

Interims Confirm Growth Optimism

19th September 2018

With positive sales growth, even faster EBITDA expansion and a sustained 38% world leading market share in kettle safety controls, Strix's interim results leave the company well-placed to match full year expectations. Moreover, the US performance complemented a recent announcement regarding coffee in that market. Strix proposes a 2.3p interim dividend confirms both an intended 7.0p full year outcome and 7.7p in FY2019.

Strix announced interim results this morning. Net revenue advanced by 1.5% to £42.9m and adjusted EBITDA by a faster 4.3% as gross and EBITDA margins both expanded: to 37.9% (37.2%) and 34.5% (33.6%) respectively. Pre-tax profit to fall by 1.9% to £11.0m but the cash position remains strong. Net debt fell by £8.0m to £37.9m as net cash from operations was positive by £15.2m: a 97% conversion rate.

Kettle controls revenue was slightly lower in the half year at 1.9%. Global category volume was strong at 6% with China returning to growth and recovering by a similar amount. Despite global category growth, Strix maintained a 38% world market share in kettle safety controls. Volumes advanced by 7.6% to 36.8m units in the period. In the USA, growth was pleasingly strong at 20%. The new U9 series of controls continued to win new business. It also drove growth in the less regulated and China market segments

Aqua Optima nearly doubled in size in the first half (+88%) and was close to 9% of group revenue. Its reach into an additional 2,500 outlets augurs well for future growth and we look forward to seeing the impact of its launch in China in the next six months.

We continue to regard the US as an important growth story across both kettle controls and the hot water on demand category. Not only is there substantial per capita volume increase in consumption in tea, but there is also a significant opportunity for meaningful growth in single-serve coffee, illustrated on 30th August when Strix announced a coffee collaboration with a leading US consumer products company.

Strix remains well placed to match market expectations for the full year and should enjoy sustained organic sales growth in our view thereafter. Moreover, its FY2018 12.0x P/E ratio and 4.2% dividend yields appear undemanding. In our view a 200p fair value – which would imply a 14.3x P/E and a 3.5% – seems realistic as further growth opportunities continue to reveal themselves, as well as offering more than 20% upside.

Company Data

EPIC	KETL
Price (last close)	168p
52 week Hi/Lo	178p/117p
Market cap	£344m

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.

Key Financials

	2016A	2017A	2018E	2019E	2020E
Revenue (£'000)	88,653	91,263	96,006	99,428	103,272
Revenue growth (%)	10.9%	2.9%	5.2%	3.6%	3.9%
EBITDA adj ('000)	33,473	35,117	36,717	38,287	39,577
EPS adj dil (p)	12.8	14.2	14.0	15.2	15.6
DPS (p)	n/a	2.9	7.0	7.7	7.9
EV/EBITDA (x)	11.3	10.8	10.3	9.9	9.6
P/E ratio (x)	13.1	11.8	12.0	11.0	10.7
Yield (%)	n/a	1.7%	4.2%	4.6%	4.7%

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Overall, Strix’s interim results were consistent with a company which operates in a growth category, enjoys clear market leadership, and is well poised to grow on a sustainable basis. There is a commitment both to new product development and sound financial management. We leave our full year forecasts broadly unchanged and we summarise the key features of the interim results in Figure 1.

Figure 1 – Interim results

	Adjusted results			Unadjusted results		
	H1 2018 £m	H1 2017 £m	Increase	H1 2018 £m	H1 2017 £m	Increase
Revenue	42.9	42.2	1.5%	42.9	42.2	1.5%
Gross profit	16.3	15.7	3.3%	16.3	15.7	3.5%
Distribution costs	-2.8	-3.2	12.4%	-2.8	-3.2	12.4%
Administrative costs	-1.7	-1.5	-15.5%	-4.1	-2.4	-69.9%
Operating profit	11.9	11.2	6.3%	9.6	10.3	-7.1%
EBITDA	14.8	14.2	4.3%	12.4	13.2	-6.2%
Profit before tax	11.0	11.2	-1.9%	8.6	10.3	-16.1%
Profit after tax	10.6	11.0	-3.5%	8.3	10.1	-18.1%
Net cash generated from operating activities	15.2	15.4	-0.9%	15.2	15.4	-0.9%

Source: Company

Results comment

A combination of modest revenue growth and improved gross margin were the key drivers of first half EBITDA growth for Strix in FY2018. Implied unit revenue was lower than the previous year’s H1 as volumes advanced at a brisk 8%. Strix is not deriving sales growth through pricing, despite its very strong 38% global market share.

Furthermore, we continue to forecast a brisk uptick in sales growth in the second half of FY2018. First, the exchange rate should be far more favourable as sterling weakened in H2, which benefits translation for a predominantly international business such as Strix. Second, there was disruption from the timing of Chinese New Year in the first half of FY2018.

