Ultimate Products plc

Balancing sales growth with cash flow generation

9 April 2024

Stable profits (EBITDA) and a marked reduction in bank debt were key features of Ultimate Products' ('UP') interim results, which were released today. The company also announced its intention to buy back up to 10% of its shares. With revenue expansion likely to resume in H2 2024, and continue into FY2025, we argue that UP is more than capable of generating sales growth and free cash flow simultaneously and thus maintain our 250p estimated fair value for the shares. FY2024 full year results are expected to match current market expectations.

UP's interim results confirmed its 13th February 2024 trading update that stated sales fell by 4% in the period and which we commented on in our report Cash generation drives shareholder value, noting three specific adverse influences. H124 EBITDA was £11.2m, little changed from £11.3m a year earlier, while EPS fell by 3% due to a higher reported tax rate. Net bank debt in relation to EBITDA fell to 0.4x from 0.7x six months earlier due to positive cash flow.

Not surprisingly given the unusual strength of air fryers in the same period a year earlier, Salter experienced a drop in sales in FY2024 H1. However, useful gains from Premier Brands Beldray and Kleeneze arrested the overall pace of the decline. UP also made significant gains in own label without any adverse impact on EBITDA margins. "Rest of Europe" was the strongest geographic performer with a 32% increase that offset declines in Germany and the UK.

UP's brands remain central to the investment case for UP. Five of the six Premier Brands are wholly owned and these remained close to 90% of the group's branded sales in the first half of FY2024. Salter was unchanged at 45% of *branded* sales while Beldray increased from 22% to 26%. We discuss initiatives for Satler and the other Premier Brands in this report.

Positive cash flow generation is associated with UP's intention to buy back up to around 10% of the company's shares outstanding. Regulatory and shareholder approval is being sought to commence this repurchase programme, which should enhance return on net equity as a result of a more aggressive balance sheet. Operating cash conversion was 128% in FY2024, an improvement from 114% a year earlier.

Underlying 6% sales growth, a robust portfolio of six Premier Brands, the ability consistently to convert profits into cash and the prospect of a buyback programme support our view that UP's shares merit a valuation significantly in excess of current levels. With a keen eye on relative valuation, we base our unchanged 250p fair value on 1.3x EV/sales, 10.3x EV/EBITDA and 16.2x P/E ratio. At this share price the dividend yield would still be 3.1% - i.e. in line with peers.

Key Financials

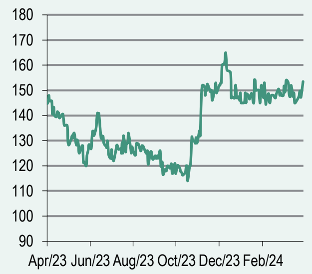
Year to 31st July	2021A	2022A	2023A	2024E	2025E
Revenue (£m)	**136.4**	**154.2**	**166.3**	**167.1**	**180.5**
Revenue growth	17.9%	13.1%	7.9%	0.5%	8.0%
EBITDA adjusted (£m)	**10.6**	**18.8**	**20.2**	**21.6**	**23.7**
EPS adjusted (p)	9.8	14.7	15.4	15.4	17.0
DPS (p)	**5.0**	**7.1**	**7.4**	**7.7**	**8.7**
EV/EBITDA (x)	13.2	7.5	6.9	6.5	6.1
P/E ratio (x)	**15.7**	**10.4**	**10.0**	**9.9**	**9.0**
Yield	3.3%	4.6%	4.8%	5.0%	5.5%

Source: Equity Development estimates, Company historic data

Company Data

EPIC	ULTP
Price (last close)	154p
52 weeks Hi/Lo	113p/170p
Market cap	£132m
ED Fair Value	250p

Share Price, p



Source: ADVFN

Description

Ultimate Products plc (ULTP) develops new, innovative concepts and brings professional, sought-after products to the mass market.

Their offices span two continents, with headquarters in the UK, a sourcing office and showroom in China and a further showroom in Continental Europe.

Key owned brands include **Salter, Beldray, Progress, Kleeneze, Petra and Intempo**. The company also markets non-electrical Russell Hobbs products under licence, now on a rolling four-year basis.

The company changed its name to Ultimate Products plc on 31 October 2023 and its stock ticker to ULTP.

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Balancing sales growth with cash flow generation

UP's FY2024 half-year results and the comment that current market expectations will be matched for the full year imply **a resumption of sales growth in the second half of the year**. Moreover, there is potential for sales to accelerate to 8% in FY2025 from closer to 1% in FY2024 based on a combination of geographical expansion and normalisation of stock levels within supermarkets.

