Strix Group

Upgrades highlight group's undervaluation

28 May 2021

The trading update ahead of the AGM was positive, highlighting the ongoing recovery in Kettle Controls and several significant product launches within the Water and Appliance categories. A strong performance at recent purchase LAICA with revenue well ahead of the previous year and further synergy/efficiency benefits augurs well for the remainder of the year. A 30% increase in Group revenue is envisaged for the year, leading us to upgrade forecasts.

Against this backdrop, current valuation continues at a marked discount to its peer group. This is unwarranted in view of the improving outlook for earnings, dividends and high returns.

The strong ongoing recovery to both revenues and orders continues within the Kettle Controls category and particularly within the regulated segment. In view of the commodity price increases borne in recent months, price increases have been implemented across legacy products across the Kettle Control and Water product categories. Coupled with further automation, the effect of the cost price inflation has been largely mitigated.

The momentum within the Water and Appliance Categories has begun to accelerate as new product launches have gained traction. Further products will be released during the remainder of the year, increasing our optimism in the outlook. The acquisition of LAICA has been justified, with revenues set to be 20% ahead of FY20 for the full year. A combination of new product launches, emerging synergy benefits and efficiency gains have combined to increase margins.

HaloPure, the water filtration system for agriculture, has secured further contracts YTD. The technology remains on track to install ten systems by the year end, underpinning our view that £10m annualised revenue target by FY25 looks conservative.

The new manufacturing facility in China remains on target (and budget) to be fully operational by August. All the press and mould machinery is now operational, with 40% of assembly lines in production, thereby increasing the level of automation within the Group.

Management will issue key performance targets on its key sustainable development goals, with annual improvements tracked at the time of the Interim results in September. All assembly lines within the new Chinese manufacturing facility will be powered by solar energy from October and 30% minimum of all plastic packaging utilised in exports to the UK, will be sourced from recycled materials.

Market yet to fully recognize attractions

The strong order book within Kettle Controls, the accelerating momentum of new products, and the acquisition/strong performance of LAICA, all contribute to an upgrade of EPS expectations. Despite recent strong performance, Strix shares' PER is at a discount of 34% to peers. Simply placing them at parity with those peers' ratings indicates a fair value of 350p.

Forecasts

Y/e 31 Dec, £m	2017	2018	2019	2020	2021E	2022E	2023E
Revenue	91.3	93.8	96.9	95.3	121.4	132.9	146.9
Adj. PBT	28.3	29.2	30.2	30.9	33.9	35.6	37.4
Adj. EPS (p)	14.2	14.2	14.2	14.3	15.6	16.3	17.1
Div. Yield (%)	1.0	2.4	2.6	2.7	2.7	2.8	2.9
P/E (x)	20.6	20.7	20.6	20.5	18.8	18.0	17.1
EV/EBITDA (x)	18.2	17.6	15.8	16.8	15.0	14.1	13.2

Source: ED estimates, Company historic data

Company Data

EPIC	KETL
Price (last close)	293p
52 weeks Hi/Lo	302p / 175p
Market cap	£603m
Net debt (Dec '20)	£37.2m

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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AGM trading update

This morning Strix updated investors with a review of trading ahead of the Group's AGM later today. The update is encouraging, with **FY21 revenues set to rise 30% y-o-y**. The drivers of this include:

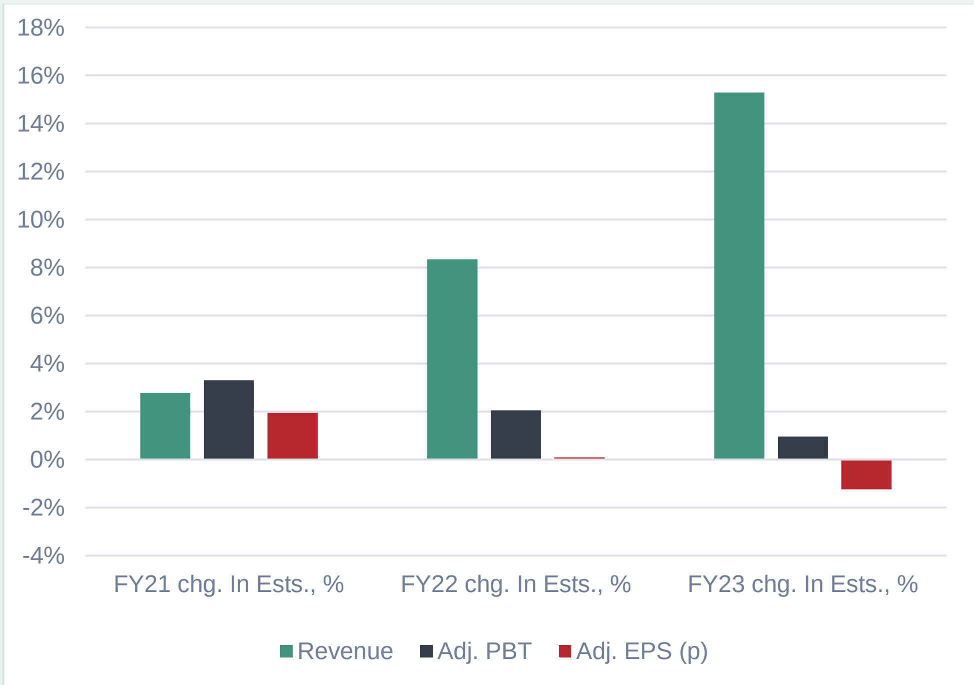
- The continuation of the strong H2 20 order book into Q2 21, giving confidence for 2H 21 and beyond, particularly within the regulated kettle control market
- New product launches within the Water Category are gaining momentum
- Full-period contribution from LAICA, acquired in October 2020
- H1 21 product launches from LAICA, such as the GlaSSmart (instant water filtering bottle), tap filters and the myLAICA sports water bottle
- Improved penetration levels of the recently launched small appliances across several markets
- Additional contract wins in the large Chinese agricultural markets for the new HaloPure technology
- Synergy benefits and efficiency gains emerging within LAICA post-acquisition
- Y-o-y revenue growth of 20% in LAICA

The guidance of a 30% uplift y-o-y in revenues should in our opinion dispel any doubt surrounding the Group's strategic target of a doubling of revenues in the five years to FY25.

Forecasts raised

We have increased our top-and-bottom-line estimates following today's announcement, with adj. EPS rising 1.9% to 15.6p in FY21F and 0.1% to 16.2 in FY22F. For now, we opt to maintain a prudently conservative stance on the outlook for beyond the current year given the macro climate.

Revisions to estimates post-AGM update



Equity Development

Operational summary

Within the **Kettle Controls Category**, regulated markets are generally seeing strong orders, in turn providing greater visibility and confidence in the outlook into FY22F. Productivity gains, largely via automation, are offsetting much of the raw material price inflation.

In the **Water Category**, the newer products launched in FY20 and H1 21 are gaining traction, with demand building strongly. The successful implementation of price increases on legacy products, coupled with efficiency measures, such as increased automation are offsetting rising commodity and transportation costs.

HaloPure has secured two additional contracts during May, with a large government owned regional pig farmer (operating 40+ farms in three provinces). The sub-division remains on track for ten installations during FY21. In view of the relative new technology, we remain encouraged, believing the targeted £10m of annual revenues by FY25F will be comfortably beaten.

For the **Appliance Category**, the much-awaited Aurora (the instant flow heater/chiller beverage station) will be launched in June on Amazon, under the AquaOptima brand.

Work on the **new manufacturing facility** in China continues at a pace. Building property certificates have been secured, completing the approvals process for the plant. The facility is currently partially operational, with all press and mould machines moved and operational, although to date only 40% of the production lines are up and running. Product approval is expected next month (June '20) and the ISO certification will be audited and recertified by the end of July. The remainder of the assembly line move, and commissioning remains on track for completion in August as per their original schedule.

Sustainability a core focus

An update on the progress of the Group's key **Sustainable Development** goals was issued. Within this, baselines have been established with improvements tracked annually. Key performance targets will be further highlighted within September's interim results, but it is encouraging that the new facility in China will be fully powered by solar energy from October 2021 and that a minimum of 30% of all plastic packaging is now from recycled sources.

