Strix Group plc

Billi drives top line growth

27 March 2024

Positives emerged, particularly in H2, as the recovery commenced within the kettle controls market. Billi was the architect of the revenue improvement, with LAICA also delivering a double-digit increase in the top line. Margins improved, notwithstanding a change in the mix. Encouragingly, investor concerns on debt were allayed with the careful management of cash, and latterly as bankers raised the net debt/EBITDA covenant to 2.75x. With further emphasis on costs and cash conservation and a likelihood that its markets will begin to deliver more meaningful recovery in H2, none of this good news looks factored into the current valuation.

Focus shifting

The results for FY23 were broadly in line with revised expectations, except for the dividend. There will be no dividend payout during CY24 following the sensible pausing of the final dividend to help accelerate a reduction in indebtedness. The resumption of dividend payments in CY25 is expected to amount to a sustainable 30% of PAT and rise in line with adj. EPS thereafter.

The proximity of the net debt/EBITDA ratio to the Group's key banking covenant was a cause for concern in H223 as it reduced to 2.25x from September. The ratio ended the year at 2.19x. Through a combination of a recovery in its markets, the contribution of Billi, regional expansion and new product launches, net debt should fall to below £80m by the FY24 (net debt/EBITDA of c.1.9x) and to below £70m by end FY25 (1.7x). The medium-term target is to remain within 1x to 2x.

Interestingly, regulated kettle control markets are c.20% below levels witnessed in FY21. Carrying the highest product margin, any acceleration in the recovery could mean a significant improvement in the margin mix. Billi is looking to introduce several new products outside its home market (Australia) and enter new markets via partnership agreements (Europe, SE Asia, and the Middle East). New contracts in the Consumer Goods division combined with new product launches are also positive (e.g. Aurora coffee machine in North America).

Our conservative view of estimates has meant reducing adj. EPS in FY24 by 5.2%. Green shoots have appeared, but recovery is underway on a selected basis only. Self-help will continue, with further efficiency improvements at Aqua Optima and working capital and costs under closer scrutiny. Nevertheless, as its markets see recovery accelerate, profitability levels may surprise on the upside.

Increase to fair value / share

We have utilised DCF and peer group comparison models to calculate fair value. **The focus is shifting from survival to recovery and as such, we increase our fair value / share to 173p (149p).**

Forecasts

Yr. to Dec, £m	FY22A	FY23A	FY24F	FY25F
Revenue	108.6	144.6	154.2	169.0
Adj. PBT	22.2	21.9	24.1	25.8
Adj. EPS (p)	10.8	9.1	9.4	10.1
DPS (p)	6.0	0.9	1.9	3.0
Net debt	-87.4	-85.7	-78.7	-68.8
EV/EBITDA	7.3	5.9	5.4	5.1
PER	6.2	7.4	7.1	6.6
Yield %	9.0	1.3	2.8	4.5
Net debt/EBITDA	2.2	2.1	1.9	1.6

Source: Company historics, ED estimates

Company Data

EPIC	KETL
Price (last close)	67p
52 weeks Hi/Lo	114p/51p
Market cap £m	£146m
ED Fair Value	173p
Net debt (Dec '23)	£85.7m

Share Price, p

Source: ADVFN

Description

Strix Group plc ("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.

The Group 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.

David O'Brien (Analyst)
0207 065 2690
david@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

