Strix Group

Recent trading proves challenging

27 November 2024

At the time of the interim results in September it was clear that Q3 trading had proven volatile. Unfortunately, this has continued into Q4, with the greatest weakness witnessed in the highest margin areas, compounding the impact of operational gearing. Should the share price decline further as this trading update is digested and test new lows, we feel this presents a strong medium-term opportunity. One should bear in mind that the Group owns one global brand and two premium regional brands (with a desire to distribute globally). The Group's largest market (kettle controls) is now 20%+ below its previous sales peak in 2019.

A tale of two halves

Following good progress in H1, where revenues increased 1.8%, gross profit by 10.2% and adj. PBT by 14.9%, volatility in trading emerged in Q3. Unfortunately, this continued into Q4, as its highest margin kettle control end markets stalled (UK, Germany and the US). In the UK, confidence suffered from uncertainty ahead of the Autumn Budget, impacting discretionary spend. Similarly, delays to the launch of new products by Billi in its home markets of Australia and New Zealand resulted in low single digit progress (9 months), rising to 5%+ following double-digit growth yoy in Q4. The Consumer Goods division trading modestly lower than H2 '23 following a rationalisation of products last year.

That said, the Canton Fair, which remains a critical sector trade show, generated positive noise with regards to the next generation kettle control, with several OEMs keen on the advances in technology, additional appliance uses and the increased functions available. We expect the first products utilising the next generation controls to be released in H2 '25. The launch of the new low-cost control in Q3 '24 has enabled Strix to re-enter previously uneconomic markets. The kettle control market continues to trade some 20% below peak 2019 sales levels. Billi will benefit from a combination of the new product launches into the UK, followed by expansion into Europe (six distributors by the year end), as well as revenues gaining momentum in Asia Pacific. Meanwhile, the Consumer goods division has made progress in additional contract manufacturing within the infant formula appliance market.

Valuation changes

Our new estimates (see adjustment to prior expectations on page 2) do not factor in much recovery in FY25. Notwithstanding the downgrades, the Group continues to operate comfortably within its core net debt banking covenant.

We still see material underlying worth in the global (Strix) and regional/premium (Billi/LAICA) brands but lower our current fair value in line with estimate changes to 102p / share.

Forecasts

Yr. to Dec, £m	FY22A	FY23A	FY24F	FY25F
Revenue	108.6	144.6	140.9	151.4
Adj. PBT	22.2	21.9	17.6	18.3
Adj. EPS (p)	10.8	9.1	6.2	6.8
DPS (p)	6.0	0.9	1.3	2.0
Net debt	-87.4	-85.7	-73.7	-68.1
EV/EBITDA	6.8	5.5	6.0	5.9
PER	5.6	6.6	9.8	8.9
Yield %	10.0	1.5	2.1	3.4
Net debt/EBITDA	2.7	2.1	2.1	1.9

Source: Company historics, ED estimates

Company Data

EPIC	KETL
Price (last close)	60p
52 weeks Hi/Lo	93p/56p
Market cap	£143.5m
ED Fair Value/share	102p
Net debt (June '24)	£68.8m

Share Price, p

Source: ADVFN

Description

Strix Group ("Strix") is a global leader in the design, manufacture and supply of kettle 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.

It has a majority share in value terms of its largest market, kettle controls and leading positions within the faster growing personal, domestic and corporate water filtration markets.

Next event

Preliminary results, March 2025

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Weakness in the highest margin areas

We highlight the impact of the delay to recovery in its markets. The business is highly operationally geared, compounded by the shortfall in its highest margin areas, the regulated kettle control market and delays of new product launches within Billi. The degree of adjustment for the Consumer Goods division was relatively limited, with further cost savings delivered during H1. Overall, on a revenue shortfall averaging 7.4% for FY24 and FY25, adj. PBT is expected to decline c. 25.3% in both years.

The scale of the decline in adj. EPS relative to adj. PBT in FY24 reflects a one-off increase in the tax charge due to prior year adjustments.

