Strix Group Plc

Deleveraging picks up steam

18 September 2024

Today's interim results to June demonstrated strong progress overall, particularly at the margin level. Double digit growth in the regulated and less regulated kettle control markets was encouraging. Furthermore, the restructuring of the Consumer Goods division and the exit from price sensitive kettle control markets also underpinned the rise in margins. Indebtedness declined markedly, reflecting a combination of firm controls in place, positive cash flow and the placing of 5% of the shares during Q2. However, Q3 has proven volatile within the kettle controls market. We have reduced estimates to reflect higher commodity pricing/FX headwinds by c. 6% across FY24 and FY25 and lowered our fair value expectation accordingly to 145p (74% above the current share price).

Good start to the year, but Q3 sees increased volatility

- Progress during H1 was very impressive, as the restructuring within Consumer Goods and the decision to withdraw from some lower cost kettle control markets ahead of the launch of the new low-cost kettle control range in Q3 resulted in an improvement in the overall margin mix. The regulated and less regulated **kettle control markets demonstrated low double-digit growth, the highest level in three years**, following strong performances in the US, UK and the Netherlands.

- Net borrowings reduced to £68.8m (FY23A: £83.7m), resulting in the key banking covenant (net debt/EBITDA) falling to 1.76x, well below the ceiling of 2.75x. The Group remains on track to achieve its goal of a net debt/EBITDA ratio of 1.5x by the end of FY25. The reduction in indebtedness has allowed the Group to consider selective capex projects to boost medium term revenue growth.

- Q3 to date has seen a degree of volatility, relative to the progress made during H1. A minority of OEM customers temporarily closed their manufacturing facilities during August. While some improvement was registered during September, it remains too early to be convinced that the recovery has firmly taken hold notwithstanding the positive H1. A modest delay both in the launch of new products, and distribution agreements in Europe at Billi, has resulted in a tempering of yoy growth expectations to high single digits.

- Higher commodity pricing (copper/silver) and a less favourable translation rate (Australian dollar and the Euro versus sterling), are expected to have a wider impact to revenues and profitability from H2. As such we have revisited our financial expectations for FY24 and FY25, resulting in adj. EPS downgrades of c. 6% for both years. **We have reduced our fair value/share to 145p (from 167p previously), which represents a premium of 74% to the current share price).**

Forecasts

Yr. to Dec, £m	FY22A	FY23A	FY24F	FY25F
Revenue	108.6	144.6	151.0	164.8
Adj. PBT	22.2	21.9	23.7	24.3
Adj. EPS (p)	10.8	9.1	8.8	9.0
DPS (p)	6.0	0.9	1.8	2.7
Net debt	-87.4	-85.7	-67.7	-62.0
EV/EBITDA	8.4	6.8	6.2	6.1
PER	7.7	9.2	9.5	9.3
Yield %	7.2	1.1	2.1	3.2
Net debt/EBITDA	2.2	2.1	1.6	1.5

Source: Company historics, ED estimates

Company Data

EPIC	KETL
Price (last close)	84p
52 weeks Hi/Lo	93p/51p
Market cap	£192.9m
ED Fair Value/share	145p
Net debt (June '24)	£68.8m

Share Price, p

Source: ADVFN

Description

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

Next event: ED investor webinar, 11am, 23 September 2024

David O'Brien (Analyst)
0207 065 2690
david@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

Strong uplift to margins

Interim results			
Period to June, £m	**H1 '23A**	**H1 '24A**	**Yoy change, %**
Kettle controls	28.8	30.5	5.9%
Billi	21.5	21.4	-0.5%
Consumer goods	14.7	14.2	-3.1%
Total revenue	64.9	66.1	1.8%
Cost of sales	-41.0	-39.7	-3.2%
Kettle controls GP	10.7	11.7	8.7%
Prem. Filtration systs. GP	10.0	10.5	5.9%
Consumer goods GP	3.3	4.2	28.5%
Gross profit	23.9	26.4	10.2%
GP %	36.9%	39.9%	8.3%
Distribution costs	-4.9	-5.5	12.9%
Admin. Expenses	-7.3	-8.3	14.4%
Total OpEx	-12.1	-13.8	13.8%
Share of JVs	0.0	0.0	-100.0%
Other op. income	0.1	0.2	43.7%
Adj. EBITDA	15.6	16.7	6.7%
EBITDA %	24.0%	25.2%	4.8%
Adj. EBIT	11.8	12.8	8.2%
EBIT %	18.2%	19.3%	6.4%
Net interest	-5.0	-4.9	-0.9%
Adj. PBT	6.8	7.8	14.9%
Exceptionals	-1.9	-11.7	529.5%
Taxation	-1.1	-1.2	8.2%
Tax %	16.2%	15.3%	-5.8%
Adj. PAT	5.7	6.6	16.2%
Minorities/Discontinued	0.0	-0.2	744.8%
Adj. Earnings	5.7	6.4	12.5%
Adj. EPS (p)	2.7	2.9	7.4%
DPS (p)	0.9	0.0	-100.0%
Net cash/(debt)	-85.7	-70.5	-17.7%

