

UP Global Sourcing Holdings PLC



Ultimately, there is Growth

2 October 2018

Ultimate Products Global Sourcing Holdings PLC (UPGS) looks well placed to return to growth. UPGS enjoys a combination of well-known household brands, a proprietary approach to managing those brands, and significant growth headroom within its distribution channels. Moreover, after a challenging H1, sales trends improved in FY2018 H2. With a strong management team and, arguably, an attractive valuation, the shares should attract investors' attention.

UPGS is a consumer goods company with a robust portfolio of household durable goods brands. Its premier offering includes Beldray, Salter, Russell Hobbs, Intempo and Progress. Uniquely, the company offers these brands at attractive prices and in categories which expand the overall footprint of the brand names.

In our view, UPGS's brand management approach positions these key names for growth but in a way which will generate shareholder value. UPGS's portfolio should experience what we refer to as mature market volume growth, which is arguably the strongest driver of value creation in the UK consumer goods sector. Overall management quality tends to be confirmed by clear vision and smart strategic positioning.

UPGS's FY2018 disappointed relative to initial expectations, notably in the first half. But its share price may have been unfairly hurt by general investor nervousness about UK consumer stocks. With scope to recover sales in FY2019 and grow in FY2020, the shares arguably command a valuation significantly in excess of where they currently trade.

Our forecasts for FY2018 – partly covered in the company's 10th September 2018 trading update – and FY2019 are summarised in the valuation box below. In our view, both the P/E ratio and dividend yield look attractive in the context of the nature of the company's business and potential for near term recovery.

Given the UK retail climate at the moment, it is challenging to set a precise value on the shares. But to give some guidance we look at our revenue estimate for FY2019 and, even applying a conservative 1x EV/sales multiple, come out with a share price of £1 per share. Furthermore, we are encouraged by the resilience that UPGS has shown in these challenging times when others have floundered. We highlight the strength of their balance sheet, as well as their ability to adapt quickly to external challenges - e.g. by focusing on international and online opportunities.

Key Financials

Y/E 31 July	2016A	2017A	2018E	2019E
Revenue (£'000)	79,028	109,953	87,575	95,400
Revenue growth (%)	23.3%	39.1%	-20.4%	8.9%
EBITDA (adj)	8,226	11,512	6,514	6,878
EPS basic adjusted (p)	8.0	10.9	5.3	5.5
DPS (p)	3.3	5.1	2.7	2.7
EV/EBITDA (x)	4.8	3.5	6.1	5.8
P/E ratio (x)	4.1	3.0	6.1	5.9
Yield (%)	10.2%	15.7%	8.3%	8.3%

Source: ED estimates

Company Data

EPIC	UPGS
Price	32.7p
52 week Hi/Lo	99p / 29.6p
Market cap	£25.8m

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.

Chris Wickham (Analyst)

0207 065 2690
chris@equitydevelopment.co.uk

Hannah Crowe

0207 065 2692
hannah@equitydevelopment.co.uk

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Investment case

Despite a relatively turbulent fiscal year in 2018, long-term growth potential remains central to the investment case for UP Global Sourcing Holdings PLC. It offers strong, attractively priced premium household product brands in sub-categories that are well-positioned to enjoy volume growth. Moreover, a tightly focused senior management team combined with a well-trained workforce should ensure that UPGS continues to act at best practice financially.

UPGS is a consumer goods company with a strong, well-invested portfolio of household durable goods brands. Its premier offering includes Beldray, Salter, Russell Hobbs, Intempo and Progress. Uniquely, the company offers these brands at attractive prices and in categories that expand the overall footprint of the brand names.

In our view, UPGS's brand management approach positions these key names for growth but in a way that will generate shareholder value. It focuses on an eclectic mix of core brands which clearly enjoy the potential to generate sustainable volume growth – importantly, in mature economies where aggregate demand conditions tend to be more.

Put simply, UPGS's portfolio should experience what we refer to as mature market volume growth, which is arguably the strongest driver of value creation in the overall UK consumer goods sector. There are no natural constraints on household goods consumption and sales and profits are all denominated in hard currency. Moreover, a number of the company's diverse distribution channels appear to be in comparatively early stage.

Overall management quality tends to be confirmed by clarity of vision and smart strategic positioning. Both strategically and tactically, the company has accumulated a strong portfolio of brands but without having exposed itself to financial strains. Moreover, the broader team should benefit from a strong commitment to in-house training and development.

FY2018 clearly disappointed relative to initial expectations. However, after a 28.9% first half sales' decline there was a strong recovery in the second half in which the pace of decline slimmed down to 6.4%. Moreover, part of the H1 drop – around £5m – was a deferral of sales due to a switch from delivery on a Free On Board to a Landed basis with one Continental European customer.

UPGS's outlook looks much more positive based on the company's 10th September 2018 trading update. We mention the better H2 position above. Moreover, we expect the company to return to sales growth in FY2019 and deliver around 5% annual growth thereafter. Gross margins throughout the "turbulent" period were reasonably constant at around 22%. EBITDA is expected to move from £6.5m in FY2018 to £6.9m in FY2019.

Calendar 2018 so far proved challenging for a number of UK consumer staples companies, notably in retail: both online and traditional. However, it should be noted that UPGS is not a retailer. It is a branded consumer goods provider with a number of the financial characteristics associated with mainstream FMCG companies – notably, positive free cash flow going forward and consistent gross margins.

