Strix Group PLC

EQUITY Development

Recovery slow, new strategy in place

21 September 2023

After early signs of green shoots during Q2, what is clear is that customers are mindful of conserving cash – ordering frequently but in lower volumes. As such and notwithstanding a very positive maiden H1 contribution from Billi, profitability has declined. The Board's response includes a fine-tuning of strategy, focusing on the most promising new products, cross-selling between brands, distribution agreements in new territories, online product launches and adjustments to the Group's capital allocation policy. We have reduced FY23 and FY24 estimates, including the dividend. However, the medium-term objectives suggest strong upside in revenue and profitability to FY26.

We have reduced our fair value / share to 180p (vs 216p) to reflect the slower recovery in FY23.

- The results for the six months to June were below expectations, despite a strong initial contribution from Billi, which added £21.5m of revenues and £10m of gross profit. The adjusted gross margin of 46.3% highlights one of the reasons why the acquisition was so coveted. With a raft of new products in the pipeline, new distribution agreements, further inroads likely into the residential market, and cross-selling to the customers of other Group brands, the outlook for the division appears promising.
- Most of the bad news related to Kettle Controls. Revenues declined 17% yoy, with the run-rate of sales still below the comparative period during early Q3. The £6m reduction in EBITDA offset the £5.2m contribution of Billi. The Consumer goods division was more resilient, led by Water, which delivered a modest uplift in revenues and EBITDA yoy.
- The increase in net debt from the FY22 year end, which reflected the final deferred consideration related to the LAICA acquisition, resulted in a rise in indebtedness during the period. Nevertheless, we expect net debt/EBITDA to be below the covenant ceiling of 2.25x by the year end, with reductions in net debt leading to an expected 1.8x by the end of FY24. The stubbornness of the debt has led to the reduction in the dividend, albeit the yield remains ahead of the average for its peer group.
- We have reduced financial estimates for the remainder of FY23 and FY24. That said, the Capital Markets Day includes several new strategic business objectives, with a plan to the end of FY26. The guidance includes an uplift in revenues between FY22 and FY26 of 93% to £206m and a similar rise in gross profit to £80m, equating to an unchanged margin of 38.8%.

While investors will be disappointed in the short-term outcome, the guidance out to FY26 is encouraging. At the current share price, this values the business on a FY26 EV/EBITDA of c.4.9x and PER of 6.0x. Our revised fair value is a premium to the current share price of 97%.

Forecasts

Yr. to Dec, £m	FY20A	FY21A	FY22A	FY23F	FY24F
Revenue	95.3	119.4	106.9	156.0	170.9
Adj. PBT	30.9	32.2	22.2	23.8	28.1
Adj. EPS (p)	14.3	14.9	10.8	9.5	10.9
DPS (p)	7.9	8.4	6.0	2.9	3.3
EV/EBITDA	5.9	5.9	8.9	6.7	5.9
PER	6.4	6.1	8.4	9.5	8.3
Yield %	8.6	9.2	6.6	3.1	3.6

Source: Equity Development

Company Data

EPIC	KETL
Price (last close)	91p
52 weeks Hi/Lo	150p/75p
Market cap	£200m
Fair Value / share	180p

Share Price, p

Source: ADVFN

Description

Strix Group plc ("Strix") is a global leader in the design, manufacture and supply of kettle safety controls, heating and temperature controls, steam management, and water filtration technologies.

The Group is backed by extensive and patented IP. It continues to innovate within the small domestic appliance and water filtration segments, with a focus on safety, design and sustainability.

The Group has a 56% global share within its largest market, kettle controls and leading positions within the faster growing personal, domestic and corporate water filtration markets.

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Strategic business objectives updated

Interim results

Period to June, £m	H1 22	H1 23	YoY change, %
SCB - Kettle controls	34.8	28.8	-17.2%
SCB - Billi		21.5	n/a
Strix Consumer Goods	15.9	14.9	-6.0%
Total revenue	50.7	65.2	28.7%
Cost of sales	-31.2	-41.3	32.3%
SCB - Kettle controls GP	15.0	10.7	-28.6%
SCB - Billi. GP		10.0	n/a
Strix Consumer Goods GP	4.5	3.3	-27.4%
Gross profit	19.5	23.9	22.8%
GP %	38.4%	36.7%	-4.6%
Distribution costs	-4.5	-5.0	11.3%
Admin. Expenses	-2.7	-7.3	173.9%
Total OpEx	-7.2	-12.3	71.7%
Share of JVs	0.0	0.0	150.0%
Other op. income	0.6	0.2	-64.9%
Adj. EBITDA	15.9	15.6	-1.9%
EBITDA %	31.4%	24.0%	
Adj. EBIT	12.9	11.7	-9.2%
EBIT %	25.4%	17.9%	
Net interest	-1.3	-5.0	295.0%
Adj. PBT	11.6	6.7	-42.0%
Exceptionals	-3.8	-1.9	
Taxation	0.0	-1.0	
Tax %	0.4%	15.1%	
Adj. PAT	11.6	5.7	-50.6%
Minorities	-0.1	0.0	
Adj. Earnings	11.5	5.8	-50.1%
Adj. EPS (p)	5.5	2.6	-52.7%
DPS (p)	2.75	0.9	-67.3%
Net debt*	-91.3	-96.8	6.1%

