Superior Group Is A High Growth Stock At 60% Off

Aug. 06, 2021 5:00 PM ET | **Superior Group of Companies, Inc. (SGC)** | 9 Comments | 10 Likes

Jeremy Blum
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Summary

- Superior Group has two rapid growth companies hidden until now inside a flat revenue legacy uniforms business.
- Those two other segments are growing revenues and earnings over 30% per year that have reached almost 50% of total revenues.
- The market has not recognized the past growth and future potential as the stock is trading at an insane EPS run-rate PE ratio of about 8.
- Superior has a good balance sheet, long-term management, long-term success, and accelerating growth.

PeopleImages/E+ via Getty Images

So many investors have been chasing the newest EV, renewable energy, software or meme stock or cryptocurrency, that it has created opportunities for more traditional growth companies.

Last September, I wrote a bullish article on Performant Financial Corporation (PFMT). Performant had a larger legacy business that was in secular decline and a smaller rapid growth business that was reaching an inflection point. Overall sales were declining but the growth business had reached a point where that was about to change. The market had the company valued as a flat to declining revenue company. I argued that Performant is a growth company, and a relatively rapid one at that, trapped in a legacy declining one. Since then, Performant has sold or closed much of its legacy business and the stock is up over 600%.

Superior Group of Companies, Inc. (SGC) is similar but in my opinion even better. The legacy company is their uniforms business. Sales there are not declining. They have been relatively flat though for at least six years. Back in 2015 uniforms were 93% of sales. Since then, its call center business (Office Gurus) has grown 213%. It also purchased a promotional products business (BAMKO) in 2016. That

business has boomed, growing revenues 323% since its first full year in 2017. Most of the growth of both segments was organic. In the first six months of 2021, the uniforms business was down to 51% of total revenues. Earnings growth of the two newer segments has been even faster than revenues.

Superior Group is my best idea right now and largest holding. It is a growth company, with accelerating growth, that is trading at a run rate PE ratio of about 8. The market as a whole trades at an average PE ratio of 20-25 and has much less growth. It also has a strong balance sheet and management that has proven successful over the long term. It's been a while since I have seen an opportunity like this in a growth company.

Background

Superior is a 100 year-old company based in Seminole, Florida. Most of that time it was a uniforms company. It made what became a transformational acquisition in 2016 of BAMKO, a promotional products company. BAMCO's founder, Philip Koosed, is still with the company. BAMKO has been so successful, that it recently promoted Mr. Koosed to Chief Strategy Officer of Superior. The

company is not seasonal, so looking at the current quarter can give a good idea of the current run rate for revenues and earnings. Superior pays a $0.12/quarterly dividend with a current yield of 2.0%. It just increased this dividend by 20%.

Management believes there are synergies between the three segments (uniforms, call center and promotional products). The same salespeople are now being used to sell both uniforms and promotional products. The call center is used to service the other two.

Financial Results

While the uniforms business has had flat revenues, remote staffing and BAMKO have enjoyed rapid growth. There have been some acquisitions, but most of that growth was organic. The call center segment has enjoyed a revenue compound annual growth rate ((CAGR)) of 30.8% over the last 5 years if the first half of 2021 is annualized. This was all organic. BAMKO's revenue CAGR was even higher at 45.7%, though with acquisitions the organic rate was closer to call centers. Earnings for both have grown even faster. This has not been a fluke or anomaly. This growth has been in place for at least five years. It slowed for both during the worst of the pandemic in 2020 but has now accelerated even faster than before. Revenues, pretax income and EPS over the past six years are shown below.

Revenues by Segment

$ in millions	Uniforms	Call Center	BAMKO	Totals
2015	$198	$16		$214
2016	$210	$18	$28	$256
2017	$205	$23	$43	$271
2018	$238	$27	$81	$346
2019	$238	$32	$108	$378

2020 (1)	$239	$37	$119	$395
6 mo. 2021 (1)	$120	$25	$92	$237

(1) Excludes PP&E sales which were $131 million in 2020 and $33.7 million in the first half of 2021 and $3-4 million in 2019 and 2018.

