UP Global Sourcing Holdings plc

UPGS on track to scale new revenue heights

14 February 2022

UPGS's achievement of 13.7% revenue growth in the first half of FY2022 and anticipation of full year growth in line with current expectations implies close to a 20% advance in sales revenue this financial year. Moreover, growth sustainability should be supported by a combination of effective brand management and enlarged distribution capacity. We maintain our current forecasts and reiterate our 275p fair value per share, well above current levels.

UPGS's FY2022 trading statement, released today, reported a 13.7% increase in first half sales compared with the same period last year to £85.7m. Based on expectations of a slight increase in H2 as a portion of sales to 47% this year compared with 45% in FY2021, we continue to forecast an 18.6% increase in FY2022 to £162m. We leave our profit forecasts unchanged.

Effective brand management remains central to the UPGS growth case in our view. Beldray and outright ownership of Salter place the company better to serve the company's prioritised supermarket and online channels in our view. These channels require strong brands. Due partly to the Salter acquisition towards the end of FY2021, UPGS believes that supermarkets could surpass discounters in FY2022 sales, while maintaining a 30% target for online as a portion of group sales.

Today's statement confirmed the opening of new distribution capacity in the Netherlands in partnership with a longstanding third party provider. International is another important source of potential growth for UPGS. The additional capacity will enhance the group's ability better to serve the online channel in its largest overseas market – Germany – as well as bolstering France and the Benelux countries. The benefits could be enjoyed towards the end of this calendar year.

Consistent with widespread media coverage relating to all import businesses, supply chain challenges remain for UPGS. However, the company, which should be credited with its ability to record steady revenue growth despite these headwinds, states that these have recently showed signs of improvement. There is cautious optimism that the worst is behind the Group. We also note positively that, in contrast to some companies, supply chain issues have not disrupted profitability.

We make no changes to forecasts in this report. However, the strength of the H1 sales growth gives us confidence in the ability of UPGS to record close to 20% growth in the full year.

Valuation

We retain our fair value of 275p per share for UPGS. Were the shares at this level, EV/sales would expand to 1.6x and EV/EBITDA to 14.0x - representing a premium to the company's peer group. But such premiums are justified, in our view, by the demonstrable effectiveness of UPGS's leading brands, notably in the supermarket and online channels.

Key Financials

Year to 31st July	2019A	2020A	2021A	2022E	2023E
Revenue (£'000)	123,257	115,684	136,367	161,709	171,412
Revenue growth	40.8%	-6.1%	17.9%	18.6%	6.0%
EBITDA (£'000) (adj)	10,720	10,363	13,291	18,797	20,867
EPS adjusted (p)	8.1	7.9	10.6	14.1	15.3
DPS (p)	4.1	4.0	5.0	7.0	7.6
EV/EBITDA (x)	17.0	17.6	13.7	9.7	9.0
P/E ratio (x)	22.6	23.2	17.4	13.0	12.0
Yield	2.2%	2.2%	2.7%	3.8%	4.2%

Source: ED estimates, company historic data

Company Data

EPIC	UPGS
Price (last close)	184p
52 weeks Hi/Lo	238p/141p
Market cap	£164m
ED Fair Value / share	275p

Share Price, p

Source: ADVFN

Description

UP Global Sourcing Holdings plc (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, a sourcing office and showroom in Guangzhou, as well as a showroom in Germany.

Key owned brands include **Salter, Beldray, Progress, Kleeneze, Petra** and **Intempo**. The company also markets non-electrical Russell Hobbs products under licence.

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FY2022 on track

UPGS's first half trading statement included positive reassurances on expectations of the full year, implied strength in the company's supermarket and online channels (bolstered by Beldray and Salter), distribution capacity expansion in the Netherlands and signs of an improvement in the supply chain.

The longer-term investment case of sustainable, profitable organic growth and underlying free cash flow generation remains intact.