Source: Company **Net debt comparative from 31/12/22*

Revenues increased 29% yoy to £65.2m, driven in opposing directions by largely two factors – the H1 inclusion of the Q4 '22 purchase of Billi and a decline in orders within regulated markets at Kettle Controls.

The divisional segmentation of the Group has changed, accommodating the acquisition of Billi. Moving forward the two divisions will comprise: Strix Controls & Billi ("SCB") and, Strix Consumer Goods ("SCG"). We have separated Billi within the tables in this document to highlight its impact on results. The largest component of the SCB division is Kettle Controls. Strix Consumer Goods comprises the Appliance and Water categories.

SCB - Kettle Controls (Revenue -£6.0m to £28.8m, Gross profit -£4.3m to £10.7m)

Following a challenging FY22 across both regulated and less regulated markets, the emergence of green shoots during Q2 within Kettle Controls was of little surprise. The improvement reflected improved ordering from OEMs, brands, and retailers, following a combination of macroeconomic uncertainty created by the war in Ukraine, the cost-of-living crisis and customer de-stocking in FY22. That said, the pace of recovery has been slower than anticipated overall as customers manage their inventory levels. The H2 bias to trading is reflected in the build-up in advance of seasonal holidays (Christmas in the western hemisphere and Chinese New Year in the East).

In regulated markets (60%+ of divisional sales) revenues were tracking a 10% yoy decline during July, notwithstanding recovery commencing during Q2. Revenues were at their highest-level YTD in July. The continued shortfall reflects weakness in North America (single-digit declines) and Japan, with the latter trading 30% lower yoy during July. Conversely, the UK, the Group's largest market within the regulated segment is up 19% yoy during early Q3, while Germany saw initial green shoots appear during Q2, which have continued into early Q3. However, regulated markets overall continued to trend downwards, with revenues 16% lower on a YTD basis.

Less regulated markets (25% of divisional revenues) fared better, recovering during Q2. However, the driver of much of the improvement (up 0.5% YTD, including July), was Russia with revenues 82% higher yoy. Unfortunately, the key western brands no longer operate in the country following the imposition of sanctions, limiting any benefit to Strix. July was up 16% yoy within the less regulated markets overall, which augurs well for the remainder of the year should the improvements continue.

Overall revenues at Kettle Controls fell 17.2% to £28.8m reflecting the above movements. Costs headed in the same direction, although the relatively fixed manufacturing costs limited the downside to an 8.6% fall, meaning £18.1m at the CoGS level. Savings in materials, coupled with efficiency improvements in product development, was more focused (the Series Z controls are nearing the point of commercialisation). The resulting divisional gross profit declined to £10.7m, producing a margin of 37.2%, representing a yoy fall of 592 bps.

SCB - Billi (Revenue £21.5m, Gross profit £10.0m, no comparative)

The integration of Billi, acquired in late Q4 '22 remains on plan, with the temporary transitional arrangement with its previous owner, Culligan, exited in May '23. The business remains on track to be a stand-alone operation in the UK by the end of September.

The new OmniOne tap (boiling, chilled and sparkling water) was launched successfully during Q2, achieving a significant order from an Australian customer. Billi has opened additional sales channels for other Strix owned brands during the period. New distributors across Asia and the Middle East have also been signed during H1.

The maiden contribution from Billi was very positive; revenues of £21.5m, driving gross profit of £10m, suggesting a very strong margin of 46.3%. We expect the momentum to be maintained, reflecting cross-selling, new distributors, a growing focus on residential (where the business is under-represented), a high-quality product and very high service and after care levels. Significantly, there is also a strong consumables income stream. Several new products should follow closely behind the OmniOne, including under worktop appliances, new filters/treatments, refillable CO_2 contracts (sparkling water), as well as new features such as IoT connectivity and voice activation.

