Supreme PLC

Strong FY23 results backed by vaping deals

6 July 2023

For the year to 31 March 2023 Supreme reported revenue of £155.6m, +19%YoY (with H2 revenue rebounding 27%YoY versus H1 +6%YoY), and (adj.) EBITDA of £19.4m, -8%YoY (compared to H1 -19%YoY). Revenue was ahead of our estimate of £150m; (adj.) EBITDA matched our outlook. Maintaining expansion momentum the Group announced a distribution agreement which we estimate has the potential to add c.£25m to the top line in FY24.

Growth led by vaping acquisitions

The **Vaping** product segment recorded revenue of £76.1m +75%YoY, 49% of total, with 40% of incremental revenue (c.£13m) generated by the acquired Liberty Flights, Cuts Ice and Flavour Core operations; ED estimate was £73.0m. Even excluding the contribution from acquisitions, we estimate that growth was an impressive 45%YoY. **Batteries** revenue grew 13%YoY to £39.5m, 25% of total (ED estimate: £39.0m). Lighting revenue declined 43%YoY (£15.4m; ED £15.0m) due to customer overstocking issues, but H2 recovered 50% on H1. **Sports Nutrition & Wellness** revenue grew 5%YoY (£16.8m; ED estimate, £16.0m), and the **Branded Household Goods & Other** segment contributed £7.8m of revenue, -17%YoY (ED estimate was £7.0m).

Cash generative

As of 31 March, the Group was (pre-IFRS 16) cash positive (£3.2m), having generated £19.3m in (net) cash from operations, in addition to which the disposal of **TJuice** yielded £4.0m. £30m in borrowing facilities offers the potential to grasp further suitable M&A opportunities. Consistent with Group policy of a 25% of net profit dividend policy, a dividend of 3.0p/share is payable for the year.

Elf Bar master distributor agreement to add >£20m to FY24(E) revenue

Supreme has announced a master distributor agreement in the UK for the popular *Elf Bar* and *Lost Mary* (QM600) range of disposable vapes (https://www.elfbar.co.uk) across its retail network; we estimate that in FY24 this could add c.£25m in additional revenue and c.£2.0m in (adj.) EBITDA. The brands are owned by Shenzhen iMiracle Technology Co. Ltd., in China, and are some of the most popular, disposable vape brands in the US (e.g. the Elf Bar BC5000). Income from the distributor agreement will be reported in the Branded Household Goods product segment.

Outlook and Fair Value raised

Reflecting the potential impact of the Elf Bar distributor agreement, we have raised our FY24 revenue outlook by 19% to £193.5m, and (adj.) EBITDA outlook by 19% to £25.6m.

Consequently, our Fair Value increases to 200p/share, indicative of a FY24 EV/EBITDA of 8.7x.

Financial outlook to FY25

Yr to March 31 (£m)	2021	2022	2023	2024E	2025E
Revenue	122.3	130.8	155.6	193.5	201.5
EBITDA (adj)	19.3	21.1	19.4	25.6	26.8
EPS (adj, p)	11.8	12.4	11.2	12.8	13.9
DPS (p)	2.7	2.2	4.6	5.6	5.8
Net debt / (cash)[1]	7.6	4.0	11.8	15.5	4.6
EV/EBITDA	6.2x	5.6x	6.1x	4.6x	4.4x
P/E	9.5x	9.1x	10.0x	8.7x	8.1x

Source: Company data, Equity Development estimates. [1] Net debt inclusive of lease obligations under IFRS 16.

Company Data

EPIC	SUP
Price (last close)	112p
52 week Hi/Lo	124/70p
Market cap	£131m
ED Fair Value / share	200p
Net debt (cash) £m	11.8

Share Price, p

Source: ADVFN

Description

Formed in 1975, Supreme Imports is a leading European and UK manufacturer, supplier and brand owner of fast-moving consumer products. It supplies five key categories of consumer spending: Vaping, Sports Nutrition & Wellness, Batteries, Lighting and Branded Household Consumer Goods.

The customer base includes leading brands such as, amazon, ASDA, b&m, BOOKER, home bargains, Iceland, Londis, Morrisons, One Below, Poundland, The Range, Sainsbury's, SPAR, Tesco and, in addition, HM Prison & Probation Service. The Group has over 3,300 active business accounts with over 10,000 branded retail outlets.

Mike Jeremy (Analyst)
0207 065 2690
mike.jeremy@equitydevelopment.co.uk

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

FY23 performance by product segment

- Boosted by acquisitions, **Vaping** product segment revenue (£76.1m; ED estimate, £73.0m) grew 75% YoY to just under 50% of total revenue, contributing (£28.1m), 71% of gross profit; gross margin was reduced from 44.7% in FY22 to 36.9% due to changes in product mix. Supreme reports that acquisitions accounted for 40% of incremental product segment revenue, i.e. £13.0m.
- The **Batteries** product segment remained an earnings mainstay with revenue of £39.5m, 25% of total (ED estimate: £39.0m) and a gross contribution of £3.9m, 10% of total (pre-forex).
- Although **Lighting** declined 43%YoY (£15.4m; ED estimate was £15.0m) due to overstocking leading to reduced demand in H1 (£6.2m, -53%YoY); H2 showed seasonal recovery at £9.3m (-33%YoY).
- **Sports Nutrition & Wellness** product segment revenue grew 5%YoY (£16.7m; ED estimate, £16.0m), but gross contribution (£2.7m, -25%YoY) was reduced due to the spike in the price of raw materials such as whey. Since the October 2022 peak, however, whey prices have reverted towards the medium-term norm, having risen in 2022 to c.130% above the 2018-2020 average.
- The **Branded Household Goods & Other** segment contributed £7.8m of revenue (ED estimate, £7.0m) and gross of £0.8m.

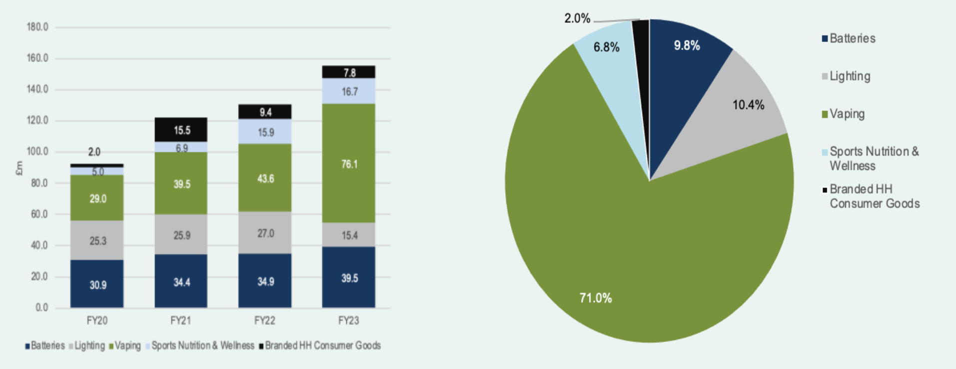
FY 23 results versus Equity Development estimates

£m		**FY 22**	**FY 23**	***YoY***	**FY23 E**	***beta***
Batteries		34.9	39.5	*13.4%*	39.0	*1.4%*
Lighting		27.0	15.4	*-42.9%*	15.0	*2.8%*
Vaping		43.6	76.1	*74.6%*	73.0	*4.2%*
Sports Nutrition & Wellness		15.9	16.7	*5.4%*	16.0	*4.7%*
Branded HH Consumer Goods		9.4	7.8	*-17.1%*	7.0	*11.5%*
Revenue		**130.8**	**155.6**	*19.0%*	**150.0**	***3.7%***
Gross		38.5	40.9	*6.1%*	41.3	*-1.2%*
	Mrg	*29.4%*	*26.3%*	*-10.9%*	*27.6%*	*-1.3%*
EBITDA (adj.)		**21.1**	**19.4**	*-7.9%*	**19.4**	*-0.2%*
	Mrg	*16.1%*	*12.5%*	*-22.6%*	*13.0%*	*-0.5%*

Source: Company data, Equity Development estimates.

