UP Global Sourcing Holdings PLC

Good reasons for optimism

29th April 2019

UPGS's half-year results included a 47.3% rise in underlying pre-tax profits, bolstered significantly by a 21% normalised increase in sales revenue. An optimistic tone on H2 sales prompts us to raise our full year forecasts and that has positive implications for both the group's financial strength and valuation.

UPGS translated brisk sales growth into strong profit gains in its first half. Underlying EBITDA increased by 48.4% to £6.6m, underlying pre-tax profits by 47.3% to £5.9m and adjusted EPS increased by 48.7% to 5.8 pence with a 39.8% increase in the interim dividend to 1.16p. Net debt:EBITDA improved to 1.6x from 2.0x at end FY2018.

Current trading was cited as being in line with previous expectations. However, we infer enough optimism in the statement to raise our full year forecasts. We now look for FY2019 sales revenue to be £119.5m, compared with a £117.5m estimate previously, and raise our EBITDA forecast to £8.95m from £8.70m.

A switch from Free on Board (FOB) to Landed terms with a key Continental European retail customer prompted major distortion to FY2018 H1 sales. As a result, the reported 36% growth in FY2019 H1 was much larger than the 21% underlying. Germany and other Continental Europe accounted for 38% of group sales. Domestic sales grew at a slower 2.1% rate, but strong momentum in supermarkets and online suggests that UK sales should accelerate significantly in H2.

UPGS' strategy remains to develop its portfolio of mass-market consumer goods in its four strategically targeted distribution channels. Importantly, the company delivers not only a value-led proposition but one that maintains a "feel-good" factor. Its offering is not reliant solely on "cheapness". The "tried and tested" focus on these four channels – UK and European discounters, UK supermarkets, Online platforms and International retailers - appears to underpin the company's confidence in its growth outlook.

We summarise key financials in the table below. In addition to the highlighted single digit prospective P/E ratio and 5.2% dividend yield, we note that the prospective EV/sales ratio is 0.6x. **Given a return to sustainable brisk sales growth, an EV/sales valuation closer to 0.8x appears reasonable, which would imply a fair value for the shares of 100p and a still appealing 13.9x prospective P/E ratio.**

Key Financials

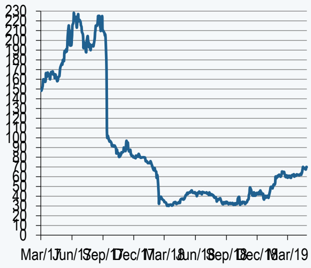
	2016A	2017A	2018A	2019E	2020E
Revenue (£'000)	79,028	109,953	87,571	119,500	125,475
Revenue growth (%)	23.3%	39.1%	-20.4%	36.5%	5.0%
EBITDA (adj)	8,226	11,512	6,472	8,950	9,425
EPS basic adjusted (p)	8.0	10.9	5.4	7.2	7.6
DPS (p)	3.3	5.1	2.7	3.6	3.8
EV/EBITDA (x)	9.2	6.6	11.7	8.5	8.0
P/E ratio (x)	8.9	6.5	13.0	9.8	9.3
Yield (%)	4.7%	7.2%	3.8%	5.1%	5.3%

Source: Company Historic Data, ED estimates

Company Data

EPIC	UPGS
Price (last close)	71p
52 week Hi/Lo	99p/29.6p
Market cap	£58m
ED fair value/share	100p

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, offices plus 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

Good reasons for optimism

FY2019 H1 results largely confirmed the profit benefits from the rapid sales growth that was announced in the company's trading update on 11th February 2019. In this report, we summarise the key numbers from the results, detail our revised forecasts and comment on the performance of the company's strategic distribution pillars. Moreover, we note that despite a steady stream of better newsflow, the shares' valuation appears to remain undemanding.

UPGS FY2019 Interim Results

The salient feature of UPGS' interim results was the brisk sales growth, which represented a combination of lapping a period a year earlier in which sales had been disrupted by a large Continental European customer's switch from doing business on a FOB to a Landed basis and rapid underlying growth in the company's main continental market, Germany. In addition, the timing of Chinese New Year aided sales in the period.

Margins did not experience swinging changes. Gross margins were unchanged from the same period a year earlier while EBITDA margins benefited from administration and overall costs not rising by as much as sales. The company remains comfortable about its £14m net debt position, which gives it ample headroom on facilities as well as being 1.6x EBITDA on a rolling annual basis. We summarise the results in Figure 1:

Figure 1 – UPGS Interim Results (6m to Jan 31)

	FY2018 H1	FY2019 H1	Increase
Revenue (£m)	48.4	65.8	36.0%
Gross margin	22.4%	22.4%	-
Underlying EBITDA (£m)	4.5	6.6	48.4%
Underlying EBITDA margin	9.2%	10.0%	80bps
Underlying pre-tax profit (£m)	4.0	5.9	47.3%
Adjusted EPS (p)	3.9	5.8	48.7%
Dividend (p)	0.83	1.16	39.8%
Net debt/u/lying EBITDA ratio (x)	0.9	1.6	0.7x

Source: Company data

Outlook for FY2019 Full Year

UPGS states that current trading for FY2019 is "comfortably" in line with expectations. We infer from this wording that there is an element of "wriggle room" in terms of full year forecasts. It is clear that Germany enjoyed an excellent first half performance and there is also scope in our view for the UK to accelerate in the second half.

