UP Global Sourcing

UPGS to acquire UK's oldest housewares brand

25 June 2021

UPGS's announcement that it is acquiring Salter, the UK's oldest housewares brand and notable for its scales, is a major positive step. The acquisition not only creates enlarged, outright ownership of a key brand and expands UPGS's kitchen and bathroom offering, but also establishes a foothold in health & lifestyle. Moreover, the deal appears attractively priced for UPGS shareholders. Assuming completion, we raise our fair value for UPGS shares from 200p to 275p.

UPGS is acquiring Salter's measuring business and brand name outside North America for £34m, of which £32m will be payable immediately and £2m deferred. Incremental sales revenue from the acquired branded business is expected to be **at least £16.7m** in FY2022. When added to the company's £25.8m of licensed revenue in FY2020, Salter will become the group's largest brand.

In its first full year of ownership Salter is expected to generate £4.6m of incremental adjusted EBITDA (excluding amortisation arising from the acquisition) and £4.0m of pre-tax profit (including savings on licence payments) and will thus be meaningfully accretive to group margins. A combination of debt and equity finance means that the purchase will enhance shareholder value.

By acquiring Salter, UPGS will wholly own a nationally recognised brand which is leader in its core category – i.e. weighing devices. Based in Tonbridge in Kent, the company has been manufacturing scales since 1760. The acquisition is consistent with UPGS's transformation from being a sourcing company to that of brand owner and manager. Moreover, Salter expands UPGS into the important health & lifestyle segment, rather than being purely a household durables supplier.

Even prior to the Salter announcement, UPGS demonstrated clear momentum in terms of both sales revenues and profitability, which was responsible for a number of upgrades to our financial forecasts in the past 12 months. The company's ability to offer beautiful products for every home appears set to deliver sustainable growth as customer lifestyles improve affordably. Furthermore, the company enjoys significant addressable market headroom from further geographic expansion.

Positive impact of the deal

Salter's impact on UPGS's shares should be positive for two main reasons. First, the deal itself will result in an increase in FY2022 EPS. Second, it reconfirms the ability of the group's management to acquire attractive brands at valuations that make sense for its shareholders. Based on a 1.9x target EV/sales ratio and a 20.0x P/E in FY2022 we revise our fair value / share upwards from 200p to 275p.

Financial summary

Year to 31st July	2018A	2019A	2020A	2021E	2022E
Revenue (£'000)	87,571	123,257	115,684	133,000	161,709
Revenue change	-20.4%	40.8%	-6.1%	15.0%	21.6%
EBITDA (£'000) (adj)	6,280	10,720	10,363	13,034	18,523
EPS adjusted (p)	5.0	8.1	7.9	10.2	13.7
DPS (p)	2.7	4.1	4.0	5.1	6.9
EV/EBITDA (x)	32.5	19.0	19.7	15.6	11.0
P/E ratio (x)	43.0	26.4	27.1	21.0	15.6
Yield	1.3%	1.9%	1.9%	2.4%	3.2%

Source: ED estimates, company historic data

Company Data

EPIC	UPGS
Price (last close)	214p
52 weeks Hi/Lo	238p/64p
Market cap	£176m
ED Fair Value / share	275p

Share Price, p

Source: ADVFN

Description

UP Global Sourcing Holding (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.

Chris Wickham (Analyst)
0207 065 2690
chris@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

UPGS acquires UK's oldest housewares brand

UPGS announced today that the company will wholly acquire British household equipment manufacturer and supplier Salter. As a result, Salter will become the group's largest brand. Previously, UPGS licensed the right to use the Salter brand name on products other than those in measuring, scales and health & lifestyle.

We view the acquisition positively. It is an attractive deal financially which not only expands UPGS's product portfolio but gives the company its first pan-UK household name brand in its core area of competence. The portfolio of established brands will benefit even greater focus, with Salter and Beldray being comfortably more than half of sales revenue.

Furthermore, the Salter acquisition is consistent with UPGS's transformation from being a sourcing company to being **a proactive brand manager**. Equity Development explored the benefits of this evolution in a 3rd November 2020 report "Ultimately, there's brand value" in which we noted the efficacy of the company's brand management in boosting sales in the supermarket and online channels.

We look at the core details of what UPGS is buying, the deal mathematics and impact of the acquisition on the company's brand portfolio in turn. We also take this opportunity to update our FY2021 and FY2022 forecasts, as well as our fair value.

