Strix Group Plc

Strong H2 cash flow

25th January 2024

We think there are several encouraging messages which jump out from Strix's trading update released today, led crucially by the strong cash generation during H2. This has enabled the Group to come in below the year end banking covenant test, thereby removing significant risk from the rating. In addition, the strong performance of Billi and LAICA has largely offset the slower than expected recovery within the regulated kettle controls market, resulting in FY23 numbers modestly below expectations at the adj. EPS level.

With significant scope for recovery in its key market and the focus switching to the most profitable areas, we expect a marked uplift in profitability and its share rating over the medium term.

- Cash flow during H2 amounted to c.£13m, resulting in net debt at the year-end of £83.7m. Billi was central to this result. The net debt/EBITDA ratio declined from 2.66x at the beginning of the period to 2.15x by the year end and below the covenant adjustment set in place by the Group's banking consortium. The covenant is to remain at 2.25x for the remaining life of the facility. **Management has targeted a net debt/EBITDA ratio of below 1.5x by the end of FY25.**

- Trading is generally stronger during H2, with its OEM customers targeting both Christmas and Chinese New Year. We estimate that revenues in H2 increased by approximately a third on a sequential basis, aided by the double-digit growth yoy at Billi and LAICA. The kettle controls market registered QoQ growth, albeit the recovery was slower than anticipated within regulated markets. Elsewhere, growth levels were more encouraging. **With the regulated market some 20% below the levels of 2021 (in volume terms but at typically at higher margins), we think this represents strong scope for recovery over the medium term.**

- The focus on costs has been incessant over the last 18 months and a further internal reorganisation programme was announced within the trading update. There is clearly an opportunity to consolidate several product lines, focusing on the most profitable or those where there is the greatest scope to improve margins. On this basis, we anticipate a greater focus on Billi and rationalising in the Consumer Goods division.

- Following the retirement of Raudres Wong in October, the Group is pleased to **announce the appointment of Clare Foster as Chief Financial Officer on 1 February**, joining the Board following a brief handover period in early April. Mark Kirkland the Interim CFO will revert to his previous role as Non-Executive Director of the Group. Clare previously held the role of CFO at Trifast, the global manufacturer and distributor of c-class components, between 2016 and 2022, recruited by the fastener group in 2015 as financial Controller and Company Secretary. Prior to this, Clare was a Project Director and Senior Audit Manager at KPMG for over 16 years. Clare brings significant experience of banking relationships and international management to Strix.

Although we have reduced adj. EPS estimates by 4.5% in FY23 and 8.8% in FY24, we remain upbeat. We believe that the recovery in its markets and the regulated kettle controls market should come through from H2 24 onwards. **Cash generation remains strong, delivering comfort on the banking covenant front. With this risk diminishing, we expect the shares to be re-rated and our valuation models strongly suggest a fair value / share of 149p.**

Company Data

EPIC	KETL
Price (last close)	74p
52 weeks Hi/Lo	114p/51p
Market cap	£162.5m
ED Fair Value	149p
Net debt (Dec '23)	£83.7m

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 and appliance and water filtration segments, with a focus on safety, design, and sustainability.

The Group has a c.56% global value 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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Valuation

We are encouraged by the trading update covering the year to December 2023, not least due to the strong cash generation, notwithstanding the modest shortfall in profitability relative to our expectations. The good news is the reduction in year-end net debt and with it the net debt/EBITDA ratio to 2.15x, which is below the covenant of 2.25x and as such, we expect the shares to receive a re-rating.

We have constructed a discounted cash flow and peer group comparison models to determine the likely fair value / share of Strix Group. For the DCF we have used conservative assumptions including a discount rate of 8.75% and a terminal growth rate of just 2.25%, **which suggests a fair value / share of 156p / share**.