A key attraction of UPGS' product offering from both an investor and a customer perspective is that the company's brands offer a high level of "feel good factor" at attractive prices. **They are skilfully positioned to benefit from an emotional attachment with the end-customer without seeming indulgent.**

As a result, we are confident about sales growth in a UK market where clearly there has been some disruption to short term consumer confidence as a result of both Brexit uncertainty and associated exchange rate volatility.

Key changes to our full year forecasts, driven by higher sales than originally expected, are summarised in Figure 2. If we are correct, the company's adjusted EBITDA outcome will only have been bettered once in the past five years: by the £11.5m number reported in FY2017. UPGS appears to be entering a period of sustainable sales growth, matched by profit expansion and comparative financial stability.

Figure 2 – Changes to FY2019 Forecasts

	Old	New	Upgrade
Sales revenue (£m)	117.5	119.5	1.7%
Adjusted EBITDA (£m)	8.70	8.95	2.9%
Adjusted EPS (p)	7.0	7.2	2.9%

Source: Equity Development estimates

Distribution – playing down the channels

UPGS' distribution strategy remains focused on UK and European discounters, UK supermarkets, online platforms and International retailers as the correct platform for its mass-market value-led consumer goods offering. This approach appears vindicated by the company's return to brisk sales growth with an expected record sales number in prospect for FY2019.

In terms of pace, online was the strongest channel in UPGS's first half. Its rapid growth moved it from 7% of total sales in the first half of last year to 9%. Elsewhere, growth pretty much matched group levels. However, the company highlighted that all the growth in discounters was from Continental Europe with the UK expected to reverse an H1 decline for that channel in H2. The UK order book was reported to be strong. Not surprisingly, Germany was the largest single contributor to growth in FY2019 as UPGS' profile there benefited from both a new office and showroom in Cologne.

Figure 3 - FY2019 H1 Sales Growth and split by Strategic Channel

£m	H1 FY2018	H1 FY2019	Increase	Share of total
UK & European discounters	24.4	32.9	34.6%	50.0%
UK supermarkets	5.7	7.5	32.1%	11.4%
Online platforms	3.3	6.1	85.2%	9.3%
Other	15.0	19.3	28.9%	29.4%
Total	48.4	65.8	36.0%	100.0%

Source: Company data

Furthermore, the nature of UPGS' distribution and its suitability for the product offering arguably bolsters sales resilience in the UK. The company's primary concern throughout the Brexit process has been the value of sterling on the foreign exchanges and the associated potential for negative pressure to be put on consumer demand due to the rising cost of imported food and similar items.

However, the company – in our view rightly - believes that it has the adaptability and resilience within its business model to combat these kinds of uncertainties. Its selection of distribution channels and focus on them is an important part of this confidence. Having been 60% of sales in FY2019 H1, we expect the UK to be a slightly larger 61% of sales in H2.

Relative valuation

Single digit ratios for both P/E and EV/EBITDA are salient features of UPGS's absolute valuation. Neither seems overly demanding given that the company has regained both sales and profit momentum. In our view, UPGS should be heading towards a 1.0x EV/sales ratio over time, with a 0.8x as a conservative near term target.

If our assessment is correct, **UPGS' fair value is 100p per share**. The implied prospective P/E ratio at this level would be 13.9x and the yield would compress to 3.6%. Neither of these valuations appears unusually demanding given where a comparable cohort trades (see below), a return to positive sales momentum, and underlying financial strength.

Furthermore, it is worth stressing the potential value to investors of consumer facing companies that generate positive sales volume growth in mature markets. UPGS does not rely upon volatile economies with potentially weak currencies for its organic growth.

Figure 4 - UPGS – Relative valuation

	Share price (pence)	Shares (m)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2019 (£m)	EV/sales (x)	EPS 2019 (p)	EPS 2020 (p)	P/E 2019 (x)	P/E 2020 (x)	DPS 2019 (p)	Yield (%)
EveSleep	6	139.3	27	0.5	28	35.0	0.8	-3.5		nmf	nmf		
Gear4Music	187	20.9	110	8.9	119	118.3	1.0	0.2	8.6	nmf	21.7		
Luceco	76	160.8	81	15.8	97	170.3	0.6	5.8	7.2	13.1	10.6	0.8	**1.1%**
UPGS	**71**	**82.2**	**58**	**17.4**	**75**	**119.5**	**0.6**	**7.2**	**7.6**	**9.8**	**9.3**	**3.6**	**5.1%**
Warpaint	108	77.0	203	2.7	206	55.2	3.7	12.6	14.7	8.5	7.3	6.6	6.1%
Average							1.3			10.5	12.2		4.1%

Sources: ADVFN, Financial Times (markets.ft.com) and Equity Development estimates

Financial forecasts

We include our revised income statement, balance sheet and free cash flow forecasts in this report. An important feature of our income statement forecast for FY2019 is the UK sales acceleration, helped by a recovery in the UK discounters.