Elsewhere, the company quantified the scale of any share buyback programme – i.e. around 10% of the current market capitalisation. The shareholder benefits of UP being able to grow sales and generate free cash flow simultaneously should be clear. This balance of achievements not only reflects the relatively fixed capital light nature of a brand and execution driven business but also tight controls on both costs and working capital.

This report looks at today's results release in more detail before discussing sales growth by key criteria, the development of UP's brand portfolio and the shareholder benefits of the company's capital allocation policy – i.e. the buybacks.

FY2024 results in more detail

The financial highlights from today's release are summarised in Figure 1. We also compare consensus forecasts relative to our own in the context of UP's expectation that they will be met. The implication is that sales growth will recover to close to our underlying 6% view in the second half of this financial year.

Interim results highlights

A two-percentage point increase in gross margins helped protect UP's first half EBITDA which was stable despite the first half decrease in sales revenue. A strong financial performance – i.e. reduced debt – helped pre-tax profits to increase as net bank debt in relation to EBITDA fell from 0.7x to 0.4x. A fall in adjusted EPS reflected an increase in the adjusted corporation tax rate to 25% from 21% in the same period a year earlier.

Figure 1 - Interim results highlights

All figures in £m	FY2023 H1	FY2024 H1	Change
Revenue	**87.6**	**84.2**	**-4%**
Gross profit	21.6	22.4	3%
Gross margin	24.7%	26.6%	2ppts
EBITDA - adjusted	**11.2**	**11.3**	**stable**
Pre-tax profit - adjusted	9.4	9.6	2%
Adjusted EPS (pence)	**8.6**	**8.3**	**-3%**
Interim dividend per share (pence)	2.43	2.45	1%
	FY2023-end	**FY2024 H1**	**Change**
Net bank debt/adjusted EBITDA	**0.7x**	**0.4x**	**-0.3x**

Source: Company data

UP's improved net debt position, which is consistent with the decision to buy back shares, implies significant cash conversion in the period. In FY2024 H1 cash from operations was £14.4m, equivalent to 128% of EBITDA which was £11.3m and compares with 114% conversion by the same measure a year earlier.

Using change in net debt as a proxy for overall free cash flow and comparing it with the movement in net income, the conversion rate at £6.8m/£7.1m was an impressive 96%. Excluding the £4.3m dividend pay-out in the period, this measure of cash conversion would have been 156% (£11.m/£7.1m).

Confirmation of key market expectations

According to today's statement, UP continues to trade in line with market expectations for FY2024. As a result, we leave our own forecasts unchanged. A comparison of these forecasts with UP's assessment of the current consensus appears in Figure 2. Equity Development's estimates are slightly beneath consensus for revenue and EBITDA and in line for EPS.

Figure 2 - Equity Development forecasts and consensus for FY2024

All figures in £m	Consensus	ED	Variance
Revenue	167.1	166.7	-0.2%
EBITDA	21.6	21.5	-0.5%
Adjusted EPS (pence)	15.4	15.4	-

Source: Company data and Equity Development estimates

Sales growth by geography, brand, product and channel

As highlighted in the 13th February 2024 trading statement, UP's first half sales setback was largely attributable to three distinct influences. These can be summarised as follows:

- UP lapped an unusually strong period a year earlier when demand for energy saving devices – i.e. air-fryers - was at a peak.
- Supermarket overstocking took longer to dissipate than might have been expected.
- The company encountered some disruption to sea freight in the Red Sea.

The patterns shown in UP's FY2024 H1 sales performance significantly reflect these influences whether cut by geographical territory, brand, product category or sales channel. We look at each in turn.

Geographical location

The UK bore the brunt of lapping a strong prior year period for air fryer sales, which explains the region experiencing a sales drop larger than for UP as a whole in FY2024 H1. Germany suffered from a backlog of overstocking amongst retailers. However, it should be noted that international sales – despite the above mentioned special influences and Germany – were in positive territory overall. They increased by 4%.