Strix Group DCF calculation

£m, year to Dec	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Free cash flow	31.0	23.1	28.6	29.3	29.9	30.6	31.3	32.0	32.7	33.4
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	29.1	19.9	22.7	21.4	20.1	18.9	17.8	16.7	15.7	14.8
Sum of discounted cash flows	197.0									
Terminal growth rate (%)	2.25									
Terminal value	227.1									
Net debt	-83.7									
Equity value	340.4									
No. of shares (m)	218.7									
Value per share (p)	155.6									

Source: Equity Development

We think the size-related discount to its peer group should decline to 10% (we previously utilised a conservative 15%, reflecting the perceived risk of higher debt levels), which is reflected in our fair value / share calculation within the table below.

We note the marked discount with which Strix Group trades, relative to its peers. We believe a large proportion of this has historically reflected the uncertainty over whether the Group would be able to reduce levels of indebtedness in line with demands from its banks. With the reduction in the net debt/EBITDA covenant met at the end of FY23, we think the risk factor previously built into the rating should reduce significantly.

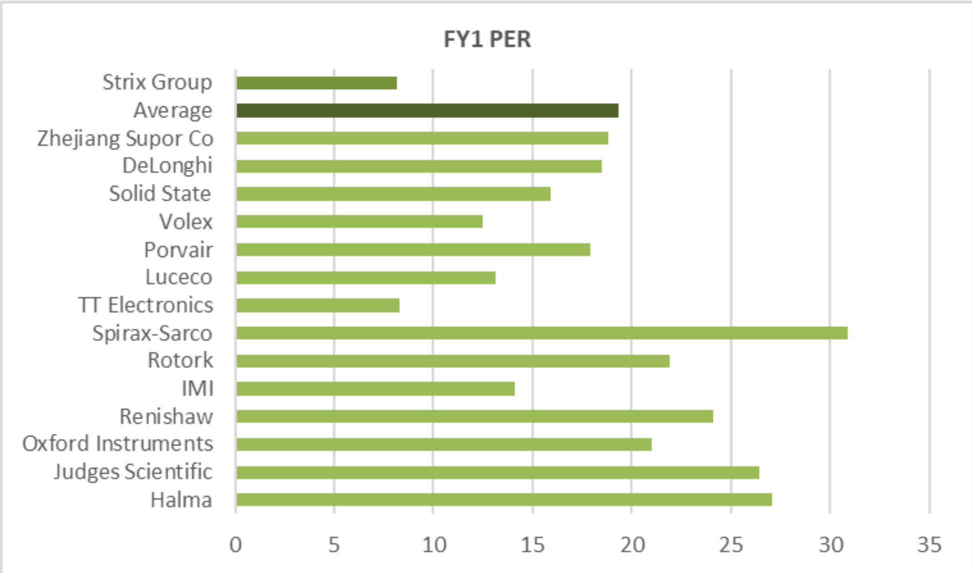
We note the dividend yield expectations remain markedly ahead of its peers at the current share price. **The average fair value / share from our valuation models amounts to 149p, representing a significant premium to the existing share price.**

Fair value

	FY23 fair value	FY24 Fair value
DCF	156	156
PER	158	160
EV/EBITDA	166	176
EV/Sales	117	
Average	149.3	163.9