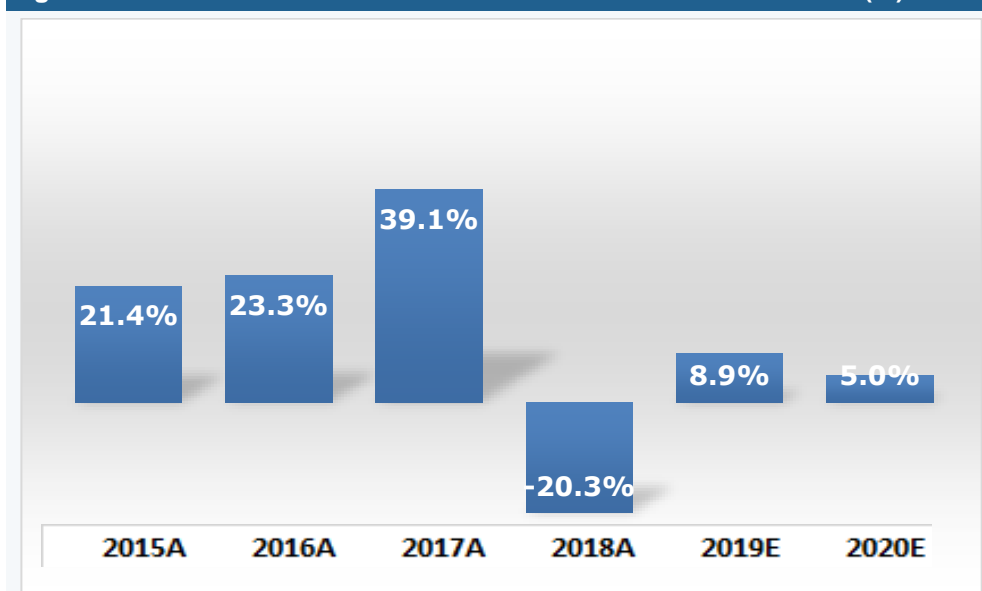
Any perception that UPGS shares the secular challenges facing UK retail right now would be wrong in our opinion. Moreover, any such perception would reinforce the case for UPGS's shares being mis-priced. Based on yesterday's close UPGS trades on FY2018 EV/EBITDA and P/E ratios of 6.1x and 5.9x respectively. Additionally, the dividend yield looks attractive at 8.3%.

Ultimately there is Growth

This report initiates Equity Development's coverage of UP Global Sourcing Holdings PLC, the company typically referred to as UPGS. Our primary objective is to demonstrate that the company is well-positioned to enjoy sustainable organic growth. UPGS benefits from a strong, well-managed premium brand portfolio, multiple strengths in distribution and is favourably structured to finance its expansion.

This report looks first at the company's brands themselves before assessing how this collection of premium brands is managed for growth. We then cover the distribution channels (UPGS's strategic pillars) again looking their growth potential, before assessing the overall growth case for UPGS's categories. Importantly, we emphasise the benefits of UPGS's status as a consumer goods company that can enjoy organic sales expansion in mature markets, an all too rare quality.

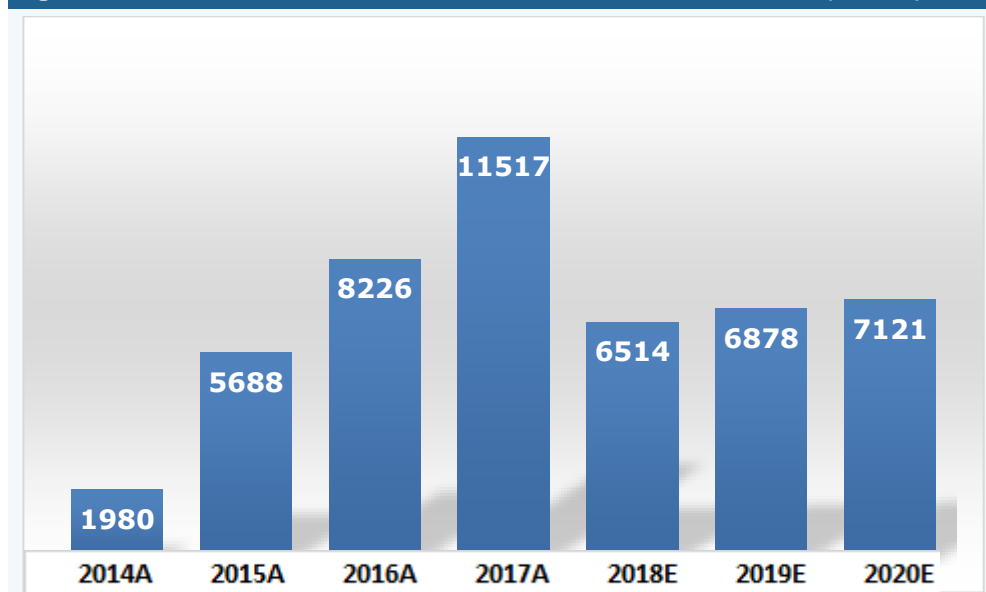
Figure 1 – Ultimate Products – Recent Sales Growth and Forecasts (%)



Source: Company Accounts Data and Equity Development estimates

After that, we include an assessment of management & strategy, which includes a summary of the company's operations, before discussing both valuation in more detail and our financial forecasts. UPGS' shares were listed on the London Stock Exchange via an IPO on 6th March 2017.

Recent sales growth trends are summarised in Figure 1. After a well-publicised sales decline in the first half of FY2018, we expect sales to recover in FY2019 before assuming a mid-single digit positive trend in FY2020. Profit trends should also be positive. Adjusted EBITDA trends are summarised in Figure 2:

Figure 2 – Ultimate Products – Achieved EBITDA and Forecasts (£'000s)

Source: Company Accounts Data and Equity Development estimates

Feeling good, affordably

As mentioned on our front page, UPGS's premier brand offering includes Beldray, Salter, Russell Hobbs, Intempo and Progress, which combine both wholly owned names and licensing agreements. A feature of UPGS's licensee brands is that they extend the brand owner's core offering – for example, the Salter offering excludes that brand's core competence in scales.

