Strix Group plc

Encouraging AGM & Investor Day insights

5 July 2023

The AGM update was encouraging and indicated that 'green shoots' continued to emerge, with momentum building during Q2 as the frequency of orders increased. Volumes, however, have yet to pick up, suggesting OEM customers are maintaining inventories and conserving cash. Significantly, the Group is seasonally H2 weighted with September to November critical months ahead of Christmas and Chinese New Year. Strix continues to trade in-line with market consensus (PAT of £25.8m) and as such we see no reason to adjust estimates.

The integration of the Q4 acquisition of Billi is on track, with a degree of excitement ahead of the launch of the new one-tap system in Australia. We are particularly encouraged by the new product pipeline and the opportunity to gain a firmer foothold in North America.

We think the shares have been largely overlooked, sitting on a single digit FY23 PER and at a marked discount to its peers. Our fair value / share, based on several valuation models, amounts to 216p, more than double the current share price.

- **Revenues increased sequentially in Q2,** as the frequency of orders from OEM customers improved. Customers have yet to increase volumes of orders, preferring to maintain inventories to conserve cash, yet the Group continues to trade in line with budgeted expectations. Trading is seasonally biased in favour of H2, reflecting the requirement to have stores primed for Christmas/Chinese New Year.

- **Billi was acquired in November.** The manufacturer and distributor of premium boiling, chilled and sparkling filtered water systems with the UK entity now separate and the overall integration proceeding to plan. Product launches in its key markets of Australia, New Zealand, Asia, and the UK include a new filtered/mains 'one-tap' system during Q3 will further drive the strong momentum seen ahead of its purchase.

- **The product launch road map is extensive,** which is expected to see the Group enter new markets including food preparation. The focus of the product launches will initially be online, with retail listings targeted in due course. Several products are targeted at North America, a region where traditionally the Group has been under-represented. Once online sales gather momentum, the expectation is for OEMs/consumer brands to launch their own version and using Strix technology/components.

- **We visited the facilities on the Isle of Man for an Investor Day** and ahead of the Group's AGM. The meetings included an introduction to the Company, greater detail on the Chinese factory opened in Q3 2021, presentation of forthcoming product launches, and a factory and tool room tour. ***We provide further information on the event within the main body of the note*.**

- **We think the valuation has been held back** by concerns over the level of indebtedness and whether the initial sign of green shoots would be maintained. With estimates unchanged and a focus on further cost-cutting and a change in the capital allocation policy (the yield remains high - 6% at the current share price), we are convinced the net debt/EBITDA ratio will have reduced to more normal levels (FY21A: 1.3x, versus our estimate of 1.4x by the end of FY24). Ongoing revenue momentum during Q2 suggests the green shoots have continued, providing further comfort.

Our 216p fair value per share is significantly higher than the current share price and is based on a conservative DCF and comparative peer group valuation models.

Company Data

EPIC	KETL
Price (last close)	106p
52 weeks Hi/Lo	190p/75p
Market cap	£231.4m
ED Fair Value / share	216p
Net debt (Dec '22)	£87.4m

Share Price, p

Source: ADVFN

Description

Strix Group plc ("Strix") is a global leader in the design, manufacture and supply of kettle safety controls, 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 56% global share within its largest market, kettle controls and leading positions within the faster growing personal, domestic, and corporate water filtration markets.

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An encouraging and informative Investor Day

As part of an investor day, we visited the offices, factory, and tool room of Strix Group plc on Monday 3 July, ahead of the AGM the following day.

This consisted of an introduction to the Company and several of its wider senior management team, followed by a demonstration of several products to be launched during H2 / Q1 2024. The timing of the launches varies, but generally they tend to be Q4 in the UK and Europe and Q1 in North America or vice versa.

The product demonstrations were followed by a Q&A over lunch before the site visit to the factory at Ramsey and the adjoining tool room.

Consumer goods launches

Strix has a pipeline of product offerings within the consumer goods area initially covering the next nine months across the UK, Europe, North America, and Asia. The new products focus on safe connectivity controls (heating and temperature), water filtration and steam management. The area of coverage will be widened to include:

- Food preparation
- Baby care
- Water filtration
- Hot water on demand, and
- Beverages.

