

Ups and downs, but H2 set fair

21 July 2022

Price increases, new product launches, implementation of additional efficiency measures, and an easing of COVID-19 related restrictions all underpin our expectation of a much stronger H2 for Strix Group. As such, we are leaving adj. EPS unchanged for FY22 despite macro and Russia-related headwinds during H1. We estimate a broadly unchanged outcome with adj. PAT and EPS declining modestly by an average of 0.9% to £32.1m and 15.3p, respectively for FY22.

Update points to stronger H2

A further price increase in the **Kettle Controls** and **Water** categories was implemented at the start of May, which augurs well for H2. Cost reduction measures began earlier in the year, including an increase in the level of automated processes, an insourcing of components within the Water category, and greater use of hedging (forex and commodities). We expect more of such measures in H2.

Service levels remained high during COVID-19 related lockdowns in China, as the Group resorted to storing finished product across a wider regional base, ensuring a continuity of supply and in turn, maintaining its 56% global market share. We anticipate the uplift in consumer spending within China following the lifting of restrictions will benefit the Group during H2.

In FY22 the group is facing challenges which include commodity price inflation, freight costs, supply chain disruption and increases in marketing and employee costs. We previously factored in a £3m hit to the top-line reflecting economic sanctions against Russia. While the Group does not distribute in the country, its Chinese OEMs do. The impact appears more severe than initially believed. With premium brands no longer supplying into Russia, the demand has shifted in favour of lower cost controls. Also, revenues from countries on the periphery of the state have stalled. The overall impact potentially rises by a further £4m to up to £7m in total. As such, we estimated that in H1 revenues declined y-o-y within Kettle Controls.

The **Appliances** category launched several products to critical acclaim from mid-2021, short-listed for design, sustainability, and Quiet Mark awards, including the Aurora, Aroura Hot, Aurora Chilled, Dual Flo (one-cup kettle) and Visione (induction kettle). Typically, the products take up to three years to achieve mature levels, albeit to date online sales have been very encouraging. Further launches are currently in the pipeline, targeting additional product areas.

The **Water** category benefitted from new product launches, an extension of the product range across the UK and Europe and the signing of additional distributors in important markets (Europe, China, US, and Canada). Online sales of Aqua Optima and LAICA expanded to include multiple retailers (Amazon, eBay, OnBuy and in-store at B&Q).

Looking ahead and clear undervaluation

We continue to believe that the target of doubling revenues in the five years to FY25 remains on course. Strix also continues to seek the purchase of either complementary technologies or companies, aided by its strong balance sheet.

We expect the stronger H2 bias in trading to result in only a modest adjustment to our fair value to 275p (previously 284p) because of the measures undertaken. This is despite tweaking our estimates to reflect the larger than anticipated reduction in revenues associated with Russia and peripheral states.

Our fair value/share at 275p continues to be at a significant premium (nearly 50%) to the current price.

Company Data

| EPIC | KETL |
|-----------------------|-----------|
| Price (last close) | 184p |
| 52 weeks Hi/Lo | 390p/157p |
| Market cap £m | £379.5m |
| ED Fair Value / share | 275p |
| Net debt (Dec '21) | £51.2m |

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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Financials

We have adjusted our expectations modestly for FY22 and FY23, albeit we consider that the strong bias towards H2 trading in the current year is likely to result in a PAT outcome at the consensus level of £32.2m. Our anticipation is that the headwinds are offset by a combination of price increases, efficiency measures, and a lifting of previous COVID-19 related measures to increase the traditional H2 bias in trading.

| Estimate changes | | | | | | |
|------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| £m | Old FY22E | New FY22E | Change, % | Old FY23E | New FY23E | Change, % |
| Revenue | 129.9 | 126.0 | -3.0% | 143.9 | 142.7 | -0.8% |
| Adj. PBT | 33.0 | 32.7 | -0.9% | 35.0 | 35.0 | 0.0% |
| Adj. PAT | 32.4 | 32.1 | -1.0% | 33.9 | 33.9 | 0.0% |
| Adj. EPS (p) | 15.4 | 15.3 | -0.8% | 16.2 | 16.2 | 0.0% |
| DPS (p) | 8.50 | 8.50 | 0.0% | 8.75 | 8.75 | 0.0% |
| Net debt | 56.5 | 56.0 | -0.9% | 49.4 | 49.0 | -0.9% |

