Strix Group Plc

Early operational recovery and net debt cut

25 July 2024

Notwithstanding the unchanged guidance on the outlook for profitability, we see areas of optimism within the statement. The chief reason is the reduction of the net debt/EBITDA ratio to 'comfortably below 2x cover', in view of the previous concern on indebtedness. We would also highlight the burgeoning recovery within the Group's kettle controls market, which declined 18% in the two years to end-2023. Product launches into less developed/Chinese markets of a new range of low-cost kettle controls combined with new taps emanating from Billi improve the outlook for H2.

- We are encouraged by the H1 trading update. The highlight was the news that the decline in indebtedness/key covenant ratio has triggered a lower interest rate on outstanding debt. **The update stated that the net debt/EBITDA ratio had fallen comfortably below the 2x level. We envisage this falling to modestly below 1.7x by the year end and achieving the Group's target of 1.5x during FY25.** The focus on cash conservation and the recent equity placing are responsible for the positive outcome.

- Good progress was seen within Kettle Controls and Billi during the period. Shipments of kettle controls are ahead yoy, led by improvements in the regulated and less-regulated markets. China remains challenging. The launch of a new range of low cost controls into the less regulated and Chinese markets during H2 should help Strix to further improve its market share. While it remains too early to determine whether the uptick in kettle control revenues is temporary or permanent, we note that UK housing transactions improved yoy from April, a key determinant in the replacement of small domestic appliances.

- Billi should build on the positive progress witnessed during H1 as new products are launched and its expansion into Europe via sales and service partners. As such, we anticipate an acceleration in growth levels, commensurate with the double-digit uplift witnessed in previous years within Premier Filtration Systems.

- The laggard remains the Consumer Goods division, notwithstanding positive progress within water filtration and in branded goods (including baby products). The rationalisation of the cost base and range continues, albeit one suspects this is nearing its end (a focus of the last 12-24 months). The division remains profitable.

- We note the increase in commodity prices and weakness of key currencies. However, management is working to hard to alleviate such pressures and are covered within our unchanged gross margin assumptions.

With no change to financial estimates, as per guidance, we retain our fair value/share of 167p, suggesting that the shares remain materially undervalued.

Forecasts

Yr. to Dec, £m	FY22A	FY23A	FY24F	FY25F
Revenue	108.6	144.6	154.2	169.0
Adj. PBT	22.2	21.9	24.3	25.8
Adj. EPS (p)	10.8	9.1	9.4	9.5
DPS (p)	6.0	0.9	1.9	2.9
EV/EBITDA	8.8	7.1	6.5	6.3
PER	8.2	9.8	9.5	9.3
Yield %	6.8	1.0	2.1	3.2

Source: Company historics, ED estimates

Company Data

EPIC	KETL
Price (last close)	89p
52 weeks Hi/Lo	103p/51p
Market cap £m	£204m
ED Fair Value	167p
Net debt (Dec '23)	£85.7m

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.

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.

Next event: 18th September (Interims)

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

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

Financials

We note the comments within the trading update covering the first half, suggesting the Group remains on track to achieve adj. PBT in line with the market consensus. Mention was also made of:

- An interest saving as the net debt/EBITDA ratio declines below 2x
- Rising input costs reflecting commodity price inflation in commodities such as silver and copper
- A weakening of key currencies - the euro and the Australian dollar
- A continued restructuring of the Consumer Goods division, focused on reducing the number of SKUs and divisional cost base
- The launch of new products within Kettle Controls and Billi during H2
- Further H2 bias as Billi expands into the European market

Nevertheless, we retain our existing estimates, expecting a greater H2 bias than normal as recovery in the kettle controls market potentially gathers pace within the division's busiest period and, as Billi's expansion into Europe, via selected partners results in accelerating top-line growth.

