

## Encouraging H1 19 update and FY on track

18th July 2019

**Strix H1 trading update just published:** *'The Group has delivered a solid performance for the period ...and expects to report (FY) results in line with market expectations'*. Accordingly, we leave our FY 19/20 forecasts unchanged. Reassuringly, Strix reconfirms at this stage its intention to pay **total dividends of 7.7p** per share for FY 19, +10% YoY. This should underline the income attractions of this stock to investors.

CEO Mark Bartlett highlights in his update the operating progress achieved by the group in H1 together with comments on stable market share as **the leading player in the global kettle controls market**. This is a market still growing at c. 2% pa.

Re **operating momentum in 2019**, we signal the appointment of a CCO (Chief Commercial Officer), to increase focus on new product innovation plus the new, enlarged manufacturing facility in China, where construction is due to start imminently, with expected completion in Q1 2021. Together **these initiatives highlight the scope for future value creation at Strix and the forward planning of management**.

**Time to revisit the Strix investment case.** The shares have been trading water through Q2 '19, in part reflecting the sell-down of a major institutional shareholding. In our view, this appears a strong and attractive entry point to the shares, with additional confidence on the back of the trading update. **Valuation multiples are undemanding at 11x PER, 9.8x EV/EBITDA**. The dividend yield at the current price is a compelling 5%. We estimate fair value for the shares in the 220p-240p share price range.

**Strix is a unique strategic asset on the UK stockmarket, with industry leading margins and a number of interesting growth initiatives underway.** It also screens well for investors with a 'sustainability' mandate, given its alignment to health products and improved filtration.

### Key Financials

y/e 31 Dec, £'000s	2017	2018	2019E	2020E
Revenue	91,263	93,769	101,498	108,083
y.o.y growth	2.94%	2.75%	8.24%	6.49%
EBITDA	35,117	36,351	36,160	38,829
EBIT	29,062	30,861	31,087	33,658
Adj. PBT	28,304	29,206	29,960	32,464
Adj PAT	27,517	28,259	28,635	30,776
EPS (p) basic adj.	14.48	14.87	15.07	15.46
EPS (p) ful dil. Adj	14.21	14.19	14.38	15.46
DPS (p)	2.90	7.00	7.70	7.90
Div yield	1.8%	4.4%	4.8%	4.9%
Div cover	0.00	2.03	1.87	1.96
Net debt/cash	45,889	27,479	30,628	33,883
P/E	11.3	11.3	11.1	10.4
EV/EBITDA	9.87	9.53	9.58	10.35

Source: Company historic data and ED estimates

### Company Data

EPIC	KETL
Price (last close)	160p
52 week Hi/Lo	182p/128p
Market cap	£304m
ED value / share	220p-240p
Net Debt	£27.5m

### 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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## Strix H1 19 trading update published

'The Group has delivered a solid performance for the (H1) period ...and expects to report (FY) results in line with market expectations'.

Strix has this morning published an H1 trading update with **Interims to be announced on Weds 18<sup>th</sup> Sept.** In recent weeks there have been a number of company profit warnings across the wider UK stockmarket, and in contrast we believe this Strix update should reassure investors. The group remains well on-track near-term, and is continuing to execute on initiatives which should build further value in the long term.

### Key takeaways

#### Forecasts and market dynamics

Our own Strix FY forecasts are laid out in detail on page 1 and on page 6. **We have made no material changes to our FY forecasts.** In terms of year on year movements (FY 2019, vs FY 2018), we would pick out our own expectations: 1/ growth in adjusted PAT; 2/ conservative year-end leverage at <1x ND/EBITDA; 3/ reconfirmation of 7.7p dividend for FY 19 (total dividend), + 10% YoY.

**The global market for kettle safety devices is estimated to have grown by 2% in H1 2019,** following mid-single digits % growth in 2018. Strix maintains leading market share.

There are, however, subtle mix differences in 2019, which explain the modest slowdown in market growth year-on-year: **growth in North America and the Far East,** offset by weaker markets in China and CIS (eg Russia and adjoining markets).

It will be no surprise to investors that the geo-political backdrop has been tougher in 2019, but it is important to stress that the Strix 'flow of goods' is between the Isle of Man and China. **Concerns over the so-called impact of either Brexit or US/China trade tariffs should be kept strictly in perspective.**

**Aqua Optima** branded products retain stable market share in the UK, albeit the market itself is estimated to be down c. 7% YoY. We consider this a short-term dip, rather than structural.