UPGS's combination of strong brands, targeted distribution channels and demonstrable success in M&A continues to augur well for sustainable growth. Moreover, the company has proven its ability to cope with supply chain disruptions given that it is "*cautiously optimistic that the worst is behind the Group.*" In our view, today's statement supports the robust investment case for UPGS, and we reiterate our 275p fair value for the shares**.**

In addition, we believe that investors should note four specific pointers towards visible, sustainable growth. UPGS enjoys a sizable addressable market in the UK and Europe Union in excess of 500 million (Source: ec.europa.eu). The company benefits from a capital-light structure which tends to ensure the early profitability of incremental growth. Moreover, the capital-light model aids dividend paying capability as sales revenue expansion does not act as a drain on cash.

Additionally, UPGS - as the ability to handle supply chain disruption suggests - enjoys significant downside resilience. We also note that the group has a pro-active approach to boosting its ESG (Environmental, Social and Governance) credentials, which is often not the case for companies of a similar market capitalisation.

First half trading statement

The financial highlights of today's statement include a 13.7% sales increase in the first half of FY2022 and reassurance that the company anticipates a full year performance in line with current market expectations. As a result, we are leaving our FY2022 forecasts unchanged.

In the full year, we look for sales revenue to increase by 18.6% to £161.7m. Clearly, this growth rate benefits from the Salter acquisition. As we highlighted in our 25th June 2021 report "UPGS to acquire UK's oldest housewares brand", the acquisition of the Salter brand outright is expected to enhance sales revenue by £16.7m in FY2022. The implied organic growth in our forecasts of 6.3% is consistent with our longer-term expectations for the group.

Salter

UPGS today reiterated the view at the time of the acquisition that Salter will be significantly earnings enhancing in FY2022. Moreover, the brand is reported to be performing well and in line with plan. On a pro forma basis, Salter and Beldray – the two largest brands in the group – would represent **between 55% and 60%** of sales in the current financial year.

The Salter acquisition is consistent with UPGS's ongoing shift in emphasis from being a sourcing company to being an effective manager of leading household brands. Having had the licence to use the Salter name outside household measuring devices, the company now has full ownership of the UK's oldest housewares brand.

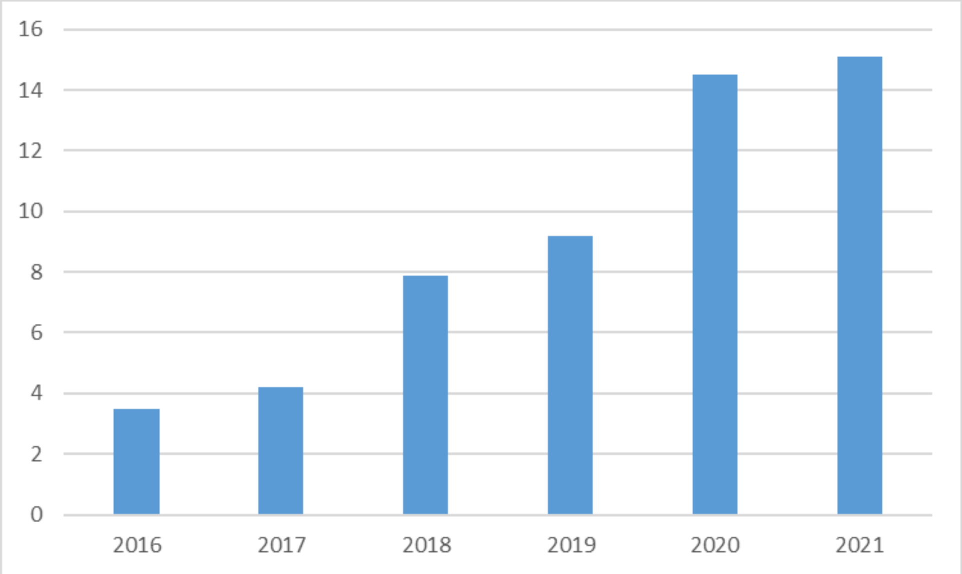
An increased perception of UPGS as an effective brand manager reads positively for the Group's rating and hence valuation.