Green shoots emerged during H2 ‘23

FY23 preliminary results, half-yearly progression							
Year to December, £m	**H1 '22A**	**H2 '22A**	**FY22A**	**H1 '23A**	**H2 '23A**	**FY23A**	**Change, %**
Kettle controls	34.8	33.4	68.2	28.8	41.3	70.1	2.7%
Premium Filtration systems		3.2	3.2	21.5	20.6	42.1	1206.0%
Consumer goods	15.9	19.6	35.5	14.9	17.4	32.4	-8.7%
Total revenue	50.7	56.2	106.9	65.2	79.4	144.6	35.2%
Cost of sales	-31.2	-34.2	-65.4	-41.3	-46.1	-87.4	33.6%
Kettle controls GP	15.0	12.9	27.9	10.7	16.6	27.4	-2.1%
Prem. Filtration systs. GP		1.1	1.1	10.0	9.3	19.3	1589.8%
Consumer goods GP	4.5	8.0	12.4	3.3	7.3	10.6	-15.2%
Gross profit	19.5	22.0	41.5	23.9	33.3	57.2	37.7%
KC GP%	43.1%	38.7%	40.9%	37.2%	40.3%	39.0%	-4.7%
PFS GP%	n/a	35.4%	35.4%	46.3%	45.2%	45.8%	29.4%
CG GP%	28.2%	40.7%	35.1%	21.8%	41.8%	32.6%	-7.2%
Group GP%	38.4%	39.2%	38.8%	36.7%	41.9%	39.6%	1.8%
Distribution costs	-4.5	-6.3	-10.8	-5.0	-5.9	-10.9	0.7%
Admin. Expenses	-2.7	-2.9	-5.6	-7.3	-7.4	-14.7	163.5%
Total OpEx	-7.2	-9.2	-16.4	-12.3	-13.3	-25.6	56.0%
Share of JVs	0.0	0.0	0.0	0.0	0.1	0.1	
Other op. income	0.6	0.2	0.8	0.2	0.2	0.4	
Adj. EBITDA	15.9	16.2	32.1	15.6	24.0	39.6	23.2%
EBITDA %	31.4%	28.8%	30.0%	24.0%	30.2%	27.4%	
Adj. EBIT	12.9	13.0	25.9	11.7	20.4	32.1	24.3%
EBIT %	25.4%	23.1%	24.2%	17.9%	25.7%	22.2%	
Net interest	-1.3	-2.4	-3.7	-5.0	-5.2	-10.2	177.0%
Adj. PBT	11.6	10.5	22.2	6.7	15.2	21.9	-1.1%
Exceptionals	-3.8	-2.2	-5.9	-1.9	-2.3	-4.2	
Taxation	0.0	0.8	0.8	-1.0	-0.5	-1.5	-291.7%
Tax %	0.4%	-8.0%	-3.6%	15.1%	3.5%	7.0%	
Adj. PAT	11.6	11.4	23.0	5.7	14.4	20.1	-12.5%
Minorities	-0.1	0.0	-0.1	0.0	-0.1	0.0	
Adj. Earnings	11.5	11.4	22.9	5.8	14.3	20.1	-12.5%
Adj. EPS (p)	5.5	5.3	10.8	2.6	6.5	9.1	-16.1%
DPS (p)	2.75	3.3	6.0	0.9	0.0	0.9	-85.0%
Net debt	-91.3	-87.4	-87.4	-96.8	-84.4	-84.4	-3.4%

Source: Company

The preliminary results were broadly in line with revised expectations. The one caveat to this was the decision not to pay a final dividend to maximise cash generation and accelerate the reduction in indebtedness. The statement that in FY25, 30% of PAT will be used to pay a dividend highlights the short-term nature of the decision and the desire to return to a sustainable dividend in future.

Billi was a strategic acquisition for Strix Group, filling a gap in its product portfolio and providing positive momentum in a relatively challenging year. Group revenues increased 35.2% yoy to £144.6m. On stripping out the impact of Billi, like-for-like revenues declined modestly (-1.1%), as the gains secured within the H2 recovery within Kettle controls were offset by a difficult period for Appliances.

Kettle Controls – revenues +2.3% to £70.1m, GP -2.1% to £27.4m

The improvement in revenues overall in FY23 suggested further market share gains. We note the decline in revenues within Kettle Controls in the 12 months to June 2023, which was despite the historical second-half bias to revenues. However, H223 witnessed a marked recovery – improving sequentially in Q3 and Q4 - with revenues some 23.5% higher yoy

The recovery was broad in nature across the regulated, less regulated, and Chinese markets. However, the magnitude of recovery was not, with regulated markets (dominated by the UK and Germany) delivering a modest uplift and China and the less regulated markets benefiting from double-digit yoy growth (+18%).