Additional ESG accreditation is under review, not least the sustainable forestry FSG and Green Dot Valpak which are currently being evaluated. LAICA is targeting an end 2021 deadline to achieve ISO14001 (Environmental Management) and ISO45001 (Occupational Health & Safety), as well as ISO9001 and ISO13485.

The Seattle office has been relocated to more suitable premises, resulting in efficiency savings and an improved environment to support the ongoing growth of the Water and Appliance activities in the US.

Strong trading at LAICA

The purchase of LAICA offered increased geographical reach in the water and health & wellness markets (small domestic appliances): segments that were growing strongly. Also, the acquisition has enabled the Group to consolidate its comprehensive water treatment product range, and an advanced new product roadmap should further drive top-line growth.

H2 2021 is expected to witness the planned geographical expansion of the extended consumer water brand portfolio with the launch of the **myLAICA** instant filtering sports water bottle. Additionally, the **GlaSSmart** instant filtering water bottle was launched during H1 and tap filters throughout the year. We expect to see the FY20 product launches gaining traction during the current year.

At the time of its acquisition, guidance suggested that LAICA would be earnings accretive by mid-single digit percentage in its first full year of ownership by Strix.

That being driven by a combination of:

- Synergy benefits
- Efficiency gains
- Product launches
- Strong trading

All the above have come to pass, meaning that **the performance of LAICA looks set to beat even best initial expectations**. Revenues are on track to improve 20% y-o-y, even set against relatively challenging comparatives. Also, the synergy benefits/efficiency gains are starting to help an expansion in margins.

The combined Aqua Optima/astrea/LAICA brands are now the fifth largest within the global water filter/reuseable bottle sector. The launch of the first joint venture product, the induction kettle is expected to launch in Dec/Jan.

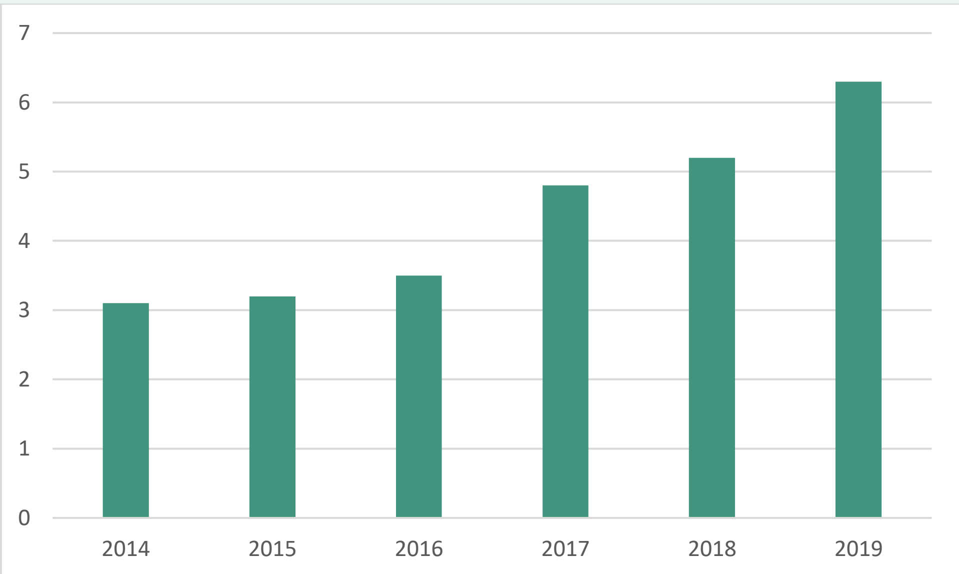
N. America and Russia increasingly important to growth aspirations

We believe that the US and Russia will become increasingly important in the future, and not just within the Kettle Controls Category. Both regional markets performed well during FY20 and further product launches should expand market share in Kettle Controls. The Aqua Optima brand is set to launch in North America, while LAICA has a presence in the small domestic appliance sector within the US.

