Dialight

Dialight plc
(“Dialight” the “Company” or the “Group”)

Unaudited preliminary results for the year ended 31 December 2022

Dialight plc (LSE: DIA.L), the global leader in sustainable LED lighting for industrial applications, announces its unaudited preliminary results for the year ended 31 December 2022.

Financial summary	2022 £m	2021 £m
Revenue	**169.7**	131.6
Underlying profit from operating activities	**5.0**	4.5
Profit from operating activities	**2.3**	2.1
Profit after tax	**0.4**	0.3
Statutory EPS – diluted	**1.2p**	0.9p
Adjusted EPS* – diluted	**7.3p**	6.4p
Pre-IFRS16 Net debt	**(20.9)**	(15.7)

Key points

- Overall Group revenues in 2022 were 29% higher than the prior year (17% at constant currency):
- Lighting revenues up 34%, with orders up 23%
- Underlying operating profit increased to £5.0m (2021: £4.5m), which was lower than initially expected due to weaker orders in the very important December trading period
- Gross margin fell to 32.2%, reflecting significant cost inflation and supply chain disruption (2021: 35.7%)
- Net debt of £20.9m (1.7x LTM EBITDA), driven by higher inventory levels

Fariyal Khanbabi, Group Chief Executive, said:

“We made important strategic progress which was reflected in significant sales growth driven by strong demand for our sustainable lighting products. However, the markets we operate within became increasingly difficult during the year due to significant price inflation and continued global supply chain disruptions, which impacted our gross margins. Whilst these headwinds remain, we believe that they are in most cases transitory, and we expect to see some alleviation in H2 2023.

The strong growth in Lighting orders demonstrates the increasing relevance of our products as energy efficiency became more urgent. We deliver innovative and sustainable lighting solutions to our customers and continue to make progress towards driving our impact on the environment and society.”

**Adjusted earnings excludes non-underlying items (see note 3) and allocates tax at the appropriate rate (see note 5)*

Full year results presentation
The 2022 full year results presentation can be found at:
https://www.dialight.com/ir/reports-news/

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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. Underlying profit from operating activities and underlying EBIT are the same measures
3. Constant currency impact is calculated by re-translating the prior year numbers at the exchange rate prevailing in the current year.
4. 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

We made important strategic and operational progress during the year, achieving revenue growth of 29% against exceptionally challenging market conditions, increasing our penetration of Tier 1 customer accounts and making over £3.0m of operating cost savings. Total revenue growth at constant currency was 17%, achieved through a combination of volume (11%) and price (6%) increases. The volume growth reflecting both an increase in market share, as well as expanding our market reach. The Maintenance, Repair and Operations (MRO) market remains generally robust, but we experienced a slowing of larger capex projects, particularly in the fourth quarter, owing to labour and material shortages. Combined with the distribution channel reducing their inventory levels, this had a significant impact on the final month of trading.

Positively, the structural demand for our products continued to increase as energy efficiency became a higher priority agenda item for businesses, accelerated by the energy crisis which commenced during 2022. This strengthened our competitive position as we executed on our strategic priorities. We developed innovative and sustainable new lighting solutions for our customers and continued to make progress towards driving a more positive impact on the environment and society.

Results

Overall Group revenues in 2022 were 29% higher than the prior year (17% constant currency). Underlying operating profit was £5.0m, compared to £4.5m in 2021, which was lower than initially expected, due to weaker orders and deliveries in the very important December trading period.

Gross margin reduced to 32.2% (from 35.7%) reflecting a number of headwinds during the year. Our supply chain was severely impacted by significant inflation, component shortages and continued challenges in shipping times and cost. Microchip availability was particularly problematic as suppliers struggled to deliver either on time or in the required volumes. We focused considerable resources to sourcing and testing alternative components and suppliers, which enabled us to successfully overcome shortages, albeit this impacted gross margin. The impact of increased material costs and expedited freight costs accounted for 4.3% of the reduction in gross margins.

Our gross margins were further impacted by increases in the minimum wage in Mexico of 23%. There were also inefficiencies in our labour utilisation due to the component shortages. This impacted gross margin by 0.9%.

Our operational performance during 2022 made key improvements despite supply chain headwinds. We were able to partially offset the increased material and labour costs by generating 1.8% of production efficiencies. These were generated by reduction in consumables, standardisation in our packaging and investments in automation. Our on-time delivery was 77%, above the current industry standard, and we achieved customer lead times of three weeks, supporting our revenue growth.

Lighting order growth in 2022 was 23% (constant currency 11%) with all regions reporting growth over the prior year. The majority of Lighting order growth was generated in our core US market which increased by 30% (constant currency 17%), with EMEA increasing by 53% (constant currency 38%). APAC increased by 7% (constant currency -3%). Obstruction orders fell by 28% (constant currency -35%) as higher steel prices led to lower levels of tower construction.

Signals & Components is a high-volume business operating within highly competitive markets. This business segment had exceptional growth during COVID-19 but has since normalised. Within this division, opto-electronic component orders fell by 13% as the market reduced the level of inventory in the channel. After two years of growth, a market correction was expected, but the level of cancellations in Q4 were higher than forecast.

As a result of the supply chain shortages, we increased our inventory to mitigate the challenges we faced. We have taken a number of actions in the second half of the year to reduce the levels of raw materials held, which has resulted in raw material inventory levels being broadly flat year on year and 9% down on a constant currency basis.

Market conditions

We operate within the industrial LED lighting market and our future will be determined by the trends within this space. The advances we have seen over the last ten years in terms of efficiencies and controls are all building a path to a more sustainable fixture. Older technologies have become more expensive to maintain while LED fixtures use 75% less energy and last 25 times longer, compared with HPS/fluorescent lighting. In the US alone there are more than 144 million industrial lighting fixtures in 455,000 facilities. With existing industrial carbon emissions in the US estimated at c. 2 billion metric tonnes per annum, high-efficiency LED lighting provides an immediate and sustainable reduction in emissions. That is a compelling proposition when companies and global economies are mapping their pathway to achieve their net zero targets.

The macro-economic backdrop presents considerable uncertainty, and we continue to take an active approach to targeting market niches with more resilient demand dynamics and where growth is driven by structural, safety, regulatory and sustainability factors.

The Group's natural resource markets in oil & gas and mining are expected to show solid demand in the short to medium term. Global energy market shortages have seen an expansion in oil extraction activity, with US onshore drilling up 60% year over year, and with three times the number of rigs in service from two years ago. Mining customers are benefitting from the demand for Lithium and Nickel in battery production, which should benefit our customers in Australia.

The Group is also seeing increasing success, led by the strategic sales team, in expanding its customer base into a wider range of process industries including aerospace, electric vehicle and food & beverage. Facilities in these markets can be very significant and often have demanding operational requirements which lend themselves to Dialight's highly engineered lighting product range.

Strategy

Dialight's core strengths centre around our products and a long history of innovation within the industrial lighting markets. Our fixtures meet the needs of our customers to enhance safety, reduce energy and maintenance costs and critically, help them achieve their corporate objectives of being carbon net zero. Our products also 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 whilst 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 overall strategy is focused on organic growth underpinned by product innovation. We have three key objectives:

- **Convert our core heavy and harsh industrial markets** -– by expanding our routes to market, emphasising our product innovations and sustainability credentials. We believe that sustainability will be a major driver in the conversion to LED and this has accelerated post COVID-19 with a return to corporate discretionary spend. Dialight will continue to grow its leading position through market share gains in MRO together with capex projects as the market recovers.

  We continue to identify and successfully engage with new key accounts through our strategic sales team. In particular, increased targeting of EPC/engineering firms and electrical contractors. We are continuing to work on strengthening our branding and focusing on vertical market applications, with good progress made during the year.

- **Improve margins** – through continued cost improvements and manufacturing efficiency programmes supported by supply chain development. By reducing the cost, weight, and size of our products we can improve our competitiveness and improve our overall margins. Over the past two years, we have successfully reduced the cost of our High Bay, 60K High Bay and Area Lights. Besides design-based cost reductions, we believe there are further cost reductions through strategic supply chain sourcing and value-added engineering to improve our manufacturing processes.

  We are also focused on simplification of our products in order to reduce costs and improve lead times. At the start of 2022, Dialight had 8,800 active finished good SKUs, and approximately 64,000 active components. Our initiatives over the past year have been to remove legacy finished SKUs from the database to simplify operational planning. We have standardised components within our product lines to reduce the complexity of sub-assembly management. At the end of 2022 we had reduced the active finished goods SKUs by 24%. Following on from standardising our mainstream Vigilant High Bay in 2021 we continued with the hazardous version resulting in 99% of our highest running product family being upgraded to the third-generation power supply. During the year we have also upgraded 92% of our Area Light family to our third-generation power supply.

  We are dual sourcing components to mitigate the risk of component shortfalls which significantly impact on operational efficiency. Out of our total active components, 588 are deemed to be critical in nature. To date we have dual sourced 248 parts with 340 remaining. We will continue to develop alternate sources and vendors for critical components and regionalise supply of components where possible, using VMI and consignment stocks. In conjunction with our dual sourcing plan, we will develop and implement a regionalisation strategy to reduce the business risk directly related to sourcing from the Far East. While these challenges are expected to continue for some time, we will continue to mitigate their impact.

  These actions will support the achievement of our targeted £5m reduction in inventory in 2023, with further inventory reductions expected in later years.

  Our focus will continue to be on further improvements in efficiency and mitigation of increasing labour costs. We plan to automate our sub-assembly operations which will improve our efficiency and cost base over time.