Although the price of both silver and copper are below recent highs, they remain above levels of a year ago. We anticipate that a portion of the higher input costs will be passed on to customers and, as we have seen in the past, Strix is highly skilled in re-engineering products to reduce the proportion of metals within its controls. However, while the latter does not occur overnight, changes in product mix can alleviate the issue. Collaboration with suppliers and advance purchasing may also help.

Commodity price inflation

Source: Trading Economics

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

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

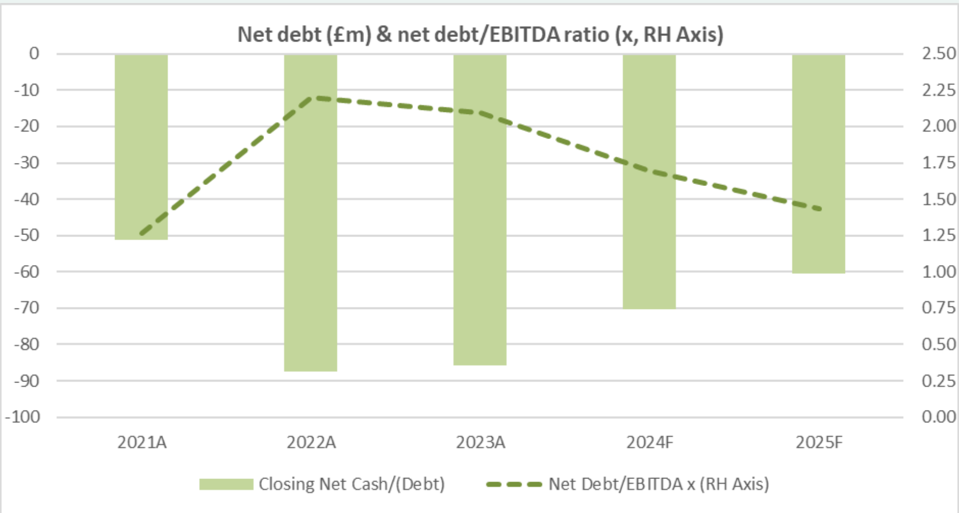
Summary Cash Flow

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

We highlight in the chart below the likely path of year end net debt and the Group's main banking covenant, net debt/EBITDA. The combination of the self-help measures and the placing in June should result in net debt of c. £70m by the current year end, falling to c. £61m by the end of FY25. **On this basis, we estimate the net debt/EBITDA ratio declining to 1.7x by the end of FY24 and 1.4x by the end of FY25, from a current position of 'comfortably below 2x'.**

Net debt and the key banking covenant, net debt/EBITDA (x)



Source: Company historics, ED estimates

Valuation

With news of the net debt leverage ratio falling comfortably below 2x and expectations of it reaching the target of 1.5x during FY25, the concerns over indebtedness/banking covenants should no longer overshadow the share price.

We use a discounted cash flow model and peer group comparison models to underpin our fair value/share expectation for Strix Group. The DCF is underpinned by conservative assumptions, not least a discount rate of 8.75% (equating to its longer term WACC) and a terminal growth rate of 2.25%. **The resulting fair value/share amounts to 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 focus on year one forecast estimates (FY1), *source: Koyfin*, covering PER, EV/EBITDA, EV/Sales, and Price/Book. We have conservatively applied a 10% size-related discount to the ratings of its peer group, in calculating fair value. We demonstrate the peer group comparison models in the charts below, which strongly suggest that Strix continues to trade at a marked discount to its peers.

