Dialight plc
("Dialight" or "the Group")

Full year results 2020

Dialight plc (LSE: DIA.L), the global leader in sustainable LED lighting for industrial applications, announces its full year audited results for the year ended 31 December 2020.

Financial summary	2020 £m	2019 £m
Revenue	**119.0**	151.0
Loss for the year	**(7.8)**	(16.2)
Statutory EPS – basic	**(24.0p)**	(49.8p)
Net debt[1]	**11.4**	16.5

Key points

- Project revenue significantly reduced but MRO revenue was strong and resulted in market share gains
- Finished goods strategy and essential business status resulted in on-time delivery maintained at 80%, despite supply chain headwinds
- Balance sheet strength improved with inventory unwind of £13.5m and net debt reduced by £5.1m
- Enhanced liquidity from £10.0m of additional bank finance secured with HSBC and UK CLBILS scheme
- Statutory loss of £7.8m reflects lower revenue, includes £6.0m of COVID-19 related costs offset by £5.1m of cost savings
- Increase in quoting activity in 2021; range of profitable outcomes for full year

Fariyal Khanbabi, Group Chief Executive, said:

"Our efforts to embed a proactive safety culture helped play a key role in how we responded to COVID-19, focusing on the safety and wellbeing of our employees. Our agile approach to balance risk mitigation and business continuity, cost control and ensuring liquidity was sufficient to weather this crisis, and I would like to thank the Dialight team for their significant contribution in ensuring employee safety and operations performance during these challenging times.

We are experiencing an increase in quoting activity early in the year and while the Group will continue to be impacted by COVID-19 during 2021 and will take steps to mitigate to the extent possible, we see a range of profitable outcomes for the full year.

Longer term the actions taken during 2020 will help ensure we are strongly positioned to return to significant growth as the pandemic eases, and as a market leader to satisfy the increased structural demand for more environmentally friendly products."

Full year results presentation

A pre-recorded video of the full year 2020 results presentation can be found at:
http://ir.dialight.com/reports-presentations-and-results/results-presentation/
The slides of the full year 2020 results presentation can be found at:
http://ir.dialight.com/reports-presentations-and-results/reports-and-presentations/

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About Dialight:

Dialight (LSE: DIA.L) is a global leader in sustainable LED lighting for industrial applications**.** Dialight's LED products are providing the next generation of lighting solutions that deliver reduced energy consumption and create a safer working environment. Our products are specifically designed to provide superior operational performance, reliability, and durability, reducing energy consumption and ongoing maintenance, and achieving a rapid return on investment.

The company is headquartered in the UK, with operations in the USA, UK, Mexico, Malaysia, Singapore, Australia, Germany and Dubai. To find out more about Dialight, visit www.dialight.com.

Notes:

1. Net debt excludes lease liabilities under IFRS 16
2. Constant currency impact is calculated by re-translating the prior year numbers at the exchange rate prevailing in the current year.
3. Cautionary Statement: This announcement contains certain statements, statistics and projections that are or may be forward-looking. The accuracy and completeness of all such statements, including, without limitation, statements regarding the future financial position, strategy, projected costs, plans and objectives for the management of future operations of Dialight plc and its subsidiaries is not warranted or guaranteed. These statements typically contain words such as 'intends', 'expects', 'anticipated', 'estimates' and words of similar import. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Although Dialight plc believes that the expectations will prove to be correct. There are a number of factors, many of which are beyond the control of Dialight plc, which could cause actual results and developments to differ materially from those expressed or implied by such forward-looking statements. This announcement contains inside information on Dialight plc.

Overview

COVID-19 presented significant and unprecedented challenges to our business. We are proud of the resilience and responsiveness of our team and impressed and grateful for how we, as a business, adapted to the changing demands and obstacles which COVID-19 presented. We would like to publicly recognise the significant contribution made by our employees in a very difficult year. We also wish to offer our deepest sympathies to the families and friends of our colleagues who sadly passed away from COVID-19.

Our strategic approach to the crisis entailed maintaining our sales team and not reducing our finished goods inventory, which enabled us to win back customers and distributors and secure new customer MRO orders. Our operations teams performed well in demanding circumstances, with a relatively resilient supply chain enabling us to deliver strong levels of customer service and maintain our lead times throughout this crisis.

Protecting our people

Dialight has always sought to operate with a high level of on-site safety. During 2020, we enhanced this further and implemented an extensive range of measures to support and ensure our teams safety across our sites. These practical measures include extra screening, reset factory layouts, extra space in amenity areas, reconfigured shift patterns, additional personal protective equipment (‘PPE’) and temperature checking on entry at all our facilities. Dialight is also providing meals and transportation to minimise the pandemic risk to our employees travelling to and from the plants. These actions added to our costs but were critical.

We also worked hard on cultural and behavioural commitments to ensure that everybody across the business is focused on keeping people safe and maintaining strict hygiene protocols. Extensive occupational health supports are in place for our colleagues both working onsite and those who are working from home.

Supplying our customers

Our strong customer relationships are critical to the business and have deepened through the challenges presented by COVID-19. These were allied with lead-times that did not falter thus enabling us to maintain excellent customer service.

We also increased our engagement in a multiple of ways at national, regional and local levels by working closely with our customers and distributors. We provided extensive product training and targeted marketing campaigns focused on key sectors and on promoting the benefits of using our products. This was particularly invaluable given customer site access was restricted. We consider our increasingly close customer relationships to be a differentiator and one that creates long term value.

Protecting our business

Whilst COVID-19 is clearly continuing to impact short term performance, our comprehensive set of actions including supply chain improvements, streamlining our fixed cost base, stronger sales platform and enhanced customer engagement model will ensure we are strongly positioned to return to significant growth as the pandemic eases. Furthermore, our strong pipeline of sustainable and differentiated products put Dialight in a unique position to be able to satisfy the increased longer-term demand for more environmentally friendly products.

Many of these actions have not been easy and have impacted many stakeholders, but all were necessary. The board and executive team took a 20% reduction in salaries, and many of our employees also took salary reductions for five months. In addition, we furloughed certain employees early in the year which regretfully we had to make permanent during Q3 2020. These permanent cost savings position us better to face the ongoing challenges of COVID-19.

We secured substantial liquidity by increasing our committed banking facilities to £35.0 million (from £25.0 million at 31 December 2019). This was achieved through a facility extension with HSBC of £2.0m and accessing £8.0m through the CLBILS UK government loan scheme. In addition, the Group received a waiver on its existing

banking covenants for the June 2020 to June 2021 period. These have been replaced by a new test based on achieving a 12-month rolling EBITDA level derived from a COVID-19 impacted business plan provided to HSBC. The Group ended the year with a reduction in net debt of approximately £5.0m to £11.4m (2019: £16.5m) and was compliant with the revised banking covenant at 31 December 2020.

Full year 2020

Given the challenges of COVID-19 we focused on streamlining our cost base, increasing our liquidity and maintaining on-time delivery to our customers and developing stronger sales and supply chain platforms to accelerate our growth strategy as the markets return. The full year underlying EBIT loss of £6.4m (loss for the year £7.8m), while understandable, was disappointing, especially in the context of the strong momentum that was building across the business in the first quarter of the year. The benefits derived from in-sourcing manufacturing were negated by the reduction in volumes, particularly in the lighting capex markets. Our production cost base is predominately fixed and, whilst we were able to meet our customers on-time delivery requirements, our fixed cost per unit increased due to the lower volumes. The main driver to return to profitability will be revenue growth and realising our productivity and cost saving initiatives.

Overall group revenues in 2020 were 21% lower than the prior year. In 2019 Lighting revenue comprised of 60% project work and 40% maintenance work (MRO). With the onset of COVID-19 at the end of Q1, project work largely disappeared as many companies deferred capex projects to conserve cash. Positively, we were able to significantly increase our MRO business thereby winning back market share.

The Lighting segment saw the largest impact from the COVID-19 related disruption to end markets with total orders 22% lower year on year. The relative resilience of the MRO business resulted in orders being down 24% in the US despite new capex projects being adversely affected by circa 74% decline. The EMEA business was significantly impacted by the strict lockdowns in Europe resulting in order intake being 24% lower than the previous year.

Australia has a good combination of MRO and project business and it had a good year with orders up 8% over 2019. It went into lockdown early and re-opened earlier than some other markets. We had some good success in securing project orders that were deferred in 2019 and the launch of the new bulkhead product also generated new demand in the mining sector. Asia had some large project orders in the prior year which they were unable to repeat due to lockdowns and this resulted in a 53% reduction in orders.

Signals and Components performed well during 2020 with an increase in orders of 7% year on year. The resilience of the business is due to the diversity of products sold and of the range of end markets served. The opto-electronics part of the business performed strongly, mainly as a result of supplying parts to the medical and telecoms market. In addition, many municipalities in the US took the opportunity of reduced road traffic to upgrade traffic light systems. At the same time, vehicle manufacturing was greatly reduced as bus replacement programmes were put on hold. The strength of the division is that the other product lines were able to compensate for this.