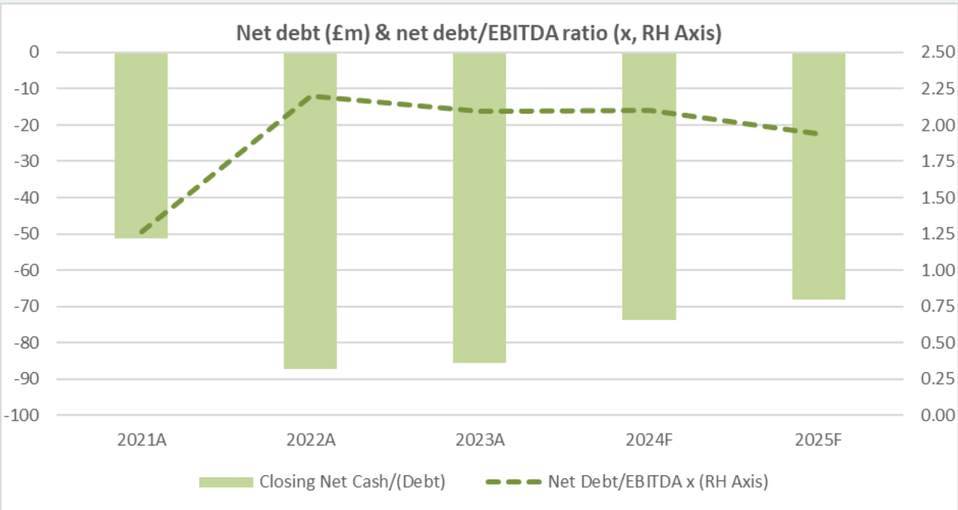
Forecast changes

Y/e Dec, £m	Old FY24F	New FY24F	Chg. %	Old FY25F	New FY25F	Chg. %
Revenue	151.0	140.9	-6.7%	164.8	151.4	-8.1%
Adj. PBT	23.7	17.6	-25.7%	24.3	18.3	-24.8%
Adj. EPS (p)	8.8	6.2	-29.7%	9.0	6.8	-24.7%
Net debt	-67.7	-73.7	8.8%	-62.0	-68.1	9.9%
Net debt/EBITDA	1.6	2.1	28.9%	1.5	1.9	30.1%

Source: ED estimates

Despite the reduction in estimates, the critical net debt/EBITDA ratio remains well within the Group's banking covenants, at 2.1x in FY24, falling to below 2x by the end of FY25.

Net debt and our estimates of the key banking covenant



Source: ED estimates

The Group continues to invest in new products, with further capex required in early FY25 ahead of the launch of the next generation kettle controls. The Canton Fair generated good demand for the new controls. As the new controls offer additional features, one could envisage the kettle replacement cycle picking up in FY25, a trend reinforced by improvements in the housing market.

Similarly, the new product launches at Billi have been received well in Australia and New Zealand, with the UK benefitting from H1 2025. With a further two distributors (including a service capability) anticipated by the year end (totalling six), we expect progress in Europe to be meaningful in FY25, albeit from a small base.

Summary Profit & Loss

Year to Dec, £m	2021A	2022A	2023A	2024F	2025F
Kettle controls	85.1	68.2	70.1	68.0	72.0
Prem. Filtratn. Systems		3.2	42.1	42.5	46.8
Consumer Goods	34.3	37.1	32.4	30.4	32.7
Revenue	119.4	108.6	144.6	140.9	151.4
CoGS	-72.0	-67.1	-87.4	-89.0	-97.2
Gross profit	47.4	41.5	57.2	51.9	54.2
Gross margin (%)	39.7%	38.2%	39.6%	36.9%	35.8%
Op costs	-14.3	-16.4	-25.6	-26.0	-28.9
Other Op. income	0.6	0.8	0.4	0.4	0.4
Operating profit	33.7	25.9	32.1	26.3	25.7
Op margin (%)	28.2%	23.8%	22.2%	18.7%	17.0%
Net Interest	-1.4	-3.7	-10.2	-8.7	-7.4
Associates	-0.1	0.0	0.1	0.0	0.0
PBT (Adjusted)	32.2	22.2	21.9	17.6	18.3
Exceptionals	-10.7	-5.9	-4.2	-11.7	0.0
PBT (Reported)	21.5	16.2	17.8	5.9	18.3
Tax	-0.9	0.8	-1.5	-3.0	-2.4
Adj. PAT	31.4	23.0	20.4	14.6	15.9
Minority interests	0.0	-0.1	0.0	0.0	0.0
Adj. Earnings	31.3	22.9	20.1	14.6	15.9
Reported PAT	20.6	17.0	16.2	2.9	15.9
Ordinary Dividends	-17.3	-13.1	-2.0	-2.9	-4.8
EPS (Adjusted) (p)	14.9	10.8	9.1	6.2	6.8
DPS (p)	8.4	6.0	0.9	1.3	2.0
Ave no of shares (FD) (m)	209.7	212.5	221.3	230.2	235.2