- **Product innovation** - we continue to lead the market in innovation. Our 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 industrial LED lighting fixture. Our "source and sell" initiative will address the 20% of the customer lighting schedule that is not highly specified. This initiative protects our market leading position with key strategic accounts and increases our relevancy to the large accounts we are targeting.

Strategy execution in 2022

Organic growth remains a key focus, both in terms of penetrating the MRO market, but more importantly delivering significant capex projects as end customers increase their expenditure on lighting over the longer term. This encompasses three strands:

Strategic sales focus

The new strategic sales team are focused on building relationships with key large corporates, primarily in the US. This is a longer-term activity particularly focused on new customers, so prospects will take time to develop into initial orders and then gain preferred supplier status. The team has already won several multi-million-dollar orders for major US corporates. There is a sizeable pipeline of opportunities, however predicting when these orders will come is challenging in the current economic climate. To date we have secured 11 strategic accounts with whom we are the preferred supplier.

Expanding routes to market

Expanding our market reach is key to wider penetration and growth of our market share. We continue to make strong inroads, developing new distribution partners along with a focus on the contractor market. We signed over 37 new distribution partners along with engaging with an additional 80 distributor locations in the US alone. We have developed over 30 new contractor relationships, expanding our routes to market. Another key milestone has been re-joining Affiliate Distributors which is a members owned group that brings growth orientated distributors and best in class suppliers together, with a view to outperforming the market and staying ahead of the competition.

Enhanced product range through innovation

Our new product platforms launched in the past two years are expected to further strengthen our position within our heavy industrial verticals. These product platforms are the Ultra-Efficiency High Bay, the GRP Linear, the new Bulkhead, and new Flood lights. In addition, we have launched two source and sell product lines (Wall-Packs and emergency lighting). We have received £22.4m in orders from products launched in the past two years. These products have been critical in advancing our technological lead and provide the best cost of ownership within the markets we operate within.

Sanmina litigation

As previously disclosed, Dialight is involved in ongoing litigation with Sanmina Corporation, following the termination in September 2018 of the manufacturing services agreement (MSA). The Board is pleased to note the Federal court ruling on 14th March 2023 that the strength of evidence on our claim of fraudulent inducement, together with various claims and counter-claims relating to accounts receivable and accounts payable, is sufficient that the dispute should be resolved by jury trial, pending any appeal process. This ruling confirms that Dialight can challenge the contractual liability cap in the MSA on the basis of Sanmina's fraudulent inducement and Dialight intends to rigorously pursue this claim, and the various other contract-based claims, to trial.

Purpose and sustainability

Sustainability is at the heart of everything we do, from product design to material sourcing and the way we operate the business.

Our products provide an easily achievable opportunity to reduce carbon emissions in the near-term by utilising our ultraefficient LED technology that generates up to 75% less emissions than legacy lighting. The time value of carbon reductions[1] is magnified by the pace at which the industrial world embraces a significant adoption of LED lighting. The lights sold in 2022 will generate avoided emissions of 2.1m tonnes over their lifetime and help our customers achieve their emission reduction goals. Our sustainable solutions have been recognised by the Lighting Council of Australia in their inaugural awards in 2022.

Over the past two years we have invested significant time in understanding our existing carbon impact and how to use R&D to reduce that impact in the design of our products and the choice of materials. We continue to recycle packaging from upstream and as much by-product of production as possible. We also target downstream end-of life recycling through the use of partnerships on a geographic basis.

In 2020, we carried out our first full Green House Gas (GHG) inventory and this will form the base year for our SBTi Net Zero targets which will be submitted during H1-2023. Dialight's internal processes are low intensity with most of the more intense processing happening upstream. Nonetheless, in the interim, we established Scope 1 & 2 reduction targets and water consumption targets, both on an intensity basis. The targeted reduction for Scope 1 & 2 was 3% and we achieved 9%; the target for water consumption reduction of 5% was also surpassed at 21%.

Dialight engages with the Carbon Disclosure Project where we achieved a B rating for climate change and B- for water security, plus an EcoVadis rating of silver. We are members of the Clean Lighting coalition which seeks to ban the use of mercury in lighting and because our products are mercury free, we have been assessed by FTSE Russell as having 100% green revenue.

The Dialight Foundation continues to enhance the communities where we operate by supporting local initiatives with funding and donated time. The specific focus areas are women's rights and educational support for children. To this end, we have continued our support of the Women's Earth Alliance and a local orphanage in Ensenada, Mexico. In addition, the Foundation also has a hardship fund which can be accessed by staff facing unforeseen expenses.

As a business at the leading edge of industrial LED technology, people are at the heart of our business. We support all our people by creating a safe, inclusive environment, where every individual is able to work and contribute to the development of the business. Having engaged, motivated, empowered and appropriately skilled employees is integral to our success. Developing a high performing and inclusive culture is a key enabler in our ability to deliver strategic growth. Our position as a long-term presence in our operating locations is reflected in the range of long service awards around the globe, ranging from 10 years in Malaysia to 50 years in the USA.

Our target of zero accidents at all our sites is a morally responsible business objective. As a producer of lighting that is used in heavy industrial and hazardous locations, our safety focus extends beyond our own staff to those of our customers. In our own operation in 2021 there were no recordable incidents but regrettably in 2022 there were five. Dialight production is mainly light engineering and assembly, so these incidents are typically strains and sprains, sustained where operating procedures were not correctly followed, or PPE not used. We take these incidents very seriously and have provided re-training where necessary to prevent recurrences. Despite the increase in recordable incidents, two of our plants have not recorded any incidents in the past two years.

Dialight is committed to always conducting its business in an ethical and responsible manner, and in full compliance with all applicable laws and regulations. All employees and all third parties who act on the Group's behalf are required to comply with our standards of behaviour and business conduct, as set out within the Code, and applicable laws and regulations in all of the countries in which we operate. In 2022 we undertook a survey

[1] The Time Value of Carbon is the concept that greenhouse gas emissions cut today are worth more than cuts promised in the future, due to the escalating risks associated with the pace and extent of climate action.

of our top 30 suppliers (c. 70% of supply chain value) to establish whether they had sustainability ratings and to understand their sustainability processes and due diligence processes in more detail.

As a sustainability solution provider to our customers, our business is primarily focussed on the opportunity that arises from the transition of the industrial market away from traditional lighting and towards LED as an alternative. Hence, the requirements of TCFD dovetail with the existing business framework. The largest opportunity lies in the scale and speed of increases in market adoption of LED. There are some smaller efficiency and logistic opportunities that could also be realised in the process.

The business strategy of growth will result in increasing the avoided emissions for our customers which outweigh the emissions from using our fixtures by a factor of 1.6x. Since we started the Lighting segment, we have helped our customers avoid c. 20m tonnes of carbon emissions, significantly reduce their operating costs and increase the safety of their facilities. Our values are designed to ensure that our sustainability solution is underpinned by a sustainable business model.

Outlook

The macroeconomic outlook remains challenging, and we expect global supply chain disruptions to continue in the short term. We expect to see some alleviation in H2 2023.

We expect to continue to grow our Lighting business demonstrating the increasing relevance of our products as energy efficiency becomes more urgent. This is underpinned by a clear organic growth strategy, solid order book, and a strong pipeline of projects. Longer term, we see significant opportunity as the established leader in the heavier industrial lighting market.

FINANCIAL REVIEW

2022 saw strong revenue growth of 29% (17% in constant currency) driven by strong customer demand across both business segments and a robust order book at the start of the year. This growth was delivered against the backdrop of a challenging supply chain with component shortages and significant cost increases, particularly in H2, that were only partially mitigated by price increases. Availability and supplier reliability impacted production and lead times to customers, but the situation is improving. The result was a decline in the gross profit margin by 350bps to 32.2%, despite strong cost control on all non-revenue linked activity.

The Group delivered a reported profit from operating activities of £2.3m, an improvement of 10% (£0.2m) over the 2021 profit of £2.1m. After increased debt financing costs, the profit for the year was £0.4m, an increase of 33% (£0.1m) over 2021. On an underlying basis the Group delivered EBIT of £5.0m (see note 3 for items regarded as non-underlying), up 11% on 2021.

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

Underlying EBIT bridge	CCY 2022 £m	Actual 2022 £m
Underlying EBIT 2021	4.7	4.5
Revenue increase impact	9.0	13.6
Change in gross margin	(6.0)	(6.0)
Change in SG&A costs	(2.7)	(7.1)
Underlying EBIT 2022	5.0	5.0

Strong revenue growth in both segments delivered a £9.0m increase in gross profit. However, 2022 saw significant increases in key raw material costs (particularly in H2), increased freight costs and increased Mexican employment costs linked to minimum wage rate rises. These were only partially offset in the period by price increases, cost reduction programmes in key Lighting products and operational leverage due to increased production volumes and resulted in a lower gross profit margin of 32.2% compared to 35.7% in 2021. Selling, General and Administrative costs increased to support the near and longer-term growth in revenue and include exchange losses on US dollar borrowings. As a percentage of revenue, costs at 29.2% were lower than last year.

Lighting revenue grew by 34% (23% at constant currency), with our core US market seeing increased levels of project and MRO business, although December did not see the traditional end of year uplift in sales and orders. Our closing order book was lower than anticipated but we are starting to see this build again. EMEA and Asia grew revenue with customer demand increasing as COVID-19 restrictions eased and delayed projects re-commenced, but Australia revenue was lower following a strong performance in 2021, with restrictions impacting customer site access for a large part of the year and larger projects being delayed. These restrictions have been lifted and performance is expected to improve in 2023.

