UP Global Sourcing Holdings plc

Brands and resilience driving growth in FY2023

3 November 2022

Strong progress for the key brands Beldray and Salter plus significant advances in supermarkets and online coincided with increased margins across-the-board and an improvement in UPGS's net debt/EBITDA position in FY2022. Moreover, the company anticipates that the market's profit expectations for FY2023 will be met. A combination of growth and resilience prompts us to maintain our Fair Value assessment of 250p per share.

UPGS's 13% sales revenue growth benefited significantly from the acquisition of Salter in June 2021. While organic growth was slower at 1%, it should be noted that all margin measures – released in today's statement – improved relative to FY2021. Sales and EBITDA data were released on 15th August 2022 and commented on in our report Record sales and profits in FY2022.

Strong sales growth in supermarkets and international sales were confirmed by today's data which reported increases of 38% (25% excluding Salter) and 22% respectively. Online sales were a significant beneficiary of the Salter acquisition and increased by 23%.

Effective brand management remains central to the growth driven investment case for UPGS. The company's commitment to a focused portfolio of well supported brands augurs positively for growth in the company's priority channels as well as facilitating margin expansion. In FY2022 EBITDA margins increased from 9.7% to 12.2% and pre-tax margins from 8.2% to 10.3%.

UPGS's resilience is evidenced by its ability to grow in what has been a challenging period due to the global shipping crisis and evidence of weakened consumer confidence in Western Europe. As a result, the company's stated anticipation that FY2023 profit performance will be in line with market expectations should be viewed as positive in our view.

Elsewhere, **Salter** was fully integrated, the German kitchen electrical brand **Petra** – acquired in February 2021 - received its first retailer orders, a major robotics process automation programme was launched, and the company secured a new agreement for **Russell Hobbs** to move the licence to a four-year rolling basis.

Success not reflected in share price

The current share price fails to capture three salient growth drivers (namely brands, distribution and international) of the business. We believe the company's ability to cope with external headwinds has been proven repeatedly, alongside its well-executed financial resilience. **Hence, 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)	13.8	10.3	7.3	6.8	6.3
P/E ratio (x)	15.8	11.8	8.9	8.7	8.4
Yield	3.0%	3.8%	5.4%	5.8%	6.0%

Source: ED estimates, Company historic data

Company Data

EPIC	UPGS
Price (last close)	131p
52 weeks Hi/Lo	222p/90p
Market cap	£113m
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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Brands and resilience to drive further growth

UPGS's FY2022 results reconfirm the key sales revenue and EBITDA data which were released in the company's 15th August 2022 trading update. In addition, margins were recorded as higher across the board and the company's net debt: EBITDA position improved.

As well as the financial results themselves, FY2022 was a year of progress: both in relation to the company's brands and their impact on the pattern of distribution – notably the raised importance of supermarkets and online – plus the operational efficiency of the group.

As a result, UPGS appears well positioned to demonstrate **both resilience and growth in FY2023** which is consistent with the company's statement that its Board anticipates profit performance will be in line with current market expectations. We leave our forecasts broadly unchanged. The company's intention is to make further market share gains and it expects to deliver growth despite what it describes as "the challenging market backdrop."

This report comments on the results themselves, the distribution channel, regional, brand and product category forces behind those results and the main operational developments in FY2022. Additionally, we detail key areas of financial resilience which in our opinion provide resistance to some of the external challenges which currently face consumer-oriented companies in the UK and Continental Europe.

The results in more detail

Highlights of UPGS's FY2022 financial results are shown in Figure 1. Sales revenue and EBITDA results were already released in the above-mentioned trading update. Other profit measures grew faster than both sales revenue and adjusted EBITDA with pre-tax profits and EPS increasing by 42% and 32% respectively with clear **positive implications for dividends** - as the company remains committed to at least a 50% pay-out in relation to net income.