However, what is more important is that these brands are all positioned as premium with a number of them arguably best-in-class. By controlling the offering and the price point, UPGS is able to offer brands that quite simply make people feel better about both themselves and what their households have to offer. UPGS offers a solution to those who want a premium feel to their household brands but not at a premium price. And that implies growth. We look at each of the brands in turn. The sales split is summarised in Figure 3.

Beldray

Beldray – UPGS's largest brand – was acquired by the company in 2009. Established originally in 1872, Beldray remains a British heritage brand which has a proud history of inventiveness – notably the first ever adjustable ironing board. Following a re-launch, Beldray's offering primarily comprises vacuum cleaners, steam cleaners, ironing boards, airers and pedal bins, fans, heaters and electric fires.

Beldray epitomises UPGS's ability to offer "feel good" products which enjoy the air of being premium but at affordable prices. Moreover, the brand includes a substantial number of low price accessories which should improve customer engagement with Beldray such as its premium branded clothes pegs (£6.99 for ten) and sharply designed "hip hugger" laundry baskets (£12.99 each).

Beldray grew rapidly from being an £11m sales revenue brand in FY2014 to £31m in FY2017, when it represented 28% of group sales.

The retail customer base is both diverse and substantial. For example, its products are available online via the major platforms. They are also present in both the major food multiples and the discounters. With a sustained commitment to the offering's combination of innovation, premiumness and affordability, Beldray is well poised to enjoy underlying growth.

Salter

Salter is a well-known, best-in-class kitchenware brand which UPGS has sympathetically extended under licence. The mother brand owner – which has been in operation since 1760 – continues to focus on scales and other measuring devices (including thermometers and timers) while UPGS extends the brand into 15 discrete kitchen categories.

These kitchen categories cover a full range of cookware and electrical items as well as cutlery and floorcare. UPGS acquired the licence in 2011. The licence's attraction is that the mother brand name endorses the premiumness and reliability of a wide range of kitchen items.

UPGS clearly has the know-how to deliver a relevant, high quality product range. However, the feel good factor associated with this range is significantly due to the use of the Salter name. Similar to Beldray, there is a strong case for UPGS's Salter offering to grow. The selection is both wide-ranging and, given its combination of good quality/affordable price, very collectible. Moreover, Salter's willingness to work with UPGS should be seen as a positive endorsement.

Intempo

Intempo, which carries the message "Making Music Cool," targets its products at teenagers. The brand delivers a wide range of music products which in addition to being interesting in their own right are compatible with the leading mobile listening brands – notably, Android and Apple.

Intempo's product categories are headphones, jukebox, powerbank, speakers, turntable and vinyl. The brand, which was acquired out of administration in 2009, was UPGS's third largest in 2017 with sales of £10.1m - having grown very rapidly from £1.5m in 2014.

Our observations elsewhere in music tend to confirm Intempo's underlying growth potential. Music fans bias towards the fashion conscious both in terms of chasing music trends and sound delivery. Moreover, the relatively low rates of youth unemployment in Germany and the UK support a robust consumer in UPGS's main markets.

Russell Hobbs

The fourth largest of UPGS's premier brands, Russell Hobbs' attractions are clear. It is a time honoured premium household brand whose primary brand owner has licensed out its cookware lines to UPGS since 2011.

Similar to Beldray and Salter, the lines should enjoy organic growth even if off a smaller base than the group's largest home brands. There is a clear feel good factor associated with the brand, which is in turn delivered by UPGS at affordable price points. Scope to add to a collection of Russell Hobbs kitchen products is reasonably substantial.

UPGS's Russell Hobbs branding opportunity is to be able to supply non-electrical kitchen and homewares. UPGS's best selling Russell Hobbs lines include bakeware, cutlery sets, ironing boards, knife blocks, scales and stainless steel cookware.

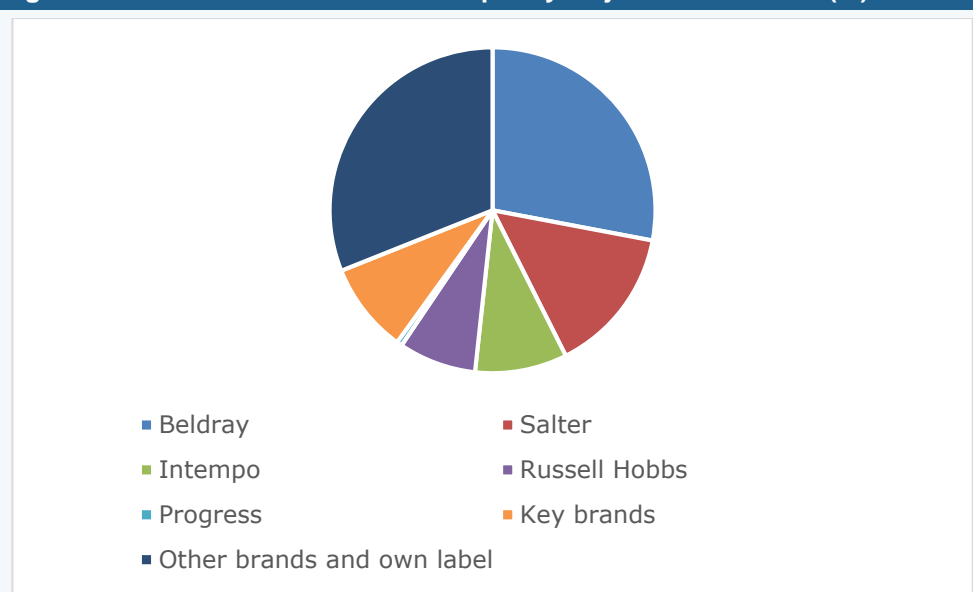
Progress

Progress is comfortably the smallest and newest of UPGS's premier brands. We expect it to have recorded positive sales growth in FY2018. The brand enjoys scope for further growth, not least because UPGS already has an established skillset in driving growth in kitchenware with Salter and Russell Hobbs.

