UP Global Sourcing Holdings plc

Shareholder value creation at its core

29 April 2022

UPGS's interim FY2022 results show a company that is creating shareholder value through its core activities. Sustainable sales growth, higher margins, positive cash flow and a 50% dividend pay-out should combine to generate earnings accretion and multiple expansion. UPGS is a brand-driven, international business, which is reinvesting in its operating practices. In our view, the share price does not reflect this and clearly lags our revised 250p fair value.

UPGS's 13.7% revenue growth in the first half of FY2022 (+2.6% excluding Salter) reconfirmed the company's 14th February 2022 trading update that we commented in a report UPGS on track to scale new revenue heights. Moreover, underlying EBITDA increased by 29% in the half year as EBITDA margins increased by 1.5 percentage points to 13.1%. Headwinds from both the global shipping crisis and Covid largely explain organic sales growth beneath trend. As a result, we trim our FY2022 sales forecast from £162m to £159m but leave EBITDA unchanged.

UPGS's increasing strength as a brand manager – bolstered by Salter – is reflected in supermarkets becoming the company's dominant route to market. Brand development is equally important in the expansion of the company's international activities where Germany grew by a sizable 59% in FY2022 H1. In addition, UPGS continues to target having 30% of its sales online. We think brand strength should be seen as a key driver of growth and value creation going forward. Positive trade related news about the German brand Petra – acquired in February 2021 – is also worth noting.

Profitability benefited from the Salter acquisition in the period as gross margins expanded due to ownership of the UK's oldest household brand. Going forward, margins should benefit from reinvestment in the business and improved practices. In particular, the company announced that it is prioritising robotics to achieve better operating margin performance.

Valuation

UPGS is not alone in its peer group in having seen share price erosion in calendar 2022. However, the current share price looks anomalous given the company's proven resilience to headwinds, 6% underlying sales growth (all in mature economies), increasing brand strength and a commitment to efficiency driven margin gains. Furthermore, a strong financing position underpins the company's ability to pay out 50% of its underlying EPS in dividends.

We modify our fair value / share from 275p to 250p to reflect exogenous factors such as higher interest rates and inflation but retain confidence in a fair value materially above the current share price. At 250p, UPGS would trade on an EV/sales ratio of 1.6x and 13.4x EV/EBITDA. Both multiples look appropriate for a branded consumer goods company with visible organic growth and a clear competence in acquiring and accelerating brands.

Key Financials

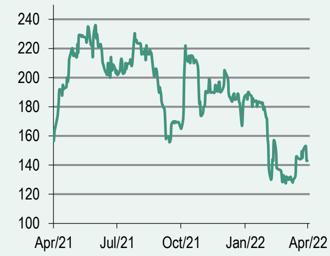
Year to 31st July	2019A	2020A	2021A	2022E	2023E
Revenue (£'000)	123,257	115,684	136,367	159,000	168,540
Revenue change	40.8%	-6.1%	17.9%	16.6%	6.0%
EBITDA (£'000) (adj)	10,720	10,363	13,291	18,800	20,181
EPS adjusted (p)	8.1	7.9	10.6	13.9	14.5
DPS (p)	4.1	4.0	5.0	7.0	7.2
EV/EBITDA (x)	14.5	15.0	11.7	8.3	7.7
P/E ratio (x)	17.6	18.1	13.5	10.3	9.9
Yield	2.9%	2.8%	3.5%	4.9%	5.1%

Source: ED estimates, company historic data

Company Data

EPIC	UPGS
Price (last close)	143p
52 weeks Hi/Lo	238p/124p
Market cap	£128m
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.

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Shareholder value creation at its core

Despite organic sales growth being beneath the company's underlying trend in the first half of FY2022, UPGS delivered significant advances in profitability and is well placed to continue to pay out dividends at a rate of 50% of underlying EPS.

Moreover, the company's ability to manage a focused, largely owned, brand portfolio is not only reflected in its strength in the increasingly important supermarket and online channels but should also drive faster growth in these channels going forward.

Overall, UPGS appears well placed to create further value for shareholders. In our view, that opinion is not reflected in the key multiples of EV/sales, EV/EBITDA and P/E ratio.

UPGS's investment case remains intact. The company positions itself to provide affordable, beautiful products for every home, which are derived from a now almost entirely owned (with the exception of Russell Hobbs) brand portfolio. We maintain our expectations of 6% underlying sales growth, gradually increasing operating margins and positive cash flow.