Source: Equity Development

| Summary Profit & Loss | | | | | |
|---------------------------|-------|-------|--------|--------|--------|
| Year to Dec, £m | 2019A | 2020A | 2021A | 2022F | 2023F |
| Kettle controls | 85.8 | 79.8 | 85.1 | 79.1 | 83.8 |
| Water products | 9.8 | 11.7 | 21.4 | 29.2 | 35.5 |
| Appliances | 1.2 | 3.7 | 12.9 | 17.8 | 23.4 |
| Revenue | 96.88 | 95.31 | 119.41 | 126.02 | 142.67 |
| CoGS | -57.3 | -55.9 | -72.0 | -79.2 | -90.8 |
| Gross profit | 39.6 | 39.4 | 47.4 | 46.9 | 51.9 |
| Gross margin (%) | 40.9% | 41.4% | 39.7% | 37.2% | 36.4% |
| Op costs | 8.7 | 8.5 | 14.3 | 14.2 | 15.9 |
| Other Op. income | 0.6 | 1.1 | 0.6 | 1.4 | 1.2 |
| Operating profit | 31.5 | 32.0 | 33.7 | 34.0 | 37.2 |
| Op margin (%) | 32.5% | 33.6% | 28.2% | 27.0% | 26.1% |
| Net Interest | -1.3 | -1.2 | -1.4 | -1.4 | -2.3 |
| Associates | 0.0 | 0.1 | -0.1 | 0.1 | 0.1 |
| PBT (Adjusted) | 30.2 | 30.9 | 32.2 | 32.7 | 35.0 |
| Exceptionals | -7.3 | -5.5 | -10.7 | 0.0 | 0.0 |
| PBT (Reported) | 22.9 | 25.5 | 21.5 | 32.8 | 35.1 |
| Tax | -1.3 | -1.4 | -0.9 | -0.6 | -1.0 |
| Adj. PAT | 28.9 | 29.5 | 31.4 | 32.1 | 33.9 |
| Minority interests | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Adj. Earnings | 28.9 | 29.5 | 31.3 | 32.0 | 33.9 |
| Reported PAT | 21.5 | 24.0 | 20.6 | 32.0 | 33.9 |
| Ordinary Dividends | -14.7 | -16.0 | -17.3 | -17.6 | -18.1 |
| EPS (Adjusted) (p) | 14.2 | 14.3 | 14.9 | 15.3 | 16.2 |
| DPS (p) | 7.7 | 7.9 | 8.4 | 8.5 | 8.8 |
| Ave no of shares (FD) (m) | 202.8 | 206.4 | 209.7 | 209.7 | 209.7 |

Source: Company historics, Equity Development estimates

Summary Cash Flow

| Year to Dec, £m | 2019A | 2020A | 2021A | 2022F | 2023F |
|------------------------------|-------|-------|-------|-------|-------|
| Operating profit | 31.5 | 32.1 | 33.7 | 34.1 | 37.3 |
| Depn. & Amortn. | 5.5 | 6.0 | 6.9 | 7.9 | 8.7 |
| Working capital movement | -0.4 | -1.6 | -11.4 | -7.8 | 1.7 |
| Other | -3.1 | -1.2 | -4.9 | -3.5 | -3.3 |
| Operating cash flow | 33.6 | 35.2 | 24.2 | 30.8 | 44.4 |
| Net Interest | -1.3 | -3.4 | -2.7 | -1.4 | -2.3 |
| Taxation | -1.0 | -0.9 | -1.9 | -2.0 | -3.0 |
| Net capex | -14.9 | -17.4 | -15.4 | -9.3 | -8.8 |
| Operating FCF | 16.4 | 13.5 | 4.2 | 18.0 | 30.3 |
| Net (Acquisitions)/Disposals | -1.5 | -6.7 | -1.6 | -5.5 | -5.5 |
| Dividends | -13.9 | -15.3 | -16.5 | -17.4 | -17.7 |
| Share Issues | 0.0 | 3.8 | 0.0 | 0.0 | 0.0 |
| Minority payment | 0.0 | -0.1 | -0.3 | 0.0 | 0.0 |
| Other financial | 0.1 | -6.0 | 0.2 | 0.0 | 0.0 |
| Increase Cash/(Debt) | 1.1 | -10.9 | -14.0 | -4.8 | 7.0 |
| Opening Net Cash/(Debt) | -27.5 | -26.3 | -37.2 | -51.2 | -56.0 |
| Closing Net Cash/(Debt) | -26.3 | -37.2 | -51.2 | -56.0 | -49.0 |

