Strix Group Plc

AGM statement offers encouragement to investors

20 June 2024

Ahead of today's AGM, Strix has issued a trading update. Encouragingly, management note signs of recovery within the kettle controls market ahead of peak season, and adj. PBT expectations for the full year remain unchanged. YTD cash conservation actions have resulted in cash generation running ahead of internal expectations which, combined with the recent placing, means reductions in net debt/EBITDA leverage are ahead of plan. We retain our prior estimates and a fair value of 167p/share almost twice the current share price.

Signs of an improving environment

- Notwithstanding the modest yoy improvement in Kettle Control revenues in FY23 (+2.3% to £70.1m), levels remain some 18% below the previous post-pandemic peak of FY21 (£85.1m). We are encouraged by the comment, *'the kettle controls market continues to show some promising signs of recovery as we move into the peak season'*. While this may turn out to be a false dawn, we note that a year ago much of the global economy nudged into recession and yet the sale of kettle controls still increased.

- We believe there are further indications of a more promising outlook, such as the first uptick in transactions in the UK housing market in 17 months (+17% yoy in April 24, *source: ONS*) and Savills predicting growth in property transactions for the full year (+4% to 1.05m). Management remains admirably cautious suggesting that it remains too early to determine whether we are witnessing a temporary re-stocking or a more meaningful recovery in demand. This is sensible ahead of the important H2 selling season of Christmas/Chinese New Year, which accounted for an average of 56% of divisional sales in the last five years.

- It is worth a reminder of the historically high level of **operational gearing** within the business, witnessing 70%+ of gross profit feeding through to EBIT. We suggest the nadir was reached during H1 '23 at 50%, rising to 62% in H2 '23, with the latter benefitting from the ongoing focus on maintaining a competitive cost base. On this basis, any top line improvement will likely feed through disproportionately to profitability.

- The company remains fully focussed on cost control and cash preservation, reiterating its target to **reduce net debt leverage to 1.5x** by the end of FY25.

We maintain our fair value/share of 167p and think the shares remain materially undervalued relative to the average of our valuation models.

Forecasts

Year to Dec, £m	FY22A	FY23A	FY24F	FY25F
Revenue	108.6	144.6	154.2	169.0
Adj. PBT	22.2	21.9	24.3	25.8
Adj. EPS (p)	10.8	9.1	9.4	9.5
DPS (p)	6.0	0.9	1.9	2.9
Net debt	-87.4	-85.7	-70.4	-60.5
EV/EBITDA	8.4	6.8	6.2	6.0
PER	7.7	9.2	8.9	8.8
Yield %	7.2	1.1	2.2	3.4
Net debt/EBITDA	2.2	2.1	1.7	1.4

Source: Company historics, ED estimates

Company Data

EPIC	KETL
Price (last close)	84p
52 weeks Hi/Lo	105p/51p
Market cap	£192.3m
ED Fair Value / share	167p
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.

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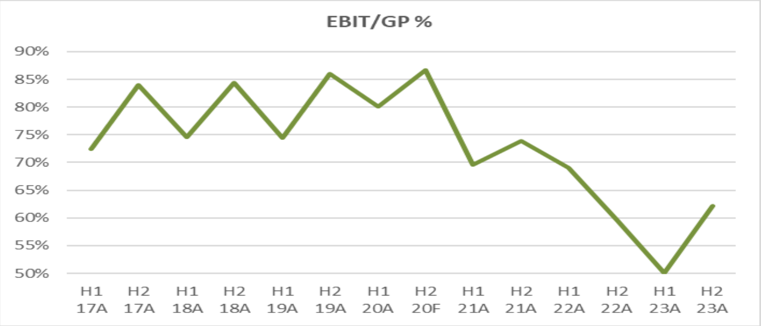
Green shoots to take hold?

We note the mention of signs of recovery within the Kettle Controls market. One could argue that we have been here previously, only for a recession to kick in and dampen expectations. However, as already noted, there are more encouraging reports on UK economic activity. As such, we expect the sale of household-related consumer goods, including kettles, to also see an uplift. We note the cautious sentiment relating to the signs of recovery ahead of the peak season, but should the commentators prove correct in their expectations on housing transactions, then profitability is likely to improve in this area.