Figure 1 - FY2022 highlights

All figures in £'000s	FY2021	FY2022	Change	
Revenue	**136,367**	**154,191**	**13%**	
Cost of sales	106,136	115,837	9%	
Gross profit	30,231	38,354	27%	
Gross profit margin	22.2%	24.9%	2.7	points
Adjusted EBITDA	**13,291**	**18,750**	**41%**	
Adjusted EBITDA margin	9.7%	12.2%	2.4	points
Adjusted pre-tax profit	**11,150**	**15,843**	**42%**	
Adjusted pre-tax profit margin	8.2%	10.3%	2.1	points
Adjusted EPS - pence	**11.12**	**14.73**	**32%**	
Dividend - pence	5.02	7.12	42%	

Source: Company data

UPGS's success in containing costs is reflected in the company's administrative expenses in FY2022. While gross profits advanced by 27% these expenses increased by a much slower 16% to £19.6m, which explains a significantly faster growth in EBITDA. As a portion of sales revenue, administrative expenses were little changed, rising from 12.4% to 12.7%.

Despite the Salter acquisition, finance costs increased from only £0.5m to £0.8m which reflects a combination of the deal being part funded by equity issuance and its earnings enhancing nature. We evaluated the transaction in full in our 25th June 2021 report UPGS acquires UK's oldest housewares brand.

Patterns of sales growth argue for sustainable expansion

Today's results release includes growth by distribution channel – the company's four strategic pillars – geographic region, brand and category. The first three of these indicate that UPGS not only has significant headroom for growth but also the correct tools in terms of its well-managed, attractive feel-good brands to deliver sustainable expansion. We continue to build our financial forecasts on the basis of a 6% underlying sales growth rate.

Growth by distribution channel

A marked increase in the proportion of sales through the supermarket and online channels was the salient feature of UPGS's distribution pattern in the past five years. These two "strategic pillars" gained share of business at the expense of discounters and multiple store retailers. In FY2022 supermarket sales increased by 32.4% and online business by 23.0%.

Their combined portion of total business increased from 43.7% in FY2021 to around half at 49.8% in FY2022. The data are summarised in Figure 2.

Figure 2 - Revenue by strategic pillar

	Sales revenue (£'000s)			Portion of sales	
	FY2021	FY2022	change	FY2021	FY2022
Supermarkets	38,914	51,523	32.4%	28.5%	33.4%
Discount retailers	51,526	48,126	-6.6%	37.8%	31.2%
Online channels	20,590	25,321	23.0%	15.1%	16.4%
Total	**111,031**	**124,970**	**12.6%**	**81.4%**	**81.0%**
Multiple-store retailers	15,578	17,312	11.1%	11.4%	11.2%
Other	9,757	11,909	22.1%	7.2%	7.7%
Total	**136,367**	**154,191**	**13.1%**	**100.0%**	**100.0%**

Source: Company data

Longer term trends in distribution and importance by strategic pillar support the case for supermarkets and online becoming comfortably more than half the business. The importance of supermarkets and online is that they are both in themselves growth channels. Online remains targeted at 30% of group sales.

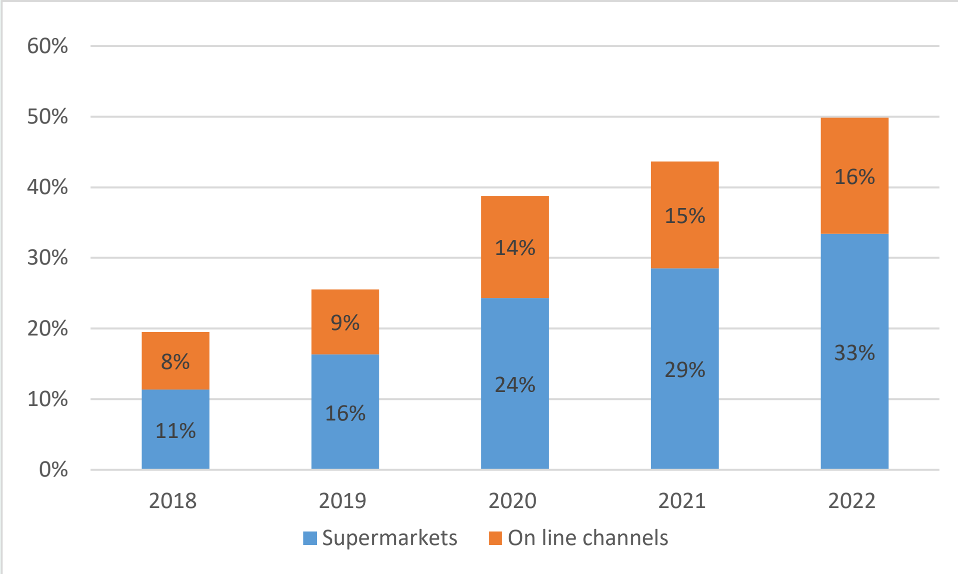
Furthermore, these two channels are well suited to growth outside the UK. There is an increasing tendency for supermarket stocking plans to become more international and their buying behaviour to be increasingly pan-European. We show longer term trends supermarket and online importance in Figure 3.