Excluding acquired operations we estimate underlying revenue growth of 9.0%YoY (£143m).

Product segment revenue FY20 – FY23, distribution of FY23 gross



Source: Company data. Equity Development estimates.

FY23 performance and outlook

FY23 performance was characterised by a recovery in two product segments – Lighting and Sports Nutrition & Wellness – and dominated by the contribution to profits from the Vaping segment, through both acquired operations and as a result of new product launches and marketing. The Batteries segment remained a mainstay of profitability, whilst the Branded Household Goods segment captures attention not for FY23 performance but for the potential impact of the Elf Bar and Lost Mary distribution agreement from FY24 onwards.

FY23 P&L, annual and semi-annual

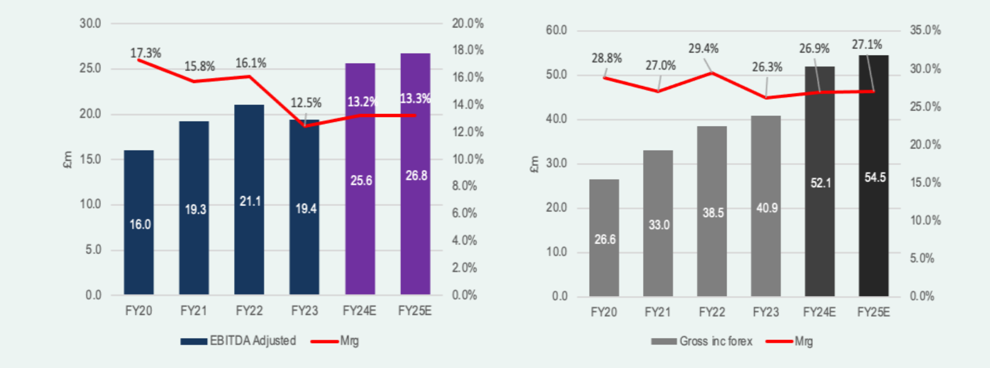
£m		FY22	H1 23	H2 23	FY23	YoY
Revenue		130.8	64.6	88.4	155.6	*19.0%*
Gross Sum		36.9	17.6	22.0	39.6	*7.4%*
Gross inc forex		38.5	18.2	22.7	40.9	*6.1%*
	Mrg	*29.4%*	*28.1%*	*25.7%*	*26.3%*	
EBIT Reported		17.0	4.8	7.9	15.4	*-9.2%*
EBIT Adjusted		18.1	6.2	7.3	16.3	*-10.1%*
	Mrg	*13.8%*	*9.7%*	*8.2%*	*10.5%*	
EBITDA Reported		20.0	6.7	11.9	18.6	*-7.0%*
EBITDA Adjusted		21.1	8.1	11.3	19.4	*-7.9%*
	Mrg	*16.1%*	*12.6%*	*12.8%*	*12.5%*	
PBT Reported		16.3	4.4	10.0	14.4	*-11.6%*
PBT Adjusted		17.4	5.8	9.4	15.3	*-12.4%*
PAT Reported		13.7	3.3	8.8	12.1	*-12.0%*
PAT Adjusted		14.8	4.7	8.2	12.9	*-12.9%*

Source: Company data, Equity Development estimates

In reporting adjusted earnings Supreme recorded a net £0.828m (FY22: £1.095m), comprising: share-based payments of £1.46m; change in the value of forward contracts, £1.119m; acquisition-related costs of £1.036m; and profit on the disposal of the IP of TJuice of £2.787m, with a cash inflow of £4.0m, having been acquired for £1.4m and sold for €4.5m.

Our medium-term earnings outlook includes raised FY24 estimates for the Batteries (4% increase), Vaping (+4%), Sports Nutrition & Wellness (+13%) and, notably the Branded Household Goods product segments (+3.6x). We expect gross margin to stabilise at c.27%, with EBITDA margin improvement from 12.5% in FY23 to 13.3% by FY25.

EBITDA (adj.) and gross profitability outlook to FY25 E



Source: Company data. Equity Development estimates.

Product segment outlook – Elf Bar impact

As summarised below, our medium-term revenue outlook shows the positive impact of: (i) the addition of expected contribution from the Elf Bar and Lost Mary master distributor agreement, which adds c.£24m (E) to the Branded Household Goods product segment in FY24; (ii) a 4% increase (£3.0m) in Vaping revenue outlook; and (iii) continued progress in the Sports Nutrition & Wellness product segment, with our outlook raised by £2.0m, +13%. Elsewhere, the Batteries product segment is expected to maintain its position as a mainstay of revenue and earnings, with outlook raised by 4% in FY24. We expect the recovery to continue in the Lighting product segment, from £15.4m in FY23 revenue to (unchanged) £19.0m in FY24.

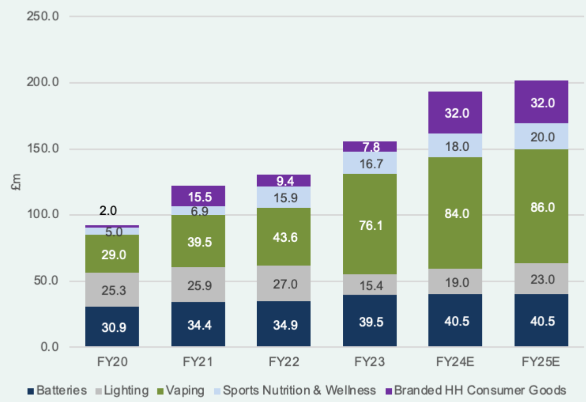
Revised FY24 and FY25 outlook

£m	**FY23**	**FY24E**	**FY25E**	**FY24E was**	***beta***
Batteries	39.5	40.5	40.5	39.0	*3.8%*
Lighting	15.4	19.0	23.0	19.0	*0.0%*
Vaping	76.1	84.0	86.0	81.0	*3.7%*
Sports Nutrition & Wellness	16.7	18.0	20.0	16.0	*12.5%*
Branded HH Consumer Goods	7.8	32.0	32.0	7.0	*357%*
Revenue	**155.6**	**193.5**	**201.5**	**162.0**	*19.4%*
Gross	**40.9**	**52.1**	**54.5**	47.8	*9.1%*
Mrg	*26.3%*	*26.9%*	*27.1%*	*29.5%*	
EBITDA (adj.)	**19.4**	**25.6**	**26.8**	**22.6**	*13.6%*
Mrg	*12.5%*	*13.2%*	*13.3%*	*13.9%*	

YoY	**FY23**	**FY24E**	**FY25E**
Batteries	*13.4%*	*2.4%*	*0.0%*
Lighting	*-42.9%*	*23.2%*	*21.1%*
Vaping	*74.6%*	*10.4%*	*2.4%*
Sports Nutrition & Wellness	*5.4%*	*7.5%*	*11.1%*
Branded HH Consumer Goods	*-17.1%*	*309.9%*	*0.0%*
Revenue	*19.0%*	*24.3%*	*4.1%*
Gross	*6.1%*	*27.6%*	*4.7%*
EBITDA (adj.)	*-10.9%*	*2.6%*	*0.5%*

Source: Company data. Equity Development estimates.