Operationally we made significant progress with on-time delivery at 80% and lead times at pre-COVID-19 levels, despite the disruption of facility closures during April and May until we received "essential business" status. We were able to execute on our comprehensive plan to drive down inventory which ended the year £13.5m lower than at the start of the year. This was achieved through significant improvements to the supply chain and by focusing on localising sourcing. We successfully negotiated with our largest suppliers on enhanced terms and continue to focus on cost reductions. We did experience some challenges relating to our critical suppliers and logistical issues caused by COVID-19, and despite proactive actions to reduce this we expect some ongoing impact in 2021.

Dialight is a technology company and our technology-enriched products are our biggest differentiation. At the start of the pandemic, we paused our new product development in order to conserve cash. However, we were

able to restart a number of projects as conditions stabilised. We are focused on preserving this strength going forward with our many years of product and domain knowledge hard to replicate in the short to medium term. We have restructured key projects that are critical in maintaining our leading technology position and filling our portfolio gaps in the industrial space.

We launched a new Vigilant bulkhead for the APAC and EMEA markets, which offers significant improvement in performance by utilising our new power supply and thermal management system. We also launched a new universal mounting adapter for our area light which offers significant flexibility in a variety of industrial applications. Our latest product launch is an upgraded version of our 60k high bay which is designed to operate at higher ceiling heights and in high ambient temperatures.

Strategy

Dialight's core strengths center around our products which have a long history of innovation within the industrial lighting markets. Our products focus on the real needs of our customers to enhance safety and reduce energy costs and going forward the critical objective of the transition to net zero carbon.

Dialight products provide the best cost of ownership to industrial customers with paybacks based on energy savings and maintenance cost avoidance. Our in-house custom designed power supply is the key to our market leading 10-year warranty and field reliability. Our optimised optics ensure improved light illumination providing uniformity and quality plus enabling our customers to use fewer lights to illuminate the target area. Their integrated design significantly reduces the burden of installation and maintenance. Our products have the ability to withstand extreme environmental conditions such as very high or low temperatures, humidity, high vibration and corrosive environments. The addition of sensors and controls brings an additional element to the value proposition for our customers.

Our primary goal is to accelerate growth across our global industrial markets. We believe that the combination of our products, strong ESG credentials, people and culture differentiates us from our peers. Our growth strategy is focused on three key objectives. First, to protect and grow within our core heavy and harsh industrial markets which has LED conversion rates below 10% offering Dialight a significant conversion growth opportunity. Dialight has a leading position within this space and combined with the strength of our highly qualified sales team we will continue to expand our reach within this space.

Second, we believe that sustainability will be a major driver in the conversion to LED and this will be accelerated post COVID-19. Therefore, we are building a strategic accounts team focused on expanding our market reach, leveraging corporate ESG goals and our differentiated products. We also continue to develop new routes to market. In order for us to increase our customer reach we need to expand our sales channel. This not only means increasing the number of distributors but also developing a three-pronged approach to getting to the end customer. This consists of targeting the EPC/engineering firms and electrical contractors. The drive to a more digital platform for selling has already started internally. We are working on strengthening our branding, and focusing on vertical market applications. These initiatives are key to securing larger sized orders and multi roll out lighting upgrades.

Third, we continue to lead the market in innovation so we can widen our market leading position. This will also include filling portfolio gaps we have so we remain strategically relevant to our customers. The next generation of technology is heavily focused on building on the sustainability needs of our customers with the goal to have the first fully recyclable product.

Our continued investment in technology is based on a deep analysis of the attractiveness of the market balanced against Dialight's ability to win. The premise of our product roadmap is based on achieving four core objectives:

- Reducing payback
- Expanding operating limits
- Value added offering
- Expanding the market

By retaining our focus on innovation, we can extend our long-term advantage. The timelines for developing new products, and our ability to quickly react to market requirements will increase our innovation lead in the market as we continue to develop advancements. Although our customers may be limiting their spending now, demand for new and innovative products will increase once the global economy begins to recover.

Our supply chain remains the single biggest factor in ensuring the Group has market-leading lead-times. Our high number of SKUs and reliance on long lead time components creates challenges in the supply chain. We have made good progress in negotiating new credit terms with our supplier base and refining our forecasting, improving the way we manage our supply chain. This, coupled with a controlled dual sourcing strategy, will be key to leveraging price reductions. Our vendor managed inventory and consignment stock plans will remain central to our strategy going forward and we will continue with more local sourcing; as border closures during this crisis have highlighted the need for a more localised approach.

We also aim to reduce inventory levels further; reduce costs by improving operational efficiency; and develop a more flexible cost structure with more of our costs being variable. This will enable us to flex up or down dependent on demand.

Purpose and sustainability

Organisational purpose is incredibly powerful when it brings together strategy and culture. At Dialight we are passionate about playing our part in building a fairer and more resilient world for generations to come. We have a real opportunity to draw on the lessons learnt from COVID-19 to do this successfully.

Underpinning this purpose is the transition to net zero carbon which is both an opportunity and an obligation for Dialight. Our products help enable our customers achieve net zero. We are committed to working to achieve their goals. Dialight itself commits to being a net zero business by 2040. We will engage with the Science Based Targets Initiative to set appropriate interim targets and report them. We also commit to reporting under CDP and the Task Force on Climate-related Financial Disclosures protocols.

In addition, we are making a set of commitments across our business. First, and we believe most importantly, we are going to provide more opportunity for our employees to become shareholders in the Company.

Second, we will increase the level of training and development for everyone who works for Dialight. Every salaried colleague who works for us will get a personal development plan.

Third, we will further enhance the quality of our products through innovation. We will also increase our use of technology in manufacturing and distribution.

Fourth, building on the success of the Dialight Foundation, we will bring our business to life in the communities we work in. Every site in Dialight will develop a community engagement plan.

Lastly, we are going to drive our sustainability initiatives across all aspects of our business. One of our targets is to develop and bring to market the first fully recyclable industrial lighting product.

Full year guidance for 2021

We are experiencing an increase in quoting activity early in the year and while the Group will continue to be impacted by COVID-19 during 2021 and will take steps to mitigate to the extent possible, we see a range of profitable outcomes for the full year.

Longer term the actions taken during 2020 will help ensure we are strongly positioned to return to significant growth as the pandemic eases, and as a market leader to satisfy the increased structural demand for more environmentally friendly products.

FINANCIAL REVIEW

COVID-19 brought many challenges outside our control but we focused on those we could influence; the cost base, liquidity and delivering orders on time and here there were notable successes. The benefit from fully insourcing sub-assembly production in 2019 was clearly evident as we were able to adapt quickly to production challenges.

Whilst overall Group revenue was 21% lower than the prior year at £119.0m, it is important to look at the revenue streams to understand the drivers behind this. In 2019, Lighting revenue was comprised of 60% project work and 40% maintenance work (MRO). When end markets were impacted by COVID-19, at the end of Q1, project work was largely stopped by most companies who deferred capex projects in order to conserve cash. However, encouragingly the MRO business increased significantly due to:

- Evidence that certain competitors were unable to maintain supply due to supply chain issues
- Dialight factories gaining essential business status which minimised closure time
- The decision to hold finished goods inventory, particularly in Tijuana, enabling us to continue serving our customers

By regaining a more significant portion of the available MRO market, Dialight recaptured the repeat business that we lost a few years ago and it also demonstrated to the market that Dialight can deliver products on-time, even in difficult times.

Signals and Components orders were 7% ahead year on year and only disruptions in our supply chain prevented us from delivering revenue growth. Despite reported revenue down 6%, we go into 2021 with a healthy backlog.

Operations performed well in 2020. Despite the disruption from factory closures, social distancing on the production lines and supply chains being erratic, the overall level of on-time delivery was maintained at 80% (same as 2019) and inventory reduced by £13.5m.

There was a very intense focus on cash conservation and liquidity. At the end of the year, despite the reduction in revenue, the Group had reduced its net debt by £5.1m to £11.4m.

The loss for the year was £7.8m (2019: £16.2m) and the underlying EBIT loss was £6.4m compared to an underlying EBIT loss of £5.0m in 2019.

The underlying EBIT bridge for the year-on-year movement is as follows:

Underlying EBIT bridge	**£m**
Underlying EBIT loss 2019	**(5.0)**
EBIT impact of reduced revenue	**(6.2)**
Gross margin improvement due to in-sourcing	**5.7**
Covid-19 margin impact	**(6.0)**
Reduced SG&A costs	**5.1**
Underlying EBIT loss 2020	**(6.4)**

We estimate that the reduction in revenue impacted underlying EBIT by £6.2m. Gross margin for the Group was 28.6% which is slightly below the margin of 29.1% in the prior year. The benefits that we should have seen from the elimination of the premiums paid for outsourced sub-component costs in 2019 was £5.7m but this has been offset by the COVID-19 impact on gross profit. The impact of lost revenue was partly offset by SG&A savings of £5.1m from significantly reduced travel, by the field-based Lighting salesforce, and headcount savings as a result of salary reductions, furloughs and redundancies.