In terms of costs associated with the division, we have the associated depreciation and amortisation included within the figures for the first time (£0.5m), resulting in EBIT of £4.7m (equating to an operating profit margin of c.21.9%) and OpEx of £5.3m.

Strix Consumer Goods (Revenue -£1.0m to £14.9m, Gross profit -£1.2m to £3.3m)

The Consumer Goods division comprises the old Appliance and Water categories, excluding Billi. Revenues declined 6% to £14.9m, albeit the old Water category delivered an improvement in revenues of £0.2m (+2.3% yoy). Water benefitted from several private label contracts, as value conscious consumers purchased lower cost alternatives. Benefits emerged from LAICA selling into the Strix customer base in both Europe and North America.

The new product launches within Appliances have widened the regional mix of revenues, benefiting from a combination of online sales and new retail listings. Nevertheless, the current squeeze on disposable incomes resulted in the modest downturn in revenues.

Gross margins declined to 21.8% (H1 '22: 28,2%), with gross profit declining modestly ahead of the fall in revenues. With further insourcing of filters during the period, across two sites (China and LAICA in Italy), inflationary pressure from third-party suppliers abated.

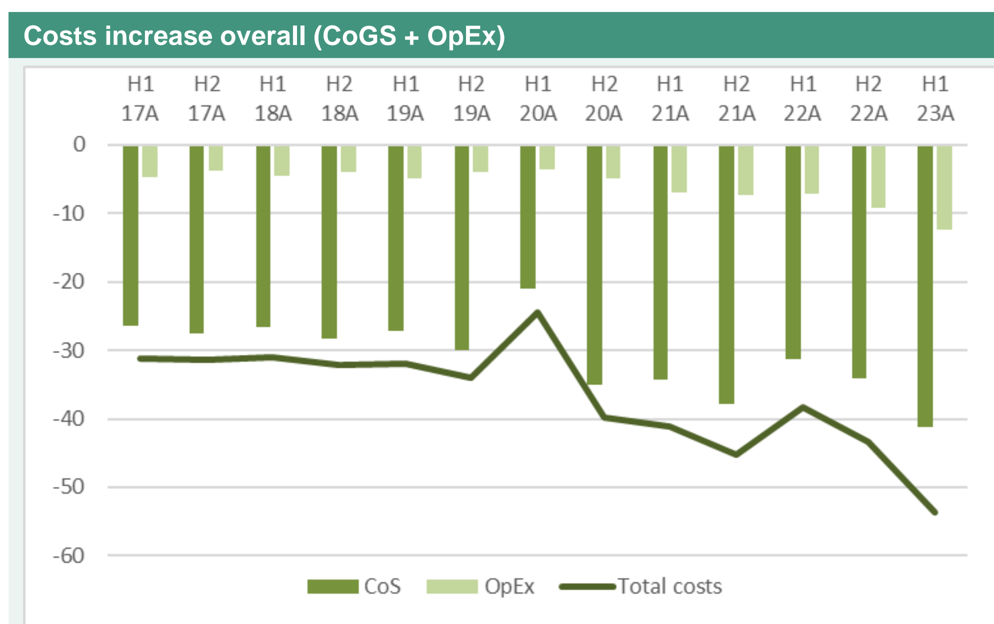
Costs increase (CoGS and OpEx)

CoGS rose 32% to £41.3m, reflecting the addition of Billi (+£11.5m). Elsewhere, the core business reduced costs by £1.4m yoy, with an ongoing focus on efficiency, removing unnecessary spending and insourcing, plus lower production volumes within Kettle Controls.

OpEx increased by 72% to £12.3m (H1 '22: £7.2m), predominantly reflecting the addition of administration costs at Billi and lower sales volumes within Kettle Controls.

Combined, total costs increased 39.7% yoy to £53.6m.

Costs increase overall (CoGS + OpEx)



Source: Company

Resilient EBITDA

Profitability declined overall, although EBITDA fell modestly, down £0.3m to £15.6m and giving rise to margins of 24.0% (H1 '22: 31.4%). Billi contributed a maiden H1 EBITDA of £5.2m, albeit not quite offsetting the £6m shortfall within Kettle Controls. The Consumer Goods division increased EBITDA by £0.5m during the period, compared to a year ago.

Net debt drives interest costs

Not only did net debt increase to £87.4m following the acquisition of Billi in late Q4 ’22 but the £7.4m payment of deferred consideration for LAICA increased indebtedness further. A succession of interest rate increases added to interest costs, which rose £3.7m yoy to £5m.