Source: Superior Group forms 10-K and 10-Q

Net Income Before Taxes By Segment and EPS

$ in millions	Uniforms	Call Center	BAMKO	Totals	Adjusted EPS
2015	$15.5	$3.4		$18.9	
2016	$17.3	$3.5	-$0.9	$19.9	$0.98
2017	$17.9	$5.6	$1.2	$24.7	$0.99
2018	$12.5	$6.7	$2.2	$21.4	$1.10
2019	$4.2	$7.8	$3.4	$15.4	$0.79

2020	$16.5	$9.0	$25.9	$51.4	$2.65
1Q 2021	$2.8	$3.0	$7.5	$13.3	$0.66
2Q 2021 (2)	$4.5	$3.7	$5.0	$13.2	$0.67

(1) All years include PP&E as profits from it are not broken
(2) Excludes one time pension costs for uniforms in 2021.

Source: Superior Group forms 10-K and 10-Q

Revenues included $131 million of personal protective equipment (PPE) in 2020, up from under $4 million in 2019 and 2018. PPE sales continued to surge to $26.8 million in the first quarter of 2021. It then declined to $6.7 million in the second quarter. Management has guided for about $45 million PPE sales for the full year. That indicates the amount last quarter is near the new normal going forward. In the second quarter of 2021, only $0.9 million or 2% of BAMKO sales were from PPE. Most PPE sales were uniforms.

Earnings in the second quarter of 2021 were $0.67 adjusted for a one time pension termination charge of $6.9 million. There were no other unusual items in this number. Since the company is not seasonal, that indicates that $0.67 is the current quarterly run rate. That annualizes to EPS of $2.68. This is important because the prior four quarters were inflated by PPE sales and earnings. The last quarter is the first to show what Superior looks like with a normal level of PPE sales.

Uniforms

This is the legacy business that until 6 years ago represented over 90% of sales. The uniforms segment is about half medical and healthcare with the rest scattered among many different industries. Its primary brands are Fashion Seal Healthcare, HPI and WonderWink. On May 2, 2018 Superior acquired CID Resources a uniform maker acquired for $86.9 million plus 150,094 shares of

stock. The integration did not go smoothly. As a result, and also due to an accounting change which deferred revenue recognition, operating income fell sharply in 2019. Things picked back up in 2020 due to personal protection equipment (PPE) sales related to the pandemic. PPE sales totaled $48.5 million in 2020 and $12.5 million in the first quarter of 2021. In the second quarter of 2021, PPE sales dropped to under $5 million a level they are expected to remain going forward. The first chart above shows that sales excluding PPE were flat in 2020 and 2021.

Management does not expect flat revenues going forward. They believe that with PPE sales returning to normal and the 2018 acquisition fully integrated, it can grow uniforms revenues at least 12% organically annually going forward. These new sales are expected to be more from medical customers and also a push to grow revenues overseas. They hope to grow total overseas sales from

$30 million to $100 million over the next few years. Much of this is expected to be uniforms sales. Superior also recently directed 70 salespeople who previously just sold BAMKOs promotional products to cross sell uniforms. These salespeople had success in the past selling BAMKO to 30% of the new PPE customers.

BAMKO

BAMKO sells promotional products such as employee gifts, point of sale signs, logo merchandise sold by non-retail businesses and much more. It has enjoyed a CAGR of 31.5% over the last three years, excluding PP&E sales in 2020 and 2021, and annualizing the first six months of 2021. BAMKO was acquired for $24.9 million effective March 1, 2016. On November 30, 2017, BAMKO acquired Tangerine Promotions West for $12.1 million. Revenues in 2018 were boosted by that acquisition. Growth excluding PPE slowed in 2020 due to the pandemic but is reaccelerating. It is on pace to grow revenues (excluding PPE) a whopping 52.9% this year. Some of that is from an acquisition in January of Gifts By Design for $6.0 million, but most is organic. As shown in the second chart, earnings have grown even faster. BAMKO had a backlog of $67.6 million on June 30, 2021, up 66% from just one quarter earlier. This indicates that sales are likely to continue to accelerate. The company mentioned that the promotional products industry only grew about 3 to 4% in the first half of 2021.

So how is BAMKO growing so much faster than its industry? There are several primary ways they are doing it. First is a heavy use of technology. They can design inhouse almost any product. Much of their products are custom made. They also are recruiting and bringing in sales teams from their competitors. Part of the alure is their strong support system for their 75 sales people. Another is

the high growth the business is getting. These sales people instead of waiting for calls, approach businesses with ideas. BAMKO's salespeople also successfully converted 30% of their new PPE customers with no other relationship into promotional products customers. I looked on Glassdoor and it had a rating of 4.1 with 61 reviews.