There also appears to be little recognition in the company's share price valuation of its ability to acquire new brands and bring them to fruition. Were success with Petra in Germany to replicate that of Beldray in the UK, the brand's sales growth would be significant – combined with the potential for the company's shares to command a higher rating if its success with acquisitions were increasingly priced in.

This report looks first at the interim results before commenting on UPGS's brands and channels, the potential for ongoing corporate culture improvements, including investment in robotics, and valuation.

Interim results and forecast changes

Financial highlights

Figure 1 - UPGS FY2022 H1

All figures in £m	FY2021 H1	FY2022 H1	Change
Revenue	75.4	85.7	+13.7%
UK revenue	51.7	56.7	+9.6%
International revenue	23.6	29.0	+22.8%
German revenue	7.4	11.8	+59.0%
Underlying EBITDA	8.8	11.3	+28.7%
Underlying EBITDA margin	11.6%	13.1%	+1.5pps
Underlying pre-tax profit	7.7	9.9	+28.6%
Underlying EPS (p)	7.3	8.7	+19.2
Interim dividend per share (p)	1.69	2.30	+36.1%

Source: Company data

Headwinds from both the global shipping crisis and Covid largely explain beneath trend organic sales growth. In FY2023 and FY2024 we expect sales growth to return to its 6% underlying pace. However, we trim this year's sales number from £161.7m to £159.0m to reflect the slower pace of expansion in the first half.

Profitability is clearly an important component of shareholder value creation with important implications for free cash flow and dividend paying ability. **Underlying EBITDA increased by 29%** in the half year as EBITDA margins increased by 1.5 percentage points to 13.1%. Indeed, as Figure 1 shows all key adjusted profit measures increased at a faster pace than overall sales revenue, which reflects both the accretive nature of the Salter acquisition and the company's commitment to operating efficiency.

Forecast changes

The impact of our revised sales forecasts on EBITDA and EPS is summarised in Figure 2. Despite a sales outcome below forecasts, we maintain our full year FY2022 EBITDA forecast and trim EPS only slightly to reflect higher interest costs and the first phase of an upwardly trending tax charge. Going forward, UPGS's corporation tax rate is expected to increase as a result not only of the announced higher UK rates but also due to a higher portion of profits being generated in Germany where the marginal rate is higher.

Figure 2 - Changes to FY2022 forecasts

All figures in £m	Old	New	change
Sales revenue	161.7	159.0	-1.7%
EBITDA (adjusted)	18.8	18.8	0.0%
EPS (basic adjusted)	14.1	13.9	-1.1%

Source: ED estimates

Brands and distribution

As highlighted in previous Equity Development reports, there is a strong link between UPGS's management of brands and the company's ability to shift its distribution focus in favour of supermarkets and online, two of the company's strategic pillars. An increased portion of business derived from these two channels is not only a reflection of brand strength but should be an important driver of increased profitability going forward.

H1 sales revenue performance by strategic pillar, both including and excluding the impact of the Salter acquisition, is summarised in Figure 3. Organic growth was comfortably strongest in the period in the supermarket channel, as online faced a tough comparator with a period a year earlier when lockdowns associated with the Covid pandemic led to a spike in internet-based shopping for household goods.

Figure 3 - Revenue by strategic pillar

£m	FY2021-H1	FY2022-H1 organic	Change	FY2022-H1 incl. Salter	Change	FY2021-H1 split	FY2022-H1 split
Supermarkets	21.4	29.0	35.5%	31.8	48.5%	28.4%	37.1%
Discount retailers	28.4	24.8	-12.6%	25.1	-11.5%	37.6%	29.3%
Online channels	11.8	10.4	-11.9%	12.8	8.8%	15.6%	15.0%
Multiple store retailers	8.6	7.7	-10.5%	9.2	7.8%	11.3%	10.8%
Other	5.2	5.5	4.5%	6.7	28.7%	7.0%	7.9%
Total	**75.4**	**77.4**	**2.6%**	**85.7**	**13.7%**	**100.0%**	**100.0%**

Source: Company data
Note - splits data include the impact of the Salter acquisition

Despite a fall in FY2022 H1, UPGS reiterates its target for online sales to be 30% of group revenue. This target was itself raised on 16th February 2021 at a capital markets day presentation from 20%. If achieved, UPGS would be on track to having around 70% of its business generated in the two important brand channels of online and supermarkets.