COVID-19 margin impact

The estimated margin impact of COVID-19 can be divided into several categories and can be summarised as follows:

	2020 £m
Facility and labour costs while factories closed	1.5
Fixed costs allocated over smaller production volume	4.1
Additional PPE	0.4
Total	**6.0**

Our Malaysian factory was closed for six weeks and our Mexican facility was closed for three weeks. During this time, we were required to pay all staff and incur the fixed costs of these production facilities. We also have 200 employees classified as vulnerable under Mexico guidelines. This group were protected due to underlying health issues and their salaries continued to be paid.

Once we re-opened our facilities, there were restrictions on the number of staff permitted per shift. The production volumes in the facilities (Q2 to Q4) were 36% lower than in 2019 whereas the fixed production costs were largely similar. Whilst we could meet on-time-delivery requirements, it was at the expense of the cost per unit and we estimate this impact on gross margin at £4.1m. There were also additional costs of £0.4m for enhanced sanitisation, protective equipment and staff transportation to reduce the risk of contracting the virus.

Currency impact

Our major trading currency is the US Dollar (84% of revenue) due to size of our US business and the use of USD as a contract currency elsewhere in the world. The Group reports its results in Sterling and this gives rise to translational exposures on the consolidation of overseas results. Transactional exposure is where the currency of sales or purchases differ from the local functional currency. We use natural hedging on revenue and purchases to mitigate the majority of the currency risk and forward contracts on a currency specific basis.

The average US dollar rate against Sterling has been flat year on year at 1.28 so there is virtually no currency impact in the Income Statement. We have seen some volatility in the year-end spot rate with the US Dollar weakening by 3% against the rate at December 2019. Based on the current mix of currencies and expected level of activity, a 1% movement in the US dollar relative to Sterling changes annual revenue by £1.0m and has no impact on underlying EBIT.

Lighting segment

Lighting	2020 £m	2019 £m	Variance
Revenue	81.7	111.5	(27%)
Gross profit	23.7	31.3	(24%)
Gross profit %	29%	28%	+100bps
Overheads	(26.8)	(34.5)	+22%
Underlying EBIT loss	**(3.1)**	(3.2)	+3%

The Lighting segment saw the largest impact from COVID-19 related disruption to end markets. In the prior year it represented 74% of the Group's revenue but that fell to 69% in the current year. The impact of COVID-19 was seen in most of our geographies.

The Lighting business consists of two main revenue streams, large retrofit projects and on-going maintenance (MRO) spend. In the US, we had close to zero project orders after Q1 but we saw an improvement in our MRO business supported by the finished goods inventory available in our distribution centre in Tijuana, Mexico, which enabled us to fulfill orders even when the factory was closed. Overall revenue in the US was down by 28% compared to the prior year as a result of capital projects being deferred. However, regaining a larger share of the MRO market is a very important demonstration that our operational issues are behind us.

The EMEA business was significantly impacted by lockdowns in Europe resulting in revenue being 31% lower than the previous year.

Australia has a good combination of MRO and project business and it had a positive year with revenue up 5% over 2019. It went into lockdown early and it re-opened earlier than some other markets. We saw the benefit from some project expenditure deferred in 2019 turning into revenue in the year and the launch of the new bulkhead product also generated new demand in the mining sector. Asia had some large project revenue in the prior year which we were unable to repeat due to lockdowns and this resulted in a 45% reduction in revenue.

There was a 100bps improvement in gross margin year on year to 29%. The benefits of the elimination of insourcing costs incurred in the prior year were offset by the impact of COVID-19 on production volumes which increased the unit costs.

Overheads were £7.7m lower than prior year due to a combination of lower revenue related costs, lower travel costs, salary reductions and furloughs. The majority of Group savings in travel were in the Lighting division as we utilise a large field-based sales force.

Signals and Components

Signals and Components	2020 £m	2019 £m	Variance
Revenue	**37.3**	**39.5**	(6%)
Gross profit	**10.3**	**12.6**	(18%)
Gross profit %	**27%**	**32%**	-500bps
Overheads	**(7.7)**	**(8.3)**	7%
Underlying EBIT	**2.6**	**4.3**	(40%)

Signals and Components is a high-volume business operating within highly competitive markets. There are three main elements to this business: traffic lights, opto-electronic (OE) components and vehicle lights.

This division performed well during 2020 with revenue only 6% lower than the previous year despite order intake growth. This was reflective of the impact of supply chain disruptions as some of our suppliers' factories were unable to operate at full capacity. The mix of revenue within the division was more heavily weighted to the lower margin traffic products and that reduced the overall margin by 500 bps. There were overheads reductions of £0.6m, resulting in an underlying EBIT profit of £2.6m for the year.

Central overheads

Central overheads are comprised of costs not directly attributable to a segment. These not allocated to the segments. In the year, they were £5.9m, a reduction of £0.2m due to reduced travel and COVID-19 related salary reductions by the Board and senior managers.

Non underlying costs

In the current year, we removed the impact of items that in the judgement of the Directors, are separately disclosed due to their nature and value to allow the reader to obtain a proper understanding of the financial information and the best indication of the underlying performance of the Group. These can be summarised as follows:

Non-underlying costs	2020 £m	2019 £m
Redundancy costs	**0.9**	**1.1**
Litigation costs	**0.7**	**-**
Loss on disposal of subsidiary	**0.8**	**2.5**
Write off receivable from outsourced manufacturer	**-**	**2.7**
Total	**2.4**	**6.3**
Cash impact	**1.3**	**1.6**

In the current year, the reduction in revenue required a review of the cost base to ensure that it was right-sized in case of prolonged COVID-19 impacts and this resulted in redundancy costs of £0.9m. We incurred litigation

costs of £0.7m related to potential claims for and against the Group. The Group disposed of its Brazilian subsidiary (75% owned Joint Venture) through a management buy-out by the minority shareholder who will revert to being a distributor of Dialight products in the region. This gave rise to a loss on sale of £0.8m.

In the prior year, there were redundancy costs of £1.1m related to various initiatives during the year to improve the performance of the business. The Group disposed of its Wind business in Denmark in September 2019 at a loss of £2.5m. We impaired a receivable balance of £2.7m with our former outsource manufacturer due to GAAP compliance rather than invalidity of the legal claim.

Inventory

We set a target of reducing inventory from £46m at the end of 2019 to £38 - £40m by the end of 2020. The actual reduction was even better than this with closing inventory of £32.2m.

Inventory (excluding spare parts)	2020 £m	2019 £m
Raw materials and sub-assemblies	19.6	28.5
Finished goods	12.6	17.2
	32.2	45.7

The main reasons for the reduction were:

- Better supplier management with the use of more Vendor Managed Inventory programmes and partnering initiatives
- We slowed R&D at the start of Q2 2020 as part of the cash conservation programme and this enabled us to focus our engineering team on inventory projects. The focus was to consume raw materials that we already had on-hand by using them as alternates to those in the original specification, as long as it did not compromise the safety and integrity of the fixtures
- We started to reap the benefit of having sub-assembly production in-house as this enabled more just-in-time production and reduced the level of sub-assemblies on hand
- The resurgence in the MRO business with fast delivery times resulted in faster turns on finished goods and reduced the quantities on hand

Cash and borrowings

The Group ended the year with net debt of £11.4m, a reduction of £5.1m from December 2019. Net debt excludes lease liabilities related to the adoption of IFRS 16 Leases (this is consistent with the basis of covenant testing). The roll forward of net debt was as follows:

Net Debt	£m	£m
Opening balance 01 January 2020		(16.5)
Inflows		
Underlying EBITDA	0.1	
Reduction in inventory	12.6	
Tax refund	2.9	15.6
Outflows		
Net working capital excluding inventory	(3.6)	
Investment in new products*	(3.7)	
Maintenance capex/other	(1.1)	
Non underlying costs	(1.3)	
FX	(0.8)	(10.5)
Closing balance at 31 December 2020		(11.4)

* includes software

The major factors for the reduction of net debt are:

- The reduction of inventory
- Utilising tax losses from 2019 to reclaim corporation tax and also using the COVID-19 stimulus incentive in the US to reclaim corporate taxes going back to 2014
- Reducing the outflows of cash through:
  - Furlough of administrative staff in the UK and US – many of which were made redundant
  - Salary reductions across the Group ranging from 5% to 20%
  - Reduced level of capital expenditure which was originally planned at c.£6m but ended less than £5m – including product development
  - Increased credit terms with key suppliers

Banking

The Group has its banking relationships with HSBC Bank plc and Wells Fargo. The Group's revolving credit facility with HSBC of £25m was re-negotiated in February 2020 and runs to February 2023. In order to ensure greater liquidity should the need arise, the Group increased its banking facility with HSBC on 15 June 2020 by adding a further £10m facility on a 3-year basis, utilising a combination of £8m under the COVID-19 Large Business Interruption Scheme (CLBILS) and a £2m commercial loan. The £10m additional facilities are repayable over 30 months, in equal installments, commencing January 2021. The Group has £35m of available funds across both facilities and £5.3m of cash on hand at the balance sheet date.