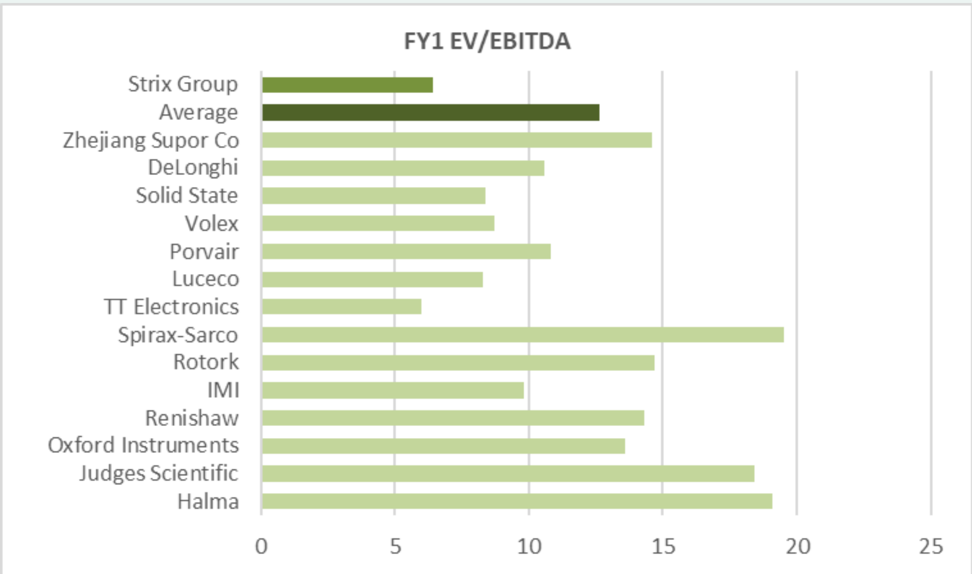
Source: ED

Peer group comparison model: FY1 PER



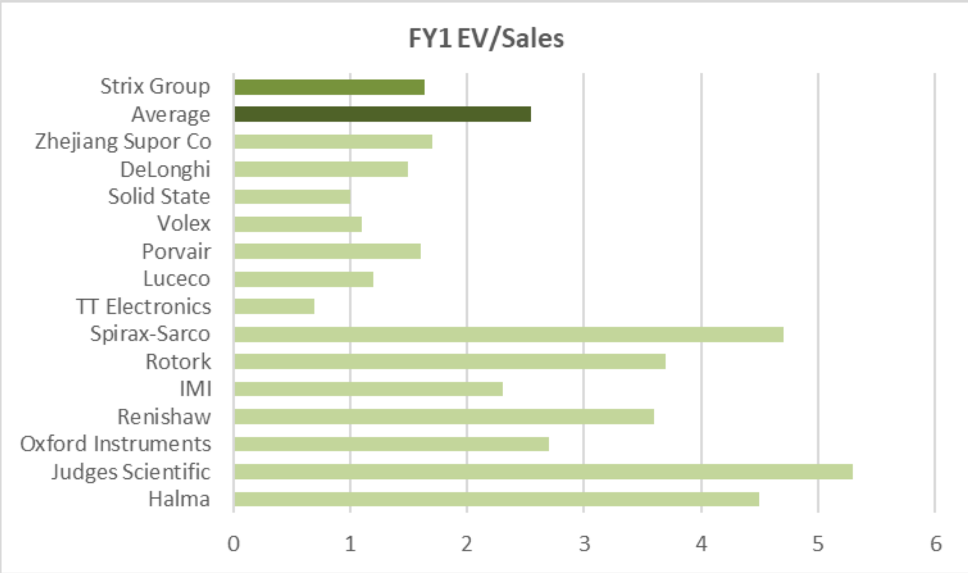
Source: Koyfin

Peer group comparison model: FY1 EV/EBITDA



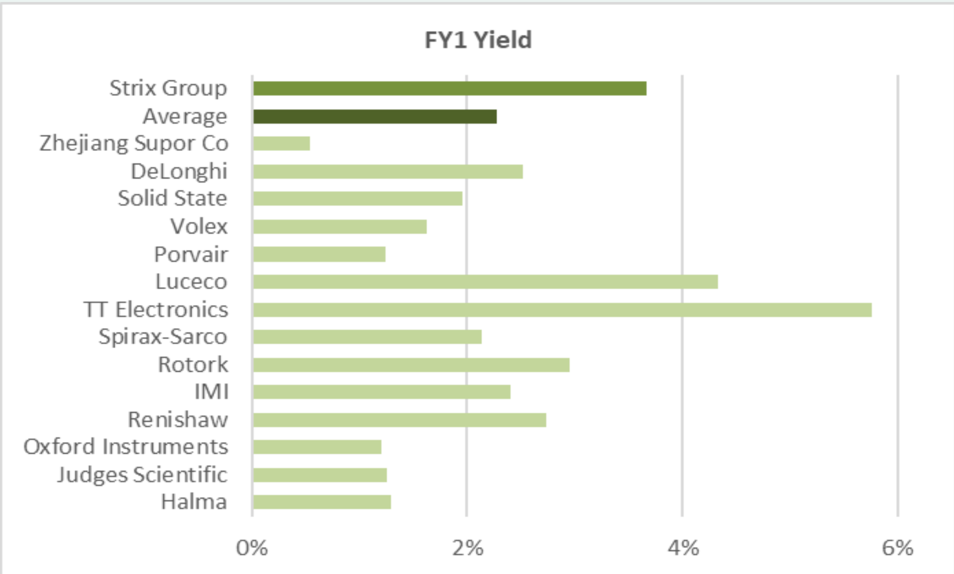
Source: Koyfin

Peer group comparison model: FY1 EV/Sales



Source: Koyfin

Peer group comparison model: FY1 Yield



Source: Koyfin

Financials

Following the trading update we have fine-tuned our estimates for FY23 and FY24, as per the table below. The key issue during FY23 was the slower than anticipated recovery of the regulated kettle controls market, with revenues some £6m below our expectations, in part offset by the strong contributions from Billi and LAICA.

Our adj. EPS expectations reduce by 4.5% in FY23 and by 8.8% in FY24, highlighting our belief that the recovery in the regulated kettle control market is unlikely to get underway before H2 '24. With FY23 revenues within the regulated market some 20% below in volume terms (albeit typically at higher margins) the levels of FY21, we think this demonstrates strong potential upside for recovery over the medium term.

