Strix Group plc

Full steam ahead

25 March 2021

Strix has published its prelims which are slightly ahead of market expectations despite a backdrop of global disruption caused by COVID 19. Net sales fell just 2% YoY, with no impact on net profits on the back of strong cost management. The progressive dividend policy has been maintained. Encouragingly, FY21 profit expectations are well underpinned from a diversified base and while the shares are already up materially YTD the Strix story remains compelling.

COVID resilience. Both the supply and demand side were affected in H1 20, with a significant decline in Q1 in China in particular, and export demand temporarily affected. However, manufacturing bounced back to full production in April ensuring good service to their defensive end markets which continue to perform well with good visibility into H1.

Strix position - the leading player in the global kettle controls market. This is a resilient market, which historically has grown in low single digits % p.a. Yet within this context, the company has been able to grow its global market value share highlighting its enduring competitive advantage. Regulated and less regulated more than offset a slight decline in China, which was largely due to limited access to physical stores where Strix's product is more prevalent.

Diversification, growth in new markets and factory. Elsewhere, Strix is seeing healthy growth in Water/Appliances, with a launch programme of new products in 2021 in tandem with Global Brand partners, burnishing both their top line and their **strong commitment to ESG principles**. Strix also confirms that the new, enlarged group manufacturing facility is well on track, with full completion still expected in Aug 2021.

FY20 leverage, c 1x. This is lower than originally budgeted for, and in part reflects the range of efficiency measures undertaken YTD, along with some deferral of capex to FY21. Leverage ratios remain conservative and offers flexibility should further M&A opportunities present themselves.

Upgrade potential from LAICA acquisition. This €31.6m bolt on deal makes sense strategically and is already delivering. Synergy benefits could yet be material, with the cross-selling of Aqua Optima and LAICA's established product range.

Investment case. The share price has rallied very strongly up from its March '20 lows (at the nadir of COVID market anxiety). Strix has reassured investors of both its defensive qualities, but also of its ability to deliver growth through both its water and appliances categories, as well as a strong commitment to ESG principles driving both product development and best practice. **Strix remains a unique strategic asset on AIM, with industry leading margins.**

Valuation multiples are 18.5x PER20, and a forecast 18.0x PER21. Strix has shown commitment to its dividend, and the near 3% yield at the current price is attractive. Current share levels still offer a quality company on attractive ratings.

Forecasts

Y/E 31 Dec	2017	2018	2019	2020	2021E	2022E	2023E
Revenue (£000's)	91,263	93,769	96,876	95,305	118,090	122,697	127,410
Adj. PBT (£000's)	28,304	29,206	30,199	30,900	32,817	34,863	37,043
EPS (p) basic adj.	14.5	14.9	15.2	14.9	15.3	16.3	17.3
Div yield	1.05%	2.54%	2.79%	2.84%	2.93%	3.01%	3.08%
P/E	19.0	18.5	18.2	18.5	18.0	16.9	16.0

Source: ED estimates, Company historic data

Company Data

EPIC	KETL
Price (last close)	276p
52 weeks Hi/Lo	284.5p / 129p
Market cap	£576m

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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FY'20 results overview

"The much improved performance in the second half has continued into 2021. The kettle controls category has a strong order book for Q2 giving management confidence in delivering a significantly stronger first half versus last year. In the water category, the Group expects sales of the new products launched in 2020 to accelerate this year as the retailers introduce them to their in-store and online portfolios. 2021 will also see many of the appliances created in 2020 penetrate the consumer markets across the world with the most notable being the Aurora (Instant Flow Heater/Chiller) in the first half, and Dual Flo and the expansion of the Baby Care technology range in the second half." CEO Mark Bartlett

Overview

The COVID-19 pandemic, which first emerged in China in Q4 19, posed unprecedented challenges on both industrial supply and demand side. **In the case of Strix, with manufacturing capacity located in China, any operating challenges have been tackled impressively, without erosion of competitive advantage or market share.**

What emerges from the group's FY results/trading update is a **very resilient performance in the circumstances, and a tailwind from an improving order book.** COVID no longer remains a risk factor.

The tone of management commentary should be reassuring to investors, in our view. We highlight below FY 20 Financial results, together with trading patterns by Strix product type.