We understand that the OEMs and their retail customers continue to maintain low stock levels, with the orders low in volume and medium in frequency. Once confidence picks up, one should expect frequency and volumes to improve further, with inventory levels replenished to normal levels.

The gross margin declined to 39% (FY22: 40.9%), largely reflecting the change in the revenue margin mix as growth in the Chinese and less regulated markets outpaced growth elsewhere.

Premium Filtration Systems – revenues +1206% to £42.1m, GP +1590% to £19.3m

The acquisition of Billi in late 2022 was the engine of top-and-bottom-line growth, performing strongly on an underlying basis (double-digit growth), while dealing with its separation from its previous parent and the investment in a new head office, warehouse, and showroom in the UK. Meanwhile, its facilities (warehouse and logistics) in Australia were consolidated to remove cost. Notwithstanding this, UK revenues improved 13% on a proforma basis.

H2 revenues declined modestly (-3.9% to £20.6m), mostly reflecting a temporary hiccough as the business's infrastructure was right sized to facilitate growth in the UK, Europe, Asia, the Middle East, and Australia.

Gross margins improved markedly to 45.8% (FY22: 35.4%), with the previous reporting period including the short time following the acquisition of Billi.

Consumer goods – revenues -8.7% to £32.4m, GP -15.2% to £10.6m

The performance of the Water category (LAICA) was robust during FY23, reflecting the more affordable cost of its products. Its higher revenues partly offset the lower demand for Appliances. Water benefitted from several private label contracts, as value-conscious consumers switched from brands.

Purchases of the higher-cost appliances were deferred owing to the economic uncertainty and the inflationary squeeze on consumer disposable incomes. The move into administration of a national UK retailer, coupled with falling demand in Asia, resulted in the bulk of the revenue decline in FY23.

H2 gross margins consisted of the highest since the acquisition, at 41.8% (H2 '22: 40.7%), which is significant given investors' concerns initially. Nevertheless, reduced production levels yoy resulted in margins declining to 32.6% for the year as a whole (FY22: 35.1%).

Costs

The focus on costs has been constant over the last 18 months. The Consumer Goods division will receive further attention, with the number of products rationalised and new launches limited to those where margin uplift is likely.

One should remember that the products generally sold in the Chinese and less regulated markets tend to be priced lower, thereby diluting margins. Recovery of the regulated market is likely to improve the margin mix of revenues.

The higher overhead base of Billi disproportionately added to costs, which on a Group level rose to £113m (FY22: £81.8m). This comprised OpEx of £25.6m and CoGS of £87.4m. Employee cost inflation more than offset lower shipping costs as rates declined from FY22's higher levels.

Uplift in EBITDA

EBITDA margins increased to 30.2% during H2 (H2 '22: 28.8%), aided by a full period of Billi. EBITDA increased 23.2% yoy on an adjusted basis. Although EBIT delivered a similar uplift yoy to £32.1m (+24.3% vs H2 '22), the hike in interest payments following the Billi acquisition meant that adj. PBT declined yoy (-1.1% to £21.9m).

The deferred consideration for LAICA (£7.5m), coupled with the purchase of Billi in late FY22, meant that average net debt for the year amounted to c.£91m during the year and resulted in interest costs rising from £3.7m in FY22 to £10.2m in FY23. Net debt reduced to £85.7m by the year-end, aided by a close control of working capital (cash generated of £2.3m), an operating cash conversion of 106% (FY22: 94%) and a yoy reduction in capex to £8.0m (FY22: £8.6m). The term loan associated with the purchase of Billi includes quarterly debt repayment of £3.5m, with the facility closing in October 2025.

