

Solid H1 results, promising outlook

18th September 2019

Strix H1 19 results published today: 'The Group has delivered a solid H1 performance and is trading in line with full year market expectations'. Accordingly, we leave our FY 19/20 forecasts unchanged. Reassuringly, Strix reconfirms at this stage its intention to **pay total dividends of 7.7p** per share for FY 19, +10% YoY. This should underline the income attractions of this stock to investors.

CEO Mark Bartlett highlights in his update the operating progress achieved by the Group in H1 together with comments on stable market share as **the leading player in the global kettle controls market**. This is a market still growing at c. 2% pa, in spite of well-flagged macro headwinds.

Re **operating momentum in 2019**, we signal the appointment of a CCO (Chief Commercial Officer) to increase focus on new product innovation plus the new, enlarged manufacturing facility in China, where construction is due to start imminently, with expected completion in Q1 2021. Agreement has also been reached for the recently acquired Astrea product to be launched globally under the Philips brand. Taken together, **these initiatives highlight the scope for future value creation at Strix and the forward planning of management**.

Time to revisit the Strix investment case. The shares have been treading water in recent months, in part reflecting the sell-down of a major institutional shareholding. In our view, this appears an attractive entry point to the shares. **Valuation multiples are undemanding at 11x PER, 9.6x EV/EBITDA**. The dividend yield at the current price is a compelling 4.7%. We estimate fair value for the shares in the 220p-240p range.

Strix is a unique strategic asset on the UK stockmarket, with industry leading margins and a number of growth initiatives. It also screens well for investors with a 'sustainability' mandate, with a focus on health products and improved filtration.

Key Financials

Y/E Dec	2017	2018	2019E	2020E
Revenue (£000's)	91,263	93,769	101,498	108,083
y.o.y growth	2.94%	2.75%	8.24%	6.49%
EBITDA (£000's)	35,117	36,351	36,160	38,829
EBIT. (£000's)	29,062	30,861	31,087	33,658
Adj. PBT (£000's)	28,304	29,206	29,960	32,464
Adj PAT (£000's)	27,517	28,259	28,635	30,776
EPS (p) basic adj.	14.48	14.87	15.07	15.46
EPS (p) ful dil. Adj	14.21	14.19	14.38	15.46
DPS (p)	2.90	7.00	7.70	7.90
Div yield (%)	1.81%	4.38%	4.68%	4.81%
Div cover	0.00	2.03	1.87	1.96
Net debt/cash	45,889	27,479	30,628	33,883
P/E	11.3	11.3	11.4	10.6
EV/EBITDA	9.87	9.53	9.58	10.35

ED forecasts / Company historic data

Company Data

EPIC	KETL
Price (last close)	164p
52 week Hi/Lo	182/127p
Market cap	£312.4m

Share Price, p



Source: ADVFN

Description

Strix Group Plc (Strix) is a global leader in the design, manufacture and supply of kettle safety controls and other components and devices involving water heating and temperature control, steam management and water filtration.

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Strix H1 19 results published

‘Strix has achieved another solid performance despite continued challenges presented by the macro-economic environment. In particular, maintenance of the Group’s market share in the regulated and less regulated markets, combined with modest growth in China, demonstrates the strength and resilience of our core business model.’

Strix has this morning published its H1 19 results, for the period ending June 30. The table below highlights the key financial metrics.

Half year results			
£m	H1 19	H1 18	Change
Revenue	43.9	42.9	2.3%
Gross profit	16.7	16.3	2.5%
Distribution costs	-2.6	-2.8	-7.1%
Admin costs	-2.3	-1.7	35.3%
Op profit	12.2	11.9	2.5%
EBITDA	14.9	14.8	0.7%
PBT	11.5	11.0	4.5%
PAT	10.9	10.6	2.8%

Company data

H1 19 results overview

Revenue grew 2.3% to £43.9m (H1 2018: £42.9m) with a constant currency increase of 0.2%. Control volume in the period was flat against the prior year, but revenue was higher YoY due to product mix changes.

Foreign exchange rate movements increased the Sterling value of the Group’s US Dollar revenue, offset by an increase in Dollar costs, causing the gross profit margin to maintain around 38%.

The Group generated an adjusted EBITDA of £14.9m, an increase of 0.7% (H1 2018: £14.8m) and the adjusted EBITDA margin decreased by c60bps YoY to 33.9%. Excluding the impact of exceptionals, adjusted operating profit increased by 2.1% to £12.2m (H1 2018: £11.9m).

Adjusted profit before tax was £11.5m (H1 2018: £11.0m), an increase of 4.5% due to lower interest charges being incurred as a result of an improved leverage ratio and a lower outstanding facility YoY. There was no corporation tax payable on the Group’s non-China generated profits as the Isle of Man corporation tax rate was 0%.