What UPGS is buying

UPGS is set to acquire from US parent company FKA the global ownership of the Salter brand outright, with the exception of the three North American jurisdictions of the United States, Canada and Mexico, which have already been sold separately. Currently, UPGS licenses in the brand name for household products other than measuring devices – i.e. kitchen scales, bathroom scales and a select group of "health & lifestyle" products.

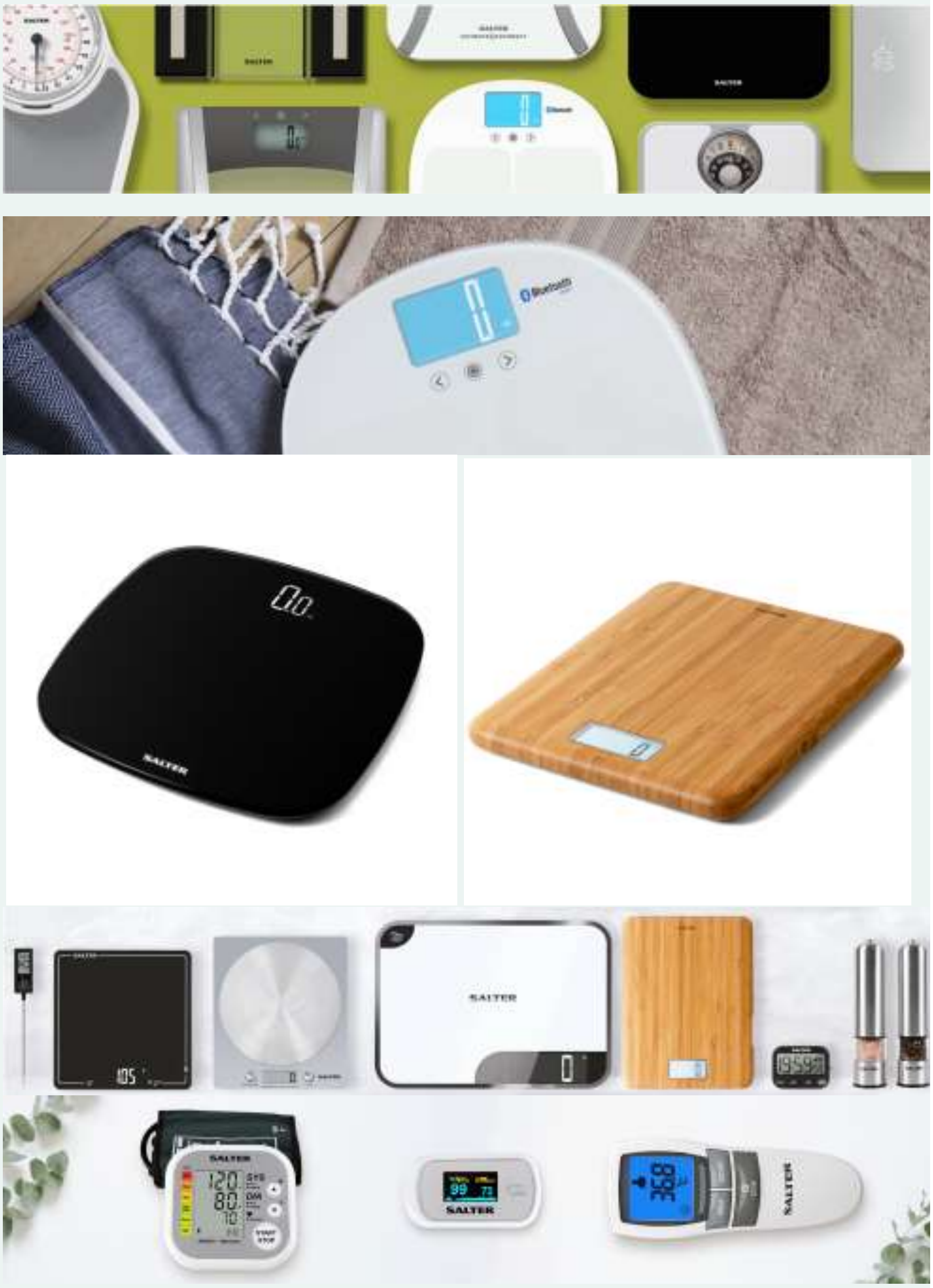
The full suite of the UK offering can be found on the Salter website www.salterhousewares.co.uk. Importantly, the Salter measuring business **manufactures on an outsourced basis** which means that the acquired business model is directly compatible with UPGS's activities for both Salter and other brands. Furthermore, UPGS has direct experience of how to manage and position the Salter brand within homeware. We illustrate key products in Figure 1.