Euromonitor anticipates the market for kettles will grow by 39% overall in retail sales terms between 2020 and the end of 2024. Anticipated factors behind this forecast include:

- The growing popularity of herbal teas, reflecting recognition of their health benefits
- Popularity of kettles with variable temperature settings to suit different beverages
- A preference for energy saving products
- Convenience
- The launch of 15 amp controls (allowing faster boiling of water)

US kettles sales (m units)



Source: Mordor Intelligence

The launch of the **StrixVQ** sub brand into less regulated markets, should be a key factor in the Group's aim to capture 50% of the Russian market (currently 34% share). Similar as to the US market, Russia continues to have a low penetration rate of kettles compared to the size of population.

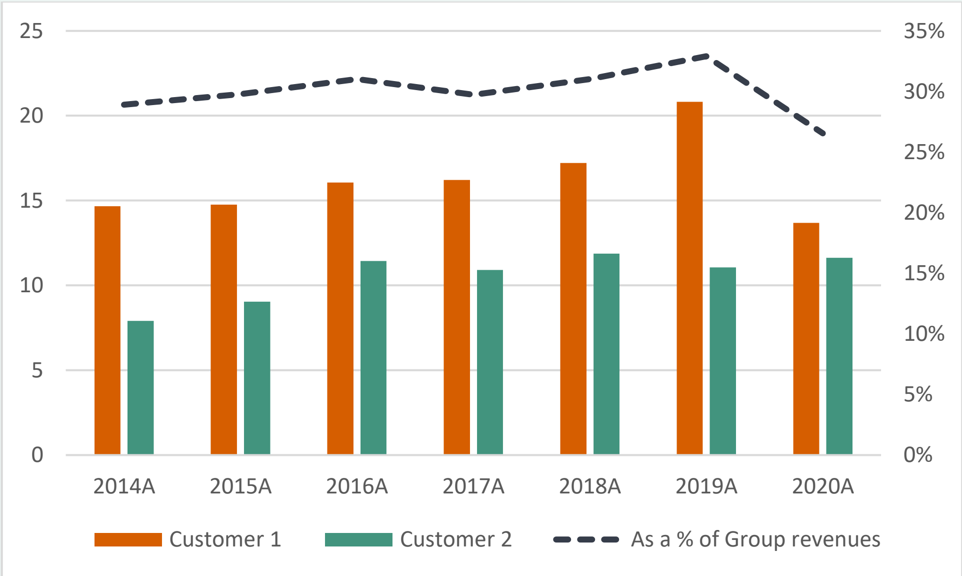
Reducing dominance of the top two customers

Much has been made of the dominance of the Group's top two customers. However, the combination of the following highlights a reduction in their importance:

- Recent acquisitions
- Strong growth in the Water and Appliances Categories
- New product launches
- Geographical expansion across all divisions
- 200+ OEM customers and 450 brand/retail customers

We therefore anticipate that as a proportion of revenues their significance will fall in the short-to-medium term.

Proportion of revenues of the two largest customers



Source: Strix plc

Financials

In view of the upbeat trading statement, we have increased our estimates for FY21, FY22 and FY23. We highlight the key changes in the following table.

Updates to estimates

£m	Old FY21F	New FY21F	YoY chg, %	Old FY22F	New FY22F	YoY chg, %	Old FY23F	New FY23F	YoY chg,
Revenue	118.09	121.37	2.8%	122.70	132.92	8.3%	127.41	146.89	15.3%
Adj. PBT	32.82	33.90	3.3%	34.86	35.58	2.0%	37.04	37.40	1.0%
Adj. EPS (p)	15.30	15.60	1.9%	16.30	16.32	0.1%	17.30	17.09	-1.2%
DPS (p)	8.10	8.00	-1.2%	8.30	8.25	-0.6%	8.50	8.50	0.0%

Source: Equity Development

We have increased our revenue projections markedly from FY22 onwards. This is down to several factors:

- Market share gains and market growth within Kettle Controls
- Market growth within the Water Category, in part reflecting the increasing desire to see single use plastic water bottles removed from sale
- A cross-selling of LAICA products internationally
- Promotion of Group products using LAICA's online marketing expertise
- New product introductions within the Appliances division
- International expansion with a focus on the US, Russia, and India in the Kettle Controls Category.

Looking forward

Typically, it takes three years for a new product launch to achieve maturity, with margins improving as volumes grow. FY20 saw 14 new products ready for launch, the most significant being the European launch of the TT Day & Night appliance, and the steriliser/dryer in the APAC region.