Covenants

As part of the additional £10m funding arrangement, the Group's existing banking covenants based on leverage and interest cover have been waived for the periods June 2020 to June 2021 inclusive. These have been replaced by a new test based on exceeding a 12-month rolling EBITDA level derived from a COVID-19 impacted business plan provided to HSBC. The Group was compliant with its revised banking covenant at 31 December 2020.

Tax

Based on a loss before tax of £10.1m in the year, the effective tax rate of 23% results in a tax credit of £2.3m. There was an unforeseen benefit in the year as the Cares Act in the US allowed us to reclaim £1.3m in tax but this only had a small impact on the effective tax rate due to UK trading losses for which we are not recognising a deferred tax asset.

In the year we received £2.9m in corporation tax reclaims:

- We used the stimulus package under the Cares Act in the US which allows us to get tax relief by carrying back losses made in 2018 and 2019 for 5 years. This enables us to benefit from tax recovery at 35% rather than the current rate of 21% which gave rise to a one-off tax credit of £1.3m
- We received repayments of taxes in the US and Australia of £1.6m based on prior year losses

Pension costs

The Group has two defined benefit schemes that are closed to new entrants. The aggregate surplus on both schemes is £1.1m, a reduction of £1.2m from 31 December 2019. The reduction is due to changes in the discount on future liabilities which increases the expected liability at the same time as the value of assets has been largely unchanged. The cash cost of the scheme in 2020 was £0.1m, a reduction of £0.4m from 2019. The Group agreed a payment holiday for six months with the pension trustees as part of its COVID-19 related cash conservation measures. Negotiations on the contribution levels as part of the triennial valuation were also concluded and the annual cash cost will be £0.4m going forward compared to £0.5m in 2019.

Brexit

The sales to the European market only account for 8% of Group revenue. The finished goods to fulfil these sales are imported from our Mexico or Malaysia manufacturing plants to our distribution centre in the UK. With the end of the Brexit transition period, there have been some administrative challenges as the logistics industry assimilates the new rules into their working practices. We will continue to monitor the impact on our lead times and whether we need to re-locate our distribution centre to mainland Europe in the future.

Capital management and dividend

The Board's policy is to have a strong capital base in order to maintain customer, investor and creditor confidence and to sustain future development of the business. The Board considers consolidated total equity as capital. At 31 December 2020 this equated to £57.3m (2019: £67.8m).

The emphasis in 2020 has been on cash conservation and preserving liquidity. Under the terms of the CLBILS scheme, distributions are not permitted while there is debt outstanding under the scheme. Therefore, the Board is not proposing a final dividend payment for 2020 (2019: nil). The Group has a clear capital allocation discipline and is committed to returning excess funds to shareholders via future dividend or share repurchase, subject to any restrictions under the CLBILS scheme.

CONDENSED CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2020

	Note	2020 £'m	2019 £'m
Revenue	2	**119.0**	151.0
Cost of sales	3	**(85.0)**	(107.1)
Gross profit		**34.0**	43.9
Distribution costs		**(20.8)**	(27.2)
Administrative expenses	3	**(22.0)**	(28.0)
Loss from operating activities		**(8.8)**	(11.3)
Underlying loss from operating activities	3	**(6.4)**	(5.0)
Non-underlying items	3	**(2.4)**	(6.3)
Loss from Operating activities		**(8.8)**	(11.3)
Financial expense	4	**(1.3)**	(1.2)
Loss before tax		**(10.1)**	(12.5)
Income tax credit/(expense)	5	**2.3**	(3.7)
Loss for the year		**(7.8)**	(16.2)
Loss for the period attributable to:			
Equity owners of the Company		**(7.9)**	(16.1)
Non-controlling Interests		**0.1**	(0.1)
Loss for the period		**(7.8)**	(16.2)
Loss per share			
Basic	6	**(24.0p)**	(49.8p)

The accompanying notes are extracted from the financial statements.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2020

	Note	2020 £'m	2019 £'m
Other comprehensive expense			
Items that may be reclassified subsequently to profit and loss			
Exchange differences on translation of foreign operations		**(1.8)**	(2.6)
Income tax on exchange difference on translation of foreign operations		**(0.3)**	(0.1)
		(2.1)	(2.7)
Items that will not be reclassified subsequently to profit and loss			
Remeasurement of defined benefit pension liability		**(1.3)**	1.6
Income tax on remeasurement of defined benefit pension liability	5	**0.3**	(0.3)
		(1.0)	1.3
Other comprehensive expense for the year, net of tax		**(3.1)**	(1.4)
Loss for the year		**(7.8)**	(16.2)
Total comprehensive expense for the year		**(10.9)**	(17.6)
Attributable to:			
- Owners of the parent		**(11.0)**	(17.5)
- Non-controlling interest		**0.1**	(0.1)
Total comprehensive expense for the year		**(10.9)**	(17.6)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2020

	Share capital	Merger reserve	Translation reserve	Capital redemption reserve	Retained earnings	**Total**	Non-controlling interests	**Total Equity**
	£'m	£'m	£'m	£'m	£'m	**£'m**	£'m	**£'m**
Balance at 1 January 2020	0.6	0.5	11.6	2.2	52.6	**67.5**	0.3	**67.8**
Loss for the year	-	-	-	-	(7.9)	**(7.9)**	0.1	**(7.8)**
Other comprehensive (expense)/income:								
Foreign exchange translation differences, net of taxes	-	-	(2.1)	-	-	**(2.1)**	-	**(2.1)**
Disposal of Subsidiary	-	-	(0.2)	-	0.2	**-**	-	**-**
Remeasurement of defined benefit pension liability, net of taxes	-	-	-	-	(1.0)	**(1.0)**	-	**(1.0)**
Total other comprehensive expense	-	-	(2.3)	-	(0.8)	**(3.1)**	-	**(3.1)**
Total comprehensive (expense)/income for the year	-	-	(2.3)	-	(8.7)	**(11.0)**	0.1	**(10.9)**
Transactions with owners, recorded directly in equity:								
Share-based payments	-	-	-	-	0.4	**0.4**	-	**0.4**
Total transactions with owners	-	-	-	-	0.4	**0.4**	-	**0.4**
Balance at 31 December 2020	0.6	0.5	9.3	2.2	44.3	**56.9**	0.4	**57.3**

	Share capital	Merger reserve	Translation reserve	Capital redemption reserve	Retained earnings	Total	Non-controlling interests	Total Equity
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Balance at 1 January 2019	0.6	1.4	14.3	2.2	66.2	84.7	0.4	85.1
Loss for the year	-	-	-	-	(16.1)	(16.1)	(0.1)	(16.2)
Other comprehensive income/(expense):								
Foreign exchange translation differences, net of taxes	-	-	(2.7)	-	-	(2.7)	-	(2.7)
Remeasurement of defined benefit pension liability, net of taxes	-	-	-	-	1.3	1.3	-	1.3
Total other comprehensive income/(expense)	-	-	(2.7)	-	1.3	(1.4)	-	(1.4)
Total comprehensive (expense)/income for the year	-	-	(2.7)	-	(14.8)	(17.5)	(0.1)	(17.6)
Transfer of merger reserve on disposal of business	-	(0.9)	-	-	0.9	-	-	-
Transactions with owners, recorded directly in equity:								
Share–based payments	-	-	-	-	0.3	0.3	-	0.3
Total transactions with owners	-	(0.9)	-	-	1.2	0.3	-	0.3
Balance at 31 December 2019	0.6	0.5	11.6	2.2	52.6	67.5	0.3	67.8

CONSOLIDATED STATEMENT OF TOTAL FINANCIAL POSITION

As at 31 December 2020

	Notes	2020 £'m	2019 £'m
Assets			
Property, plant and equipment		**12.8**	15.6
Right of use assets		**9.8**	12.2
Intangible assets		**21.2**	21.3
Deferred tax asset		**1.4**	1.7
Employee Benefits		**1.1**	2.3
Other Receivables		**5.0**	4.7
Total non-current assets		**51.3**	57.8
Inventories		**32.5**	46.1
Trade and other receivables		**19.9**	23.8
Income tax recoverable		**1.0**	1.1
Cash and cash equivalents	9	**5.3**	0.5
Total current assets		**58.7**	71.5
Total assets		**110.0**	129.3
Liabilities			
Trade and other payables		**(21.5)**	(28.4)
Provisions		**(1.5)**	(0.9)
Tax liabilities		**(1.5)**	(1.5)
Lease liabilities		**(1.4)**	(1.6)
Borrowings	10	**(4.0)**	-
Total current liabilities		**(29.9)**	(32.4)
Provisions	7	**(1.2)**	(1.4)
Borrowings	10	**(12.7)**	(17.0)
Lease liabilities		**(8.9)**	(10.7)
Total non-current liabilities		**(22.8)**	(29.1)
Total liabilities		**(52.7)**	(61.5)
Net assets		**57.3**	67.8
Equity			
Issued share capital		**0.6**	0.6
Merger reserve		**0.5**	0.5
Other reserves		**11.5**	13.8
Retained earnings		**44.3**	52.6
		56.9	67.5
Non-controlling interests		**0.4**	0.3
Total equity		**57.3**	67.8