The Group returned to a position of paying tax overall in FY23, following the acquisition of Billi and a strong performance by LAICA. This resulted in adj. EPS declining 16.1% yoy to 9.1p / share. We highlighted the dividend earlier, and with no final dividend, the payout level fell 85% to 0.9p / share.

Board changes

We note the appointment of Clare Foster as CFO, replacing the Interim CFO, Mark Kirkland, on 2 April, following a handover period. Mark will revert to his previous Non-Executive Director role. Clare was previously the CFO of Trifast, the global fastener manufacturer and distributor.

Valuation

A slowdown in the Group's markets – not least regulated kettle controls and appliances, combined with concerns over the debt profile and proximity to covenants has held back the valuation. The improvement during H2 in the kettle control market, combined with a move to a more sensible net debt/EBITDA covenant, should allay investor concerns moving forward.

We utilise two models to calculate the fair value / share expectation for Strix Group:

- Discounted Cash Flow, and
- Peer group comparisons

We have utilised conservative assumptions in building our discounted cash flow model, which includes a discount rate of 8.75% and a terminal growth rate of just 2.25%. **The model suggests a fair value / share of 167p, representing a significant uplift on the current share price.**

The peer group comparison models incorporate forecast year one estimates (*source: Koyfin*) of PER, EV/EBITDA, EV/Sales and Price/Book. We have applied a 10% size-related discount to the ratings of its peers in calculating a likely fair value. We highlight this in the charts below, which suggest that Strix Group is trading at a marked discount to its peers.

We have excluded yield comparisons, considering the Company's expectation that it will resume dividend payments in FY25, at a rate of 30% of PAT. On this basis, our FY25 dividend estimate suggests a yield of 4.6% at the current share price.

The average of the valuation models suggests a fair value / share assumption of 173p, representing a marked uplift over the current share price of 67p.

Fair value

	FY24 fair value
DCF	167
PER (x)	167
EV/EBITDA (x)	178
EV/Sales (x)	129
Price/Book (x)	227
Average	**173.4**

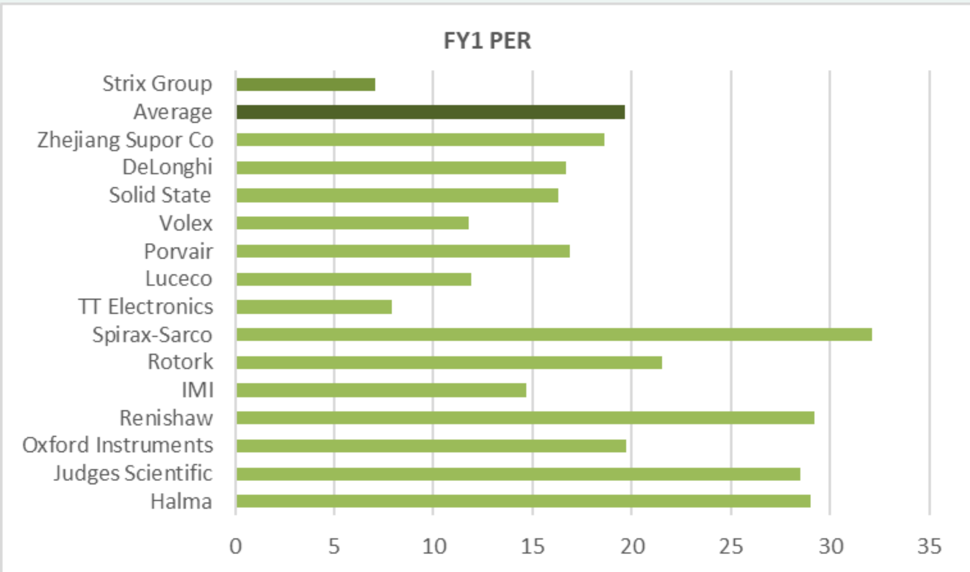
Source: ED

Strix Group DCF calculation

£m, year to Dec	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Free cash flow	19.5	23.1	29.5	30.2	30.9	31.6	32.3	33.0	33.8	34.5
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	19.0	20.8	24.5	23.0	21.6	20.3	19.1	18.0	16.9	15.9
Sum of discounted cash flows	199.2									
Terminal growth rate (%)	2.25									
Terminal value	244.4									
Net debt	-78.7									
Equity value	364.8									
No. of shares (m)	218.7									
Value per share (p)	166.8									