Figure 3 - FY2023 H1 and FY2024 H1 revenue by geographical location

All figures in £'000s	FY2023 H1	FY2024 H1	change
United Kingdom	62,569	58,150	-7.1%
Germany	8,825	4,557	-48.4%
Rest of Europe	15,642	20,676	32.2%
Rest of the World	570	796	39.6%
Total	**87,606**	**84,179**	**-3.9%**
International sales	25,037	26,029	4.0%
International as a portion of total	28.6%	30.9%	

Source: Company data

Brand

Salter and Beldray remain the two most important brands for UP. In particular, they are the chief brands in the UK. Their share of total sales remained at 60% despite higher private label sales and a lower number for Salter. However, as a portion of the group's "Premier Brands," they increased from 74% to 80%.

Salter's setback was mainly attributable to the difficult comparison for the brand's air fryers as it lapped a period of unusually strong demand for these appliances a year earlier. Beldray experienced a useful return to growth having declined in the post COVID years of both FY2022 and FY2023. Homewares sales experienced an unusual jump during the pandemic as they benefited from a switch in spending away from consumers going out.

Petra's inclusion in Premier Brands augurs positively for international expansion with the brand – acquired in February 2021 – being particularly relevant for continental European markets given its German heritage.

Figure 4 - FY2023 H1 and FY2024 H1 revenue by brand

All figures in £'000s	FY2023 H1	FY2024 H1	change
Salter	35,219	32,104	-8.8%
Beldray	17,174	18,450	7.4%
Russell Hobbs (licensed)	10,546	5,787	-45.1%
Progress	4,005	3,449	-13.9%
Kleeneze	1,547	1,895	22.5%
Petra	1,932	1,754	-9.2%
Premier brands	**70,423**	**63,439**	**-9.9%**
Other proprietorial brands	8,789	8,505	-3.2%
Own label and other	8,394	12,235	45.8%
Total	**87,606**	**84,179**	**-3.9%**

Source: Company data

Product category

Again, unfavourable comparisons for air fryers tends to explain the pattern of sales by product category as small domestic appliances fell by around 10%. Elsewhere, overstocking within German supermarkets had a negative impact on housewares – notably in the area of cookware.

Figure 4 - FY2023 H1 and FY2024 H1 revenue by product category

All figures in £'000s	FY2023 H1	FY2024 H1	change
Small domestic appliances	36,695	33,175	-9.6%
Housewares	26,483	21,387	-19.2%
Laundry	8,621	10,204	18.4%
Audio	7,157	7,757	8.4%
Heating and cooling	2,950	1,656	-43.9%
Others	5,700	10,000	75.4%
Total	**87,606**	**84,179**	**-3.9%**

Source: Company data

Sales channel

Supermarket overstocking is reflected clearly in the pattern of FY2024 H1 sales by channel as these outlets experienced a 19% fall in sales for UP. As a result, discounters returned to being the company's largest channel. That said, they remain a long way short of their annual peak of 58% share of the overall business in FY2017.

Online channels which remain targeted at 30% of UP's overall revenue were also negatively affected by lower air fryer sales. However, the channel was still 25% of sales which is what was achieved in FY2023.

Figure 5 - FY2023 H1 and FY2024 H1 revenue by sales channel

All figures in £'000s	**FY2022 H1**	**FY2023 H1**	**change**
Discount retailers	21,063	23,277	10.5%
Supermarkets	28,097	22,716	-19.2%
Online channels	22,904	20,874	-8.9%
Multiple-store retailers	10,966	11,080	1.0%
Other	4,576	6,232	36.2%
Total	**87,606**	**84,179**	**-3.9%**