Net debt has increased since FY 2018 period end to £33.4m (2018: £27.5m) as a result of the land right-of-use acquisition, the HaloSource acquisition and the dividend of £8.9m paid in H1 2019.

Capital expenditure (including the £1.7m land usage right) increased from £2.6m in H1 2018 to £4.6m in H1 2019.

The Group continues to have in place a revolving credit facility of £51.0m (2018: £53.0m) of which £42.0m (2018: £41.0m) has been drawn down.

Net debt to adjusted EBITDA ratio was 0.9x (2018: 0.8x). Strix remains conservatively financed, in our view, which is a strength of the investment case.

An interim dividend of 2.6p (H1 2018: 2.3p) has been declared. This is in line with our expectations. The ordinary shares will go ex-dividend on 26 September. Strix remains committed to paying a total dividend that will equate to 7.7p per share for FY 19.

Key takeaways

Forecasts and market dynamics

We have made no material changes to our FY forecasts, on the back of these H1 results. In terms of year on year movements (FY 2019, vs FY 2018), we would pick out our own expectations: 1/ growth in adjusted PAT; 2/ conservative year-end leverage at <1x ND/EBITDA; 3/ reconfirmation of 7.7p dividend for FY 19 (total dividend), + 10% YoY.

The global market for kettle safety devices is estimated to have grown by 2% in H1 2019, following mid-single digits % growth in 2018. Strix maintains leading overall market share. In the *Less Regulated* sector, Strix's market volume share is c. 20% with the U9 series gaining positive traction. In the *Regulated* sector, the Group maintains its consolidated volume share of c. 61%. China remains the largest single country kettle market of just under 50 million - Strix has a c. 46% share.

The core kettle control market therefore exhibits fairly solid growth credentials, in spite of the geo-political events which continue to overshadow global trade, including trade tensions between the US and China, and the so-called impact of Brexit. **Average selling prices have remained relatively stable following the price increase in Q4 2018.**

There are, however, subtle mix differences in 2019, which explain the modest slowdown in market growth rates YoY. E.g. **growth in North America and the Far East**, offset by weaker markets in China and CIS.

It will be no surprise to investors, of course, that the geo-political backdrop has been tougher in 2019, but it is important to stress that the Strix 'flow of goods' is in fact between the Isle of Man and China. Reassuringly, the Group states that 'appropriate stocks have been secured to prevent any potential logistics disruption resulting from Brexit'. **Concerns over the so-called impact of either Brexit or US/China trade tariffs should, in our view, be kept strictly in perspective.**

Aqua Optima branded products retain stable market share in the UK, albeit the market itself is estimated to be down c. 7% YoY. We consider this a short-term dip, rather than structural.

Operating and commercial developments

In terms of operating momentum in 2019, we note:

- **the appointment of a Strix CCO (Chief Commercial Officer)**, Harry Kyriacou, to increase focus on new product innovation;
- **the new, enlarged manufacturing facility in China, where construction is due to start imminently**, with expected completion in Q1 2021.

Over many years, Strix has developed a portfolio of water, temperature and steam management technologies that have been commercialised in adjacent products and markets as opportunities arise.

For example, on the back of the successful launch of the U9 Series during 2017, Strix has successfully produced over 7 million controls. The Group continues to develop this series with new variants launched to target the smaller size and split switch kettle appliances to further enhance the portfolio of "best in class" controls.

The U6 series control for electronic kettles was launched in Q4 2018 and Strix has subsequently shipped over 0.5 million sets.

Looking ahead, **baby products and small domestic appliances are new growth verticals, where Strix is already working with partners.** According to independent estimates, the global mother and baby category for consumer products has a value of c£160bn. This is a resilient vertical that should not be affected by macro trends.

In terms of China, **the company highlights the security advantage of moving to a 50 year, rather than 20 year, tenure for its new factory location,** which underlines the support they receive from the regional Chinese government.

The plot itself can support a maximum facility size of 34,000m² compared to the current facility of 13,200m². Increased capital expenditure arising from the factory move/construction, c. £17m rising to c£20m next year, should already be factored into market forecasts.

Recap on other developments

Strix technology in new Philips branded product

Interestingly, Strix has recently announced a product launch with AquaShield Health Technology Company Ltd, the global exclusive Philips brand licensee for water purifiers and dispensers.

The collaboration will launch **a new co-branded water bottle with in-built filter, supported by Strix's water filtration expertise**. This launch, as a co-branded product has allowed Strix to achieve a large-scale unveiling and promotion whilst leveraging existing channels without significant investment.

The target launch of the water bottle for consumers is Q1 2020. In our view, this partnership validates the quality of the Astrea technology and suggests further development opportunities for the HaloSource assets.