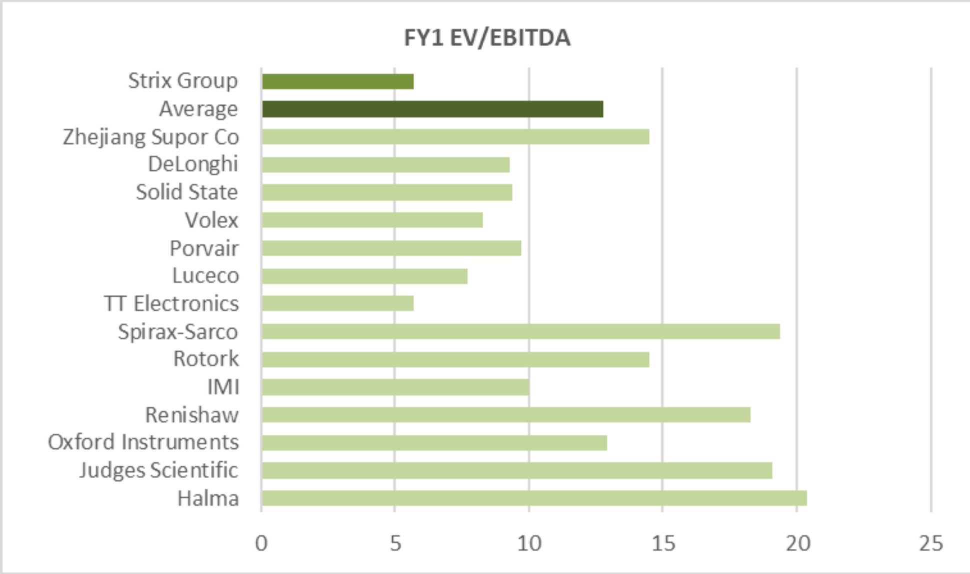
Source: Equity Development

Peer group comparison: FY1 PER (x)



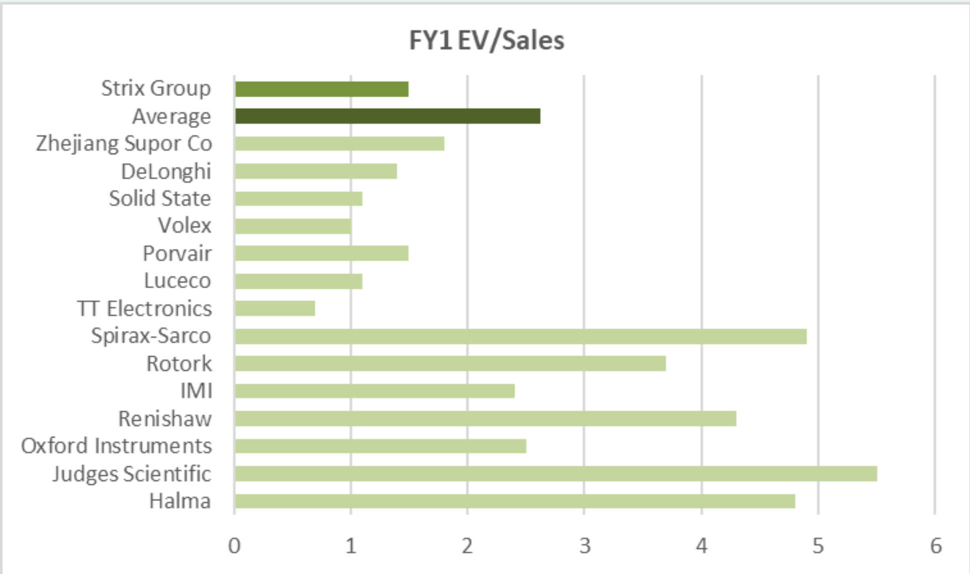
Source: Koyfin

Peer group comparison: FY1 EV/EBITDA (x)



