

UP Global Sourcing Holdings plc



Feeling good about FY2019

6th November 2018

After an unquestionably challenging year, UPGS delivered FY2018 preliminary earnings results in line with consensus as underlying EPS was 5.4p. Sales revenue of £88m and £6.5m adjusted EBITDA reconfirmed an earlier announcement. UPGS's international business continued to gain ground as a portion of sales due to a strong H2. Moreover, FY2019 appears to have started well and we raise our EBITDA estimate from £6.9m to £7.1m, largely due to better than expected sales revenue: the future feels good.

UPGS's ability to supply high quality known brands at affordable prices, places it firmly in the "feel good" camp as a supplier of consumer products. Investors should also feel good about how FY2019 has started in our view. Sales revenue is in line with expectations and international momentum is encouraging. Hence, we raise our earnings forecasts for the full year – EBITDA by 3% and EPS by 2%. It's a contrast with FY2018.

Overall, there were few surprises in UPGS's FY2018 results. Revenue and EBITDA were pre-released in a 10th September trading statement, which reported that FY2019 orders were ahead of last year and that online rose 52% to be 7.9% of sales revenue. Importantly, international regained ground in the second half of FY2018 and comprised 36.9% of sales compared with 19.8% in the first half and 27.4% in the year as a whole. International sales grew 16.4% in the 6 months. German business doubled in FY2018.

UPGS reconfirmed that FY2019 started well and we infer good reason for ongoing optimism. A well-positioned brand portfolio and good growth prospects in both online and international prompt us to raise our FY2019 sales forecast from £95.4m to £97.0m, EBITDA from £6.9m to £7.1m and EPS from 5.5p to 5.6p. Dividend policy is for a 2x cover, while debt headroom and projected cash conversion underpin future dividends.

The longer-term investment case for UPGS remains intact. The company is committed to driving its brands' revenue growth through its four strategic pillars: discount retailers, raised supermarket penetration, online and international. We retain our future expectations of sustainable 5% organic sales revenue growth.

Based on our revised forecasts for FY2019, UPGS trades on 6.2x EV/EBITDA, a 6.8x P/E ratio and offers a generous 7.4% prospective dividend yield. Investors should probably feel good about the share price potential.

Key Financials

Y/e 31 July	2016A	2017A	2018A	2019E	2020E
Revenue (£'000)	79,028	109,953	87,571	96,975	101,824
Revenue growth	23.3%	39.1%	-20.4%	10.7%	5.0%
EBITDA (adj)	8,226	11,512	6,472	7,100	7,355
EPS basic adjusted (p)	8.0	10.9	5.4	5.6	5.9
DPS (p)	3.3	5.1	2.7	2.8	2.9
EV/EBITDA (x)	5.3	3.8	6.8	6.2	6.0
P/E ratio (x)	4.8	3.5	7.0	6.8	6.4
Yield (%)	8.7%	13.4%	7.1%	7.4%	7.6%

Source: Company Historic Data, ED estimates

Company Data

EPIC	UPGS
Price (last close)	38p
52 week Hi/Lo	97p / 30p
Market cap	£31m

Share Price, p



Source: ADVFN

Description

UPGS develops new, innovative concepts and brings professional, sought-after products to the mass market. Their offices span two continents, with headquarters in the UK, offices and a showroom in Guangzhou and a showroom in Germany.

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Key figures for revenue, EBITDA and net debt were released at the time of UPGS's FY2018 trading statement on 10th September. The pre-tax and EPS numbers released in today's full year results tend to confirm market expectations. Dividend policy was maintained at a 50% pay-out ratio, or 2x covered.

More importantly, the better performance in the second half of last year versus the first half appears to have continued into FY2019. Today's release maintains a positive stance on overall business momentum two months after its trading update, which augurs well for the peak trading period. Quite clearly, sales growth will differ markedly in the first of this year from last when it was disrupted by an overseas customer's switch from FOB to landed terms of business.

Summary of FY2018 Results

We summarise the key FY2018 movements in Figure 1. A number of these data points are already known to the market. However, it is worth, in our view, reiterating the strength of the second half recovery in terms of both revenue and EBITDA.

Furthermore, UPGS's inherently cash generative nature, and debt facility headroom, imply that the group is not subject to some of the financial pressures that have been seen elsewhere in the UK consumer-facing sector this year.

UPGS reconfirmed its financial strength in the results released. Net debt: underlying EBITDA was 2.0x at end-FY2018 compared with 0.5x a year earlier. However, headroom in relation to covenants remains significant at £9.1m.