Signals & Components performed well with revenue up 18%, (7% at constant currency) driven by strong demand for opto-electronic (OE) product. The cyclical OE market has been strong for two years and is now going into an expected downturn.

Operations had another challenging year. While disruption from COVID-19 and government restrictions reduced, world-wide shortages of key components continued to severely impact our supply chain along with significant increases in shipping times and availability. To mitigate the impact, the Group increased stocks of raw material in H1 but in H2 actions were taken to reduce holdings, leading to raw material inventory levels being broadly flat year-on-year at December (down 9% ccy). The provision for excess or obsolete raw material inventory increased in 2022 by £2.0m, partly due to the decision to move to an aged-based method of calculation.

Net debt increased by £5.2m to £20.9m with a higher level of finished goods inventory and adverse movements in the USD exchange rate. At December, the Group had access to £7.5m in undrawn facilities and £1.7m in cash.

Currency impact

Our major trading currency is the US Dollar (87% of revenue) due to the 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 differs 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 strengthened to 1.24 from 1.38, a favourable impact of 10% with the year-end spot rate with the US Dollar rising by 11% to GBP: USD 1.21.

In constant currency, Group revenue grew by 17% with gross profit up 6% (versus 29% and 16% at actual rates). Underlying EBIT grew by £0.5m at actual currency rates and £0.3m at constant rates.

Lighting

Lighting	2022 £m	2021 £m	Variance %	2021 at constant currency £m	Constant currency variance %
Revenue	**121.0**	90.5	+34%	98.8	+23%
Gross profit	**40.6**	33.7	+20%	36.9	+10%
Gross profit %	***33.6%***	37.2%	-360bps	37.3%	-370bps
Overheads	**(33.7)**	(28.4)	(19%)	(31.2)	(8%)
Underlying EBIT	**6.9**	5.3	+30%	5.7	+21%

The Lighting segment saw continued strong growth in 2022, with revenue up 34%. Lighting represents 71% of the Group's revenue (2021: 69%), and consists of two main revenue streams, large retrofit projects and on-going MRO spend.

US revenues saw strong growth of 37% with the region benefitting from a high opening backlog of orders supported by price increases implemented in H1. We continued to gain market share in the MRO market, saw an increase in the number of sales to retrofit projects and started to see orders generated from the strategic sales team. However, revenue was significantly below our expectations in December, reflecting seasonal demand being below historic levels as well as several strategic customers deferring anticipated orders. Margins reduced in the year due to the challenges of increased material and freight costs, negated in part by operational efficiencies resulting from the capital investment.

EMEA revenue grew by 36% as COVID-19 restrictions lifted, with orders up 53% driven by new product launches. 2023 will see the benefit from price increases implemented in Q4 that will help offset the impacts from economic headwinds.

Following two years of strong growth, Australia suffered from lockdowns and close contact rules that reduced the ability of contractors and our sales teams to get on site, which reduced both sales (4%) and order intake (5%). With the relaxation of restrictions, we are seeing improved enquiry and MRO rates. Revenue growth rates are expected to increase in 2023, with improved product availability following transfer of more production to Penang and the benefit from recent price rises.

Asia, our smallest region, saw revenue grow by 133% to £3.4m as restrictions lifted with strong order growth at 60%. Activity levels remain excellent, with several larger projects under discussion and a strong backlog going into 2023.

Gross margins came under pressure from significant component price increases and a lack of availability, especially for aluminium, microchips, electrical components, and high freight costs. This particularly impacted H2 and was partially offset by the benefits from better fixed overhead absorption (higher production volumes)

and cost saving programmes on key products. Sale prices for new orders were raised on two occasions but there is a lag before their benefits are realised in revenue and the overall impact saw margin falling to 33.6%, a reduction of 360bps on 2021.

Operating costs were £5.3m higher than 2021 with higher sales and marketing (including commissions) to support the strong revenue growth as well as engineering costs to support sourcing and testing of alternative critical components. As a percentage of sales, overheads fell from 31% of revenue to 28% in 2022.

This resulted in an underlying operating profit of £6.9m, compared to a profit of £5.3m in 2021.

Signals & Components

Signals & Components	2022 £m	2021 £m	Variance %	2021 at constant currency £m	Constant currency variance %
Revenue	**48.7**	41.1	+18%	45.7	+7%
Gross profit	**14.0**	13.3	+5%	14.8	(5)%
Gross profit %	***28.7%***	*32.4%*	-370bps	32.4%	-370bps
Overheads	**(8.3)**	(7.8)	(6%)	(8.4)	+1%
Underlying EBIT	**5.7**	5.5	+4%	6.4	(11)%

Signals & 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.

The segment performed strongly during 2022 with revenue up 18% (7% at constant currency), helped by the strong order book carried from 2021. Continued high customer demand drove OE revenue up 21%, with increased sales of new products and expansion of our distributor footprint. OE is a cyclical business and the past two years have seen strong volume growth driven by customer concerns over supply chain instability. H2 saw the expected downturn in orders and revenue, which is expected to continue into 2023 as customers work through their raised inventory levels.

Traffic improved by 9% with higher orders placed ahead of price increases and changes to our shipping costs policy. Vehicle grew by 22%, despite the impact from curtailed bus production due to supply chain shortages.

Gross margin fell by 370bps driven by increased input prices for raw material and components, particularly in H2. Pricing has been raised for new orders, but the high level of committed customer orders and contracts resulted in only limited benefit in H2. Overheads increased by £0.5m to £8.3m due to foreign exchange movements but fell as a percentage of revenue.

The benefit from improved revenue was largely offset by the lower gross margin and resulted in an underlying operating profit of £5.7m compared to £5.5 in 2021.

Central overheads

Central overheads comprise costs that are not directly attributable to a segment and are shown separately. In the year, these totaled £7.6m, an increase of £1.3m (£0.2m at constant currency) due to a combination of foreign exchange movements, underlying inflation, annual pay awards and increased travel following the lifting of COVID-19 restrictions.

Non-underlying costs

Non-underlying costs	2022 £m	2021 £m
Sanmina costs	1.0	2.9
Development cost impairment	1.3	-
Release of warranty provision post sale	-	(0.3)
Other litigation costs	0.4	(0.2)
Total	2.7	2.4
Cash impact	1.4	2.4

To give a full understanding of the Group's performance and aid comparability between periods, the Group reports certain items as non-underlying to normal trading. These are summarised above, and further details are in note 3.

Costs of £1.0m were incurred in the year in relation to the ongoing litigation with Sanmina Corporation, following the termination in September 2018 of the manufacturing services agreement (MSA). Following unsuccessful mediation at the beginning of the year, Sanmina lodged a motion for summary judgement to dismiss the majority of Dialight's claim. The detailed evidence from both parties was examined by Federal judge and the Court's ruling on Sanmina's dismissal motion was released to the parties under seal on Tuesday 14 March 2023. The court denied Sanmina's motion to dismiss Dialight's fraudulent inducement claim and denied its motion for summary judgment on Sanmina's accounts receivable claim. The court granted Sanmina's motion as to the dismissal of Dialight's willful misconduct claim. The judge ruled that the strength of the evidence on the fraudulent inducement claim, together with various claims and counterclaims relating to accounts receivable and accounts payable, is sufficient that the dispute should be resolved by jury trial, pending any appeal process.

This ruling confirms that Dialight can challenge the contractual liability cap in the MSA on the basis of Sanmina's fraudulent inducement and Dialight intends to rigorously pursue this claim, and the various other contract-based claims, to trial. During the year, the Group has also incurred £0.4m in legal costs relating to a disagreement initiated by Dialight over royalty payments covering a number of years. Further costs will be incurred during 2023.

At the beginning of 2021, the Group paused development of a new range of Obstruction products within the Lighting segment. This was a temporary measure while technical and engineering resources supported the supply chain team in identifying and sourcing alternative components, following world-wide shortages linked to COVID-19. Over the past year management has explored options to complete the development, with the most likely outcome now unlikely to involve use of the Dialight developed technology. Accordingly, the development costs of £1.3m have been impaired.

In the prior year, we incurred £2.4m in legal costs and £0.5m in provisions for slow moving inventory in relation to Sanmina; £0.3m was released following the expiry of the warranty period on a disposed subsidiary and a provision of £ 0.2m for employment claims was released.

Inventory

Inventory levels grew £11.2m over 2021 (£6.7m at constant currency), driven by increased holdings of sub-assemblies and finished goods.

	2022 £m	2021 £m
Raw materials	22.7	22.2
Sub-assemblies	11.9	8.7
Finished goods	18.8	11.2
Spare parts	0.2	0.3
	53.6	42.4

Dialight, in common with many companies, has continued to be impacted by the well-publicised global commodity shortages as well as increased shipping times for inbound raw materials and outbound finished goods. Supplier lead times and the level of de-commits have been higher than normal in 2022 and, especially for semi-conductors, lack of availability forced us to temporarily purchase via expensive brokers. This continuing uncertainty led to the decision to maintain the level of raw material holdings in order to safeguard production and fulfil customer orders.

Inflation and foreign exchange have also increased the value of inventory held, with significant raw material price rises across many key components and movements in exchange rates since December 2021 increasing inventory by c. £4.5m.

Finished goods and sub-assembly levels increased following lower-than-expected customer demand in December. Inventory of high-running lines is normally built up in anticipation of a strong order take for immediate delivery, but this seasonal demand did not occur to the expected level and the inventory is now expected to be sold during early 2023.

We continue to keep inventory levels and future commitments under close review but will continue to maintain above average raw material and WIP stocks until lead times on both availability and shipping times for raw materials return to more normal levels, which is expected over the course of 2023. This is targeted to deliver a reduction of at least £5m, with further reductions delivered in later years through increased product and sub-assembly standardisation.