Progress - established in Burnley, Lancashire in 1931 - is a heritage brand, which enjoys strong associations with Lancashire. Effectively, it hails from the doorstep of UPGS's Oldham, Greater Manchester head office. Like Intempo, the business was purchased out of administration and has been with the group since 2015.

A tendency to be irreverent is a significant attraction of Progress and its offering. Examples include written messages on chopping boards and the use of strong, bright colours on a number of its items such as the brand's turquoise salt and pepper mills and bright orange kitchen scales. In our view, Progress delivers "feel good" at an attractive price, which is a key component of the UPGS growth formula.

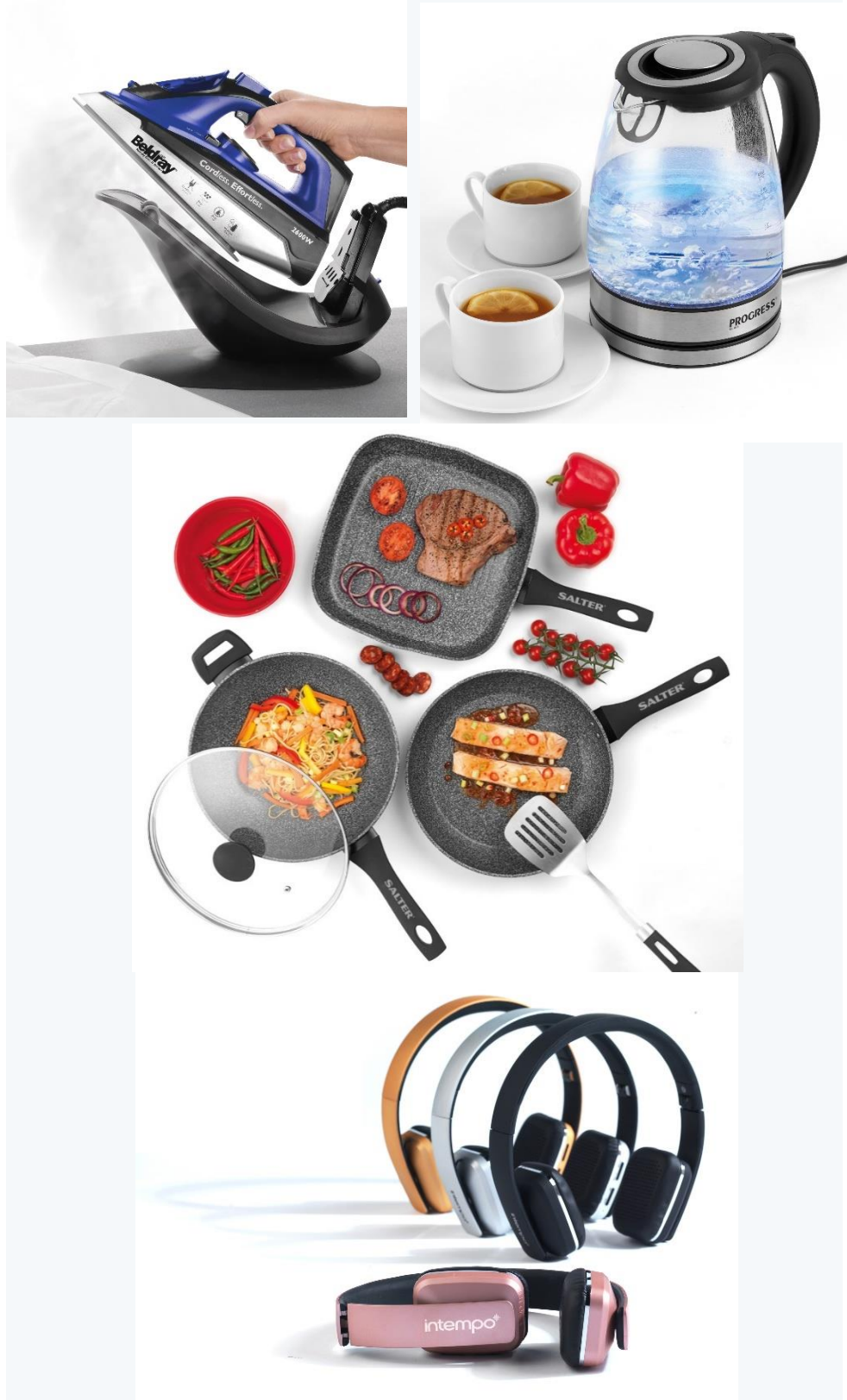
Figure 3 - Ultimate Products – Sales Split by Major Brand in 2017 (%)



Source: Company Accounts data

Ultimate Products

Brand Illustrations – Beldray, Progress, Salter, and Intempo



Source: Company

Other key brands and own label

As Figure 3 implies, in FY2017 UPGS's Premier brands represented 60.0% of UPGS's sales revenue. Key brands accounted for a further 9.0% with the remaining 31.1% comprising other brands and private label. Key brands include luggage brands Constellation and ZFrame, the home entertaining and kitchen brands, Giles & Posner and American Originals as well as Portobello (china) and PROlectrix (electrical appliances).