Then there is the high level of operational gearing within Strix to consider. With the close control of costs over the last two or so years, any recovery in activity could well have a marked impact on profitability. Should we see a continuation of the recent upward trend towards previous levels, there should be a rapid recovery in divisional profitability. In our view, the firm action taken on the cost base, plus a determination to at least maintain those levels ahead of the re-financing of banking facilities in 2025, augurs well. We expect the rate of gross profit feeding through to EBIT to improve further from here.

Operationally leveraged

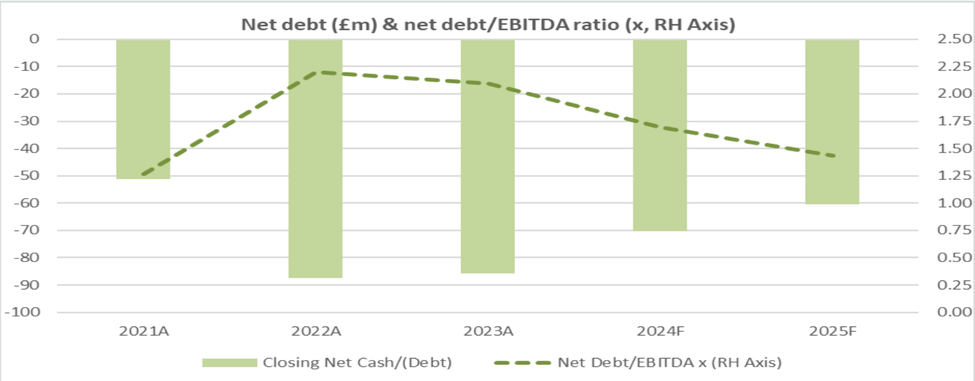


Source: Company

Management remains cautious and has not changed guidance on FY expectations. In view of the traditional H1:H2 split of revenues of c. 45%:55%, we think this approach is wise. As such, we reiterate our estimates published following the preliminary results in March, modestly adjusted for the recent placing of 5% of the issued share capital.

We would point investors towards the next chart which focuses on the Group's critical banking covenant ratio, net debt/EBITDA. The placing resulted in the likelihood of the Group achieving previous targets for indebtedness four to six months early. We expect the net debt/EBITDA ratio to decline to 1.7x by the end of FY24 and to 1.4x by the end of FY25. This augurs well for the re-financing in FY25 and enables the Group to take advantage of growth opportunities should they arise.

Key liquidity ratio



Source: Company historics, Equity Development estimates

Financials

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	-8.4	-7.0
Associates	-0.1	0.0	0.1	0.1	0.1
PBT (Adjusted)	32.2	22.2	21.9	24.3	25.8
Exceptionals	-10.7	-5.9	-4.2	-4.0	0.0
PBT (Reported)	21.5	16.2	17.8	20.4	25.9
Tax	-0.9	0.8	-1.5	-2.6	-3.4
Adj. PAT	31.4	23.0	20.4	21.6	22.4
Minority interests	0.0	-0.1	0.0	0.0	0.0
Adj. Earnings	31.3	22.9	20.1	21.6	22.4
Reported PAT	20.6	17.0	16.2	17.6	22.4
Ordinary Dividends	-17.3	-13.1	-2.0	-4.2	-6.7
EPS (Adjusted) (p)	14.9	10.8	9.1	9.4	9.5
DPS (p)	8.4	6.0	0.9	1.9	2.9
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	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	-1.2
Operating cash flow	24.2	23.2	43.1	32.1	41.4
Net Interest	-2.7	-3.2	-8.9	-8.4	-7.0
Taxation	-1.9	-1.2	-1.3	-2.1	-3.0
Net capex	-15.4	-8.6	-8.0	-12.0	-15.0
Operating FCF	4.2	10.3	24.9	9.6	16.4
Net (Acquisitions)/Disposals	-1.6	-39.3	-6.5	0.0	0.0
Dividends	-16.5	-17.3	-9.1	0.0	-6.5
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	15.3	9.9
Opening Net Cash/(Debt)	-37.2	-51.2	-87.4	-85.7	-70.4
Closing Net Cash/(Debt)	-51.2	-87.4	-85.7	-70.4	-60.5