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

| Year to Dec, £m | 2019A | 2020A | 2021A | 2022F | 2023F |
|--------------------------------|-------|-------|-------|-------|-------|
| Intangible Assets | 7.1 | 29.6 | 27.3 | 25.4 | 23.3 |
| Tangible Assets | 25.5 | 37.2 | 49.8 | 52.4 | 54.3 |
| Investments/other | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 |
| Net Working Capital | -2.4 | 4.4 | 15.9 | 23.7 | 21.9 |
| Capital Employed | 30.2 | 71.4 | 93.1 | 101.6 | 99.6 |
| Other | -3.0 | -2.8 | -2.1 | -2.0 | -1.9 |
| Net Cash/(Debt) | -26.3 | -37.2 | -51.2 | -56.0 | -49.0 |
| Provisions Liabilities/Charges | 0.0 | -9.3 | -9.3 | -8.5 | -8.0 |
| Net Assets | 0.9 | 22.0 | 30.5 | 35.1 | 40.7 |

Source: Company historics, Equity Development estimates

Valuation

DCF

We have constructed a discounted cash flow model for Strix, using what we believe are conservative assumptions: a discount rate of 8.25%, a terminal growth rate of 2.5% and capex ahead of depreciation throughout (to drive revenue growth). This model suggests a **value / share of 292p**, 59% above the current share price.

Strix Group DCF calculation

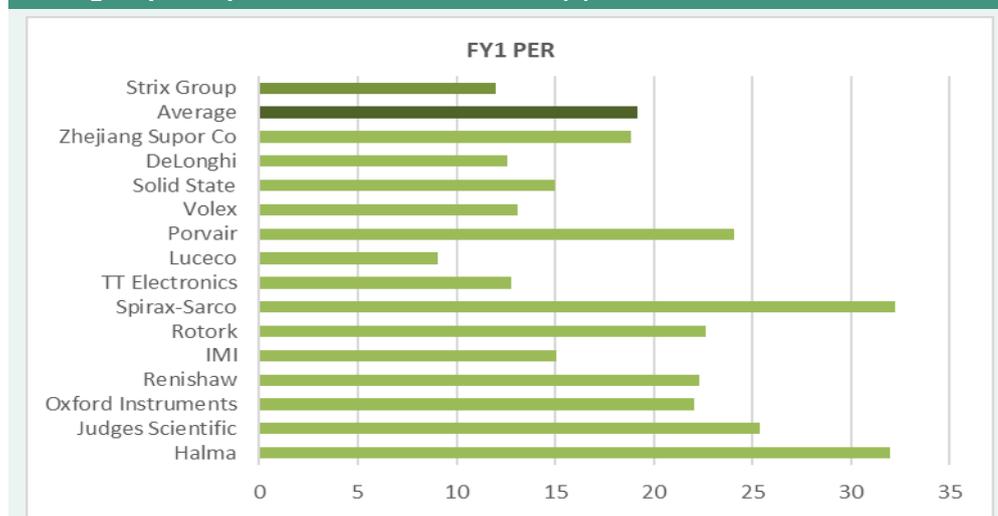
| | 2022F | 2023F | 2024F | 2025F | 2026F | 2027F | 2028F | 2029F | 2030F | 2031F |
|------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Free cash flow | 17.6 | 30.4 | 35.5 | 40.9 | 42.0 | 43.0 | 44.1 | 45.2 | 46.3 | 47.5 |
| WACC (%) | 8.25 | 8.25 | 8.25 | 8.25 | 8.25 | 8.25 | 8.25 | 8.25 | 8.25 | 8.25 |
| 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 | 0.91 | 0.84 | 0.77 | 0.71 | 0.66 | 0.61 | 0.56 | 0.52 | 0.48 |
| Present value | 17.2 | 27.6 | 29.7 | 31.6 | 30.0 | 28.4 | 26.9 | 25.4 | 24.1 | 22.8 |
| Sum of discounted cash flows | 263.7 | | | | | | | | | |
| Terminal growth rate (%) | 2.50 | | | | | | | | | |
| Terminal value | 396.7 | | | | | | | | | |
| Net debt | -56.0 | | | | | | | | | |
| Equity value | 604.4 | | | | | | | | | |
| No. of shares (m) | 206.7 | | | | | | | | | |
| Value per share | 292.4 | | | | | | | | | |