The focus on cash conservation and changes to capital allocation policies will undoubtedly help, although the slower recovery within Kettle Controls is likely to result in net debt rising to £91.3m by the year end, as cash generation falls below previous expectations.

Nevertheless, we continue to be of the view that the Group will remain within its most significant banking covenant, net debt/EBITDA, with year-end values of 2.1x, falling to 1.8x in FY23 and FY24, respectively.

Adj. PBT decline largely reflects higher interest costs

Adj. PBT declined £4.9m to £6.7m, 42% lower yoy. However, EBIT was just £1.2m lower at £11.7m, reflecting the increase in depreciation (Billi, +£0.5m) and an increase in OpEx. Higher interest costs accounted for the remaining £3.7m increase. EBIT margins fell less than expected to 17.9% (H1 ’22: 25.4%).

The addition of Billi resulted in taxation of £1m, contributing to the decline in adj. PAT to £5.7m.

Adj. EPS declined 52.7% to 2.6p. Consequently, and in-line with the change in capital allocation, the dividend was cut to 0.9p per share. It is worth noting that the expected yield is amongst one of the highest in its sector.

Capital Markets Day – key points

The Group is hosting an updated Capital Markets Day (“CMD”) today following the Interim results. The Board will set out the Strategic Business Objectives (“SBOs”) to be delivered by 31 December 2026 and in turn, reset growth expectations. A new divisional reporting structure will be put in place, with the Appliance and Water categories largely subsumed into Consumer Goods and Kettle Controls and Billi comprising SCB.

During the FY22 to FY26 period, the targets for revenues and gross profit are as follows, by segment:

- Group revenues to increase by a CAGR of 17.8% to £206m, representing overall growth of 92.7% in the four years to end 2026
- Total gross profit to rise from £41.5m to £80m, with gross margins unchanged by period end, from 38.8% in FY22
- Growth is projected to be slower in the mature Kettle Controls division, reflecting the Group’s mature market position. Revenues are expected to rise to £88m by FY26, from £68.2m in FY22 and equating to a CAGR of 6.6%
- Gross margins are expected to remain broadly static during the period, exiting at 39.8% and resulting in an estimated gross profit of £35m by period end within Kettle Controls
- Adjusting for the timing of the acquisition of Billi, the CAGR in revenue is estimated to be 10.5% to deliver revenues of £58m within Premium Filtration Systems (part of SCB)
- While the gross margin is anticipated to modestly decline, it is expected to end the period at a very healthy 44.8%, suggesting FY26 gross profit of £26m
- Consumer Goods should remain the fastest growing division, with revenues set to improve at a CAGR of 16.4% to £60m by FY26, and

- Margins are expected to recover within the Consumer Goods division to 31.7% by FY26, suggesting gross profit increasing by a CAGR of 13.6% to £19m in the four years to FY26.

How will the demanding targets be met? The Board are highlighting three factors to enable them to achieve the above goals:

- **Geographical expansion.** Although Strix has a wide reach, its focus has been predominantly on the UK, Europe, Australia, New Zealand and increasingly Asia and North America. Further expansion into new territories will continue, with the expectation of launching products in South America over the medium term

- **Technology.** With several product launches in the offing, we expect to see a standardisation of components, new features (including IoT), and environmental savings amongst other things. The new next generation kettle control is 30% smaller than its predecessor, with the ability to be utilised in a wider range of products than previously was the case. Strix is also developing new ranges of low cost and fast flow efficient water heater control systems. New filters are close to being launched, adaptable to local market requirements and by FY24, one that is entirely sustainable. We highlighted the pipeline of new products in the last note issued following the AGM in July, which in general use existing technology. Strix remains an innovative Company, and

- **Talent and skills.** Simplistically, the Group is focused on ensuring it has the right people available wherever required. Training programmes are available to ensure those individuals have the right skills and can grow with the business, utilising a range of options but not least the Group's in-house e-learning platform. Importantly, it is key that staff are incentivised to perform, with several means available and not just LTIPS, as retention of skilled staff remains a priority for the Group as it pursues its growth objectives.

Sustainability

In many segments of the business the Group has attained net zero Scope 1 & 2 targets (energy efficiency and renewable power generation) and secured ISOs 14001, 45001 and 50001 accreditation. However, Billi will need to be brought up to speed with the remainder of the Group on these issues over the short-to-medium term.

The next phase is to attain Scope 3, following the primary analysis undertaken to date involving customer engagement. Ultimately, this is likely to prove a barrier to entry vis-à-vis the Group's competitors. Also, an ESG roadmap is in place for all the products under development and nearing launch.