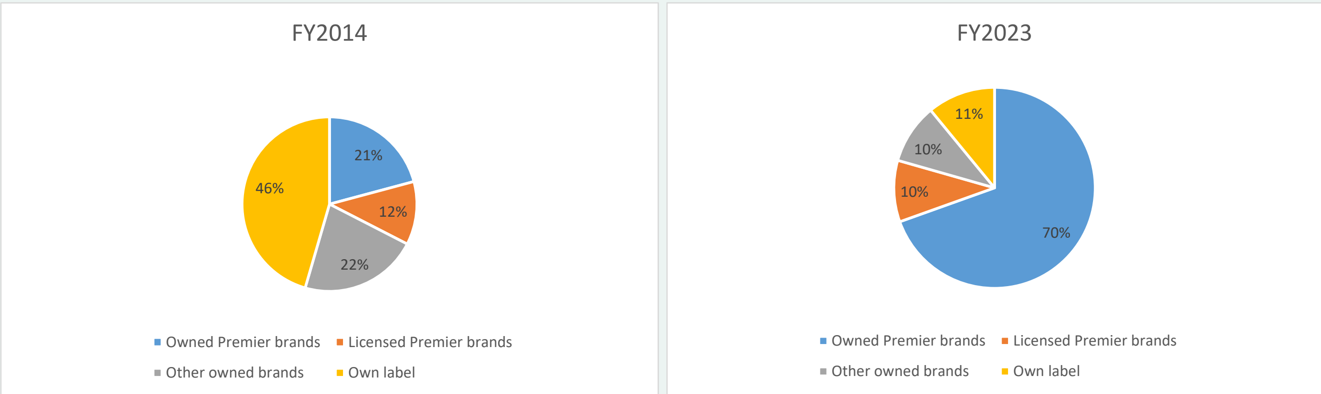
Source: Company data

Building even better brands

UP's well-established journey from its origins as a sourcing company to being a mainstream brand manager continues. The landmark transaction which accelerated this progress was the acquisition of the UK's oldest housewares brand Salter (founded 1760) in the summer of 2021.

The result of UP's ten-year evolution is illustrated in Figure 6. Having had as little as 21% of the business represented by what are owned and deemed to be "Premier Brands" in FY2014, these accounted for 70% of sales in FY2023 and were 68% in the first six months of FY2024.

Figure 6 – UP's owned Premier Brands – the 10 year journey



Source: Company data

The impact for UP's investment case is, in our opinion, significant. The underlying franchise value of the company is increasingly represented by a tightly managed collection of owned, proprietorial brands which the company has significant experience of positioning and promoting.

In addition, the customer engagement with and recognition of such brands will continue to facilitate product range expansion and distribution reach into new channels. Notable examples include success with Salter branded air fryers and the company's ability to expand into supermarkets and online where strong brand names are paramount.

Examples of further work with the brands in FY2024 H1 included the ongoing process of rebranding Salter with the aim both to elevate its identity and raise consumer recognition. This process, managed by Tracy Carroll, the company's first ever appointed Brand Director, witnessed a re-vamp of the Salter logo as well as a number of measures designed to simplify the message to retail customers and end-consumers.

The company also states its intention to focus brand development initiatives on core categories and to engage in a more brand-led approach to design. The brands themselves are increasingly seen as central to UP's ability to drive sales volumes forward.

Other brand strategy highlights include emphasizing the importance of consistency, establishment of clear brand guidelines and simplification of the styling process for products to match the overall brand message. Updated brand squares, or logos, for UP's premier brands are shown in Figure 7. Note that UP only has the Russell Hobbs licence for non-electrical products.

Figure 7 – Ulitimate Products premier brands – updated brand squares

Source: Company data

Capital allocation policy and share buybacks

UP's evolution from a sourcing company to a brand manager has important implications for return on capital employed and free cash flow generation. The company outsources manufacturing but adds significant value through product category selection, quality control, distribution and ultimately the "feel good" factor associated with its Premier Brands. UP has remained true to its embedded mantra of "beautiful products for every home."

This business structure results in the company being relatively "capital light." While increased sales volumes may lead to pressure for more working capital, they do not in themselves generate large scale capital expenditure requirements. As a result, UP is in the attractive position of being able to grow sales volumes and increase its free cash flow simultaneously.

In our view, investors stand to be rewarded significantly as a result of this virtual balance because of UP's decision to implement a new capital allocation policy and engage in share buybacks. At present, regulatory approval is being sought to commence the programme.

The interim results points to the potential for UP to repurchase up to 10% of the company's shares in the form of a buyback. The benefits of such a programme will be twofold. First, earnings will be distributed across a smaller number of shares and second the company's weighted average cost of capital should be reduced, subject to unchanged interest rates.

The initial impact of a 10% share buyback on our estimated adjusted EPS in FY2025 is illustrated in Figure 8. Key assumptions are that the buyback happens on the opening day of the new financial year at the current share price, that the marginal interest rate is 6.0% and that the tax rate is 26.5%. Our central conclusion is that a 10% share buyback would uplift adjusted EPS by around 7%.

It is vital, in our view, to note that these calculations are for illustrative purposes only. The share price at which any buyback will occur is necessarily unknown and it is likely that the repurchases will take place over a considerable period of time – i.e. not 10% in one transaction.