#### Operating and commercial developments

In terms of operating momentum in 2019, we note: 1/ **the appointment of a Strix CCO (Chief Commercial Officer),** Harry Kyriacou, to increase focus on new product innovation; 2/ **the new, enlarged manufacturing facility in China, where construction is due to start imminently,** with expected completion in Q1 2021. Taken together, these initiatives highlight the scope for future value creation at Strix and the forward planning of management.

Over many years, Strix has developed a portfolio of water, temperature and steam management technologies that have been commercialised in adjacent products and markets as opportunities arise. Looking ahead, **baby products and small domestic appliances are new growth verticals, where Strix is already working with partners.**

In terms of China, **the company highlights the security advantage of moving to a 50 year, rather than 20 year, tenure for its new factory location,** which underlines the support they receive from the regional Chinese government.

The plot itself can support a maximum facility size of 34,000m<sup>2</sup> compared to the current facility of 13,200m<sup>2</sup>. Increased capital expenditure arising from the factory move/construction, c. £17m rising to c£20m next year, should already be factored into market forecasts.

## Recap on earlier developments

### HaloSource

**Strix completed its £1m acquisition of certain HaloSource assets on 7th March 2019.**

These included the HaloPure division and the Astrea product.

According to today's H1 update, post-acquisition 'performance has been in line with expectations'. The company now reiterates the benefits of some key technologies and research & development skills in the water filtration market.

**Revenue synergies will be derived from using Strix existing sales channels to commercialise the two acquired technologies.** In the medium term, the HaloSource assets should also support Aqua Optima's overall growth as well as entrenching the group's important USA foothold. Together, these drive future profitability.

In terms of near term financials, our core assumption is that the HaloSource assets will breakeven in FY20 and make a positive contribution to profitability in FY21.

**The acquired technologies broaden the current water filtration offering and improve its capability.** The assets include two patented technologies, a bromine-based water treatment bead system proven to kill 99.99%+ of bacteria and viruses, and a composite filter material, certified to remove lead, to the NSF-53 standard important for the US market, and other heavy metals.

Meanwhile, Strix's balance sheet (and free cash flow) should continue to support tactical M&A activity, albeit in niche applications.

### Site visit

**We recently took part in an investor visit to the Isle of Man, including the Ramsey site,** which is a high precision engineering business. It produces bimetal blades and high-speed stampings, including contact insertion. These represent the primary non-plastic components of an underfloor heated kettle's safety system. The parts are shipped from the Isle of Man to China.

## Strix investment case

**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.

It is a global service provider (across the value chain), domiciled in the Isle of Man 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) and filtration technologies for consumers across the world. The engineering capability is backed up by a rigorous approach to IP protection and safety actions.

Specifically in kettle controls, the market dynamics remain attractive notwithstanding the turbulent geopolitical backdrop, which is of course beyond the company's control. **With c. 196m appliances globally, penetration is c35, implying continued long-term growth potential.**

With the HaloSource deal, there is also now clearly room for a new "high ground" to be established over time in purified water, and **Strix has a clear strong track record of achieving global leadership** based on what it has achieved in kettle safety devices.

**With FY forecasts now underpinned, we expect investors to focus once again on the strategic merits of Strix, the long-term growth initiatives and the lowly trading multiples.**

## Share price in context

**The Strix IPO price was 100p (market cap at IPO, £190m, Aug '17). The current share price is 160p.** Year-to-date, the shares are basically unchanged. The share price high in 2019 is 180p, set in Apr 19.

**The main recent development on the share register has been the comprehensive sell-down of a major institutional shareholding**, and our understanding is that this is now complete. This corporate action was not unique to Strix in the UK stockmarket, but has perhaps recently overshadowed the underlying equity story.

## Valuation

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

At Equity Development, we have nonetheless established a specialist engineering cohort for relative valuation (see below).

**Our overall conclusion is that Strix appears very inexpensive by the standards of this cohort / peer group, whilst we also flag that many of these names are mid/large caps who would ordinarily trade at a premium.**

For Strix, both EV/EBITDA and P/E multiples are comfortably beneath the average while EV/sales reflects the high margins generated. Dividend cover on our FY 19/20 forecasts is a shade under 2x and appears very secure. It is encouraging to see Strix reconfirm its FY 2019 commitment to 7.7p total dividend per share.

