

Steaming ahead

18 July 2018

A combination of steady top line expansion, operating margins fully supported by technological excellence and unique product experience, all support the case for Strix – the world’s largest supplier of kettle controls – consistently to deliver profit growth to shareholders. Despite strong cash conversion, a circa 38% global market share and high growth visibility, valuation looks undemanding.

Strix kettle safety controls should deliver steady sales growth for some time in our view. With a clearly articulated market structure, broken down into Regulated, Less Regulated and China, the company demonstrates an ability to perform well at the premium, arguably most demanding, end of the spectrum. Its market share in Regulated markets is an impressive 61%, bolstered by a commitment to technological excellence. Kettle safety controls represent around 90% of Strix’s sales revenue.

Strix’s latest trading update, which refers to the first half of 2018, was released today. The company confirms that it is on-track to meet current market expectations with very strong cash conversion likely to be achieved. Key revenue growth highlights included North America and the success of the company’s U9 series of controls. Among new products Aqua Optima performed well and achieved c.20% market share. The company continues to protect its IP rigorously. Strix cited a successful infringement claim in China and that it effected removal of a number of webpages from Amazon’s European platform.

Kettle safety controls as a category should continue to grow. There are a number of important markets where their current level of penetration appears ripe for improvement. In addition, the proven health benefits of tea and other infusions should benefit underlying demand for Strix’s key customers’ products – i.e. the Original Equipment Manufacturers’ kettles.

Moreover, while kettles and tea might be considered in some markets to be staple pieces of kitchen equipment and arguably unglamorous, investors should not ignore their massive scope to become more relevant. In particular, penetration rates in a number of large economies – notably the USA – are relatively low. Furthermore, the tea category is itself primed to grow, benefiting from both new flavours and raised health awareness.

Strix’s tightly controlled but internationally experienced management team operates within 3 strategic pillars – Build and maintain market share, Focus on safety and Explore new technologies. The team appears to be delivering against all three. Moreover, there is clear scope to expand market share from its current c.19% in Less Regulated markets. Further ahead, growth outside kettles should be increasingly exciting.

Strix’s commanding market share, associated high margins, and strong cash conversion - around 100% (based on free cash flow and net income) in 2017 - might be expected to prompt premium EV/EBITDA & P/E ratios. However, relative to our selected precision engineering cohort, the shares trade below the sector average.

Based on our forecasts the 2019 P/E ratio is just 11x. As investors become more aware of the group’s strengths and growth, it would be logical for that rating to increase accordingly.

Company Data

| EPIC | AIM:KETL |
|--------------------|------------------|
| Price (last close) | 168p |
| 52 week Hi/Lo | 169p /125p |
| Market cap | £334m |
| Next event | Interims 19 Sept |

Share Price, p



Source: ADVFN

Description

Strix is a global leader in the design, manufacture and supply of kettle safety controls and other components as well as devices involving water heating and temperature control, steam management and water filtration.

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Investment Case

Strix should enjoy steady top line expansion. The company demonstrates product superiority and integrity in what appears a growth market. Strix’s leading c.38% global market share tends to confirm product superiority while we identify ample scope for the market to grow.

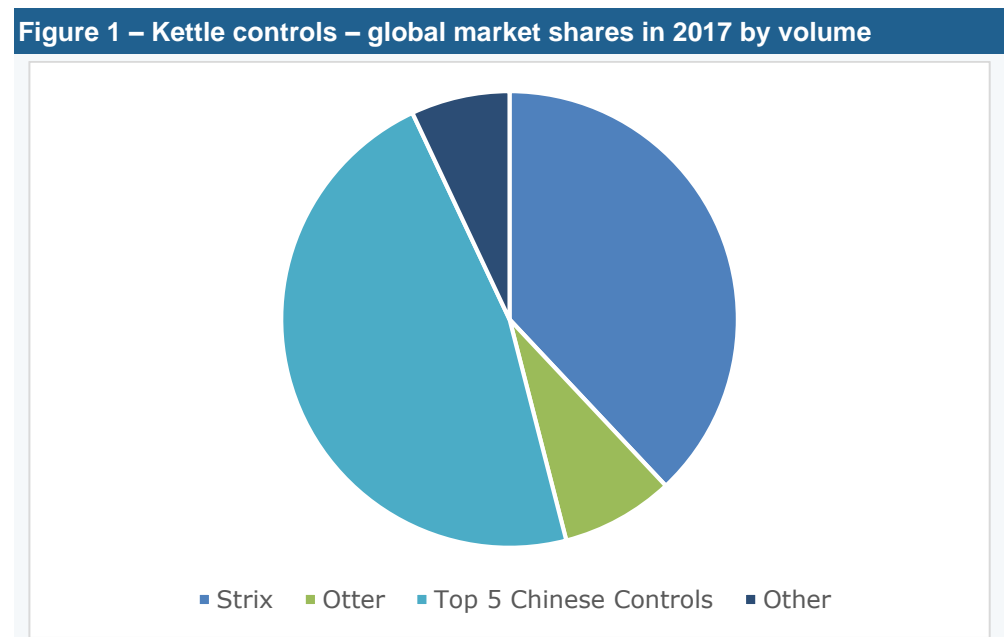
Strix’s high global market share reflects its c.61% share in the more premium, Regulated markets, c.19% share of Less Regulated markets and a c.50% share in China. We see significant scope for share to grow in Less Regulated while Regulated includes the United States, where kettle demand could well grow exponentially.

Strix is run by a compact, experienced and internationally oriented management team. Moreover, group strategy is well articulated into three distinct pillars: build and maintain market share, focus on safety and explore new technologies.

Strix enjoys close relationships with its Original Equipment Manufacturers and their associated international brands, aided by its administrative presence in Hong Kong and its manufacturing base in Guangzhou, China. In addition to proximity, these relationships tend to be supported by a combination of longevity in the market and technological excellence.