Product segment revenue outlook to FY25(E)

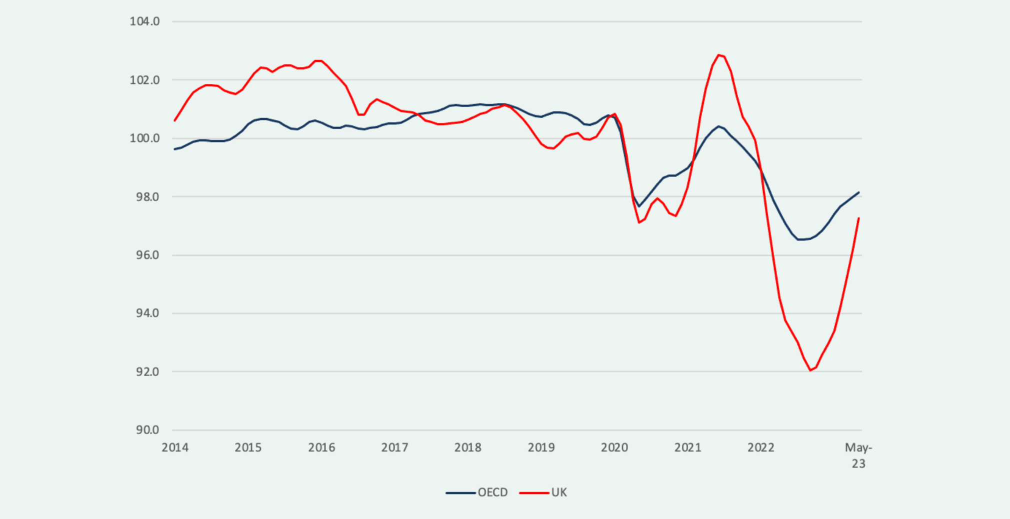


Source: Company data. Equity Development estimates

UK consumer confidence – signs of recovery

The latest UK GDP data (Office of National Statistics data released on 14 June 2023 https://commonslibrary.parliament.uk/research-briefings/sn02784) indicate that Q1 2023 UK GDP growth was 0.1% Q/Q (matching Q4 22). Headline commentary was dominated by persistent inflation at (CPI) 8.7%YoY in May; food and non-alcoholic beverages exerted some downward influence, but this was offset by recreation, restaurant and hotel prices. Overall, UK consumer confidence – data to May – continued to recover from the depressed levels of mid-2022, but remains below par.

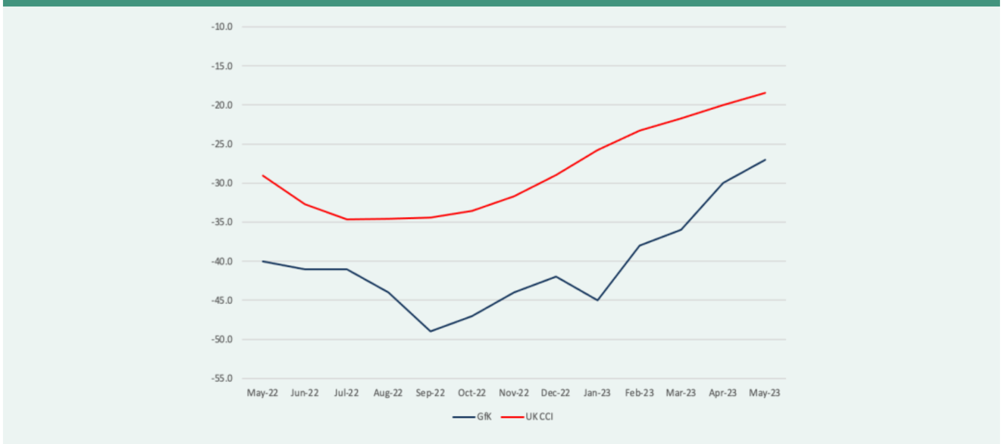
Consumer Confidence Index - January 2014 to May 2023



Source: OECD - https://data.oecd.org/leadind/consumer-confidence-index-cci.htm#indicator

In its latest survey, consumer market observer GfK Group strikes a cautiously optimistic note: "*May sees an encouraging three-point uptick in consumer confidence. This is the fourth monthly increase in a row from January's score of -45. While Brits have little control over the general economy, it's good to see further improvement in how people view their personal finances in the next 12 months with a robust five-point jump to -8. This measure most keenly reflects our hopes and fears for the coming year, and it underpins our ability to spend on goods and services that drive our economy*." (https://www.gfk.com/press/UK-Consumer-confidence-continues-to-recover-in-may)

UK consumer confidence – GfK and OECD CCI data compared



Source: OECD, GfK Group. OECD data is modified for scaling at ([Index - 100)x10].

We next review FY23 product segment performance and outlook.

Batteries product segment

At year-end FY23 the product segment comprised 25% of Group revenue and 10% of gross profits.

- Revenue grew 13%YoY to £39.5m (ED E: £39.0m).
- Gross contribution was 10% of total on a 9.9% margin compared to 10.6% a year earlier and a FY20-22 average of 10.2%.
- For FY24 we expect revenue growth of c3% on flat gross margins and, at this stage, maintain a low growth, stable outlook for FY25.

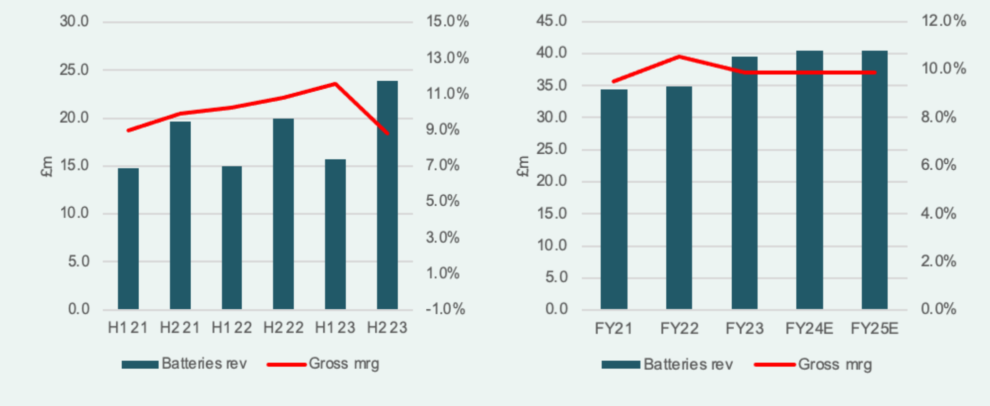
Revenue, gross FY20 – FY25E

£m	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	30.9	34.4	34.9	39.5	40.5	40.5
YoY		*11.3%*	*1.3%*	*13.4%*	*2.4%*	*0.0%*
% of	*33.5%*	*28.2%*	*26.7%*	*25.4%*	*20.9%*	*20.1%*
Gross	3.3	3.3	3.7	3.9	4.0	4.0
% of	*12.7%*	*10.3%*	*10.0%*	*9.9%*	*7.8%*	*7.5%*
Gross mrg	*10.6%*	*9.5%*	*10.6%*	*9.9%*	*9.9%*	*9.9%*

Source: Company data, Equity Development estimates.

H2 23 revenue recovered 52%HoH (£24m vs £15.7m) to reach the highest semi-annual level for three years. We expect the Batteries product segment to maintain its role as a 'mainstay' of Group earnings based on the strength of customer relationships and the obvious renewable aspect of the product.

Revenue, gross margin semi-annual to FY23 and annual FY21 - FY25E



Source: Company data, Equity Development estimates.

Lighting product segment

At year-end FY23 the product segment comprised 10% of Group revenue and 10% of gross profits.

- Revenue declined 43%YoY to £15.4m (ED E: £15.0m).
- Gross contribution was 10% of total on a 26.7% margin compared to above 30% in previous years.

