

## Securing Future Expansion

21st March 2019

**Strix – the world’s largest kettle safety controls supplier – released preliminary FY2018 results in line with our own and market expectations. Expansion plans, including the new Chinese factory and growth outside kettle controls, notably Aqua Optima, appear on track. In 2019, dividends are still planned to increase by 10.0% to 7.7p per share, which reflects management confidence.**

Strix’s 2018 results reported a 2.7% sales increase (+4.5% constant currency), a 3.5% gain in adjusted EBITDA, 3.2% higher pre-tax profit and a full year 7.0p per share dividend. Going forward, dividends are planned to rise in line with underlying earnings growth with a useful 10.0% increase to 7.7p committed to for 2019. Net debt fell by £18m and closed the year at £27.5m, consistent with the company’s 22<sup>nd</sup> January 2019 trading update, and was relatively modest at only around 0.8x last year’s EBITDA.

**The 2018 results augur well for 2019** about which the company already expressed confidence. Importantly, volumes remain strong having increased by 7.9% last year and, on a constant currency basis, sales growth was faster than headline at 4.5%. Strix maintained 38% share of the global kettle controls market while making some important gains in both the regulated (notably North America) and less regulated markets (where Africa and South East Asia performed well). China should return to growth this year.

Strix completed its £1m acquisition of certain HaloSource assets on 7<sup>th</sup> March 2019. These included the HaloPure division and the Astrea product. The company reiterates the benefits of some key technologies and research & development skills in the water filtration market. The HaloSource assets are expected to support Aqua Optima’s overall growth as well as entrenching the group’s important USA foothold.

In our view, the investment case for Strix remains positive. The company aligns itself to increased demand for healthy products through the association of kettles with tea and pure water with hydration. Furthermore, the benefits of strong finances tend to be confirmed by its ability to acquire well strategically – as in the case of HaloSource – while its core business benefits from a rigorous approach to IP protection.

Strix’s key financials are summarised in the table below. Based on yesterday’s close the shares continue to trade on a single digit EV/EBITDA multiple while boasting an undemanding 11.6x P/E ratio and a very generous 4.6% prospective dividend yield.

### Key financials

y/e Dec 31	2016A	2017A	2018A	2019E	2020E
Revenue (£'000)	88,653	91,263	93,769	101,498	108,083
Revenue growth (%)	10.9%	2.9%	2.7%	8.2%	6.5%
EBITDA adj ('000)	33,473	35,117	36,351	36,160	38,829
EPS adj dil (p)	12.8	14.2	14.2	14.4	15.5
DPS (p)	n/a	2.9	7.0	7.7	7.9
EV/EBITDA (x)	10.8	10.3	9.9	10.0	9.3
P/E ratio (x)	13.1	11.7	11.8	11.6	10.8
Yield	n/a	1.7%	4.2%	4.6%	4.7%

Source: ADVFN, Company data, ED estimates

### Company Data

EPIC	KETL
Price (last close)	167p
52 week Hi/Lo	178/117
Market cap	£317m

### 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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### 2018 Preliminary Results

Strix's 2018 preliminary results were very much in line with market expectations as well as reconfirming the key points of the 22<sup>nd</sup> January 2019 trading update. Importantly, growth remains positive and volume driven. The company is arguably unusual for one which is consumer facing in that it generates volume growth in mature markets, which is useful from perspectives of both more reliable currencies and relatively predictable economies. We summarise the results in Figure 1. On a constant currency basis, revenue advanced 4.5%.

**Figure 1 - Strix full year results highlights**

y/e Dec 31, £m	2017	2018	Change
Revenue	91.3	93.8	2.7%
EBITDA	35.1	36.4	3.5%
Gross profit	37.2	38.9	4.6%
Operating profit	29.1	30.9	6.2%
Profit before tax	28.3	29.2	3.2%
Profit after tax	27.5	28.3	2.7%
Net debt	45.9	27.5	−£18m
Basic EPS, p	14.5	14.9	2.7%
Final dividend per share, p	1.9	4.7	147.4%
Total dividend per share, p	2.9	7.0	141.4%

Source: Company Data

Strix disclosed sales across three product types. Clearly the largest by far remains kettle safety devices. However, there is a notable commitment to the water filtration business which grew rapidly in 2018. We summarise the position in Figure 2.