Source: Equity Development

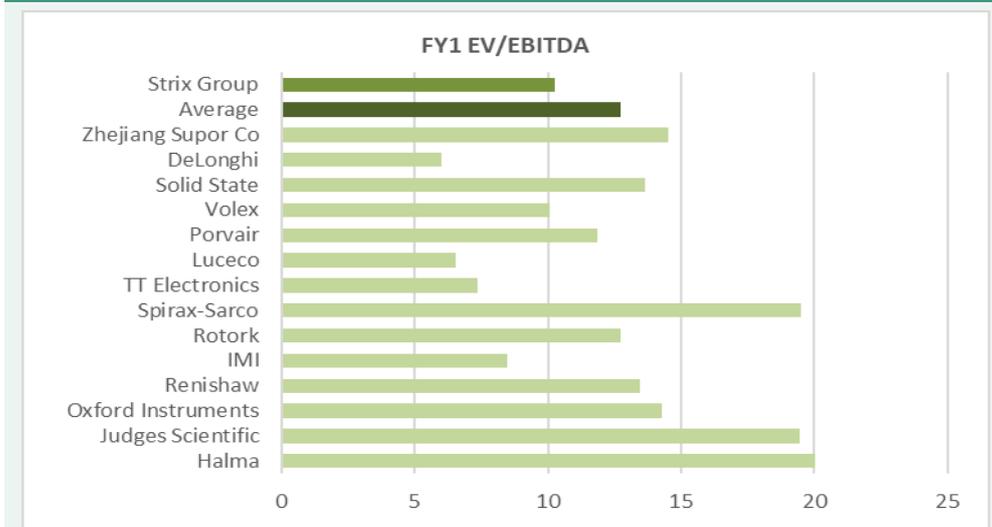
Peer comparison

We can see from the charts below that Strix is trading at ratings materially below the average of its peer group, while demonstrating a higher yield. On a FY1 PER basis, the discount to the average of its peer group amounts to 37.2% (12.0x versus 19.1x), while on a FY1 EV/BITDA basis the gap amounts to 19.5% (10.2x compared to 12.7x). Conversely, Strix's anticipated FY1 yield of 3.4% stands at a 34% premium to the 2.6% average of its peers.

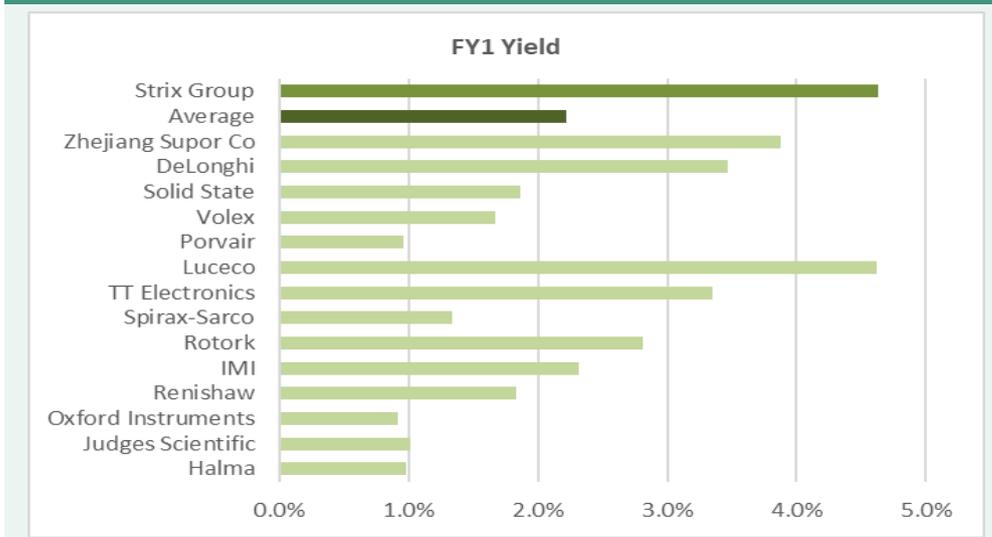
Peer group comparison model – FY1 PER (x)



Source: Market Screener

Peer group comparison model – FY1 EV/EBITDA (x)


Source; Market Screener

Peer group comparison model – FY1 Yield %


Source; Market Screener

Conclusion

We have combined the discount to its peers on an FY1 PER and FY1 EV/EBITDA basis with our DCF model to determine an averaged Fair Value / share of the Group in the table below, namely **275p**.

Fair value / share

| Methodology | Current fair value |
|----------------|--------------------|
| DCF | 292p |
| PER | 294p |
| EV/EBITDA | 240p |
| Average | 275p |

Source: ED



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