Following the negative impact of a period of customer overstocking resulting in reduced demand, we continue to expect a moderate recovery in FY24-25 towards revenue levels of FY20, with gross profitability also at a similar level (30%). Supreme notes that it retained its customer base and relationships, and adds that it now has access to the EPOS and stocking data of its largest customers; this should enable more effective monitoring of stock and demand levels and forewarning of changes in demand. Supreme also reports an extension, to 2030, of its licenses with Energizer and Eveready, and the addition of a new licence with Black & Decker.

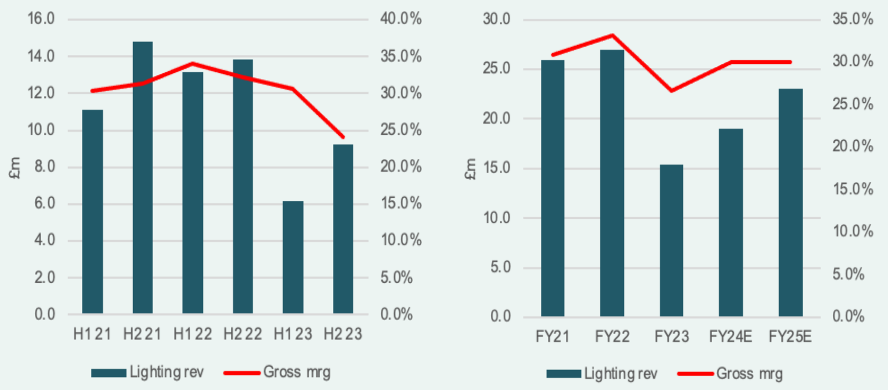
Revenue, gross FY20 – FY25E

£m	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	25.3	25.9	27.0	15.4	19.0	23.0
YoY		*2.2%*	*4.3%*	*-42.9%*	*23.2%*	*21.1%*
% of	*27.5%*	*21.2%*	*20.7%*	*9.9%*	*9.8%*	*11.4%*
Gross	8.5	8.0	9.0	4.1	5.7	6.9
% of	*32.8%*	*25.0%*	*24.3%*	*10.4%*	*11.2%*	*12.9%*
Gross mrg	*33.4%*	*30.9%*	*33.1%*	*26.7%*	*30.0%*	*30.0%*

Source: Company data, Equity Development estimates.

Semi-annual performance exhibited the usual second half revenue bias, albeit on a lower level of gross profitability.

Revenue, gross margin semi-annual to FY23 and annual FY21 - FY25E



Source: Company data, Equity Development estimates.

Vaping product segment

At year-end FY23 the product segment comprised 49% of Group revenue and 71% of gross profits.

- Revenue grew 75% YoY to £71.6m, of which £12.8m was derived from contributions from acquired companies (Liberty Flights, Cuts Ice and Flavour Core), in the absence of which underlying growth indicated was a healthy 45%YoY (£63m of revenue) backed by the popularity of the core *88vape* brand. The launch of a range of disposable vapes, augmenting the *hero* e-liquid range, generated a reported £12.0m in additional revenue. The contract with HM Prisons generated 25%YoY growth in demand.
- Gross contribution of £28m, comprising 71% of total, reflected an overall 37% gross margin resulting from changes in product mix, divided H1: 38.0% and H2 36.2%.
- Supreme noted the full integration of the acquired Liberty Flights and Cuts Ice operations – comprising 40% of growth in the division - with the acquisition of Superdragon in March adding to FY24 earnings.

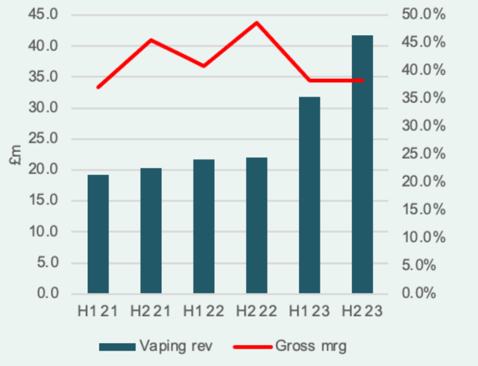
Revenue, gross FY20 – FY25E

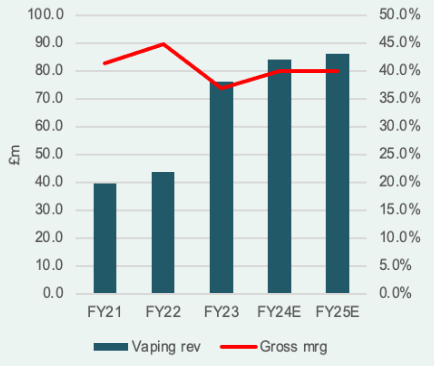
£m	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	29.0	39.5	43.6	76.1	84.0	86.0
YoY		*36.2%*	*10.2%*	*74.6%*	*10.4%*	*2.4%*
% of	*31.4%*	*32.3%*	*33.3%*	*48.9%*	*43.4%*	*42.7%*
Gross	11.7	16.4	19.5	28.1	33.6	34.4
% of	*45.1%*	*51.2%*	*52.9%*	*70.9%*	*65.7%*	*64.2%*
Gross mrg	*40.2%*	*41.4%*	*44.7%*	*36.9%*	*40.0%*	*40.0%*

Source: Company data, Equity Development estimates.

Supreme reports that the Liberty Flights and Cuts Ice operations are now fully-integrated with Group systems, followed by the acquisition in March 2023 of Superdragon[2]. Our outlook indicated c10%YoY growth in FY24 and an improvement in gross profitability towards 40%. Whilst the master distributor agreement for Elf Bar and Lost Mary vapes aligns with this product segment, the absence of manufacturing involvement means that revenue will accrue to the Branded Household Goods segment.

Revenue, gross margin semi-annual to FY23 and annual FY21 - FY25E





Source: Company data, Equity Development estimates.

[2] Superdragon Imports Ltd., acquired the trade and assets of Superdragon TCM UK Ltd., on 30 March 2023 for a cash consideration of £2.47m and deferred consideration of £0.187m to be recognised in FY24, as are earnings.

Elf Bar master distributor agreement

Supreme has announced a master distributor agreement for the *Elf Bar* and *Lost Mary* disposable vaping ranges which we estimate could add c.£25m in revenue and c.£2.0m in (adj.) EBITDA in FY24, accounted in the Branded Household Goods / Other product segment.

As VersedVaper notes (https://versedvaper.com) "*Elf Bars are undoubtedly one of the most popular disposable vapes in the world and THE most popular brand in several countries, including the U.K. In the United States, the largest vape market in the world, Elf Bars must surely sit at or near the top of the most popular disposables list … Elf Bars hit the market early and in time to take advantage of a big increase in vaping in general and disposable vaping in particular*." The grocery and convenience store network Supreme is able to offer includes Tesco, Morrisons, WH Smith and One Stop.

The Elf Bar and Lost Mary brands are by the Chinese manufacturer Shenzhen iMiracle Technology Company Ltd. and produced in Shenzhen (production processes are illustrated in a promotional video at https://www.youtube.com/watch?v=nRnFwB5lUf8&feature=youtu.be.) The leading *Elf Bar BC5000 Ultra* is available in nine vape flavours (Strawberry Mango, Mint, Orange Soda etc.) with four more flavoured tobacco versions. Particularly popular are the *Lost Mary* VM600 and AM600 disposable vapes.