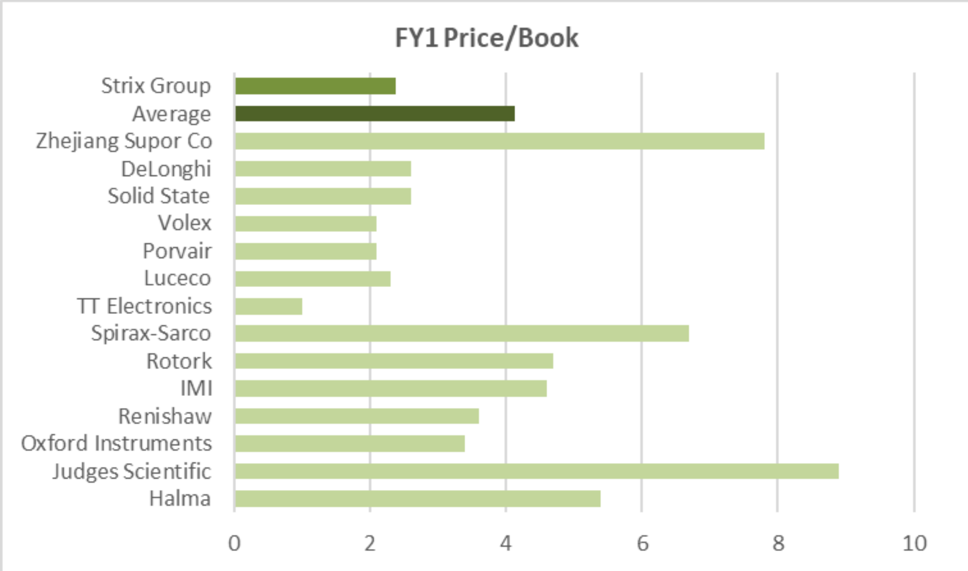
Source: Koyfin

Peer group comparison: FY1 EV/Sales (x)



Source: Koyfin

Peer group comparison: FY1 Price/Book (x)



Source: Koyfin

Financials

We have fine-tuned our financial estimates for Strix Group, expecting the pace of the recovery in most of its markets to pick up during H2 '24. The drag on expectations continues to be the regulated kettle controls market and Appliances, with a robust recovery underway at LAICA and in the less regulated/Chinese kettle controls markets. Billi has continued to perform well.

Our adj. EPS expectation was reduced by 5.2% in FY24, followed by an expected uplift of 7.2% into FY25E. As new products are launched across the three divisions and markets return to normal levels, we expect the outlook to improve further.