FY'20 results: Profit & Loss

FY 2020 revenue has declined by 1.6% to £95.3m. This is a modest impact, given the disruption of the pandemic worldwide. The acquisition of LAICA has had a part-year effect contributing revenue of £4.1m in two months. Revenue on a constant currency basis was down 1.3%.

Adjusted Gross Profit was relatively flat versus the previous year showing a modest £0.2m decline. Adjusted gross profit margin has further increased from 40.9% to 41.4% reflecting the addition of LAICA, supported by a strong product mix and lower labour costs, benefiting in part from continued automation.

Adjusted EBITDA increased to £38.1m from £36.9m, representing a 3.2% rise, **reflecting Strix's strong ability to optimize the overheads cost to accommodate the softening top line performance.** Excluding the acquisition of LAICA, adjusted EBITDA increased 1.7% to £37.6m.

Adjusted operating profit was impacted by higher depreciation including right-of-use asset and amortisation (2020: £6.0m; 2019: £5.5m) and hence a lower increase of 1.8% to £32.1m (2019: £31.5m) was delivered in the reported period.

Adjusted PBT increased 2.4%, to £30.9m, again despite the softer market. LAICA's contribution on a part-year basis was £0.3m. Adjusted PAT increased to £29.5m (2019: £28.9m), which included LAICA's contribution of £0.2m, an increase of 2.3%. Taxes were held at roughly the same level, at an effective tax rate of 4.5% (2019: 4.4%) of the Group's adjusted profit before tax.

Adjusted diluted EPS was 14.3p (2019: 14.2p). Weighted average number of diluted shares has increased by 2% due to

- vesting of the 2017 IPO LTIPs,
- new equity raised for the acquisition of LAICA and
- Warrants being exercised by Zeus. All remaining warrants have now been exercised.

Given the continued strength of its cash generation, the Board confirms its intention to increase the total dividend to 7.85p / share in respect of the 2020 financial year, in line with its progressive dividend policy that is linked to underlying earnings.

FY'20 results: Balance Sheet and cashflow

Property, plant and equipment increased to £37.2m (2019: £25.5m). Capital additions include £9.1m for the new factory under construction in Guangzhou (2019: £5.7m), £3.9m of plant machinery and tooling (2019: £3.4m), and a £3.7m increase due to the acquisition of LAICA.

Net cash generated from operating activities was down £3.2m in 2020 to £31.2m (2019: £34.4m) with Net working capital outflows of £1.7m, predominately due to the addition of LAICA. Net cash used in investing activities increased £7.8m (2019: £8.9m) to £24.2m due to the acquisition of LAICA; and the increased investment in tangible and intangible assets.

Net debt (excluding the impact of IFRS 16 lease liabilities) has increased from £26.3m in 2019 to £37.2m to fund the LAICA acquisition, investment in capital expenditure and new factory construction.

We expect the Group's net debt and leverage to maintain at roughly the same level with the Group's strong cash generation ability to fund any incremental operating capex. Including the impact of IFRS 16 lease liabilities, which was adopted from 1 January 2019, net debt has increased to £41.3m (2019: £30.8m).

Kettle Safety Controls

The market experienced a strong bounce back in H2 2020 and ended the year broadly flat after the COVID-19 pandemic disrupted both supply and demand during H1.

Throughout this period, Strix has managed to grow its market leading position of the global kettle controls market, continuing to grow the number of specifications using its latest platform ranges and regions which demonstrates how successfully the Company has dealt with the challenges of the pandemic.

Encouragingly, the improved performance in the second half has continued into 2021. The kettle controls category has a strong order book for Q2 giving management the confidence in delivering a stronger first half versus last year.

Regulated segments grew with a strong contribution from UK, North America, Australia and New Zealand offsetting declines in Mainland Europe. Less regulated segments also grew with strong growth in South East Asia, Middle East and Russia offsetting declines in South Africa and Eastern Europe. Some weakness was experienced within the Chinese market last year which has begun to show a marked recovery in 2021.

Strix continues to focus product development on opportunities within the Regulated, Less Regulated and China markets that will further strengthen market share.