Source: Company

The results for the six months to June demonstrated strong progress with revenues improving modestly overall and an impressive uplift in the gross margin. At constant exchange rates yoy, revenues improved by 3.5% to £67.2m (H1 ‘23A: £64.9m). With c.76.6% of Billi’s revenues reflecting the Australian manufacturing base and LAICA selling mostly within Europe, the translation into sterling cost £1.1m at average exchange rates, with reported revenues rising 1.8% yoy to £66.1m.

Strongest uplift in revenues within Kettle Controls

Kettle Controls delivered the largest yoy improvement, with revenues 5.9% higher at £30.5m, notwithstanding a decline in sales generated within the Chinese market. The changing mix to revenues resulted in a firm uplift in gross margins yoy (+100 bps to 38.2%) as the regulated and less regulated markets delivered top-line growth of 11% yoy. The US, UK and the Netherlands were at the forefront of that growth. Significantly, this represents the first yoy growth in H1 since 2021 (which benefitted from previous COVID-related restrictions). However, we note the challenging trading period in August and discuss this point in greater detail within the financials section.

Meanwhile, the 25.9% decline in revenues within the Chinese market reflected a combination of lower demand and the decision to withdraw from lower margin product areas ahead of the launch of the new low-cost kettle control during Q3. Several OEMs temporarily closed their manufacturing facilities during August.

Billi continues to deliver the highest margins within the Group

Although reported revenues were flat yoy (£21.4m), against a strong comparative, at constant exchange rates Billi saw a 3.5% increase in the top-line. Revenue growth was always expected to accelerate during H2 ’24, reflecting the launch of new product introductions and the push into Europe. Modest delays of the growth drivers temper the FY24 growth outlook to high single digits. Importantly, initial distribution agreements were signed in Q2 with the new product launches now set for Q3.

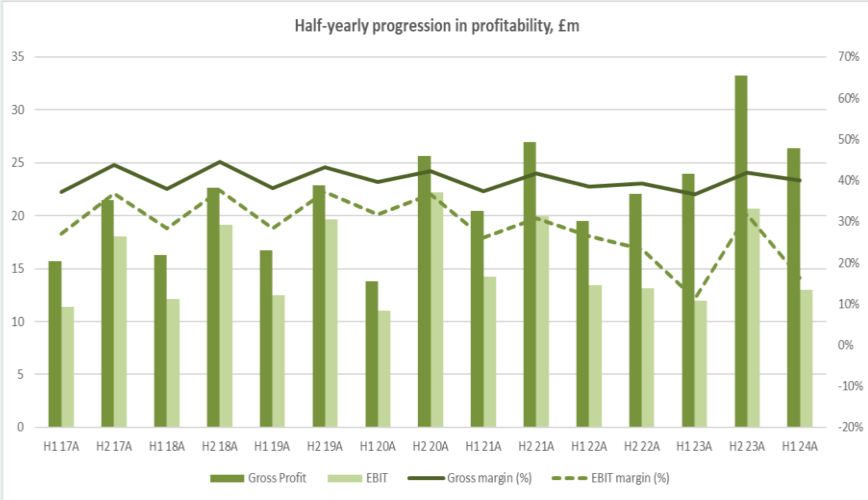
Reported gross margins in H1 improved 300 bps to 49.3%, reflecting an improved product mix and growth within the UK business.

