UP Global Sourcing Holdings plc

Brand strength underpins strong growth outlook

2 November 2021

UPGS's combination of strong brands, targeted distribution channels and demonstrable success in M&A augurs well for sustainable growth. Moreover, the company's track record in coping with disruptions associated with Covid-19 should give investors confidence in senior management's ability to handle any ongoing logistics problems associated with both international shipping and domestic haulage. We reiterate our 275p fair value for the shares.

UPGS's FY2021 results reconfirmed the sales and EBITDA growth, which were announced in the company's 23rd August trading statement and commented on in our report "Another Year of Good Growth Delivered". Today's announcement includes data for underlying pre-tax profits and EPS which advanced by 36.6% to £11.2m and 34.2% to 10.6p, respectively. At this stage we are leaving our FY2022 forecasts unchanged, which is arguably prudent.

UPGS remains committed to a four strategic pillar distribution strategy. However, within these pillars it is Supermarkets and Online Channels which continue to grow most quickly with advances of and 32.3% and 23.2% respectively in FY2021. Online sales as a portion of the total increased from 14.5% to 15.1%. While still well shy of their revised 30% of group sales target, it should be noted that they were as little as 3.5% in FY2016 and have increased in importance for each of the past five years.

Brand strength remains critical to UPGS's ability to grow in what we argue are the more "level playing field" channels of supermarkets and online. Thus the company's acquisition of Salter which we highlighted in a 25th June 2021 report UPGS acquires UK's oldest housewares brand was an important move. Early indications for the integration of Salter into the business look positive.

UPGS expects that global shipping will remain disrupted until after Chinese New Year (February 2022). However, consistent with the company's ability to grow overall revenue at a 5.2% pace since the pre-Covid FY2019, UPGS has mitigating actions in place. In particular, the company anticipates growth to be driven by its FOB and forward order channels, as well as being able to offset higher shipping costs through a stronger and a largely contracted stronger £/US$ exchange rate.

UPGS financial strength underpins our confidence in the company's ability to continue to pay out dividends at a 50% pay-out ratio – i.e. a twice covered basis. Dividend yield is a salient valuation advantage of UPGS relative to its peers. Moreover, even at our fair value price of 275p, the company would not be rated out of line with peers on key EV/sales, EV/EBITDA, and P/E measures.

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)	16.1	16.7	13.0	9.2	8.5
P/E ratio (x)	21.3	21.9	16.4	12.3	11.3
Yield	2.4%	2.3%	2.9%	4.1%	4.4%

Source: ED estimates, company historic data

Company Data

EPIC	UPGS
Price (last close)	173p
52 weeks Hi/Lo	238p/82p
Market cap	£154m
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 **Beldray, Intempo, Kleeneze, Petra, Progress** and **Salter**. The company also markets non-electrical Russell Hobbs products under licence.

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Brand strength underpins strong growth outlook

UPGS's FY2021 results largely confirmed the key growth metrics which were reported in the 23rd August trading statement for the financial year. However, as well as presenting full financials, today's statement includes important messages for distribution channels, early stages of the Salter acquisition and how the company expects to mitigate the challenges associated with global shipping disruption.

We cover each of these items in this report as well as updating our financial forecasts to include the FY2021 actual numbers and our relative valuation. Fair value remains 275p per share, in our view.

FY2021 results

Overall, FY2021 was a year of brisk growth which more than compensated for the heavy disruption to progress experienced in FY2020 when the company was hampered by the first and early stages of the Covid 19 pandemic, the forced closure of non-essential retailing and associated weakness in commercial customer demand. Importantly, sales grew at a 5.2% compound rate across the two years.

Total revenue in FY2021 grew by 17.9% to £136.4m and underlying EBITDA rose by 28.3% to £13.3m in FY2021, as announced in August. **Today's statement reported a 36.6% increase in underling pre-tax profits with a 34.2% increase in underlying EPS to 10.6p**. Gross margins suffered in the second half due to the current global shipping crisis and were 1.4% points lower than in the first six months of FY2021.

The increase in net debt in FY2021 was caused by the 15th July 2021 Salter acquisition which occurred just prior to the financial year-end on 31st July 2021. UPGS acquired Salter for an initial £30.6m consideration, a further £1.1m post year end, and a deferred consideration of £2.0m.

Despite the acquisition and associated increase in net debt, UPGS's **financial position remains strong** with a net debt/underlying EBITDA ratio of 1.4x and £16.2m of stated bank facility headroom, down £5.1m from £21.3m in FY2020 despite the Salter acquisition. We note that FY2021 EBITDA includes a minimal contribution from Salter. The Salter purchase was financed by a combination of debt and £14.4m net proceeds from a share issue. We summarise highlights of the results in Figure 1.