The highlights of the new product launches comprise:

- The Aurora series continues to win awards, boiling/chilling only the filtered water required by the user. The new coffee maker will launch online in the US during Q4 and is one of less than a dozen coffee machines to achieve the highest industry standards.
- The Dual Flo 'one-cup'/kettle can be used as both a kettle or a 'one-cup' hot water dispenser. It launched in the UK in H2 2022 and in Europe during Q1 2023.
- LAICA vacuum sealers, which reduce food waste by preserving food for up to eight times longer.
- The LAICA digital water filter kettle, a variable temperature kettle, which uses specialist LAICA water filters.
- Breakfast sets including a toaster with a LAICA water filter kettle and with the option of a coffee maker. There is a high correlation of kettles and toasters purchased together and the Group expects to benefit from this trend.
- The sparkling water maker will be launched in the UK and Europe during Q3 and carries a subscription for the home collection and delivery of CO2 bottles.
- Having worked with the number one baby bottle brand in the UK, launching the Perfect Prep machine a decade ago, it is now providing the design and technology for a bottle steriliser dryer for the number one brand in the US, Baby Brezza. The launch of this product was incredibly strong, with the OEM discussing launching into other territories.
- To be used in larger fridges, the Group is in the process of launching a water dispenser in the US initially.

- The Perfect Pour filtered water jug does exactly what it says on the tin – there is no cross contamination of filtered and unfiltered water and no spillages during pouring, and
- The 'one-tap' boiling/chilled/sparkling filtered, and warm/cold mains launch from Billi, initially in Australia.

Aurora Coffee – dispenses coffee and boiling, pre-filtered water

Source: Company

Dual Flo 'one-cup' kettle – it boils only the water you need

Source: Company

Perfect Pour fridge jug – no spillages or contamination with unfiltered water

Source: Company

LAICA sparkling water maker – subscription service for gas bottles

Source: Company

Perfect Pour fridge dispenser – to launch in the US market

Source: Company

LAICA vacuum sealer – keeps food fresher for up to 8x longer

Source: Company

LAICA breakfast set

Source: Company

We think the road map of new products looks very promising.

Historically, successful launches or 'proof of concept' tends to result in interest from OEMs/consumer brands, using the Strix technology to launch their own version of the product. We are particularly excited by the boost to volumes following successful product launches in North America, a region where the Group has historically been under-represented.

Factory/tool shop tour

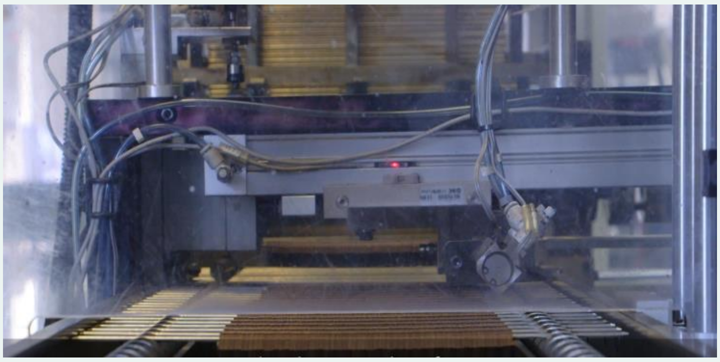
Although the plant in China ships finished parts to customers via locally based OEMs or to retailers globally for most own brand products, Ramsay is integral to the Group. The Group retains the factory on the island to guard its patents and IP, churning our 500m parts per annum, which are then shipped to the Group's manufacturing facility in China. All lines are automated within the plant. The Ramsay site also incorporates:

- Product design
- Engineering (including new applications, sustainability, and manufacturing efficiency)
- Patent infringement enforcement
- Tooling, and
- Quality control.