Salter's heritage as a measuring brand is beyond question. The business was founded in 1760 by Richard Salter in the English Midlands village of Bilston, near Wolverhampton. Originally a spring maker, the founder diversified his business into hand-held weighing devices known as "pocket steelyards".

The founder's nephew George Salter took over the company in 1825, established a manufacturing plant in nearby West Bromwich, where its works team eventually became the professional football team West Bromwich Albion, and diversified the business's product range while retaining measurement as a core competence. Salter lays claim to producing the UK's first ever bathroom scale.

Importantly, the current UPGS Salter offering complements what is being acquired. Salter is a household name in weighing and measuring. Salter remains at the forefront of technological advances – most notably in terms of digital scales. Moreover, a complete Salter offering for UPGS fits well within the company's aim to provide "beautiful products for every home."

Figure 1 – Salter measuring devices



Source: www.salterhousewares.co.uk

Salter deal in summary

UPGS will acquire for £34m of which £2m will be in the form of a deferred payment. The planned financing of the £32m initial payment is to be from a conditional gross equity raise of £15m, the grant of a £10m term loan and £7m utilisation of existing facilities.

The Salter measuring business is expected to generate in excess of £16.7m in sales revenue in UPGS's FY2022 fiscal year. Effectively, it is being purchased for 2x sales revenue. While this is in excess of where UPGS's shares currently trade in terms of EV/sales revenue, that kind of multiple is not unusual for a branded market leader in a core consumer goods category.

Salter's most recently reported sales figures were £20.8m in 2020 and £16.9m in 2019. However, it is assumed that there was an element of Covid-19 related bounce in the 2020 figure. An element of prudence with regard to the FY2022 expectation appears appropriate. We factor the company's £16.7m guidance into our forecasts and note that licence costs are brought back into the group.

The Salter measuring business is highly profitable and **generates EBITDA margins significantly in excess of those currently enjoyed by UPGS at group level**, another reason why it is arguably worth more as a multiple of sales than its acquirer's pre-transaction market valuation. We also concur with UPGS's view that acquisition risk is mitigated by **detailed existing knowledge** of the target's brand and overlapping customer relationships.

The business is expected to contribute £4.6m of incremental EBITDA to UPGS of which £1.5m represents royalty payment savings on the UPGS licensed range. As a result, the core Salter business's EBITDA is inferred to be £3.1m, which implies an EBITDA margin of 18.6% compared with the group's current 9.8%. We summarise key deal numbers in Figure 2.

Figure 2 - Salter acquisition highlights

Purchase price	£34m	(£32m upfront and £2m deferred)
FY2022 sales revenue	£16.7m	
FY2022 EBITDA contribution	£4.6m	
FY2022 Pre-tax profit contribution	£4.0m	
Equity raise	£15m	
Term loan	£10m	
Use of existing facilities	£7m	

Source: UPGS investor presentation

Importantly, the Salter acquisition will not only be earnings enhancing – i.e. adds to EPS - but also arguably delivers economic value. The impact on EPS is calculated in Figure 3 which shows the positive impact of profits from the Salter acquisition offset by increased interest costs and a larger share count.

UPGS will hold a General Meeting to approve the acquisition and fundraise on 13 July 2021.

Figure 3 - Salter impact on FY2022 EPS

All figures in £m	
Salter pre-tax profits in FY2022	**4.0**
Assumed tax rate	21.0%
Adjusted net income exc Salter	9.1
Salter net income in FY2022	3.2
Net income cum Salter	12.3
Shares in issue pre raise (m)	82.2
New shares when issued (m)	7.1
Shares in issue post raise	89.3
EPS in FY2022 exc Salter deal	11.1
EPS in FY2022 cum Salter	13.7
Uplift to EPS	**24.0%**

Sources; UPGS company presentation and Equity Development estimates

The calculation of economic profit refers to the business's ability to deliver a NOPAT (net operating profit after tax) return on consideration paid in excess of an appropriate hurdle rate, or cost of capital.