Following the successful launch of the U9 Series during 2017, the Group has successfully produced over 33 million controls to date. 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.

Strix's products have historically had **limited correlation with short term consumer confidence** since kettles are seen by many as a household essential and repeat purchase. Ecommerce/online is also proving a successful retail platform. The central expectation is that there will be no current noticeable effect on OEM or end market demand.

Water Filtration and Appliances

2020 was a transformational year for Strix's water filtration category with the acquisition of LAICA in October and the Aqua Optima brand delivering record sales for yet another year. Overall, the water category reported a significant growth in revenue in 2020 with the combined contribution of LAICA and HaloPure technology.

For professional water, Strix launched the HaloPure technology and recently announced that it was selected by Chia Tai Group, one of the most specialized and well-known livestock companies operating in China, and Strix installed its full system in January 2021. With a drive from the Chinese State to reduce the use of antibiotics in farming, HaloPure's technology has become increasingly well recognised by the market. The evolution of this technology to offer farming solutions clean drinking water is likely to result in significant incremental business opportunities for the Group in the future.

Astrea and LAICA reusable filtered water bottles offer significant benefits from purchased bottled water in terms of re-usability of the container whilst also significantly reducing transportation costs. To complete the full product life cycle Aqua Optima has put a recycling agreement in place in the UK with specialist TerraCycle.

The acquisition of HaloSource has brought new technology, **including lead reduction and patented bromine technology, that kills bacteria and viruses.** These technologies, coupled with the enhanced new product roadmap from LAICA, enable Strix to offer improved quality drinking water to both the consumer and agriculture markets.

Within appliances, Strix seeks to use its technology to develop adjacent products to solve problems in tangential markets. The Group looks to develop products offering meaningful benefits to customers which can then be commercialised through existing relationships with experienced and trusted OEM's and consumer appliance specialists. 2020 has seen the acceleration of Strix Global Brand partnerships on new innovative project launches.

2021 will see many of the appliances created in 2020 penetrate the consumer markets across the world with the most notable being the Aurora (Instant Flow Heater/Chiller) in the first half, and Dual Flo and the expansion of the Baby Care technology range in the second half.

T**he potential for significant value creation here should not be underestimated**:

- In the medium-term, entering into commercial agreements which will drive future profitability, with retail interest and distribution
- New contracts secured for specific sterilization applications in both the farming and medical segments.

New Factory

The relocation of Strix's existing manufacturing operations in China is in line with the project schedule and set to be fully operational by August 2021 as originally planned. In terms of project capex, FY21 should be the last year of material cash spend.

The company has highlighted in the past the security advantages of moving to 50 years, rather than 20 years, tenure for its new factory location (Zengcheng). This also underlines the support they receive from the regional Chinese government.

Macro environment

In terms of global macro, there are also clear signs of improvement, particularly in China, one of the only major economies expected to report growth in 2020. The outlook for global GDP is improving since the Q2 trough, but global GDP may not yet return to the pre-pandemic level before 2022.

China and International Real GDP Growth YoY

	China	World	UK
2011	9.5%	3.1%	1.5%
2012	7.9%	2.5%	1.5%
2013	7.8%	2.7%	2.1%
2014	7.3%	2.8%	2.6%
2015	6.9%	2.9%	2.4%
2016	6.8%	2.6%	1.9%
2017	6.9%	3.3%	1.9%
2018	6.8%	3.0%	1.3%
2019	6.1%	2.9%	1.4%
2020	2.3%	-4.9%	-10.2%
2021E	9.2%	-5.4%	6.3%

Source: OECD

It remains the case that overall recovery is also lagging China and a 'V shape' is by no means assured. This is particularly true with new lockdown restrictions now being imposed in Europe, for example.

As highlighted by the recent CNBC Global CFO Council Survey**, the world's leading chief financial officers now have a more positive outlook for China's economy than for the economy of the United States.** That is the first time ever in the survey's history that executives are more upbeat on China.

Mainland Chinese stock markets have also been solid in recent months, again reflecting improved investor confidence.

Why is this relevant to Strix investors? Simply because Strix is highly exposed to the Chinese economy and the Chinese consumer. China remains the largest market for kettles, as well as accounting for 90% of global production. China's ability to keep maintain production during the pandemic, combined with an economy that is improving ahead of expectations, should provide a positive tailwind for the company's own business model.