Supermarkets and online distribution channels

An acid test of how strong UPGS's range of "feel good" brands are becoming is their performance in the supermarket and online distribution channels. This point was highlighted in our 8th February 2021 report "Broadening the scope for growth" which reiterated the view that strong brands are essential for a company to perform well in the relatively "level playing field" of these two channels.

In FY2022 supermarkets could well become the largest distribution channel for UPGS. In FY2021 they were second largest at 27% compared with 38% for discounters. However, that was prior to the Salter acquisition. Online continues to be targeted at 30% of total revenues in the medium to long term according to today's statement. We illustrate the long-term growth of online as a portion of sales in Figure 1:

Figure 1 – UPGS online sales as a portion of total (%)



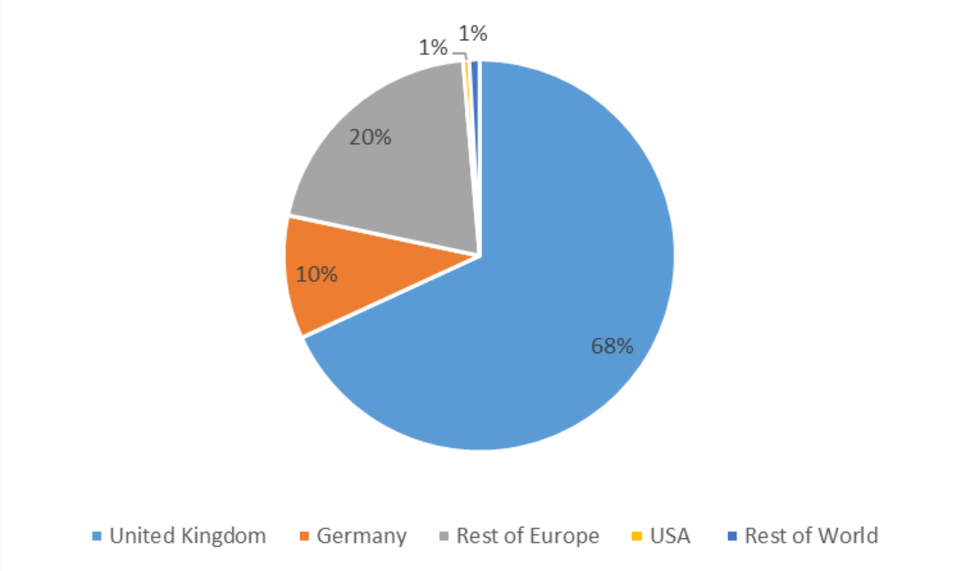
Source: Company data

Netherlands distribution centre

International expansion is an important part of the UPGS growth story as evidenced by its increase in importance from 26% of sales in FY2016 to 32% of total revenue in FY2021. Greater investment in overseas distribution should be seen as positive for sustainable growth in our view.

The company expects that the opening of new distribution centre capacity in the Netherlands in partnership with one of UPGS's longstanding third party providers will benefit Continental European distribution. **The additional capacity is expected materially to enhance the group's online performances in Germany, France and the Benelux countries.** The breakdown of UPGS's FY2021 sales revenue by region is illustrated in Figure 2.

Figure 2 – UPGS sales revenue by region FY2021 (%)



Source: Company data

Supply chain

The supply chain and logistics challenges associated with Covid-19, the Suez Canal blockage and potential disruption associated with higher energy costs have been well covered by the key news media and acknowledged by UPGS itself. However, today's statement includes the company's cautiously optimistic view that the company believes that it has seen the worst of the disruption, which should be welcome news.

Importantly, the ability of UPGS to combine being a talented brand manager with its core competence in sourcing and supply chain management should enhance confidence in the company's ability to cope with future potentially disruptive headwinds. In turn that delivers a positive message not only for the sustainability of organic sales growth but also consistency.

Moreover, we note that there have been no downgrades to profit expectations or unusual movements in working capital at UPGS as a result of this.