Consumer Goods delivered a modest reduction in revenues

Revenues fell just 1.4% within the **Consumer Goods** division. We think this represents a positive result when one considers the reduction in the number of SKUs, favouring profitable, higher margin product lines. Similarly, a higher proportion of products were sold to OEMs (B2B, where margins tend to be higher), as opposed to online. As a result, gross margins improved 730 bps to 29.5%.

Group margins improved yoy at the gross and EBIT levels. In the case of the former, the margin reached the highest level at the H1 stage post-IPO, aided by the improvement across the board but specifically, Billi. The group-wide improvement fed through at the EBIT level, rising to 16.3% (H1 ‘23A: 11.2%), notwithstanding an increase in OpEx to £13.8m (H1 ‘23A: £12.3m).

Margin progression



Source: Company

Net interest was broadly stable at £4.9m (H1 '23A: £5.0m), resulting in adj. PBT of £7.8m and representing an uplift of 14.9% yoy from £6.8m a year ago. Adj. EPS increased 7% to 2.9p in H1 '24 from a 2.7p a year earlier, with tax rising £0.1m yoy to £1.2m.

In-line with the previously stated strategy, no dividend will be paid during CY24, with the next payment following the FY24 results in mid-CY25.

Adjusting items

The planned re-basing of the business has resulted in a focus on cash generation to accelerate the debt reduction programme. Included within this is a transfer of resources away from less profitable areas to more attractive ones, with an eye on improving the margin mix of revenues.

The Consumer Goods bore much of the pain, with the number of product lines rationalised and headcount reduced. Some manufacturing was relocated to China, from the Isle of Man, thereby improving efficiency levels. The core IP has remained in Ramsey. Also, Halo Pure was deemed non-core, partly reflecting the long decision-making processes involved in awarding contracts and the capex required to support further growth. The focus moving forward remains on smaller scale domestic filtration systems.

Total adjusting items reported during H1 '24 amounted to £13.4m, comprising:

- Restructuring of continuing operations totalled £7.8m, of which the largest segment comprised Consumer goods, at £6.4m
- The proposed disposal of Halo Pure amounts to an adjustment of £2.5m, with completion anticipated during Q4, and
- Settlements relating to IFRS 15 'Revenue from Contracts with Customers', of which the largest item amounted to £2.2m, with the next sizeable item reflecting the property transfer on the LAICA acquisition.

Balance sheet/cash flow

Key highlights within the balance sheet and cash flow during H1 ’24 include:

- Operating cash flow remained at high levels, equating to 115% of EBITDA (H1 ‘23A: 99%)
- Ongoing attention on cash generation resulted in a further reduction in working capital (+£2.8m generated), notwithstanding the improvement in revenues during the period
- Capex declined c. 40% to £3.9m during H1, compared to £6.5m in the comparative period last year. This was planned to enable ongoing investment into attractive, added-value areas, while retaining a close focus on cash outflows
- Gross proceeds of £8.4m raised during H1 from a placing of 5% of the Group’s shares, enabling a reduction in the RCF-related indebtedness
- Net debt declined further to £68.8m (FY23A: £83.7m), reducing the key banking covenant ratio (net debt/EBITDA) to 1.76x, compared to the upper ceiling of 2.75x. **The net debt/EBITDA ratio is currently well below the previously reported target of 2.0x by the end of FY24**
- The banking facility was extended by a year in September to late October 2026. The change should allow for a sensible re-financing process in CY25.

Financials

Forecast changes						
Y/e Dec, £m	**Old FY24F**	**New FY24F**	**Chg. %**	**Old FY25F**	**New FY24F**	**Chg. %**
Adj. PBT	24.3	23.7	-2.3%	25.9	24.3	-6.0%
Adj. EPS (p)	9.4	8.8	-6.4%	9.5	9.0	-5.6%
Net debt	-70.4	-67.7	-3.8%	-60.5	-62.0	2.5%
Net debt/EBITDA	1.7	1.6	-3.6%	1.4	1.5	4.1%

Source: ED estimates

Factors influencing revenue for H2 24 and beyond:

- The launch of the new lower cost **kettle control**, initially in Q3 '24 will enable the Group to re-build its market share of the Chinese and other price competitive markets, while delivering more acceptable margins.
- The launch of the next generation of kettle controls into regulated markets in FY25, following further investment during H2 '24.
- Q3 has proven volatile so far, with August affected by several Chinese clients closing manufacturing plants during the month. A degree of recovery was seen on a month-on-month basis during early September, but the volatility suggests a degree of uncertainty remains as to whether the 11% jump in revenues within added value markets was the start of a trend or a one-off, particularly as we move into the crucial Q4 selling period.
- H1 revenues within Kettle Controls stood at more than 20% below peak pre-COVID, suggesting significant potential upside over the medium term.
- Further uplift in the level of housing transactions, as interest rates reduce further, should benefit Kettle Controls and small kitchen appliances (Consumer Good division).
- Expectations have reduced modestly, from the historic double-digit top-line growth to high single digits for FY24, suggesting that the new product launches should begin to positively impact **Billi's** revenues during H2 '24 and into FY25. The new product lines include a Multi-Function Tap, compatible with existing ranges and the Omni-One under-the-counter unit.
- Billi's push into European markets ramps up from H2 '24 onwards, reflecting new distribution agreements.
- The **Consumer Goods** division has undergone a significant restructuring, resulting in a focus on core areas and added value products and sales channels, plus contract manufacturing for selected clients where Strix owns the IP.

Margin improvement partly offset by commodity/FX headwinds

We have reduced estimates for FY24 and FY25 to reflect the following:

- Positive H1 margin progress, offset by
- Forex headwinds, as the Australian dollar and the euro have depreciated against major currencies, including sterling.
- Commodity pricing continuing at higher levels, with copper and silver.

With most of the manufacturing of Billi and LAICA based in Australia and Europe respectively, the appreciation of sterling relative to the two currencies has been an issue all year, reflected in the £1.1m H1 revenue shortfall using average exchange rates compared to constant rates. Similarly, copper and silver are key commodities utilised within the production of kettle controls/small appliances and while the Group has historically reduced their levels within each control/appliance, further improvements in this regard generally takes time as opposed to a short-term fix. The Group forward commits and buys commodities ahead, which has pushed out the related pressure on margins to Q4.

We expect gross margins to remain at relatively high levels for the duration of our financial estimates but reduce modestly for the FY (compared to 39.9% in H1) and further in FY25, reflecting the FX/commodity pressures and the introduction of the new low-cost kettle controls and selective contract manufacturing.

Relative to previous adj. EPS expectations, we have reduced estimates for FY24 and FY25 by 6.4% and 5.6%, respectively. We continue to expect net debt to fall, aided by a lower working capital requirement than initially anticipated and offsetting the reduction in profitability in FY24. In FY25 we maintain our view that the net debt/EBITDA ratio will reduce to c.1.5x by the period end.

Commodity pricing remaining higher for longer (copper and silver)

Source: Yahoo Finance

Appreciation of sterling vs the Australian $ and the €, YTD

Source: Yahoo Finance

Summary Profit & Loss					
Year to Dec, £m	**2021A**	**2022A**	**2023A**	**2024F**	**2025F**
Kettle controls	85.1	68.2	70.1	74.0	78.8
Prem. Filtratn. Systems		3.2	42.1	45.6	50.2
Consumer Goods	34.3	37.1	32.4	31.4	35.9
Revenue	119.4	108.6	144.6	151.0	164.8
CoGS	-72.0	-67.1	-87.4	-94.5	-106.0
Gross profit	47.4	41.5	57.2	56.5	58.9
Gross margin (%)	39.7%	38.2%	39.6%	37.4%	35.7%
Op costs	-14.3	-16.4	-25.6	-24.8	-28.0
Other Op. income	0.6	0.8	0.4	0.4	0.4
Operating profit	33.7	25.9	32.1	32.1	31.3
Op margin (%)	28.2%	23.8%	22.2%	21.2%	19.0%
Net Interest	-1.4	-3.7	-10.2	-8.4	-7.0
Associates	-0.1	0.0	0.1	0.0	0.0
PBT (Adjusted)	32.2	22.2	21.9	23.7	24.3
Exceptionals	-10.7	-5.9	-4.2	-11.7	0.0
PBT (Reported)	21.5	16.2	17.8	12.0	24.3
Tax	-0.9	0.8	-1.5	-3.1	-3.2
Adj. PAT	31.4	23.0	20.4	20.6	21.2
Minority interests	0.0	-0.1	0.0	0.0	0.0
Adj. Earnings	31.3	22.9	20.1	20.6	21.2
Reported PAT	20.6	17.0	16.2	8.9	21.2
Ordinary Dividends	-17.3	-13.1	-2.0	-4.0	-6.4
EPS (Adjusted) (p)	14.9	10.8	9.1	8.8	9.0
DPS (p)	8.4	6.0	0.9	1.8	2.7
Ave no of shares (FD) (m)	209.7	212.5	221.3	230.2	235.2