Recap: Acquisition of LAICA

As a reminder, Strix completed the acquisition of LAICA in Q4 20, an Italian company focussed on water purification and personal health and wellness.

The key details were as follows:

- Initial consideration of €19.6m, comprising approximately €11.6 million in cash and €8.0 million in Strix ordinary shares (3.3m new shares at the current share price);
- with up to a further €12.0m payable in cash subject to certain conditions being met, including threshold financial targets for the financial years ending 2021 and 2022
- Upfront acquisition multiple, 6.8x FY19 Adj. EBITDA; and including earnout, 10.9x FY19 Adj. EBITDA. These multiples are struck before any synergies
- In 2019, LAICA generated revenue of €20.4m, Adjusted EBITDA of €2.9m and Adjusted Profit Before Tax of €2.6m
- The Vendors will have a lock-up arrangement in relation to their consideration shares, which will restrict disposal of those shares for six months from the completion date. The maximum earnout of 12.0m euros is effectively a balance sheet liability.

LAICA is based in Vicenza, Italy and has been operating for over 40 years. The business has developed from a small domestic appliances business (predominately kitchen scales at first) in Italy, into internationally renowned water treatment and small appliances.

Over the last ten years, LAICA has expanded in Europe and Asia and created an international sales network with products now being sold on five continents. LAICA has a manufacturing site at its base in northern Italy and manufacturing capabilities in China. **This base in Italy should be a competitive benefit when compared to others relying on their UK facility alone with Brexit now in place.** It currently employs 50 staff. LAICA's current product range comprises two main areas:

- Water treatment: Water jug filters, filter replacements, water dispensers, bottle filters and filters for coffee machines; and
- Health and wellness appliances: Personal care, vacuum sealers, and kitchen appliances.

LAICA has a global presence, an established product range and strong R&D culture. There should be some consolidation of the water treatment range, driving efficiencies and providing a comprehensive portfolio of products for the Group.

LAICA will expand Strix's water category, enhance its presence in the health and wellness market and enable Strix to capitalise on the double-digit growth of global sales (in 2019) for both the small domestic appliance and water markets. Strix has little exposure to Italy at present, so the deal is complementary in terms of geography.

LAICA’s standalone EBITDA margin is c 14%. This represents a medium-term opportunity at first glance. There should in time be additional synergies, perhaps related to shipping and R&D, amongst other areas.

Long-term outlook and equity story

At the Capital Markets Day in November, the Group outlined its medium-term strategy, which should form the basis of the next stage of the Strix equity story:

- Double revenues over the next five years primarily through organic growth in its water and appliances categories;
- Actively seek opportunities that will add value across the Group through niche acquisitions or technologies;
- Further enhance the Group's growth potential within the water and appliance categories. And continue to grow market share in kettle controls and invest in compelling growth opportunities with particular focus on new product development and commercialisation strategy that support the medium-term growth ambition.

Sustainability remains at the heart of the way the Group operates.

In 2020 the Group has reassessed its approach with a view of integrating a sustainability strategy within core business activities aligned with the United Nation’s Sustainable Development Goals (SDGs).

Now **i**n 2021, Strix aims to bring their sustainability strategy to life, establishing baselines within their identified key SDG’s, which they will use to track improvements, and monitor their progress year on year.

Share price, put in context

The Strix share price was 100p and its market cap £190m, at the time of its IPO in August 2017.

The share price grew steadily in 2020, after the COVID crash. The current share price is 276p, with the market cap £576m. The share price is near its all-time high.

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

At Equity Development, we have nonetheless established a specialist engineering cohort for relative valuation (see below). This comprises well-known UK listed businesses, including Halma and Spirax-Sarco.

Note, however, the median market value here is in the £billions, whereas Strix is a relatively small cap in comparison (even with an EV of c £500m). And many companies have suspended all earnings guidance for FY20 and beyond. Hence current or forward multiples are not available.

For Strix, both EV/EBITDA (15.9x) and P/E multiples (18.5x) are still below the cohort average (17.4x and 20.8x respectively). An EV/sales multiple of >5x reflects the high margins generated.