New product development should be an important feature of Strix’s growth looking forward. In addition to key innovations within kettle safety controls – for example, the U9 – the company looks to expand into other areas: single serve hot water, infant related products and pure water.

Strix’s key financials point to a smartly managed company. While its operating margins are consistent with a high market share and strong barriers to entry, the company clearly operates with tight cost controls. In addition, it converts the bulk of its profits into cash. In 2017, net free cash flow before dividends and adjusted net income were £27.4m and £27.5m respectively.



Source: Company

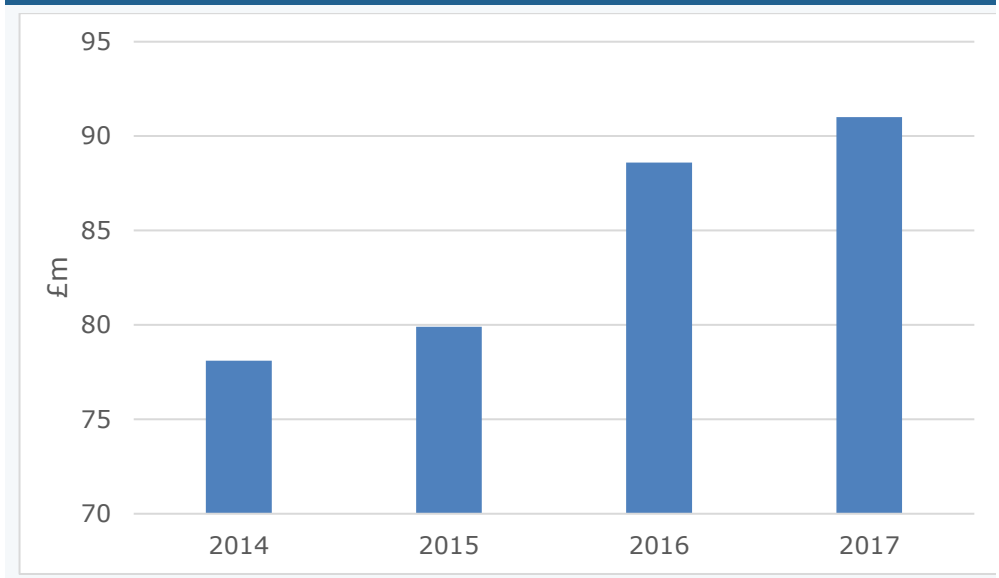
Steaming ahead

Overview

Isle of Man and Hong Kong based Strix, established in its current form in 1982, is the world’s leading supplier of safety controls for the electric kettle industry. It boasts a c.38% global market share of its main, 182 million sets a year in 2017, market and has enjoyed consistent, robust growth. The company’s excellent commercial and financial performance reflects a strong management team that is committed both to product quality and best-in-class client service. Equity Development initiates coverage with this report.

Strix manufactures in both the Isle of Man and China. Its core product is the safety device which prevents kettles’ elements from overheating either when empty or when the boiling process has commenced – i.e. the devices cause kettles automatically to cut off electricity supply. Other activities include chilled water and services related to infant formula.

Figure 2: Strix - Group Sales Revenue 2014 to 2017



Source: Company

Strix’s lengthy heritage is as a provider of safety products. Its origins date back to 1951 when the company from which Strix evolved became a provider of heating devices for servicemen in the British Royal Air Force who, as a result of high altitude flying, required their flying suits to be heated, although with a strong commitment to safety. Strix as it stands today was founded in 1982.

Strix’s business strategy focuses on three pillars. These are to build and maintain market share, focus on safety, and explore new technologies. Its ability to implement these pillars and grow reflects a robust core business, scope for category growth, product excellence and the potential to develop new products. This report examines each of these in turn.

Having covered these, we then assess senior management and group strategy, valuation and include additional comment on our financial forecasts. In summary, we believe Strix to be a well-managed business with a high quality product portfolio and scope to grow.

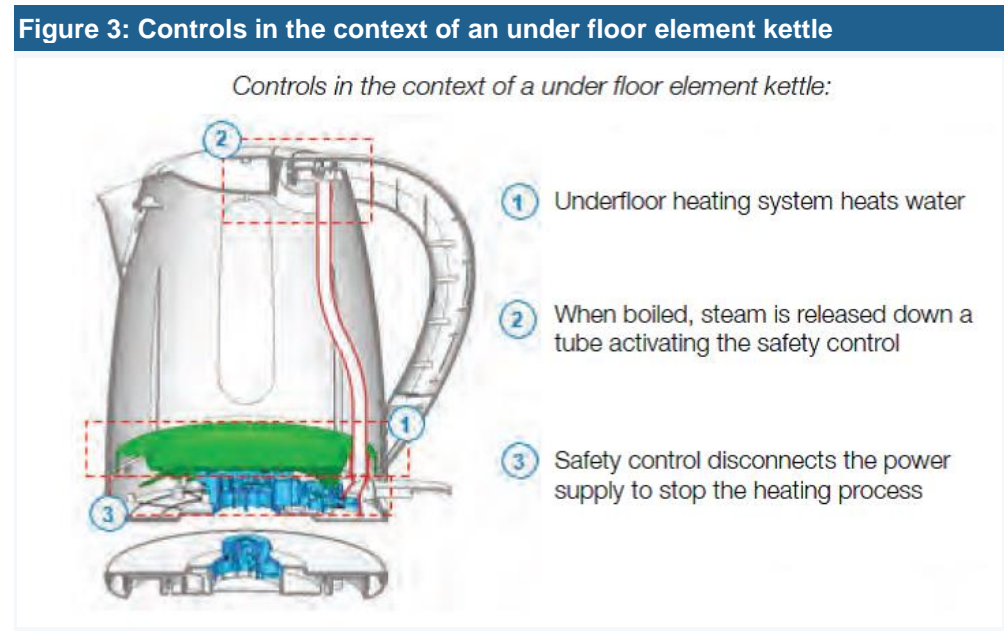
A robust core business

Core product overview

Strix’s core product – around 90% of sales revenue - is kettle safety controls where it is, as mentioned in our overview, global leader in their design, manufacture and supply. These and other products are summarised below:

- Kettle safety controls and other components
- Devices involving water heating and temperature control
- Devices involving steam management
- Devices involving water filtration

Electric kettles tend either to use an immersion or an underfloor mechanism to heat water. Traditional immersion techniques, which relied on an in-kettle electric element to generate heat, have largely made way for underfloor heating systems. The primary purpose of Strix’s controls is to disconnect power to the heating element once the water has boiled. In 2017, the company sold 74 million such control devices. A summary of where Strix’s technology appears in a typical underfloor kettle is given in Figure 3:



Company AIM Admission Document

In Figure 3 Strix identifies three key controls which are as follows:-

- 1 – Underfloor heating system heats water.
- 2 – When boiled, steam is released down a tube which activates the safety control.
- 3 – Safety control disconnects the power supply to stop the heating process.

Within the blue, green and grey colour coding of the kettle in Figure 3, Strix performs three functions. In the case of the blue shading, Strix designs, manufactures and supplies the control and connector.

With the green area, the company provides designs for suppliers to produce elements compatible with the Strix system. The grey area refers to Strix’s ability to provide appliance design support throughout the value chain.

In our view, the breakdown of these three functions is important. It tends to confirm Strix’s ability to operate not only as a high precision parts designer and manufacturer, but also to work compatibly with manufacturers of kettles – i.e. the original equipment managers (OEMs) - which supply the brand manufacturers which are the end-consumer facing businesses.

Moreover, the proprietary nature of these relationships partly explains the company’s high global market share in kettle safety controls as well as underpinning it.

Manufacturing locations

Strix manufactures in both the Isle of Man, where it has a factory in Ramsey (on the opposite side of the island from its headquarters), and in Guangzhou in China, where it has operated since 1997. The Hong Kong sales office was opened in 1989 – i.e. ahead of any local manufacturing - which reflects the importance of Chinese manufacturers when dealing with OEMS.

The Ramsey site, which was showcased as part of an investor site visit on 18th June 2018, is a high precision 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 Guangzhou.

Guangzhou has four technology areas: precision moulding, high speed pressing, final assembly and test of kettle controls, and water filtration production. These components of group manufacturing and the administrative and sales functions are summarised in Figure 4.

Figure 4 – Strix Operations by Geographic Location and Function

| | | |
|-----------------------|------------|-------------------------------------|
| Isle of Man | Ronaldsway | Group Head Office, NPD |
| Isle of Man | Ramsey | Precision component manufacturing |
| United Kingdom | Chester | Sales and marketing |
| China | Guangzhou | Finished product manufacturing |
| Hong Kong | Hong Kong | Administration, sales and marketing |

Source: Company

Looking ahead, Guangzhou should be the prime group focus for changes in manufacturing. It is the group’s largest manufacturing operation by far and employs around 800 staff. These employees operate a combination of manual and semi-automated lines.

As Chinese labour costs begin to creep up, we expect that more automation will be implemented. Such automation should lead both to better consistency in terms of product quality as well as cost efficiencies. Moreover, efficiency gains would probably enhance the company’s ability to broaden its end-market away from those countries which comprise sales of mainly premium kettles.

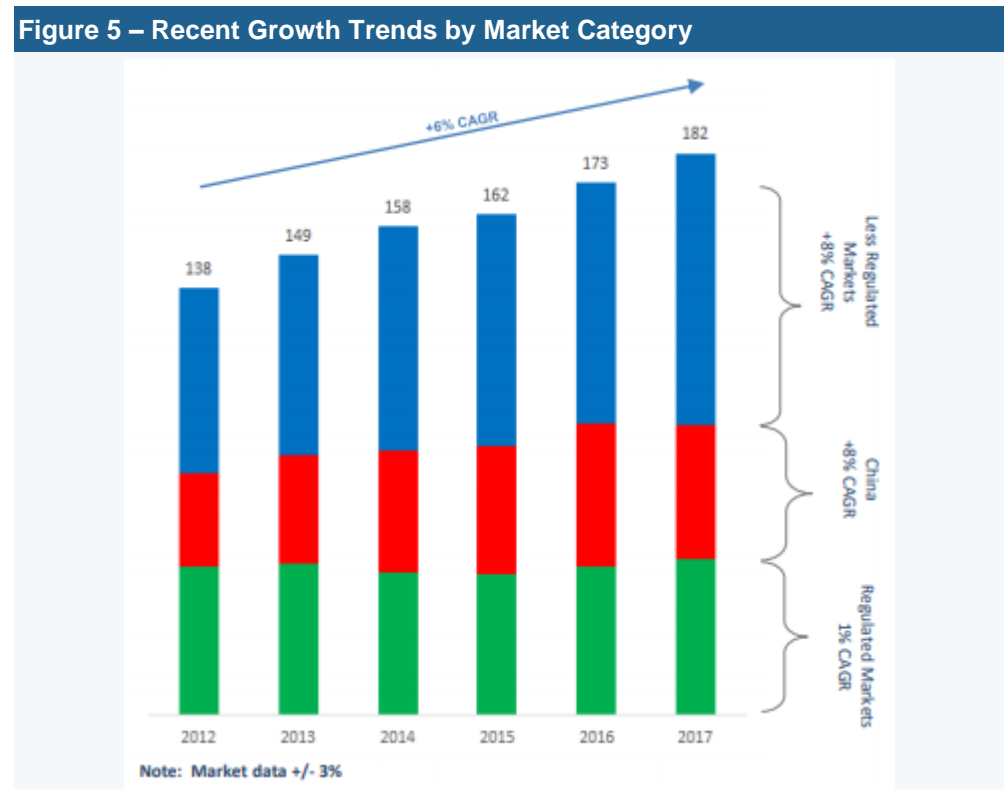
Market categorisation

Strix categorises its end markets into Regulated, Less Regulated and China. At present, its key market share strengths are in Regulated markets and China where it enjoys circa 61% and c.50% market shares respectively. In Less Regulated markets, the company’s share is currently c.19% - i.e. half its global 38% position.