Protecting youth

We note that Elf Bar enforces **strict age verification** for its online sales via AgeChecked (https://www.agechecked.com), a specialist in age verification and regulatory compliance. In January 2023 Elf Bar also launched the 'Lighthouse Guardian Program" which it states is designed to "protect teenagers' safety and prevent their usage of nicotine in any form (https://www.elfbar.com/minor-protection.html) and reports 30,555 participants to date, with the mission statement:

- "ELFBAR products will be closely regulated to prevent misuse and are not intended for those who do not smoke or vape, or for anybody under the age of 18.
- We support strong laws and regulations that forbid minors from buying and using our products.
- We have a large nicotine warning on our package that says: "This product contains nicotine. Nicotine is an addictive chemical."
- The official ELFBAR website is age-gated to prevent minors from accessing and buying ELFBAR products there.
- To maximize the positive impact of the Lighthouse Guardian Program, we make every effort to spread the word among our stakeholders and business partners. We provide training to our business partners so they may execute the Lighthouse Guardian Program. We also have reseller agreements that entail oversight and sanctions for breaking age limitations."

Product purity

Elf Bar also notes that its products do not contain diacetyl (DA), an a-diketone used to flavour e-cigarettes which is thought to be associated with *bronchiolitis obliterans* or 'popcorn lung' scarring of lung tissue (https://www.nature.com 15.02.2022). Elf Bar states that its products are based on food grade propylene glycol and vegetable glycerine, and both natural and artificial flavourings – plus nicotine for tobacco-substitute products.

Environmental awareness

The Elf Bar brand also emphasises its awareness of environmental concerns surrounding the impact of quantities of disposable vaping products, stating:

- "We are committed to continuously improving our business activities and achieving the highest standards of environmental sustainability and we have fully adhered to the Waste Electrical and Electronic Equipment (WEEE) Regulations."

UK vaping market - two sides of the debate

The sale of vaping products in the UK is currently the subject of debate. On the one hand government (Public Health England, Office for Health Improvement & Disparities), voluntary organisations (IBVTA, ASH) and the health sector (NHS, NHS Scotland, Royal College of Physicians, BMA, Cancer Research UK, MHRA) continue to promote vaping as a healthy alternative to smoking tobacco, and as a means of persuading the current population of approximately 5.4m adults to quit smoking.

Opposition to vaping products focuses on the unregulated sale to minors, abetted by packaging which is thought to appeal to a 'confectionary' brand image, and the vulnerability of certain products to adulteration with proscribed substances. As the NHS states:

- "*A 2021 review found that people who used e-cigarettes to quit smoking … can be up to twice as likely to succeed as people who used other nicotine replacement products such as patches or gum*." (https://www.nhs.uk/live-well/quit-smoking/using-e-cigarettes-to-stop-smoking).
- In April the government launched the *swap to stop* scheme within which *"One million smokers will be encouraged to swap cigarettes for vapes under a pioneering new 'swap to stop' scheme designed to improve the health of the nation and cut smoking rates. As part of the world-first national scheme, almost 1 in 5 of all smokers in England will be provided with a vape starter kit alongside behavioural support*."
https://www.gov.uk/government/news/smokers-urged-to-swap-cigarettes-for-vapes-in-world-first-scheme

Summarising concerns about the accessibility of vaping products to minors – leading to calls for a ban by the Royal College of Paediatrics and Child Health (RCPCH) on the sale of disposable vapes – the BBC reports (6th June):

- "*Selling vapes or e-cigarettes to children is illegal, but that has not stopped a rise in 11 to 17-year-olds experimenting with vaping - from 7.7% in 2022 up to 11.6% in 2023, according to a YouGov survey for Action on Smoking and Health (Ash). About 15% of 16 to 17-year-olds and 18% of 18-year-olds are current vapers, it suggests. Brightly coloured nicotine vapes in a variety of flavours, which are used once and then thrown away, are the most popular product among teenagers*." (https://www.bbc.co.uk/news/health-65809924).

The perceived benefits of vaping in combating tobacco smoking stand in contrast to the perceived risks to minors of unregulated access to vaping products.

Regulation and education

The response to issues raised by vaping in Australia is a proposed ban on all e-cigarettes unless prescribed by a pharmacist, particularly single use vapes, restrictions on flavouring and nicotine content and a shift to plain packaging. Australia joins Argentina, Brazil, Japan, India, Singapore and Thailand amongst 47 countries that have so far imposed various bans on the sale of e-cigarettes. In the UK the direction of travel favours a crackdown on 'corner shops' which sell to minors, promotion of plain packaging or packaging which is less likely to mimic confectionary (e.g. 'bubble gum') and more effective control over chemical content, backed by testing.

Supreme – product control and differentiation

Supreme reports a number of initiatives designed to ensure the sale of safe products to the appropriate customer base.

Targets mature market segment

Overall, Supreme observes that its vaping brands do not target younger age groups and are not promoted via social media, whilst its most popular tobacco and menthol product flavours appeal primarily to ex-smokers.

Acquired product screening technology

Supreme has maintained its own laboratory product testing and quality assurance service from the outset. This was augmented with the acquisition of Cuts Ice and Flavour Core - as we noted at the time of acquisition:

- As a specialist in the scientific development of e-liquid vaping flavourings **Cuts Ice** generates a *toxilogical monograph* using gas chromatographic and mass spectrometry analysis to provide a detailed picture of e-liquid flavouring components at molecular level. Its ISO Class-7 cleanroom matches GMP (good manufacturing practice) industry standards, to meet vaping-related Tobacco Products Directive (TPD) and other regulatory standards compliance.

- **Flavour Core Limited** screens compounds to identify 'molecules of concern', cross-check with published banned lists and assess for potentially harmful CMR (carcinogenic, mutagenic, reprotoxic) substances.

Age verification practices

For online sales Supreme deploys its own age verification system via a third-party specialist, under which customers are required to provide information such as a valid passport or driving license, or a pre-registered item such as a mobile phone contract. Once registered details are stored for future transactions.

The Group is also deploying a 'pre-order' due diligence process to ensure that distributors and customers enforce sales strict age verification.

Sports Nutrition & Wellness product segment

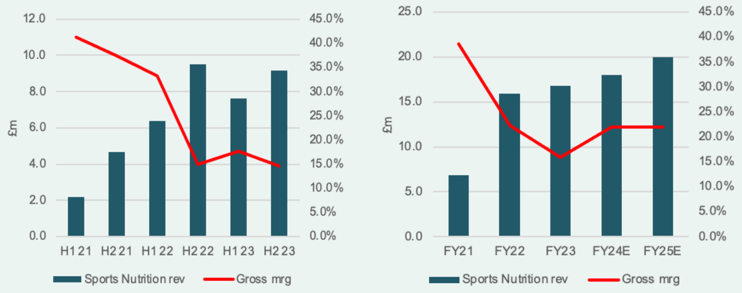
At year-end FY23 the division comprised 11% of Group revenue and 7% of gross profits. Revenue grew 6%YoY to £16.8m, with a H2 bias, supported by the launch of a refreshed Sci-Max range and Battle Bites protein bars. Gross contribution of £2.7m reflected the impact of increased raw material costs – principally whey products – reducing margin to 6.8% (H1: 7.6%; H2: 6.1%).

Revenue, gross FY20 – FY25E

£m	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	5.0	6.9	15.9	16.7	18.0	20.0
YoY		*37.7%*	*132%*	*5.4%*	*7.5%*	*11.1%*
% of	*5.4%*	*5.6%*	*12.2%*	*10.8%*	*9.3%*	*9.9%*
Gross	2.1	2.6	3.5	2.7	4.0	4.4
% of	*8.2%*	*8.3%*	*9.6%*	*6.7%*	*7.7%*	*8.2%*
Gross mrg	*42.5%*	*38.6%*	*22.3%*	*15.9%*	*22.0%*	*22.0%*

Source: Company data, Equity Development estimates.

