Schneider, IPD (with CMI) is still a niche operator with ample room for expansion of their catalogue and into adjacent segments. Based on the revenues of their two larger competitors, Schneider and NHP, we think it's reasonable for IPD to target at least a doubling of revenues from their current size, and that figure is independent of the market expansion we anticipate from the energy transition. Our sense is management would like to match Schneider's market share over the long-term!

ABB's Australian market share is significantly below the 30 – 40 per cent achieved in other regions. The Australian market dominance of Schneider is a large contributing factor, but it is not uncommon in other regions for both ABB and Schneider to collectively capture 60 – 80 per cent market share.

IPD has done an excellent job increasing the market share of ABB over the last few years as exclusive distributor, nearly doubling from a sub five per cent starting share. Improving service levels and sales education have been key factors since ABB's products are more advanced compared to some brands with larger Australian market share but lower R&D budgets. Management equates recent share gains with harvesting low hanging fruit, and the rate of market share uplift should not be counted upon to keep doubling every few years!

Markets Served

Demand for electrical equipment is closely tied to project activity, so industry sales can ebb and flow with commercial and engineering construction. Electrical equipment is usually procured in the late stages of a project, creating a lagged effect between changes in market activity and when it is felt through IPD's profit and loss. IPD has minimal exposure to residential construction as this market is considered non-core and their product catalogue skews towards commercial equipment.

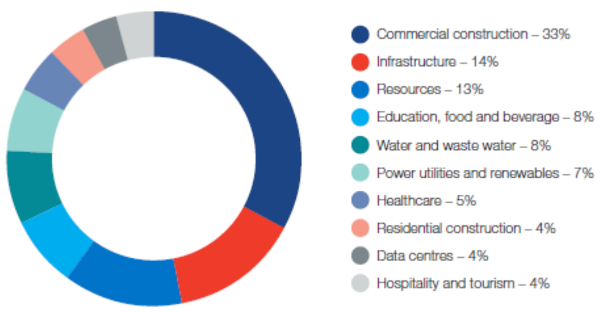
Construction sub-markets tend to operate on different cycles. Participation across these sub-markets can offer diversification benefits. For example, data centre project opportunities are not expected to be correlated with resource sector project opportunities. Within the resource sector there are different project cycles based on individual mineral supply/demand dynamics.

Broadly, we categorise sub-markets into:

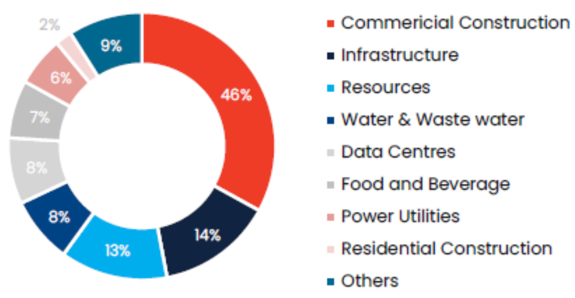
- Resources
- Infrastructure (transport and utilities, including water)
- Commercial (within this subsector we would include hospitals, shopping centres and data centres).

In FY23 IPD generated more than half of product sales from the commercial construction market (including data centres).

Figure 3.9: FY21 pro forma revenue by end-market[8]



END CUSTOMER MARKETS



Source: IPD Prospectus 2021

Market conditions have been buoyant since FY20 and the outlook remains positive, underpinned by a near decade-long pipeline of state and federal infrastructure investment and a need to transition electricity generation away from fossil fuels. Many of the road transport infrastructure projects we believe to be in IPD's sweet spot are approaching completion, which is the main supply window for electrical equipment.

Transport Infrastructure Expected Construction Completion:

- 2024: Sydney Metro - City and Southwest - *$20.5 billion* (NSW)
- 2025: METRONET - *$10.6 billion* (WA)
- 2025: Melbourne Metro Tunnel - *$12.9 billion* (VIC)
- 2025: West Gate Tunnel - *$10.2 billion* (VIC)
- 2026: Cross River Rail - *$7.7 billion* (QLD)
- 2026: Sydney Metro - Western Sydney Airport Stage One - *$11 billion* (NSW)
- 2026: M12 Motorway - *$2 billion* (NSW)

Source: ANZ Research

Mining investment has been strong in recent periods due to commodity price rises and investment into new battery minerals extraction, but activity has started to moderate from peaks. Data centre spending is also booming after investment deferrals during the pandemic, and increased interest from pension fund investors. New data centre capacity is also being installed to handle growth in cloud computing and expected growth from data-intensive new technologies, such as Internet of Things and artificial intelligence models.