Capital expenditure

During 2022, the Group invested £7.3m in capital expenditure (2021: £5.6m).

New product development expenditure of £3.6m included the new Prosite High Mast/High Output Floodlight, next generation Highbay, new battery back-up systems and next generation GaN power supply.

Capital expenditure of £3.4m was focused on increasing automation of sub-assemblies in our Mexico factories, tooling for new or existing products, investment in capacity through production transfer to Malaysia, essential health and safety works in Mexico and completing the replacement of the Roxboro factory roof.

In 2023 the Group is planning to increase the level of investment to circa £10m, with 40% on new product development and 60% on capital expenditure. Product development will focus on new technologies, cost reduction for existing products and next generation Highbay/linear. Capital expenditure will focus on automation to reduce labour, increasing factory capacity to support revenue growth, replacing end of life equipment and digitise the business. This increased spend will help facilitate our multi-year growth.

Purchase of minority interest

In May, the Group acquired a further 12.5% of Dialight ILS Australia Pty Ltd for £1m (satisfied by issuing 266,958 new ordinary shares of 1.89 pence) and a cash payment of £100,000. This increased our shareholding to 87.5%, with the balance owned by a current senior employee.

Cash and borrowings

The Group ended the year with net debt of £20.9m, an increase £5.2m from December 2021 and £0.7m since June 2022. Net debt excludes lease liabilities related to the adoption of IFRS 16 Leases, which 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 2022		**(15.7)**
Inflows		
Underlying EBITDA	**12.3**	
Net working capital excluding inventory	**0.2**	**12.5**
Outflows		
Increase in inventory	**(6.7)**	
Investment in new products	**(3.6)**	
Maintenance capex/other	**(3.7)**	
Non underlying costs	**(1.4)**	
Provisions and other movements	**(0.1)**	
Interest and tax paid	**(2.6)**	**(18.1)**
Foreign exchange		**0.4**
Closing balance at 31 December 2022		**(20.9)**

The main factors behind the increase in net debt were:

- Increase in raw material inventory during H1 to mitigate the impact of world-wide commodity shortages and increased shipping times plus increased finished goods inventory following lower-than-expected December sales
- Improved credit terms with key suppliers
- Continued capital investment into new product development, increasing factory capacity and maintenance (see earlier capital expenditure section)
- Non-underlying costs (see earlier section)
- Higher interest and tax payments

There is a focus on reducing borrowings in the coming year, partly driven by the reduction in inventory discussed above.

The interest expense is analysed in note 4 and taxes paid in note 5. Interest expense will be higher in 2023 following the renegotiation of bank facilities and higher level of borrowing.

Banking

The Group has its banking relationships with HSBC Bank plc. The Group's multicurrency revolving credit facility with HSBC of £25m was re-negotiated and signed in July 2022 and will now run until at least July 2025. The three-year facility has two one-year extension options exercisable between 60 days before and 30 days from the first and second anniversary of the effective date, giving a maximum duration of five years. In November 2022, the facility was re-denominated to USD 34m as the majority of the Group's income and expenditures are

denominated in USD. In accordance with the Group's strong ESG commitment, the new facility is a sustainability linked loan.

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 instalments, from January 2021. £4m was repaid in the year, with a further £2m payable in 2023 and the facilities will be fully repaid by June 2023 at the latest. At 31 December the Group had £30m (2021: £31m) in facilities of which £22.6m was drawn and £1.7m of cash on hand.

Covenants

The Group's quarterly banking covenants have reverted to a maximum leverage and minimum interest cover level for all facilities, with the CLBILS facility having an additional test based on the ratio of adjusted cashflow to debt service. The Group was fully compliant with all leverage and interest covenants on its RCF facilities at 31 December 2022 and throughout 2022. The additional covenant test on the CLBILS facility was complied with through June 2022 and has been waived for all periods thereafter, until the end of the facility in June 2023. The trailing 12-month leverage multiple is 1.7x EBITDA and is expected to reduce towards 1x by the end of 2023, with interest cover at over 9x.

Tax

Based on a profit before tax of £0.5m in the year, the Group had an effective tax rate of 20% (2021 57.1%) resulting in a tax charge of £0.1m. This was broadly in line with our normalised rate, with prior year and R&D credits offsetting UK trading losses for which we are not recognising a deferred tax asset.

In the year we made a net cash tax payment of £0.8m, with £2.5m in corporation tax on operations in the USA, Australia and Malaysia offset by a £1.7m carry back refund in the US.

Pension costs

The Group has two defined benefit schemes that are closed to new entrants. The aggregate surplus on both schemes is £4.5m, an increase of £0.6m from 31 December 2021. The increase is the result of actuarial gains from changes in demographic and financial assumptions, as well as investment returns being higher than expected and cash contributions. The cash cost of the scheme in 2022 was £0.4m (2021: £0.4m) as agreed with the trustees following the 2019 valuation. The latest valuations were completed as at April 2022, and future cash contributions have been agreed at the current levels.

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 2022 this equated to £68.7m (2021: £60.2m).

Management's focus in 2022 has been on profitably growing revenue and maintaining availability of component supplies during a period of continuing world-wide commodity shortages and increased pricing, which has led to the higher-than-normal level of inventory. Distributions are not permitted under the terms of the CLBILS facility whilst there is debt outstanding, with the last repayment due in June 2023. The Board is not proposing a final dividend payment for 2022 (2021: nil). The Group has a clear capital allocation discipline and is committed to returning excess funds to shareholders via future dividend or share repurchases.

CONDENSED CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2022

	Note	2022 (unaudited) £'m	2021 (audited) £'m
Revenue	2	**169.7**	131.6
Cost of sales		**(115.1)**	(84.6)
Gross profit		**54.6**	47.0
Distribution costs		**(25.5)**	(21.3)
Administrative expenses		**(26.8)**	(23.6)
Profit from operating activities		**2.3**	2.1
Underlying profit from operating activities	2	**5.0**	4.5
Non-underlying items	3	**(2.7)**	(2.4)
Profit from operating activities		**2.3**	2.1
Financial expense	4	**(1.8)**	(1.4)
Profit before tax		**0.5**	0.7
Taxation	5	**(0.1)**	(0.4)
Profit for the year		**0.4**	0.3
Profit for the year attributable to:			
Equity owners of the Company		**0.4**	0.1
Non-controlling Interests		**-**	0.2
Profit for the year		**0.4**	0.3
Profit per share			
Basic	6	**1.2p**	0.9p
Diluted	6	**1.2p**	0.9p

The accompanying notes are extracted from the financial statements.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2022

	Note	2022 (unaudited) £'m	2021 (audited) £'m
Other comprehensive income			
Items that may be reclassified subsequently to profit and loss			
Exchange differences on translation of foreign operations		8.1	0.7
Income tax on exchange difference on translation of foreign operations		(0.6)	-
		7.5	0.7
Items that will not be reclassified subsequently to profit and loss			
Remeasurement of defined benefit pension liability		0.3	2.5
Income tax on remeasurement of defined benefit pension liability	5	(0.1)	(0.5)
		0.2	2.0
Other comprehensive income for the year, net of tax		7.7	2.7
Profit for the year		0.4	0.3
Total comprehensive income for the year		8.1	3.0
Attributable to:			
- Owners of the parent		8.1	2.8
- Non-controlling interests		-	0.2
Total comprehensive income for the year		8.1	3.0

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2022 (unaudited) and the year ended 31 December 2021 (audited)

	Share capital	Merger reserve	Translation reserve	Capital redemption reserve	Share premium	Own Shares	Retained earnings	**Total**	Non-controlling interests	**Total Equity**
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	**£'m**	£'m	**£'m**
Balance at 1 January 2022	0.6	0.5	10.0	2.2	-	(0.7)	47.0	**59.6**	0.6	**60.2**
Profit for the year	-	-	-	-	-	-	0.4	**0.4**	-	**0.4**
Other comprehensive income:										
Foreign exchange translation differences, net of taxes	-	-	7.5	-	-	-	-	**7.5**	-	**7.5**
Remeasurement of defined benefit pension liability, net of taxes	-	-	-	-	-	-	0.2	**0.2**	-	**0.2**
Total other comprehensive income	-	-	7.5	-	-	-	0.2	**7.7**	-	**7.7**
Total comprehensive income for the year	-	-	7.5	-	-	-	0.6	**8.1**	-	**8.1**
Transactions with owners, recorded directly in equity:										
Share-based payments	-	-	-	-	-	-	0.5	**0.5**	-	**0.5**
Re-purchase of own shares	-	-	-	-	-	(0.1)	-	**(0.1)**	-	**(0.1)**
Minority interest purchase	-	-	-	-	1.0	-	(0.6)	**0.4**	(0.4)	**-**
Total transactions with owners	-	-	-	-	1.0	(0.1)	(0.1)	**0.8**	(0.4)	**0.4**
Balance at 31 December 2022	0.6	0.5	17.5	2.2	1.0	(0.8)	47.5	**68.5**	0.2	**68.7**