Financials

Following the publication of the strategic business objectives from the CMD, we have modified our financial estimates to take account of a slower recovery than initially expected in FY23 and into H1 '24, but thereafter benefitting from the pipeline of opportunities associated with:

- Geographical expansion
- New product launches, particularly online, and
- A cross-selling of complimentary products across the customer bases of each division.

We highlight in the table below the change in estimates from those issued at the time of the preliminary results in March. The most significant reduction is to dividend expectations, to pay down the indebtedness of the Group. Dividend cover moving forward is comfortable and as debt levels reduce, the Board will then have room to consider its capital allocation options, from FY25 and beyond.

Estimate changes

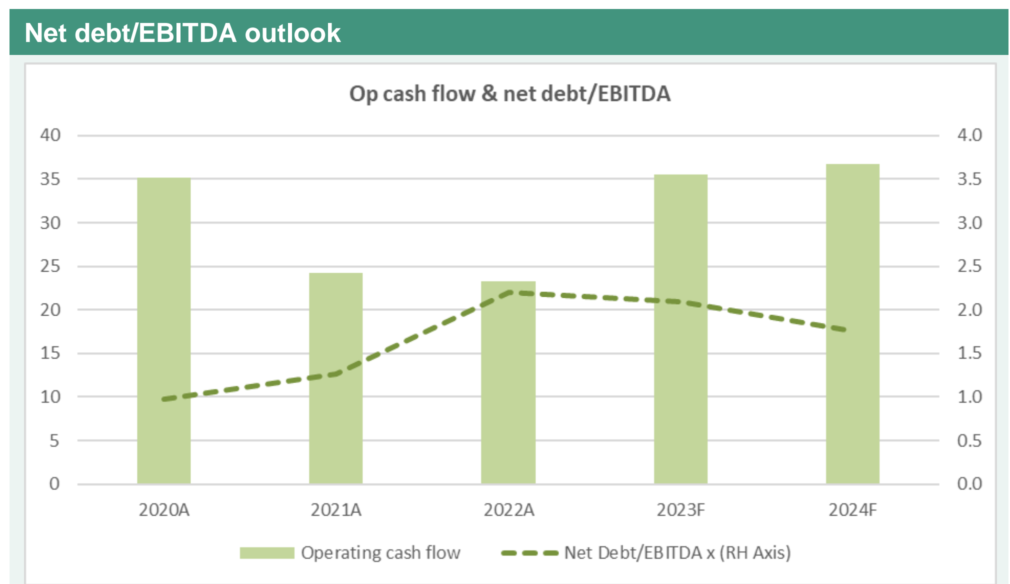
£m	Old FY23E	New FY23E	Change, %	Old FY24E	New FY24E	Yoy change, %
Revenue	155.2	156.0	0.5%	169.3	170.9	0.9%
Adj. EBITDA	48.4	43.6	-10.0%	52.421	48.0	-8.5%
Adj. PBT	29.2	23.8	-18.6%	34.221	28.1	-17.9%
Adj. PAT	25.8	21.1	-18.4%	29.057	24.2	-16.8%
Adj. EPS (p)	11.8	9.5	-19.3%	13.7	10.9	-20.3%
DPS (p)	6.3	2.9	-54.6%	6.7	3.3	-51.1%
Net debt	-84.8	-91.3	-7.7%	-70.87	-84.2	-18.8%

Source: Equity Development

The main banking covenant focused on net debt/EBITDA adjusts from a 2.75x ceiling to 2.25x in FY24. On this basis, we expect the Group to remain on track, with our estimates suggesting a net debt/EBITDA ratio of 2.1x FY23 EBITDA and 1.8x in FY24.

We note the expected recovery of operating cash flows in FY23, before exceeding FY20's levels in FY24.