Using historic multiples, our conclusion is that Strix appears inexpensive, although the relative valuation gap has closed in recent months. Note, in addition we also flag that many of these other stocks are mid/large caps which would ordinarily trade at a premium.

Revisiting the Strix investment case

In terms of Strix risk profile, we see the following as being most relevant to the investment case:

- High operating margins
- Dividend cover of 1.8x, implying a sustainable dividend (at a time of widespread dividend cuts in UK Plc). We would underline the income attractions, and we still forecast modest growth in FY20.
- ND/EBITDA leverage of c1x (likely to be higher temporarily post LAICA deal), implying well below average financial risk. And well below bank covenant requirements of < 2.5x.
- As at December 2020, net debt was £37.2 million, with ample headroom. Completion of a new £80 million revolving credit facility with RBS International Limited and Bank of China ensures this
- In prior years, Strix has delivered strong shareholder returns, in spite of Brexit and associated geopolitical concerns beyond the company control
- Very experienced senior management, including Mark Bartlett (CEO) and Raudres Wong (CFO)

Having made these points about Strix risk profile, COVID-19 and the market backdrop, we now attempt to put Strix PLC into more context.

Strix is an unusual strategic asset in our view, with 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.

The company has **world-class research & development** and operates a lean and agile engineering business, which is a long-term competitive advantage. During 2019 for example, 521 million parts were manufactured at the factory in Ramsey, Isle of Man by a team of only 37 people. With its Isle of Man domicile, Strix also operates a very tax efficient model. The IoM location has also proven very effective during the COVID lockdown.

It is however 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), filtration technologies and appliances for consumers across the world. The engineering capability is backed up by a rigorous approach to IP protection and safety actions.

Strix has steadily built up a market leading capability and know-how in this field since being founded in 1982. Specifically, in kettle controls the market dynamics remain attractive notwithstanding the turbulent geopolitical backdrop, 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 only stands at 35%, implying there is ongoing long-term growth potential.

Long term growth initiatives. The stock market has never seen Strix as a 'high growth' name. However, the recent CMD should give investors a fresh roadmap.

Forecasts

Investors should be aware that Strix is usually H2 weighted in terms of contribution to FY outcome. In the light of COVID, Strix's profitability model was always going to strategically target H2 2020 for recovery.

Management comments around recent order book progress suggest that trading momentum is strong early in FY21. Note, the Company will be up against 'easy' YoY comps in H1.

Following the FY 20 results, our own Strix forecast model shows **unchanged FY21 and FY22 estimates.**

Forecasts							
Y/E 31 Dec	**2017**	**2018**	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue (£000's)	91,263	93,769	96,876	95,305	118,090	122,697	127,410
y.o.y growth	2.9%	2.7%	3.3%	-1.6%	23.9%	3.9%	3.8%
EBITDA (£000's)	35,117	36,351	36,904	38,100	40,599	42,439	44,464
EBIT. (£000's)	29,062	30,861	31,361	32,100	34,667	36,413	38,343
Adj. PBT (£000's)	28,304	29,206	30,199	30,900	32,817	34,863	37,043
Adj PAT (£000's)	27,517	28,259	28,863	29,505	31,504	33,468	35,561
EPS (p) basic adj.	14.5	14.9	15.2	14.9	15.3	16.3	17.3
EPS (p) ful dil. Adj	14.2	14.2	14.2	14.3	15.3	16.3	17.3
DPS (p)	2.9	7.0	7.7	7.9	8.1	8.3	8.5
Div yield	1.05%	2.54%	2.79%	2.84%	2.93%	3.01%	3.08%
Div cover	0.0	2.0	1.8	1.8	1.9	2.0	2.0
Net debt/cash	45,889	27,479	30,810	37,200*	42,199**	31,416	18,408
P/E	19.0	18.5	18.2	18.5	18.0	16.9	16.0
EV/EBITDA	17.2	16.7	16.4	15.9	15.0	14.1	12.8
ND / EBITDA	1.3	0.8	0.8	1.0	1.0	0.7	0.4

Source: ED estimates, Company historic data
** excludes lease liabilities plus any LAICA deferred payments*
*** excludes lease liabilities*

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