Brand strength at the core of the business

The ability to manage its leading brands and significantly to rejuvenate brands are central to the UPGS value creation opportunity going forward. As a result, we view positively the acquisition of Salter outright where indications are that the acquired business was smoothly integrated and performed well in the first half. Moreover, Salter's incremental first half performance was strongest in the supermarket and online channels where the brand generated sales of £2.8m and £2.4m respectively out of a total of £8.4m resulting from the acquisition.

Sales revenue by brand in H1 of FY2022

We summarise the group's overall sales revenue performance by brand in FY2022H1 in Figure 4. The acquisition of Salter led to a marked increase in the portion of the UPGS brand portfolio being accounted for by the company's premier brands. In fact even excluding the Salter acquisition, these brands grew at **9.0%** which was comfortably more than the overall 2.6% organic growth rate.

Figure 4 - Revenue by brand

£m	FY2021-H1	FY2022-H1	Change %	FY2021-H1 split	FY2022-H1 split
Beldray	21.5	23.9	10.9	28.6%	27.9%
Salter (organic)	16.6	17.7	6.5	22.0%	20.6%
Salter (acquired business)		8.4			9.8%
Russell Hobbs (licensed)	8.9	13.4	50.9	11.8%	15.6%
Progress	4.0	3.9	-3.2	5.3%	4.5%
Intempo	2.8	1.9	-32.7	3.7%	2.2%
Kleeneze	1.0	1.3	32.0	1.3%	1.5%
Premier brands – total	**54.8**	**70.4**	**28.5**	**72.7%**	**82.1%**
Other proprietorial brands	10.1	7.3	-28.0	13.4%	8.5%
Premier/Prop brands - total	**64.9**	**77.6**	**19.7**	**86.1%**	**90.6%**
Other brands / own label	10.5	8.1	-22.9	13.9%	9.4%
Total	**75.4**	**85.7**	**13.7**	**100.0%**	**100.0%**

Source: Company data

The Salter acquisition also concentrates a larger portion of sales within UPGS's two largest brands – Beldray and Salter. These two accounted for 58% of sales revenue in FY2022 H1 compared with 51% a year earlier. A more concentrated brand portfolio should arguably be easier to manage effectively in terms of marketing strategy as well as enjoying better pricing potential.

Petra – a big opportunity

Aside from its ability to manage the existing brand portfolio, UPGS should be given credit for its skill in building new brands. Moreover, the company's stated objective of expanding international should benefit from the ability to build brands outside the UK. In addition, building new brands for specific markets obviates the potential for the brand portfolio to become proliferated or arguably cluttered.

UPGS announced the acquisition of German kitchen electrical brand Petra, which was founded in the German region of Bavaria in 1968, on 15th February 2021. We commented on the transaction in a note entitled Petra acquisition to enhance international business.

Petra has the potential further to accelerate the company's growth in Germany as well as internationally. Furthermore, a view that Petra could grow rapidly tends to be supported by UPGS's track record with other brands. In particular, it should be noted that when the company acquired Beldray in 2009, sales of what (pre-Salter) was the company's largest brand were modest. In FY2021 the brand achieved £42m in sales revenue.

While relatively early days for Petra, there was encouraging news on 1st March 2022 when UPGS released a statement that Petra had received its first substantial order from a major German hypermarket retailer worth €1m, for a combination of electrical products including waffle makers, air fryers and multi-meal makers. The company expressed confidence in further growth from that retailer. Today's statement expresses their belief that Petra has the potential to be a brand of the scale of Salter or Beldray.

International – the added fillip for sales revenue growth

Petra's potential importance for UPGS is illustrated by a strong German performance in the first half of FY2022. It is clearly an overseas market where UPGS is enjoying unusual success as international sales expanded as a portion of the overall business to 34% from 31% a year earlier. We detail the company's performance by geographical location in Figure 5.

Figure 5 - Revenue by geographic region

£m	**FY2021-H1**	**FY2022-H1**	**Change %**	**FY2021-H1 split**	**FY2022-H1 split**
United Kingdom	51.7	56.7	9.6	68.6%	66.1%
Germany	7.4	11.8	59.0	9.8%	13.7%
Rest of Europe	15.0	14.9	-1.1	19.9%	17.3%
USA	0.5	0.4	-11.6	0.7%	0.5%
Rest of World	0.7	2.0	174.4	0.9%	2.3%
Total	**75.4**	**85.7**	**13.7**	**100.0%**	**100.0%**
International sales	**23.6**	**29.0**	**22.8**		
Percentage of total	31.4%	33.9%			

Source: Company data

Investing in a winning culture for the future

UPGS's success as a branded consumer goods company tends to confirm the company's ability to be aware of trends and developments. However, it is also worth noting that the company continues to make progress in the key areas of robotics (important for profitability), its environmental social & governance credentials (ESG) and in creating a dynamic working environment. We look at each in turn.