Call Centers

This business known as Office Gurus has grown revenues at a 30.8% CAGR over the past five years if 2021 is annualized. This growth was all organic. This was their only segment that had no benefit from PPE sales. Revenues if anything are accelerating. During the second quarter of 2021 Superior added 437 billable agents across all sites. That is on top of 184 agents in the first quarter for a total of 621 agents for the first half of 2021. Their original 2021 forecast was 362 additional agents all year. This is an increase of over 20% just in the first half of 2021. All of the added agents were needed due to growth.

Again, you have to ask, how are they getting this type of growth in an industry full of others that struggle. Support.com (SPRT) and StarTek (SRT) are two peers who have been losing money or had declining revenues for years. What they do that I really like is they focus on smaller customers. Unlike many peers, losing one large customer doesn't hurt them. Their agents are from lower income

countries such as Belize and Jamaica where they speak English and El Salvador. The company also is benefitting from the pandemic as a vast majority of their agents currently work from home. This has helped in recruiting. They also use less incentive pay than their peers.

Guidance

Management has a goal is $900 million in revenues by 2025 achieved organically. This is a 17.4% CAGR from here. They expect to be $1 billion+ with acquisitions which puts the revenue CAGR projection through 2025 just over 20%. The company has plenty of balance sheet it can use for acquisitions. The recent promotion of Philip Koosed to Chief Strategy Officer provides an executive available to focus on mergers.

Management has also guided for sales of $525 million this year including $43 million of PP&E. Excluding PP&E guidance is for $482 million, which is up 22% from 2020.

Superior is making a push overseas. Revenues there were $30 million last year and they believe they can do $100 million in a few years.

Balance Sheet

Balance sheet is in good shape. Long term debt was paid down from $119.3 million December 31, 2019 to $87.6 million December 31, 2020. It increased to $114 million as of June 30, 2021 due to the need to fund the growth in working capital as revenues increased. Working capital was $175 million on that date. The company had a $125 million line of credit on June 30, 2021 that doesn't mature

until 2026 with $51 million drawn. Tangible net worth was $114 million on June 30, 2021, which is equal to interest bearing debt. There is a pension liability $14.4 million as of June 30, 2021.

Concerns

I always include a section in my writeups for concerns and issues. This is the smallest one I have ever included.

Superior is facing the same supplier logistics problems and labor shortages as many other companies right now. This should be a short term issue and the fact they hired 621 call center employees in the first half of the year bodes well going forward. Management indicated the logistics problems cost them about $4-5 million in revenues last quarter, about 2%.

The stagnant uniforms segment remains the largest by revenues. However, it no longer provides the majority of earnings. Management is optimistic about this segment and expects it to be stronger than before Covid. But they do not expect the kind of growth they are seeing in the other two segments.

Why the Valuation Disconnect

Yes, Superior really did earn $0.67 last quarter adjusted for a pension settlement, which puts its PE ratio at about 8 if annualized. There were no other unusual items and the company is not seasonal, so this appears to be the new run rate. This is a company with two of three segments with a long history of revenue and earnings growth in excess of 30% per year. That growth is if

anything accelerating. Most companies with this type growth get PE ratios of over 50. Why is there such a disconnect?

The best I can tell it is due to three things. One is that the true growth and earnings picture were masked somewhat by all the PPE sales last year and in the first quarter of this year. A lot of investors are starting to avoid Covid plays. But the second quarter of 2021 returned to a more normal level of PPE sales and had strong earnings.

The second is the industries where Superior is getting its growth are slower growing ones where others struggle. Also, these are not tech or medical businesses, which are the ones that usually get the high PE multiples. However, there are many non-tech or medical high growth companies with high earnings multiples. BAMKO uses a lot of technology but is not considered a tech stock. But Superior has a consistently superior track record in both segments to its peers. Way superior in fact. Its backlogs and recent seat additions indicate it is nothing like its peers. Their growth if anything is accelerating.

I believe it also comes back to my opening comments. The market still sees Superior as a slow growth uniforms company. But that has changed quite suddenly. Half the company is now very high growth and management expects the legacy uniforms business to also have good growth.

Valuation

Overall revenues (excluding PPE sales) are growing about 20% a year right now and projected to continue on that trajectory by management. Earnings are growing even faster. Most companies with that type of growth have PE ratios of 40 or more.