	Share capital	Merger reserve	Translation reserve	Capital redemption reserve	Own Shares	Retained earnings	Total	Non-controlling interests	Total Equity
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	**£'m**
Balance at 1 January 2021	0.6	0.5	9.3	2.2	-	44.3	**56.9**	0.4	**57.3**
Profit for the year	-	-	-	-	-	0.1	**0.1**	0.2	**0.3**
Other comprehensive income:									
Foreign exchange translation differences, net of taxes	-	-	0.7	-	-	-	**0.7**	-	**0.7**
Remeasurement of defined benefit pension liability, net of taxes	-	-	-	-	-	2.0	**2.0**	-	**2.0**
Total other comprehensive income	-	-	0.7	-	-	2.0	**2.7**	-	**2.7**
Total comprehensive income for the year	-	-	0.7	-	-	2.1	**2.8**	0.2	**3.0**
Transactions with owners, recorded directly in equity:									
Share based payments	-	-	-	-	-	0.6	**0.6**	-	**0.6**
Re-purchase of own shares	-	-	-	-	(0.7)	-	**(0.7)**	-	**(0.7)**
Total transactions with owners	-	-	-	-	(0.7)	0.6	**(0.1)**	-	**(0.1)**
Balance at 31 December 2021	0.6	0.5	10.0	2.2	(0.7)	47.0	**59.6**	0.6	**60.2**

CONSOLIDATED STATEMENT OF TOTAL FINANCIAL POSITION

at 31 December 2022

	Notes	2022 (unaudited) £'m	2021 (audited) £'m
Assets			
Property, plant and equipment		**13.9**	12.0
Right of use assets		**10.5**	11.3
Intangible assets		**21.4**	21.4
Deferred tax assets		**2.4**	1.3
Employee benefits		**4.5**	3.9
Other receivables		**5.6**	4.7
Total non-current assets		**58.3**	54.6
Inventories	8	**53.6**	42.4
Trade and other receivables		**30.2**	26.2
Income tax recoverable		**0.6**	1.2
Cash and cash equivalents	10	**1.7**	1.2
Total current assets		**86.1**	71.0
Total assets		**144.4**	125.6
Liabilities			
Trade and other payables		**(37.3)**	(32.9)
Provisions	7	**(0.6)**	(0.6)
Tax liabilities		**(2.3)**	(1.7)
Lease liabilities		**(1.2)**	(1.2)
Borrowings	11	**(2.0)**	(4.0)
Total current liabilities		**(43.4)**	(40.4)
Provisions	7	**(1.6)**	(1.3)
Borrowings	11	**(20.6)**	(12.9)
Lease liabilities		**(10.1)**	(10.8)
Total non-current liabilities		**(32.3)**	(25.0)
Total liabilities		**(75.7)**	(65.4)
Net assets		**68.7**	60.2
Equity			
Issued share capital		**0.6**	0.6
Merger reserve		**0.5**	0.5
Share premium		**1.0**	-
Other reserves		**18.9**	11.5
Retained earnings		**47.5**	47.0
		68.5	59.6
Non-controlling interests		**0.2**	0.6
Total equity		**68.7**	60.2

CONSOLIDATED STATEMENT OF CASH FLOWS

for the year ended 31 December 2022

	Notes	2022 (unaudited) £'m	2021 (audited) £'m
Operating activities			
Profit for the year		**0.4**	0.3
Adjustments for:			
Financial expense	4	**1.8**	1.4
Income tax expense	5	**0.1**	0.4
Share-based payments		**0.5**	0.6
Depreciation of property, plant and equipment		**2.9**	3.1
Depreciation of right of use assets		**1.8**	2.2
Amortisation of intangible assets		**4.4**	3.5
Impairment losses on intangible assets		**1.3**	-
Operating cash flow before movements in working capital		**13.2**	11.5
(Increase) in inventories		**(6.7)**	(9.6)
(Increase) in trade and other receivables		**(1.1)**	(5.8)
Increase in trade and other payables		**1.3**	11.1
Increase /(decrease) in provisions	7	**0.3**	(0.8)
Pension contributions in excess of the income statement charge		**(0.4)**	(0.4)
Cash generated by operations		**6.6**	6.0
Income taxes paid		**(0.8)**	(0.6)
Interest paid[2]	4	**(1.8)**	(1.4)
Net cash generated by operations		**4.0**	4.0
Investing activities			
Capital expenditure		**(3.4)**	(2.1)
Capitalised expenditure on development costs and other intangible assets		**(3.6)**	(3.2)
Purchase of software and licenses		**(0.2)**	(0.3)
Purchase of 12.5% of Dialight Australia		**(0.1)**	-
Net cash used in investing activities		**(7.3)**	(5.6)
Financing activities			
Drawdown of bank facility	11	**8.5**	4.2
Repayment of bank facility	11	**(4.0)**	(4.0)
Arrangement fee for revised facility		**(0.5)**	-
Re-purchase of own shares		**(0.1)**	(0.7)
Repayment of lease liabilities[1]		**(1.7)**	(1.7)
Net cash inflow/(outflow) from financing activities		**2.2**	(2.2)
Net decrease in cash and cash equivalents		**(1.1)**	(3.8)
Cash and cash equivalents at beginning of year	10	**1.2**	5.3
Effect of exchange rates		**1.6**	(0.3)
Cash and cash equivalents at end of year	10	**1.7**	1.2

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 2022 (unaudited)

1. Basis of preparation and principal accounting policies

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with UK-adopted International Accounting Standards in conformity with the requirements of the Companies Act 2006.

The financial information for the year ended 31 December 2021 and 2022 is derived from the statutory accounts for 2021 (which has been delivered to the Registrar of Companies) and 2022 (which will be delivered to the Registrar of Companies following the AGM in May 2023). The auditors have reported on the 2021 accounts; their report was (i) unqualified, (ii) did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006. The statutory accounts for 2022 will be finalised on the basis of the financial information presented by the directors in this preliminary announcement and will be delivered to the Registrar of Companies in due course.

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 will be included in the 2022 Annual Report; these will be available to shareholders via the Group website.

(b) Consolidated basis of preparation

The uncertainty as to the future impact on the financial performance and cash flows of the Group from the uncertainty in the economic environment and current world-wide commodity challenges have 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 multicurrency revolving credit facility with HSBC of £25m was re-negotiated in July 2022 to a sustainability-linked loan and runs until July 2025. In November 2022, the £25m facility was redenominated to a $34m facility as most drawings are in USD and recent fluctuations in the GBP: USD exchange rate had adversely impacted headroom. The new facility contains normal covenants, covering maximum net leverage and minimum interest cover levels and contains options for two one-year extensions.

The Group increased its banking facility with HSBC on 15 June 2020 by adding a further £10m facility on a three-year basis, utilising a combination of a £8m Coronavirus Large Business Interruption Loan Scheme (CLBILS) loan and a £2m commercial loan. The £10m additional facilities are repayable over 30 months, in equal instalments, from January 2021. £8m has been repaid to date (2022 £4.0m), with the remaining £2m to be fully repaid by June 2023 at the latest. During the year the debt service cover ratio (DSCR) covenant , which only applies to the CLBILS loan, was waived for Q2 and Q3 as the covenant penalises investment in working capital and capex. In December 2022, HSBC waived the remaining covenant tests for Q4 2022 and Q1 2023. At 31 December the Group had £30m (2021: £31m) in facilities of which £22.6m was drawn and £1.7m of cash on hand.

Further details, including the relevant covenant tests, are included in note 11.

In assessing the going concern assumptions, the Directors have prepared downside scenarios that reflect the risk of lower-than-expected revenue growth in our core Lighting markets, higher revenue decline in the opto-electronic market, lower gross margins due to input cost inflation, the associated forecast outturns alongside identified downside risks and mitigating actions. The Group has modelled four main scenarios in its assessment of going concern, being the base case, a lower revenue scenario, a lower margin scenario and a combined downside taking elements of lower revenue and lower margin.

Base case

The base case is derived from the Board approved 2023 budget, which assumes that demand for our new and existing products remains strong, component availability and pricing normalises, and our factories operate as normal. In this scenario, the Directors consider that the Group will continue to operate within its available committed facilities of $34m (£30m) with sufficient headroom and meet its ongoing financial covenant obligations.

The key assumptions in the base case include:

- continued revenue growth in Lighting due to our focus on markets with growing demand and where growth is driven by structural, safety and sustainability factors but at a lower level than seen in 2022;
- a short-term cyclical downturn in the opto-electronic segment;
- gross margins normalise to pre-COVID levels as component price premiums reduce and supply becomes more readily available, freight costs normalise, and the benefits from cost reduction and automation programmes are delivered; and
- operating costs are flexed in line with the incremental revenue and increasing operational leverage.

Downside cases

Lower revenue

In a severe revenue downside scenario, the Directors have assumed:

- no growth in Lighting revenue in 2023 followed by growth in 2024 at less than 50% of that achieved in 2022;
- no growth in Signals and Components revenue versus 2022; and
- no change in segmental gross margins.

Lower margin

In the margin downside scenario, the Directors have assumed:

- segmental revenues in line with the base case;
- gross margin reduction in 2023 of 1% caused by continued input cost pressures that are not fully mitigated by in year price increases; and
- gross margin improvement in 2024 to achieve a similar margin to 2021.

Combined downside case

In the combined downside case, the Directors have assumed:

- flat volume compared with 2022 but with the price increases negotiated in November 2022 applying throughout 2023 and into early 2024;
- gross margin reduction of 2% throughout 2023 and into early 2024;

In all these scenarios, the Group has a series of controllable mitigating actions that can be taken swiftly (a number of which have already been enacted), including various temporary and permanent cost and cash saving measures.

The base case and downside cases have been further modelled to show headroom for any material one-off costs.

In the post mitigation downside scenarios, 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. Consequently, the Directors are confident that the Group 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.

Significant judgements

Termination of outsourced manufacturing agreement

Significant judgement is applied in determining whether to recognise a provision or a contingent liability in respect of the claims from the Group's former manufacturing partner Sanmina. 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 in note 15, which contains further details on the matter.