Figure 8 - Illustrative 10% share buyback impact based on FY2025 forecasts

Impact of buyback	**No buyback**	**With buyback**	**Change**
Current share price (pence)	154	154	
Number of shares (m)	86.3	77.7	-10%
After tax income - adjusted (£'000s)	14,648	14,063	-4%
EPS - adjusted	**17.0**	**18.1**	**7%**
Workings			
Shares bought back		8.6	
Cost of buyback (£'000s)		13,249	
Assumed marginal interest rate		6.0%	
Assumed tax rate - adjusted		26.5%	
Impact on net income (£'000s)		584	

Source: Equity Development estimates

The estimated impact of a share buyback on UP's weighted average cost of capital (WACC) is shown in Figure 9. We base this calculation on the assumptions used in Figure 8 with the critical conclusion that the company's WACC would be reduced by around 30 basis points were a 10% buyback to be executed at the current share price. We assume an 8.5% cost of equity in our calculations.

Figure 9 - Impact on weighted average cost of capital

	No buyback	With buyback
Market cap (value of shares outstanding) £	132,486,334	119,237,700
Net debt - end FY2024 estimate £	7,817,381	21,066,015
Enterprise value based on debt + equity £	140,303,715	140,303,715
Weight of shares	94%	85%
Weight of debt	6%	15%
Cost of equity	8.5%	8.5%
Cost of debt	6.0%	6.0%
Weighted average cost of capital	**8.4%**	**8.1%**

Source: Equity Development estimates

Valuation and financials

Relative valuation

Our 250p fair value assessment for UP is significantly above the current share price. This fair value is justified in our view given the relative lack of recent valuation credit for the company now wholly owning Salter, its clear ability to generate significant amounts of free cash flow and focus on a carefully constructed portfolio of owned proprietorial brands.

At a share price of 250p UP would trade on 1.3x EV/sales, similar to the average of the peer group we choose for relative valuation. EV/EBITDA would be 10.3x and the P/E ratio would be 16.2x.

UP's attractive yield and consistent 50% pay-out ratio (either side of COVID) should also be noted. At a 250p share price this would shrink to 3.1% but remain in line with selected peers. We include a relative valuation in Figure 10.

Figure 10 - Relative valuation

	Share price (p)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2024 (£m)	EV/ sales (x)	EBITDA 2024 (£m)	EV/ EBITDA (x)	EPS 2024 (p)	P/E (x)	DPS 2024 (p)	YLD %
Accrol (ACRL)	39	128	62	189	207	0.9	21.2	8.9	2.9	13.4	0.3	0.6
Gear4Music (G4M)	136	29	28	57	144	0.4	9.8	5.8	3.6	37.7		
Luceco (LUCE)	157	246	20	266	226	1.2	33.6	7.9	11.4	13.8	4.9	3.1
Portmeirion (PMP)	223	31	16	47	100	0.5	10.7	4.4	24.8	9.0	7.3	3.3
Procook (PROC)	27	29	33	62	63	1.0	7.6	8.2	0.6	44.4	0.5	1.9
Ultimate Products (ULTP)	**154**	**132**	**8**	**140**	**167**	**0.8**	**21.6**	**7.3**	**15.4**	**9.9**	**7.7**	**5.0**
Warpaint (W7L)	375	289	-2	287	95	3.0	21.4	13.4	21.4	20.2	11.6	3.1
Average						**1.1**		**8.0**		**21.2**		**2.8**

Source: ADVFN (prices), MarketScreener (EBITDA), Stockopedia (Debt, EPS, dividends) and Equity Development estimates (UPGS forecasts)

Financial forecasts

Our forecasts for income statement, balance sheet and free cash flow are included in Figures 11, 12 and 13. Given the adjustments we made at the time of the trading update and confirmation of expectations in today's release we leave these unchanged.

We assume an underlying sales growth rate of 6% although that will clearly be slower in FY2024 and should be faster in FY2025.

The salient feature of the projected FY2024 balance sheet is our expectation that net debt will close the year at around £8m which would be 0.4x forecast EBITDA and explains the headroom for share buybacks discussed in this report.