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to Dec, £m	2021A	2022A	2023A	2024F	2025F
Operating profit	33.7	25.9	32.1	26.3	25.7
Depn. & Amortn.	6.9	6.3	8.7	8.8	9.4
Working capital movement	-11.4	-2.6	2.3	-1.8	1.2
Other	-4.9	-6.3	-0.1	-4.0	-1.2
Operating cash flow	24.2	23.2	43.1	29.3	35.1
Net Interest	-2.7	-3.2	-8.9	-8.7	-7.4
Taxation	-1.9	-1.2	-1.3	-2.3	-2.7
Net capex	-15.4	-8.6	-8.0	-12.0	-15.0
Operating FCF	4.2	10.3	24.9	6.3	10.0
Net (Acquisitions)/Disposals	-1.6	-39.3	-6.5	0.0	0.0
Dividends	-16.5	-17.3	-9.1	0.0	-4.4
Share Issues	0.0	10.7	-0.2	8.1	0.0
Minority payment	-0.3	0.0	0.0	0.0	0.0
Other financial	0.2	-0.6	-7.5	-2.5	0.0
Increase Cash/(Debt)	-14.0	-36.2	1.7	12.0	5.6
Opening Net Cash/(Debt)	-37.2	-51.2	-87.4	-85.7	-73.7
Closing Net Cash/(Debt)	-51.2	-87.4	-85.7	-73.7	-68.1

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec, £m	2021A	2022A	2023A	2024F	2025F
Intangible Assets	30.5	73.4	73.4	75.2	71.7
Tangible Assets	39.5	43.7	46.2	52.7	61.7
Investments/other	3.3	3.7	1.0	1.0	1.0
Net Working Capital	11.2	19.0	22.9	24.7	23.5
Capital Employed	84.4	139.8	143.5	153.5	157.9
Other	-2.6	-2.8	-3.6	-3.6	-3.6
Net Cash/(Debt)	-51.2	-87.4	-85.7	-73.7	-68.1
Provisions Liabilities/Charges	-4.7	-12.3	-11.2	-11.2	-11.2
Net Assets	26.0	37.2	43.0	65.1	75.0

Source: Company historics, Equity Development estimates

Valuation

The decline in fair value follows EPS momentum

In formulating our fair value for Strix Group we utilise a combination of discounted cash flow and peer group comparison models. We note the change in financial estimates reflecting the ongoing trading volatility stretching from Q3 into Q4, typically the Group's busiest trading period. This was a result of:

- Political uncertainty impacting discretionary spend (ahead of the UK Budget in particular)
- Delays in shipments of new products at Billi
- A slowdown in China, albeit initial demand for the next generation controls was encouraging
- Higher commodity prices and,
- A weakening of key currencies.

DCF

We have utilised conservative assumptions in constructing our discounted cash flow model (DCF), namely a discount rate of 8.75% (equating to the Group's longer term WACC) and a terminal growth rate of 2.25% (broadly equating to CPI).

The resulting DCF value / share equates to 86p.

Strix Group DCF calculation

£m, year to Dec	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Free cash flow	15.0	17.4	17.6	18.0	18.4	18.8	19.3	19.7	20.1	20.6
WACC (%)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Timing factor	0.25	1.25	2.25	3.25	4.25	5.25	6.25	7.25	8.25	9.25
Discount rate	0.98	0.90	0.83	0.76	0.70	0.64	0.59	0.54	0.50	0.46
Present value	14.7	15.7	14.6	13.7	12.9	12.1	11.4	10.7	10.1	9.5
Sum of discounted cash flows	125.4									
Terminal growth rate (%)	2.25									
Terminal value	145.7									
Net debt	-73.7									
Equity value	197.4									
No. of shares (m)	229.9									
Value per share (p)	85.9									