Using the company's 21% adjusted tax rate, we assume NOPAT on the transaction to be £3.6m, which is an implied 10.5% NOPAT return. In our view such a return should be seen as adding economic value for a business which operates almost exclusively in mature economies. We summarise this calculation in Figure 4.

Figure 4 – UPGS – estimated economic value added from Salter

All figures in £m	
Salter FY2022 adjusted operating profit	**4.5**
Assumed tax rate	21.0%
Salter NOPAT	**3.6**
Consideration for Salter	34.0
NOPAT return on consideration	10.5%

Source: UPGS investor presentation and Equity Development estimates

UPGS brand portfolio – ownership and focus

The Salter acquisition delivers an increase in the portion of wholly owned brands to UPGS. In addition, the company should benefit from enlarged reach in terms of consumers and the reduction of any risk associated with potential loss of a brand licence.

Wholly owned brands dominate

The impact of the Salter acquisition on the portion of UPGS's brands which are wholly owned is twofold. First, the percentage amount benefits from the addition of around £16.7m in revenue generated from the newly acquired Salter business. Second the existing Salter sales, which were £25.8m in FY2020, become wholly owned rather than licensed.

Prior to the acquisition wholly owned brands were 62% of the company's premier and key brands portfolio. A pro-forma calculation which adds our FY2022 estimate for the acquired Salter business to the most recent breakdown of business by brand – i.e. FY2020 – generates a figure of closer to 90%. There is a meaningful shift in business towards wholly owned brands.

UPGS's two leading brands – Beldray and Salter - will also increase in importance as a result of the acquisition from 51% to 57%. While greater focus is to be welcomed, the more salient impact should be that the company has a strong, owned brand to grow alongside Beldray rather than the group's largest brand effectively leading the way on its own. The impact of outright Salter ownership on the brand portfolio as a whole is illustrated in Figure 5.

Salter to expand distribution reach

Full ownership of the Salter brand should enhance UPGS's consumer reach in terms of brand positioning. While the group's stated strategy of providing beautiful products for every home is important, Salter provides an opportunity for the portfolio to benefit from higher price points.

This should be particularly advantageous for the **online business** which was 16% of group revenue in the first half of the current financial year but is targeted to be 30%. We illustrate recent years' online growth in Figure 6.

Risk reduction

However well they are managed and enhance the overall portfolio, licensed brands do carry the risk of non-renewal. As a result, there is the potential for brand managers not to invest fully in their licensed brands in terms of both marketing support and product innovation relative to those which are wholly owned. The removal of this risk should be important for the overall Salter brand voltage going forward. The current Salter licence is due for renewal in 2024.

Furthermore, the Salter acquisition arguably removes licensing as an overall business risk for the group as a whole. Two risks which were highlighted at the time of the group's IPO were the threat of licence cessation and customer concentration. Once the Salter acquisition is completed Russell Hobbs will be the group's only licensed brand.