HaloSource

Strix completed its £1m acquisition of certain HaloSource assets on 7th March 2019.

These included the HaloPure division and the Astrea product. According to today's H1 results, post-acquisition 'performance has been in line with expectations'. The company reiterates the benefits of some key technologies and research & development skills in the water filtration market.

Revenue synergies will be derived from using Strix existing sales channels to commercialise the two acquired technologies. In the medium term, the HaloSource assets should also support Aqua Optima's overall growth as well as entrenching the group's important USA foothold. Together, these drive future profitability.

We note the increase in-group administration costs YoY, £2.3m in H1 2019 vs £1.7m in H1 2018. This reflects higher staffing costs following the increase in headcount due to the HaloSource acquisition and further strategic appointments to support the long-term growth aspirations of Strix. In terms of near term financial forecasts, our core assumption is that the HaloSource assets will breakeven in FY20 and make a positive contribution to profitability in FY21.

The acquired technologies broaden the current water filtration offering and improve its capability. The assets include two patented technologies, a bromine-based water treatment bead system proven to kill 99.99%+ of bacteria and viruses, and a composite filter material, certified to remove lead, to the NSF-53 standard important for the US market, and other heavy metals.

Meanwhile, Strix's balance sheet (and free cash flow) should continue to support tactical M&A activity, albeit in niche applications.

Site visit

Earlier this year we took part in an investor visit to the Isle of Man, including the Ramsey site, which is a high precision engineering business. It produces bimetal blades and high-speed stampings, including contact insertion. These represent the primary non-plastic components of an underfloor heated kettle's safety system. The parts are shipped from the Isle of Man to China.

Strix investment case – revisited

Strix is an unusual strategic asset in our view, with a well-assembled competitive advantage. This is reflected in its market share (in excess of 60% in regulated markets) and high 30% group EBITDA margins. From these high margins, there is significant free cashflow that in turn funds, inter alia, an attractive dividend and growth capex where necessary. With its Isle of Man domicile, Strix also operates a very tax efficient model.

It is a global service provider (across the value chain), operating in the IoM and China, providing components and value-added services to OEMs, brands and retailers. These components are used to produce water heating appliances (e.g. kettles) and filtration technologies for consumers across the world. The engineering capability is backed up by a rigorous approach to IP protection and safety actions.

Specifically in kettle controls, the market dynamics remain attractive notwithstanding the turbulent geopolitical backdrop, which is of course beyond the company's control. Kettles are replaced by households on average every 3 ½ years, and remain a 'small ticket' in terms of consumer spending habits. However, **with c. 196m appliances globally, penetration is c35%, implying there is continued long-term growth potential.**

With the HaloSource deal, there is also now clearly room for a new "high ground" to be established over time in purified water, and **Strix has a clear strong track record of achieving global leadership** based on what it has achieved in kettle safety devices.

In recent weeks there have been a number of company profit warnings across the wider UK stockmarket, together with a number of high-profile accounting concerns. In contrast, we believe Strix H1 results announced here, together with the outlook, should reassure investors.

The group remains well on-track near-term, and is continuing to execute on initiatives which should build further value in the long term.

With FY forecasts now well underpinned, we expect investors to focus once again on the strategic merits of Strix, the long-term growth initiatives and the lowly trading multiples.

Share price in context

The Strix IPO price was 100p (market cap at IPO, £190m, Aug '17). The current share price is 169p. Year-to-date (YTD) in 2019, the shares are basically unchanged. The share price high in 2019 YTD is 180p, set in Apr 19.

The main recent development on the share register has been the comprehensive sell-down of a major institutional shareholding, and our understanding is that this is now complete. This corporate action was not unique to Strix in the UK stockmarket, but has perhaps recently overshadowed the underlying equity story.

Valuation

There is no well-defined industry peer group for Strix, and hence traditional multiples-based analysis has clear limitations. At the same time, this underlines the company's scarcity value.

At Equity Development, we have nonetheless established a specialist engineering cohort for relative valuation (see below).

Our overall conclusion is that Strix appears very inexpensive by the standards of this cohort / peer group, whilst we also flag that many of these names are mid/large caps that would ordinarily trade at a premium.