Furthermore, UPGS continues opportunistically to add brands to its portfolio through M&A. Kleeneze, which specializes in laundry and floorcare, is a good example. UPGS acquired the intellectual property rights to the brand from the administrator in June 2018.

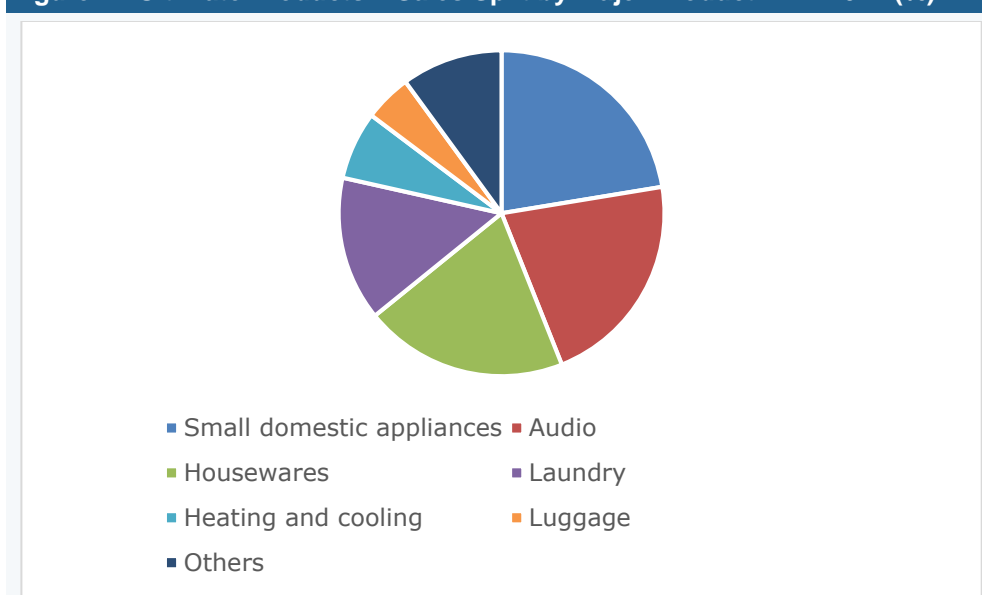
Brand management

UPGS manages the brand portfolio, which we discussed earlier in this report, to give the company a clear commercial advantage. The company is not a major purchaser of above the line advertising – billboards, newsprint, TV etc. However, demand for the brands is supported by its choice of a select group of parent brands (notably, Russell Hobbs and Salter) and by continuing to focus on a small group of names. In addition, non-Premier and own label is kept pretty much to a minimum.

Parent brands should continue to support a premium view of the UPGS portfolio. For example, Salter are themselves sufficiently active brand builders to ensure recognition and pricing power for the UPGS goods that carry its name. Moreover, the focus on building premium brand images is in our view positive for growth.

Proactive brand building by UPGS includes point-of-sale and the internet. In the case of the former retailers clearly desire on-shelf support for products and of the latter, not only do the company's Premier brands all have their own websites but also UPGS is a proactive user of social media.

Figure 4 - Ultimate Products – Sales Split by Major Product in FY2017 (%)



Source: Company Accounts Data

Managing brands for growth

A salient and consistent theme of UPGS's brand portfolio is that **the brands themselves** are well positioned for growth. In particular, the Premier brands bring to the market a group of relevant, modern, "feel good," products at very affordable price points and which appear to represent good value. Moreover, we believe that the brands are well managed for growth.

In particular, UPGS manages its brands according to what we observe to be a small group of core principles. In our view these principles position UPGS well to deliver reliable organic growth on a financially secure basis.

Growth within the channels

UPGS's business strategy identifies its key distribution channels that are referred to as "The four pillars to growth." These comprise international, discounters, UK supermarkets and online. These strategic pillars reflect both the historic mix and scope for future growth. Importantly, UPGS is not reliant solely on domestic business for growth nor traditional retail. We discuss the channels individually. The sales split is summarised in Figure 5.

International

UPGS is an international business both in terms of product sourcing (China) and distribution. Moreover, international is and will remain an important source of future growth. In FY2017, the channel represented 28% of group sales, having been only 17% in 2014. International dipped to 20% in FY2018 H1. However, as the terms of trade issue which impacted Continental Europe in this period unwinds, it should recover as a portion of group business.

Continental Europe represents by far the largest component of international with Germany the current poster child.

Total addressable market arguments and UPGS's relatively low current penetration rate represent strong macroeconomic cases for UPGS's international channel to grow briskly. In our view, the product categories lend themselves to growth. The primary Continental European markets are mature markets that should respond well to UPGS's portfolio of affordable and useful, feel good branded products.

Discounters

Similar to the trends in food retailing, discounters represent an important UK growth channel where UPGS looks to gain advantage. UPGS offers branded products at mass-market prices, which is arguably more attractive than own-label. Chief components of UPGS's approach to discounters include shelf-space expansion through more listings with existing customers, natural growth through the discounters' increase in site numbers, and new European accounts.