Strix, Ramsay. Specialist parts manufacturing facility

Source: Company

Automated bimetal pick and placement machine

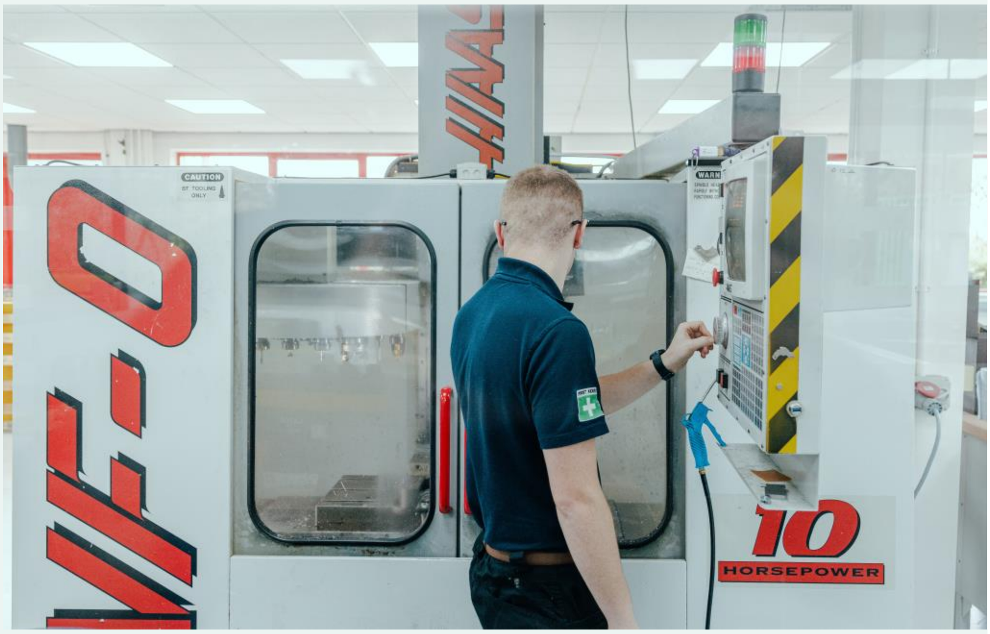


Source: Company

The factory operates several presses, including this 100-tonne example

Source: Company

CNC machine in operation within the tooling department



Source: Company

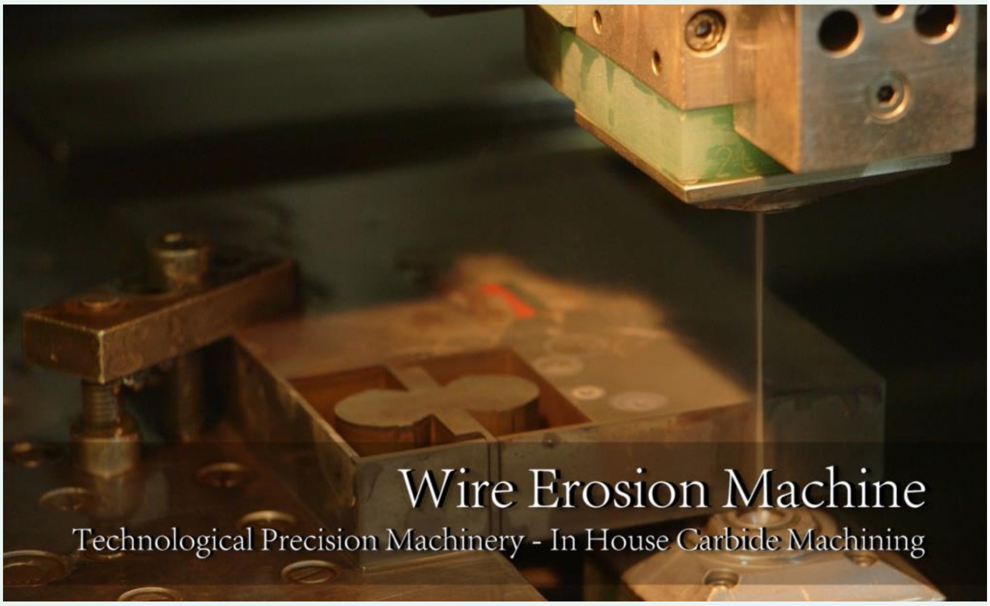
Wire erosion machine

Source: Company

Setting up a CNC machine

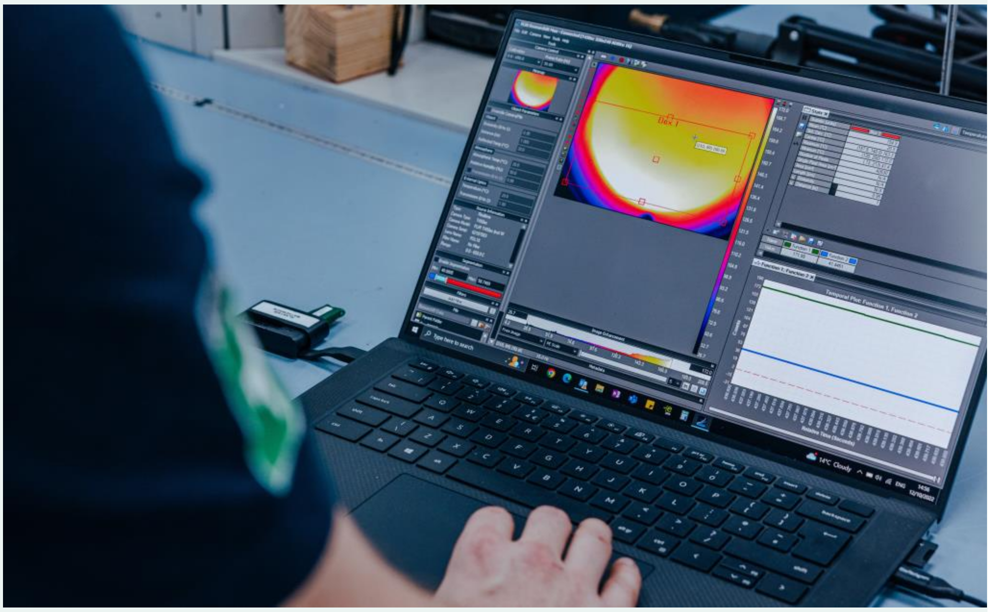
Source: Company

In-house carbide tool machining



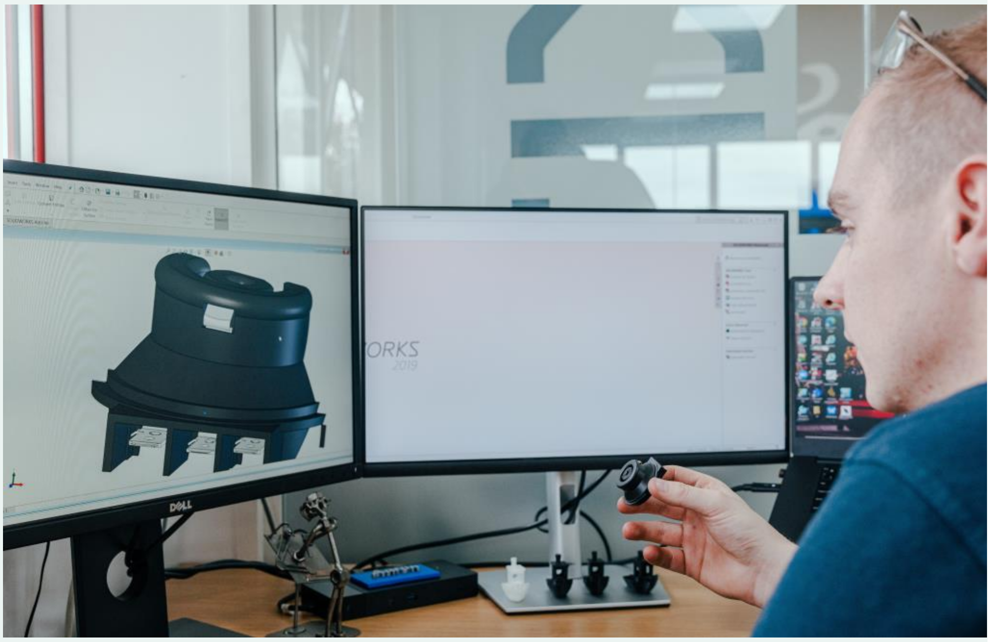
Source: Company

Quality control - measuring accuracy



Source: Company

Designing a prototype



Source: Company

Setting up the 3-D printers to manufacture protoyypes

Source: Company

Quality control – measuring machine

Source: Company

Financials

The AGM trading update spoke of a further improvement in trading with Q2 noticeably brighter than Q1. Order frequency has improved, while quantities of such orders remain steady, as customers' keep inventories in check to conserve cash. The net effect is building momentum in what is traditionally the quieter period of the year. September onwards traditionally represents the busiest period of the year, ahead of Christmas and Chinese New Year. Significantly, we have left estimates unchanged at this stage.

We note investors' concerns with regards to indebtedness. However, based on the confirmed guidance of market consensus estimates being on track and targets for net debt/EBTDA, we expect the Group to beat those estimates on indebtedness, as suggested in the table below. In fact, the net debt/EBITDA should be close to 'normal' levels as seen in FY20 and FY21.