As a result, were markets overall to become more heavily supervised we argue this should be seen as positive for Strix. Such increased regulation would swing the underlying regulatory market characteristics in Strix’s favour. The company’s focus on quality and its proprietary precision manufacturing in Ramsey tend to bolster Strix’s Regulated market strength in our view.

A useful example of a “Less Regulated” market which applied stricter controls is **Chile**, which was highlighted at the recent investor day. According to Strix the country boasts some of the highest kettle safety standards in the world, largely as a result of its implementation of mandatory internal safety standards.

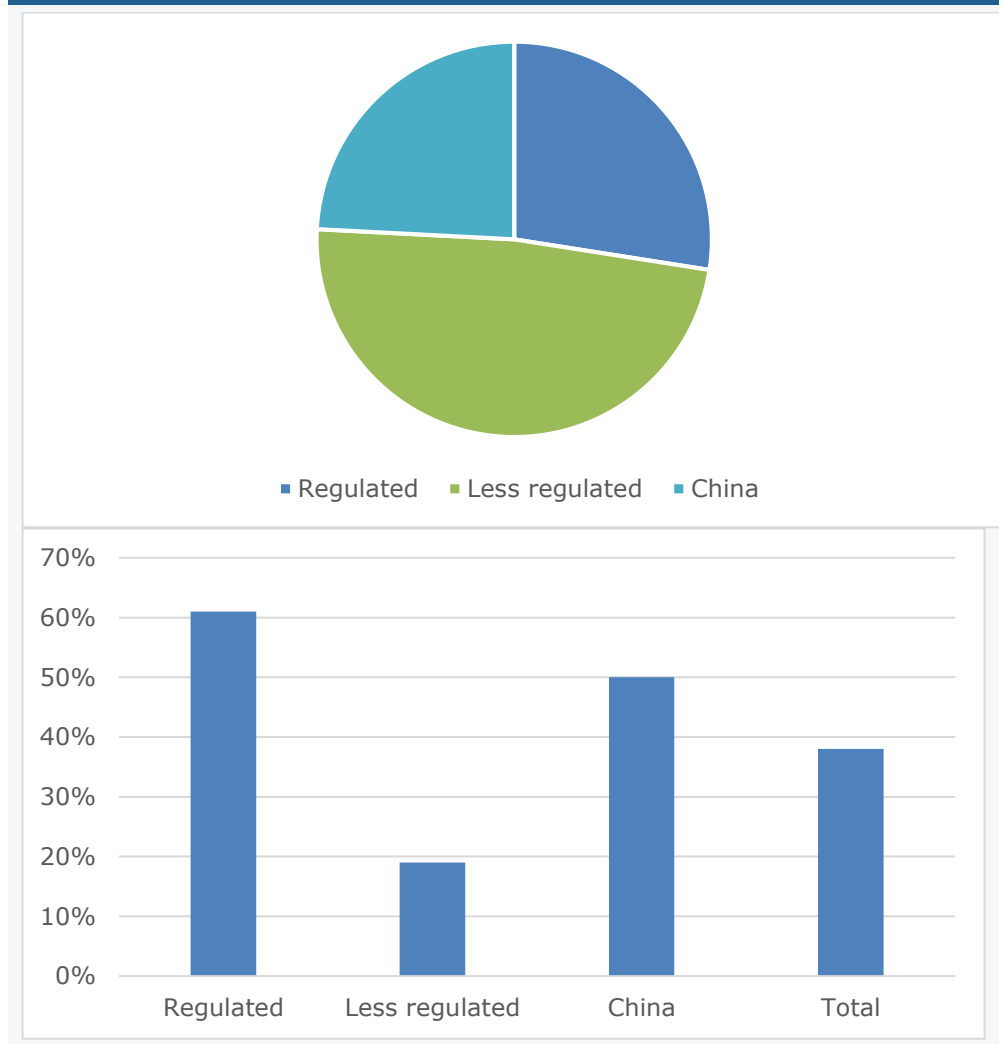
However, ahead of then it should be noted that the Less Regulated markets were the fastest growing of Strix’s categories in 2017. These increased sales volume by 12% while Regulated as a category grew by 5% and China suffered a 6% downturn. Longer term trends are summarised in Figure 5.



Source: Company

Looking ahead, we expect China and the current Less Regulated markets to grow faster than the Regulated. But we make no allowance in our forecasts for any shift in overall market balance in favour of Regulated, which arguably renders the projections conservative. Moreover, Regulated includes the USA where kettle penetration is relatively low but growing. We summarise key data in relation to Strix’s market categories in Figure 6.

Figure 6 – Kettle Controls Mkt & Strix Mkt Share by Geographic Category



Source: Company

In our view, the key features of the business appear robust. The company demonstrates superiority in Regulated markets. Its fixed asset footprint is compact, appears well run and importantly capable of not only benefiting from increased fixed investment but also well equipped to meet demand growth and support volume while the company is still cash generative.

Scope for category growth

Tea and growth

Being a global market leader with an impressive c.38% market share suggests that Strix’s growth outlook is more likely to be driven by **category expansion** than any near term ability to gain share within its category. That said, we do sympathise with the view that Strix makes a superior product – hence its c.61% share of the Regulated markets.

Category growth should be a function of both increased demand for hot drinks – leaf tea and soluble coffee – and for more efficient kettles.

In addition, the potential for stronger regulation argues in favour of Strix’s kettle controls maintaining a high share of both Regulated markets and elsewhere.