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2020

	Notes	2020 £'m	2019 £'m
Operating activities			
Loss for the year		**(7.8)**	(16.2)
Adjustments for:			
Financial expense	4	**1.3**	1.2
Income tax (credit) /expense	5	**(2.3)**	3.7
Share-based payments		**0.4**	0.3
Depreciation of property, plant and equipment		**3.1**	2.6
Depreciation of right of use assets		**2.0**	1.7
Amortisation of intangible assets		**3.0**	2.0
Loss on disposal of property, plant and equipment		**-**	0.1
Impairment losses on intangible assets		**0.3**	-
Loss on disposal of business	3	**1.1**	1.7
Operating cash flow before movements in working capital		**1.1**	(2.9)
Decrease/(Increase) in inventories		**12.6**	(1.9)
Decrease in trade and other receivables		**2.7**	8.8
Decrease in trade and other payables		**(6.3)**	(0.3)
Increase in provisions	7	**0.5**	0.3
Pension contributions in excess of the income statement charge		**(0.1)**	(0.5)
Cash generated by operations		**10.5**	3.5
Income taxes received/(paid)		**2.9**	(0.6)
Interest paid[2]	4	**(1.3)**	(1.1)
Net cash generated by operations		**12.1**	1.8
Investing activities			
Capital expenditure		**(0.8)**	(6.8)
Capitalised expenditure on development		**(3.4)**	(6.0)
Purchase of software and licenses		**(0.3)**	(0.3)
Cash and cash equivalents in business disposed of		**-**	(0.5)
Disposal of business		**-**	(0.5)
Net cash used in investing activities		**(4.5)**	(14.1)
Financing activities			
Drawdown of bank facility	10	**10.0**	11.9
Repayment of bank facility	10	**(10.3)**	-
Repayment of lease liabilities[1]		**(1.7)**	(1.2)
Net cash (outflow)/ generated from financing activities		**(2.0)**	10.7
Net increase/(decrease) in cash and cash equivalents		**5.6**	(1.6)
Cash and cash equivalents at beginning of year	9	**0.5**	2.2
Effect of exchange rates		**(0.8)**	(0.1)
Cash and cash equivalents at end of year	9	**5.3**	0.5

The Group has classified:

1. cash payments for the principal portion of lease payments as financing activities;
2. cash payments for the interest portion of lease payments as operating activities consistent with the presentation of interest payments chosen by the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31 December 2020 (Audited)

1. Basis of preparation and principal accounting policies

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006 and International Financial Reporting Standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union.

The financial information for the year ended 31 December 2019 and 2020 is derived from the statutory accounts for 2019 (which has been delivered to the Registrar of Companies) and 2020 (which will be delivered to the Registrar of Companies following the AGM in May 2021). The auditors have reported on the 2019 and 2020 accounts; their report was unqualified and did not contain a statement under Sections 498(2) or 498(3) of the Companies Act 2006. For the statutory accounts of 2019, the auditor's report included a reference to going concern to which the auditor drew attention by way of emphasis of matter without qualifying their report. For the statutory accounts of 2020, the auditor's report does not include any audit emphasis of matter.

Whilst the financial information included in this statement has been compiled in accordance with the recognition and measurement principles of applicable IFRS, this statement does not itself contain sufficient information to comply with IFRS. Full Financial Statements that comply with IFRS are included in the 2020 Annual Report; these will be available to shareholders via the group website in March 2021.

(b) Consolidated basis of preparation

The uncertainty as to the future impact on the financial performance and cash flows of the Group as a result of the ongoing COVID-19 pandemic has been considered as part of the Group's adoption of the going concern basis in the preparation of the consolidated financial statements. The consolidated financial statements are prepared on a going concern basis which the Directors believe to be appropriate for the reasons stated below.

The Group's current £25m revolving credit facility with HSBC which matures in February 2023 has an option for two consecutive one-year extensions, with the approval of the bank. In order to ensure the availability of sufficient liquidity, the Group increased its banking facility with HSBC on 15 June by adding a further £10m facility on a 3-year basis by utilising a combination of £8m under the COVID-19 Large Business Interruption Scheme (CLBILS) and a £2m commercial loan. This new facility is in addition to the existing banking facility with HSBC of £25m. The Group now has access to £35m of banking facilities and has drawn £16.7m against both facilities as at 31 December 2020, with a net debt headroom of £18.3m and cash on hand of £5.3m. At the date of approving these consolidated financial statements the funding position of the Group has remained unchanged and the cash position is not materially different.

The £25m revolving credit facility term loan runs up till February 2023 whilst the £10m loan will be repaid in equal installments starting on the 15th January 2021.

As part of the new facility, the original banking covenants of net debt to EBITDA ratio and interest cover have been replaced by a new test based on exceeding a 12-month rolling EBITDA level that was derived from a COVID-impacted business plan as agreed with HSBC, for the testing periods of June 2020 to June 2021. The Group is compliant with its revised banking covenant as at 31 December 2020.

1.Basis of preparation and principal accounting policies (continued)

Covenant test		For Q3-21	For Q4-21 onwards
Ratio	**Calculation**	**Threshold**	**Threshold**
Leverage ratio	Net debt/Adjusted EBITDA	<3.5x	<3.0x
Interest cover	Adjusted EBITDA/Interest expense	>4.0x	>4.0x

In assessing going concern, the Directors have prepared various scenarios incorporating the continuing impact of COVID-19 based disruptions. These include the extent and financial impact of new government restrictions on our operations in the countries where we operate, a potential time period of these disruptions and the timescale to recover from them. In addition, we have also considered the mitigating actions that can be taken to reduce the impact on the Group. We have modelled future financial performance taking into account these restrictions, mitigations, expected inventory unwind not materialising and a negative outcome from ongoing litigation as per note 14.

In the base case scenario, consistent with current trading patterns, our factories which have been granted "essential business" status will remain in operation albeit with reduced capacity in line with local guidelines with a gradual recovery. In this scenario, the Directors consider that the Group will continue to operate within its available committed facilities with sufficient headroom and meet its financial covenant obligations.

In a severe but plausible downside scenario, the Directors have assumed a significant adverse development from a global pandemic, the associated forecast outturns alongside identified downside risks, having considered the following:

1. Revenue recovery is delayed by one year, with 2021 achieving 0% growth and recovery in the beginning of 2022 with 8% revenue growth
2. Gross margin reduction ranging from 2.5% to 4.5% over the three years from the Board-approved strategic plan
3. Targeted inventory reduction is not achieved in 2021 and reduction in the inventory of £2m to £3m in 2022 and 2023
4. Litigation by the former outsource manufacturing partner is settled at the maximum liability of their claim (£8.0m) and the Dialight claim for damages in excess of £190m was unsuccessful

In all these scenarios, the Group assumes a series of mitigating actions can be put in place swiftly, including various temporary and permanent cost and cash reductions. In this severe but plausible downside scenario, the Group continues to retain sufficient committed headroom on liquidity and is able to meet its financial covenant obligations within the going concern assessment period. It has also been assumed that no additional debt is raised during the assessment period.

Consequently, the Directors are confident that the Group and Company will have sufficient funds to continue to meet their liabilities as they fall due for at least 12 months from the date of approval of the financial statements and therefore have prepared the financial statements on a going concern basis.

(c) Use of estimates, judgements and assumptions

The preparation of the consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. These estimates, judgements and assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The areas which require the most use of management estimation and judgement are set out below.

1.Basis of preparation and principal accounting policies (continued)

Significant judgements

Termination of outsourced manufacturing agreement

We have sought to reach a negotiated conclusion on various outstanding matters following the termination of the manufacturing services agreement with our former outsourced manufacturing partner, Sanmina Corporation. On Friday, 20th December 2019, both parties issued legal proceedings against the other, with Sanmina claiming up to £8m against Dialight and Dialight counter claiming up to £190m against Sanmina. The basis of the claim filed by Sanmina Corporation relates to outstanding invoices and residual inventory they allege they purchased for Dialight. The claim filed by Dialight is more complex in nature and relates to significant costs and losses suffered as a direct consequence of Sanmina Corporation not performing in accordance with the terms of the manufacturing services agreement. In the unlikely event that Sanmina's claim is successful, the range of outcomes could be £0 - £8m. Management have assessed the claim in conjunction with external legal advice and the judgement is that we are confident of the merits of our legal position. In the view of management, it is not probable that the group will have to make a payment. Therefore, no provision is required and the matter is disclosed as a contingent liability.