In the current year, we expect approximately more than 15 new introductions with the most promising being :

- Aurora, the instant flow heater/chiller beverage station in H1
- Dual Flo launches in H2, further extending the range of hot water on demand products
- The expansion of the Baby Care technology range in H2
- The steriliser/dryer in North American market with a leading brand

In addition, the Kettle Controls Category has expanded its 15-amp controls (predominantly targeting the US and Japanese markets), the StrixvQ (controls for less regulated markets) and new wash proof controls (Turkish coffee).

In terms of gross profit, this will remain at high levels, notwithstanding the dilution from the accelerating growth within the Water and Appliance Categories. The sustainability of high margins reflects patents and the significant barriers to entry, owing to the inclusion of Strix controls by the OEMs/brand partners at the design stage.

Also, Strix's high market share within the Kettle Controls Category allow for significant pricing power.

The strong new product pipeline reflects high research and development costs, which in FY20 amounted to 4.3% of revenues. R&D spend is set to rise to 5% of revenues within the timeframe of our projections and is a further reason for high gross margins.

FY20 proforma gross margins amounted to 38.7%, which we expect to fall to 37.0% in FY21. Based on Group guidance for FY25, gross margins are set to continue to decline to 33.7% by then, highlighting the more rapid growth in the smaller Water and Appliance Categories. However, with further M&A activity expected we estimate that overall **gross profit rises at a CAGR of 9.3% from FY20 (proforma) to FY25** (that is, £43m to £67m, representing a 56% increase overall).

Capex & Opex

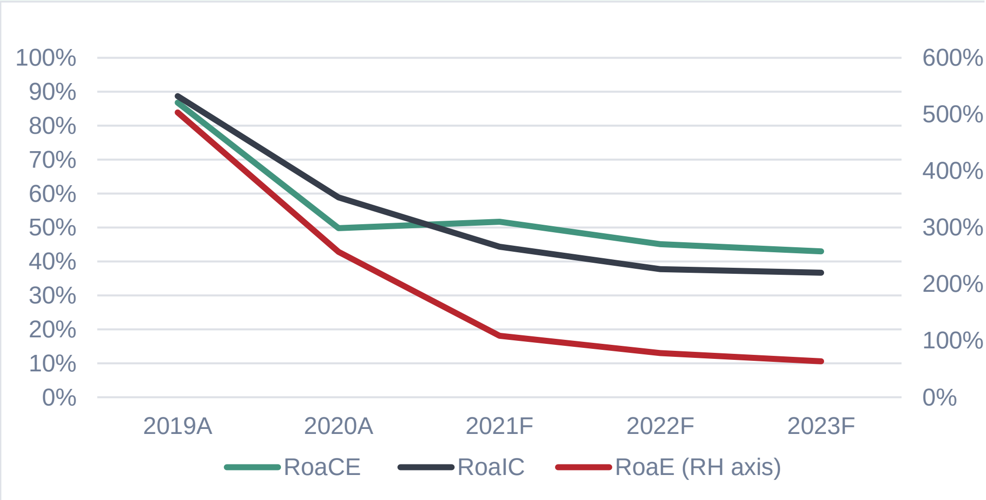
The new Chinese manufacturing facility is expected to be fully operational from August. Following the factory opening, we expect that capex is likely to decline to more normal levels (to an estimated 6% to 7% of revenues, from 12.2% in FY21F) for the duration of our projections from FY22 onwards. As a result, we anticipate that the proportion of fully automated lines will rise to 73% by the FY21 year end, compared to 67% in December FY20. Ultimately, we believe that the level of automation will increase to at least 80%, providing further assistance to gross margins.

Further efficiency gains will undoubtedly be made within LAICA's facility in Vicenza, northern Italy. Integration is largely complete. New product launches/product development will be a main driver of revenues, albeit have a modest impact on margins in the short term. Margin protection is in the form of strong IP (patents/industrial property rights/strong relationships with OEMs) and as the products are launched into additional geographic markets (Americas, South East Asia and the UK).

Commodity prices have risen YTD, with a price rise pushed through to compensate. Although transport costs have risen sharply in recent months, the bulk of this expense is borne by the OEM/retailer, with only a relatively modest impact to Strix.