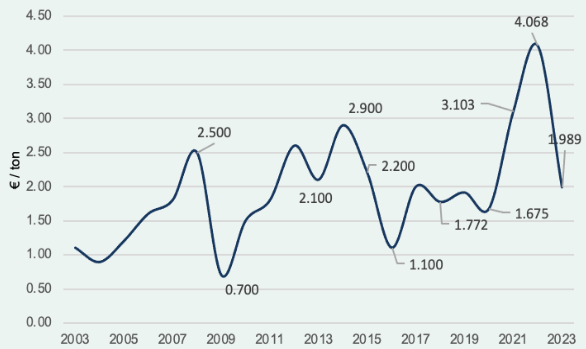
Revenue, gross margin semi-annual to FY23 and annual FY21 - FY25E



Source: Company data, Equity Development estimates

As pricing pressure on raw materials eases, we expect gross margin to recover to above 20% in FY24-25. The latest June 2023 price of whey protein concentrate (US whey protein concentrate, €1.989/ton) has retreated to levels 18% below the 2017-23 average and 51% below the October 2022 peak. The price of skim milk powder (German, €) has similarly declined, down 42%YoY from the April 2022 peak of €4.299/ton (source: CLAL.it, Italian economic dairy consultants).

US whey protein concentrate price, 2003 – June 2023 (€/ton)



Source: https://www.clal.it/en/?section=whey_usa.

Branded Household Goods product segment

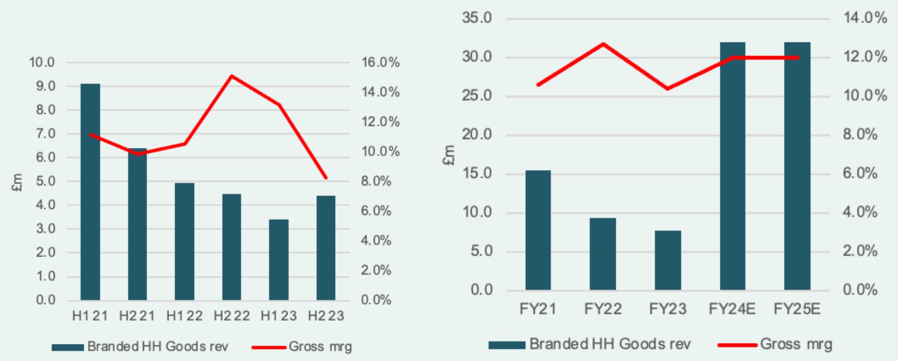
At year-end FY23 the division comprised 5% of Group revenue and 2% of gross profits. Revenue (£7.8m) declined 17%YoY, whilst gross margin reverted to FY21 levels at c10%.

Revenue, gross FY20 – FY25E

£m	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	2.0	15.5	9.4	7.8	32.0	32.0
YoY		*665%*	*-39.3%*	*-17.1%*	*3109%*	*0.0%*
% of	*2.2%*	*12.7%*	*7.2%*	*5.0%*	*16.5%*	*15.9%*
Gross	0.3	1.6	1.2	0.8	3.8	3.8
% of	*1.3%*	*5.2%*	*3.2%*	*2.1%*	*7.5%*	*7.2%*
Gross mrg	*16.1%*	*10.6%*	*12.7%*	*10.4%*	*12.0%*	*12.0%*

Source: Company data, Equity Development estimates.

Revenue, gross margin semi-annual to FY23 and annual FY21 - FY25E



Source: Company data, Equity Development estimates.

Product segment outlook transformed by Elf Bar distributor agreement

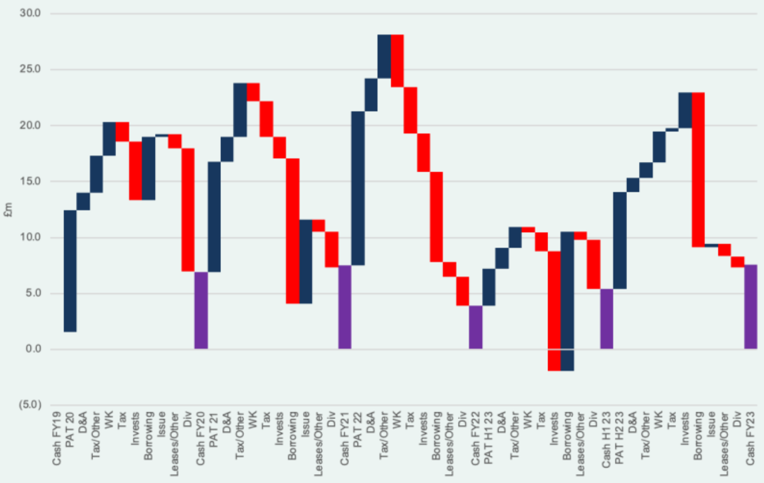
The announcement of the *Elf Bar* and *Lost Mary* vaping products master distributor agreement for the UK effectively raises our FY24 product segment outlook by £25.0m to £32.0m, based on Supreme's assessment of the market opportunity represented by its network of over 10,000 branded retail outlets and thousands of independent retail stores.

The agreement is distribution only – Supreme will not undertake manufacture. We expect the initiative to absorb working capital in the first part of FY24.

Cashflow

The year-end cash balance was £7.5m, with net cash generated of £19.3m and a year-end net cash balance of £3.2m excluding lease obligations (i.e. pre-IFRS 16) of £15.0m (FY22: £2.2m). Adjusted EBITDA of £19.4m included administrative expenses of £28.2m +31%YoY. Excluding depreciation and amortisation, adjusted items and the gain on disposal of the IP of TJuice, expenses totalled £21.5m compared to £18.6m in FY22, with £2.8m arising from the acquisition – albeit earnings-accretive – of Liberty Flights. In respect of the acquisition £2.0m in deferred consideration (plus an estimated £2.2m in performance-related payment) is due in FY24. Sound working capital management contributed £2.2m, the major outflows being cap-ex of £1.3m (FY22: £1.3m) and acquisition of Liberty Flights (£7.5m) and Cuts Ice (£2.6m). The Group drew down £18.4m of its £25.0m HSBC RCF, repaying £14.0m, and resulting in an overall change in borrowings of £(1.4)m. The combined RCF and a £8.5m working capital facility resulted in c.£30m of facilities available at year-end for potential M&A activity, or otherwise to fund growth.

Cahflow bridge H1 20 – H2 23



Source: Company data, Equity Development estimates.

In November 2022 Supreme finalised a 15-year lease on a 167,000 sq.ft. facility in Trafford Park (Manchester: M17 1HJ) to consolidate manufacturing, storage and distribution operations. The company estimates that the new facility will accommodate revenue streams of £350m - £450m; FY23 capex included fit out of the new facility as does a portion of cap-ex for FY24 which we estimate at £3.0m..

Ark Trafford Park manufacturing and distribution facility

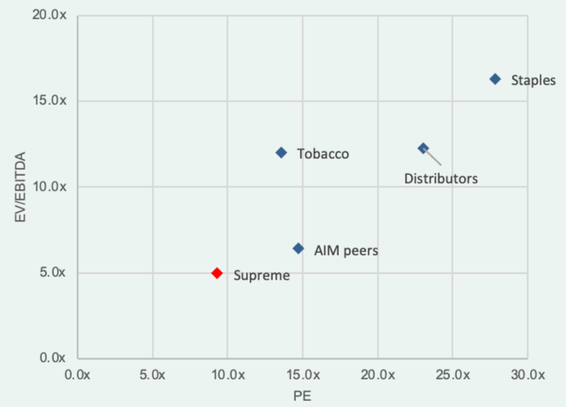
Source: Company data, Equity Development estimates.