The market is cyclical and the focus of procurement and level of competition in tender response fluctuates through the cycle. We have exited an unusual period during the pandemic combining supply shortages and a boom in commercial and engineering projects. This created conditions for material cost inflation, which faced little resistance being passed downstream. Procurement decisions over the past couple of years have weighted urgency and availability over price, in our view. Distributors with inventory availability were rewarded with market share gains and sales at good margin.

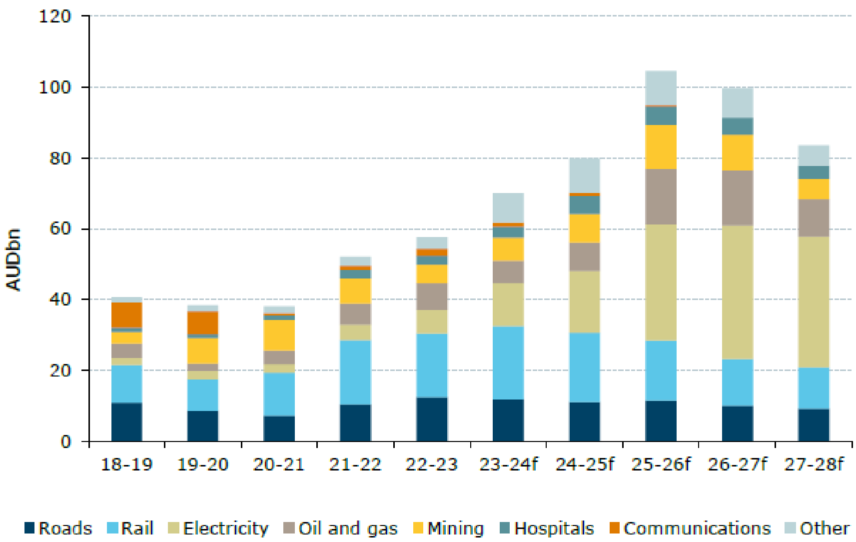
Market Opportunities and Activity Outlook

The pipeline for commercial investment in Australia is robust, even after a recent Federal review that led to a collection of prospective projects being cut. A large portion of major projects forecast for completion in FY24 – FY27 are approved, funded and with construction having already commenced. Demand in IPD's end markets looks robust for at least the next few years, and we expect conditions beyond FY27 to support organic sales growth as energy transition spending accelerates.

Transportation infrastructure, particularly tunnels and rail have featured heavily in commercial investment over the past few years. This has combined with some good years (and a still solid outlook) for resource projects. The forward pipeline arguably sees this mix change. Transportation supply opportunities are starting to moderate but investment in hospitals and education are set to increase materially. We expect hospitals to be an attractive end-use category for power management, in particular.

Heading into FY25 and FY26, the major project pipeline looks materially stronger than the favourable activity levels experienced over the past few years.

Chart: Total Major Projects, by industry sector



Source: ANZ Research, November 2023

Electricity projects comprise the largest category of prospective major project activity beyond FY26. Much of this spending has been earmarked for investment by federal and state energy transmission programs in line with a federal commitment for Australia to reduce carbon emissions by 43 per cent by 2030 and to a net zero position by 2050.

There is little hope of achieving 2030 emissions targets without a significant increase in investment, but the last few years have been plagued by setbacks and project deferrals. The renewables pipeline has struggled with supply chain issues, rising costs and changed funding markets. Our channel conversations cited equipment access as a major constraint; energy transition is being simultaneously pursued globally and there are long lead times for hardware.

A notable feature of the electricity project pipeline is the concentration of spending among a few mega projects, and the financial and timing risks entailed. For example, the pipeline is dominated by three mega projects:

- Western Green Energy Hub ($100bn spend, commencing 2027),
- Australian Renewable Energy Hub ($50bn spend, commencing 2025), and
- Sun Cable ($36bn spend, commencing 2024).