Expected net debt reduction

£m	2020A	2021A	2022A	2023F	2024F
Net debt	-37.2	-51.2	-87.4	-84.8	-70.9
Net debt/EBITDA (x)	1.0	1.3	2.2	1.8	1.4

Source: Company historics, Estimates Equity Development Ltd

Summary Profit & Loss					
Year to Dec, £m	**2020A**	**2021A**	**2022A**	**2023F**	**2024F**
Kettle controls	79.8	85.1	68.2	71.0	74.0
Water products	11.7	21.4	24.1	43.9	50.4
Appliances	3.7	12.9	14.5	40.3	44.9
Revenue	95.31	119.41	106.92	155.17	169.33
CoGS	-55.9	-72.0	-65.4	-91.3	-100.0
Gross profit	39.4	47.4	41.5	63.9	69.3
Gross margin (%)	41.4%	39.7%	38.8%	41.2%	41.0%
Op costs	8.5	14.3	16.4	25.6	27.9
Other Op. income	1.1	0.6	0.8	0.7	0.7
Operating profit	32.0	33.7	25.9	38.9	42.1
Op margin (%)	33.6%	28.2%	24.2%	25.1%	24.9%
Net Interest	-1.2	-1.4	-3.7	-9.7	-7.9
Associates	0.1	-0.1	0.0	0.0	0.0
PBT (Adjusted)	30.9	32.2	22.2	29.2	34.2
Exceptionals	-5.5	-10.7	-5.9	-2.2	0.0
PBT (Reported)	25.5	21.5	16.2	27.0	34.2
Tax	-1.4	-0.9	0.8	-3.4	-4.3
Adj. PAT	29.5	31.4	23.0	25.8	30.0
Minority interests	0.0	0.0	-0.1	0.0	0.0
Adj. Earnings	29.5	31.3	22.9	25.9	30.0
Reported PAT	24.0	20.6	17.0	23.7	30.0
Ordinary Dividends	-16.0	-17.3	-13.1	-13.8	-14.5
EPS (Adjusted) (p)	14.3	14.9	10.8	11.8	13.7
DPS (p)	7.9	8.4	6.0	6.3	6.7
Ave no of shares (FD) (m)	206.4	209.7	212.5	218.7	218.7

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to Dec, £m	2020A	2021A	2022A	2023F	2024F
Operating profit	32.1	33.7	25.9	38.9	42.1
Depn. & Amortn.	6.0	6.9	6.3	9.5	10.3
Working capital movement	-1.6	-11.4	-2.6	-0.6	-0.8
Other	-1.2	-4.9	-6.3	0.0	0.0
Operating cash flow	35.2	24.2	23.2	47.8	51.6
Net Interest	-3.4	-2.7	-3.2	-9.7	-7.9
Taxation	-0.9	-1.9	-1.2	-1.3	-3.8
Net capex	-17.4	-15.4	-8.6	-13.5	-12.0
Operating FCF	13.5	4.2	10.3	23.4	27.9
Net (Acquisitions)/Disposals	-6.7	-1.6	-39.3	-7.4	0.0
Dividends	-15.3	-16.5	-17.3	-13.3	-14.0
Share Issues	3.8	0.0	10.7	0.0	0.0
Minority payment	-0.1	-0.3	0.0	0.0	0.0
Other financial	-6.0	0.2	-0.6	0.0	0.0
Increase Cash/(Debt)	-10.9	-14.0	-36.2	2.6	13.9
Opening Net Cash/(Debt)	-26.3	-37.2	-51.2	-87.4	-84.8
Closing Net Cash/(Debt)	-37.2	-51.2	-87.4	-84.8	-70.9

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec, £m	2020A	2021A	2022A	2023F	2024F
Intangible Assets	29.6	30.5	73.4	71.0	68.3
Tangible Assets	37.2	39.5	43.7	50.1	54.5
Investments/other	0.1	3.3	3.7	3.7	3.7
Net Working Capital	4.4	15.9	18.5	19.0	19.8
Capital Employed	71.4	89.1	139.2	143.8	146.3
Other	-2.8	-2.6	-2.8	-2.8	-2.8
Net Cash/(Debt)	-37.2	-51.2	-87.4	-84.8	-70.9
Provisions Liabilities/Charges	-9.3	-4.7	-12.3	-12.3	-12.3
Net Assets	22.0	30.7	36.7	43.9	60.3

Source: Company historics, Equity Development estimates

Valuation

DCF

We think that Strix continues to be overlooked by investors with an excessive focus on the level of indebtedness. Furthermore, Strix management has remained resolute that the level of net debt/EBITDA will decline, with the target of below 2x during 2023 and less than 1.5x in 2024, aided by changes to capital allocation and the more recent streamlining programme.