Valuation considerations

On our revised outlook Supreme trades on a FY24 (E) EV/EBITDA of 4.6x and PE of 8.7x, a significant discount to the following *market cap-weighted* averages across Supreme's product segment range:

Distributors - Diploma, Bunzl, Ferguson, Travis Perkins: 12.3x / 23.0x; **Consumer Staples** - Unilever, P&G, Nestle, Walmart, PepsiCo, Reckitt: 16.3x / 27.8x; **Tobacco** - BATS, Philip Morris, Altria, Imperial Brands: 12.0x / 13.6x; **AIM classification peers** - Accrol, IG Design, Kitwave, Uniphar: 6.4x / 14.7x.

Comparative valuation, EV/EBITDA and PE +1 year (E)



Source: Yahoo Finance, Equity Development estimates.

Comparative valuation, EV/EBITDA, PE, EV/Revenue

Company	Code	PE		EV/EBITDA		EV/Rev
		-1 Yr	+1YrE	-1 Yr	+1YrE	+1YrE
Distribution						
Diploma PLC	DPLM.L	38.3x	36.5x	24.2x	23.1x	3.7x
Bunzl	BNZL.L	22.4x	21.4x	10.6x	10.1x	0.9x
Ferguson	FERG.L	0.2x	0.2x	1.1x	1.1x	0.1x
Tr Perkins	TPK.L	8.6x	8.2x	4.3x	4.1x	0.4x
Consumer						
Unilever	UL.L	17.3x	16.5x	11.8x	11.3x	2.5x
P&G	PG.L	25.0x	23.8x	17.8x	17.0x	4.5x
Nestle	NSRGY	31.7x	30.2x	19.9x	19.0x	3.2x
Walmart	WMT	36.0x	34.3x	15.0x	14.3x	0.7x
Pepsico	PEP	28.8x	27.4x	19.5x	18.5x	3.2x
Reckitt	RKT	18.6x	17.7x	12.9x	12.3x	3.3x
Tobacco						
BATS	BATS	8.9x	8.5x	8.0x	7.6x	3.4x
Ph Morris	PM	16.6x	15.8x	15.5x	14.8x	5.7x
Altria	MO	13.9x	13.2x	11.9x	11.3x	4.8x
Imp Brands	IMBBY	13.7x	13.0x	8.2x	7.8x	0.9x
AIM						
Accrol	ACRL.L	*N.M.*	*N.M.*	8.2x	7.8x	0.6x
IG Design	IGR.L	28.1x	26.8x	*N.M.*	*N.M.*	*N.M.*
Kitwave	KITW.L	14.3x	13.6x	9.4x	9.0x	0.5x
Uniphar	UPR.L	15.8x	15.1x	7.0x	6.6x	0.3x

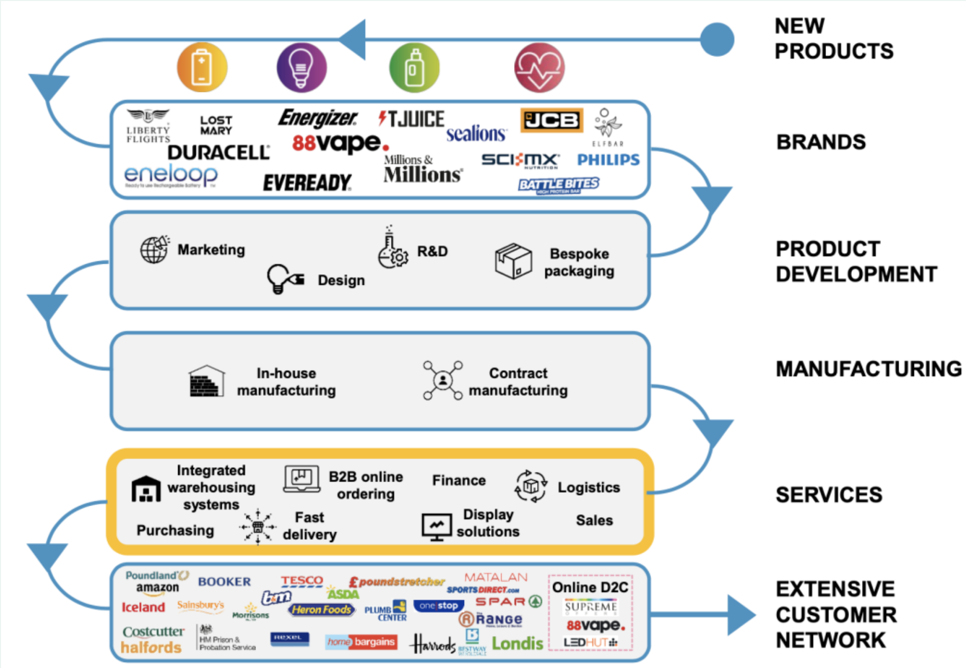
Source: Yahoo Finance, Equity Development estimates.

Appendix I: Supreme integrated platform

Supreme has developed an integrated process which aligns product development and manufacture with distribution and sales to its customer network. As illustrated, the process aligns:

- New product design, both in-house and via 3rd party collaboration.
- Brand development, licensed brands and distribution agreements.
- Product development including white label for customers.
- In-house manufacturing of Vaping and Sports Nutrition & Wellness segment products.
- Online ordering and integrated distribution management for retailers.
- A network of 10,000 branded retail outlets and thousands of independent stores, plus direct-to-customer online.

Supreme integrated production and sales platform



Source: Company data.

Summary P&L

Summary P&L outlook to FY25 E

£m		FY22	H1 23	H2 23	FY23	FY24E	FY25E
Batteries		34.9	15.7	23.9	39.5	40.5	40.5
Lighting		27.0	6.2	9.3	15.4	19.0	23.0
Vaping		43.6	31.8	41.7	76.1	84.0	86.0
Sports Nutrition & Wellness		15.9	7.6	9.1	16.7	18.0	20.0
Branded HH Consumer Goods		9.4	3.4	4.4	7.8	32.0	32.0
Revenue		**130.8**	**64.6**	**88.4**	**155.6**	**193.5**	**201.5**
Gross Sum		36.9	17.6	22.0	39.6	51.1	53.5
	Mrg	*28.2%*	*27.3%*	*24.9%*	*25.4%*	*26.4%*	*26.6%*
COGS		(93.9)	(47.0)	(66.4)	(116.0)	(142.4)	(148.0)
Forex		1.6	0.5	0.7	1.3	1.0	1.0
Gross inc forex		**38.5**	**18.2**	**22.7**	**40.9**	**52.1**	**54.5**
	Mrg	*29.4%*	*28.1%*	*25.7%*	*26.3%*	*26.9%*	*27.1%*
Sum Op-ex		(21.5)	(13.4)	(14.8)	(28.2)	(33.3)	(34.0)
One-off costs		(1.1)	(1.4)	0.6	(0.8)	(2.5)	(1.5)
One off gain		0.0	0.0	0.0	2.8	0.0	0.0
EBIT Reported		17.0	4.8	7.9	15.4	18.8	20.6
EBIT Adjusted		**18.1**	**6.2**	**7.3**	**16.3**	**21.3**	**22.1**
	Mrg	*13.8%*	*9.7%*	*8.2%*	*10.5%*	*11.0%*	*10.9%*
Depreciation		(2.6)	(1.4)	(0.8)	(2.2)	(2.8)	(3.0)
Amortisation		(0.4)	(0.5)	(0.4)	(0.9)	(1.5)	(1.7)
EBITDA Reported		20.0	6.7	11.9	18.6	23.1	25.3
EBITDA Adjusted		**21.1**	**8.1**	**11.3**	**19.4**	**25.6**	**26.8**
	Mrg	*16.1%*	*12.6%*	*12.8%*	*12.5%*	*13.2%*	*13.3%*
Financial income		0.00	0.00	0.03	0.03	0.00	0.00
Financial expense		(0.7)	(0.4)	(0.6)	(1.0)	(1.0)	(1.0)
PBT Reported		16.3	4.4	10.0	14.4	17.8	19.5
PBT Adjusted		**17.4**	**5.8**	**9.4**	**15.3**	**20.3**	**21.0**
Tax		(2.6)	(1.1)	(1.4)	(2.5)	(4.4)	(4.9)
Reported tax rate		*15.8%*	*25.2%*	*13.5%*	*20.0%*	*25.0%*	*25.0%*
	Tax rate adjusted	*14.8%*	*19.0%*	*14.4%*	*16.2%*	*21.9%*	*23.2%*
PAT Reported		13.7	3.3	8.8	12.1	13.3	14.6
PAT Adjusted		**14.8**	**4.7**	**8.2**	**12.9**	**15.8**	**16.1**
Amortisation & tax items		1.3	0.0	(0.1)	1.8	2.5	2.5
PAT Adjusted		**15.0**	**3.3**	**8.7**	**13.8**	**15.8**	**17.1**
Basic wtd. av. shares (m)		116.6	116.6	116.7	116.7	116.7	116.7
Diluted wtd. av. shares (m)		121.1	121.1	123.5	123.5	123.5	123.5
EPS rptd. basic (p)		11.8	2.8	7.5	10.3	11.4	12.5
EPS rptd. dil. (p)		11.3	2.7	7.1	9.8	10.8	11.9
EPS adj. basic (p)		12.8	2.8	7.4	11.8	13.6	14.7
EPS adj. dil. (p)		**12.4**	**2.7**	**7.0**	**11.2**	**12.8**	**13.9**