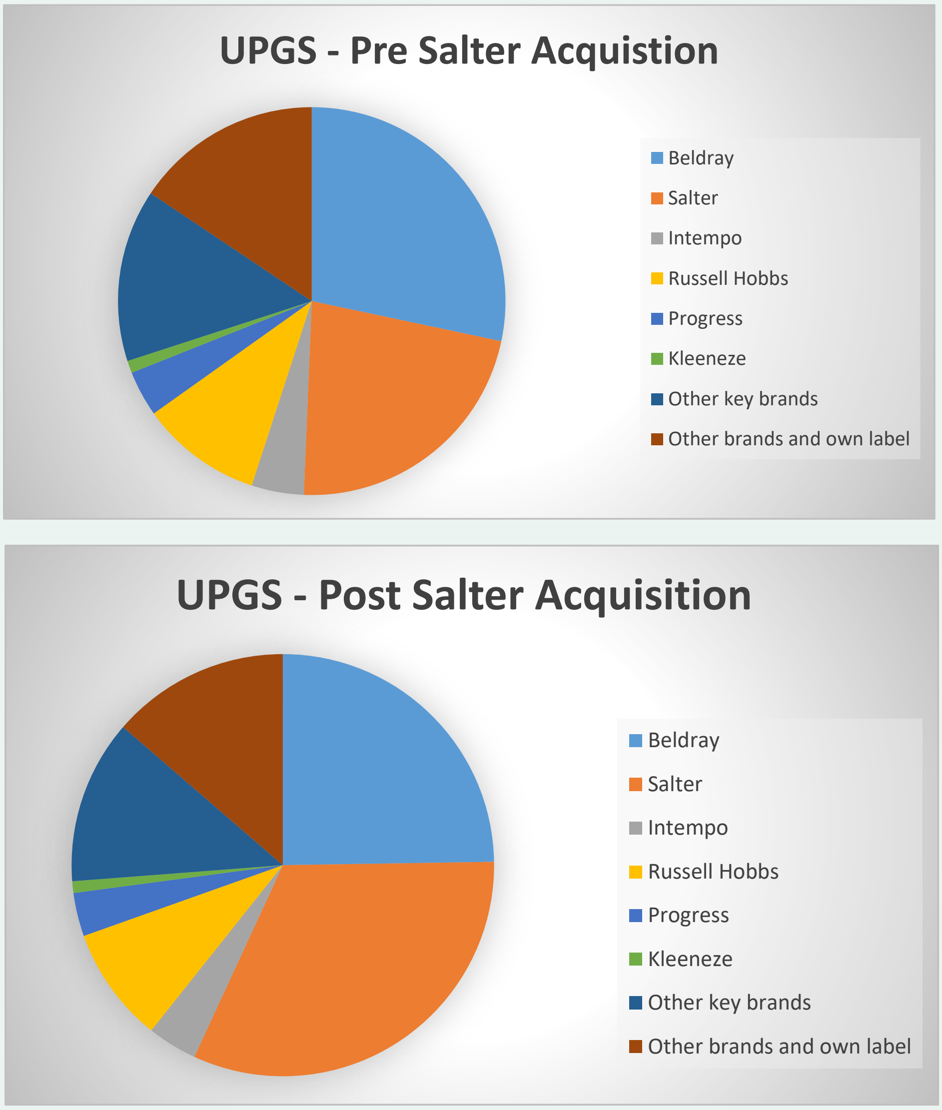
UPGS improved stature as a brand manager has been instrumental in reducing any risks associated with the customer concentration. Indeed, it is the company's strong brands which have enabled it to make so much progress in supermarkets and online. This issue of customer concentration was addressed in the company's 16th February 2021 capital markets day when the proportion of business channelled through the company's two largest customers was shown to have fallen from 47% in FY2017 to 26% in FY2020.

Salter acquisition enhances cultural change

The acquisition of Salter is consistent with UPGS's cultural shift in recent years from being a sourcing company to that of brand owner and brand manager. A stronger branded profile was instrumental in the company's ability to increase the portion of its business transacted in the supermarket and online channels, both of which arguably reflect brand superiority relative to the group's other strategic distribution pillars, discounters, and multiple store retailers.

Outright ownership of Salter would represent a significant step forward in that process of cultural change. It is the first time that UPGS has taken ownership of a clear leader both in terms of product evolution and market share in a key household category – kitchen and bathroom scales. Moreover, the company is now able to promote the brand in its area of core competence rather than in subsidiary products.

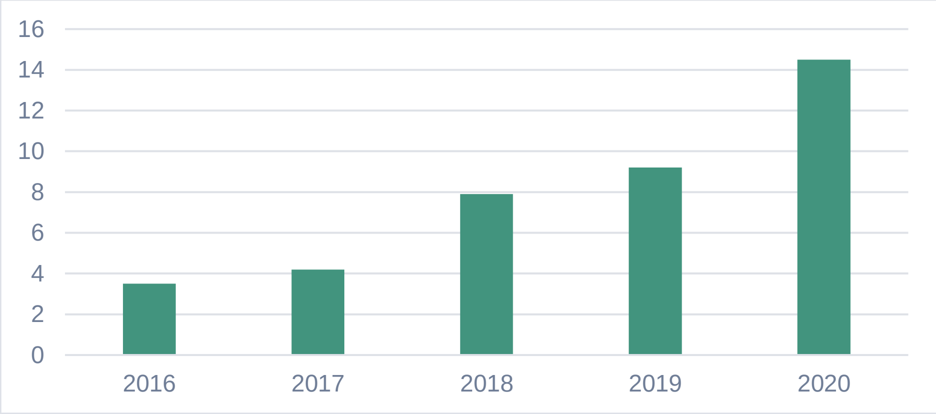
Figure 5 – Salter impact on UPGS brand portfolio



Source: Company historic data and UPGS investor presentation

As mentioned, the change in distribution patterns for UPGS has been significant with online growth being notably more important as a portion of sales. We illustrate the brisk pace of online growth in Figure 6.