As mentioned on our front page, both pre-tax profit and net income were lower than last year. H1 Pre-tax profits lapped a period in which in Strix reported no interest due to that year’s financial reorganization. Net income was further affected by a more even distribution of tax between H1 and H2 in FY2018 than last year. Regardless, our expectation for the full year tax charge is unchanged at 3.5% of adjusted pre-tax profit.

Outlook remains positive

Our central view is that Strix remains on track to deliver further organic growth. The company’s senior management stated that the full year numbers were in line with expectations, which is consistent with the proposed 2.3p interim dividend.

Moreover, the company is committed to a progressive dividend with a proposed 7.0p per share in FY2018 and a 10% increase to 7.7p in FY2019. Based on our EPS forecasts which are detailed in Figure 2, cover will be 2.0x in FY2018.

The exchange rates comment above about Strix being an international business is also relevant for the company's relatively upbeat stance on current UK political trends. In particular, the company believes any potential Brexit effects to be limited. The majority of its transactions are conducted between Strix's corporate office in the Isle of Man and OEM customers in China, so they are not exposed to the challenges of selling in the EU directly.

Investors should also note Strix's vigorous defence of its intellectual property. Utilising the dual strategy of focusing on both safety and IP, 8 internet brands were removed from sale in France, Germany, Italy and the UK during H1. Furthermore, Strix was successful in its legal actions against 19 appliances which fell within the Shanghai IP Court's authority and which had infringed in multi-cooker appliances.

New product development enhances growth

Strix's interim results reported revenue breakdown on a more detailed basis than previously. What is interesting is that overall sales growth was positive despite lower kettle safety devices growth due to Aqua Optima's increasing by 88%. We summarise reported sales by product in Figure 2.

Figure 2 - Strix - Revenue by activity (£'000s)

	H1 revenue growth		H2 revenue breakdown		
	2017 H1	2018 H1	% increase	% 2017 H1	% 2018 H1
Kettle controls	38,236	37,525	-1.9%	90.6%	87.5%
Aqua Optima	1,984	3,723	87.7%	4.7%	8.7%
Other	1,996	1,620	-18.8%	4.7%	3.8%
Total revenue	42,216	42,868	1.5%	100.0%	100.0%

Source: Company Data

On 30th August, Strix announced that the company had entered into a collaboration with a leading global consumer product company, based in the USA, to develop a new range of coffee machines utilising Strix's proprietary technology. Overall, the announcement reads positively for growth.

Strix and its US partner will focus on developing a new appliance that will produce a single cup of high quality coffee. This appliance will benefit from both Strix's knowledge and expertise in relation to temperature accuracy and methods of water dispense. It will use Strix's patented technology. A move into US coffee should enhance the company's American growth potential, where the company already enjoys a 70% market share in kettle safety controls. First half growth in North America was around 20%

Financial forecasts

Our full year forecasts for FY2018 are summarised in Figure 4. We leave our revenue, EBITDA, pre-tax profit and EPS forecasts unchanged from prior to the interim results announcement. We continue to look for adjusted Profits After Tax (PAT) of £28m. The company's intention to pay a 7.0p full year dividend in FY2018 rising to 7.7p in FY2019 is also in line with our own forecasts. While the tax rate may pick up longer term, we expect it to be beneath 5.0% for the foreseeable future.

Our longer term expectations for sales revenue growth remain positive with global category volume expected to be of the order of 2% to 3% and Strix holding market share at around its current 38%. With achieved pricing expected to be of the order of 1% overall revenue prospects are around mid-single digit.

Other key components of Strix going forward – borne out by the interims – remain its ongoing commitment to cost control and high levels of cash conversion. We presented these qualities in more detail in our 18th July initiation report "*Strix – Steaming Ahead.*" KPI advances in FY2018 H1 included a 6% improvement in productivity and a 16% gain in its ppm (parts per million) process quality measure.

