

Online drives first half growth

14th February 2023

Online channels were the main driver of growth for UPGS in the first half of FY2023 with a 2% sales revenue gain. At the same time key indicators of financial strength also improved. Commenting on outlook, the company anticipates that the market's current expectations for FY2023 will be met. The combination of growth and resilience prompts us to maintain our Fair Value assessment of 250p per share.

UPGS's 2% sales growth benefited from a strong online performance, moving them closer to their 30% target of total revenue for the online channel. Areas of product strength included energy efficient and money saving items, which were cited as being buoyant across all distribution channels – i.e., discount retailers, multiple store retailers, online and supermarkets.

The trading backdrop showed signs of improvement in the first half of FY2023. UPGS highlighted a normalisation of global supply chains as well as some easing of cost pressures due to the partial recovery of sterling and the current softness in global shipping pricing, which augurs positively for margins. There are also signs that post-COVID overstocking within its retailer partners has been reduced. More normal patterns of order placing have already recommenced.

UPGS's strength in online, like supermarkets, reaffirms the quality of their brand portfolio. Brands and products in both channels are effectively put on a "level playing field" against each other. Tangible benefits are now visible from the company's ongoing transformation from its roots as a sourcing company to now being a brand manager led by Beldray and Salter. We view the appointment of Tracy Carroll in December 2022 as Brand Director as being consistent with positive momentum for UPGS's brand development.

UPGS continues to highlight the positive impact that the company's automation programme is having on the business. The company expects that its "bottom-up, demand-led" approach to automation enables it to concentrate efforts on the tasks that cause the most increased productivity, which should both enhance operating margins and improve customer experience going forward.

Fair value at 250p / share

Despite recent share price strength, we still believe that the company's current valuation fails to fairly reflect UPGS's three salient growth drivers - brands, online & supermarkets distribution and international. With external headwinds easing a second half acceleration is in prospect, plus a robust financial position, the near-term outlook appears positive. We base our 250p fair value / share assumption on an FY2023 EV/sales ratio of 1.5x and 12x EV/EBITDA.

Key Financials					
Year to 31st July	2020A	2021A	2022A	2023E	2024E
Revenue (£'000)	115,684	136,367	154,191	163,442	173,249
Revenue growth	-6.1%	17.9%	13.1%	6.0%	6.0%
EBITDA (£'000) (adj)	9,915	13,291	18,750	20,176	21,680
EPS adjusted (p)	8.3	11.1	14.7	15.1	15.6
DPS (p)	4.0	5.0	7.1	7.5	7.8
EV/EBITDA (x)	16.8	12.6	8.9	8.3	7.7
P/E ratio (x)	20.1	15.0	11.3	11.0	10.7
Yield	2.4%	3.0%	4.3%	4.5%	4.7%

Source: ED estimates, Company historic data

Company Data

EPIC	UPGS
Price (last close)	167p
52 weeks Hi/Lo	189p/90p
Market cap	£144m
ED Fair Value / share	250p

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, now on a rolling four-year basis.

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Online drives first half sales growth

UPGS's sales revenue increased by 2% in the first half of FY2023. This robust trading performance, which lapped a 13.7% increase in the same six months a year earlier, benefited from unusually good growth in the online channels as well as the normalisation of global supply chains. Moreover, consumer demand for energy efficient and money saving products – including air fryers – was notably buoyant across all distribution channels.

FY2023 H1 trading update highlights

Highlights of today's first half trading update are summarised in Figure 1. In addition to the company's revenue gains there were improvements in both financial measures published in today's update. Net debt reduced from 1.3x EBITDA to 1.0x and there was a £4.6m increase in the company's bank facilities headroom.

There is no reason to believe that UPGS's ability to grow revenue - through satiating rising demand for its brands and products - will be constrained by the company's financial position.

Figure 1 – FY2023 trading update highlights

31st July year-end	FY2022 H1	FY2023 H1	increase
Sales revenue (£m)	85.7	87.6	2%
Net debt/EBITDA (x)	1.3	1.0	-0.3x
Bank facilities headroom (£m)	17.8	22.4	4.6

Source: Company data

A strong online performance should be seen as a vindication of the group's distribution strategy to increase the relative importance of both this channel and supermarkets. Furthermore, strength in these channels tend to reflect the successful development of the company's brands – notably Beldray, Petra and Salter as well as the licensed brand Russell Hobbs - which combined were 70% of sales in FY2022. Hence, we highlight the importance of the appointment of Tracy Carroll as Brand Director on 6th December 2022 on the front page of this report.