These are ambitious projects involving large scale renewable generation in remote locations. The Sun Cable project has already appointed administrators due to cost overruns in the design phase. A high concentration of spend amongst a few, mega projects can heighten competitive tension, since a mega project can generate sizeable orders spanning multiple years. We saw this dynamic at play when LNG infrastructure was being constructed in the last decade.

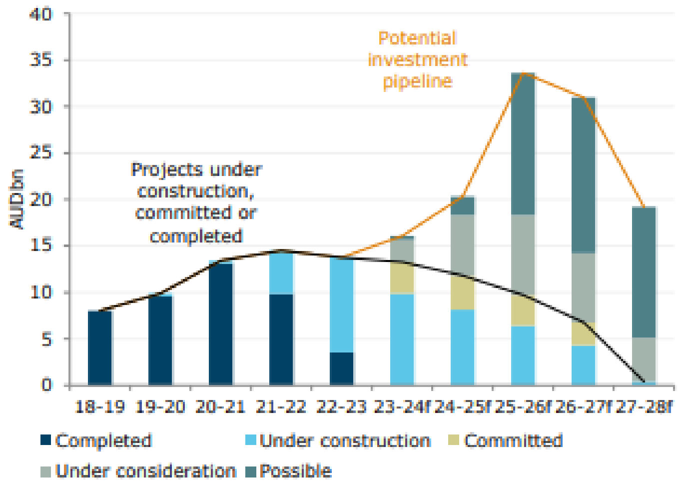
Commodity prices have been favourable over the past few years, and even after declining from recent peaks they are still supportive of profitable production and new mine development. The price surges for coking coal and thermal coal correspond to improving fortunes in the CMI Plugs business over the last couple of years.

Key Commodities Prices

Source: ANZ Research, November 2023

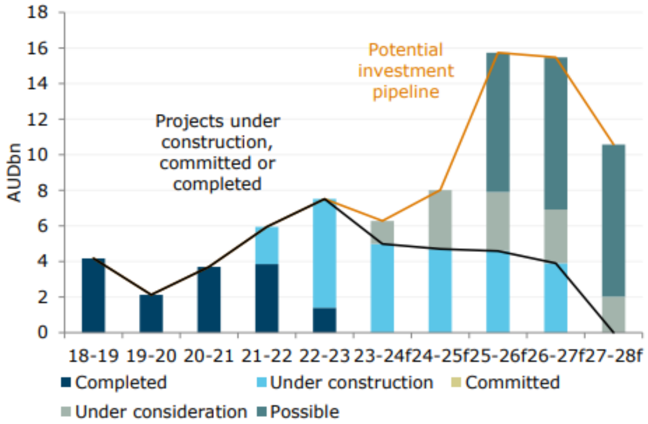
The resources pipeline is diverse and is distributed across companies, commodity types and geography. Key projects include Lithium, Gold, Coal and Gas with a spike of activity proposed from 2025/26. There are also a couple of oil and gas mega projects proposed for commencement in 2025.

Chart: Major Projects Pipeline, Resources



Source: ANZ Research, November 2023

Chart: Major Projects Pipeline, Oil & Gas



Source: ANZ Research, November 2023

Data centre investment is also booming. The proposed development pipeline for data centre capacity dwarfs the current installed base but these figures include two 300MW+ ‘super-sites’ that are currently in the planning stage. Planned investment in data centre capacity is arguably comparable to strong spending years in the resources sector. Gartner estimates total Australian spend on data centre systems surpassed $4.3bn in 2022 and is expected to exceed $4bn again in 2023.