Relative Valuation														
Company	Share price	Mark cap	Net debt	EV	Sales 2018	EV/sales	EBITDA 2018	EV/EBITDA	EPS 2018	EPS 2019	P/E 2018	P/E 2019	Div 2018	Yld
	(p)	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(p)	(x)	(x)	(p)	(%)
Discover IE	450	330	30	360	338	1.1	29.3	12.3	21.9	25.8	20.5	17.4	8.7	1.9
Halma	1947	7392	196	7588	1076	7.1	252.0	30.1	42.3	46.7	46.0	41.7	14.1	0.7
IMI	1036	2822	265	3087	1877	1.6	315.0	9.8	69.1	78.7	15.0	13.2	38.9	3.8
Judges Scientific	3450	215	8	222	75	3.0	12.4	17.9	32.8	137.0	105.2	25.2	28.5	0.8
Oxford Instruments	1294	740	109	849	297	2.9	55.6	15.3	59.0	58.0	21.9	22.3	13.0	1.0
Renishaw	3900	2836	-52	2784	612	4.5	186.0	15.0	168.0	183.0	23.2	21.3	57.0	1.5
Rotork	324	2817	13	2830	693	4.1	162.0	17.5	11.9	13.5	27.2	24.0	5.7	1.8
Spirax-Sarco	7990	5884	373	6257	1138	5.5	299.0	20.9	246.0	258.0	32.5	31.0	98.0	1.2
Strix	164	327	28	355	94	3.8	36.4	9.8	14.2	14.4	11.6	11.4	7.0	4.3
TT Electronics	253	412	-46	366	378	1.0	44.7	8.2	13.2	15.7	19.2	16.1	6.1	2.4
Average						3.4		15.6			32.2	22.3		1.9

** Forecasts derived from Capital IQ and other sources

For Strix, both EV/EBITDA and P/E multiples are comfortably beneath the average while EV/sales reflects the high margins generated. Dividend cover on our FY 19/20 forecasts is a shade under 2x, and appears very secure. It is encouraging to see Strix now reconfirm its FY '19 commitment to 7.7p total dividend per share.

Income statement					
Y/E Dec , £'000s	2017A	2018A	2019E	2020E	2021E
Revenue	91,263	93,769	101,498	108,083	113,531
increase in revenue	2.9%	2.7%	8.2%	6.5%	5.0%
Cost of sales - pre exceptionals	-54,071	-54,851	-59,985	-64,526	-67,778
Cost of sales - exceptionals	-23				
Gross profit	37,169	38,918	41,513	43,558	45,753
Gross margin	40.7%	41.5%	40.9%	40.3%	40.3%
Distribution costs	-5,790	-5,344	-7,250	-7,000	-7,210
Admin pre exceptionals	-2,682	-3,083	-3,175	-2,900	-3,045
Admin - exceptional	-2,862	-5,072			
Other operating income	342	370			
Net operating costs	-10,992	-13,129	-10,425	-9,900	-10,255
EBIT - reported	26,177	25,789	31,087	33,658	35,498
EBIT margin (%)	28.7%	27.5%	30.6%	31.1%	31.3%
Exceptionals	-2,885	-5,072			
EBIT - adjusted	29,062	30,861	31,087	33,658	35,498
EBIT margin - adj	31.8%	32.9%	30.6%	31.1%	31.3%
Depreciation	-3,023	-3,198	-3,294	-3,393	-3,495
Amortisation	-3,032	-2,292	-1,779	-1,779	-1,779
Depreciation & amortisation	-6,055	-5,490	-5,073	-5,172	-5,274
EBITDA - adjusted	35,117	36,351	36,160	38,829	40,772
EBITDA - reported	32,232	36,351	36,160	38,829	40,772
EBITDA margin - adj	38.5%	38.8%	35.6%	35.9%	35.9%
EBITDA margin - rep	35.3%	38.8%	35.6%	35.9%	35.9%
Net financial income	-758	-1,655	-1,127	-1,193	0
Pre-tax profit - reported	25,419	24,134	29,960	32,464	35,498
Pre-tax profit - adjusted	28,304	29,206	29,960	32,464	35,498
Taxation	-787	-947	-1,325	-1,688	-1,846
Tax rate (%)	-3.1%	-3.9%	-4.4%	-5.2%	-5.2%
Net income - reported	24,632	23,187	28,635	30,776	33,652
Net income - adjusted	27,517	28,259	28,635	30,776	33,652
Number of shares – basic, k	190,000	190,000	190,000	199,100	199,100
Dilutive potential - ordinary shares	3,587	9,100	9,100		
No of shares – dil, k	193,587	199,100	199,100	199,100	199,100
EPS - basic reported p	13.0	12.2	15.1	15.5	16.9
EPS - basic adjusted p	14.5	14.9	15.1	15.5	16.9
EPS - fully diluted adjusted (pence)	14.2	14.2	14.4	15.5	16.9
EPS (%)	11.3%	-0.1%	1.3%	7.5%	9.3%
Dividend per share (p)	2.90	7.00	7.70	7.90	8.41
Dividend cover		2.0	1.9	2.0	2.0
Dividend increase		268.4%	10.0%	2.6%	6.5%

ED estimates/Company Data



Investor Access

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