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	61.8
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	157.3	162.5
Other	-2.6	-2.8	-3.6	-3.6	-3.6
Net Cash/(Debt)	-51.2	-87.4	-85.7	-70.4	-60.5
Provisions Liabilities/Charges	-4.7	-12.3	-11.2	-11.2	-11.2
Net Assets	26.0	37.2	43.0	72.1	87.2

Source: Company historics, Equity Development estimates

Valuation

Notwithstanding the influx of liquidity last week following the 5% share placing, the shares continue to be dogged by concerns over indebtedness. We think this has been overdone.

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

- Discounted cash flow and,
- Peer group comparisons.

In the former, we have used conservative assumptions in building our discounted cash flow model, especially a discount rate (WACC) of 8.75% and a terminal growth rate of 2.25%. **With a higher number of shares following the placing, the DCF suggests a fair value/share of 148p**

Strix Group DCF calculation

£m, year to Dec	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Free cash flow	18.0	23.4	27.3	27.9	28.5	29.2	29.8	30.5	31.2	31.9
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	17.6	21.0	22.6	21.2	20.0	18.8	17.7	16.6	15.6	14.7
Sum of discounted cash flows	185.8									
Terminal growth rate (%)	2.25									
Terminal value	225.8									
Net debt	-70.4									
Equity value	341.2									
No. of shares (m)	229.9									
Value per share (p)	148.4									

Source: Equity Development

The peer group comparison models incorporate forecast year one (FY1) 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, suggesting that Strix continues to trade at a marked discount to its peers.

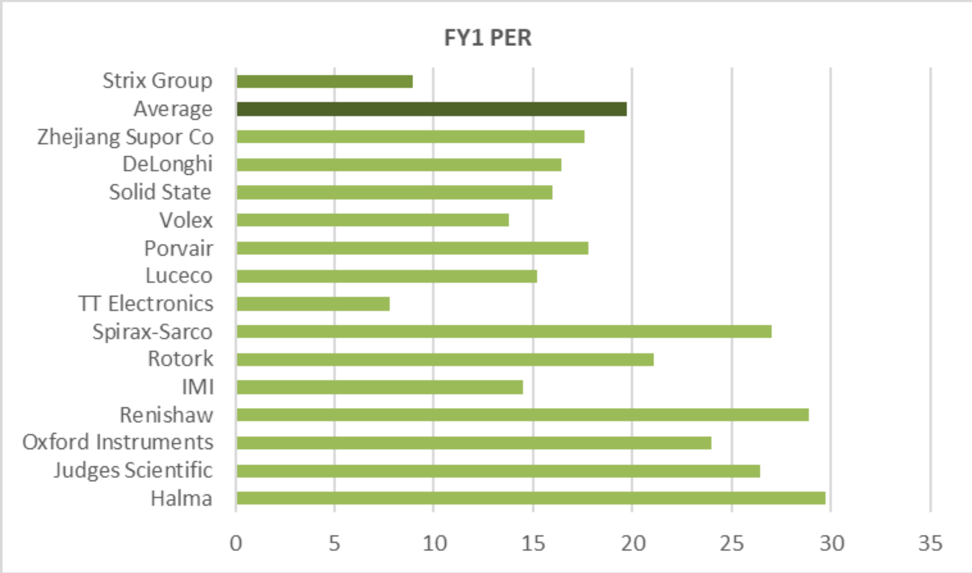
Although the average of the valuation models suggests a fair value/share assumption of 177p, we prefer to retain our fair value expectation of 167p, unchanged from the time of the 5% placing a week ago. Nevertheless, this represents a significant uplift to the current share price.