Source: Company historics, Equity Development estimates

Summary Cash Flow					
Year to Dec, £m	**2021A**	**2022A**	**2023A**	**2024F**	**2025F**
Operating profit	33.7	25.9	32.1	32.1	31.3
Depn. & Amortn.	6.9	6.3	8.7	9.4	10.3
Working capital movement	-11.4	-2.6	2.3	-2.5	-3.4
Other	-4.9	-6.3	-0.1	-4.0	-1.2
Operating cash flow	24.2	23.2	43.1	35.0	37.0
Net Interest	-2.7	-3.2	-8.9	-8.4	-7.0
Taxation	-1.9	-1.2	-1.3	-2.3	-3.1
Net capex	-15.4	-8.6	-8.0	-12.0	-15.0
Operating FCF	4.2	10.3	24.9	12.3	11.9
Net (Acquisitions)/Disposals	-1.6	-39.3	-6.5	0.0	0.0
Dividends	-16.5	-17.3	-9.1	0.0	-6.1
Share Issues	0.0	10.7	-0.2	8.1	0.0
Minority payment	-0.3	0.0	0.0	0.0	0.0
Other financial	0.2	-0.6	-7.5	-2.5	0.0
Increase Cash/(Debt)	-14.0	-36.2	1.7	18.0	5.7
Opening Net Cash/(Debt)	-37.2	-51.2	-87.4	-85.7	-67.7
Closing Net Cash/(Debt)	-51.2	-87.4	-85.7	-67.7	-62.0

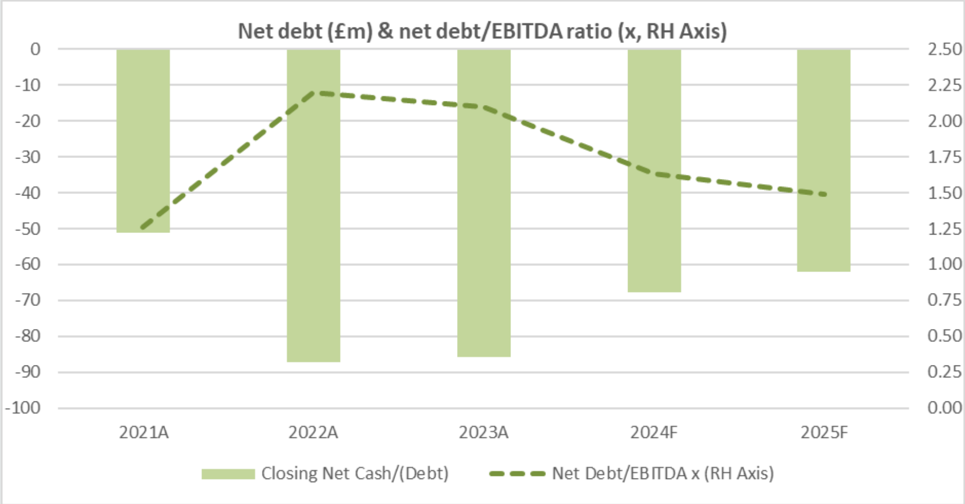
Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet					
Year to Dec, £m	**2021A**	**2022A**	**2023A**	**2024F**	**2025F**
Intangible Assets	30.5	73.4	73.4	75.2	71.4
Tangible Assets	39.5	43.7	46.2	52.3	60.8
Investments/other	3.3	3.7	1.0	1.0	1.0
Net Working Capital	11.2	19.0	22.9	25.4	28.8
Capital Employed	84.4	139.8	143.5	153.8	162.0
Other	-2.6	-2.8	-3.6	-3.6	-3.6
Net Cash/(Debt)	-51.2	-87.4	-85.7	-67.7	-62.0
Provisions Liabilities/Charges	-4.7	-12.3	-11.2	-11.2	-11.2
Net Assets	26.0	37.2	43.0	71.4	85.2

Source: Company historics, Equity Development estimates

At the period end net debt stood at £68.8m, excluding right of use lease liabilities of £4.5m and accrued interest of £2m. This figure compares to net debt of £83.7m at the FY23 year end. Notwithstanding the reduction in financial estimates, **we expect FY24 year end net debt to continue to decline, highlighting the Board's focus on costs and cash generation**, to c. £67.7m and to £62m by the end of FY25. The slowing trajectory in debt reduction reflects investment in revenue growth as capex returns to FY21 levels by FY25.