Figure 1 - FY2021 Results Highlights

All figures in £m, year to 31st July	FY2020	FY2021	Change
Revenue	**115.7**	**136.4**	**+17.9%**
Gross margin	23.0%	22.2%	-80bps
Underlying EBITDA	**10.4**	**13.3**	**+28.3%**
Underlying EBITDA margin (%)	9.0%	9.7%	+70bps
Underlying profit for the year	**6.5**	**8.7**	**34.2%**
Profit for the year	6.6	7.3	16.1%
Net cash from operations	**15.8**	**9.2**	**-£6.6m**
Free cash flow	14.5	6.5	-£8.0m
Net bank debt	**3.8**	**18.9**	**+£15.1m**
Net bank debt/EBITDA* (x)	0.4x	1.4x	+1.0x
Underlying EPS (pence)	**7.9**	**10.6**	**+34.2%**

Source: Company data

Senior management change

In a separate announcement, UPGS's Chief Financial Officer Graham Screawn states his intention to retire from the group after eleven years of service in a senior financial role, having initially joined the company as Finance Director in 2010. Graham will remain with UPGS until the second half of 2022 to ensure a smooth succession process and handover. The Board announces that an external recruitment process for Graham's successor has already been put in place.

Distribution channels confirm brand strength

UPGS's identification of four strategic distribution pillars and the prioritisation of those which respond best to the company's inherent brand strength represent an important part of the company's overall growth strategy.

In particular, Supermarkets and Online stand not only to be the most relevant channels of distribution for the company's product portfolio but are in our view those which **respond best to strong brands**. The channels are naturally competitive and offer what we deem to be a "level playing field" for brands.

Supermarkets and Online increased their share of UPGS's overall business from a combined 38.8% of the company's business to 42.4% in FY2021 as they advanced by 32.3% and 23.2% respectively. Discount retailers grew by 15.3% and multiple store retailers a similar 15.2%. We summarise FY2021 growth by distribution channel and the channels' movements as a portion of the total business in Figure 2.

Figure 2 - Revenue by strategic pillar (£'000s)

Year to End July	FY2020	FY2021	Increase	Portion of business	
				FY2020	FY2021
Discount Retailers	44,685	51,527	15.3%	38.6%	37.8%
Supermarkets	28,126	37,207	32.3%	24.3%	27.3%
Online Channels	16,719	20,590	23.2%	14.5%	15.1%
Total	89,530	109,324	22.1%	77.4%	80.2%
Multiple-store Retailers	15,010	17,285	15.2%	13.0%	12.7%
Other	11,144	9,758	-12.4%	9.6%	7.2%
Group	**115,684**	**136,367**	**17.9%**	**100.0%**	**100.0%**

Source: Company data

In February 2021 UPGS raised the stated longer-term target for Online as a portion of total sales from 20% to 30%. This upwardly revised target looks more than achievable in the context of the 5-year increase in online as a portion of total sales from 3.5% to 15.1% and the company's ongoing focal shift towards being a branded consumer goods provider rather than a sourcing-oriented business.

However, there was a setback to online in the second half of the year when the channel fell both in terms of absolute sales value and as a portion of the total as a direct result of the current disruption to shipping. UPGS responded to this disruption by prioritising forward orders. As a result, this weakness for Online may be expected to continue into FY2022.

But once the current shipping crisis ameliorates, Online's absolute growth and expansion as a portion of group sales should resume. We summarise recent half-years in Figure 3, and 5-year growth in Figure 4.

Figure 3 - Online sales split by half-year (£'000s)

Year to end July	FY2020 H1	FY2020 H2	FY2020	FY2021 H1	FY2021 H2	FY2021
Online sales	7,680	9,039	16,719	11,794	8,796	20,590
Total sales	67,690	47,994	115,684	75,382	60,985	136,367
Online portion	**11.3%**	**18.8%**	**14.5%**	**15.6%**	**14.4%**	**15.1%**