Development and patent costs

The Group capitalises development costs and patent costs provided they meet all criteria in the respective accounting policy. Costs are only capitalised when management apply judgement that they are satisfied as to the ultimate commercial viability of the projects based on review of the relevant business case. The capitalised costs are amortised over the expected useful economic life, which is determined based on the reasonable commercial prospects of the product and a comparison to similar products being sold by the Group.

The Group has £11.9m (2019: £11.8m) of development and patent costs that relate to the current product portfolio and new products expected to launch over the next 1-2 years. All of these are within the Lighting CGU and are tested for impairment at the CGU level as part of the goodwill testing. However, management perform a review of each project to see if there are any indications of specific impairment. Management review all of these for specific impairment by comparing carrying amount of development assets with net present value derived from the Board approved three-year strategic plan.

Inventory reserve

In the previous year, the basis for reserving Lighting and Obstruction raw materials and sub-assemblies was to reserve for items greater than 24 months old, whilst for finished goods it was to reserve for items greater than 12 months old. The basis for reserving Signals and Components inventory was based on a system generated calculation using an algorithm based on historical and forecast usage compared with the quantity on hand. In addition to the ageing basis, inventory is reviewed regularly by operational and financial management for useability.

In view of the significant impact the prolonged pandemic has had on our operations and the consequential logistics and supply chain challenges it posed on our inventory holding strategy, the Group has revised the basis of estimate to calculate the inventory reserve by focusing on usage (historical or forecast usage, whichever is higher) for all inventory. During this process, management considered the nature and condition of the inventory on an item by item and category basis giving due consideration to external market developments, change in strategy or business model, regulatory and technology changes.

1.Basis of preparation and principal accounting policies (continued)

Reserves were made accordingly under different assessment categories, applying the updated standard costs and historical or forecast usage. Lighting raw materials and sub-assemblies are reserved if the quantity on hand exceeds 2 years historic or forecast usage, or it has not been used in the past 12 months. Signals and components raw materials and sub-assemblies are reserved if the quantity on hand exceeds 2 years historic usage. This took into consideration the longer and different sales cycles of components, traffic and vehicle within this segment. Items identified as relating to products where a redesigned version had been launched were reviewed to ensure that they continued to be usable. Brackets, packaging, batteries and kits were specifically identified given they are common parts for our entire product range and their long useful life. As such they are not considered excess and no provision was made. Mechanical parts similarly have a long useful life and mostly do not have an expiration date. A 5-year usage measure is applied to these items. Any quantity on hand that is higher than the past 5 years usage is specifically reserved for. As part of the review process, management applied judgement to reserve for an additional £0.3m taking into consideration the overall uncertainty and potential impact to the business as a result of the ongoing pandemic.

Finished goods were reviewed by discreet segments. Inventory on hand was compared to historical sales, current backlog orders, sales pipeline and new product holdings. Management judgement was applied in the categorisation assessment (for example active stock of existing and new product range, items for rework) for each discreet segment, which will determine if a reserve is required or not.

Significant estimates

Inventory reserve

The overall level of inventory in the Group has reduced significantly during the year. As outlined in the significant judgement section above, the Group has revised the basis of estimate to calculate the inventory reserve with focus on usage (historical or forecast usage, whichever is higher) for raw materials, sub-assemblies and finished goods.

For raw materials and sub-assemblies, all excess quantity or items identified by Engineers for partial scrap were provided for at 50% of the excess quantity. Scrap items were fully provided for. For items identified to be excessive or obsolete where Supply Chain recommends for sale through third-party agents, a 50% provision was made in consideration of the commission payable and the likely success rate of sale.

Finished goods which are identified to fall within the rework category are reserved at a range of 10% to 25% where consideration is given to the cost of reworking the item and the ultimate sale. Items identified as slow moving (active items but quantity on hand is excessive considering the current sales and potential orders) are reserved at a range of 10% to 50% where consideration is given to the specific situation in each of the region and segments.

Inventory–absorbed overhead costs

The valuation of inventory requires the use of estimates in the amount of costs to be absorbed into inventory valuation. There are two elements of cost over which estimates are applied.

Firstly, in relation to the amount of production overheads that are included in the inventory valuation. The pools of cost related to production comprise labour and direct overheads attributable to the production process. They are assessed to ensure that costs not related to production are excluded. Consistent with last year, the Group uses the weighted average inventory turns calculated by comparing the level of inventory on hand with the amount of production by month. This gives the number of days of overhead that should be absorbed in inventory. The value of directly attributable costs over which judgement was exercised was £4.3m (2019: £6.3m)

1.Basis of preparation and principal accounting policies (continued)

and this represents 13% (2019: 14%) of the inventory value. For every day that the estimate of the days used for the overheads absorbed changes, it changes the calculation by £44k.

Secondly, in relation to the amount of freight costs that are included in the inventory valuation. The costs represent transportation costs for raw materials and the labour cost of the buyers placing the orders. The cost is absorbed into inventory by comparing the level of inventory on hand with the amount of material costs in the cost of sales. This gives the number of days of freight costs that are capitalised. Costs of transporting finished goods to distribution centers on a global basis are included in the inventory valuation until the associated finished goods have been sold outside the Group. The value of freight costs over which judgement was exercised was £2.2m (2019: £2.4m) and this represents 7% (2019: 5%) of the inventory value. For every day that the estimate of the days used for the overhead absorbed changes, it changes the calculation by £8k.

Goodwill and other intangible assets

The Group tests at least annually whether goodwill has suffered any impairment. The recoverable amounts of the Group's cash-generating units (CGU) have been determined based on value in use calculations, which this year involve a higher inherent level of estimation due to the uncertainty caused by COVID. These calculations require the use of estimates and assumptions consistent with the Board approved three-year strategic plan.

Although the impact of COVID is not expected to impact the long-term prospects of the business, the impact of a prolonged global pandemic resulting in a slower recovery and consequently lower growth rates over the assessment period have reduced the level of headroom in the Lighting CGU.

(d) Adoption of new and revised standard/ interpretations and amendments

The following accounting standards, interpretations, improvements and amendments have become applicable for the current period and although the Group have adopted them, they have had no material impact on the Group. These comprise:

- Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate benchmark Reform.
- Amendments to References to the Conceptual Framework for IFRS Standards.
- Amendments to IFRS 3: Definition of a Business.
- Amendments to IAS 1 and IAS 8: Definition of Material.

The following accounting standards and amendments that are applicable to the Group have been issued by the IASB but had either not been adopted by the European Union or were not yet effective in the European Union as at 31 December 2020.

- IFRS 17 Insurance Contracts. The current effective date is 1 January 2022. This is not expected to be applicable to the Group.
- Sale or Contribution of Assets between an Investor and its Associate or Joint venture (Amendments to IFRS 10 and IAS 28). These amendments are not expected to be material to the Group, if adopted.

2. Operating segments

The Group has two reportable operating segments. These segments have been identified based on the internal information that is supplied regularly to the Group's chief operating decision maker for the purposes of assessing performance and allocating resources. The chief operating decision maker is considered to be the Group Chief Executive Officer.

The two reportable operating segments are:

- Lighting, which develops, manufactures and supplies highly efficient LED lighting solutions for hazardous and industrial applications in which lighting performance is critical and includes anti–collision obstruction lighting; and
- Signals & Components, which develops, manufactures and supplies status indication components for electronics OEMs, together with niche industrial and automotive electronic components and highly efficient LED signaling solutions for the traffic and signals markets.

There is no inter–segment revenue and there are no individual customers that represent more than 10% of revenue.

All revenue relates to the sale of goods. Segment gross profit is revenue less the costs of materials, labour, production and freight that are directly attributable to a segment. Overheads comprise operations management, selling costs plus corporate costs, which includes share-based payments.

Segmental assets and liabilities are not reported internally and are therefore not presented below.

Reportable segments

2020	Lighting	Signals and Components	Unallocated	Total
	£'m	£'m	£'m	£'m
Revenue	81.7	37.3	-	119.0
Gross Profit	23.7	10.3	–	34.0
Overhead costs	(26.8)	(7.7)	(5.9)	(40.4)
Underlying (loss)/profit from operating profit	(3.1)	2.6	(5.9)	(6.4)
Non-underlying costs	(2.4)	–	–	(2.4)
(Loss)/profit from operating activities	(5.5)	2.6	(5.9)	(8.8)
Financial expense				(1.3)
Loss before tax				(10.1)
Income tax credit				2.3
Loss after tax				(7.8)

2. Operating segments (continued)

2019	Lighting	Signals and Components	Unallocated	Total
	£'m	£'m	£'m	£'m
Revenue	111.5	39.5	-	151.0
Gross profit	31.3	12.6	-	43.9
Overhead costs	(34.5)	(8.3)	(6.1)	(48.9)
Underlying (loss)/profit from operating activities	(3.2)	4.3	(6.1)	(5.0)
Non-underlying costs	(6.3)	-	-	(6.3)
(Loss)/profit from operating activities	(9.5)	4.3	(6.1)	(11.3)
Financial expense				(1.2)
Loss before tax				(12.5)
Income tax expense				(3.7)
Loss after tax				(16.2)

Other segmental data

	2020			2019		
	Lighting	**Signal & components**	**Total**	Lighting	Signals & components	Total
	£'m	**£'m**	**£'m**	£'m	£'m	£'m
Depreciation of property, plant and equipment	**2.1**	**1.0**	**3.1**	1.9	0.7	2.6
Depreciation of right of use assets	**1.4**	**0.6**	**2.0**	1.3	0.4	1.7
Amortisation	**2.1**	**0.9**	**3.0**	1.5	0.5	2.0
Impairment of intangibles assets	**0.3**	**–**	**0.3**	–	–	–

Geographical segments

The Lighting, Signals and Components segments are managed on a worldwide basis, but operate in three principal geographic areas, North America, EMEA and Rest of World. The following table provides an analysis of the Group's sales by geographical market, irrespective of the origin of the goods. All revenue relates to the sale of goods.