Figure 7 - Per Capita Tea Consumption - Leading Countries (lbs/capita)

| | | | | | |
|----------------|------|----------------|------|-------------|------|
| Turkey | 6.96 | Germany | 1.52 | Norway | 0.60 |
| Ireland | 4.83 | Hong Kong | 1.43 | Austria | 0.59 |
| United Kingdom | 4.28 | Ukraine | 1.28 | Finland | 0.54 |
| Russia | 3.05 | China | 1.25 | USA | 0.50 |
| Morocco | 2.68 | Canada | 1.12 | Argentina | 0.47 |
| New Zealand | 2.63 | Malaysia | 1.06 | Israel | 0.45 |
| Egypt | 2.23 | Indonesia | 1.01 | France | 0.44 |
| Poland | 2.20 | Switzerland | 0.97 | Vietnam | 0.44 |
| Japan | 2.13 | Czech Republic | 0.93 | South Korea | 0.37 |
| Saudi Arabia | 1.98 | Singapore | 0.81 | Spain | 0.32 |
| South Africa | 1.79 | Slovakia | 0.80 | Denmark | 0.32 |
| Netherlands | 1.72 | India | 0.72 | Italy | 0.31 |
| Australia | 1.65 | Taiwan | 0.65 | Belgium | 0.28 |
| Chile | 1.61 | Sweden | 0.64 | Bulgaria | 0.24 |
| UAE | 1.59 | Hungary | 0.62 | Romania | 0.16 |

Note - All figures in US lbs / Capita / Per Annum

Source: Statista

Figure 7 above makes it clear that there is substantial scope for a number of countries to increase per capita tea consumption. Half of the top 45 countries consume less than one third – on a per capita basis – of the unweighted average consumption of the world’s strongest recognizable grouping of tea drinking nations: Ireland, United Kingdom, New Zealand, South Africa and Australia.

Where growth in tea consumption and hence demand for kettle controls might be expected to be strongest is in large population, mature market economies which demonstrate a propensity to consume health products. The salient opportunity among the countries shown above is the United States, which currently boasts a 326 million domestic population. In particular, per capita consumption grew rapidly in recent years, associated with increased kettle purchases. Headroom for household kettle penetration is substantial relative to comparable mature economies.

A nice hot cup of tea for Uncle Sam

With a sizable economy, observable growth in tea consumption, and currently low levels of kettle ownership – or market penetration - the USA should be a major growth opportunity for kettle controls. At present, US kettle penetration runs at a 13% rate compared with 120% in the UK, which begs the question whether a country where the average household consumes 9 times as much tea demands 9 times as many kettles. The answer is probably yes!

The big challenge for kettles and United States tea consumption is to shift patterns of consumption. Presently, around 80% of US tea consumption is iced tea, which is no problem for kettle manufacturers as even iced tea has to be infused. However, according to data from Tea Association of the USA Inc. a sizable 46% of US tea is purchased in ready-to-drink form, which negates the use of an electric kettle.

Why might things change? The central answer in our view is **health**. Ready-to-drink tea products are in many cases proxy soft drinks. They contain preservatives and the current mature economies' *bete noir*, sugar. Consumption of freshly brewed black tea and herbal teas should both continue to resonate with the US health lobby. Both contain antioxidants and they can be served free of any added sugar.

Figure 8 – USA Tea Market – Recent segmental growth trends by value

| US\$bn | 2014 | 2015 | 2016 | 2017 | 3yr CAGR |
|--------------------------------|------|------|------|------|----------|
| Grocery, drug store etc | 2.51 | 2.58 | 2.54 | 2.58 | 0.9% |
| Ready-to-drink | 5.23 | 5.56 | 5.80 | 6.00 | 4.6% |
| Foodservice | 1.20 | 1.23 | 1.35 | 1.50 | 7.6% |
| Speciality Segment | 1.90 | 2.09 | 2.25 | 2.50 | 9.5% |

Source: Tea Association of the USA Inc.

Market data shown in Figure 8 illustrates the growth in tea consumption through the foodservice channel, a useful pointer because it tends to be premium and confirms relevance as well as speciality.

The fast growth in the speciality segment is encouraging. Speciality teas are far more likely to require kettles to make infusions than other forms of tea, and electric kettles tend to have most appeal in those countries that consume freshly brewed tea, which is a proxy for specialities in the US.

The Less Regulated cohort of countries includes a number of emerging market economies where Strix sees growth prospects as attractive. Chile is a notable example. We summarise the key geographical groupings in Figure 9.

Figure 9. A summary of key markets regulatory category

| Market | Key Features | Examples |
|------------------------|--|--|
| Regulated Markets | Markets where high safety and Intellectual Property protection standards are in place. Those standards are rigorously monitored and enforced. Limitations on competition from low quality players. Requirements to meet customer expectations of safety and quality. | Western Europe United Kingdom North America Japan Australia/New Zealand Turkey |
| Less Regulated Markets | Markets where high safety and Intellectual Property protection standards are not in place, or are in place but less rigorously enforced. Lower quality players are able to offer lower quality products at lower prices. | Far East (excl. Japan) CIS (former USSR) Middle East (excl. Turkey) South Americans Africa Eastern Europe |
| China | China is generally considered a 'Less Regulated' market, although it is developing quickly with improving safety standards and enforcement. | N/A |

Source: Company

Product Excellence

Nuts and bolts of Strix's IP

Product excellence, integrity and quality remain central to the Strix investment case. They drive the company's ability to maintain such a high market share in Regulated markets while limiting vulnerability to low cost competition and counterfeiting in the Less Regulated markets and China.

Strix's overall product superiority remains a function of longevity of expertise, refusal to compromise on component quality, intense research and rigorous testing.

Strix's **U9** series is the latest to be developed by the company. Moreover, unlike other members of its kettle control systems family, the U9 has variants which are appropriate for all markets. We summarise the current Strix product range in Figure 10.