Chart: Australian Data Centre Capacity (MW) Colocation Only

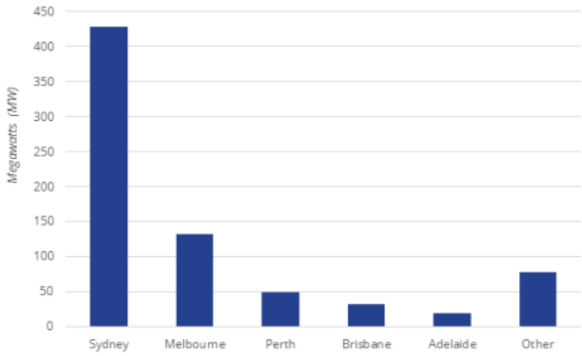
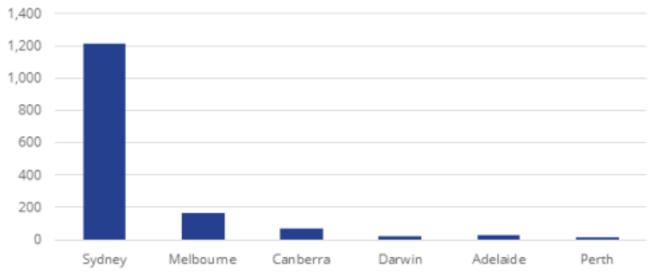


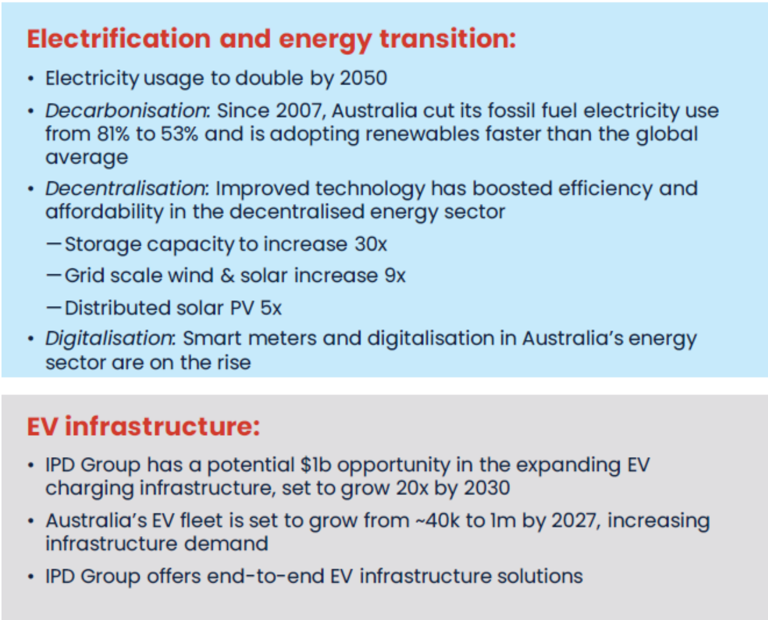
Chart: Australian Data Centre Development Pipeline (MW)



Source: Colliers Data Centre Insight 2023

Energy Transition and Electric Vehicles Tailwind

In presentation materials, IPD highlight the scale of the opportunities that could present as the energy transition gains momentum.



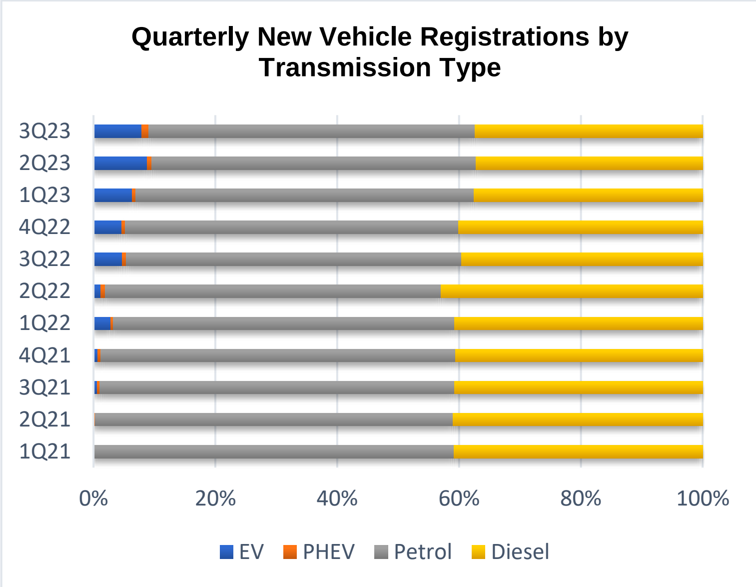
Source: IPD presentation materials

The modernisation of Australia's energy grid, a shift to renewables for generation and the anticipated growth in electricity usage will require billions of dollars of investment in infrastructure, power management and control systems. This investment will also require significant design assistance from services and solutions providers like IPD. We think IPD may consider bolt-ons to expand their product offering and services capabilities for utilities and contractors specialising in renewable generation.