Source: Company data

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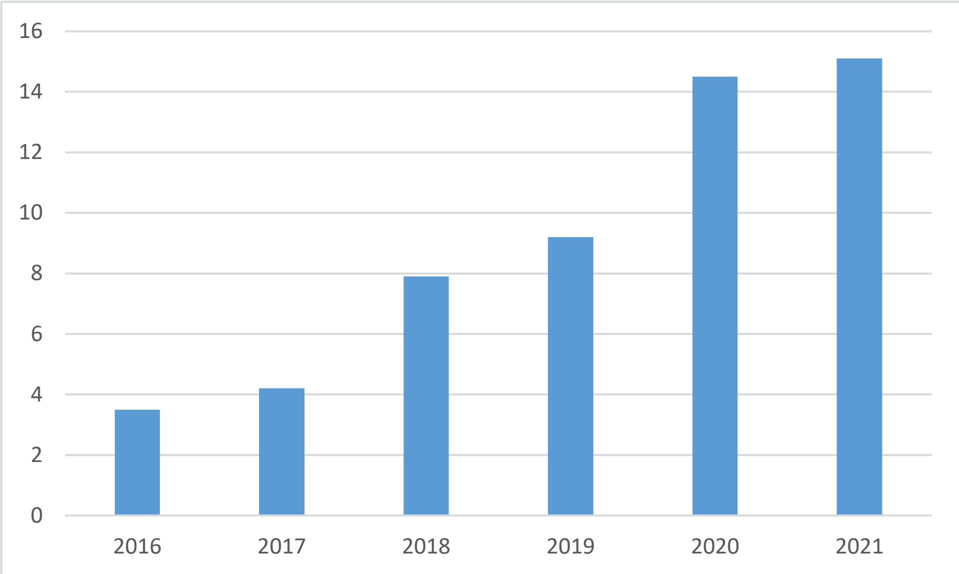
Figure 4 – Online as a portion of group sales – FY2016 to FY2021 (%)



Source: Company data

Brand performance in FY2021

Salter – early stages of integration on track

Salter, which will be owned across all household categories for the entirety of FY2022, increased sales by 9.9% in FY2021. Salter and Beldray are the group's two leading brands and combined represent a little over half of the business having modestly increased their joint share from 50.6% to 51.9% in FY2021.

As a slimmed down business, which was purchased from FKA Brands Limited to include rights to the Salter Brand globally (excluding North America), Salter fits into the overall UPGS business model well in our view. Although legacy headcount was small, its brand profile is pleasingly high.

Salter is the UK's oldest household brand with a renowned presence in measuring devices, as highlighted in our 25th June 2021 report UPGS acquires UK's oldest housewares brand. Outright ownership of the brand benefits UPGS not only by reducing any continuity risk associated with being licensed but also by being able to run the business as a single Salter entity. Already, it appears that enlarged ownership has brought in new customers to UPGS.

Brand performance as a whole

The overall performance of the brand portfolio in FY2021 is summarised in Figure 5. Importantly, the group's premier brands increased their share of overall business in FY2021 with a notably strong performance from the only remaining licensed brand, Russell Hobbs.

The strong growth rates of the smaller premier brands support the continued growth case for UPGS model. **All three of Progress, Intempo and Kleeneze recorded strong expansion rates**. Moreover, of these only Intempo was in negative territory in the previous year.

There is a clear and proven competence at UPGS in acquiring smaller brands and making them grow, which bodes well for Petra and the potential to uncover similar opportunities. With re-launch planned for Spring/Summer 2022, Petra is expected to start making a meaningful contribution to sales revenue in FY2023.

Figure 5 - Revenue by brand (£'000s)

Year to end July				Portion of business	
	FY2020	**FY2021**	**FY2021 vs FY2020**	**FY 2020**	**FY2021**
Beldray	32,762	42,374	29.3%	28.3%	31.1%
Salter	25,834	28,379	9.9%	22.3%	20.8%
Russell Hobbs (licensed)	11,741	16,840	43.4%	10.1%	12.3%
Progress	4,410	6,683	51.6%	3.8%	4.9%
Intempo	5,049	6,514	29.0%	4.4%	4.8%
Kleeneze	1,183	2,136	80.6%	1.1%	1.6%
Premier brands	**80,979**	**102,926**	**27.1%**	**70.0%**	**75.5%**
Other proprietorial brands	19,070	17,842	-6.4%	16.5%	13.1%
Subtotal	**100,049**	**120,768**	**20.7%**	**86.5%**	**88.6%**
Own label and other	15,635	15,599	-0.2%	13.5%	11.4%
Total	**115,684**	**136,367**	**17.9%**	**100.0%**	**100.0%**

Source: Company data

Petra and International

At a disclosed transaction value of £91,000, Petra, the German kitchenware brand acquired by UPGS In February 2021, was small in relation to Salter. However, the clear message from the smaller premier brands' combined performance and some of the other proprietorial brands is that UPGS should be able to rejuvenate the Petra brand and significantly upscale its profile and sales revenue.

Furthermore, the legacy German business performed particularly well in FY2021. Sales revenue in the country rose by 26.8% to £13.9m as International overall grew by 4.4%. UPGS cites Germany as being a "*particularly exciting opportunity*" which, given the ability simultaneously to grow organically and make further acquisitions in Europe's largest economy, seems appropriate. It already represents around one third of the company's Continental European sales revenue. We summarise sales growth by location in Figure 6.