Figure 12 – Relative Valuation

	Share price	Mkt cap	Net debt	EV	Sales 2018	EV/sales	EBITDA 2018	EV/EBITDA	EPS 2018	EPS 2019	P/E 2018	P/E 2019	Div 2018	Yield
	(p)	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(p)	(x)	(x)	(p)	(%)
Discover IE	390	286	30	316	338	0.9	29.3	10.8	21.9	25.8	17.8	15.1	8.7	2.2%
Halma	2019	7665	196	7861	1076	7.3	252.0	31.2	42.3	46.7	47.7	43.2	14.1	0.7%
IMI	1016	2767	265	3032	1877	1.6	315.0	9.6	69.1	78.7	14.7	12.9	38.9	3.8%
Judges Scientific	3579	223	8	230	75	3.1	12.4	18.6	32.8	137.0	109.1	26.1	28.5	0.8%
Oxford Instruments	1324	758	109	867	297	2.9	55.6	15.6	59.0	58.0	22.4	22.8	13.0	1.0%
Renishaw	3796	2760	-52	2708	612	4.4	186.0	14.6	168.0	183.0	22.6	20.7	57.0	1.5%
Rotork	308	2678	13	2691	693	3.9	162.0	16.6	11.9	13.5	25.9	22.8	5.7	1.8%
Spirax-Sarco	8865	6528	373	6901	1138	6.1	299.0	23.1	246.0	258.0	36.0	34.4	98.0	1.1%
Strix	160	319	28	347	94	3.7	36.4	9.5	14.2	14.4	11.3	11.1	7.0	4.4%
TT Electronics	228	372	-46	325	378	0.9	44.7	7.3	13.2	15.7	17.3	14.5	6.1	2.7%
Average						3.5		15.7			32.5	22.4		2.0%

\*\* Forecasts derived from Capital IQ and other sources

<b>Income statement</b>				
<b>Y/E Dec, £000s</b>	<b>2018A</b>	<b>2019E</b>	<b>2020E</b>	<b>2021E</b>
Revenue	93,769	101,498	108,083	113,531
increase	2.70%	8.20%	6.50%	5.00%
Salescost pre exceps	-54,851	-59,985	-64,526	-67,778
Gross profit	38,918	41,513	43,558	45,753
Gross margin (%)	41.50%	40.90%	40.30%	40.30%
Distribution costs	-5,344	-7,250	-7,000	-7,210
Admin pre exceps	-3,083	-3,175	-2,900	-3,045
Admin - exceptional	-5,072			
Other ops income	370			
Net operating costs	-13,129	-10,425	-9,900	-10,255
EBIT - reported	25,789	31,087	33,658	35,498
EBIT margin (%)	27.50%	30.60%	31.10%	31.30%
Exceptionals	-5,072			
EBIT - adjusted	30,861	31,087	33,658	35,498
EBIT margin (%) - adjusted	32.90%	30.60%	31.10%	31.30%
Depreciation	-3,198	-3,294	-3,393	-3,495
Amortisation	-2,292	-1,779	-1,779	-1,779
Depreciation & amortisation	-5,490	-5,073	-5,172	-5,274
EBITDA - adjusted	36,351	36,160	38,829	40,772
EBITDA – reported	36,351	36,160	38,829	40,772
EBITDA margin – adj	38.80%	35.60%	35.90%	35.90%
EBITDA margin – rep	38.80%	35.60%	35.90%	35.90%
Net financial income	-1,655	-1,127	-1,193	0
Pre-tax profit - reported	24,134	29,960	32,464	35,498
Pre-tax profit – adj	29,206	29,960	32,464	35,498
Taxation	-947	-1,325	-1,688	-1,846
Tax rate (%)	-3.90%	-4.40%	-5.20%	-5.20%
Net income – rep	23,187	28,635	30,776	33,652
Net income - adj	28,259	28,635	30,776	33,652
<b>Shares, '000s</b>				
No. basic shares	190,000	190,000	199,100	199,100
Diln. potential - ords	9,100	9,100		
No.shares - diluted	199,100	199,100	199,100	199,100
<b>EPS, pence</b>				
Basic reported	12.2	15.1	15.5	16.9
Basic adjusted	14.9	15.1	15.5	16.9
Fully diluted adj.	14.2	14.4	15.5	16.9
Growth full dild.adj	-0.10%	1.30%	7.50%	9.30%
<b>Dividend / share (p)</b>	<b>7</b>	<b>7.7</b>	<b>7.9</b>	<b>8.41</b>

Source: Company historic data, ED estimates



## Investor Access

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