Based on our revised forecasts, net debt: EBITDA should close FY2019 at around 1.9x – i.e. we expect closing net debt to be £13.7m.

Figure 1 – UPGS FY2018 results highlights

Y/e 31 July, £m	FY2017	FY2018	Change
Revenue	110.0	87.6	-20.4%
Gross margin	22.3%	22.4%	10 bps
Underlying EBITDA	11.5	6.5	-43.8%
Underlying EBITDA margin	10.5%	7.4%	-310 bps
Underlying profit for the year	8.4	4.5	-46.8%
Profit for the year	5.6	4.3	-23.2%
Net cash from operations	9.4	-2.1	-121.8%
Free cash flow	7.8	-3.2	-140.7%
Net debt	6.0	12.8	6.8
Net debt: underlying EBITDA ratio (x)	0.5	2.0	400.0%
Underlying EPS (p)	10.9	5.4	-50.5%

Source: Company data

Right brands in the right places

Important fresh information contained in today's release included full year sales by location, brand, category and strategic pillar. International remained above 27.0% of the business in FY2018 largely due to a strong second half. In the year as a whole, UK business was 20.1% lower than in FY2017 but with an improved H2 run rate.

Importantly for the channels, online continues to grow. As we highlighted in our 2nd October 2018 initiation report "Ultimately, There Is Growth," UPGS is in a strong position to use the major established online distribution channels incrementally to expand its business. It is not an internet retailer in its own right.

Within the strategic pillars, discount retailers fell by 29% in FY2018, significantly due to the changes in trade terms that we mentioned earlier. However, supermarkets were only 7% down on the previous year and online increased by an impressive 52%.

Sales by Geographic Region

Sales by geographic region are published on both a half-yearly and annual basis. Overall, the picture was much rosier in H2 than H1 as Germany's growth quickened, Rest of Europe grew in H2 and the pace of decline slowed in the UK. Only the Rest of World region experienced a larger decline in H2 than H1. We summarise the position in Figure 2.

Figure 2 – UPGS Revenue by Location

	2018 H1	2018 H2	2018 FY	2018 H1	2018 H2	2018 FY
Revenue (£'000s) and increase from a year earlier (%)						
United Kingdom	38810	24725	63535	-22.5%	-16.1%	-20.1%
Germany	1036	2514	3550	45.5%	290.4%	161.8%
Rest of Europe	7432	11114	18546	-51.9%	6.1%	-28.5%
USA	377	441	818	-10.7%	14.8%	1.5%
Rest of World	753	369	1122	-47.3%	-59.0%	-51.8%
Total	48408	39163	87571	-28.9%	-6.5%	-20.4%

Source: Company data

Sales by brand and product category

Sales data by brand, product category and strategic channel were published only for the full year in FY2018. Only the recently acquired brand Progressive made a full year advance among the premier brands.

All categories experienced a decline in FY2018. The slowest decliners were houseware which saw a 6.5% drop and small domestic appliances which experienced a 13.1% decline.

Relative valuation

Figure 3 below updates our relative valuation for UPGS. As highlighted on our front page, neither of the major multiples – EV/EBITDA and P/E – looks demanding relative to peer group.

Moreover, given the implicit financial strength of the group, income investors should be attracted to the dividend yield. Company policy is for a 50% pay-out ratio. Given the likelihood of earnings growing significantly faster than future sales, prospects for dividend growth look positive.

Relative Valuation															
	Share price (pence)	Shares (m)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2018 (£m)	EV/sales (x)	EBITDA 2018 (£m)	EV/EBITDA (x)	EPS 2018 (p)	EPS 2019 (p)	P/E 2018 (x)	P/E 2019 (x)	DPS 2018 (p)	Yield (%)
Accrol	23	195.3	38	34	72	140	0.5	-5.0	-14.4	9.0		2.2			
EveSleep	17	139.3	27	7	34	38	0.9	-19.5	-1.8	-14.0	-4.3	-1.2	-4.0		
Gear4Music	566	20.9	110	5	115	80	1.4	3.5	33.2	6.7	10.9	84.5	51.9		
Luceco	43	160.8	81	51	133	173	0.8	19.1	6.9	6.2	5.8	7.0	7.5		
UPGS	38	82.2	31	13	44	88	0.5	6.5	6.8	5.4	5.6	7.0	6.8	2.7	7.1%
Warpaint	118	76.8	203	0	203	55	3.7	13.3	15.3	8.3	13.5	14.1	8.7	4.0	3.4%
Average							1.3		7.7			18.9	14.2		5.2%

ED estimates, various websites



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