Figure 3 – Financials

	2017	2017	2017	2018	2018	2018
	H1A	H2A	FYA	H1A	H2E	FYE
Revenue (£'000s)	42,216	49,047	91,263	42,868	53,138	96,006
% increase				1.5%	8.3%	5.2%
Cost of sales - pre exceptionals	-26,475	-27,596	-54,071	-26,600	-30,332	-56,932
Cost of sales - exceptional items	-23		-23			
Cost of sales	-26,498	-27,596	-54,094	-26,600	-30,332	-56,932
Gross profit	15,718	21,451	37,169	16,268	22,807	39,075
Gross margin (%)	37.2%	43.7%	40.7%	37.9%	42.9%	40.7%
Distribution costs	-3,168	-2,622	-5,790	-2,775	-3,305	-6,080
Admin expenses - pre exceptionals	-1,490	-1,192	-2,682	-1,721	-1,095	-2,816
Admin expenses - exceptionals	-931	-1,931	-2,862	-2,393	-2,357	-4,750
Other operating income	158	184	342	175	184	359
Operating profit	10,287	15,890	26,177	9,554	16,234	25,788
Operating margin (%)	24.4%	32.4%	28.7%	22.3%	30.6%	26.9%
Analysed as:						
Adjusted EBITDA	14,189	20,928	35,117	14,802	21,915	36,717
Amortisation	-1,437	-1,595	-3,032	-1,220	-1,159	-2,379
Depreciation	-1,511	-1,512	-3,023	-1,635	-2,165	-3,800
Exceptional items	-954	-1,931	-2,885	-2,393	-2,357	-4,750
Operating profit	10,287	15,890	26,177	9,554	16,234	25,788
Net finance costs	-1	-757	-758	-923	-805	-1,728
Pre-tax profit (reported)	10,286	15,133	25,419	8,631	15,429	24,060
Taxation	-207	-580	-787	-378	-630	-1,008
Tax rate (%)	2.0%	3.8%	3.1%	4.4%	4.1%	4.2%
Net income	10,079	14,553	24,632	8,253	14,799	23,052
EPS and DPS in pence per share						
Earnings per share - Basic	n/a		13.0	4.3	7.8	12.1
Earnings per share - Fully diluted	n/a		12.7	4.1	7.5	11.6
Earnings per share - Basic adjusted	n/a		14.5	5.6	9.0	14.6
Earnings per share - Fully diluted Adjusted	n/a		14.2	5.3	8.7	14.0
Dividend per share	1.0	1.9	2.9	2.3	4.7	7.0

Source: Company data and Equity Development estimates

Relative valuation

Strix's yield is a key attraction. Moreover, given the clarity of longer term growth and the relatively conservative nature of the company's finances – good cost control, high cash conversion – the relative P/E ratio looks undemanding.

We can approach fair value for Strix from a number of angles. In our view 200p, which implies more than 20% upside, looks reasonable from four of the key measures, especially in relation to the peer group which we identify below.

At 200p, Strix would trade on a 4.6x EV/sales ratio and 10.3x FY2018 EV/EBITDA. For P/E and dividend yield the values would be 12x and 4.2% respectively. The latter two of these would still represent good value in our view given the clarity of volume growth and the group's underlying financial strengths. Strix reconfirmed that it plans to raise its dividend by 10% to 7.7p in FY2019.

Furthermore, Strix continues to grow well in what classifies as "regulated markets," which tend to be mature. In our view, the ability to grow in these markets, which tend to boast strong currencies, augurs well for both sustainable earnings and valuation.

Figure 4 – Relative Valuation

	Share price	Shares	Market cap	Net debt	EV	Sales 2018	EV/ sales	EBITDA 2018	EV/EBIT DA	EPS 2018	EPS 2019	P/E 2018	P/E 2019	Div 2018	Yield
	(p)	m shares	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(p)	(x)	(x)	(p)	(%)
Discover IE	384.0	73	282	30	312	338	0.9	29.3	10.6	21.9	25.8	17.5	14.9	8.7	2.3
Halma	1398.0	380	5308	196	5504	1076	5.1	252.0	21.8	42.3	46.7	33.0	29.9	14.1	1.0
IMI	1110.0	272	3023	265	3288	1877	1.8	315.0	10.4	69.1	78.7	16.1	14.1	38.9	3.5
Judges Scientific	2720.0	6	169	8	177	75	2.4	12.4	14.3	32.8	137.0	82.9	19.9	28.5	1.0
Oxford Instruments	980.0	57	561	109	670	297	2.3	55.6	12.0	59.0	58.0	16.6	16.9	13.0	1.3
Renishaw	4956.0	73	3603	-52	3552	612	5.8	186.0	19.1	168.0	183.0	29.5	27.1	57.0	1.2
Rotork	331.2	870	2880	13	2893	693	4.2	162.0	17.9	11.9	13.5	27.8	24.5	5.7	1.7
Spirax-Sarco	7205.0	74	5306	373	5679	1138	5.0	299.0	19.0	246.0	258.0	29.3	27.9	98.0	1.4
Strix	167.4	199	333	46	379	96	3.9	36.7	10.3	14.0	15.2	12.0	11.0	7.0	4.2
TT Electronics	253.5	163	413	-46	367	378	1.0	44.7	8.2	13.2	15.7	19.2	16.1	6.1	2.4
Average							3.2		14.4			28.4	20.2		2.0

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