In terms of OpEx, we expect these to remain relatively stable at 9% to 9.6% between FY19 and FY23F. As a result, operating margins remain high at 28.9% in FY21F. We show below the industry leading returns in the chart below. On our projections, RoaCE, RoaIC and RoaE continue at high levels throughout the forecast period at 51.7%, 44.4% and 108.5%, respectively in FY21F. The returns remain very high in FY23F at 43.0% (RoaCE), 36.7% (RoaIC) and 63.5% (RoaE).

Returns



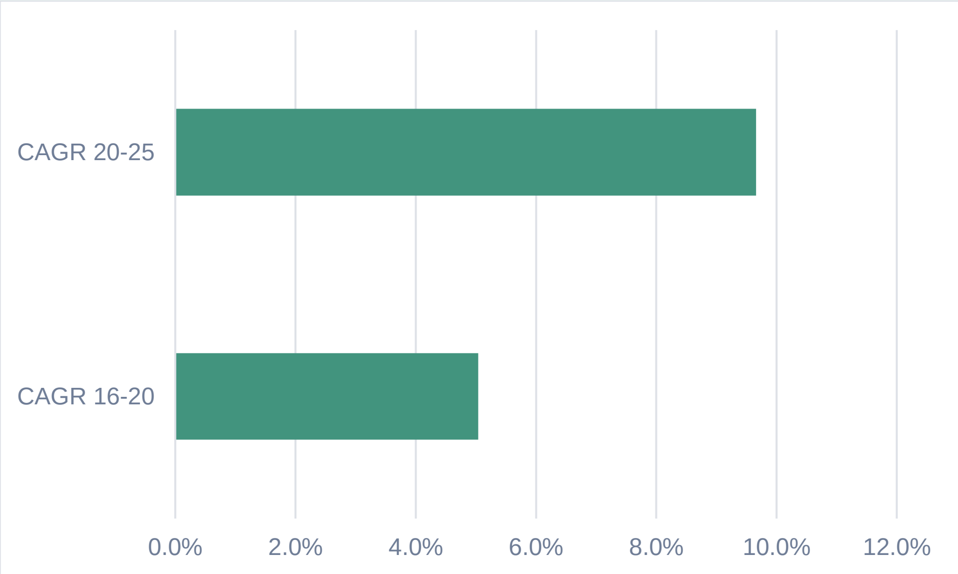
Source: Equity Development forecasts

Strong growth metrics

Based on the Group's projections of revenues of £199m and gross profit of £67m, this translates to adj. EPS of 22.7p in FY25F (owing to EBIT of £49.6m, as per the guidance provided in October's Capital Markets Day).

The acquisitions, coupled with product launches and market growth in the smaller divisions, result in **Adj. PBT and EPS growth near doubling from a CAGR of 5.0% between FY16 and FY20, to a CAGR of 9.7% between FY20 and FY25F** based on management's medium to longer term projections.

EPS growth



Source: Company Data, Equity Development

We anticipate that operating cash flow will remain strong, averaging 105.3% of operating profits for the duration of our projections to FY23F. Net debt should decline to £32.2m by the end of FY23F, aided by the completion of the new Chinese manufacturing facility by August 2021 and a return to more normal levels of capex. We expect the Net debt/EBITDA ratio to decline from 1.0x in FY20 to 0.7x by FY23.

In terms of the balance sheet, we see further uplift in net assets to £62.0m by the end of FY23F, up from £22.0m at the end of FY20. What should be obvious from the above is that the balance sheet remains healthy, with strong cash flows.

In order to achieve the guidance provided to investors at the time of the Capital Markets Day in October 2020, we can see how this will be achieved primarily by organic growth. Acquisitions will not be relied upon, but they do offer the opportunity of further upside and are unlikely to stretch what is clearly a healthy balance sheet.