UPGS's premier brands increasingly drive the business

As we have discussed in recent reports, we believe that UPGS should increasingly be seen as a brand management company rather than a business whose primary route to adding value is effective sourcing. The group clearly has a competence in developing what it describes as "beautiful and more sustainable" products for every home.

But the product offering has become significantly more powerful as a result of being increasingly associated with a small number of well recognised brand names of which the most important are Salter, Beldray and non-electrical products sold under the Russell Hobbs umbrella.

Figure 3 – Supermarkets and online as % sales - FY2018 to FY2022



Source: Company data

Indeed, the shift in distribution which we summarise in Figure 3 would not have been possible without a more intense focus by the group on its premier brands. UPGS has made significant progress in the past 15 months in this area through the purchase of the Salter business, which means that it owns the brand outright across all product categories and the change in terms with Russell Hobbs to move the licence to a rolling four-year basis.

As a result, UPGS now wholly owns 87% of its brand portfolio and has a minimum four-year visibility on Russell Hobbs. We summarise FY2022 revenue growth by brand in FY2022 in Figure 4.

Figure 4 - Revenue by brand

	Sales revenue (£'000s)			Portion of sales	
	FY2021	**FY2022**	**Change**	**FY2021**	**FY2022**
Salter	28,379	48,080	69.4%	20.8%	31.2%
Beldray	42,374	39,950	-5.7%	31.1%	25.9%
Russell Hobbs (licensed)	16,840	20,165	19.7%	12.3%	13.1%
Progress	6,683	8,287	24.0%	4.9%	5.4%
Kleeneze	2,136	2,835	32.7%	1.6%	1.8%
Premier brands	**96,412**	**119,317**	**23.8%**	**70.7%**	**77.4%**
Other proprietorial brands	24,357	17,032	-30.1%	17.9%	11.0%
Own label and other	15,599	17,841	14.4%	11.4%	11.6%
Total	**136,367**	**154,191**	**13.1%**	**100.0%**	**100.0%**

Source: Company data

The success of UPGS's strategic mutation from sourcing company to brand manager tends to be confirmed by the increased concentration of sales represented by the company's now five premier brands. In addition, the premier brands grew significantly faster than the rest of the portfolio which bodes well for Petra as a potential sixth member of the company's premier brand stable.

In FY2022 these five brands increased as a portion of the business from 70.7% to 77.4%. Salter was an important contributor to that greater concentration. However, we note that the group's premier brands accounted for a significantly smaller 60.0% portion of the business in FY2017 which supports the view that the company's longer-term strategy is working.

An advantage of a more concentrated brand portfolio is that advertising spend can be more productively allocated to fewer labels and thus have more impact. That UPGS noted that particular success with its air fryers range in FY2022 sold under both the Beldray and Salter brand umbrellas reflects this capability.

International – significant growth headroom

International sales increased at a **significantly faster pace than UK sales** in FY2022 with the overseas pace of expansion remaining close to double the domestic run rate in the second half of the year. A little over one third of the business was accounted for by non-UK sales in the latest financial year.

Given the size of the EU economy relative to the UK and clearly a far larger aggregate population, the potential to grow sales revenue through international expansion is clear. Overall EU GDP was €14.5 trillion in 2021 relative to €2.5 trillion in the UK *(sources: european-union.europa.eu and statista)*. Furthermore, an increased ability to drive business through strong brand management and associated strength in supermarkets and online should sustain geographic expansion.