**Figure 2 - Strix Sales Revenue by Product Category**

	2017 £'000s	2018 £'000s	% increase	2017 % of sales	2018 % of sales
Kettle controls	82,954	83,514	0.7%	90.9%	89.1%
Aqua Optima	7,357	9,263	25.9%	8.1%	9.9%
Other	952	992	4.2%	1.0%	1.1%
Total	91,263	93,769	2.7%	100.0%	100.0%

Source: Company

### Outlook for 2019

Strix's preliminary results commentary reiterates the January trading statement's level of confidence in prospects for 2019. The company believes that its vigorous defence of its intellectual property in 2018 should aid recovery in China. Moreover, within kettle safety devices the company launched a product, VnQ, which sells at a discount to the U9 and thus has a pricing advantage when seeking to gain market share in less regulated markets, while not compromising the company's pricing overall.

The company also highlights the security advantage of moving to a 50 year, rather than 20 year, tenure for its factory location, which underlines the support they receive from the regional Chinese government. Increased capital expenditure arising as from the factory move will be £20m.

Other salient features of 2019 should be the integration of the HaloSource businesses, which is also consistent with the company's "good, better, best" strategy.

HaloSource, as well as implementation of IFRS16 which refers to the treatment of leases, prompts us to make a few modest changes to our 2019 forecasts. Clearly, the acquisition of a loss-making business makes it likely that net sales revenue and key profit measures will initially move in opposite directions.

Free cash flow should shift to being negative in 2019 as the company's enlarged final 2018 dividend hits this year's numbers and increased cap ex associated with the new factory, and the purchase cost of the Halo Source businesses also impact negatively. However, the central investment message remains the same. **Strix should continue to grow at a mid-single digit pace driven by both industry demand and its own ability to gain share.**

**Figure 3 - Changes to 2019 forecasts**

£'000s	Old	New	% change
<b>Sales revenue</b>	99,428	101,498	2.1%
<b>EBITDA</b>	38,287	36,160	-5.6%
<b>EBIT</b>	32,493	31,087	-4.3%
<b>EPS - basic adjusted (pence)</b>	15.3	15.1	-1.4%

*Source: Equity Development estimates*

## HaloSource

Many of the benefits arising from the HaloSource acquisition were highlighted in Strix's 8<sup>th</sup> March 2019 press release. The company believes that HaloSource's assets acquired will be complementary to Aqua Optima as it seeks to grow the business outside kettle control devices and achieve a greater share of the market for temperature controlled water devices. In particular, Strix believes that there will be a know-how upload from HaloSource developed technology for the Aqua Optima product range, which should be a differentiating factor.

Strix states that it expects to benefit from integration and commercialisation of HaloSource's technically advanced water purification technologies to expand existing product portfolio and market penetration. In addition, the company expects to expand its operational footprint with an innovation centre for water filtration in the US and retain HaloSource's well-regarded R&D team.

The acquisition also brings in revenue synergies from customer and supplier relationships in China. Further ahead, China may deliver manufacturing synergies as Strix expands its footprint. These may accrue in 2021.

Moreover, there is clearly room for a new “high ground” or thought leadership to be established 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. If HaloSource is a route to this achievement, the implications could be sizable.

Financially, the acquisition should put Strix’s finances under minimal strain. As mentioned on our front page, the deal closed at around £1m and income statement investment costs in Year 1 should be around £2m – i.e. the acquired business is pre-profit. Incremental cap-ex costs may run to the order of £1m initially.

## Financial statements

Our updated financial forecasts for 2019 and 2020 are summarised in Figures 4 to 6. The overarching message is that Strix should, long term, continue to grow sales and profits on a cash positive basis with its inherent balance sheet continuing to support tactical M&A activity.