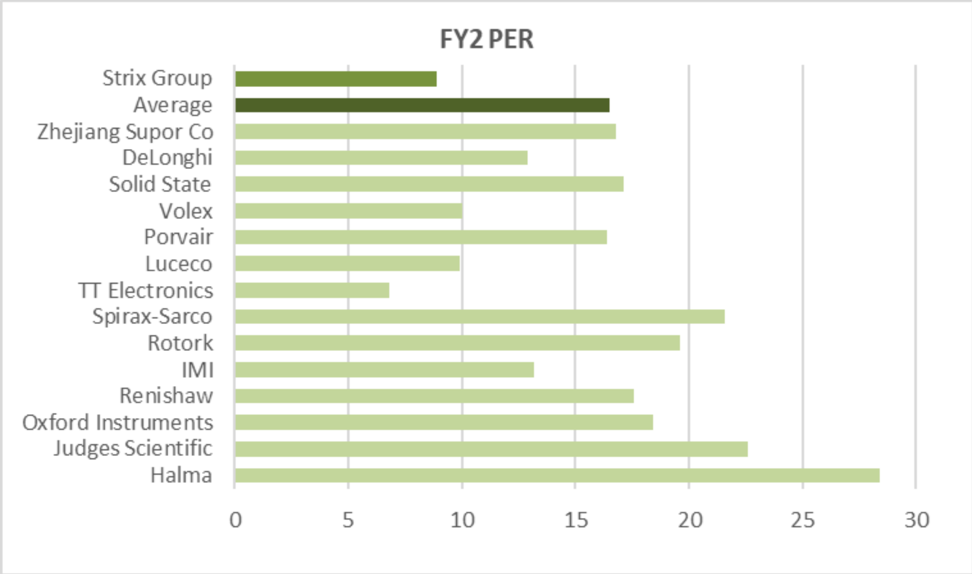
Source: Equity Development

Peer group comparison models

We focus on year two forecasts (FY2) within our peer group comparison models, reflecting where we are currently in CY24 and the shifting nature of investors' focus. We source our estimates from Koyfin and pay particular attention to PER and EV/EBITDA. To remain conservative, we have applied a 10% size related discount to the fair value outcome relative to its peers.

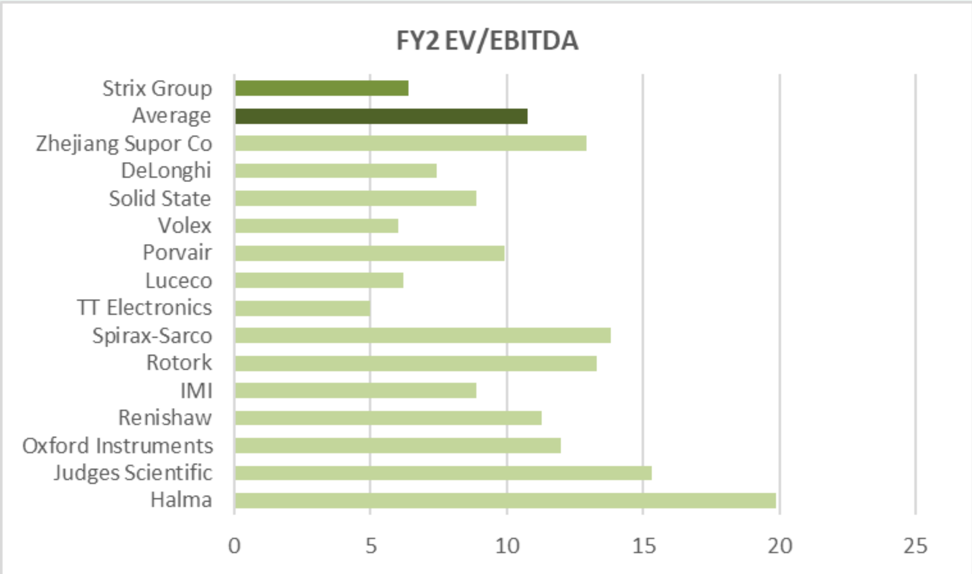
Our valuation models demonstrate that Strix continues to trade at a marked discount to its peer group, while delivering a yield close to its peers at the closing share price on 26/11/2024 of 60p.

Peer group comparison: FY2 PER (x)



Source: Koyfin

Peer group comparison: FY2 EV/EBITDA (x)



Source: Koyfin

Fair value

The table below summarises the fair value / share derived from each of our valuation models, suggesting a weighted average of 102p.

Fair value		
	FY24 fair value	**FY25 Fair value**
DCF	86	86
PER (x)	107	101
EV/EBITDA (x)	137	117
Average	109.8	101.2

Source: ED

We think that common sense should prevail in the case of Strix. Notwithstanding a 20% decline in kettle control revenues since 2019, Strix remains the leading player globally within the market, with a c.56% share. Not only is there scope for recovery but the Group's leading position from a technology standpoint has value, particularly as the next generation of controls can be utilised in several appliances, widening the end market for the product.

In addition, Billi and LAICA are premium regional brands currently. Strix is developing a distribution network to ultimately build two additional global brands in its portfolio.

We think the market is undervaluing the long-term worth of the brands, market positions and scope for recovery on FY25 ratings of EV/Sales of 1.4x and EV/EBITDA of 5.9x.

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