Figure 10 – Strix – Summary of product range

| Product name | Target market | Key features |
|--------------------|------------------------------|--|
| U18/U88 | Regulated | Original best-in-class under floor control |
| Electronic control | All 3 categories | Under-floor control system which interfaces with electronics |
| Immersed | Regulated and Less Regulated | Opening price-point control. On market >30 years |
| Product X | China | Low cost China market specific variant of U18 |
| KeAi | Less Regulated | Unique, lower cost micro control |
| U9 series | Variants for all markets | Lower material cost, automation, enhanced quality, marginal improvements |

Source: Company

An important feature of Strix's approach to product has been to be consistently matching the industry trends experienced by its key customers, the OEMs. Strix was at the forefront of automatic immersion kettle technology – e.g. the much heralded Morphy Richards – before progressing into underfloor, which brought the added benefit of easily detachable jugs.

Moreover, Strix possesses a significant amount intellectual property, which protects the company's position across its product range. According to its AIM Admission Document, the company's portfolio includes over 150 patents. The company has successfully defended a number of infringements.

Aside from the litigious component of intellectual property protection, it should be noted that any failure in kettle safety controls potentially endangers end-consumers seriously. Kettle safety controls are put in place for a reason – i.e. to protect private citizens from fire and scalding. **Any OEM or brand that compromises on quality faces significant reputational damage.**

Furthermore, Strix was visibly able to demonstrate the superiority of its products, notably to counterfeit, at the analysts site visit. It has also included these type of comparisons in its investor presentations.

That there is no viable commercial reason for the company's OEM customers to compromise on quality also tends to be vindicated by its unusually high share of Regulated markets.

Keeping good company

Strix's customer base largely comprises OEM's which manufacture in China but have substantial reputations to uphold in mature market economies. In 2017 the company's top ten customers accounted for 57% of group revenue with the largest of these being 19% of group revenue. In addition to these OEMs the company has direct working relationships with such revered brand names as Tesco, Tefal, Siemens, Philips, Walmart and Supor.

New Product Development

As noted earlier in this report, around 90% of Strix's sales revenue comprises kettle controls. However, new product development – i.e. products other than kettle controls but in adjacent markets -remains a key component of the company's growth strategy.

Important areas of NPD in 2017 included development of the Turbo toaster, Breville Hot Cup in the hot-water-on-demand segment, and the Aqua Optima filter kettle. Strix also plans to raise its profile in the mother & baby segment through provision of safe methods of working with infant formula.

Another feature of Strix's NPD activities is that they tend to align Strix with unique end-products rather than unique components. We look at each in turn.

Strix Turbo Toaster

Strix's Turbo Toaster technology is a patented two-stage process designed to speed up toasting. Its prime benefit for the end-customer is clearly speed. However, it also attempts to improve evenness of coverage and raise the quality of toast texture. The product benefits from a Strix patent protected design as well as airflow optimization.

Breville Hot Cup

Breville Hot Cup is similar to Strix's kettle business model in that it operates on a "Strix inside" basis. Hot Cup's application is to deliver single serve hot water for infusions.

Aqua Optima

Aqua Optima has been in place since 2005. However, it continues to benefit from innovation. Globally, its market share of water filtration systems is high with a 20% share reported in 2017, up from 8% in the previous year.

Aqua Optima's success in filtered water links well with the mother & baby segment which requires pure water. In 2017 the company launched a Perfect Prep product which works in collaboration with baby product provider Tommee Tippee. Overall, Aqua Optima comprises water filter jugs and a range of other filters and appliances.

In 2017 Strix invested £3.5m in Research & Development spending which was equivalent to 3.9% of net sales compared with a 3.7% reinvestment rate in 2016. Our expectation is that the rate of R & D spend will remain at or above this amount in the near term.

Figure 11 – New Product Development

Turbo Toast



Steam Boiler

Instant Flow Heater



Food Steamer



Infant Formula

Water Dispenser



AQUA OPTIMA

Water Filter Kettle



Water Filter Jug



Oria Blue

Water Filters



Source: Company

Management and Strategy

Board and Management team

Strix operates with a compact senior management team that divides its time equally between the company’s European and Asian locations. In our view, an international outlook, length of tenure and consistent articulation of strategy are the key positive features of Strix’s management. We summarise board structure as follows.

Strix – Board of Directors

| | | |
|---------------------------------|----------------------|-------------|
| Chairman (non-executive) | Gary Lamb | 52yo |
| Chief Executive Officer | Mark Bartlett | 53yo |
| Chief Financial Officer | Raudres Wong | 55yo |
| Non-executive Director | Mark Kirkland | 50yo |

Both executives enjoy the benefit of direct international experience.

CEO Mark Bartlett joined the company in 2006. His background includes Engineering Director and Managing Director Roles, within both Europe and the Americas. His most recent roles were at Ametek – a global manufacturer of electronic instruments and electromechanical devices - and ABS Waste Water Ltd. – the UK headquartered manufacturer of water related engineering products.

CFO Raudres Wong, who has over 25 years of international experience in corporate finance, business management and M&A, joined the company in 2011. Key countries in which she has worked include Toronto, Beijing and Hong Kong with a significant bias towards multinationals. These include IDT International, Nortel, Level 3 Communications and Nike.

Senior Management Team

| | |
|----------------------------------|---------------------------|
| Chief Operating Officer | Frank Gao |
| Engineering Director | Nick Gibbs |
| Sales Director | Simon Charlesworth |
| Commercial Director | David Trustrum |
| Director, Aqua Optima | Nigel Wheeler |
| Director of Group HR | Pauline McGee |
| Director of Group Finance | Peter Taylor |
| Director of GM, E and CQ* | Matt Thomas |

**Group Manufacturing, Engineering and Customer Quality*

Length of service, an international bias, and compact reporting structures are all themes of Strix’s management structure. The team’s background appears well suited to its dual continent manufacturing footprint and truly international customer base.

Group Strategy – Market Share, Safety, New Technologies

Strix summarises its strategy in terms of three strategic pillars. These are as follows:-

- 1 – Build and maintain market share
- 2 – Focus on safety
- 3 – Explore new technologies

Each pillar is articulated and reported on regarding its progress in the company's annual report, with comprehensive detail too about its actions for the current financial year.