Fair value / share

	FY24 fair value, p
DCF	148
PER (x)	167
EV/EBITDA (x)	184
EV/Sales (x)	127
Price/Book (x)	259
Average	**177.0**

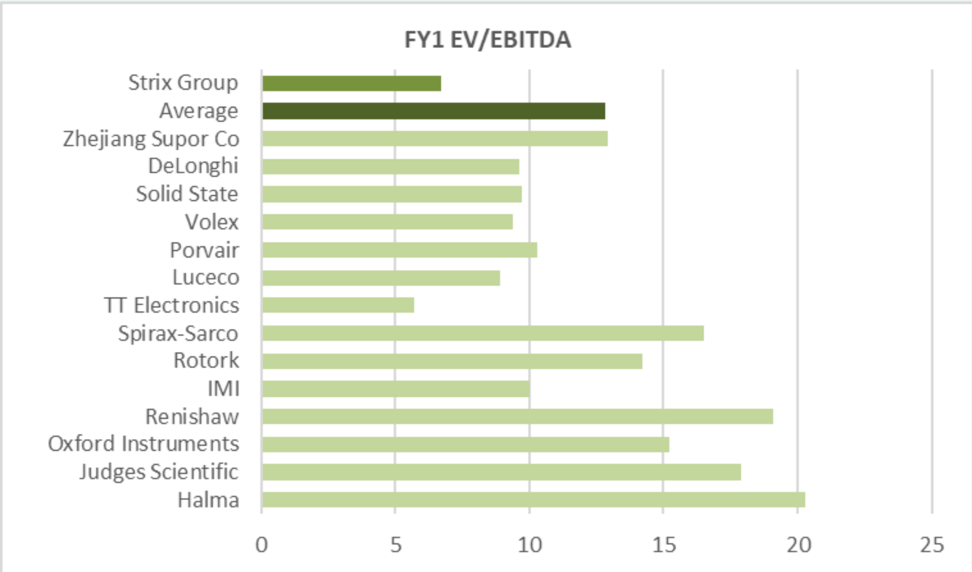
Source: ED

Peer group comparison: FY1 PER (x)



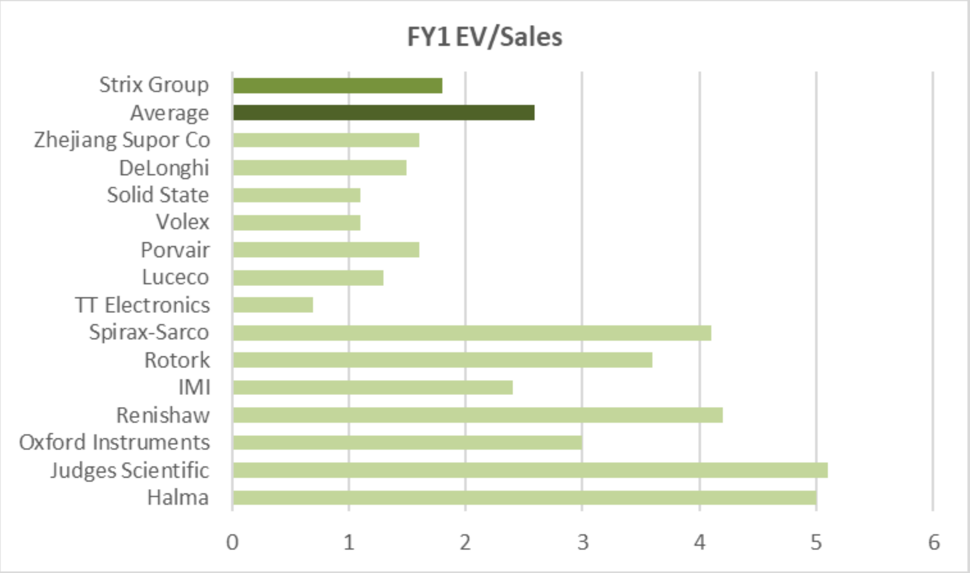
Source: Koyfin

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

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