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 applies judgement that is 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 £11.5m (2021: £12.0m) of development and patent costs that relate to the current product portfolio and new products expected to launch over the next one to two years. Within the prior year cost, there was £1.3m relating to development projects which were paused during COVID-19 while the engineering team was redeployed to focus on projects to source alternative components and consume raw materials on hand, to help the business mitigate the global supply chain challenges. This project was expected to recommence in 2022, but the Group is currently exploring other options that may not use these capitalised costs. Due to uncertainty of next steps, capitalised costs of £1.3m have been written off and the impairment recorded in the income statement as a non-recurring expense (note 3). All of the development projects are within the Lighting CGU and are tested for impairment at the CGU level as part of the goodwill testing. However, management also performs a review of each individual project to see if there are any indications of specific impairment by comparing the carrying amount of the asset with the net present value derived from the Board approved strategic plan.

Estimates

Inventory reserve - Raw Materials and Sub-Assemblies

In the previous year, the basis for reserving raw materials and sub-assemblies was to reserve the quantity on hand that was greater than 365 days old, exceeded three year's historical usage and where, following a review by engineering and supply chain personnel, there was no reasonable prospect of the components being used or their shelf life not being exceeded. This estimate was felt appropriate given the significant impact that the prolonged pandemic/geopolitical situation had on our operations and the consequential logistics and supply chain challenges, that resulted in inventory being held for longer than normal. The Group has now revised its basis of estimate for calculating the inventory reserve to provide for raw and sub-assembly inventory that is over 24-months old at the balance sheet date. This basis for estimate reduces estimation subjectivity, whilst allowing for the adverse impact from component shortages that have led to high inventory levels and some components being held for longer than expected. Two years is felt to be appropriate as the components have a long shelf life, continue to be used in production and the product demand mix between project and MRO business has been skewed during COVID-19.

Management believes that any reasonably possible change in the assumption would not cause any significant change in the provision estimate for raw materials and sub-assemblies in the next financial year.

Inventory reserve - finished goods

The review of finished goods inventory was based on all inventory over 365 days old. Inventory on hand was compared to historical sales, current orders, sales pipeline and whether the product had been recently launched.

Management judgement was then applied to determine whether there was a reasonable probability that the inventory would be sold, with a provision being required for any inventory that failed this assessment.

Management believes that any reasonably possible change in the assumption would not cause any significant change in the provision estimate for finished goods.

The value of the provision for all categories of inventory over which judgement has been exercised was £4.1m (2021: £3.0m) and this represents 7.7% (2021: 7.0%) of the gross inventory value.

Details of the inventory reserve are set out in note 8.

Inventory - absorbed overhead costs

The valuation of inventory, detailed in note 8, 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 (2022: 68 days, 2021: 64 days). The value of directly attributable costs over which judgement was exercised was £7.0m (2021: £5.0m) and this represents 13% (2021: 12%) of the inventory value. For every day that the estimate of the days used for the overheads absorbed changes, it changes the calculation by £17k.

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 (2022: 151 days, 2021: 162 days). Costs of transporting finished goods to distribution centres 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 £4.1m (2021: £3.1m) and this represents 8% (2021: 7%) of the inventory value. For every day that the estimate of the days used for the overhead absorbed changes, it changes the calculation by £91k.

Management believes that any reasonably possible change in the assumptions would not cause any significant change in the amount of costs absorbed into inventory.

Goodwill and other intangible assets

The Group tests at least annually whether goodwill has suffered any impairment in accordance with the accounting policy. The recoverable amounts of the Group's CGU's have been determined based on value in use calculations, which involve a high level of estimation due to the uncertainty caused by the geopolitical situation and potential material shortages due to delays in the supply chain.

In undertaking the assessment, the potential net impact of climate change on the forecasts has been considered. Considering the Group's business model, strategy and exposure, the opportunities overcome the risk and the majority of the risk relates to the ability to cope with accelerated product demand and has been reflected in our forecast.

Management believes that any reasonably possible change in the assumptions would not cause the carrying amount to exceed the recoverable amount in the next financial year.

Pensions/Retirement benefits

Benefits in the form of retirement pensions are provided to current and former employees under defined benefit plans. Obligations under defined benefit plans are calculated annually by independent actuaries using the Defined Accrued Benefit method.

Defined benefit plan surpluses are recognised as an asset to the extent they are considered recoverable. The amount recognised in the statement of comprehensive income in respect of defined benefit plans mainly comprises service cost and net interest. Remeasurement of the net defined benefit asset resulting from actuarial gains and losses, and return on plan assets, are recognised in other comprehensive income. The Group has £4.5m (2021: £3.9m) of defined benefit asset.

The valuation of the defined benefit pension obligations requires the use of estimates for three elements, discount rate, inflation and life expectancy.

The discount rate is a key assumption in calculating the value of defined benefit obligations. The assumption is used to calculate the net present value of the expected benefit payments. The rate is derived from high quality corporate bonds. The rate used for this year's valuation is 4.85% (2021: 1.85%). For every 0.1% change in the discount rate used in the estimate it changes the calculation by £160k.

The inflation rate is a key assumption in calculating the value of defined benefit obligations. The assumption is used to calculate the expected amounts of future benefit payments. The rate is derived from the central bank inflation curve less an inflation premium. The rate used for this year's valuation is 3.3% (2021: 3.6%). For every 0.1% change in the inflation rate used in the estimate it changes the calculation by £100k.

The mortality rate is a key assumption in calculating the value of defined benefit obligations. The mortality assumption estimates how long members are expected to live and receive benefits for. The assumption is used to calculate the expected amounts of future benefit payments, the assumption is derived from current life expectancy and the Continuous Mortality Investigation (CMI) projection tables. For every 6 months change in the mortality rate used in the estimate it changes the calculation by £300k.

(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 has adopted them, they have had no material impact on the Group. These comprise:

- Onerous Contracts – Cost of Fulfilling a Contract (Amendment to IAS 37);
- Annual Improvements to IFRS Standards 2018-2020;
- Property, Plant and Equipment: Proceeds Before Intended Use (Amendments to IAS 16);
- Reference to the Conceptual Framework (Amendments to IFRS 3).

The following amendments to standards and interpretations have also been issued, but are not yet effective and have not been early adopted for the financial year ended 31 December 2022:

- IFRS 17 Insurance Contracts (Effective day 1 January 2023);
- Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendment to IAS 12) (Effective from 1 January 2023);
- Classification of Liabilities as Current and Non-current (Amendment to IAS 1) (Deferred until not earlier than 1 January 2024);
- Accounting Policies, Changes in Accounting Estimates and Errors: definition (Amendments to IAS 8) (Effective from 1 January 2023);

- Amendments to IAS1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements (Effective from 1 January 2023);
- Sale or Contribution of Assets between an Investor and its Associate or Joint venture (Amendments to IFRS 10 and IAS 28).

The adoption of these amendments is not expected to have a material impact on the Group.

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

2022 (unaudited)	**Lighting**	**Signals and Components**	**Unallocated**	**Total**
	£'m	**£'m**	**£'m**	**£'m**
Revenue	**121.0**	**48.7**	**_**	**169.7**
Gross profit	**40.6**	**14.0**	**–**	**54.6**
Overhead costs	**(33.7)**	**(8.3)**	**(7.6)**	**(49.6)**
Underlying profit/(loss) from operating activities	**6.9**	**5.7**	**(7.6)**	**5.0**
Non-underlying items (note 3)	**(2.7)**	**–**	**–**	**(2.7)**
Profit/(loss) from operating activities	**4.2**	**5.7**	**(7.6)**	**2.3**
Financial expense				**(1.8)**
Profit before tax				**0.5**
Taxation				**(0.1)**
Profit after tax				**0.4**

2021 (audited)	Lighting	Signals and Components	Unallocated	Total
	£'m	£'m	£'m	£'m
Revenue	90.5	41.1	_	131.6
Gross profit	33.7	13.3	–	47.0
Overhead costs	(28.4)	(7.8)	(6.3)	(42.5)
Underlying profit/(loss) from operating activities	5.3	5.5	(6.3)	4.5
Non-underlying items (note 3)	(2.4)	–	–	(2.4)
Profit/(loss) from operating activities	2.9	5.5	(6.3)	2.1
Financial expense				(1.4)
Profit before tax				0.7
Taxation				(0.4)
Profit after tax				0.3

Other segmental data

	2022 (unaudited)			2021 (audited)		
	Lighting	**Signal & components**	**Total**	Lighting	Signals & components	Total
	£'m	**£'m**	**£'m**	£'m	£'m	£'m
Depreciation of property, plant and equipment	**2.1**	**0.8**	**2.9**	2.1	1.0	3.1
Depreciation of right of use assets	**1.3**	**0.5**	**1.8**	1.5	0.7	2.2
Amortisation*	**4.4**	**_**	**4.4**	3.5	_	3.5
Impairment of intangible assets	**1.3**	**–**	**1.3**	–	–	–

Re-presentation of 2021 amortisation, with no impact on segmental income statement

Geographical segments

The Lighting and Signals & 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

	2022 £'m (unaudited)	2021 £'m (audited)
North America	**132.7**	101.0
EMEA	**14.5**	10.2
Rest of World	**22.5**	20.4
Total sales revenue	**169.7**	131.6

3. Non-underlying items

Statutory operating profit includes 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.