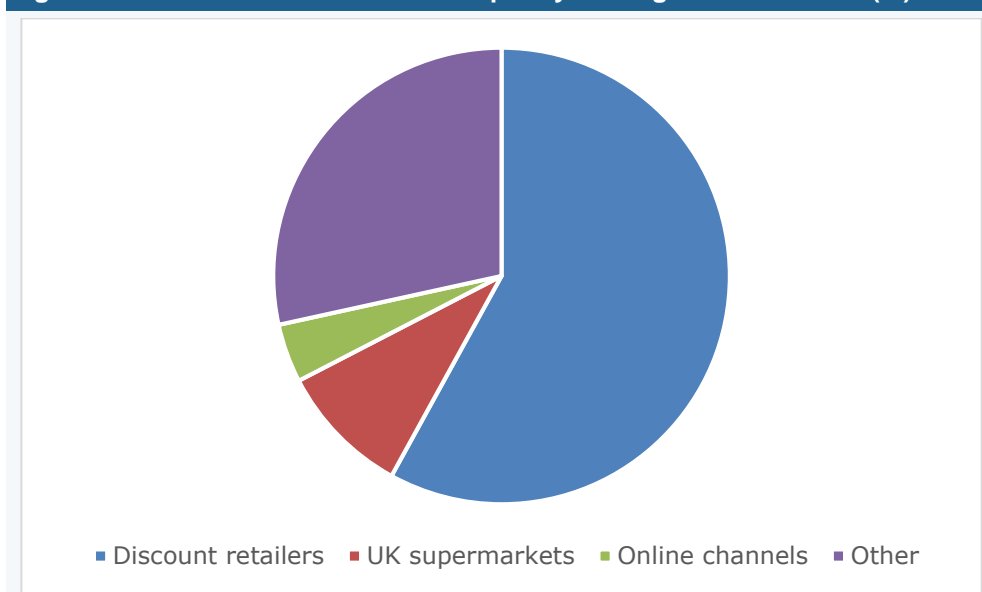
Aside from this channel's inherent growth, UPGS should benefit from its commitment to a portfolio of strong, well-managed brands. Discounters rely significantly on their demonstrable pricing advantage to secure business. Offering a better price on comparable brands is essential to making this advantage transparent.

Supermarkets

UPGS's products are available in the UK's largest supermarket and discount food retail chains. However, sales within this channel remain low relative to their potential, despite a brisk start to the penetration process when the company enjoyed very good growth in business with the UK's "Big-4."

There is good reason why growth in the channel should be brisk. Discounters benefit from having recognisable, comparable brands in their stores. Furthermore, that UPGS has already generated good growth in the channel off a small base tends to confirm both momentum and headroom. There is a strong case that a concerted push into the supermarket channel should be rewarded with a sharp uptick in sales.

Figure 5 - Ultimate Products – Sales Split by Strategic Pillar FY2017 (%)



Source: Company Accounts

Online

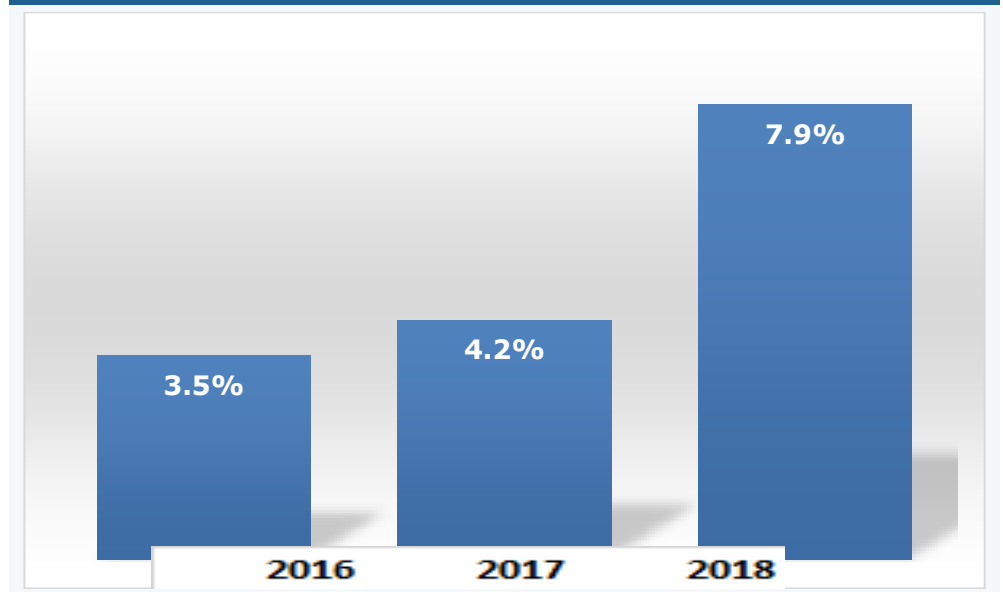
UPGS's objective is to raise online as a portion of its sales to around 20% - i.e. to be similar to the market for non-food retail as a whole. Should it achieve this sales would expand from £7m (based on current year estimates) to close to £20m.

Having been £4.5m in FY2017 online sales rose sharply by an implied 51.5% in FY2018 based on the 10th September trading statement, which reported them to be 7.9% of FY2018's £87.6m sales revenue. With due regard for any cannibalisation of other channels, the overall sales growth impact is potentially sizable. Recent growth in online's portion of sales is shown in Figure 6.

An advantage of online for UPGS is the ability to deal well with small quantities of product. As a result, there is scope for the above-mentioned cannibalisation to be kept to a minimum. Moreover, the channel's infrastructure is already well established and business can be handled on an outsourced basis.

We highlight that UPGS does not distribute via its own websites. Rather, it uses established platforms.

Figure 6 - Ultimate Products – Growth in Online as a Portion of Sales (%)



Source: Company Accounts and Press Releases

The case for category growth

Having covered the channels individually, we note the scope for UPGS's product portfolio as a whole to generate consistent, underlying growth. UPGS splits its offering into six categories: Small Domestic Appliances, Housewares, Audio, Laundry, Heating & Cooling and Luggage. Their collective offering gives them the ability to deliver practical, feel good brands at affordable prices.