Estimate changes

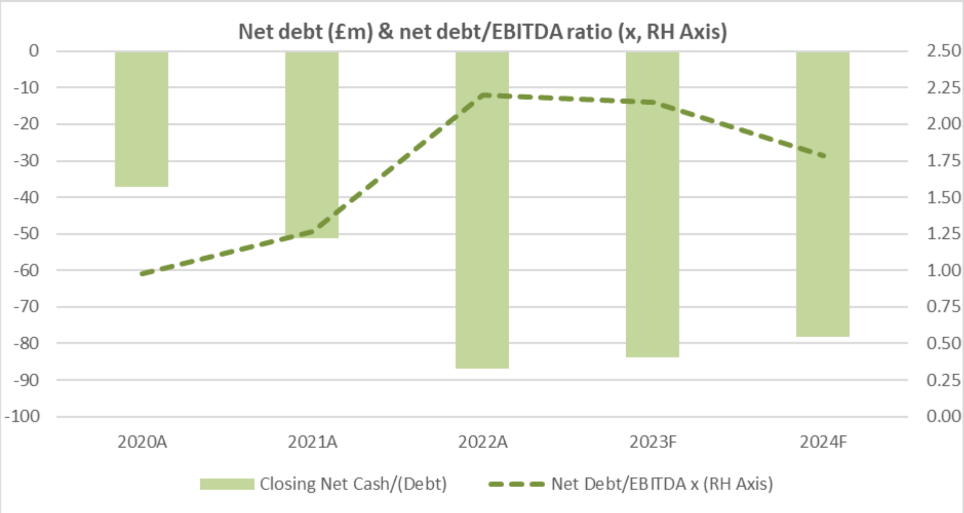
£m	Old FY23E	New FY23E	Change, %	Old FY24E	New FY24E	Yoy change, %
Revenue	156.0	147.1	-5.7%	170.9	158.0	-7.5%
Adj. EBITDA	43.6	38.9	-10.8%	48.0	43.8	-8.7%
Adj. PBT	23.8	21.2	-10.9%	28.1	25.4	-9.6%
Adj. PAT	21.1	20.1	-4.6%	24.2	22.0	-8.8%
Adj. EPS (p)	9.5	9.1	-4.5%	10.9	10.0	-8.8%
DPS (p)	2.9	2.7	-4.5%	3.3	3.0	-8.9%
Net debt	-91.3	-83.7	8.3%	-84.2	-78.3	7.0%

Source: Equity Development

We highlight the estimates for the income statement, cash flow statement and balance sheet to the end of FY24 in the tables below. Management discussed a further internal reorganisation, removing a further level of cost from the business and consolidating the number of products sold. This is expected to feed through into EBIT margins from H2 '24, also leading to a favourable effect on cash generation.