Germany – as Figure 5 illustrates – is the main driver of international growth at present. Potential in the country was arguably enhanced by the acquisition of the Petra kitchenware brand in February 2021, which has resulted in a major retailer being contracted to purchase products under this brand umbrella that should be on sale as part of this year's big Christmas promotion.

Figure 5 - Revenue by geographic region

	Sales revenue in £'000s			Portion of sales	
	FY2021	FY2022	Change	FY2021	FY2022
United Kingdom	92,916	101,050	8.8%	68.1%	65.5%
Germany	13,882	19,231	38.5%	10.2%	12.5%
Rest of Europe	27,720	29,700	7.1%	20.3%	19.3%
Rest of World	1,849	4,210	127.7%	1.4%	2.7%
Total	**136,367**	**154,191**	**13.1%**	**100.0%**	**100.0%**

Source: Company data

Small domestic appliances and housewares remain at the forefront

UPGS's focus on supplying beautiful, feelgood products for every home is clearly well suited to the small domestic appliance and houseware product categories. Hence the company benefits from its focus on the premier brands Salter, Beldray and Russell Hobbs. Close to 75% the group's sales were in these categories in FY2022 and they generated all of the growth.

The position is summarised in Figure 6.

Figure 6 - Revenue by major product category

	Sales revenue in £'000s			Portion of sales	
	FY2021	FY2022	change	FY2021	FY2022
Small dom. appliances	48,715	57,032	17.1%	35.7%	37.0%
Housewares	35,898	54,539	51.9%	26.3%	35.4%
Audio	15,457	12,907	-16.5%	11.3%	8.4%
Laundry	17,216	14,799	-14.0%	12.6%	9.6%
Heating and cooling	6,937	5,870	-15.4%	5.1%	3.8%
Others	12,144	9,044	-25.5%	8.9%	5.9%
Total revenue	**136,367**	**154,191**	**13.1%**	**100.0%**	**100.0%**

Source: Company data

Important areas of progress

Three important areas of progress within the group (other than revenue and profitability growth) include the new licensing agreement with Russell Hobbs, increased investment in robotics, the post-acquisition integration of Salter and achievement of orders for Petra branded products within the German retail system. We discuss each of these in turn.

Russell Hobbs

The Russell Hobbs licensing agreement which refers exclusively to non-electrical items was formerly on a fixed contract basis. As a result, UPGS was arguably constrained in its marketing strategy for the brand towards the tail end of licensing periods as the brand came up for renewal

By moving to a four-year rolling basis for the licensing agreement, Russell Hobbs can be treated more similarly to an "owned" brand as discussed in our 18th October 2022 report Russell Hobbs - improved brand visibility for UPGS. Effectively, all the group's premier brands can be strategically managed on a similar basis with due regard for less product flexibility at Russell Hobbs given that the agreement excludes electrical products.

Robotics

UPGS hosted an investor webinar which dealt with key logistics initiatives with notable significance for its online business on 13th October 2022. The webinar updated the financial markets on the initiatives covered in our 29th April 2022 report UPGS shareholder value at its core which highlighted planned investment in robotics.

The stated intention was to enhance operating margins and deliver an even better customer experience and support the view that the progress of both online and profitability in today's results is a harbinger of further improvements to come.

The use of robotics will also generate economies of scale and improve 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. The process automation programme was launched in the final quarter of FY2022.

Salter

FY2022 was the first year since the Salter brand was acquired outright. The business is described as fully integrated and significantly earnings enhancing. Importantly, UPGS is able to manage the brand's legacy position in measuring devices and its own brand extensions – formerly operated under licence – seamlessly. Outside North America, UPGS owns the entire proposition.

Petra

Key attributes of last year's German kitchenware brand acquisition were highlighted in our 15th February report Petra acquisition to enhance international business. UPGS's original plan to rejuvenate a range of electrical appliances under the brand's name appears to have come to fruition with the first retailer orders for Petra already received for FY2023.

Resilience

Two financial features of today's results show the resilience of UPGS – notably the strength of forex and interest rate coverage. We also draw attention to the company's **proven ECG credentials** – both for investors and customers – and the prospect of lower shipping costs as an added benefit for margins.