Unlike food and drink, none of UPGS's products are consumed internally, which in a mature market is clearly an advantage. Moreover, they tend not to be either big ticket items in terms of selling price nor do they take up much room. For most households, UPGS's products would be a combination of add-ons and collectables. Any mature market economy that is experiencing good economic growth should see positive demand growth for these kinds of items.

Management team & Strategy

Management team

UPGS's senior management team is a compact group, which boasts significant consumer facing experience. CEO Simon Showman and Managing Director Andrew Gossage have worked together since 2005, with Simon Showman having founded the company in 1997. He assumed the CEO role after an LDC management buy-out, which effectively created the company in its present form.

Non-executive Chairman James McCarthy introduces a significant amount of relevant outside experience to the team. Barry Franks was a founder investor. We summarise the team in the box below.

Ultimate Products Global Sourcing Holdings PLC – Board of Directors

Position		Age	Year joined
Independent Non-Executive Chairman	James McCarthy	62	2017
Chief Executive Officer	Simon Showman	45	1997
Managing Director	Andrew Gossage	47	2005
Finance Director	Graham Screawn	51	2010
Senior Independent Non-Executive Director	Alan Rigby	62	2017
Independent Non-Executive Director	Robbie Bell	45	2017
Non-Executive Director	Barry Franks	72	1997

Source: Company

Tight reporting lines and a simple structure seem likely to remain features of UPGS's management style. The three key functions of the Board of Directors – CEO, MD and FD – effectively form the executive management committee. With a robust graduate recruitment process in place and a strong internal training programme in place, UPGS maintains a positive and opportunistic culture.

Strategy

Organic growth remains central to UPGS's strategy. This is reflected in its relatively compact brand portfolio and identification of both categories and sales channels that are well placed to generate organic sales growth. Moreover, the company has proved adept at acquiring brands on a bolt-on basis, including the two that were taken out of administration.

UPGS's cost and financial culture appears conservative. As the company's latest trading update revealed, there is plenty of headroom between current debt levels and actual facilities. Moreover, historic values for net debt:EBITDA were beneath 1.0x, comfortably.

That changed in FY2018 when we estimate a 2.0x closing ratio. The position should start to improve in FY2019 and more markedly thereafter.

FY2018 Trading Update

H1 and H2 performance

UPGS's 10th September trading update reported that FY2018 sales would be of the order of £87.6m and that EBITDA should be around £6.5m. We factor both of these into our forecasts. Moreover, the company stated that online increased as a portion of sales from 4.2% in FY2017 to 7.9% in FY2018.

Figure 7 – Key FY2018 Trading Data

£m	FY2017			FY2018		
	H1	H2	Total	H1	H2	Total
Revenue	68.1	41.9	110.0	48.4	39.2	87.6
EBITDA	8.8	2.7	11.5	4.5	2.0	6.5
Debt headroom	9.7		6.2	8.0		9.1

Source: Company Press Release, 10th September 2018

The implied first half and second half split for net sales revenue and adjusted EBITDA are summarised in Figure 7. Both sales and profits experienced much slower declines in H2. Sales shrank by 6% relative to a 29% drop in H1 while the H2 drop in adjusted EBITDA was 26% compared with halving – i.e. -51% – in the opening six months of the year.

The company's debt headroom position has also improved and is close to £3m better than a year ago.

From FOB to Landed

While UPGS's first half trading performance was clearly hurt by a "challenged" UK consumer with additional strains for imported consumer durables associated with UK currency weakness, we also highlight the negative impact on UPGS in H1 from a major customer switching supply arrangements from Free On Board to Landed.

UPGS sources manufactured product from suppliers who are mostly based in China. With production being outsourced any FOB arrangement, whereby goods move directly from the outsourced manufacturer to retail customer, naturally accelerates the timing of their booking. However, the position should unwind and lead to a pick-up in sales in FY2019. We assume the FY2018 H1 impact to have been around £5.0m.

Valuation and Financial Forecasts

Valuation

We include a relative valuation for UPGS in Figure 8. Establishment of a tight peer group is challenging. UPGS is a brand manager and procurer of product rather than a direct manufacturer. It is not a retailer, which should also reduce profit and returns volatility. The central message in our view is that UPGS's relative valuation on key metrics such as EV/EBITDA, P/E and dividend yield is *not* a barrier to investment.

FY2018 was clearly volatile for UPGS given the drop in first half profits and the associated statement to the financial markets. But top line volatility was clearly less pronounced than at the earnings levels. As a result, we see no reason why sales should not return to closer to £100m. Any valuation target put onto UPGS's shares using sales as a benchmark – say 1.0x to 1.5x EV/sales – would generate considerable upside.

Figure 8: Relative Valuation

	Share price (p)	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	22	195.3	38	34	72	140	0.5	-5.0	-14.4	9.0		2.2			
EveSleep	19	139.3	27	7	34	38	0.9	-19.5	-1.8	-14.0	-4.3	-1.4	-4.4		
Gear4 Music	514	20.9	110	5	115	80	1.4	3.5	33.2	6.7	10.9	76.7	47.2		
Luceco	50	160.8	81	51	133	173	0.8	19.1	6.9	6.2	5.8	8.1	8.7		
UPGS	33	82.2	27	13	40	88	0.5	6.5	6.1	5.3	5.5	6.1	5.9	2.7	8.3%
Warpaint	266	76.8	203	0	203	55	3.7	13.3	15.3	8.3	13.5	31.9	19.7	4.0	1.5%
Average							1.3		7.6			20.5	15.3		5.1%

Source: Equity Development, various websites

Financial forecasts

UPGS's preliminary FY2018 results are due for release 6th November 2018. On 10th September 2018 the company announced that FY2018 sales were £87.6m which represented a 20.4% decline from FY2017. However, this was an improvement on H1's 28.9% decline and implied a 6% H2 sales drop.