In February 2021 the company increased its longer-term target for online from 15% to 30% of group sales. Online was a record 16.4% of sales in FY2022 compared with 15.1% in FY2021 and can be inferred from today's release to have risen in FY2023 H1. Measures to improve the online offering were discussed in our 22 June 2022 report [Reinforcing the online offering](#).

Positive outlook statement

The normalisation of supply chains and key areas of distribution and product category strength is reflected in a robust outlook statement as the company expects a full year performance in line with current expectations, which implies an 11% second half gain based on our forecasts which we leave unchanged.

Given the current strength of online sales there should be some reduction in the skew of UPGS's sales into the first half, which clearly includes pre-Christmas trading. Our expectation is for a 54%/46% first half/second half split in FY2023 compared with 56%/44% recorded in FY2022.

We also note that within its retail partners UPGS is seeing signs that the level of post-COVID retail customer inventory levels have been reduced. Hence there should be scope for an uptick in orders going into FY2023 H2. Meanwhile, the company's comments about the softness in global shipping costs and sterling strength augur positively for the margin backdrop.

Robotics

The other main operational highlight in today's release referred to the company's use of robotics process automation within the office, where it operates with a bottom-up, demand-led approach. UPGS' focus has been on increasing process automation, helping to reduce the number of repetitive administrative functions. This relentless focus on improving process should help the business enjoy the benefits as these continue to be removed over time.

Financials and valuation

Relative valuation

A relative valuation for UPGS based on a peer group of companies is shown in Figure 2. The company trades at a slight discount to this peer group on both EV/sales and EV/EBITDA and more pronounced discounts in terms of both P/E and dividend yield.

UPGS's ability to generate cash and reward shareholders with a 50% dividend pay-out ratio is an important supplement to the investment case, in our view. Moreover, we highlight that demand growth for the company's branded goods and its ability to satiate that demand with product is unlikely to be constrained by its financial position.

We base our 250p fair value assumption on an FY2023 EV/sales ratio of 1.5x and 12x EV/EBITDA.

Figure 2 - Relative valuation

	Share Price	Market cap	Net debt	EV	Sales 2023	EV/sales	EBITDA 2023	EV/EBITDA	EPS 2023	P/E	DPS 2023	Yield
	(p)	(£m)	(£m)	(£m)	(£m)	(x)	(£m)	(x)	(p)	(x)	(p)	
Accrol (ACRL)	32	100	61	161	230	0.7	15.5	10.4	1.8	17.3	0.4	1.2%
Gear4Music (G4M)	89	20	34	53	155	0.3	8.9	6.0	3.8	23.5		
Luceco (LUCE) *	141	222	38	261	204	1.3	28.5	9.1	10.0	14.2	3.6	2.6%
Portmeirion (PMP) *	355	50	6	56	110	0.5	12.0	4.7	44.9	7.9	17.5	4.9%
Procook (PROC)	45	50	24	74	61	1.2	5.7	13.1	3.0	14.9	1.5	3.3%
UPGS (UPGS)	167	144	24	168	163	1.0	20.2	8.3	15.1	11.0	7.5	4.5%
Warpaint (W7L) *	176	135	-1	134	50	2.7	11.8	11.4	10.5	16.8	6.8	3.9%
Average						1.1		9.0		15.1		3.4%

* Refers to FY2022 data

Share prices as at 13 February market close

Source: ADVFN (prices), MarketScreener (EBITDA), Stockopedia (Debt, EPS, dividends) and Equity Development estimates (UPGS forecasts)

Financial forecasts

Given the company's comment in today's statement that the Board anticipates a full year performance in line with current expectations, we leave our forecasts unchanged from our above mentioned 3rd November 2022 report [Brands and resilience driving growth in FY2023](#). However, we note the positive comments regarding shipping costs in today's statement.

We summarise our income statement, balance sheet and free cash flow projections for FY2023 and FY2024 in Figures 3, 4 and 5. UPGS is scheduled to release its interim FY2023 financial results on Wednesday 29th March 2023.