We note the further reduction in the net debt/EBITDA from 2.15x in FY23 to 1.79x in FY24, with the expectation that this will decline further in FY25 to below 1.5x.

Net debt and net debt/EBITDA expectations



Source: Company data, ED Estimates

Summary Profit & Loss					
Year to Dec, £m	**2020A**	**2021A**	**2022A**	**2023F**	**2024F**
Kettle controls	79.8	85.1	68.2	70.0	74.2
Prem. Filtratn. Systems			1.0	41.1	45.8
Consumer Goods	15.5	34.3	37.7	36.0	38.0
Revenue	95.3	119.4	106.9	147.1	158.0
CoGS	-55.9	-72.0	-65.4	-89.6	-98.2
Gross profit	39.4	47.4	41.5	57.5	59.8
Gross margin (%)	41.4%	39.7%	38.8%	39.1%	37.8%
Op costs	8.5	14.3	-16.4	-27.0	-24.8
Other Op. income	1.1	0.6	0.8	0.4	0.4
Operating profit	32.0	33.7	25.9	31.0	35.4
Op margin (%)	33.6%	28.2%	24.2%	21.0%	22.4%
Net Interest	-1.2	-1.4	-3.7	-9.7	-9.9
Associates	0.1	-0.1	0.0	-0.1	-0.1
PBT (Adjusted)	30.9	32.2	22.2	21.2	25.4
Exceptionals	-5.5	-10.7	-5.9	-2.2	0.0
PBT (Reported)	25.5	21.5	16.2	19.0	25.4
Tax	-1.4	-0.9	0.8	-1.1	-3.4
Adj. PAT	29.5	31.4	23.0	20.1	22.0
Minority interests	0.0	0.0	-0.1	0.0	0.0
Adj. Earnings	29.5	31.3	22.9	20.1	22.0
Reported PAT	24.0	20.6	17.0	17.9	22.0
Ordinary Dividends	-16.0	-17.3	-13.1	-6.0	-6.5
EPS (Adjusted) (p)	14.3	14.9	10.8	9.1	10.0
DPS (p)	7.9	8.4	6.0	2.7	3.0
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	30.9	35.3
Depn. & Amortn.	6.0	6.9	6.3	8.0	8.5
Working capital movement	-1.6	-11.4	-2.6	2.2	-10.6
Other	-1.2	-4.9	-6.3	0.0	0.0
Operating cash flow	35.2	24.2	23.2	41.1	33.2
Net Interest	-3.4	-2.7	-3.2	-9.7	-9.9
Taxation	-0.9	-1.9	-1.2	-0.1	-2.2
Net capex	-17.4	-15.4	-8.6	-10.0	-9.5
Operating FCF	13.5	4.2	10.3	21.3	11.6
Net (Acquisitions)/Disposals	-6.7	-1.6	-39.3	-7.4	0.0
Dividends	-15.3	-16.5	-17.3	-10.7	-6.2
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	0.0	0.0	0.0
Increase Cash/(Debt)	-10.9	-14.0	-35.6	3.1	5.4
Opening Net Cash/(Debt)	-26.3	-37.2	-51.2	-86.8	-83.7
Closing Net Cash/(Debt)	-37.2	-51.2	-86.8	-83.7	-78.3

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	75.2	77.0
Tangible Assets	37.2	39.5	43.7	47.7	50.9
Investments/other	0.1	3.3	3.7	3.7	3.7
Net Working Capital	4.4	15.9	18.5	16.3	26.9
Capital Employed	71.4	89.1	139.2	142.8	158.4
Other	-2.8	-2.6	-2.8	-0.9	-0.9
Net Cash/(Debt)	-37.2	-51.2	-87.4	-83.7	-78.3
Provisions Liabilities/Charges	-9.3	-4.7	-12.3	-11.4	-11.4
Net Assets	22.0	30.7	36.7	46.8	67.8

Source: Company historics, Equity Development estimates

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