Summary Profit & Loss

Year to Dec, £m	2019A	2020A	2021F	2022F	2023F
Kettle controls	85.8	79.8	80.8	83.7	86.6
Water products	9.8	11.7	27.2	33.1	40.7
Appliances	1.2	3.7	13.4	16.1	19.6
Revenue	**96.88**	**95.31**	**121.37**	**132.92**	**146.89**
CoGS	-57.3	-55.9	-76.5	-85.1	-95.3
Gross profit	**39.6**	**39.4**	**44.9**	**47.8**	**51.6**
Gross margin (%)	40.9%	41.4%	37.0%	36.0%	35.1%
Op costs	8.7	8.5	10.9	12.2	14.1
Other Op. income	0.6	1.1	1.2	1.3	1.4
Operating profit	**31.5**	**32.0**	**35.1**	**36.8**	**38.9**
Op margin (%)	32.5%	33.6%	28.9%	27.7%	26.5%
Net Interest	-1.3	-1.2	-1.3	-1.4	-1.6
Associates	0.0	0.1	0.1	0.1	0.1
PBT (Adjusted)	**30.2**	**30.9**	**33.9**	**35.6**	**37.4**
Exceptionals	-7.3	-5.5	0.0	0.0	0.0
PBT (Reported)	**22.9**	**25.5**	**34.0**	**35.7**	**37.5**
Tax	-1.3	-1.4	-1.7	-1.9	-2.1
Adj. PAT	**28.9**	**29.5**	**32.2**	**33.7**	**35.3**
Minority interests	0.0	0.0	0.0	0.0	0.0
Adj. Earnings	**28.9**	**29.5**	**32.2**	**33.7**	**35.3**
Ordinary Dividends	-14.7	-16.0	-16.5	-17.0	-17.5
Retained Profit	**14.2**	**13.5**	**15.7**	**16.7**	**17.8**
EPS (Adjusted) (p)	**14.2**	**14.3**	**15.6**	**16.3**	**17.1**
DPS (p)	**7.7**	**7.9**	**8.0**	**8.3**	**8.5**
Ave no of shares (FD) (m)	**202.8**	**206.4**	**206.4**	**206.4**	**206.4**

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to Dec, £m	2019A	2020A	2021F	2022F	2023F
Operating profit	**31.5**	**32.1**	**35.2**	**37.0**	**39.0**
Depn. & Amortn.	5.5	6.0	7.5	8.4	8.9
Working capital movement	-0.4	-1.6	-3.7	-2.9	-1.4
Other	-3.1	-2.8	-3.8	-3.6	-3.4
Operating cash flow	**33.6**	**33.7**	**35.3**	**38.9**	**43.1**
Net Interest	-1.3	-1.9	-1.3	-1.4	-1.6
Taxation	-1.0	-0.9	-3.0	-3.0	-3.0
Net capex	-14.9	-17.4	-14.8	-9.3	-8.8
Operating FCF	**16.4**	**13.4**	**16.1**	**25.2**	**29.7**
Net (Acquisitions)/Disposals	-1.5	-10.4	-2.1	-5.5	-5.5
Dividends	-13.9	-15.3	-16.1	-16.6	-17.1
Share Issues	0.0	3.1	0.0	0.0	0.0
Minority payment	0.0	-0.1	0.0	0.0	0.0
Other financial	0.1	-1.6	0.0	-1.5	-1.5
Increase Cash/(Debt)	**1.1**	**-10.9**	**-2.1**	**1.6**	**5.5**
Opening Net Cash/(Debt)	-27.5	-26.3	-37.2	-39.3	-37.7
Closing Net Cash/(Debt)	**-26.3**	**-37.2**	**-39.3**	**-37.7**	**-32.2**

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec, £m	2019A	2020A	2021F	2022F	2023F
Intangible Assets	7.1	29.6	27.8	25.8	23.6
Tangible Assets	**25.5**	**37.2**	**46.3**	**48.6**	**50.2**
Investments/other	0.0	0.1	0.1	0.1	0.1
Net Working Capital	-2.4	4.4	8.1	11.0	12.4
Capital Employed	**30.2**	**71.4**	**82.3**	**85.5**	**86.4**
Other	-3.0	-2.8	-2.1	-2.0	-1.9
Net Cash/(Debt)	-26.3	-37.2	-39.3	-37.7	-32.2
Provisions Liabilities/Charges	0.0	-9.3	-9.3	-8.5	-8.0
Net Assets	**0.9**	**22.0**	**31.7**	**37.2**	**44.3**