Estimate changes

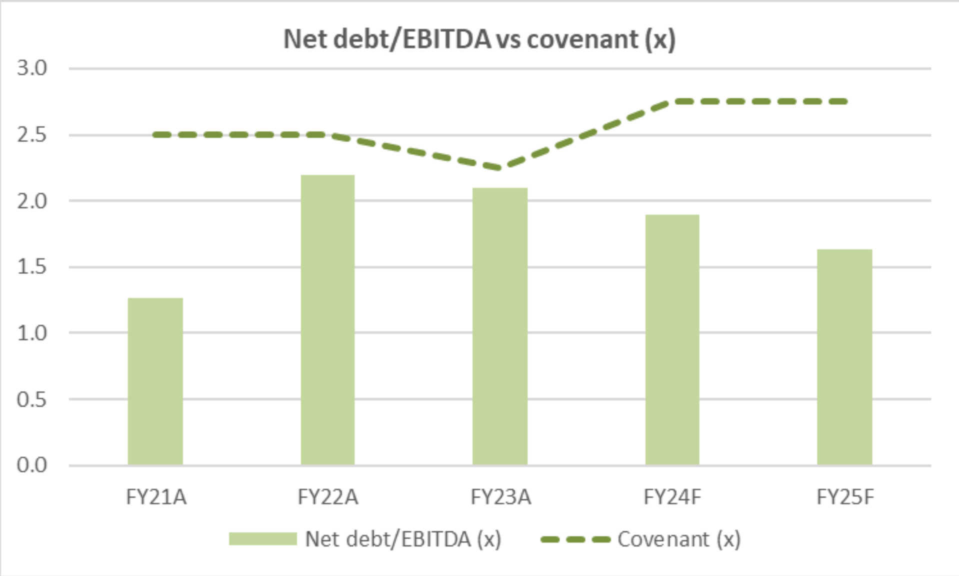
£m	Old FY24E	New FY24E	Change, %	Old FY25E	New FY25E
Revenue	158.0	154.2	-2.4%	n/a	169.0
Adj. EBITDA	43.8	41.6	-5.1%	n/a	42.2
Adj. PBT	25.4	24.1	-5.0%	n/a	25.8
Adj. PAT	22.0	20.9	-5.0%	n/a	22.4
Adj. EPS (p)	10.0	9.4	-5.2%	n/a	10.1
DPS (p)	3.0	1.9	-36%	n/a	3.0
Net debt	-78.3	-78.7	-0.6%	n/a	-68.8

Source: Equity Development

The tables below include estimates for the income statement, cash flow statement, and balance sheet to the end of FY25. Management has suggested that the internal reorganisation has further to go, potentially reducing the cost base and consolidating the number of products sold.

Crucially, the improving outlook and close control of costs should result in improved cash generation. On this basis, we anticipate the net debt/EBITDA ratio declining to 1.6x by the end of FY25E, some 115 b.p.s below the existing covenant. We highlight this in the next chart, demonstrating the rising gap between the likely outcome and the covenant.

Net debt/EBITDA vs covenant (x)



Source: Company (historics), Equity Development estimates

The medium-term target for net debt/EBITDA is 1.5x, with the parameters beyond this set at 1x to 2x and well within covenanted levels.

We expect the drivers of the top line to include the following over the next 12-24 months:

- A broadening of the recovery in its markets – the regulated kettle controls market was c.20% below FY21 levels in FY23, highlighting the potential uplift
- The new Series Z kettle controls are undergoing tests with OEM customers to be launched in FY25, with an ability to be utilised in new and related applications
- The imminent launch of new lower-cost kettle controls to broaden the appeal within the Chinese and less regulated markets
- The launch of the Omni-One hot/chilled/sparkling under-the-counter unit into commercial and residential applications within export markets
- The introduction of the new Luxgarde UVC purification system to prevent waterborne bacteria and pathogens
- A new multi-function tap, compatible with the Omni-One, is to be launched globally
- Billi is seeking partners to:
  - Provide technical and commercial support and to facilitate a pan-European launch
  - A targeting of the residential market
  - Further expand the business in South East Asia and the Middle East
- One new contract and an expansion of an existing contract should drive recovery within Consumer Goods, and
- New product development across filtration and vacuum sealer categories.

Profitability will also benefit from:

- The underlying operational gearing as revenues improve

- A re-basing of the core Kettle Controls business to remove excess costs
- Divisional restructuring within Consumer Goods, with LAICA positioned as a centre of excellence
- Reducing debt levels to shrink the interest expense
- A leveraging of production facilities, increasing throughput and driving efficiencies of scale
- Improved sourcing and,
- A rationalisation of products.