Net debt and the expected progression of the key banking covenant



Source: Company historics, ED estimates

Valuation

Fair value reduces in line with estimates but remains ahead of the share price

We utilise discounted cash flow and peer group comparison models to underpin our fair value / share for Strix Group. We note the news within the interim results statement of the trading volatility during Q3 and headwinds due to higher commodity prices and a weakening of key currencies, suggesting lowered guidance.

DCF

Our DCF valuation model is underpinned by conservative assumptions in our opinion, including a discount rate of 8.75% (equating to the Group's longer term WACC) and a terminal growth rate of 2.25% (broadly equating to CPI). **The resulting fair value / share equates to 130p.**

Strix Group DCF calculation

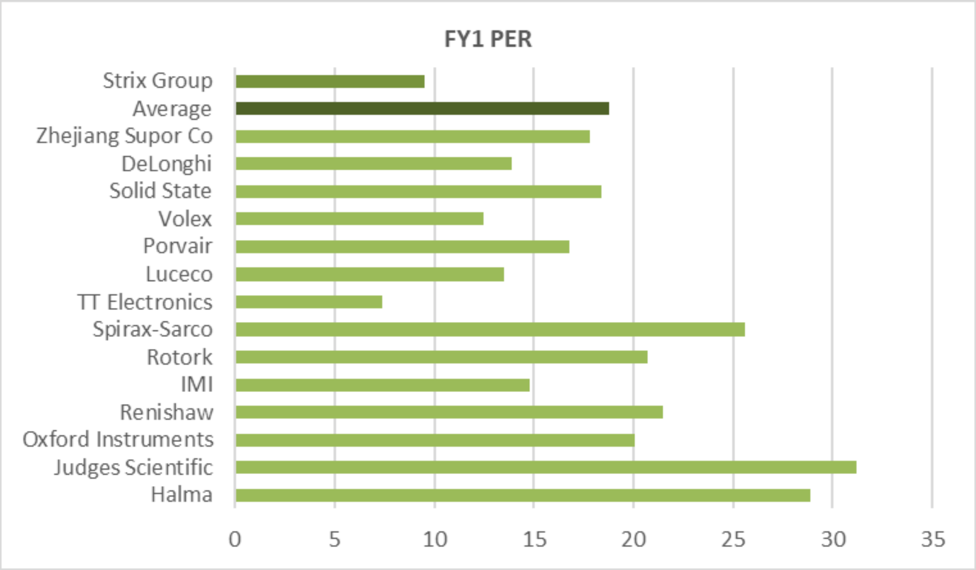
£m, year to Dec	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F
Free cash flow	20.7	18.8	24.1	24.6	25.2	25.7	26.3	26.9	27.5	28.1
WACC (%)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Timing factor	0.25	1.25	2.25	3.25	4.25	5.25	6.25	7.25	8.25	9.25
Discount rate	0.98	0.90	0.83	0.76	0.70	0.64	0.59	0.54	0.50	0.46
Present value	20.3	17.0	19.9	18.7	17.6	16.6	15.6	14.6	13.8	12.9
Sum of discounted cash flows	167.0									
Terminal growth rate (%)	2.25									
Terminal value	199.2									
Net debt	-67.7									
Equity value	298.6									
No. of shares (m)	229.9									
Value per share (p)	129.9									