The electrification of Australia's vehicle fleet will also require investment into charging infrastructure and upgrading commercial power management systems. IPD believe this represents a $1bn sales opportunity by 2030, but we suspect they are on the optimistic side with their timing. We think a national services capability will be necessary to capture a large market share and to maintain exclusive product relationships in this field.

There is need to install / refresh electrical equipment in residential and commercial end markets to help managed the increased draw on the grid from electric vehicle (EV) charging equipment. There will also be design and installation opportunities for commercial customers looking to build out charging networks, which in turn could create recurring base of service and maintenance work.

Presently the small, but rapidly growing, EV fleet and relatively high cost of charging systems has led to only a modest investment in EV charging infrastructure in Australia. We would characterise the market as in 'pilot phase' with commercial customers still experimenting with property and hardware strategies on a small scale.



Source: FCAI/VFACTS

EV adoption in Australia has suffered from vehicle supply chain disruptions over the past few years, and right-hand drive variants for popular models arriving later than in other geographies. Currently just under eight per cent of new vehicle deliveries are electric vehicles, amounting to roughly 25,000 EV deliveries per quarter. EV sales share will certainly need to accelerate to meet a projected 1m unit fleet by 2027.

With vehicle supply normalising, we think the commercial fleet sector will drive a rapid uptake of EV's in the coming periods. Commercial fleets have resources, are emissions-sensitive and have an imperative to act. Commercial fleets have largely been unable to replenish vehicle fleets during in the tight supply environment since pandemic onset and are now starting to see orders arrive.

We speculate commercial fleets operators are more likely to install charging infrastructure at their sites and also underwrite third party operated charging infrastructure business models. Ultimately, we think the EV narrative for IPD is more of a medium-term opportunity and the major projects pipeline offers better prospects for sales growth over the next few years.

Financial Discussion

IPD has delivered nearly 40% compounded sales growth since FY20, including bolt-on acquisitions. Excluding bolt-ons we estimate organic sales have doubled in the past three years, including sales transitioned from ABB's direct sales team.

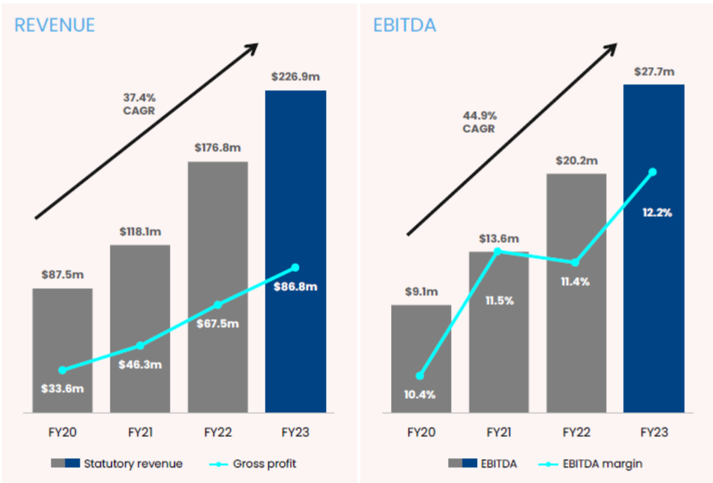
Gross profit margins have been maintained in the 38 – 40 per cent range whilst EBITDA margins have improved by nearly 200 bps from operating leverage.

Price rises have also materially contributed to sales growth. IPD raised prices four times in FY23 compared to typically once per year previously. We observed double-digit price increases in some channels, although this was necessary to pass through increases in cost of goods and freight costs.

Financial conditions over the last couple of years have been unusually favourable, although supply chain conditions have been anything but favourable. Demand has been aided by government policy to urgently fund small-scale and local projects as job stimulus measures in response to the COVID-19 pandemic.