We have constructed several models to determine our fair value / share. Our discounted cash flow model, using conservative assumptions (a discount rate of 8.75% and a terminal growth rate of 2.25%), **suggests a value / share of 242p.**

Strix Group DCF calculation

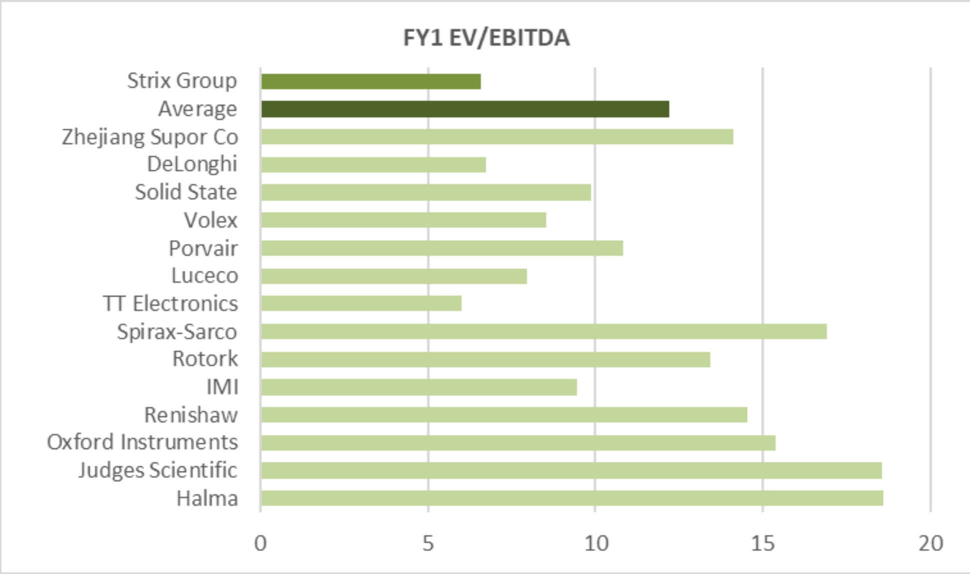
£m, year to Dec	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Free cash flow	33.1	36.9	41.1	42.0	43.0	44.0	44.9	46.0	47.0	48.0
WACC (%)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Timing factor	0.50	1.50	2.50	3.50	4.50	5.50	6.50	7.50	8.50	9.50
Discount rate	0.96	0.88	0.81	0.75	0.69	0.63	0.58	0.53	0.49	0.45
Present value	31.7	32.5	33.3	31.3	29.5	27.7	26.1	24.5	23.0	21.7
Sum of discounted cash flows	281.3									
Terminal growth rate (%)	2.25									
Terminal value	333.2									
Net debt	-84.8									
Equity value	529.7									
No. of shares (m)	218.7									
Value per share (p)	242.2									