Figure 3 - Income statement

All figures in £'000s	2021A	2022A	2023E	2024E
31st July year end				
Revenue	136,367	154,191	163,442	173,249
change in revenue	17.9%	13.1%	6.0%	6.0%
Gross profit	30,231	38,354	40,819	43,441
Gross margin (%)	22.2%	24.9%	25.0%	25.1%
EBITDA - adjusted	13,291	18,750	20,176	21,680
EBITDA margin - adjusted	9.7%	12.2%	12.3%	12.5%
Net financial expense	-518	-841	-1,102	-978
Pre-tax profit - adjusted	11,150	15,843	16,958	18,536
Taxation	-2,423	-3,120	-3,943	-5,051
Tax rate (%) - adjusted	21.7%	19.7%	23.3%	27.3%
EPS - basic adjusted (p)	11.1	14.7	15.1	15.6
Dividend per share (pence)	5.0	7.1	7.5	7.8

Source: ED estimates, Company historic data

Figure 4 - Balance sheet
All figures in £'000s

31st July year end	2021A	2022A	2023E	2024E
Assets				
Intangible assets	36,929	37,025	37,025	37,025
Property, plant and equipment	5,719	6,369	6,192	6,041
Deferred tax				
Total non-current assets	42,648	43,394	43,217	43,066
Inventories	21,674	29,162	31,262	33,137
Trade and other receivables	26,544	32,194	34,476	35,044
Derivatives	384			
Current tax	62			
Cash and cash equivalents	133	182	182	182
Total current assets	48,797	65,680	65,919	68,364
Total assets	91,445	109,074	109,136	111,430
Liabilities				
Trade and other payables	29,451	29,644	29,523	29,394
Derivative financial instruments	220			
Current tax				
Borrowings	7,951	16,294	15,302	11,156
Lease liabilities	771			
Deferred consideration	990	987		
Total current liabilities	39,383	47,912	45,642	41,367
Borrowings (negative => cash)	10,847	8,144	8,144	8,144
Deferred tax	6,147	7,585	6,000	6,000
Deferred consideration	983			
Lease liabilities	2,030	1,940	1,190	440
Total non-current liabilities	20,007	17,669	15,334	14,584
Share capital	223	223	223	223
Share premium account	14,334	14,334	14,334	14,334
Employee benefit trust reserve	-2,152	-1,571	-1,571	-1,571
Share-based payment reserve	1,024	1,166	1,569	1,972
Hedging reserve and other reserves	-162	3,239	7,503	14,419
Retained earnings	18,788	26,102	26,102	26,102
Total equity	32,055	43,493	48,160	55,479
Total equity and liabilities	91,445	109,074	109,136	111,430

Source: ED estimates, Company historic data

Figure 5 - Free cash flow

All figures in £'000s				
31st July year-end	2021A	2022A	2023E	2024E
Profit for the period	7,313	12,370	13,016	13,485
Adjustments for:				
Finance costs (net)	518	842	1,102	978
Income tax expense	2,423	3,120	3,943	5,051
Depreciation and impairment	1,607	2,044	2,094	2,144
Amortisation	16	22	16	16
Loss on disposal of a current asset				
Derivative financial instruments	-678			
Share based payments	228	403	403	403
Income taxes paid	-2,566	-2,345	-4,113	-5,051
Working capital adjustments				
(Increase)/decrease in inventories	-368	-7,721	-2,100	-1,876
Decrease/(increase) in receivables	-8,091	-5,649	-2,282	-569
(Decrease)/increase in payables	9,031	112	-121	-129
Cash generated from operations	9,433	3,472	11,958	14,453
Cash flows used in investing activities				
Acquisition of a business	-30,578	-851	-1,000	
Purchase of intangible assets				
PP&E	-2,263	-1,843	-1,917	-1,993
Proceeds from P, P & E disposals	3			
Finance income				
Repayment of lease liabilities			-750	-750
Total	-32,949	-2,694	-3,667	-2,743
Free cash flow before financing	-23,516	778	8,291	11,710
Interest paid	-335	-850	-1,102	-978
Free cash flow before dividends etc	-9,501	-72	7,189	10,732
Dividends paid	-4,409	-4,830	-6,198	-6,585
Free cash flow after dividends etc	-13,908	-4,529	992	4,147

Source: ED estimates, company historic data



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