Source: Company historics, Equity Development estimates

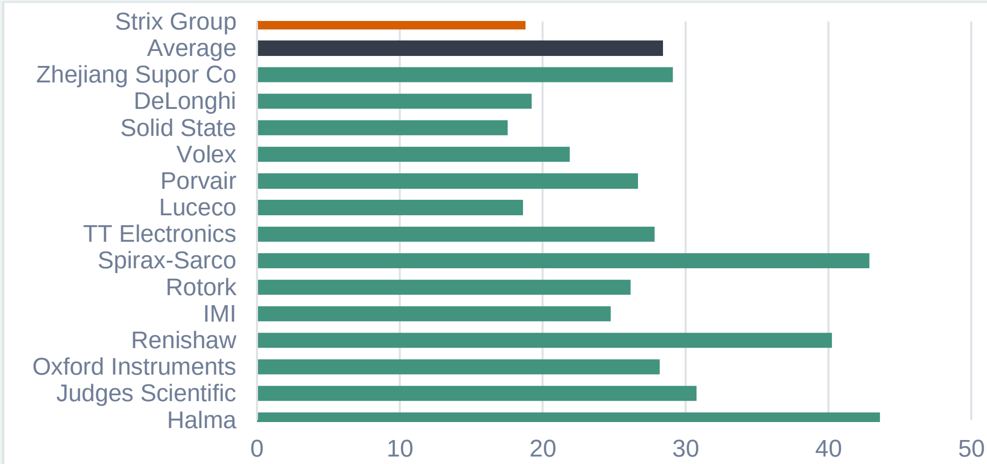
Valuation

Gross and operating margins at Strix are amongst the highest within its peer group, while its returns on capital employed, invested capital and equity are enviable. Such returns & margins support our contention that **Strix is indeed a world-class operator.**

That is particularly true within the Kettle Controls Category, skills that we believe will ultimately be transferred to the smaller Water and Appliances divisions. The latter two Categories are providing much of the top-and-bottom line growth within our projections, resulting in a near doubling of EPS growth over levels experienced in recent years.

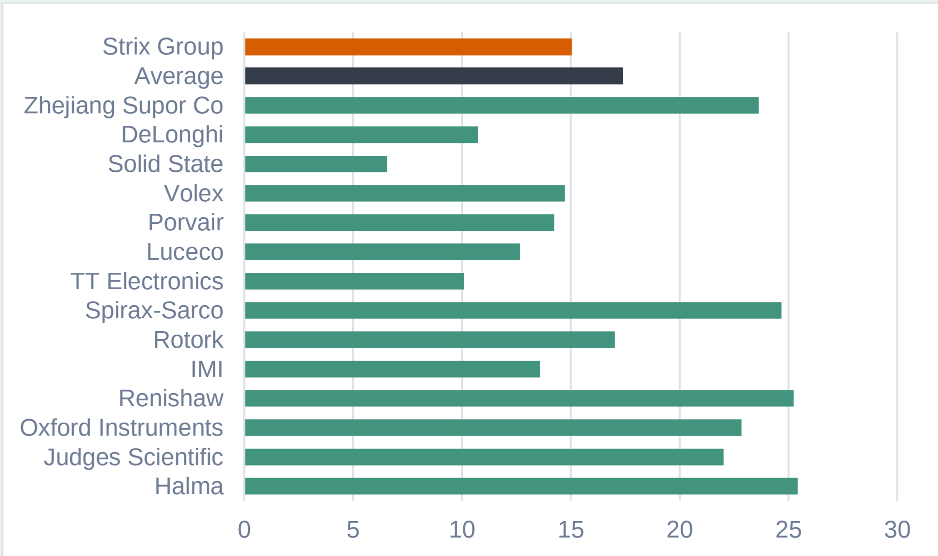
We continue to believe that the Group's track record and growth prospects are not fairly recognised in the rating. Looking at the FY1 PER and EV/EBITDA ratios for Strix versus the average of its peer group, it continues to trade at discounts of 33.8% and 13.6%, respectively. This is unwarranted and affords scope for a material rerating even if only to match peer averages.

FY1 PER



Source: ED, various websites

FY1 EV/EBITDA



Source: ED, various websites

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