Net debt/EBITDA outlook



Source: Company historics, Equity Development estimates

Summary Profit & Loss					
Year to Dec, £m	**2020A**	**2021A**	**2022A**	**2023F**	**2024F**
SCB - Kettle controls	79.8	85.1	68.2	75.0	79.1
SCB - Billi			1.0	43.0	47.5
Strix Consumer Goods	15.5	34.3	37.7	38.0	44.2
Revenue	95.31	119.41	106.92	156.00	170.86
CoGS	-55.9	-72.0	-65.4	-96.0	-104.8
Gross profit	39.4	47.4	41.5	60.0	66.1
Gross margin (%)	41.4%	39.7%	38.8%	38.5%	38.7%
Op costs	8.5	14.3	-16.4	-26.6	-29.1
Other Op. income	1.1	0.6	0.8	0.7	0.7
Operating profit	32.0	33.7	25.9	34.1	37.6
Op margin (%)	33.6%	28.2%	24.2%	21.8%	22.0%
Net Interest	-1.2	-1.4	-3.7	-10.3	-9.5
Associates	0.1	-0.1	0.0	0.0	0.0
PBT (Adjusted)	30.9	32.2	22.2	23.8	28.1
Exceptionals	-5.5	-10.7	-5.9	-2.2	0.0
PBT (Reported)	25.5	21.5	16.2	21.6	28.1
Tax	-1.4	-0.9	0.8	-2.7	-3.9
Adj. PAT	29.5	31.4	23.0	21.1	24.2
Minority interests	0.0	0.0	-0.1	0.0	0.0
Adj. Earnings	29.5	31.3	22.9	21.1	24.2
Reported PAT	24.0	20.6	17.0	18.9	24.2
Ordinary Dividends	-16.0	-17.3	-13.1	-6.3	-7.2
EPS (Adjusted) (p)	14.3	14.9	10.8	9.5	10.9
DPS (p)	7.9	8.4	6.0	2.9	3.3
Ave no of shares (FD) (m)	206.4	209.7	212.5	221.3	221.3

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to Dec, £m	2020A	2021A	2022A	2023F	2024F
Operating profit	32.1	33.7	25.9	34.0	37.6
Depn. & Amortn.	6.0	6.9	6.3	9.6	10.4
Working capital movement	-1.6	-11.4	-2.6	-8.1	-11.2
Other	-1.2	-4.9	-6.3	0.0	0.0
Operating cash flow	35.2	24.2	23.2	35.5	36.8
Net Interest	-3.4	-2.7	-3.2	-10.3	-9.5
Taxation	-0.9	-1.9	-1.2	-0.9	-3.3
Net capex	-17.4	-15.4	-8.6	-10.0	-10.3
Operating FCF	13.5	4.2	10.3	14.3	13.7
Net (Acquisitions)/Disposals	-6.7	-1.6	-39.3	-7.4	0.0
Dividends	-15.3	-16.5	-17.3	-10.8	-6.6
Share Issues	3.8	0.0	10.7	0.0	0.0
Minority payment	-0.1	-0.3	0.0	0.0	0.0
Other financial	-6.0	0.2	-0.6	0.0	0.0
Increase Cash/(Debt)	-10.9	-14.0	-36.2	-3.9	7.1
Opening Net Cash/(Debt)	-26.3	-37.2	-51.2	-87.4	-91.3
Closing Net Cash/(Debt)	-37.2	-51.2	-87.4	-91.3	-84.2

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec, £m	2020A	2021A	2022A	2023F	2024F
Intangible Assets	29.6	30.5	73.4	71.0	68.3
Tangible Assets	37.2	39.5	43.7	46.6	49.1
Investments/other	0.1	3.3	3.7	3.7	3.7
Net Working Capital	4.4	15.9	18.5	26.5	37.8
Capital Employed	71.4	89.1	139.2	147.7	158.8
Other	-2.8	-2.6	-2.8	-2.8	-2.8
Net Cash/(Debt)	-37.2	-51.2	-87.4	-91.3	-84.2
Provisions Liabilities/Charges	-9.3	-4.7	-12.3	-12.3	-12.3
Net Assets	22.0	30.7	36.7	41.3	59.6

Source: Company historics, Equity Development estimates

Valuation

We think that Strix continues to be overlooked by investors, with the focus on the level of indebtedness. However, management has remained resolute that the level of net debt/EBITDA will decline, with a target of 2.1x during 2023 and 1.8x in 2024, aided by changes to capital allocation and the more recent streamlining programme.

We have constructed several models to determine our fair value / share. Our discounted cash flow model, using conservative assumptions (a discount rate of 8.75% and a terminal growth rate of 2.25%), **suggests a value / share of 280.5p.**

Strix Group DCF calculation

£m, year to Dec	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Free cash flow	24.6	25.8	50.3	51.5	52.6	53.8	55.0	56.2	57.5	58.8
WACC (%)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Timing factor	0.75	1.75	2.75	3.75	4.75	5.75	6.75	7.75	8.75	9.75
Discount rate	0.94	0.86	0.79	0.73	0.67	0.62	0.57	0.52	0.48	0.44
Present value	23.1	22.3	40.0	37.6	35.3	33.2	31.2	29.4	27.6	26.0
Sum of discounted cash flows	305.5									
Terminal growth rate (%)	2.25									
Terminal value	399.3									
Net debt	-91.3									
Equity value	613.5									
No. of shares (m)	218.7									
Value per share (p)	280.5									

Source: Equity Development

We have utilised a comparative peer group valuation model using FY1 EV/EBITDA, FY1 PER, FY1 EV/Sales, and FY1 yields in the charts below. Strix is consistently valued at the lower end of its wider peer group average, highlighting the concerns on debt rather than any focus on the prospects of recovery. We note that even following the reduction to dividend pay-out, Strix sits on a higher-than-average sector yield.