Financials and valuation

Relative comparisons

UPGS's strong financial position and commitment to a 50% dividend pay-out ratio relative to EPS puts the company at a yield advantage to its peer group. Moreover, at the current share price the company trades well beneath its peer group average on both EV/sales and EV/EBITDA measures.

The fair value for UPGS which we retain in this report is 275p per share, still considerably higher than where the shares trade now and a 20% premium to where they traded at the time of the Salter acquisition last year.

We retain our fair value of 275p per share for UPGS. Were the shares at this level, EV/sales would expand to 1.6x and EV/EBITDA to 14.0x - representing a premium to the company's peer group. But such premiums are justified, in our view, by the demonstrable effectiveness of UPGS's leading brands, notably in the supermarket and online channels. Furthermore, three of these five "peer group" of companies have seen downgrades to sales and two to profit expectations since publication of our 2nd November 2021 report Brand strength underpins strong growth outlook, which is in marked contrast to UPGS.

At 275p / share the company's dividend yield would be 0.4 percentage points beneath those of its peers which are expected to pay dividends in FY2022, which also supports the case for this being fair value. UPGS's strong financial position and recent earnings stability reinforces the company's dividend paying capability. Our relative valuation is summarised in Figure 3.

Figure 3: Relative Valuation

	Share price (p)	Shares (m)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2022 (£m)	EV/ sales (x)	EBITDA 2022 (£m)	EV/ EBITDA (x)	EPS 2022 (p)	P/E (x)	DPS 2022 (p)	YLD (%)
Accrol Group	24	319	78	33	110	160	0.7	9.0	12.3	n/a	n/a	n/a	n/a
Gear4Music	600	21	126	12	138	149	0.9	12.0	11.5	20.0	30.0	n/a	n/a
Luceco	276	154	424	36	460	256	1.8	50.6	9.1	21.0	13.1	8.0	2.9
Portmeirion	660	14	91	-	91	100	0.9	14.2	6.4	57.0	11.6	19.0	2.9
UPGS	**184**	**89**	**164**	**18**	**182**	**162**	**1.1**	**18.8**	**9.7**	**14.1**	**13.0**	**7.0**	**3.8**
Warpaint	143	77	109	-6	104	53	2.0	8.1	12.8	n/a	n/a	5.0	3.5
Average							1.2		10.3		16.9		3.3

Source: ADVFN, MarketScreener and Equity Development estimates, Prices as at close 11th February 2022

Financial forecasts

We maintain our current forecasts for the FY2022 and FY2023 financial years, based on a continued expectation of 6% underlying sales revenue growth. Moreover, our numbers echo the company's confidence that there can be a full recovery in gross margins in FY2022.

FY2022 will include a full year of Salter ownership, which is expected to bring in around £17m in additional sales revenue and £4.6m in incremental EBITDA. There is no reason at this stage to expect any disruption to Salter's ability to deliver against expectations.

UPGS's robust earnings and strong financial position continue to underpin the company's dividend paying ability. We summarise income statement, balance sheet and free cash flow forecasts below in Figures 4, 5 and 6.

Figure 4 - Income statement

All figures in £'000s	**2020A**	**2021A**	**2022E**	**2023E**
31st July year end				
Revenue	**115,684**	**136,367**	**161,709**	**171,412**
change in revenue	-6.1%	17.9%	18.6%	6.0%
Gross profit	26,600	30,231	39,619	42,167
Gross margin (%)	23.0%	22.2%	24.5%	24.6%
EBITDA - adjusted	**10,363**	**13,291**	**18,797**	**20,201**
EBITDA margin - adjusted	9.0%	9.7%	11.6%	11.8%
Net financial expense	-753	-518	-1,100	-1,100
Pre-tax profit - reported	8,362	9,508	15,665	16,969
Pre-tax profit - adjusted	**8,163**	**11,150**	**15,893**	**17,197**
Taxation	-1,747	-2,195	-3,338	-3,560
Tax rate (%) - adjusted	21.4%	19.7%	21.0%	20.7%
Net income - adjusted	6,504	8,727	12,560	13,637
EPS - basic adjusted (p)	**7.9**	**10.6**	**14.1**	**15.3**
Dividend per share (pence)	4.0	5.0	7.0	7.6