Source: Equity Development

Peer comparison

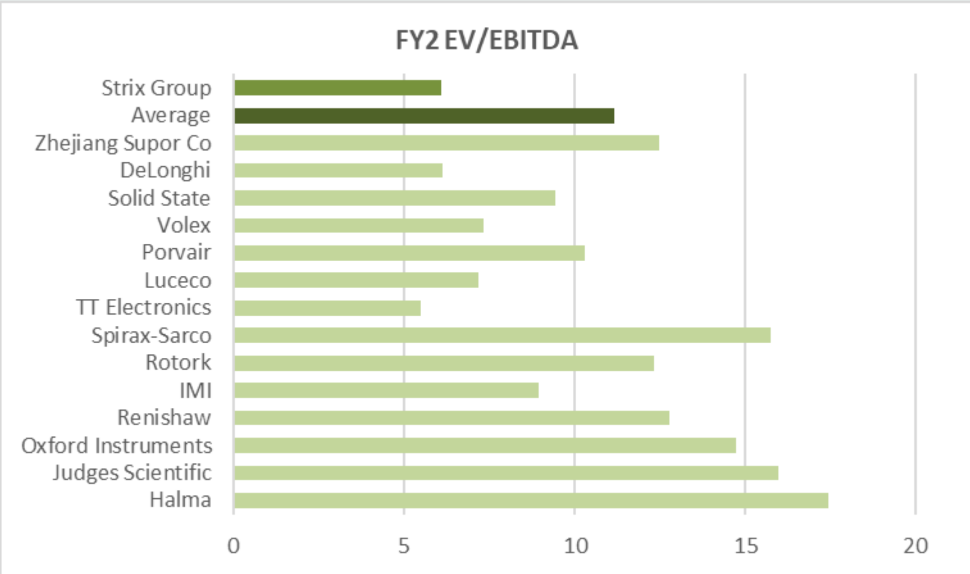
We have utilised a comparative peer group valuation model using EV/EBITDA, PER and yields in the charts below. Strix is consistently valued at the lower end of its wider peer group, highlighting the concerns on debt rather than any focus on green shoots and the plan to reduce indebtedness. We note that Strix pays the highest yield amongst its peers by some margin.