Source: Equity Development

Peer group comparison models

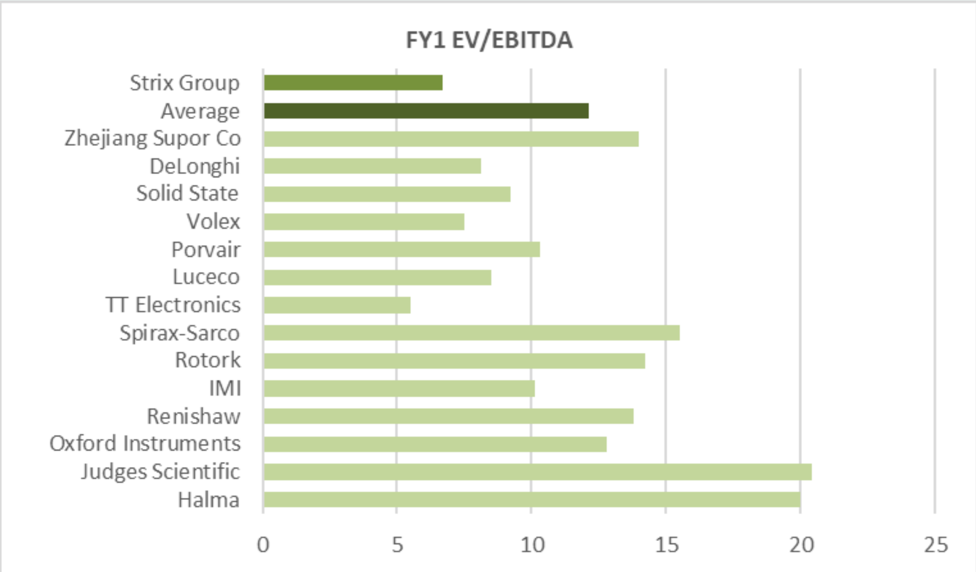
The peer group comparison models focus on year one forecast estimates (FY1), and cover PER, EV/EBITDA and dividend yield. We have conservatively applied a 10% size related discount to Strix's valuation outcome compared to its peers to calculate fair value. Our valuation models demonstrate that Strix continues to trade at a marked discount to that of its peers, while delivering an above average sector yield.

Peer group comparison: FY1 PER (x)



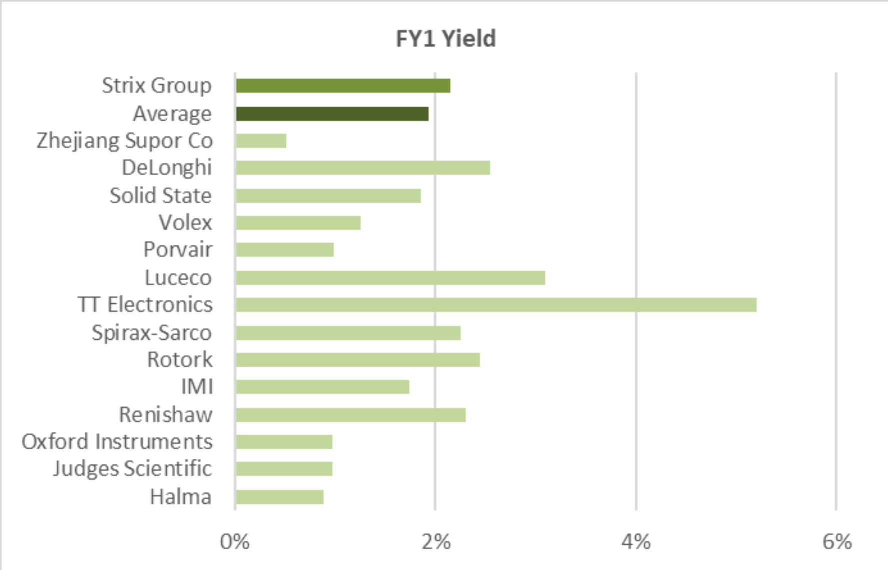
Source: Koyfin

Peer group comparison: FY1 EV/EBITDA (x)



Source: Koyfin

Peer group comparison: FY1 Yield (%)



Source: Koyfin

Fair value

The following table demonstrates the fair value / share derived from each of our valuation models, suggesting an average of 145p. We have excluded the EV/Sales and Price/Book valuation outliers from the calculation, which has resulted in a decline from the fair value / share of 167p previously. **Nevertheless, our updated fair value / share represents a significant improvement on the current share price of 83.5p.**

Fair value

	FY24 fair value	FY25 Fair value
DCF	130	130
PER (x)	149	138
EV/EBITDA (x)	171	151
Average	149.9	139.4

Source: ED

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Disclaimer

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London EC2M 7EB

Contact: info@equitydevelopment.co.uk | 020 7065 2690