	2022 £'m (unaudited)	2021 £'m (audited)
Non-underlying items:		
Costs related to manufacturing partner	**1.0**	2.9
Impairment of capitalised development costs	**1.3**	-
Other litigation costs	**0.4**	-
Release of warranty provision	**-**	(0.3)
Release of litigation provision	**-**	(0.2)
Non-underlying items recorded in administrative expenses	**2.7**	2.4

As previously reported, Dialight sought to reach a negotiated conclusion of various outstanding matters and performance issues following the termination, in 2018, of the manufacturing services agreement (MSA) with its former manufacturing partner, Sanmina Corporation ("Sanmina"). Following unsuccessful mediation at the beginning of the year, Sanmina lodged a motion for summary judgement to dismiss the majority of Dialight's claim. The detailed evidence from both parties was examined by Federal judge and the Court's ruling on Sanmina's dismissal motion was released to the parties under seal on Tuesday 14 March 2023. The court denied Sanmina's motion to dismiss Dialight's fraudulent inducement claim and denied its motion for summary judgment on Sanmina's accounts receivable claim. The court granted Sanmina's motion as to the dismissal of Dialight's willful misconduct claim. The judge ruled that the strength of the evidence on the fraudulent inducement claim, together with various claims and counter-claims relating to accounts receivable and accounts payable, is sufficient that the dispute should be resolved by jury trial, pending any appeal process. This ruling confirms that Dialight can challenge the contractual liability cap in the MSA on the basis of Sanmina's fraudulent inducement and Dialight intends to rigorously pursue this claim, and the various other contract-based claims, to trial. Dialight has sought external legal advice and is paying for the legal costs as incurred. During the year, legal costs of £1m have been expensed, compared to prior-year legal and inventory write off costs of £2.9m.

At the beginning of 2021, the Group paused development of a new range of Obstruction products within the Lighting segment. This was a temporary measure while technical and engineering resources supported the supply chain team in identifying and sourcing alternative components, following world-wide shortages linked to COVID-19. Over the past year management has explored several options to complete the development, including continuing internal development or utilising third party technology. The most likely option is now to utilise third party components in the new product suite, as this will be quicker and allow Dialight to capitalise on market opportunities and gain market share. Given this change in strategy would not involve use of the Dialight developed technology, the paused development costs of £1.3m have been impaired and the non-cash cost classified as non-underlying in accordance with Group accounting policy.

Other litigation costs of £0.4m relate to a contractual litigation case, initiated by Dialight during 2022, relating to the use of the intellectual property. The costs incurred relate to the legal costs incurred in the year.

Prior year release of warranty provision of £0.3m related to unclaimed warranty related to the disposal of the Group's Wind business in 2019. The Group had received and paid all claims related to this disposal and the remaining balance of the provision was therefore released. Prior year litigation credit related to employment

litigation cases; a provision of £0.2m (see note 7) was released as it was not probable that Group would have to pay for the claims which was netted off with £0.2m legal cost incurred in the year relating to the cases.

4. Financial expense

	2022 £'m (unaudited)	2021 £'m (audited)
Net interest on defined benefit liability	**0.1**	0.1
Interest expense on financial liabilities, except lease liabilities	**1.1**	0.7
Arrangement fee amortisation	**0.1**	0.1
Interest expense on lease liabilities	**0.5**	0.5
Net financing expense recognised in the consolidated income statement	**1.8**	1.4

5. Taxation

	2022 £'m (unaudited)	2021 £'m (audited)
Current tax expense		
Current year	**2.1**	1.3
Adjustment for prior years	**(0.2)**	(0.6)
Total current tax	**1.9**	0.7
Deferred tax expense		
Origination and reversal of temporary differences	**(1.9)**	0.1
Adjustment for prior years	**0.1**	(0.4)
Total deferred tax	**(1.8)**	(0.3)
Total tax expense	**0.1**	0.4

Reconciliation of effective tax rate

	2022 %	2022 £'m (unaudited)	2021 %	2021 £'m (audited)
Profit for the year		**0.4**		0.3
Total tax charge		**0.1**		0.4
Profit before tax		**0.5**		0.7
Income tax using the UK corporation tax rate	**19.0**	**0.1**	19.0	0.1
Effect of higher taxes on overseas earnings	**20.0**	**0.1**	43.0	0.3
Non-deductible expenses	**20.0**	**0.1**	28.6	0.2
Current year losses for which no deferred tax is recognised	**40.0**	**0.2**	57.1	0.4
US carry back claim	**-**	**-**	(43.0)	(0.3)
Adjustment for prior years	**(20.0)**	**(0.1)**	(88.3)	(0.6)
Research and development credits	**(19.0)**	**(0.1)**	(28.6)	(0.2)
Foreign taxes incurred	**(40.0)**	**(0.2)**	69.3	0.5
	20.0	**0.1**	57.1	0.4

The effective tax rate for the year is 20% compared with 57.1% in the prior year and the standard rate of 19% (2021: 19.0%) in the UK. During the year, the Group made a profit of £0.5m, which was lower than the prior year, which resulted in a tax charge in the year of £0.1m.

The normalised tax rate for the Group in the year is 25% (tax rate before adjustments) and based on a pre-tax profit of £0.5m this would generate a tax charge of £0.1m. The Group's overall tax rate was 20%, which was broadly the same as the normalised rate due to untypical adjustments equating each other out. The major adjustments were:

- The current losses in the European Lighting business are not recognised as a deferred tax asset, resulting in £0.2m of tax credit not being recognised in the year. We do not anticipate this business making sufficient taxable profits in the foreseeable future to utilise the losses.
- A current year adjustment of £0.1m relating to additional research and development credit in the US.
- A £0.1m prior year adjustment in Malaysia and US truing up prior year provisions to actual submissions.

Tax charge/(credit) recognised directly in equity

	2022 £'m (unaudited)	2021 £'m (audited)
Employee benefits	**0.1**	0.5
Other	**0.6**	(0.1)

Current tax

Current tax is calculated with reference to the profit or loss 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% (2021: 19.0%). There are no UK timing differences recognised at 31 December 2022. In the March 2021 Budget, the UK Government announced that legislation will be introduced in the Finance Bill 2021 to increase the main rate of UK corporation tax from 19% to 25%, effective 1 April 2023.

US

The majority of the Group's profits arise in the US where the corporation tax rate is 24%, including 21% federal tax and 3% state tax (2021: 24%, including 21% federal tax and 3% state tax).

Group

The majority of the Group's profits are driven by the US entity where the tax rate is 24% underpinning the Group's tax rate.

6. Earnings per share

Basic earnings per share

The calculation of basic earnings per share ("EPS") at 31 December 2022 was based on a profit for the year of £0.4m (2021: £0.3m profit) and the weighted average number of ordinary shares outstanding during the year of 32,574,668 (2021: 32,393,109).

Weighted average number of ordinary shares

	2022 '000 (unaudited)	2021 '000 (audited)
Weighted average number of ordinary shares	32,575	32,393

	2022	2021
Basic earnings per share	1.2p	0.9p
Basic adjusted earnings per share*	7.4p	6.5p

Diluted earnings per share

The calculation of diluted EPS at 31 December 2022 was based on a profit for the year of £0.4m and the weighted average number of diluted ordinary shares during the year of 33,231,301 (2021: 32,803,606), excluding the purchase of 225,451 own shares by the Group.

Weighted average number of ordinary shares

	2022 '000 (unaudited)	2021 '000 (audited)
Weighted average number of ordinary shares	33,231	32,804

	2022	2021
Diluted earnings per share	1.2p	0.9p
Adjusted diluted earnings per share*	7.3p	6.4p

*Adjusted earnings excludes non-underlying items (see note 3) and allocates tax at the appropriate rate (see note 5)

7. Provisions

	Warranty and claims £'m	Lease-restoration £'m	Total £'m
Balance at 1 January 2022 (audited)	1.7	0.2	1.9
Provisions made during the year	1.4	–	1.4
Provisions used during the year	(1.3)	–	(1.3)
Effects of foreign exchange movement	0.2	–	0.2
Balance at 31 December 2022 (unaudited)	2.0	0.2	2.2

The warranty provision relates to sales made over the past nine years. In the previous year, the provision also included other claims across the Group, which were either utilised or released (see note 3). 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:

	2022 £'m (unaudited)	2021 £'m (audited)
Due within one year	0.6	0.6
Due within one and five years	1.2	1.1
Due after five years	0.4	0.2
	2.2	1.9

8. Inventories

	2022 £'m (unaudited)	2021 £'m (audited)
Raw materials and consumables	**22.7**	22.2
Sub-assemblies	**11.9**	8.7
Finished goods	**18.8**	11.2
	53.4	42.1
Spare parts	**0.2**	0.3
	53.6	42.4

Inventories to the value of £79.0m (2021: £55.8m) were recognised as expenses in the year. The inventory reserve at the balance sheet date was £4.1m, which represents 7.7% of inventory (2021: £3.0m representing 7.0% of inventory). Additional reserves of £2.0m were booked in year with an increase of £0.3m due to foreign exchange movements, being offset by utilisation of £1.2m, resulting in a net movement in the reserve of £1.1m.

As at 31 December 2022, management's best estimate of the amount of inventory that will not be used within the next 12 months is c.£4.8m (2021: £3.4m).

In the previous year, the basis for reserving raw materials and sub-assemblies was to reserve the quantity on hand that was greater than 365 days old, exceeded three year's historical usage and where, following a review by engineering and supply chain personnel, there was no reasonable prospect of the components being used or their shelf life not being exceeded. This estimate was felt appropriate given the significant impact that the prolonged pandemic/geopolitical situation had on our operations and the consequential logistics and supply chain challenges, that resulted in inventory being held for longer than normal. The Group has now revised its basis for estimate to calculating the inventory reserve to provide for raw and sub-assembly inventory that is over 24-months old at the balance sheet date. This new basis for estimate reduces estimation subjectivity whilst allowing for the adverse impact from component shortages that have led to high inventory levels and some components being held for longer than expected. Two years is felt to be appropriate as the components have a long shelf life, continue to be used in production and the product demand mix between project and MRO business has been skewed during COVID-19.