Peer group comparison model: FY1 EV/EBITDA



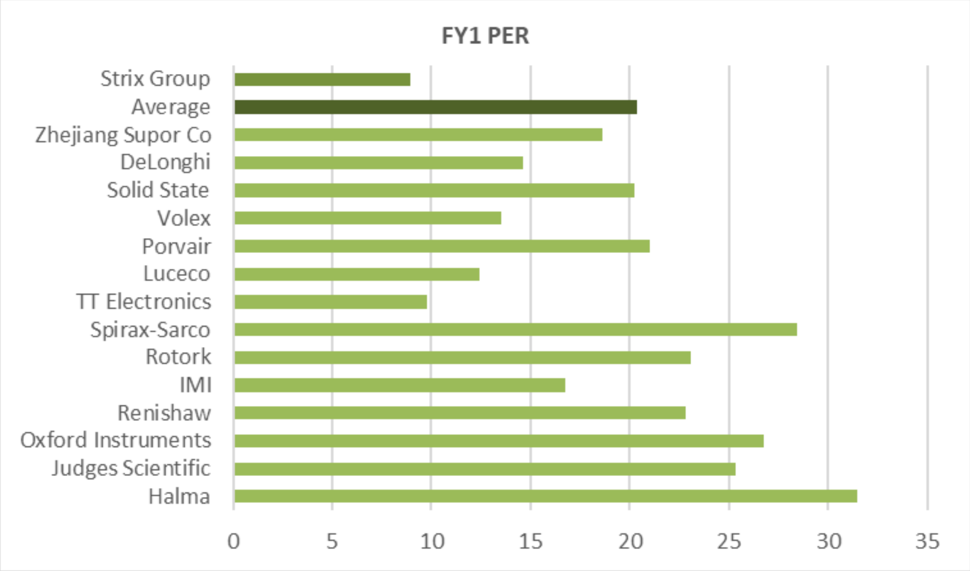
Source: MarketScreener

Peer group comparison model: FY2 EV/EBITDA



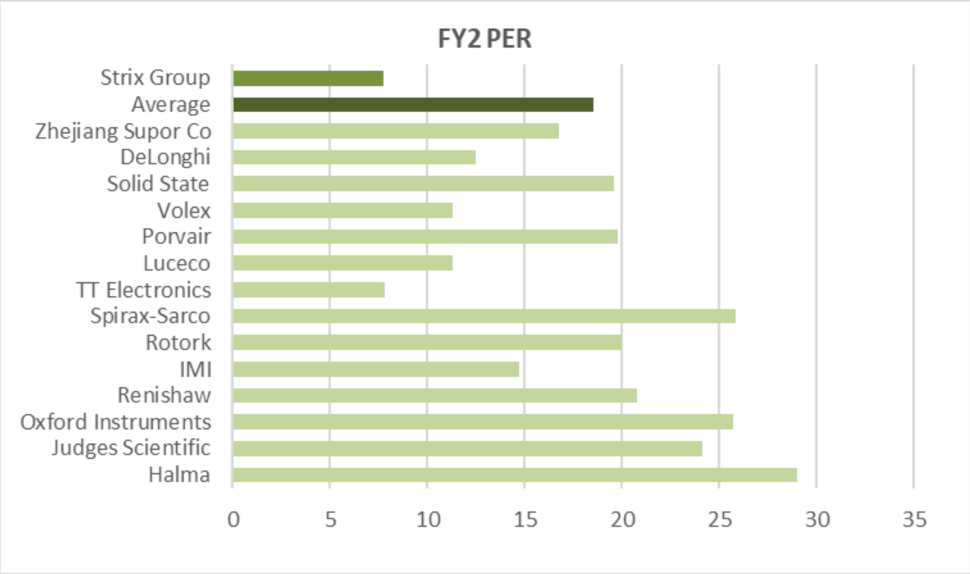
Source: MarketScreener

Peer group comparison model: FY1 PER



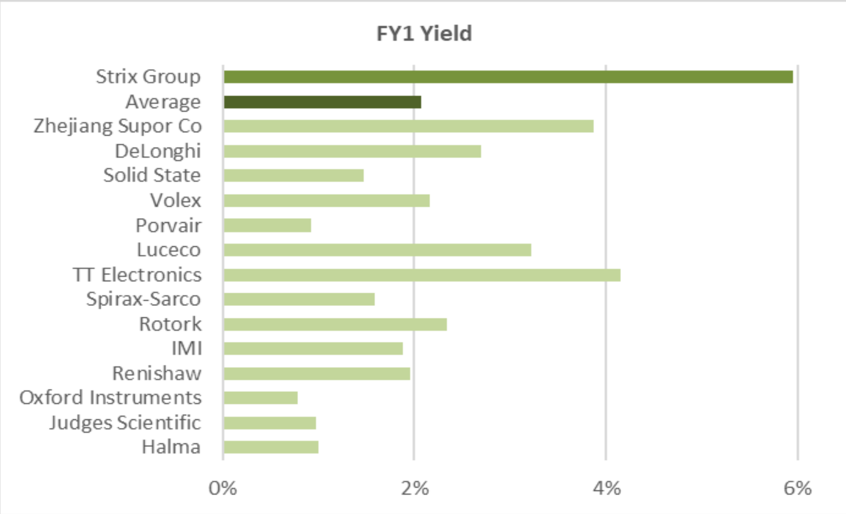
Source: MarketScreener

Peer group comparison model: FY2 PER



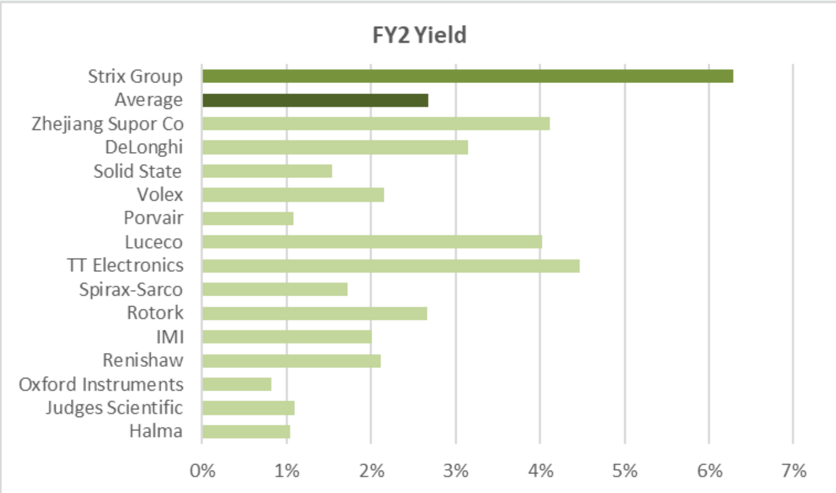
Source: MarketScreener

Peer group comparison model: FY1 Yield %



Source: MarketScreener

Peer group comparison model: FY2 Yield %



Source: MarketScreener

Conclusion

We have applied a 15% size related discount relative to its peers and highlight the average of the valuation models in the table below which forms the basis of our fair value / share.

The average fair value/ share of 215.9p represents a premium of 104% to the current price.

Fair value / share , pence

	FY23 fair value	FY24 Fair value
DCF	242	242
PER	204	216
EV/EBITDA	196	195
Average	**214.2**	**217.5**

Source: ED

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