Source: Company data, Equity Development estimates.

Summary Cashflow

Summary cashflow, outlook to FY25 E						
Yr to March 31 (£m)	**FY22**	**H1 23**	**H2 23**	**FY23**	**FY24E**	**FY25E**
PAT Reported	13.7	3.3	8.7	12.0	13.3	14.6
One-off items	1.1	0.4	0.5	0.8	2.5	1.5
Depreciation	2.6	1.4	0.8	2.2	2.8	3.0
Amortisation	0.4	0.5	0.4	0.9	1.5	1.7
Tax	2.6	1.1	1.4	2.5	4.4	4.9
Finance/other	0.2	0.4	(0.4)	(0.0)	1.0	1.0
Operating Cash Flow	**20.6**	**7.0**	**11.3**	**18.4**	**25.6**	**26.8**
(Increase)/Decrease inventories	(4.9)	(2.2)	5.1	2.9	(8.9)	0.8
(Increase)/Decrease in receivables	(2.2)	(6.7)	6.0	(0.7)	(8.5)	0.1
Increase/(Decrease) in payables	2.5	8.4	(8.4)	(0.0)	5.7	(3.1)
Movement in working capital	**(4.7)**	**(0.5)**	**2.7**	**2.2**	**(11.6)**	**(2.2)**
Cash generated by operations	**15.9**	**6.5**	**14.1**	**20.6**	**14.0**	**24.5**
Tax (paid)/received	(4.2)	(1.7)	0.3	(1.3)	(4.4)	(4.9)
Net cash from operations	**11.8**	**4.9**	**14.4**	**19.3**	**9.5**	**19.7**
Investing activities	0.0	0.0	0.0	0.0	0.0	0.0
Interest received	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles	(1.5)	0.0	0.0	0.0	0.0	0.0
PPE	(1.3)	(0.5)	(0.7)	(1.3)	(3.0)	(1.0)
Acquisition	(1.0)	(10.1)	0.1	(10.1)	(4.0)	0.0
Sale of PPE	0.4	0.0	4.0	4.0	1.3	0.0
Net cash used in investing	(3.4)	(10.7)	3.2	(7.6)	(5.7)	(1.0)
Net OpFCF	**8.4**	**(5.9)**	**17.6**	**11.7**	**3.8**	**18.7**
Borrowings (net)	(8.1)	12.5	(13.8)	(1.3)	0.0	0.0
Share issue	0.0	0.0	0.3	0.3	0.0	0.0
Interest paid	(0.3)	(0.2)	(0.6)	(0.8)	0.0	0.0
Leases	(1.0)	(0.5)	(0.5)	(1.0)	(1.0)	(1.0)
Dividend	(2.6)	(4.4)	(0.9)	(5.4)	(6.6)	(6.7)
Net cash from financing	**(11.9)**	**7.3**	**(15.5)**	**(8.2)**	**(7.6)**	**(7.7)**
Net increase in cash / equivalents	(3.5)	1.5	2.1	3.5	(3.8)	11.0
Cash start	7.5	3.9	5.4	3.9	7.5	3.8
Forex	(0.0)	0.0	0.1	0.1	0.0	0.0
Cash end	**3.9**	**5.4**	**7.5**	**7.5**	**3.8**	**14.7**

Source: Company data, Equity Development estimates.

Summary Balance sheet

Summary balance sheet, outlook to FY25 E

Yr to March 31 (£m)	FY22	H1 23	H2 23	FY23	FY24E	FY25E
Intangible assets	3.7	14.1	15.3	15.3	13.8	12.1
PPE net	2.6	3.6	5.2	5.2	5.4	3.4
RoU	2.1	1.7	15.6	15.6	15.6	15.6
Investments	1.3	0.6	0.0	0.0	0.0	0.0
Sum Fixed Assets	**9.7**	**20.1**	**36.1**	**36.1**	**34.8**	**31.1**
Inventories	25.9	30.6	25.6	25.6	34.5	33.7
Trade receivables	19.0	26.9	20.9	20.9	29.4	29.3
Tax assets	0.0	0.0	0.0	0.0	0.0	0.0
Financial insts	0.5	0.8	0.0	0.0	0.0	0.0
Cash, Equivalents	3.9	5.4	7.5	7.5	3.8	14.7
Sum Current Assets	**49.3**	**63.8**	**54.0**	**54.0**	**67.6**	**77.7**
Total Assets	**59.0**	**83.8**	**90.1**	**90.1**	**102.4**	**108.8**
Trade payables	(17.3)	(31.8)	(26.1)	(26.1)	(31.8)	(28.7)
Borrowings	(6.7)	(0.4)	(5.0)	(5.0)	(5.0)	(5.0)
Tax, Other	(1.3)	(0.8)	(3.2)	(3.2)	(3.2)	(3.2)
Sum Current Liabilities	**(25.3)**	**(33.0)**	**(34.3)**	**(34.3)**	**(40.0)**	**(36.9)**
Total Assets less Current Liabilities	33.8	50.8	55.8	55.8	62.4	71.9
Borrowings	(1.3)	(19.6)	(14.3)	(14.3)	(14.3)	(14.3)
Tax/Provisions	(0.2)	(0.3)	(1.6)	(1.6)	(1.6)	(1.6)
Sum Long-term liabilities	(1.5)	(19.8)	(15.9)	(15.9)	(15.9)	(15.9)
Total liabilities	**(26.7)**	**(52.9)**	**(50.2)**	**(50.2)**	**(55.9)**	**(52.8)**
Net Assets	32.3	31.0	40.0	40.0	46.5	56.0
Share Capital	11.7	11.7	11.7	11.7	11.7	11.7
Share Premium	7.2	7.2	7.4	7.4	1.2	(6.5)
Capital Reserve	(22.0)	(22.0)	(22.0)	(22.0)	(22.0)	(22.0)
Retained earnings	33.1	31.9	39.8	39.8	55.6	72.7
Equity	**32.3**	**31.0**	**40.0**	**40.0**	**46.5**	**56.0**
Net debt / (cash)	4.0	14.6	11.8	11.8	15.5	4.6
Net debt / (cash) pre-IFRS 16	1.8	12.4	(3.2)	(3.2)	1.5	(8.4)

Source: Company data, Equity Development estimates.

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

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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