We have applied a 15% size related discount relative to its peers. We highlight the average of the valuation models in the table below which forms the basis of our fair value / share.

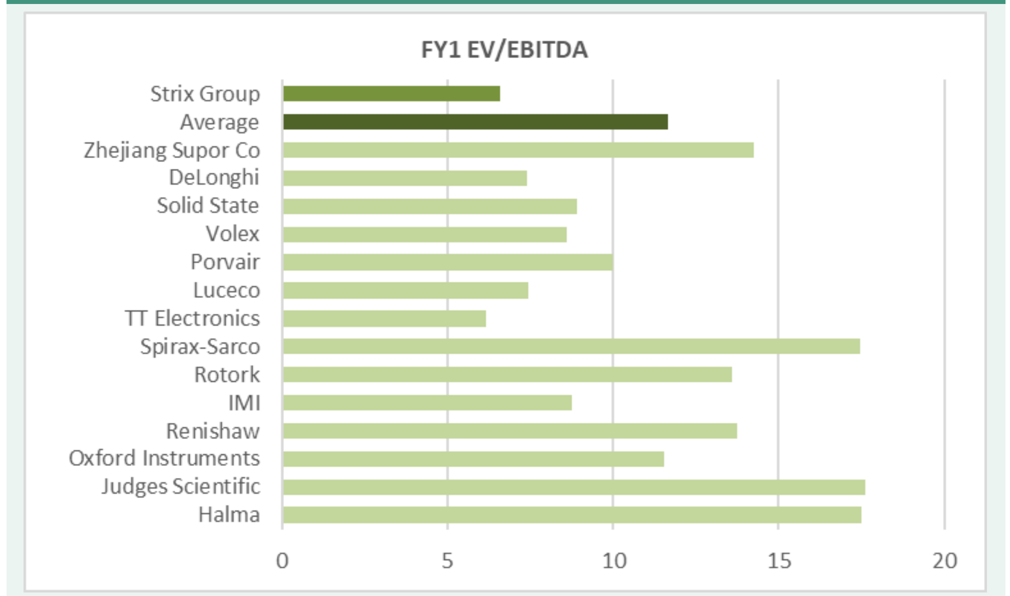
The average fair value/ share of 180p represents a premium of 97% to the current price.

Fair value

	FY23 fair value
DCF	281
PER	165
EV/EBITDA	165
EV/Sales	108
Average	179.6

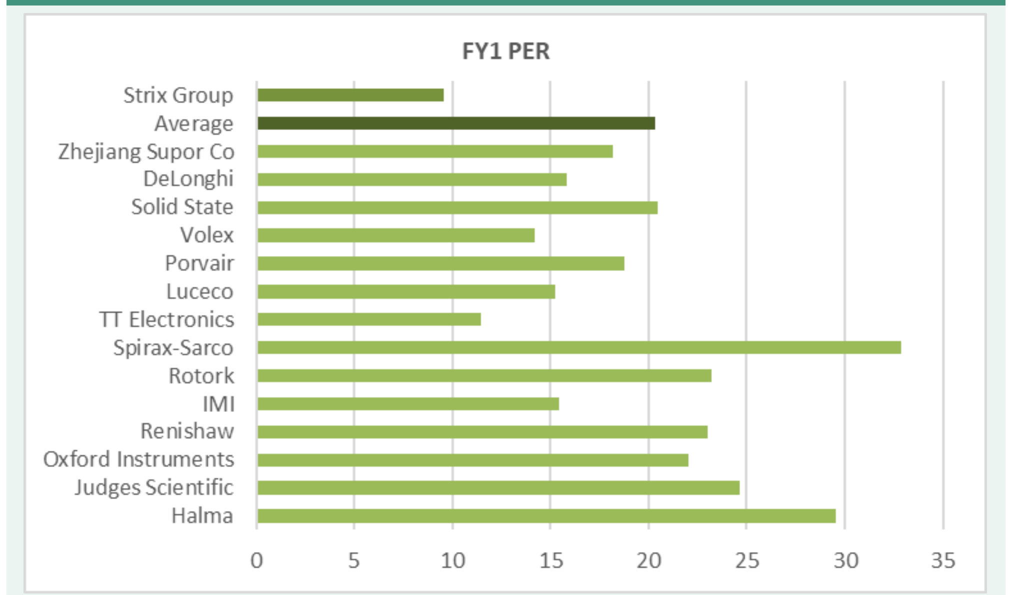
Source: ED

Peer group comparison: FY1 EV/EBITDA (x)