Contractors today are still working through elevated backlogs from this period and the pipeline for new activity is underpinned by major infrastructure projects for the next few years. Large backlogs and rising prices created a level of urgency and price insensitivity over the last eighteen months that has started to moderate. We think this dynamic and general market share gains largely contributed to a series of earnings upgrades for IPD over the past two years.

We see stimulus spending and private investment tailwinds (data centres, electrical grid, electric vehicle infrastructure) supporting healthy activity levels for the foreseeable future. With further sales growth we expect increasing operating leverage, but we also expect some margin benefit will be reinvested into building out sales and services teams.



Source: IPD FY23 Results Presentation

FY24 Outlook and the CMI acquisition

EX Engineering was acquired in early 1H24 and it should contribute >$10m and >$2m of incremental sales and EBITDA. FY24 will also see incremental benefit from price rises instituted part-way through FY23 and new supplier distribution arrangements. A first half trading update in November included underlying 1H24 guidance of:

- EBITDA $16.0 – $16.5m
- EBIT $13.5 – $14.0m

This equates to just over 15 per cent operating profit growth, with scope for acceleration in 2H24 based on major project supply.

The CMI transaction is scheduled to close in January, contributing around five and a half months of sales in FY24. On a pro forma basis, the combined business should surpass $350m revenues in FY24 with EBIT margins approaching 12 per cent. CMI's gross margins are around 10 per cent lower than IPD currently, and we model for the combined group to have GP margins of around 35 per cent. We expect inventory turns will be similar at 3 – 4 times.

Assuming CMI's earnings power can be maintained at >$15m EBIT, it should generate compelling financial returns for IPD shareholders. Funding the transaction included a roughly 20 per cent increase in shares outstanding, but the deal will still be highly EPS accretive. On a pro forma basis EPS accretion is greater than 30 per cent and we expect the combined group before synergies to deliver more than $50m EBITDA in FY25.

Excelsior (CMI's parent company) provided a trading update for the first four months of FY24. Gross and net revenue were flat, but PBT margins increased by around 10%, mostly due to improving GP margins. At current run rate CMI are on track to achieve their full earn out. We think integration and synergy realisation will start in FY25, since the plan is for CMI to remain stand-alone at least until the earn out period is completed.

Balance sheet discussion

IPD's balance sheet comprises mostly working capital, and goodwill after the CMI acquisition. We estimate around $70m of net working capital invested at FY24 year end, including roughly $70m of inventory. Inventory is almost all finished goods, although some offerings involve custom assembly. IPD carried around 6,000 SKUs before the CMI acquisition and debtor days of 60 days are typical.

Since all warehousing is leased, increasing working capital is the main capital cost of growth. Typically, there is around 10 weeks of inventory in transit plus a further 90-100 days in warehouses. It's necessary to carry a deep inventory reserve since lead times often exceed five weeks and some products can't be air freighted.

Ageing inventory is the main balance sheet risk, especially with gearing at only modest levels. Vendor rebates/marketing support are uncommon, so clearance activity will come at the expense of gross margins, if required. Technological obsolescence and rapid product refresh cycles are not a feature of this industry, and we have been told historical inventory write downs have been infrequent and immaterial.

Inventory growth has weighed on cash conversion in the last twelve months but this is consistent with an expanding product range and sales growth. We don't foresee any material risks in the short term, especially with IPD growing market share and stock turns holding at 3 – 4 times.

Annual plant and equipment capex is minor. We model annual capex for the combined IPD/CMI at less than 1% of sales, including capitalised development at CMI. This capital light model has consistently delivered returns on tangible equity above 20% and enabled growth to be funded with retained earnings.

We expect returns on tangible equity will remain attractive after the CMI transaction. We estimate around $30m of debt funding will be required at transaction close. Assuming a 50% dividend payout ratio is maintained, we estimate net debt will be negligible by the end of FY24.

In our view the balance sheet could comfortably support higher gearing if other transaction opportunities were to arise, although the board has imposed a limit of 1X net debt to EBITDA.

Valuation

ASX-listed distributors trade on mid-to-high teens FY25e PE multiples. Peers trading at above-average multiples share similar characteristics including large founder shareholdings, good profitability metrics (ROE/ROIC) and a long-term growth record. IPD arguably also meets these criteria, although its public record is limited to a couple of years either side of the IPO.