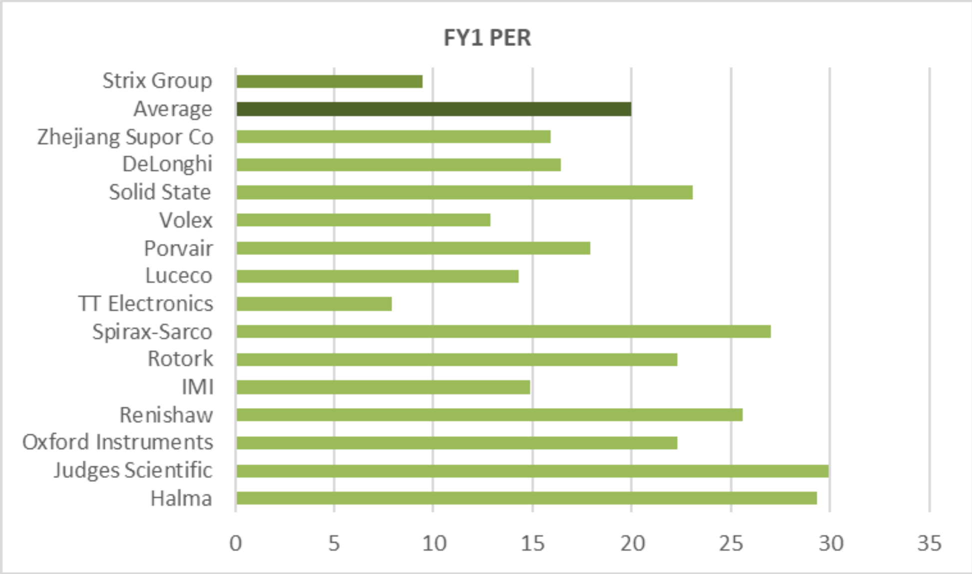
We highlight the average of our various valuation models in the table below, suggesting a fair value/share assumption of 176p. **However, in view of the unchanged financial guidance, we retain our previous 167p fair value/share assumption, which nevertheless represents a significant uplift compared to the current share price of 89p.**

Fair value

	FY24 fair value
DCF	148
PER (x)	169
EV/EBITDA (x)	182
EV/Sales (x)	126
Price/Book (x)	257
Average	176.4

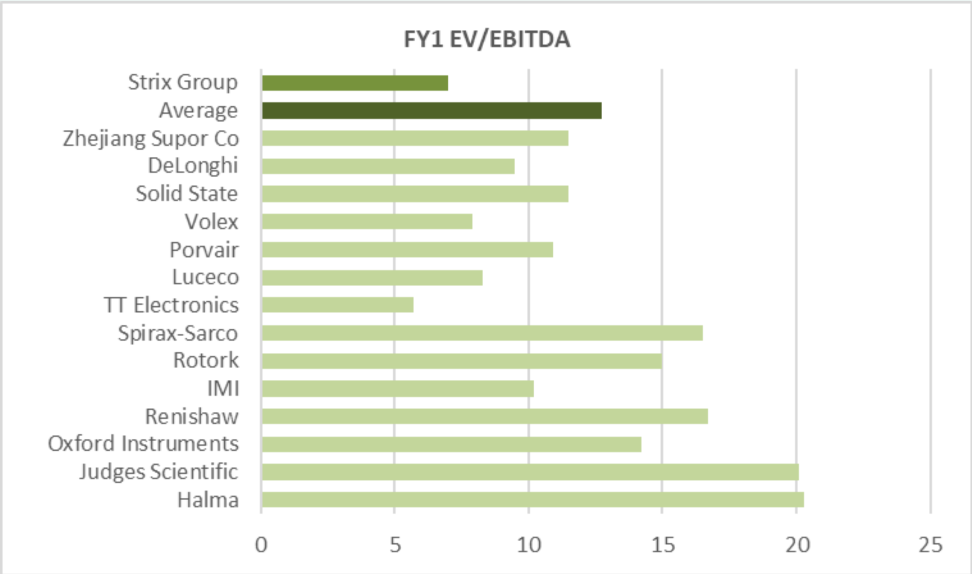
Source: ED

Peer group comparison: FY1 PER (x)