Robotics to enhance profitability

Today's statement that UPGS plans to invest in robotics across the entire business has positive implications for profitability, not least because the company retains its target for online to be 30% of overall sales revenue. The stated intention is to enhance operating margins and deliver an even better customer experience.

UPGS's robotics investment will be supervised by a 6-strong team that can optimise interaction between the company's supply chain – i.e. its sourced products – and distribution. This development is most important for online where costs will benefit from the ability to fulfil orders on a single-pick basis using robots.

The use of robotics will also enhance the economies of scale and operational gearing of the business as UPGS returns to its underlying trend growth rate. As a result, we are confident in our expectations of improved operating margins.

ESG

The ESG credentials of UPGS are not only a function of its work within the communities in which it operates close to its headquarters in Oldham, Greater Manchester but also a function of the products which it sells.

The company rightly highlights its work during the Covid pandemic with foodbanks, the NHS and domestic abuse survivors as well as its full compliance with the UK Corporate Governance Code and a Net Zero commitment.

It should also be noted that the company's products are able to fulfil the requirements of those who are more environmentally sensitive. UPGS reports an increase in demand for its less energy intensive products such as air fryers in place of oil fryers and mechanical scales instead of battery-operated ones.

Manor Mill

As head office employees fully return to work after the Covid pandemic, the workplace environment will become increasingly important. Hence, we view the £1.6m refurbishment of the workspace at Manor Mill which re-opened in September 2021 as positive for the integrity of the company's core cultural commitment to growing a business which provides beautiful products for every home on a sustainable and growing basis.

Valuation and Financials

Relative valuation comparisons

UPGS's strong financial position and commitment to a 50% dividend pay-out ratio relative to underlying 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. The position is summarised in Figure 6.

We reduce our fair value for UPGS in this report to 250p / share. However, that is a reflection of changes to the overall business environment – i.e. a likely climate of higher interest rates and uncertainties associated with rising inflation and disruption to peace in parts of Eastern Europe.

Our view that UPGS is a resilient company with a strong growth outlook remains intact and we see a significant gap between its current stock-market worth and what we consider fair value.

Putting a value on resilience

Senior management is given insufficient credit for its ability to negotiate uncertain trading conditions, the most noteworthy of which have been the Covid pandemic and the associated shipping crisis. Neither external obstacle materially disrupted UPGS's operating capability. The company remained on-track to deliver products sourced from overseas into its two largest European markets via multiple channels.

Putting a value on Salter

Given the transformational nature of the Salter acquisition which Equity Development covered in a 25th June 2021 note (UPGS acquires UK's oldest housewares brand), it is arguably surprising that there has been so little long-term credit given by the market to the company's share price valuation. Rather, the company traded at 214p ahead of the acquisition, which is well above the current price.

Our June 2021 report noted not only the earnings accretive nature of the acquisition but also its ability to generate a positive economic return from the outset – i.e. an after-tax return in excess of the company's cost of capital. Moreover, Salter gave the company additional learnings in terms of brand management as well as enhancing the profitability of one of its two largest brands. There appears scope for this apparent anomaly to be removed.

Figure 6 - 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	22	319	71	33	103	160	0.6	9.0	11.5	n/a	n/a	n/a	n/a
Gear4Music	223	21	47	17	64	148	0.4	11.0	5.8	17.0	13.1	n/a	n/a
Luceco	187	148	275	42	318	244	1.3	48.5	6.6	20.0	9.3	8.0	4.3
Portmeirion	565	14	78	-	78	110	0.7	14.0	5.6	67.0	9.9	19.0	3.4
UPGS	**143**	**89**	**128**	**28**	**156**	**159**	**1.0**	**18.8**	**8.3**	**13.9**	**10.3**	**7.0**	**4.9**
Warpaint	133	77	102	-4	98	56	1.7	8.9	11.0	n/a	n/a	5.0	3.8
Average							**1.0**		**8.1**		**10.6**		**4.1**

Source: ADVFN, MarketScreener and Equity Development estimates, Prices as at close 28th April 2022

Financials

Our income statement, balance sheet and cash flow projections are summarised in Figures 7, 8 and 9. These include an adjustment to FY2022 sales revenue from £162m to £159m and the earlier mentioned associated reductions to EPS. We maintain our EBITDA forecasts as there will be some overheads offsets to the reduced sales value. In FY2023 and FY2024 we expect sales growth to return to the faster pace of 6%.