Longer-term forecasts include sustainable mid-single digit sales growth. We expect EBITDA margins to remain stable to positive as the company offsets any upward wage pressures with the investment in new technologies.

Figure 5 – Income Statement

£'000s	2016A	2017A	2018A	2019E	2020E
Revenue	79,028	109,953	87,571	119,500	125,475
% increase in revenue	23.3%	39.1%	-20.4%	36.5%	5.0%
Gross profit	18,914	24,567	19,592	26,529	27,981
Gross margin (%)	23.9%	22.3%	22.4%	22.2%	22.3%
EBITDA - adjusted	8,226	11,512	6,472	8,950	9,425
EBITDA margin - adjusted	10.4%	10.5%	7.4%	7.5%	7.5%
Net financial income	-441	-464	-330	-735	-824
Pre-tax profit - reported	6,259	7,427	5,423	7,365	7,825
Taxation	-1,361	-1,852	-1,141	-1,634	-1,672
Tax rate (%) - reported	21.7%	24.9%	21.0%	22.2%	21.4%
Net income - adjusted	5,895	8,406	4,474	5,931	6,253
EPS - fully diluted adjusted (pence)	8.0	0.7	5.4	7.2	7.6
Dividend per share (pence)	3.3	5.1	2.7	3.6	3.8

Source: ED estimates, Company historic data

Figure 6 – Balance Sheet

£'000s	2016A	2017A	2018A	2019E	2020E
Assets					
Intangible assets			100	100	100
Property, plant and equipment	970	1,715	2,018	1,968	1,916
Deferred tax	209	162	107	100	100
Total non-current assets	1,179	1,877	2,225	2,168	2,116
Inventories	10,545	11,064	16,466	21,050	22,103
Trade and other receivables	16,231	11,728	14,791	19,700	20,685
Derivatives		17	985		
Current tax		481			
Cash and cash equivalents	136	91	95	95	95
Total current assets	26,912	23,381	32,337	40,845	42,883
Total assets	**28,091**	**25,258**	**34,562**	**43,013**	**44,999**
Liabilities					
Share capital	184	205	205	205	205
Share premium account	2	2	2	2	2
Share-based payment reserve			272	472	572
Reserves	441	-193	846	-674	-574
Retained earnings	567	6,779	7,423	10,639	13,773
Total equity	1,194	6,793	8,748	10,172	13,406
Trade and other payables	16,403	12,316	12,531	14,531	15,258
Derivative financial instruments		200			
Current tax	478		427	817	
Short term borrowings	7,132	1,518	10,992	15,629	14,471
Total current liabilities	24,013	14,034	23,950	30,997	29,728
Long term borrowings	2,884	4,431	1,864	1,864	1,864
Total non-current liabilities	**2,884**	**4,431**	**1,864**	**1,864**	**1,864**
Total liabilities	**28,091**	**25,258**	**34,562**	**43,013**	**44,999**

Source: ED estimates, Company historic data

Cash flow

All figures in £'000s	2016A	2017A	2018A	2019E	2020E
Profit for the period	4,898	5,575	4,282	5,731	6,153
Adjustments for:					
Finance costs (net)	441	464	330	735	824
Gain on disposal of non-current assets		-5			
Income tax expense	1,361	1,852	1,141	1,634	1,672
Depreciation and impairment	280	394	525	650	676
Amortisation			2		
Derivative financial instruments			-99		
Share based payments		80	192	200	100
Income taxes paid	-1,309	-678	-178	-1,244	-2,489
Total	5,671	7,682	6,195	7,706	6,936
Working capital adjustments					
(Increase)/decrease in inventories	-2,815	-519	-5,402	-4,584	-1052
Decrease/(increase) in receivables	-4,740	4,049	-3,063	-4,909	-985
(Decrease)/increase in payables	5,545	-1,790	215	2,000	727
Total	-2,010	1,740	-8,250	-7,493	-1311
Net cash from operations	**3,661**	**9,422**	**-2,055**	**213**	**5625**
Cash flows used in investing activities					
Purchase of intangible assets			-102		
PP&E	-652	-1162	-829	-600	-624
Proceeds from P, P & E disposals		28			
Finance income			53		
Total	**-652**	**-1134**	**-878**	**-600**	**-624**
Free cash flow before financing	**3,009**	**8,288**	**-2,933**	**-387**	**5,001**
Interest paid	-2,316	-451	-355	-735	-824
Free cash flow before divs etc	**693**	**7,837**	**-3,288**	**-1,122**	**4,177**
Dividends	-1,466	-3,780	-3,554	-2,515	-3,019
Share issues		21			
Other cash flows related to shares	-18			-1,000	
Free cash flow after divs etc	**-791**	**4,078**	**-6,842**	**-4,637**	**1,158**

Source: ED estimates, Company historic data

Investor Access

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

More information is available on our website

www.equitydevelopment.co.uk

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