Raised cap-ex is a salient feature of 2019 and 2020, including £20m (£8m in 2019 and £12m in 2020) on the new factory. Hence we expect end-year net debt to increase to £31m in 2019, and to £34m in 2021. **In 2022 we expect the company to return to being cash positive.**

**Figure 4: Income statement**

£'000s	2017A	2018A	2019E	2020E	2021E
Revenue	91,263	93,769	101,498	108,083	113,531
% increase in revenue	2.9%	2.7%	8.2%	6.5%	5.0%
Gross profit	37,169	38,918	41,513	43,558	45,753
Gross margin (%)	40.7%	41.5%	40.9%	40.3%	40.3%
EBIT - adjusted	29,062	30,861	31,087	33,658	35,498
EBIT margin (%) - adjusted	31.8%	32.9%	30.6%	31.1%	31.3%
EBITDA - adjusted	35,117	36,351	36,160	38,829	40,772
EBITDA margin - adjusted	38.5%	38.8%	35.6%	35.9%	35.9%
Net financial income	-758	-1,655	-1,127	-1,193	0
Pre-tax profit - reported	25,419	24,134	29,960	32,464	35,498
Taxation	-787	-947	-1,325	-1,688	-1,846
Tax rate (%)	-3.1%	-3.9%	-4.4%	-5.2%	-5.2%
Net income - adjusted	27,517	28,259	28,635	30,776	33,652
EPS - fully diluted adjusted (pence)	14.2	14.2	14.4	15.5	16.9
Dividend per share (pence)	2.9	7.0	7.7	7.9	8.4

*Company Data/ED estimates*

**Figure 5 - Balance Sheet**

£'000s	2016A	2017A	2018A	2019E	2020E	2021E
<b>Assets</b>						
Intangible assets	6,380	5,179	4,804	5,100	5,531	6,073
Property, plant and equipment	7,919	9,378	11,093	24,799	41,406	45,912
Total non-current assets	14,299	14,557	15,897	29,899	6,937	51,984
Inventories	8,560	9,165	10,518	11,518	12,518	13,149
Trade and other receivables	5,650	7,195	7,254	8,254	9,254	9,712
Receivables from former gp rel parties	370,835					
Cash and cash equivalents	10,959	10,111	13,521	13,521	13,521	25,767
Total current assets	396,004	26,471	31,293	33,293	35,293	48,628
Total assets	410,303	41,028	47,190	3,192	82,230	100,612
<b>Liabilities</b>						
Share capital	2	1,900	1,900	1,900	1,900	1,900
Share based payment reserve		2,042	6,904	6,904	6,904	6,904
Other reserves	1,793			-16,899	-34,768	-52,640
Retained earnings	248,499	-36,406	-21,180	9,596	43,248	78,707
Total equity	250,294	-32,464	-12,376	1,501	17,284	34,870
Trade and other payables	14,289	16,164	16,824	15,800	15,800	16,596
Current income tax liabilities	43	1,103	1,575	1,575	1,575	1,575
Payables due to ex gp co related parties	144,586					
Derivative financial instruments	42					
Total current liabilities	159,760	17,267	18,399	17,375	17,375	18,171
Borrowings		56,000	41,000	44,149	47,404	47,404
Post employment benefits	249	225	167	167	167	167
Total non-current liabilities	249	56,225	41,167	44,316	47,571	47,571
Total liabilities	410,303	41,028	47,190	63,192	82,230	100,612
Closing net debt/(cash)	-10,959	45,889	27,479	30,628	33,883	21,637

*Company Data/ED estimates*

### Free Cash Flow

£'000s	2017A	2018A	2019E	2020E	2021E
Cash generated from operations	34,348	35,431	33,136	36,829	40,479
PP&E	-4,013	-5,703	-17,000	-20,000	-8,000
Capitalised development costs	-1,688	-1,849	-2,001	-2,131	-2,239
Purchase of software	-291	-68	-74	-78	-82
Proceeds from P, P & E disposals	10				
Net cash used in investing activities	-5,982	-7,485	-20,075	-22,210	-10,321
Operating cash flow	28,366	27,946	13,061	14,620	30,158
Net interest	-458	-1,288	-1,127	-1,193	0
Free cash flow	27,908	26,658	11,934	13,426	30,158
Tax paid	-527	-475	-1,325	-1,688	-1,846
Net free cash flow before dividends	27,381	26,183	10,609	11,738	28,312
Dividends paid	-1,900	-7,980	-13,758	-14,993	-16,066
Forex adjustment		207			
Free cash flow before financing	25,481	18,410	-3,149	-3,255	12,246

*Company Data/ED estimates*



## Investor Access

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