Sales revenue by geographical market

	2020 £'m	2019 £'m
North America	**89.8**	117.8
EMEA	**9.9**	12.6
Rest of World	**19.3**	20.6
	119.0	151.0

3. Non–underlying items

Statutory operating loss included the following non-underlying costs which are separately disclosed to allow the reader to obtain a full understanding of the financial information and the best indication of the underlying performance of the Group. The table below presents the components of non-underlying profit or loss recorded within cost of sales and administrative expenses.

3. Non–underlying items (continued)

	2020 £'m	2019 £'m
Non-underlying items:		
Redundancy costs	**0.9**	1.1
Loss on disposal of subsidiary	**0.8**	2.5
Litigation costs	**0.7**	–
Write-off receivable from outsource manufacturer	**-**	2.7
Non-underlying items recorded in administrative expenses	**2.4**	6.3

Redundancy costs of £0.9m relate to severance payments for the various initiatives during the year to right-size the cost base, including the facility exit costs for the UK research and development centre. Litigation costs of £0.7m relate to legal fees and potential claims for and against the Group. The loss on disposal of subsidiary relates to the sale of the Group's Brazil business in November 2020. The revenue of this business was £2.1m with an operating profit of £0.4m for the period of ownership whilst 2019 full year revenue was £0.9m with an operating loss of £0.1m.

The net assets and the net loss on disposal of Dialight Do Brasil Technologia Led Ltda were as follows:

	2020 £'m
Current assets	**1.4**
Current liabilities	**(0.6)**
Net assets of the business disposed of	**0.8**
Loss on disposal of the business	**(1.1)**
Total consideration paid	**(0.3)**
Satisfied by:	
Foreign translation	**(0.2)**
Other disposal costs	**(0.1)**
Total	**(0.3)**

Proforma unaudited costs

In the prior year £10.2m of production costs relating to in-sourcing were identified separately as unaudited costs. These were management's best estimate of the cost of in-sourcing and due to their subjective nature, it was not possible to audit them and they were presented as proforma unaudited costs. There are no similar costs in the current year.

4. Financial expense

Recognised in profit and loss

	2020 £'m	2019 £'m
Net interest on defined benefit liability	**0.1**	0.1
Interest expense on financial liabilities, except lease liabilities	**0.6**	0.5
Interest expense on lease liabilities	**0.6**	0.6
Net financing expense recognised in the consolidated income statement	**1.3**	1.2

5. Income tax (credit)/expense

	2020 £'m	2019 £'m
Current tax expense		
Current year	**0.3**	0.6
Adjustment for prior years	**(2.9)**	(0.1)
Total current tax	**(2.6)**	0.5
Deferred tax expense		
Origination and reversal of temporary differences	**(0.9)**	(0.9)
Adjustment for prior years	**1.2**	(0.4)
De-recognition of deferred tax assets in respect of European losses	**–**	4.5
Total deferred tax	**0.3**	3.2
Total tax (credit)/expense	**(2.3)**	3.7

Reconciliation of effective tax rate

	2020 %	2020 £'m	2019 %	2019 £'m
Loss for the year		**(7.8)**		(16.2)
Total income tax (credit)/charge		**(2.3)**		3.7
Loss before income tax		**(10.1)**		(12.5)
Income tax using the UK corporation tax rate	**(19.0)**	**(1.9)**	(19.0)	(2.4)
Non–deductible loss on disposal of a business	**1.0**	**0.1**	4.0	0.5
Reduction in tax rate	**(1.0)**	**(0.1)**	-	-
Non-deductible expenses	**1.9**	**0.2**	1.6	0.2
Current year losses for which no deferred tax is recognised	**9.9**	**1.0**	8.0	1.0
US carry back claim	**(12.5)**	**(1.3)**	-	-
De-recognition of deferred tax previously recognised	**-**	**-**	35.9	4.5
Adjustment for prior years	**(4.0)**	**(0.4)**	(4.0)	(0.5)
Research and development credits	**(1.0)**	**(0.1)**	(0.8)	(0.1)
Recovery of foreign taxes suffered	**1.9**	**0.2**	3.9	0.5
	(22.8)	**(2.3)**	29.6	3.7

The effective tax rate for the year is 22.8% compared with 29.6% in the prior year and compared with the standard rate of 19.0% (2019: 19.0%) in the UK.

The normalised tax rate for the Group in the year is 21.0% (tax rate before adjustments) and based on a pre-tax loss of £10.1m this would generate a tax credit of £2.2m. However, in the year there is a tax credit of £2.3m (22.8%). The major difference of 1.8% is due to the following factors:

- the current losses in the European Lighting business not recognised as a deferred tax asset, resulting in £1.0m (charge of 9.9%) of tax credit not being recognised in the year. We do not anticipate this business making sufficient taxable profits in the short-term to utilise the losses.

5. Income tax (credit)/expense (continued)

- we have benefited from the stimulus package under the Cares Act in the US which allows us to get tax relief by carrying back losses made in 2018 and 2019 for 5 years. This allows us to benefit from tax recovery at 35% rather than the current rate of 21% that was used to calculate the recoverable amount in 2019 and this gives rise to a one-off tax credit of £1.3m (credit of 12.5%)
- a non-deductible loss of £0.1m (charge of 1.0%) on disposal of Dialight Brazil which was sold in November 2020

Tax recognised directly in equity

	2020 £'m	2019 £'m
Employee benefits	**(0.3)**	0.3
Other	**0.3**	0.1

Current tax

Current tax is calculated with reference to the profit of the Company and its subsidiaries in their respective countries of operation. Set out below are details in respect of the significant jurisdictions where the Group operates and the factors that influenced the current and deferred taxation in those jurisdictions.

UK

The UK companies are subject to a corporate tax rate of 19.0% (2019: 19.0%). No UK corporation tax rate reductions have been announced. There are no UK timing differences recognised at 31 December 2020.

US

The majority of the Group's profits arise in the US where the corporation tax rate is 21% (2019: 21%).

6. Loss per share

Basic loss per share

The calculation of basic loss per share ("EPS") at 31 December 2020 was based on a loss for the year of £7.8m (2019: £16.2m loss) and the weighted average number of ordinary shares outstanding during the year of 32,555,137 (2019: 32,536,701).

Weighted average number of ordinary shares

	2020 '000	2019 '000
Weighted average number of ordinary shares	32,555	32,537

	2020 Per share	2019 Per share
Basic loss	**(24.0)p**	(49.8)p

7. Provisions

	Warranty and claims £'m	Lease-restoration £'m	Total £'m
Balance at 1 January 2020	2.0	0.3	2.3
Provisions made during the year	**2.0**	**–**	**2.0**
Provisions used during the year	**(1.4)**	**(0.1)**	**(1.5)**
Effects of foreign exchange	**(0.1)**	**-**	**(0.1)**
Balance at 31 December 2020	**2.5**	**0.2**	**2.7**

The potential claims provision relates to warranty provisions for sales made over the past seven years, and other claims across the Group. The warranty provision has been estimated based on historical warranty data with similar products. The Group expects to settle the majority of the liability over the next two to three years.

The table below provides a breakdown of the provisions into their short–term and long–term portions:

	2020 £'m	2019 £'m
Due within one year	**1.5**	0.9
Due within one and five years	**1.1**	1.2
Due after five years	**0.1**	0.2
	2.7	2.3

8. Dividends

There were no dividends declared or paid in the 12 months ended 31 December 2020.

9. Cash and cash equivalents

	2020 £'m	2019 £'m
Cash and cash equivalents	**5.3**	0.5

10. Borrowings

The Group's financing arrangements consisted of a revolving credit facility with HSBC of £25m which matures in February 2023 and has an option for two extensions of one year each, with the approval of the bank. In order to ensure the availability of sufficient liquidity, the Group increased its banking facility with HSBC on 15 June by adding a further £10m facility on a 3-year basis by utilising a combination of £8m under COVID-19 Large Business Interruption Scheme (CLBILS) and a £2m commercial loan. The remaining facility fees of £0.3m are amortised over the tenure of the facility till February 2023.