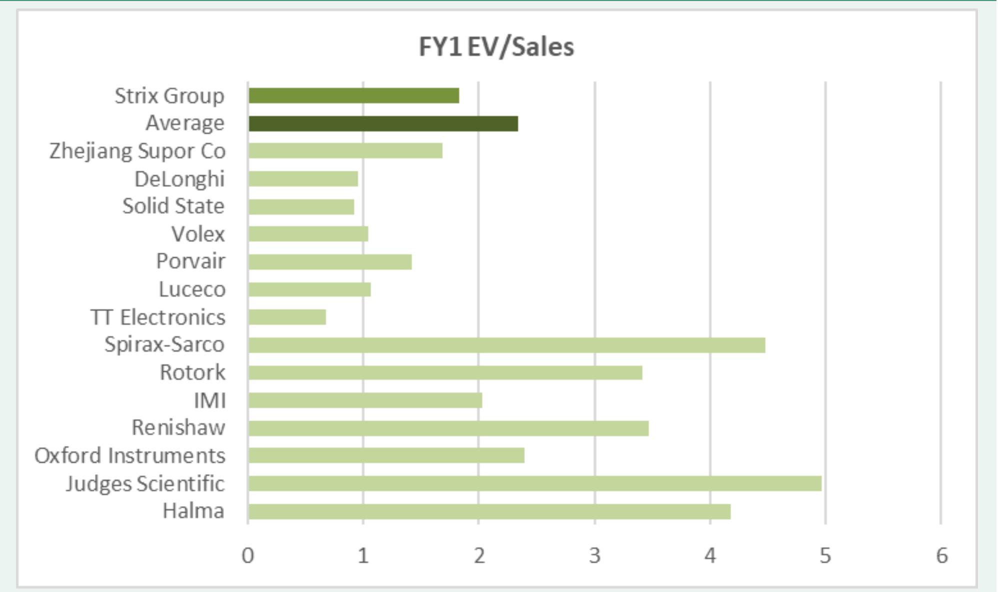
Source: MarketScreener

Peer group comparison: FY1 PER (x)



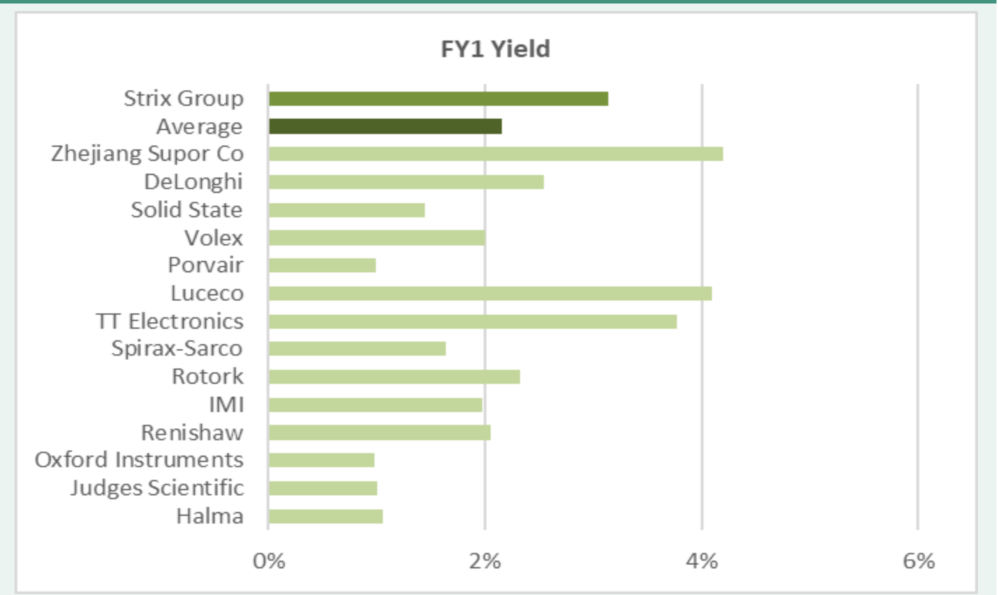
Source: MarketScreener

Peer group comparison: FY1 EV/Sales (x)



Source: MarketScreener

Peer group comparison: FY1 yield (%)



Source: MarketScreener

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