Source: ED estimates, Company historic data

Figure 5 - Balance Sheet

All figures in £'000s				
31st July year end	**2020A**	**2021A**	**2022E**	**2023E**
Assets				
Intangible assets	86	27,253	27,253	27,253
Goodwill		9,676	9,660	9,644
Property, plant and equipment	5,065	5,719	5,431	5,103
Deferred tax	106			
Total non-current assets	**5,257**	**42,648**	**42,344**	**42,000**
Inventories	16,022	21,674	24,000	25,790
Trade and other receivables	18,495	26,544	29,600	31,726
Derivatives	53	384		
Current tax		62		
Cash and cash equivalents	329	133	133	133
Total current assets	**34,899**	**48,797**	**53,733**	**57,649**
Total assets	**40,156**	**91,445**	**96,077**	**99,649**
Liabilities				
Share capital	205	223	223	223
Share premium account	2	14,334	14,334	14,334
Employee benefit trust reserve	-2,155	-2,152	-2,152	-2,152
Share-based payment reserve	796	1,024	1,252	1,480
Hedging reserve and other reserves	-961	-162	579	572
Retained earnings	15,527	18,788	26,294	33,246
Total equity	**13,414**	**32,055**	**40,530**	**47,703**
Trade and other payables	17,614	29,451	29,000	28,840
Derivative financial instruments	1,342	220		
Current tax	280			
Borrowings	3,903	7,951	8,430	6,729
Lease liabilities	710	771		
Deferred consideration		990	990	
Total current liabilities	**23,849**	**39,383**	**38,420**	**35,569**
Borrowings (negative => cash)	89	10,847	9,847	9,847
Deferred tax		6,147	6,000	6,000
Deferred consideration		983		
Lease liabilities	2,804	2,030	1,280	530
Total non-current liabilities	**2,893**	**20,007**	**17,127**	**16,377**
Total equity and liabilities	**40,156**	**91,445**	**96,077**	**99,649**

Source: ED estimates, Company historic data

Figure 6 - Free Cash Flow

All figures in £'000s				
31st July year-end	**2020A**	**2021A**	**2022E**	**2023E**
Profit for the period	**6,615**	**7,313**	**12,327**	**13,409**
Adjustments for:				
Finance costs (net)	753	518	1,100	1,100
Income tax expense	1,747	2,195	3,338	3,560
Depreciation and impairment	1,417	1,563	1,788	1,888
Amortisation	12	16	16	16
Loss on disposal of a current asset	18	44		
Derivative financial instruments	324	-678		
Share based payments	267	228	228	228
Income taxes paid	-2,255	-2,566	-3,276	-3,560
Operating free cash flow	**8,898**	**8,633**	**15,521**	**16,641**
Working capital adjustments				
(Increase)/decrease in inventories	4,377	-368	-2,326	-1,790
Decrease/(increase) in receivables	150	-8,091	-3,056	-2,126
(Decrease)/increase in payables	2,339	9,031	-451	-160
Total	6,866	572	-5,833	-4,076
Net cash from operations	15,764	9,205	9,688	12,565
Cash flows used in investing activities				
Acquisition of a business		-30,578	-1,000	-1,000
Purchase of intangible assets				
PP&E	-601	-2,263	-1,500	-1,560
Proceeds from P, P & E disposals	12	3	4	4
Finance income				
Repayment of lease liabilities			-750	-750
Total	-589	-32,949	-3,246	-3,306
Free cash flow before financing	**15,175**	**-23,744**	**6,441**	**9,259**
Interest paid	-698	-335	-1,100	-1,100
Free cash flow before dividends etc	**14,477**	**-9,729**	**5,341**	**8,159**
Dividends paid	-2,307	-4,409	-4,820	-6,458
Purchase of own shares (EBT)	-506			
Free cash flow after dividends etc	**11,664**	**-14,136**	**521**	**1,701**

Source: ED estimates, company historic data

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