Income statement

Despite the sharp fall in H1, UPGS's net sales revenue advanced at a 13.5% CAGR in the four years to FY2017. We forecast some recovery in FY2018 and for the company thereafter to establish a mid to high single digits growth trajectory. In our view, this is conservative given the relative freshness of a number of the company's growth channels – notably online and international.

Gross margins are expected to be broadly stable at around 22%. Achieved EBITDA and operating margins are sensitive to the company's administrative costs of which a significant portion is staff – i.e. £10m in FY2017. We estimate overall administration expenses rose to 15.4% of sales in FY2018 from 15.1% a year earlier despite a useful £3.2m drop in the money amount.

Balance sheet

We see UPGS's balance sheet as consistent with the company being conservatively managed. Despite this year's envisaged drop in profits the company's net debt : EBITDA looks set to be 2.0x, with ample headroom on facilities, rather than anything more dramatic. In addition, a significant portion of the movement on working capital which we expect relates to a shift in the company's business mix away from FOB towards delivered.

Underlying profitability remains strong for UPGS, which is reflected in our expectations of further gains in net equity (shareholders' funds). We look for these to expand from £6.8m to £7.9m in FY2018 with a further gain to £9.4m in FY2019.

Free cash flow

Long-term trends in free cash flow appear set to be positive. What is important to note is that UPGS does not require investment in manufacturing infrastructure to grow sales. Our forecasts suggest that the company's asset turnover should expand with growth, which is clearly beneficial for free cash flow and paying down debt.

Income statement				
£'000s, Y/E 31 July	2016A	2017A	2018E	2019E
Revenue	79,028	109,953	87,575	95,400
% increase in revenue	23.3%	39.1%	-20.4%	8.9%
Gross profit	18,914	24,567	19,272	20,988
Gross margin (%)	23.9%	22.3%	22.0%	22.0%
EBITDA - adjusted	8,226	11,512	6,514	6,878
EBITDA margin - adjusted	10.4%	10.5%	7.4%	7.2%
Net financial income	-441	-464	-497	-512
Pre-tax profit - reported	6,259	7,427	5,325	5,516
Taxation	-1,361	-1,852	-1,131	-1,168
Tax rate (%)	21.7%	24.9%	21.2%	21.2%
Net income - adjusted	5,895	8,406	4,386	4,548
EPS - fully diluted adjusted (pence)	8.0	10.7	5.3	5.5
Dividend per share (pence)	3.3	5.1	2.7	2.7

Source: ED estimates, Company historic data

Balance Sheet

£'000s, Y/E 31 July	2016A	2017A	2018E	2019E
Assets				
Property, plant and equipment	970	1,715	2,315	2,265
Deferred tax	209	162	200	200
Total non-current assets	1,179	1,877	2,515	2,465
Inventories	10,545	11,064	14,064	15,321
Trade and other receivables	16,231	11,745	15,745	17,152
Current tax		481		
Cash and cash equivalents	136	91	91	91
Total current assets	26,912	23,381	29,900	32,563
Total assets	28,091	25,258	32,415	35,028
Liabilities				
Share capital	184	205	205	205
Share premium account	2	2	2	2
Reserves	441	-193	59	-466
Retained earnings	567	6,779	7,591	9,670
Total equity	1,194	6,793	7,857	9,410
Trade and other payables	16,403	12,516	11,016	13,016
Current tax	478		566	584
Short term borrowings	7,132	1,518	8,545	7,587
Total current liabilities	24,013	14,034	20,127	21,187
Long term borrowings	2,884	4,431	4,431	4,431
Total non-current liabilities	2,884	4,431	4,431	4,431
Total liabilities	28,091	25,258	32,415	35,028

Source: ED estimates, Company historic data

Free Cash Flow				
£'000s, Y/E 31 July	2016A	2017A	2018E	2019E
Profit for the period	4,898	5,575	4,194	4,348
Adjustments for:				
Finance costs	441	464	497	512
Gain on disposal of non-current assets		-5		
Income tax expense	1361	1852	1131	1168
Depreciation and impairment	280	394	500	650
Share based payments		80	192	200
Income taxes paid	-1309	-678	-85	-1150
Total	5671	7682	6430	5729
Working capital adjustments				
(Increase)/decrease in inventories	-2815	-519	-3000	-1257
Decrease/(increase) in receivables	-4740	4049	-4000	-1407
(Decrease)/increase in payables	5545	-1790	-1500	2000
Total	-2010	1740	-8500	-663
Net cash from operations	3661	9422	-2071	5065
Cash flows used in investing activities				
PP&E	-652	-1162	-1100	-600
Proceeds from P, P & E disposals		28	22	24
Total	-652	-1134	-1078	-576
Free cash flow before financing	3009	8288	-3148	4489
Interest paid	-2316	-451	-497	-512
Free cash flow before dividends etc	693	7837	-3645	3977
Dividends	-1466	-3780	-3382	-2270
Share issues		21		
Other cash flows related to shares	-18			-750
Free cash flow after dividends etc	-791	4078	-7027	958

Source: ED estimates, Company historic data



Head of Corporate

Gilbert Ellacombe

Direct: 0207 065 2698

Tel: 0207 065 2690

gilbert@equitydevelopment.co.uk

Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Felix Grant-Rennick

Direct: 0207 065 2693

Tel: 0207 065 2690

ben.ferguson@equitydevelopment.co.uk

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www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690