We focus on FY25e metrics since that will be the first period with a full contribution from CMI Electrical. IPD trades in line with the median PE multiple of peers and at a 1-point discount on an EV/EBIT and EV/EBITDA basis.

We think IPD's sector exposures and balance sheet are more favourable than the peer set, but we have just been through a couple of years of strong demand and unusual pricing power. It's difficult to assess normalised earnings power, especially given roughly one-third of FY25e EBIT comes from an acquisition which itself has seen profits triple over the past few years.

Peer Comparison

		Mkt Cap	EV	EV / Sales			EV / EBITDA			EV / EBIT			Price / Earnings		
		($m)	($m)	FY23 Act.	FY24 Est.	FY25 Est.	FY23 Act.	FY24 Est.	FY25 Est.	FY23 Act.	FY24 Est.	FY25 Est.	FY23 Act.	FY24 Est.	FY25 Est.
IPG	IPD Group	480	396	1.7x	1.3x	1.0x	16.8x	9.8x	7.5x	16.8x	11.4x	8.5x	29.9x	20.3x	15.4x
REH	Reece	12,810	14,399	1.6x	1.6x	1.6x	15.1x	15.9x	15.4x	21.7x	24.3x	23.6x	37.1x	41.1x	38.2x
ANN	Ansell	3,070	3,576	1.5x	1.4x	1.4x	9.0x	9.4x	8.3x	12.1x	13.2x	11.3x	13.9x	17.2x	14.4x
BLX	Beacon Lighting Group	497	626	2.0x	2.0x	1.8x	7.4x	7.7x	7.0x	11.6x	12.8x	11.5x	18.6x	21.7x	19.1x
DDR	Dicker Data	2,165	2,464	0.8x	0.8x	0.7x	19.3x	16.6x	15.0x	21.4x	18.2x	16.3x	29.6x	26.5x	23.3x
SNL	Supply Network	654	698	2.8x	2.4x	2.1x	14.5x	12.6x	11.4x	17.1x	14.8x	13.3x	25.5x	22.2x	19.8x
BAP	Bapcor	1,857	2,421	1.2x	1.2x	1.1x	9.0x	7.8x	6.7x	14.0x	11.5x	9.5x	17.4x	14.7x	11.6x
GUD	G.U.D. Holdings	1,596	2,118	2.0x	2.1x	2.0x	8.5x	9.2x	8.5x	10.8x	11.3x	10.3x	21.5x	17.8x	15.8x
RDX	Redox	1,244	1,427	1.1x	1.1x	1.0x	10.1x	9.7x	8.8x	10.7x	10.3x	9.3x	15.4x	12.9x	11.7x
GWA	GWA Group	533	702	1.7x	1.7x	1.7x	8.0x	7.6x	7.4x	10.1x	9.8x	9.5x	16.3x	15.9x	14.8x
SXE	Southern Cross Electrical	224	156	0.3x	0.3x	0.3x	3.9x	4.1x	3.8x	5.0x	5.1x	4.7x	11.1x	10.2x	9.4x
Mean				**1.5x**	**1.4x**	**1.3x**	**11.1x**	**10.0x**	**9.1x**	**13.8x**	**13.0x**	**11.6x**	**21.5x**	**20.1x**	**17.6x**
Median				**1.6x**	**1.4x**	**1.4x**	**9.0x**	**9.4x**	**8.3x**	**12.1x**	**11.5x**	**10.3x**	**18.6x**	**17.8x**	**15.4x**

We arrive at a DCF valuation of $5.00 per share applying a 10% discount rate, mid-single-digit organic sales growth beyond FY25, 13.5% EBITDA margins and capex at 1% of sales. This is not materially above the current share price, and the terminal value accounts for around two-thirds of the intrinsic value.

Our twelve-month price-target of $4.80 is calculated as a 50/50 blend of our DCF valuation and 11x FY25e EV/EBIT.

Overall, we believe IPD is fairly valued currently based on discounted future earnings power. Our investment thesis for IPD is built upon the potential for value creation from M&A and we see a long runway of potential opportunities. In our view, optionality from capital management is not currently reflected in the IPD share price. We are betting this option will prove to be lucrative over time.