Figure 6 - Revenue by region (£'000s)

				Portion of business	
	FY2020	**FY2021**	**FY2021 vs FY2020**	**FY 2020**	**FY2021**
United Kingdom	74,045	92,916	25.5%	64.0%	68.1%
Germany	10,951	13,882	26.8%	9.5%	10.2%
Rest of Europe	29,716	27,720	-6.7%	25.7%	20.3%
USA	403	688	70.6%	0.3%	0.5%
Rest of World	569	1,161	104.5%	0.5%	0.9%
Total	**115,684**	**136,367**	**17.9%**	**100.0%**	**100.0%**

Source: Company data

Managing the current shipping crisis

As a company which sources comfortably the largest portion of its products from China, UPGS is unavoidably affected by the current disruptions to shipping from the region. Press reports are currently widespread regarding the cost of shipping, the unusually competitive nature of securing container space on ships and increased freight costs. All three issues directly affect UPGS.

But investors should find some solace from both UPGS's track record at dealing with acute problems – for example, the company grew sales and satiated demand in the opening 18 months of the Covid19 pandemic – and long-term experience in sourcing and importing. Furthermore, there are already a number of ameliorative measures in place to protect both sales and margins.

UPGS's view about the potential longevity of the current international shipping crisis is consistent with that reported in the *Financial Times* 25th October when CEO of Ocean Network Express Jeremy Nixon warned in an article entitled "Governments need to fix supply chain crisis, top shipping boss warns" that disruption could even last until 2023.

UPGS's results statement commented specifically on current constraints to global shipping capacity which it believes are caused by a mix of factors including COVID related labour shortages, lower port productivity due to COVID procedures, catch-up related surges in demand due to economies reopening and a shortage of heavy goods drivers.

While there was an apparent gross margin shortfall due to the shipping crisis which led to FY2021 H2 margins being 1.4% points lower than in FY2021 H1, **UPGS has put in mitigating measures**. These include prioritisation of forward orders from retail customers ahead of stock purchases. While this is important for key commercial customer satisfaction, it explains the slowdown in online business which we mention in the commentary associated with Figures 3 and 4.

Moreover, UPGS can drive growth through its FOB and forward order channels. Additionally, the company should benefit from a stronger £/US$ exchange rate, which is largely contracted in, relative to FY2021 and FY2020. The £/US$ exchange rate averaged £1 = US$1.36 in FY2021 compared with £1 = US$1.26 in FY2020 which represents an 8% favourable move for UPGS as an importer. The corresponding year-end exchange rates were £1 = US$1.39 for FY2021 and £1 = US$1.31 for FY2020.

Financials and valuation

Relative valuation

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.

Despite the acquisition of Salter, which was transacted in our view on a shareholder value accretive basis (as detailed in our 25th June 2021 report) and which will enhance FY2022 earnings significantly, UPGS's shares have not been re-rated upwards. Rather, the shares have declined in value. We continue to emphasise the importance of the Salter acquisition, both in terms of customer reach and the enlarged proportion of business accounted for by brands owned outright.

The fair value for UPGS calculated in this report is 275p per share, which is considerably higher than where the shares trade now and a 20% premium to where they traded at the time of the acquisition, i.e. 220p.

Were the shares to achieve a 275p price, UPGS's EV/sales ratio would be a 7% premium to peer group and EV/EBITDA a 21% premium. However, the group's status as an outright brand owner arguably justifies such higher valuation ratios relative to some of its peers.

At 275p the company's dividend yield would be in line with 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 7.

Figure 7: 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	39	311	120	28	148	170	0.9	18.8	7.9	n/a	n/a	1.0	2.6
Gear4Music	903	21	190	5	195	160	1.2	14.0	13.9	28.0	32.2	n/a	n/a
Luceco	360	154	555	15	570	247	2.3	50.2	11.4	22.0	16.4	8.0	2.2
Portmeirion	682	14	94	-4	90	100	0.9	14.2	6.3	n/a	n/a	19.0	2.8
UPGS	**173**	**89**	**154**	**18**	**173**	**162**	**1.1**	**18.8**	**9.2**	**14.1**	**12.3**	**7.0**	**4.1**
Warpaint	150	77	115	-6	110	49	2.2	7.5	14.6	n/a	n/a	6.0	4.0
Average							1.4		10.5		20.3		3.1

Source: ADVFN, MarketScreener and Equity Development estimates, Prices as at close 1st November 2021

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 incremental sales revenue and close to £5m 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 projections in Figures 8, 9 and 10.

Figure 8 - 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 9 - 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 10 - 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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