	Loans £'m
At 1 January 2019	5.1
Facility drawdown	11.9
At 31 December 2019	17.0
Facility drawdown	**10.0**
Facility repayment	**(10.3)**
At 31 December 2020	**16.7**

10. Borrowings (continued)

The £25m revolving credit facility term loan runs up till February 2023 whilst the £10m loan will be repaid in equal installments over 3 years, starting on the 15th January 2021.

Details of the facilities	Tenure	Interest rate per annum	Maturity date	**Amount drawn 31 December 2020**	Amount drawn 31 December 2019
	Years	%		£'m	£'m
£25m revolving credit facility	3*	3.15	February 2023	**6.7**	17.0
£8m CLBILS	3	2.11	June 2023+	**8.0**	–
£2m commercial loan	3	3.03	June 2023+	**2.0**	–

* The Group's current £25m revolving credit facility with HSBC which matures in February 2023 has an option for two consecutive one-year extensions, with the approval of the bank

+ This loan will be repaid in equal installments over 3 years, starting on the 15th January 2021

As part of the new facility, the original banking covenants of net debt to EBITDA ratio and interest cover have been replaced by a new test based on exceeding a 12-month rolling EBITDA level that was derived from a COVID impacted business plan as agreed with HSBC, for the testing periods of June 2020 to June 2021. The Group is compliant with its banking covenant as at 31 December 2020.

Covenant test		For Q3-21	For Q4-21 onwards
Ratio	**Calculation**	**Threshold**	**Threshold**
Leverage ratio	Net debt/Adjusted EBITDA	<3.5x	<3.0x
Interest cover	Adjusted EBITDA/Interest expense	>4.0x	>4.0x

11. Principal exchange rates

	2020 Average rate	**2020 At balance sheet date**	2019 Average rate	2019 At balance sheet date
US dollar	**1.28**	**1.36**	1.28	1.32
Euro	**1.12**	**1.11**	1.14	1.18
Canadian dollar	**1.72**	**1.74**	1.69	1.72
Mexican Peso	**27.51**	**27.14**	24.56	24.93

12. Related party transactions

The ultimate controlling party of the Group is Dialight plc. Transactions between the Company and its subsidiaries has been eliminated on consolidation.

13. Reconciliation to non-GAAP performance measures

	2020 £'m	2019 £'m
Loss from operating activities	(8.8)	(11.3)
Non-underlying items (see note 3)	2.4	6.3
Underlying loss from operating activities	(6.4)	(5.0)
Loss from operating activities	(8.8)	(11.3)
Non–underlying items (see note 3)	2.4	6.3
Depreciation of property, plant and equipment	3.1	2.6
Amortisation of intangible assets	3.0	2.0
Share based payments	0.4	0.3
Underlying EBITDA	0.1	(0.1)
Proforma unaudited costs added back (see note 3)	n/a	10.2
Proforma unaudited EBITDA	n/a	10.1
Loss from operating activities	(8.8)	(11.3)
Non-underlying items (see note 3)	2.4	6.3
Depreciation of property, plant and equipment	3.1	2.6
Amortisation of intangible assets	3.0	2.0
Share based payments	0.4	0.3
Net movement on working capital (Inventories, trade and other receivables, trade and other payables) as per Consolidated statement of cash flows	9.0	6.6
Underlying operating cashflow	9.1	6.5
Proforma unaudited costs added back (see note 3)	n/a	10.2
Proforma unaudited operating cashflow	n/a	16.7

Constant currency

The Group's revenues are mainly earned in the US and it presents certain key metrics on a constant currency basis to remove any impact of currency fluctuations. The constant currency impact is calculated by re-translating the prior year numbers at the exchange rate prevailing in the current year.

Net debt

Net debt is defined as total Group borrowings less cash. Net debt of £11.4m at the year-end (2019: £16.5m) consisted of borrowings of £16.7m (2019: £17.0m) less cash of £5.3m (2019: £0.5m).

14. Contingencies

As previously reported, we have sought to reach a negotiated conclusion of various outstanding matters following the termination of the manufacturing services agreement with our former outsource manufacturer, Sanmina Corporation. On Friday, 20th December 2019, both parties issued legal proceedings against the other. The parties are therefore in formal litigation, with no conclusion expected before 2022. The basis of the claim filed by Sanmina Corporation relates to outstanding invoices and to residual inventory, which they allege that they purchased for Dialight. The claim filed by Dialight is more complex in nature and relates to significant costs and losses suffered as a direct consequence of Sanmina Corporation not performing in accordance with the terms of the manufacturing services agreement. The Group has sought external legal advice and is paying for the legal costs as and when it occurs. As at 31 December 2020, the Group has not made any provision for future legal costs. The Group is confident of the merits of its legal position, however in the unlikely event, that Sanmina's claim is successful, the range of outcomes could be £0 - £8m.

14. Contingencies (continued)

The claim filed by Dialight alleges that Dialight suffered significant costs and losses with total damages exceeding £190m suffered as a result of: (a) Sanmina's fraudulent inducement of Dialight to enter into a manufacturing services agreement (MSA); (b) Sanmina breaching the terms of the MSA in a wilful and/or grossly negligent manner (for example in respect of their failure to appropriately manage supply chain and inventory levels and to deliver product on time and free of workmanship defects); and, (c) Sanmina's gross negligence and/or willful misconduct.

During 2011, the Roxboro UK Pension Fund (the "Scheme") was closed to future accrual. This Scheme is included within pension asset. As part of the negotiations regarding closure, the Company agreed to grant a parent company guarantee in respect of all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally and in any capacity whatsoever) of Dialight Europe Limited, the principal employer, to make payments in the Scheme up to a maximum amount equal to the entire aggregate liability, on the date on which any liability under the guarantee arises, of every employer (within the meaning set out in Section 318 of the Pensions Act 2004 and regulations made thereunder) in relation to the Scheme, were a debt under Section 75(2) of the Pensions Act 1995 to have become due on that date. No provision has been made in relation to this contingency.

The Group operates in certain jurisdictions that are unstable or have changing political conditions, giving rise to occasional uncertainty over the tax treatment of items of income and expense. In addition, from time-to-time certain tax positions taken by the Group are challenged by the relevant tax authorities, which carry a financial risk as to the final outcome. The Directors have considered the potential impact arising from these uncertainties and risks, on the Group's tax assets and liabilities, both recognised and unrecognised, and believe that they are not material to the Financial Statements.

The Group has received two claims from former employees in France and, whilst recognising the inherent risks of employee-related litigation in France, the Directors believe that these two claims are without merit and will be robustly defended, and are not considered likely to result in any material outflow of funds from the Group.

15. Principal and emerging risks and uncertainties

The Board is responsible for identifying the nature and extent of the risks the Group has to manage in order to successfully pursue its growth strategy and generate shareholder value over the long term.

The Board uses a risk framework, which is designed to support the process for identifying, evaluating and managing both financial and non-financial risk. The Group has identified the following key risks. This is not an exhaustive list but rather a list of the most material risks facing the Group. The impact of these risks, individually or collectively, could potentially affect the ability of the Group to operate profitably and generate positive cash flows in the medium to long term. As a result, these risks are actively monitored and managed, as detailed below.

- **Organic growth** - Growth of the business has stagnated over the past few years driven by the impact of outsourcing production (reduced supply) and also the COVID-19 impact on demand. If this continues, we will see further erosion of shareholder value. Growth needs to be stimulated by having compelling technologies that hasten the adoption of LED by utilising our products
- **Environmental and geological** - The Group's main manufacturing centre is in Mexico and its main market is North America. Any impediment to raw materials getting into Mexico or restrictions on finished goods entering North America related to natural disasters could have a large impact on profitability. Disruption to global markets and transport systems arising from geological, biological, economic and/or political events may impact the Group's ability to operate and the demand for its products
- **Funding** - The Group has a net debt position and there is a risk related to liquidity. The Group has not paid a dividend since 2015. The Group reports in Sterling; however, the majority of its revenues and its cost base are in US Dollars. Fluctuations in exchange rates between Sterling and US Dollar could cause profit and balance sheet volatility
- **Production capacity and supply chain** - Disruption to production capacity due to impact of bio-hazards or supply chain disruption. Disruption to supply chain from border friction, tariffs or impacts on logistics related to bio-hazards
- **Cyber and data systems** – Disruption to business systems would have an adverse impact on the Group. The Group also needs to ensure the protection and integrity of its data. With significantly more employees working from home on a part-time basis, there is greater risk of systems being compromised as well as significant reliance on platforms such as Zoom and Microsoft Teams in order to operate the business.
- **Product development strategy** – Inability to translate market requirements into profitable products. Failure to deliver technologically advanced products and to react to disruptive technologies.
- **Product risk** – The Group gives a ten-year warranty on Lighting products which are installed in a variety of high-risk environments. Risks could arise in relation to product failure and harm to individuals and damage to property.
- **Talent and diversity** - The Group performance is dependent on attracting and retaining high-quality staff across all functions.
- **Intellectual property** – Theft or violation of intellectual property by third parties or third parties taking legal action for IPR infringement.