DCF valuation

PV Calculation w/ EV/EBITDA Exit Multiple	
Projected FY30 EBITDA ($m)	65
Selected TTM Multiple	8.0x
Discount Factor	0.56
Implied Terminal Value	291.89
Sum of Discounted Cash Flows	227.03
Implied Terminal Value	291.89
Total Enterprise Valuation	518.92
Less: Total Debt (FY24e)	(20)
Less: Noncontrolling Interest	
Plus: Cash & ST Investments (FY24e)	21
Total Equity Valuation	520
Implied Value Per Share	**5.03**
Premium to Current Share Price	*8.3%*

Risks

- Supplier/Vendor concentration – We estimate two vendors (ABB and Elsteel) are responsible for >40% of sales. This presents several vendor specific risks including, but not limited to:
    - Product/reputational risks
    - Vendor-specific supply chain issues
    - Performance-related risks (meeting vendor targets, reasonable or otherwise).
    - Changes to contractual relationships including loss of supply or exclusivity.

- Industry Cyclicality – The electrical industry is strongly correlated with commercial and engineering construction activity. We are currently in a period of strong industry profitability. Even for a distribution business model like IPD, which does not take on contractual risk or construction risk, a high fixed cost base can result in material profit erosion during softer sales years.
- Customer concentration – Around 40% of sales are expected to come from electrical wholesalers in FY25. One of these wholesalers is already IPD's largest customer. There are risks that electrical wholesalers can leverage their bargaining power to extract better terms/rebates.
- Regulatory changes – Australia has a strict regulatory framework that requires products and installed systems to adhere to safety standards. Standards and changes to standards can influence the attractiveness and even relevance of IPD's solutions.
- New products have long lead times – Evaluation of new products to market have long lead times. Often there are regulatory and safety concerns which must be addressed before new products are able to be sold.
- Capital allocation risks – In our view, IPD are pursuing an intelligent but also ambitious growth strategy. We expect capital allocation through M&A will be necessary to accomplish long-term growth objectives.

  IPD's track record for executing small acquisitions is excellent, but the CMI transaction is materially larger than previous transactions and IPD are acquiring with earnings near all time highs. There are risks that IPD overpays for the normalised earnings power of acquisitions and/or share issuance to fund transactions proves to be value destructive.

Board of Directors & Key Management Personnel

David Rafter
Independent, Non-executive Chairman
MBA – Charles Sturt University, Master of Design Science (Facilities Management) – University of Sydney

David was appointed as a Director on 14 August 2019. He was previously COE of O'Donnell Griffin and Haden Engineering and held senior leadership positions at Transfield Services and Web FM. David is a member of the AICD.

Chairman of Remuneration and Nomination Committee
Member of the Audit and Risk Committee

Relevant interest in IPD shares: 145k

Andrew Moffat
Independent, Non-executive Director
Bachelor of Business – Curtin University

Andrew was appointed a Director on 24 March 2020. He has more than two decades experience in investment banking, including as a director of Equity Capital markets and Advisory for BNP Paribas Equities. Andrew is also a director of Sports Entertainment Group Ltd, 360 Capital Group Ltd, ICP Funding Pty Ltd and CASL Funder Pty Ltd.
Chairman of Audit and Risk Committee
Member of the Remuneration and Nomination Committee
Relevant interest in IPD shares: 450k

Michael Sainsbury
Executive Director and CEO
Advanced Diploma Business Management – Leadership Management Australia

Michael has over 25 years of experience within the electrical, including more than thirteen years in senior management roles at Schneider Electric. Michael joined IPD in 2013 and has been CEO since 2015.

Relevant interest in IPD shares: 1.25m

Mohamed Yoosuff
Executive Director
Associate of Chartered Institute of Management Accountants (ACMA)

Mohamed joined IPD at inception (in 2005) and held the position of Chief Financial Officer until January 2023. His current position is Director of Strategic Development. Mohamed has held senior positions at Ludowici Group and Otis Elevators.

Relevant interest in IPD shares: 11.25m

Jason Boschetti
Chief Financial Officer
Bachelor of Business (Accounting) Western Sydney University, CPA

Jason was appointed Chief Financial Officer in January 2023. He was previously a senior financial executive at Shriro Australia Pty Ltd.

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