Figure 6 - UPGS - online growth as a portion of sales FY2016 to FY2020



Source: Company data

Financials and valuation

This report includes our forecasts for FY2021 based on current scope and we revise FY2022 to include the impact of the Salter acquisition. Given some of the constraints on imports from Asia associated with the recent Suez Canal blockage and wider shipping challenges, we believe it to be prudent to reduce our FY2021 sales revenue forecast by £4m to £133m. However, the overall message from the organic forecasting remains one of growth. The impact of Salter on sales revenue, EBITDA and EPS on FY2022 is as discussed earlier in this report.

Relative valuation

Prior to the Salter acquisition, UPGS's shares traded at a discount to our selected peer group on the basis of both EV/sales and P/E ratio and a modest premium in terms of EV/EBITDA. Clearly, there has been some re-rating upwards of the shares in recent months. However, this looks appropriate given the company's secular shift towards being a stronger brand manager and online and supermarkets being a larger portion of the business.

In addition, we highlight the "option value" associated with the company's ability to make attractively priced strategic acquisitions. In February 2021, the group acquired the Petra kitchenware brand in Germany. Salter is clearly a more significant transaction. Our expectation is that the company – given its proven track record in M&A and balance sheet strength – will continue to acquire businesses on a favourable basis for shareholders.

Our 275p fair value for UPGS's shares implies 1.6x FY2022 sales (i.e. including the acquired Salter revenues) which is beneath group average and 13.6x FY2022 EV/EBITDA – i.e. similar to where this peer group currently trades based on 2021. The company's FY2022 P/E ratio would at 20.0x be in line with the average for this peer group, again based on 2021. Investors should bear in mind that UPGS has a 31st July year end. As a result, 5 months of its FY2022 financial year fall into calendar 2021.

Figure 7: Relative Valuation

	Share price	Shares	Mkt cap	Net debt	EV	Sales	EV/ sales	EBITDA	EV/ EBITDA	EPS	P/E	DPS	YLD
	(p)	(m)	(£m)	(£m)	(£m)	2021 (£m)	(x)	2021 (£m)	(x)	2021 (p)	(x)	2021 (p)	(%)
Accrol Group	48	311	149	24	173	137	1.3	15.7	11.0	n/a	n/a	n/a	n/a
Gear4Music	1012	21	212	5	217	157	1.4	18.7	11.6	32.0	32.4	n/a	n/a
Luceco	383	154	590	11	600	208	2.9	42.4	14.2	17.0	n/a	7.0	1.8
Portmeirion	700	14	97	-3	95	90	1.1	10.7	8.9	38.0	18.4	12.0	1.7
UPGS	**214**	**82**	**176**	**25**	**201**	**133**	**1.5**	**13.0**	**15.4**	**10.2**	**21.0**	**5.1**	**2.4**
Warpaint	171	77	131	-5	126	45	2.8	6.1	20.6	6.1	n/a	5.0	2.9
Average							1.8		13.6		23.7		2.2

Source: ADVFN, MarketScreener and Equity Development estimates, Prices as at close 24 June 2021

Forecasts

The salient changes to our financial forecasts are the reduction in our FY2021 sales revenue estimate from £137m to £133m. However, we leave our EBITDA, pre-tax profits and EPS forecasts unchanged. The company is in a position to offset its sales shortfall – which it expects to recoup in FY2022 – through a range of mitigating actions.

FY2022 includes the impact of the Salter revenue uplift and reduction in royalty payments offset by the impact of increased interest charges on pre-tax profits and share offering on earnings per share. We note that while revenue and profits from Salter only benefit revenue in FY2022 the impact on the balance sheet and free cash flow will be shown in the current year, FY2021.