Figure 11 - Income statement

All figures in £'000s	**2022A**	**2023A**	**2024E**	**2025E**
31st July year end				
Revenue	**154,191**	**166,315**	**167,147**	**180,518**
% increase in revenue	13.1%	7.9%	0.5%	8.0%
Cost of sales	-115,836	-123,568	-122,619	-132,139
Gross profit	38355	42747	44528	48379
Gross margin (%)	24.9%	25.0%	26.6%	26.8%
Administrative expenses	-19,605	-22,534	-22,900	-25,275
EBITDA - adjusted	**18,750**	**20,213**	**21,628**	**23,104**
EBITDA margin - adjusted (%)	12.2%	12.2%	12.9%	12.8%
Depreciation & amortisation - total	-2,066	-2,260	-2,496	-2,732
EBIT - adjusted	16,684	17,953	19,132	20,372
EBIT margin - adjusted	10.8%	10.8%	11.4%	11.3%
Net financial expense	-842	-1,132	-1,008	-443
Pre-tax profit - adjusted	**15,842**	**16,821**	**18,124**	**19,929**
Taxation	-3,120	-3,560	-4,803	-5,281
Tax rate (%) - adjusted	19.7%	21.2%	26.5%	26.5%
After tax income - adjusted	12,722	13,261	13,321	14,648
Share based payment charges	-403	-837	-837	-837
Statutory profit after tax (attributable)	12,370	12,586	12,654	14,011
EPS - basic adjusted (p)	**14.7**	**15.4**	**15.4**	**17.0**
Dividend per share (pence)	7.1	7.4	7.7	8.5

Source: ED estimates, Company historic data

Figure 12 - Balance sheet

All figures in £'000s	2022A	2023A	2024E	2025E
31st July year end				
Assets				
Intangible assets	37,025	37,003	37,003	37,003
Property, plant and equipment	6,369	8,443	7,008	5,378
Total non-current assets	43,394	45,446	44,011	42,381
Inventories	29,162	28,071	28,420	30,694
Trade and other receivables	32,194	29,890	28,539	29,323
Cash and cash equivalents	6,202	5,086	5,086	5,086
Total current assets	**71,700**	**64,280**	**62,046**	**65,103**
Total assets	**115,094**	**109,726**	**106,057**	**107,484**
Liabilities				
Trade and other payables	29,644	30,005	28,255	28,615
Derivative financial instruments		1,806		
Current tax	170			
Borrowings	22,314	15,891	8,913	2,746
Lease liabilities	817	836	836	836
Deferred consideration	987			
Total current liabilities	**53,932**	**48,538**	**38,004**	**32,197**
Borrowings (negative => cash)	8,144	3,990	3,990	3,990
Deferred tax	7,585	6,797	6,000	6,000
Lease liabilities	1,940	4,262	3,512	2,762
Total non-current liabilities	**17,669**	**15,049**	**13,502**	**12,752**
Share capital	223	223	223	223
Share premium account	14,334	14,334	14,334	14,334
Employee benefit trust reserve	-1,571	-1,571	-1,571	-1,571
Share-based payment reserve	1,166	2,003	2,840	3,677
Hedging reserve and other reserves	3,239	-4,265	-6,017	-9,126
Retained earnings	26,102	35,415	44,742	54,998
Total equity	**43,493**	**46,139**	**54,550**	**62,535**
Total equity and liabilities	**115,094**	**109,726**	**106,057**	**107,484**

Source: ED estimates, Company historic data

Figure 13 - Free cash flow

All figures in £'000s	**2022A**	**2023A**	**2024E**	**2025E**
31st July year-end				
Profit for the period	**12,370**	**12,586**	**12,654**	**14,011**
Adjustments for:				
Finance costs (net)	842	1,132	1,008	443
Income tax expense	3,069	3,399	4,803	5,281
Depreciation and impairment	2,044	2,238	2,474	2,710
Amortisation	22	22	16	16
Loss on disposal of a current asset				
Derivative financial instruments				
Share based payments	403	837	837	837
Income taxes paid	-2,345	-3,957	-4,803	-5,281
Working capital adjustments				
(Increase)/decrease in inventories	-7,721	1,090	-349	-2,274
Decrease/(increase) in receivables	-5,649	2,691	1,351	-783
(Decrease)/increase in payables	1,221	559	-1,750	360
Cash generated from operations	**4,530**	**20,399**	**16,240**	**15,320**
Cash flows used in investing activities				
Acquisition of a business	-1,960	-987		
PP&E	-1,843	-999	-1,039	-1,081
Repayment of lease liabilities		2,322	-750	-750
Total	-3,803	336	-1,789	-1,831
Free cash flow before financing	**727**	**20,735**	**14,451**	**13,490**
Interest paid	-850	-1,147	-1,008	-443
Free cash flow before dividends etc	**250**	**19,056**	**13,443**	**13,047**
Dividends paid	-4,830	-6,255	-6,466	-6,879
Principal paid on lease obligations	-936	-840		
Debt issue costs paid		-94		
Free cash flow after dividends etc	**-5,516**	**11,867**	**6,978**	**6,167**

Source: ED estimates, company historic data

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