Build and maintain market share

With a c.38% share of kettle safety devices globally, Strix has clearly been successful in building a strong market position. The unusual strength of its market share in Regulated markets, at c.61%, tends to confirm the premium nature of its products. However, the company operates a "good, better, best" strategy which enables it to connect with its OEM customer base at different price points.

As a result, there is scope for Strix to add to market share in Less Regulated markets where it currently has a c.19% market share.

China is more complex. Already its market share is high at c.50%. However, it was c.30% as recently as 2015. Overall market volumes were recently harmed by a health scare arising from poor quality competitor products. Clearly, as global market leader, Strix was able to be part of the solution in China. The jump in Chinese market share tends to confirm this.

Focus on safety

Safety is arguably the DNA of Strix as a group. Not surprisingly, the company demonstrates leadership globally on the subject with a number of associated actions. The company actively lobbies governments and market monitors in all categories of markets and will continue to make submissions to authorities. Its close relationships with OEMs continue to be supported by a perception of a superior deliverer of product safety than competition.

Important actions in 2017 included market surveillance activities which in 2017 led to the recall of two products in Germany. In addition, Strix implemented similar initiatives in South America and Africa. But Strix's commitment to safety also includes its own initiatives and those of its key OEM customers, which set their own standards. The launch of the U9 control significantly reflects its commitment to safety.

Explore new technologies

As mentioned above Strix invests 3% to 4% of sales in research and development, which is reflected in a combination of new technologies being applied to kettle controls, and the new product development that we discussed earlier. In 2017 these included the U9 control, Turbo Toaster, Breville Hot Cup and the Aqua Optima filter kettle. In 2018, Strix raised its game in "hot water on demand" and "mother & baby."

Strix timeline

| | |
|---------------|---|
| 1951 | Castletown Thermostats founded by Eric Taylor, thermostat used to control heated flying suits during WWII |
| 1985/6 | The R-series control (using an immersed heating element) and P-series cordless connector are launched |
| 1988 | Becomes market leader as the 10 millionth control is produced |
| 1989 | The first overseas office is opened in Hong Kong |
| 1995 | The 100 millionth control is produced & Received the Queen's Award for Export achievement |
| 1996 | The U-series family of controls and P72 connectors are launched, a revolutionary underfloor heating system with 360-degree rotation |
| 1997/8 | Opening of new manufacturing facility in Guangzhou, China & Received the Queen's Award for Export achievement, again |
| 2000 | Receives the third Queen's Award for Enterprise: Innovation for the U series control |
| 2003 | The 500 millionth control is produced |
| 2005 | Aqua Optima launches water filters globally |
| 2007 | The EK controls and connectors are launched which offer user functionality never seen before |
| 2009 | 1 billionth control is produced |
| 2010 | Wins patent infringement law suits against two kettle control manufacturers in China |
| 2011 | Aqua Optima launches the 'Evolve' range of water filters |
| 2013 | Launch of baby formula maker, an innovation that addresses previously unmet consumer needs |
| 2016 | Aqua Optima sells 25 millionth filter |
| 2017 | Floats on the London Stock Exchange, and the 2 billionth production |

Source: Company

Financials

Valuation

Strix is comfortably the largest supplier globally of a specialist product. As a result, direct valuation comparisons are somewhat challenging. However, we establish a specialist engineering cohort in our relative valuation below. Our overall conclusion is that Strix does not appear expensive by the standards of its peer group. Both EV/EBITDA and P/E are comfortably beneath the average while EV/sales reflects the high margins generated by the company.

Figure 12 – Relative Valuation

| | Share price (pence) | Market cap (£m) | Net debt (£m) | EV (£m) | Sales (£m) | EV/sales (x) | EBITDA 2017 (£m) | EV/EBITDA (x) | EPS 2018 (pence) | EPS 2019 (pence) | P/E 2018 (x) | P/E 2019 (x) |
|-----------------------|------------------------|--------------------|------------------|------------|---------------|-----------------|------------------------|------------------|------------------------|------------------------|--------------------|--------------------|
| Discover IE | 420 | 308 | 30 | 338 | 338 | 1.0 | 29.3 | 11.5 | 21.9 | 25.8 | 19.2 | 16.3 |
| Halma | 1369 | 5198 | 196 | 5394 | 962 | 5.6 | 230.0 | 23.5 | 42.3 | 46.7 | 32.4 | 29.3 |
| IMI | 1140 | 3105 | 265 | 3370 | 1751 | 1.9 | 305.0 | 11.0 | 69.1 | 78.7 | 16.5 | 14.5 |
| Judges Scientific | 2380 | 148 | 8 | 156 | 71 | 2.2 | 16.4 | 9.5 | 32.8 | 137.0 | 72.6 | 17.4 |
| Oxford Instruments | 967 | 553 | 109 | 662 | 348 | 1.9 | 53.0 | 12.5 | 59.0 | 58.0 | 16.4 | 16.7 |
| Renishaw | 5625 | 4090 | -52 | 4038 | 537 | 7.5 | 163.0 | 24.8 | 168.0 | 183.0 | 33.5 | 30.7 |
| Rotork | 347 | 3017 | 13 | 3030 | 642 | 4.7 | 145.0 | 20.9 | 11.9 | 13.5 | 29.2 | 25.7 |
| Spirax-Sarco | 6795 | 5004 | 373 | 5377 | 999 | 5.4 | 267.0 | 20.1 | 246.0 | 258.0 | 27.6 | 26.3 |
| Strix | 168 | 334 | 46 | 380 | 91 | 4.2 | 35.1 | 10.8 | 14.0 | 15.2 | 12.0 | 11.1 |
| TT Electronics | 246 | 401 | -46 | 355 | 360 | 1.0 | 37.1 | 9.6 | 13.2 | 15.7 | 18.6 | 15.7 |
| Average | | | | | | 3.5 | | 15.4 | | | 27.8 | 20.4 |

Source: Company, various websites, prices as at 17 July, 2018

Forecasts

Steady sales growth, sustainably high margins and excellent cash conversion are the salient features of our financial forecasts that appear in the coming pages. We assume that Strix maintains its global market share of kettle controls at around the current c.38% level. Income statement, balance sheet and free cash flow forecasts appear in the subsequent pages. They are factored back into the relative valuation above.