Figure 8 - Income statement

Y/E July, All figures in £'000s	**2019A**	**2020A**	**2021E**	**2022E**
	(re-stated)			
Revenue	123,257	115,684	133,000	161,709
change in revenue	40.8%	-6.1%	15.0%	21.6%
Gross profit	27,244	26,600	30,058	39,619
Gross margin	22.1%	23.0%	22.6%	24.5%
EBITDA - adjusted	**10,720**	**10,363**	**13,034**	**18,523**
EBITDA margin - adjusted	8.7%	9.0%	9.8%	11.5%
Net financial expense	-810	-753	-700	-1,200
Pre-tax profit - reported	8,130	8,362	10,028	15,257
Pre-tax profit - adjusted	**8,387**	**8,163**	**10,760**	**15,524**
Taxation	-1,720	-1,747	-2,172	-3,260
Tax rate (%) - adjusted	20.5%	21.4%	20.2%	21.0%
Net income - adjusted	6,667	6,504	8,360	12,264
EPS - basic adjusted (p)	**8.1**	**7.9**	**10.2**	**13.7**
Dividend per share (p)	4.1	4.0	5.1	6.9

Source: ED estimates (post deal), UPGS historic data

Figure 9 - Balance Sheet

Y/E July, All figures in £'000s	2019A	2020A	2021E	2022E
Assets				
Intangible assets	98	86	30,586	30,586
Property, plant and equipment	4,993	5,065	6,003	5,316
Deferred tax	130	106	106	106
Total non-current assets	**5,221**	**5,257**	**36,695**	**36,008**
Inventories	20,399	16,022	20,500	22,425
Trade and other receivables	18,644	18,495	20,500	22,425
Derivatives	1,335	53	-	-
Cash and cash equivalents	122	329	329	329
Total current assets	**40,500**	**34,899**	**41,329**	**45,179**
Total assets	**45,721**	**40,156**	**78,024**	**81,187**
Liabilities				
Share capital	205	205	223	223
Share premium account	2	2	12984	12984
Employee benefit trust reserve	-1,649	-2,155	-2,155	-2,155
Share-based payment reserve	529	796	1,063	1,330
Hedging reserve and other reserves	1,238	-961	-1,158	-2,141
Retained earnings	11,227	15,527	18,754	25,927
Total equity	**11,552**	**13,414**	**29,711**	**36,167**
Trade and other payables	15,284	17,614	20,200	20,700
Derivative financial instruments	54	1,342		
Current tax	812	280		
Borrowings	14,567	3,903	10,260	8,217
Lease liabilities	793	710	710	710
Total current liabilities	**31,510**	**23,849**	**31,170**	**29,627**
Long term borrowings		89	15,089	14,089
Lease liabilities	2,659	2,804	2,054	1,304
Total non-current liabilities	**2,659**	**2,893**	**17,143**	**15,393**
Total equity and liabilities	**45,721**	**40,156**	**78,024**	**81,187**

Source: ED estimates (post deal), UPGS historic data

Figure 10 - Free Cash Flow

Y/E July, All figures in £'000s	2019A	2020A	2021E	2022E
Profit for the period	**6,410**	**6,615**	**7,856**	**11,997**
Adjustments for:				
Finance costs (net)	816	753	700	1,200
Income tax expense	1,720	1,747	2,172	3,260
Depreciation and impairment	1,512	1,417	1,562	1,787
Amortisation	11	12		
Loss on disposal of a current asset		18		
Derivative financial instruments	132	324		
Share based payments	257	267	267	267
Income taxes paid	-1,314	-2,255	-2,452	-3,260
Total	**9,538**	**8,898**	**10,105**	**15,251**
Working capital adjustments				
(Increase)/decrease in inventories	-3,932	4,377	-4,478	-1,925
Decrease/(increase) in receivables	-3,933	150	-2,005	-1,925
(Decrease)/increase in payables	2,947	2,339	2,586	500
Total	**-4,918**	**6,866**	**-3,897**	**-3,350**
Net cash from operations	**4,620**	**15,764**	**6,208**	**11,901**
Cash flows used in investing activities				
Acquisition of a business			-32,000	-1,000
Purchase of intangible assets	-9			
PP&E	-711	-601	-2,500	-1,100
Proceeds from P, P & E disposals	18	12	14	17
Finance income	6			
Repayment of lease liabilities			-750	-750
Total	-696	-589	-35,236	-2,833
Free cash flow before financing	**3,924**	**15,175**	**-29,028**	**9,068**
Interest paid	-702	-753	-700	-1,200
Free cash flow before dividends etc	**3,222**	**14,422**	**-16,728**	**7,868**
Dividends paid	-2,428	-2,307	-4,629	-4,824
Purchase of own shares (EBT)	-1,649	-506		
Free cash flow after dividends etc	**-855**	**11,609**	**-21,357**	**3,044**

Source: ED estimates (post deal), company historic data

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Disclaimer

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD

Contact: info@equitydevelopment.co.uk | 020 7065 2690