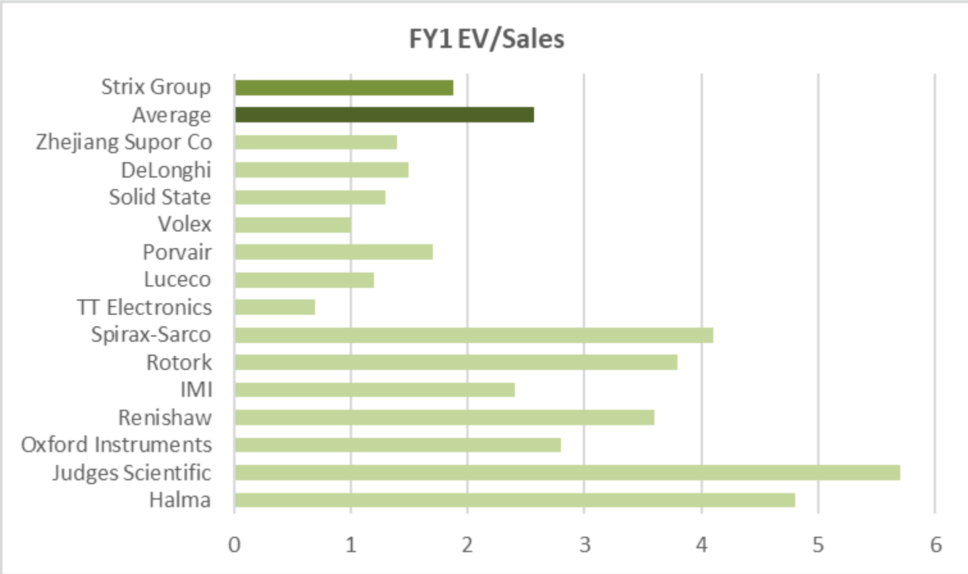
Source: Koyfin

Peer group comparison: FY1 EV/EBITDA (x)



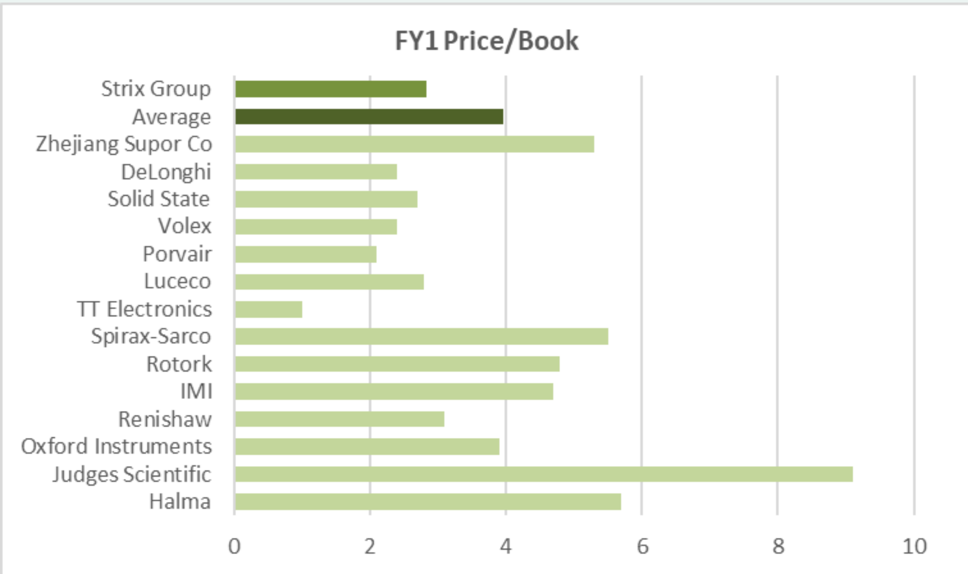
Source: Koyfin

Peer group comparison: FY1 EV/Sales (x)



Source: Koyfin

Peer group comparison: FY1 Price/Book (x)



Source: Koyfin

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

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

Equity Development, 16-18 Finsbury Circus, London, EC2M 7EB

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