Financial resilience

At end-FY2022 UPGS had a net bank debt/adjusted EBITDA ratio of 1.3x which represented a small drop from 1.4x a year earlier. Moreover, the group maintains comfortable levels of headroom within its bank facilities. Estimated headroom at end-FY2022 was £17.8m, an improvement from £16.2m a year earlier.

We note that the company is well hedged on a forward basis against both foreign currency and interest rate fluctuations. Notes in today's statement refer to forward contracts and interest rate swaps and caps respectively.

Foreign exchange

The fair value of forward contracts that offset exchange rate risk is accounted for as an asset that is valued at £3.4m compared with a £0.2m liability in FY2021. As a result, the company has visibility in terms of being able to fix selling prices and predict gross margins despite the potential for the pound/dollar exchange rate to vary.

Interest rates

UPGS has entered into interest rate swaps and interest rate caps to protect exposure to interest rate movements in relation to the group's banking facility. This protection amounted to £18.3m in FY2022 compared with £15.6m in FY2021. It represents a significant level of protection in relation to the company's overall £24.3m net debt at end-2022.

Strong ESG credentials

In our view UPGS boasts tangible ESG credentials in both how it manages energy and in terms of product offering. The head office facility in Oldham, Greater Manchester is estimated to be capable of supplying 40% of its energy requirements through the installation of 1,150 solar panels on the roof of Manor Mill.

The ESG positive salient product offering is the company's ability to satiate demand for energy saving products. These include air fryers for which demand has been notably strong.

Elsewhere, the company highlights its achievement of **one million trees** now having been planted in partnership with Ecologi.

Financials and valuation

Relative valuation

A relative valuation for UPGS based on a peer group of companies is shown in Figure 7. The company trades in line with this peer group on both EV/sales and EV/EBITDA but at a meaningful discount 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.

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

Figure 7 - Relative valuation

	Share price (pence)	Mkt cap £m	Net debt £m	EV £m	Sales 2023 £m	EV/ sales (x)	EBITDA 2023 £m	EV/ EBITDA (x)	EPS 2023 (p)	P/E 2022 (x)	DPS 2022 (p)	YLD (%)
Accrol (ACRL)	24	77	39	115	214	0.5	15.0	7.7	1.8	13.6	0.4	1.6%
Gear4Music (G4M)	109	23	21	43	155	0.3	8.9	4.9	4.2	25.7		
Luceco (LUCE)	83	134	45	179	207	0.9	26.8	6.7	9.6	8.7	3.6	4.4%
Portmeirion (PMP)	308	43	1	44	111	0.4	13.5	3.2	52.5	5.9	17.5	5.7%
Procook (PROC)	35	38	20	58	68	0.9	10.9	5.3	3.5	10.2	1.5	4.3%
UPGS (UPGS)	**131**	**113**	**23**	**136**	**163**	**0.8**	**20.2**	**6.8**	**15.1**	**8.7**	**7.5**	**5.8%**
Warpaint (W7L)	152	116	-4	112	66	1.7	11.1	10.1	9.9	15.3	6.8	4.5%
Average						**0.8**		**6.4**		**12.6**		**4.4%**

Share prices are as of 2 November close

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

Financial forecasts

We maintain our central belief that the underlying sales growth rate for UPGS is 6% in our forecasts, with due regard for external inflationary influences. We expect adjusted EBITDA margins to increase modestly in both FY2023 and FY2024 and for free cash flow to be positive in both years – more so in FY2024 - which benefits the company's financial position.

Overall, our forecasts in the outyears remain unchanged from the company's trading update on 15th August 2022. We summarise our income statement, balance sheet and free cash flow projections for FY2023 and FY2024 in Figures 8,9 and 10.

Figure 8 - Income statement

All figures in £'000s	2021A	2022A	2023E	2024E
31st July year end				
Revenue	**136,367**	**154,191**	**163,442**	**173,249**
% increase 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 9 - Balance sheet

31st July year end	2021A	2022A	2023E	2024E
All figures in £'000s				
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 10 - Free cash flow

31st July year-end	2021A	2022A	2023E	2024E
All figures in £'000s				
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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