Ultimate Products plc

Cash generation drives shareholder value

13 February 2024

Ultimate Products' (UP) sales fell by 4% in the first six months of FY2024 according to a trading statement released today, with the likelihood of a broadly flat full year. But the company's FY2024 profit expectations - and our own EBITDA forecasts - remain unchanged as improved gross margins should offset lower sales. With positive cash conversion and a stated interest in executing share buybacks, we reiterate our 250p fair value for UP's shares.

UP's first half sales setback was caused by 3 important temporary effects. First, the company lapped an unusually strong period a year earlier when demand for air fryers was at a peak. Second, supermarket overstocking has taken longer to dissipate than might be expected. Third, UP was negatively affected by disruptions to global supply chains related to conflict in the Red Sea. In FY2024 H2 we expect some growth recovery, but not enough to mitigate a flat full year – hence we cut our sales forecast.

In contrast, the gross margin outlook is significantly more positive as the uplift to gross margins achieved in the second half of FY2023 appears likely to be retained in FY2024. We increase our gross margin expectations in FY2024 from 25.5% to 26.6%. With tight controls in place on operating costs, the company should see EBITDA increase from FY2023, and we leave our profit forecast for this measure unchanged.

UP's ability to convert profits into cash remains central to the investment case for the company. Cash generation not only enables the company to grow its net profits more quickly than operating profits due to lower finance charges but also gives it greater flexibility over capital allocation. We highlighted the importance of cash conversion in our 31st October 2023 report Ultimate quality and value for customers

Some idea of buyback potential is available from today's trading update. The company targets long-term net debt/EBITDA at 1.0x. If our expectations for end-FY2024 net debt of £8.0m are met and £21.6m EBITDA are met, the implied headroom for share buy-backs would be of the order of £13m to £14m – equivalent to around 10% of the company's current market cap.

Separately, UP announced last week that Andrew Gossage (formerly MD) will become the new CEO with Simon Showman moving into the Chief Commercial Officer (CCO) role. This announcement should, in our view, secure greater clarity around strategic direction for the company as well as succession in the longer term. With positive news on the scope for buybacks in our view offsetting lower than expected sales revenue in FY2024 **we maintain fair value of 250p per share.**

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**	**23.1**
EPS adjusted (p)	9.8	14.7	15.4	15.4	17.0
DPS (p)	**5.0**	**7.1**	**7.4**	**7.7**	**8.5**
EV/EBITDA (x)	12.7	7.2	6.7	6.2	5.8
P/E ratio (x)	**15.0**	**10.0**	**9.6**	**9.5**	**8.7**
Yield	3.4%	4.8%	5.0%	5.2%	5.8%

Source: Equity Development estimates, Company historic data

Company Data

EPIC	ULTP
Price (last close)	147p
52 weeks Hi/Lo	166p/113p
Market cap	£127m
ED Fair Value / share	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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Cash generation drives shareholder value

Ultimate Products' 4% first half sales decline was clearly disappointing, not least because it seems unlikely that there will be sufficient bounce back in the second half of the year for the company to match what we believe is the company's underlying sales growth momentum of around 6%.

However, investors should note that UP's ability to maintain gross margins at the level enjoyed in the second half of FY2023 - and to continue to convert its profits into free cash flow - imply sustained strength in overall financial performance.

In addition, these metrics tend to vindicate the company's commitment to focusing on a small number of largely owned brands – notably Beldray and Salter. Shareholders should be rewarded by the company's ability to maintain a 50% dividend pay-out ratio as well as its stated interest in pursuing share buybacks.

Trading update highlights

The main features of today's update were the 4% decline in group revenues commented on above and an improvement in the net debt to EBITDA ratio from six months earlier. These are summarised in Figure 1.

Importantly, the sales setback was caused by three distinct adverse influences. The company's brands – which serve the mantra of "beautiful products for every home" - continue to resonate well with both retail and end customers.

Figure 1 - Trading statement highlights

All figures in £m	FY2023 H1	FY2024 H1	Change
Sales revenue	87.6	84.0	-4%
	End-FY2023	**FY2024 H1**	
Net debt/EBITDA	0.7x	0.4x	-0.3 points

Source: Company

FY2024 H1 lapped a challenging period a year earlier when sales growth was unusually boosted by a peak in popularity for energy saving devices – i.e. air fryers – which prompted UK sales to be 10% higher than in FY2023 H1.

Moreover, UP continues to suffer from supermarket overstocking. As overstocking clears, sales growth should recover to its underlying rate which we estimate to be 6%.

The company has been subject to global shipping disruption associated with the recent outbreak of conflicts in the Red Sea. UP encountered similar problems when there was a blockage in the Suez Canal.

Changes to forecasts

We summarise changes to our sales and EBITDA forecasts in Figure 2. The key change is a lower sales revenue number for FY2024. In FY2025 we assume that sales growth will reflect an underlying 6% rate although off a lower base than previously envisaged – hence 8.0% in FY2025.

Despite lowering our sales forecast, **we leave our EBITDA estimate in FY2024 broadly unchanged as UP benefits from spreading a similar gross margin to that enjoyed in FY2023 H2 across a whole year**. Moreover, the company continues to maintain strict controls over administration costs.

Positive expectations for both gross margins and free cash flow prompt us to raise our forecasts for EBITDA and EPS respectively in FY2025. We note that in FY2023 H2, gross margins were 26.6% which was a peak level for any half year period reported by the group.