Summary Profit & Loss

Year to Dec, £m	2021A	2022A	2023A	2024F	2025F
Kettle controls	85.1	68.2	70.1	74.3	79.3
Prem. Filtratn. Systems		3.2	42.1	46.6	51.7
Consumer Goods	34.3	37.1	32.4	33.3	38.0
Revenue	119.4	108.6	144.6	154.2	169.0
CoGS	-72.0	-67.1	-87.4	-96.6	-108.7
Gross profit	47.4	41.5	57.2	57.6	60.3
Gross margin (%)	39.7%	38.2%	39.6%	37.4%	35.7%
Op costs	-14.3	-16.4	-25.6	-25.5	-28.1
Other Op. income	0.6	0.8	0.4	0.5	0.5
Operating profit	33.7	25.9	32.1	32.5	32.7
Op margin (%)	28.2%	23.8%	22.2%	21.1%	19.3%
Net Interest	-1.4	-3.7	-10.2	-8.5	-7.0
Associates	-0.1	0.0	0.1	0.1	0.1
PBT (Adjusted)	32.2	22.2	21.9	24.1	25.8
Exceptionals	-10.7	-5.9	-4.2	0.0	0.0
PBT (Reported)	21.5	16.2	17.8	24.2	25.8
Tax	-0.9	0.8	-1.5	-3.2	-3.3
Adj. PAT	31.4	23.0	20.4	20.9	22.4
Minority interests	0.0	-0.1	0.0	0.0	0.0
Adj. Earnings	31.3	22.9	20.1	20.9	22.4
Reported PAT	20.6	17.0	16.2	20.9	22.4
Ordinary Dividends	-17.3	-13.1	-2.0	-4.2m	-6.7
EPS (Adjusted) (p)	14.9	10.8	9.1	9.4	10.1
DPS (p)	8.4	6.0	0.9	1.9	3.0
Ave no of shares (FD) (m)	209.7	212.5	221.3	221.3	221.3

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	32.6	32.8
Depn. & Amortn.	6.9	6.3	8.7	8.9	9.5
Working capital movement	-11.4	-2.6	2.3	-5.5	0.3
Other	-4.9	-6.3	-0.1	-4.0	-5.0
Operating cash flow	24.2	23.2	43.1	32.1	37.6
Net Interest	-2.7	-3.2	-8.9	-8.5	-7.0
Taxation	-1.9	-1.2	-1.3	-2.4	-3.3
Net capex	-15.4	-8.6	-8.0	-9.2	-10.1
Operating FCF	4.2	10.3	24.9	12.0	17.1
Net (Acquisitions)/Disposals	-1.6	-39.3	-6.5	0.0	0.0
Dividends	-16.5	-17.3	-9.1	0.0	-6.4
Share Issues	0.0	10.7	-0.2	0.0	0.0
Minority payment	-0.3	0.0	0.0	0.0	0.0
Other financial	0.2	-0.6	-7.5	-5.0	-0.8
Increase Cash/(Debt)	-14.0	-36.2	1.7	7.0	9.9
Opening Net Cash/(Debt)	-37.2	-51.2	-87.4	-85.7	-78.7
Closing Net Cash/(Debt)	-51.2	-87.4	-85.7	-78.7	-68.8

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	49.9	54.1
Investments/other	3.3	3.7	1.0	1.0	1.0
Net Working Capital	11.2	19.0	22.9	28.4	28.1
Capital Employed	84.4	139.8	143.5	154.5	154.8
Other	-2.6	-2.8	-3.6	-3.6	-3.6
Net Cash/(Debt)	-51.2	-87.4	-85.7	-78.7	-68.8
Provisions Liabilities/Charges	-4.7	-12.3	-11.2	-11.2	-11.2
Net Assets	26.0	37.2	43.0	61.0	71.2

Source: Company historics, Equity Development estimates

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Disclaimer

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London EC2M 7EB

Contact: info@equitydevelopment.co.uk | 020 7065 2690