The main external concerns include higher interest rates and increases to UK corporation tax. In addition, as German sales increase as a portion of business more profits will be taxed at that country's higher rate of corporation tax.

Balance sheet and free cash flow forecasts are consistent with a financially robust company capable of generating positive cash returns. As a result, we see little threat to UPGS's dividend pay-out policy of 50% of underlying EPS. Our projected net debt /EBITDA ratio is 1.5x at end-FY2022, which we expect to fall to 1.4x in FY2023, with scope for a further decline to 1.1x in FY2024.

Figure 7 - Income statement

All figures in £'000s	**2020A**	**2021A**	**2022E**	**2023E**
31st July year end				
Revenue	**115,684**	**136,367**	**159,000**	**168,540**
Change in revenue	-6.1%	17.9%	16.6%	6.0%
Gross profit	26,600	30,231	38,955	41,461
Gross margin	23.0%	22.2%	24.5%	24.6%
EBITDA - adjusted	**10,363**	**13,291**	**18,800**	**20,181**
EBITDA margin - adjusted	9.0%	9.7%	11.8%	12.0%
Net financial expense	-753	-518	-911	-1,273
Pre-tax profit - reported	8,362	9,508	15,661	16,630
Pre-tax profit - adjusted	**8,163**	**11,150**	**15,889**	**16,858**
Taxation	-1,747	-2,195	-3,435	-3,920
Tax rate (%) - adjusted	21.4%	19.7%	21.6%	23.3%
Net income - adjusted	6,504	8,727	12,454	12,939
EPS - basic adjusted (p)	**7.9**	**10.6**	**13.9**	**14.5**
Dividend per share (pence)	**4.0**	**5.0**	**7.0**	**7.2**

Source: ED estimates, Company historic data

Figure 8 - Balance Sheet

31st July year end / All figures in £'000s	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	5,235	4,761
Deferred tax	106			
Total non-current assets	**5,257**	**42,648**	**42,148**	**41,658**
Inventories	16,022	21,674	29,000	31,090
Trade and other receivables	18,495	26,544	34,600	37,026
Derivatives	53	384		
Current tax		62		
Cash and cash equivalents	329	133	133	133
Total current assets	**34,899**	**48,797**	**63,733**	**68,249**
Total assets	**40,156**	**91,445**	**105,881**	**109,907**
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	26,211	32,615
Total equity	**13,414**	**32,055**	**40,446**	**47,073**
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	18,318	17,617
Lease liabilities	710	771		
Deferred consideration		990	990	
Total current liabilities	**23,849**	**39,383**	**48,308**	**46,457**
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**	**105,881**	**109,907**

Source: ED estimates, Company historic data

Figure 9 - Free Cash Flow

31st July year-end / All figures in £'000s	2020A	2021A	2022E	2023E
Profit for the period	6,615	7,313	12,226	12,711
Adjustments for:				
Finance costs (net)	753	518	911	1,273
Income tax expense	1,747	2,195	3,435	3,920
Depreciation and impairment	1,417	1,563	1,984	2,034
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	-3,373	-3,920
Operating free cash flow	8,898	8,633	15,427	16,262
Working capital adjustments				
(Increase)/decrease in inventories	4,377	-368	-7,326	-2,090
Decrease/(increase) in receivables	150	-8,091	-8,056	-2,426
(Decrease)/increase in payables	2,339	9,031	-451	-160
Total	6,866	572	-15,833	-4,676
Net cash from operations	**15,764**	**9,205**	**-406**	**11,586**
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**	**-3,653**	**8,280**
Interest paid	-698	-335	-911	-1,273
Free cash flow before dividends etc	**14,477**	**-9,729**	**-4,564**	**7,007**
Dividends paid	-2,307	-4,409	-4,803	-6,307
Purchase of own shares (EBT)	-506			
Free cash flow after dividends etc	**11,664**	**-14,136**	**-9,367**	**700**

Source: ED estimates, company historic data

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