For valuation purposes the three segments will be valued separately. The uniforms segment has two mostly pure play publicly traded competitors which are shown below. Aramark also does a lot of uniforms but it is their third largest segment.

Uniforms Peers	Revenues 2000 in millions	Revenue CAGR 5 yrs	Profit Margin 2000	PE Ratio	Price to Revenues
Cintas (CTAS)	$7,085	9.6%	12.4%	38.0	5.6
Unifirst (UNF)	$1,804	4.4%	7.5%	26.9	2.2
Superior-Uniforms(1)	$239	2.6%	6.9%		

(1) Uniforms segment only, the profit margin is pretax.

Source: Value Line, and SEC Forms 10-K

Cintas is a powerhouse that gets much more growth and profit margin than Superior. Unifirst is also superior on those metrics but closer to Superior. Both trade for high PE ratios. Investors like this business as it is very stable and there is no reliance on any one customer. Based on the comparables, I believe if Superior spun off its uniform business it would trade for a PE ratio of 18. This is

below the peers and the market average as a whole. A 20% discount is then needed because the earnings shown are pretax.

Call Center Peers	Revenues 2000 in millions	Revenue CAGR 5 yrs	Profit Margin 2000	PE Ratio	Price to Revenues
Atento S.A. (ATTO)	$1,412	-6.2%	-3.3%	NA	0.3
Sykes (SYKE)	$1,710	6.2%	4.9%	17.5	1.2
Support.com (SPRT)	$44	-10.7%	1.0%	NA	3.8
Startek (SRT)	$640	17.8%	-6.1%	NA	0.3
Superior-Call Center(1)	$37	18.3%	24.3%		

(1) Call Center segment only, the profit margin is pretax.

Source: Value Line, and SEC Forms 10-K

Only three of the peers listed by Superior as competitors in its last 10-K are publicly traded. Atento and Sykes are listed above and Concentrix was omitted as call centers are a much smaller part of their business. I have added Support.com and StarTek which are smaller call center companies. Atento, Support.com and StarTek are examples of why this industry appears to get little respect. All are either losing money or revenues or both. Sykes and Support are under contract to sell so you are essentially seeing the premium sale price. Superior is clearly superior to all three and the only real comparable is Sykes. It's revenue growth as mentioned earlier has actually accelerated to 30.8% if the first half of 2021 is annualized. That is far superior to Sykes. Adjusting for a takeover premium for Sykes, I value it at 1.5x revenues.

Superior did not mention any peers for BAMKO I could not find any either. It has grown revenue at a CAGR of 45.7% over the past five years if the first half of 2021 is annualized. This excludes PPE sales. Earnings have increased even faster though PPE sales in 2020 and the first quarter of 2021 make a true calculation difficult. If you annualize second quarter 2021 pretax earnings, the earnings

CAGR is an off the charts 75.5%. Most companies with this kind of growth get PE ratios well over 50. I will discount for perceptions about the industry and lack of peers and apply a PE ratio of 30 to second quarter 2021 earnings annualized. I believe that is very conservative based on what the market usually gives stocks with this growth rate. This then needs to be discounted 20% to adjust for using BAMKO's pretax earnings.

Segment	Valuation Method	Value in Millions
Uniforms	PE Ratio of 18 to annualized 2Q 2021 pretax earnings less 20%	$259
BAMKO	PE Ratio of 30 to annualized 2Q 2021 pretax earnings less 20%	$480
Call Center	1.5X Revenues	$222
Total		$961
Less Net Debt as of 6/30/21		-$106
Value after debt		$855
Shares outstanding		15,824,530
Value per Share		$54.03

Source: Calculations dome above

As noted above, 20% is deducted from the first two segments because the earnings used are pretax. My one year price target is $54.00.

As I noted earlier, true earnings have been masked until the most recent quarter by PPE sales. The second quarter of 2021 showed a return to normalcy. But the market may not be comfortable working off of just one quarter. I am confident that if the current quarter shows similar or better earnings it will be clear how strong post PPE surge earnings really are.

The $54 price target is only a PE ratio of 20 if second quarter 2021 earnings are annualized. Most companies with 20% or more revenues and earnings growth get a much higher PE ratio. That makes the $54 one year price target a conservative number.