Our income statement forecasts project around 4% revenue growth in the years 2018 to 2020. Gross margins are expected to remain at about 41%, although the company emphasises overall margin, with adjusted EBIT margins of around 31% to 32%.

Strix's robust operating margins are reflected in strong returns on the company's assets. We forecast total assets will be £45.1m at end-2018 with capital employed being £29.5m after netting off receivables and that the company will generate £30.5m of adjusted EBIT off these asset and capital bases. In our view, these returns numbers are consistent with the high quality of Strix's IP, itself reflected in a strong global market share.

| Income statement | | | | |
|---|---------------|---------------|---------------|----------------|
| End Dec y/e, £'000s | 2017A | 2018E | 2019E | 2020E |
| Revenue | 91,263 | 96,006 | 99,428 | 103,272 |
| % increase in revenue | 2.9% | 5.2% | 3.6% | 3.9% |
| Gross profit | 37,169 | 39,075 | 40,666 | 41,309 |
| Gross margin (%) | 40.7% | 40.7% | 40.9% | 40.0% |
| EBIT - adjusted | 29,062 | 30,538 | 32,493 | 32,909 |
| EBIT margin (%) - adjusted | 31.8% | 31.8% | 32.7% | 31.9% |
| EBITDA - adjusted | 35,117 | 36,717 | 38,287 | 39,577 |
| EBITDA margin - adjusted | 38.5% | 38.2% | 38.5% | 38.3% |
| Net financial income | -758 | -1,728 | -1,167 | -637 |
| Pre-tax profit - reported | 25,419 | 24,060 | 31,326 | 32,272 |
| Taxation | -787 | -1,008 | -1,096 | -1,130 |
| Tax rate (%) | -3.1% | -3.5% | -3.5% | -3.5% |
| Net income - adjusted | 27,517 | 27,802 | 30,229 | 31,142 |
| EPS - fully diluted adjusted (pence) | 14.2 | 14.0 | 15.2 | 15.6 |
| Dividend per share (pence) | 2.9 | 7.0 | 7.7 | 7.9 |

Source: Company historic data, ED forecasts

| Balance Sheet | | | | |
|--|----------------|---------------|---------------|---------------|
| End Dec y/e, £'000s | 2016A | 2017A | 2018E | 2019E |
| Assets | | | | |
| Intangible assets | 6,380 | 5,179 | 4,882 | 5,259 |
| Property, plant and equipment | 7,919 | 9,378 | 11,778 | 15,263 |
| Total non-current assets | 14,299 | 14,557 | 16,660 | 20,522 |
| Inventories | 8,560 | 9,165 | 10,165 | 11,165 |
| Trade and other receivables | 5,650 | 7,195 | 8,195 | 9,195 |
| Receivables from former gp rel parties | 370,835 | - | - | - |
| Cash and cash equivalents | 10,959 | 10,111 | 10,111 | 10,111 |
| Total current assets | 396,004 | 26,471 | 28,471 | 30,471 |
| Total assets | 410,303 | 41,028 | 45,131 | 50,993 |
| Liabilities | | | | |
| Share capital | 2 | 1,900 | 1,900 | 1,900 |
| Share based payment reserve | | 2,042 | 2,042 | 2,042 |
| Other reserves | 1,793 | | -15,177 | -29,829 |
| Retained earnings | 248,499 | -36,406 | -6,177 | 24,966 |
| Total equity | 250,294 | -32,464 | -17,411 | -921 |
| Trade and other payables | 14,289 | 16,164 | 15,600 | 15,800 |
| Current income tax liabilities | 843 | 1,103 | 1,103 | 1,103 |
| Payables due to ex gp co rel parties | 144,586 | | | |
| Derivative financial instruments | 42 | | | |
| Total current liabilities | 159,760 | 17,267 | 16,703 | 16,903 |
| Borrowings | | 56,000 | 45,614 | 34,786 |
| Post employment benefits | 249 | 225 | 225 | 225 |
| Total non-current liabilities | 249 | 56,225 | 45,839 | 35,011 |
| Total liabilities | 410,303 | 41,028 | 45,131 | 50,993 |

Source: Company historic data, ED forecasts

| Free Cash Flow | | | | |
|--|---------------|---------------|---------------|---------------|
| End Dec y/e, £'000s | 2017A | 2018E | 2019E | 2020E |
| Cash generated from operations | 34,348 | 29,403 | 36,487 | 37,577 |
| PP&E | -4,013 | -6,200 | -7,500 | -7,500 |
| Capitalised development costs | -1,688 | -1,776 | -1,839 | -1,910 |
| Purchase of software | -291 | -306 | -317 | -329 |
| Proceeds from P, P & E disposals | 10 | | | |
| Net cash used in investing | -5,982 | -8,282 | -9,656 | -9,739 |
| Operating cash flow | 28,366 | 21,121 | 26,831 | 27,838 |
| Net interest | -458 | -1,728 | -1,167 | -637 |
| Free cash flow | 27,908 | 19,393 | 25,664 | 27,201 |
| Tax paid | -527 | -1,008 | -1,096 | -1,130 |
| Net free cash flow before dividends | 27,381 | 18,385 | 24,567 | 26,071 |
| Dividends paid | -1,900 | -7,999 | -13,739 | -14,993 |
| Free cash flow before financing | 25,481 | 10,386 | 10,828 | 11,078 |

Source: Company historic data, ED forecasts



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