Figure 2 - Revisions to forecasts

All figures in £m		**FY2024**			**FY2025**	
	old	new	change	old	new	Change
Sales revenue	**176.3**	**167.1**	**-5.2%**	**186.9**	**180.5**	**-3.4%**
EBITDA – adjusted	21.7	21.6	-0.3%	23.0	23.1	0.4%
EPS (p) – adjusted	**15.4**	**15.4**	**0.2%**	**16.8**	**17.0**	**1.2%**

Source: ED estimates

Capital Allocation Policy - cash generation at the core

UP’s relatively capital light business structure – i.e. the company is a focused brand manager not a manufacturer – and associated cash generation have clear positive implications. **We look at both in turn**.

Cash drivers

We highlighted UP’s cash generating capabilities in our 31st October 2023 report Ultimate quality and value for customers, which coincided with full year FY2023 results.

UP’s ability to become more cash generative should be supported by the company operating with a more focused brand portfolio which, in turn, delivers higher margins without the company engaging in supra inflationary pricing. Effectively, the company benefits from its customers “trading up.”

Such trading up reflects a greater concentration of sales into its two largest brands, Beldray and Salter, with the latter being a key component of this process. Between FY2020 and FY2023 these (the company’s two largest) brands increased their overall share of sales from 50.6% to 61.1%.

Moreover, working capital remains tightly managed. In FY2023 inventories fell to 17% of sales revenue from 19% of sales in FY2022. We assume that this measure remains constant in FY2024 and FY2025.

Cash benefits – share buybacks

A key feature of today’s release is “Capital Allocation Policy.” UP has fully paid down debt associated with the June 2021 Salter acquisition and the company’s board has thus approved a new capital allocation policy which **will allow the company to raise its debt level to 1.0x EBITDA**.

The route towards such capital allocation will be share buybacks, with a timing and schedule of buybacks yet to be announced and will include requisite shareholder and regulatory approvals. Some idea of the potential scale of buybacks can be inferred from our own estimate of an £8m end-FY2024 net debt level and our estimate of £22m EBITDA shown above.

To match the capital allocation policy the company could re-purchase around £13m to £14m worth of stock – i.e. equivalent to around 10% of the current market capitalisation.

Furthermore, investors should feel reassured that UP will be in a position sustainably to retain its current 50% dividend payout policy as a portion of earnings per share. The company not only has the profits to enable but also the cash to execute these payments.

Valuation and financials

Relative valuation

Our 250p fair value assessment for UP is significantly above the current share price. Despite our downgrade to sales expectations in FY2024 and FY2025 we maintain our estimated fair value at this level. In particular, we note the potential for the Capital Allocation Policy to generate share buybacks and note that the company maintains its current expectations for profits.

At a 250p share price, UP would trade on a 1.3x EV/sales ratio, 10.3x EV/EBITDA and a 16.2x P/E ratio based on our forecasts for FY2024. Thus, at this much higher price point the shares would trade at a slight premium to the average for its peers on EV/sales, around two points on EV/EBITDA and a discount on P/E.

However, any premium valuation would be justifiable in our view given not only the brand management and cash generation qualities of UP referred to in this report, but also the longer-term sales momentum of the business.

Figure 3 - 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)	37	119	62	181	207	0.9	21.2	8.5	2.9	12.5	0.3	0.7
Gear4Music (G4M)	145	30	28	59	144	0.4	9.8	6.0	4.1	35.0		
Luceco (LUCE)	150	235	43	278	209	1.3	30.4	9.2	10.7	14.0	4.4	3.0
Portmeirion (PMP)	216	30	21	52	102	0.5	9.2	5.6	16.9	12.8	15.5	7.2
Procook (PROC)	33	36	33	69	63	1.1	7.6	9.1	0.6	54.6	0.5	1.5
Ultimate Products (ULTP)	**147**	**127**	**8**	**135**	**167**	**0.8**	**19.1**	**7.0**	**15.4**	**9.5**	**7.7**	**5.2**
Warpaint (W7L)	401	309	-2	307	90	3.4	21.4	14.3	18.0	22.3	11.5	2.9
Average						**1.2**		**8.5**		**23.0**		**3.4**

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

Financial forecasts

Our revised financial forecasts appear in Figures 4 to 6. We continue to assume an underlying sales growth rate of 6% although that will clearly be slower in FY2024 for the reasons discussed earlier.

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 compared with the company's 1.0x target as stated in its comments regarding Capital Allocation Policy.

Figure 4 - 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	12,484	13,811
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 5 - 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	9,083	3,116
Lease liabilities	817	836	836	836
Deferred consideration	987			
Total current liabilities	**53,932**	**48,538**	**38,174**	**32,567**
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	44,572	54,628
Total equity	**43,493**	**46,139**	**54,380**	**62,165**
Total equity and liabilities	**115,094**	**109,726**	**106,057**	**107,484**

Source: ED estimates, Company historic data

Figure 6 - Free cash flow

All figures in £'000s	**2022A**	**2023A**	**2024E**	**2025E**
31st July year-end				
Profit for the period	**12,370**	**12,586**	**12,484**	**13,811**
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**	**16,070**	**15,120**
Cash flows used in investing activities				
Acquisition of a business	-1,960	-987		
Purchase of intangible assets				
PP&E	-1,843	-999	-1,039	-1,081
Proceeds from P, P & E disposals				
Finance income				
Repayment of lease liabilities		2,322	-750	-750
Total	-3,803	336	-1,789	-1,831
Free cash flow before financing	**727**	**20,735**	**14,281**	**13,290**
Interest paid	-850	-1,147	-1,008	-443
Free cash flow before dividends etc	**250**	**19,056**	**13,273**	**12,847**
Dividends paid	-4,830	-6,255	-6,466	-6,879
Sale of own shares	0	0		
Principal paid on lease obligations	-936	-840		
Debt issue costs paid		-94		
Free cash flow after dividends etc	**-5,516**	**11,867**	**6,808**	**5,967**

Source: ED estimates, company historic data

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