The review of finished goods inventory was based on all inventory over 365 days old. Inventory on hand was compared to historical sales, current orders, sales pipeline and whether the product had been recently launched. Management judgement was then applied to determine whether there was a reasonable probability that the inventory would be sold, with a provision being required for any inventory that failed this assessment.

The level of inventory was increased by £11.2m in 2022 driven by £4.5m in foreign exchange and management decisions to increase finished goods stock levels in December to fulfil seasonal demand, however this demand was lower than expected along with several strategic customers deferring anticipated orders.

9. Dividends

There were no dividends declared or paid in the 12 months ended 31 December 2022 or 31 December 2021.

10. Cash and cash equivalents

	2022 £'m (unaudited)	2021 £'m (audited)
Cash and cash equivalents	**1.7**	1.2

11. Borrowings

The Group's multicurrency revolving credit facility with HSBC of £25m was re-negotiated in July 2022 to a sustainability-linked loan and runs until July 2025. In November 2022, the £25m facility was redenominated to a $34m facility as most drawings are in USD and fluctuations in the GBP: USD exchange rate had adversely impacted headroom. The new facility contains normal covenants, covering maximum net leverage and minimum interest cover levels and contains options for two one-year extensions.

The Group increased its banking facility with HSBC on 15 June 2020 by adding a further £10m facility on a three-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 instalments, from January 2021. £4m was repaid in the year, with a further £2m payable in 2023 and the facilities will be fully repaid by June 2023 at the latest. During the year, the debt service cover ratio (DSCR), linked to the CLBILS loan, was waived for Q2 and Q3 2022 as the test penalises investment in working capital and capex. In December 2022, HSBC waived the remaining DSCR covenant tests for Q4 2022 and Q1 2023.

At 31 December the Group had £30m (2021: £31m) in facilities and £1.7m of cash on hand.

	Loans £'m
At 1 January 2021 (audited)	16.7
Facility drawdown (RCF)	4.2
Facility repayment (CLBILS)	(4.0)
At 31 December 2021(audited)	16.9
Facility drawdown (RCF)	**8.5**
Facility repayment (CLBILS)	**(4.0)**
Interest accrued	**1.1**
Interest paid (note 4)	**(1.1)**
Foreign exchange	**1.2**
At 31 December 2022 (unaudited)	**22.6**

Details of the facilities	Tenure	Interest rate per annum*	Maturity date	**Amount drawn 31 December 2022 (unaudited)**	Amount drawn 31 December 2021 (audited)
	Years	%		£'m	£'m
$34m revolving credit facility	3	6.97	July 2025	**20.6**	10.9
£8m CLBILS	3	5.59	June 2023⁺	**1.6**	4.8
£2m commercial loan	3	5.79	June 2023⁺	**0.4**	1.2

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

* This is an indicative rate as at December 2022.

The banking covenants were based on a 12-month rolling EBITDA test until June 2021, when they reverted to:

Covenant test		**Every Quarter**
Ratio	**Calculation**	**Threshold**
Leverage ratio	Net debt/Adjusted EBITDA	<3.0x
Interest cover	Adjusted EBITDA/Interest expense	>4.0x
Debt service ratio*	Net operating income/Total debt service	>1.2

* The debt service cover ratio does not apply to the revolving credit facility and has been waived from June 2022 to the end of the loan.

12. Principal exchange rates

	2022 Average rate	2022 At balance sheet date	2021 Average rate	2021 At balance sheet date
US Dollar	**1.24**	**1.21**	1.38	1.35
Euro	**1.17**	**1.13**	1.16	1.19
Canadian Dollar	**1.61**	**1.64**	1.72	1.72
Mexican Peso	**24.87**	**23.53**	27.88	27.64

13. Related party transactions

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

14. Reconciliation to non-GAAP performance measures

	2022 £'m	2021 £'m
Profit from operating activities	**2.3**	2.1
Non-underlying items (see note 3)	**2.7**	2.4
Underlying profit from operating activities	**5.0**	4.5
Profit from operating activities	**2.3**	2.1
Non–underlying items (see note 3)	**2.7**	2.4
Depreciation of property, plant and equipment	**2.9**	3.1
Amortisation of intangible assets	**4.4**	3.5
Underlying EBITDA	**12.3**	11.1
Profit from operating activities	**2.3**	2.1
Non-underlying items (see note 3)	**2.7**	2.4
Depreciation of property, plant and equipment	**2.9**	3.1
Amortisation of intangible assets	**4.4**	3.5
Share based payments	**0.5**	0.6
Net movement on working capital (Inventories, trade and other receivables, trade and other payables) as per Consolidated statement of cash flows	**(6.5)**	(4.3)
Underlying operating cash flow	**6.3**	7.4

Underlying profit from operating activities and underlying EBIT referred to in the earlier sections of this announcement are the same measures. Underlying operating cash flow and adjusted operating cash flow referred to in the earlier sections of this announcement are the same measures.

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 Group uses GBP based constant currency models to measure performance. These are calculated by restating the results of the Group for the comparable year at the same average exchange rates as those used in reported results for the current year.

This gives a GBP denominated income statement, which excludes any variances attributable to foreign exchange rate movements. The most important foreign currencies for the Group are: US Dollar, Euro, Canadian Dollar and Mexican Peso. The exchange rates used are set out in note 12.

Net debt

Net debt is defined as total Group borrowings less cash. Net debt of £20.9m at the year-end (2021: £15.7m) consisted of borrowings of £22.6m (2021: £16.9m) less cash of £1.7m (2021: £1.2m).

15. Contingencies

Sanmina litigation

As previously reported, Dialight sought to reach a negotiated conclusion of various outstanding matters and performance issues following the termination, in 2018, of the manufacturing services agreement (MSA) with its former manufacturing partner, Sanmina Corporation ("Sanmina"). The failure to reach a satisfactory resolution of these issues led to both parties issuing formal legal proceedings against the other on 20th December 2019 in the US District Court for the Southern District of New York. The basis of the claim filed by Sanmina 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 counterclaims, and costs and losses suffered by Dialight. Dialight has sought external legal advice and is paying for the legal costs as incurred. As at 31 December 2022, Dialight has not made any provision for future legal costs.

The claim filed by Dialight alleged that Dialight suffered significant costs and losses (with total potential damages of approximately $220m) as a result of: (a) Sanmina's fraudulent inducement of Dialight to enter into the 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 wilful misconduct in the performance of its duties owed to Dialight. If Sanmina's claim is successful, the range of outcomes could include the payment by Dialight to Sanmina of between $0 and $8.3m (excluding legal costs and judicial interest, but inclusive of Dialight 'escrow' monies held by Sanmina). If Dialight's claims are successful, the range of outcomes could include the payment by Sanmina to Dialight of between $0 and c. $220m (excluding legal costs and judicial interest).

Sanmina subsequently lodged a motion for summary judgement to dismiss elements of Dialight's claims/counter-claims (first filed on 2 May 2022). The detailed evidence and legal arguments from both parties (submitted in May-July 2022) was examined by Federal judge and the Court's ruling on Sanmina's dismissal motion was released to the parties under seal on Tuesday 14 March 2023. The court denied Sanmina's motion to dismiss Dialight's fraudulent inducement claim and denied its motion for summary judgment on Sanmina's accounts receivable claim. The court granted Sanmina's motion as to the dismissal of Dialight's willful misconduct claim. The judge ruled that the strength of the evidence on the fraudulent inducement claim, together with various claims and counter-claims relating to accounts receivable and accounts payable, is sufficient that the dispute should be resolved by jury trial, pending any appeal process. This ruling confirms that Dialight can challenge the contractual liability cap in the MSA on the basis of Sanmina's fraudulent inducement and Dialight intends to rigorously pursue this claim, and the various other contract-based claims, to trial.

Dialight currently expects that the case will go to trial in late 2023 (subject, potentially, to the timing impact of either party appealing any adverse judgment). Open court documents, including the ruling and pleadings in respect of the motion for summary judgment, can be accessed on the Public Access to Court Electronic Records (PACER) public access system for the U.S. District Court for the Southern District of New York (https://ecf.nysd.uscourts.gov).

Defined benefit pension schemes

During 2011, the Roxboro UK Pension Fund (the "Scheme") was closed to future accrual. This Scheme is included within pension assets. 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.

Uncertainties under income tax treatment

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.

16. 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** - The risk of stagnation of growth where the product portfolio is not renewed, where there is any failure to identify customer requirements (including pricing sensitivity and economic models), and the risk of concentration of certain verticals and/or geographical markets.

- **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, or environmental 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** - The Group operates a complex international supply chain (both inbound and outbound) which can be impacted by a range of risk factors including political disruption, border frictions, logistics challenges and other compliance issues. Supply chain challenges can in turn impact production capacity and efficiency – as well as other factors including investment in capacity, labour-supply issues and costs of production.

- **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 the Group's dispersed international footprint and increased homeworking following COVID-19 there is greater risk of impact on IT infrastructure/communications between employees.

- **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 10-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 ("IPR") by third parties or third parties taking legal action for IPR infringement.

- **Geopolitical / macro-economic impacts -** The Group faces a range of external geo-political, socio-political and macro-economic risks which, after a period of relative calm in global markets, have recently emerged as significant potential disruptors. In particular, the Group sources a significant amount of key components from China.