This article was written by

Jeremy Blum
5.05K Followers

I retired early in 2013. I was the Credit Manager for a mid-sized publicly traded bank. Despite never worki... more

Disclosure: I/we have a beneficial long position in the shares of SGC either through stock ownership, options, or other derivatives. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Comments (9)

Newest

Pierre-Alexandre Ravoire Today, 2:58 AM

Contributor Premium

Comments (86)

Thank you very much for this very insightful article on SGC. Quite interested on this name.
How is SGC doing in terms of free cash flows?

Reply Like

Jeremy Blum Today, 8:58 AM

Contributor Premium

Comments (4.23K)

Author's Reply *@Pierre-Alexandre Ravoire* Last year their free cash flow (cash flow from operations less Capex) was $35 million. This year to date - $14 million. Keep in mind, Superior is a growth company. It needs to grow inventory, fixed assets and receivables in order to grow sales. That all uses cash. Some growth companies, such as software companies, don't have inventory and don't need much fixed assets. So they can grow without consuming a lot of cash. Superior is a more traditional company.

The free cash flow numbers will jump around due to timing differences. That's why they can be hard to use at times. I believe, with the current growth, free cash flow when smoothed out is probably around breakeven.

Reply Like

pigs 06 Aug. 2021

Comments (8)

I've owned this stock from the 70's. Bought most of it in the 80's. Sell a little when ever it pops up, but haven't sold any for at least 5 years. Waited most of my life for it to appreciate like I thought it should. At 77 I don't have a lot of

of my life for it to appreciate like I thought it should. At 77 I don't have a lot of time left so I sure hope you are right. Jim

Reply Like (1)

Jeremy Blum Yesterday, 8:57 AM

Contributor Premium

Comments (4.23K)

Author's Reply *@pigs* this was a slower growth company when it was just uniforms. Things changed about six years ago when they bought BAMKO and got the formula right for what was then a small call center operation.

Reply Like

Mostly Small Caps 06 Aug. 2021

Comments (802)

@Jeremy Blum - Nice article. It's comforting to see someone with your acumen sharing my belief that SGC should get more respect from investors. It's not my

largest position, but it is up there and I have been steadily adding to my position.

If one judges leadership by what they do when there's a crisis, then SGC's executive team (and really the whole company) demonstrated their brilliance since the start of the pandemic. Their ability to pivot to sourcing and supplying much needed PPE soon after the pandemic started was amazing. Certainly this achievement also brought them new fans, expanded their customer base, and has bolstered an already solid growth rate.

Although Uniforms / Healthcare apparel have been sluggish by comparison to Bamko and The Office Gurus, there is reason to believe that their largest segment will also start demonstrating growth. The article noted the move to use the Bamko sales team to bring in new uniform opportunities. Additionally, they have expanded their sales channels (to institutional and retail buyers) and have expanded their offerings (e.g., healthcare apparel that can hold up to the harsh hospital laundering).

They have also been making investments which will expand capacity and improve operations. The 3 year, $10 M project to expand and automate their distribution center in Arkansas should be complete by year-end. A third factory in Haiti is getting closer to being staffed and operational.

People keep telling me that the stock market is overpriced. Certainly the stocks of many companies are overpriced. As you have shown with this article, even in an overheated market there are exceptions to be found and you have provided readers with one of them. I trust that SGC will ultimately get the respect it deserves from investors. Meanwhile, I'm staying long and adding to my position.

Reply Like

Jeremy Blum 06 Aug. 2021

Contributor Premium

Comments (4.23K)

Author's Reply *@Mostly Small Caps* I agree that large portions of the

market are overpriced. But I'm not having trouble finding good buys.

Reply Like (1)

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abdulmoiz1254 06 Aug. 2021

Comments (2.82K)

I also like it but was getting kinda bored with how it's going and was wondering if I should dump it

But I can't seem to
And now I'll use this article as an excuse to keep it

Reply Like

Jeremy Blum 06 Aug. 2021

Contributor Premium

Comments (4.23K)

Author's Reply *@abdulmoiz1254* I expect this one to get moving pretty fast. One more quarter as good as the last should be enough, if it doesn't before that.

Reply Like

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abdulmoiz1254 06 Aug. 2021

Comments (2.82K)

@Jeremy Blum
I would say it would struggle to top 15x ..but still ~40 is somewhat visible

Reply Like