UP Global Sourcing

Broadening the scope for growth

30th April 2021

UPGS's success in online and supermarkets, combined with the ability of key brands to resonate with its end-customers' desire for quality affordable homebased products, shows that the company is well positioned for further growth as the Covid19 pandemic eases. Moreover, the potential for more M&A and new geographies implies substantial headroom for future expansion. We upgrade our profit forecasts and fair value in this report.

UPGS's FY2021 half-year report, released today, re-confirms the £75.4m (+11.4%) sales number which was released in its end-period trading statement on 8th February 2021 and the favourable net bank debt position of only £1.5m. **Profits in the six months to end-January 2021 increased at a significantly faster pace than sales.** Underlying EBITDA increased 20.8% to £8.8m and underlying pre-tax profits rose 24.4% to £7.7m. **Interim dividends will be 45.7% higher at 1.69p**.

The pattern of UPGS's trading performance supports our expectation of further brisk sales growth. In particular, the company's brands continue to grow rapidly in the **supermarket and online channels,** as well as performing strongly in the company's largest overseas market, Germany. Despite international revenue rising only 0.5% and significant non-essential store closures due to Covid19 lockdowns, German sales advanced at an impressive **25.7% pace** in the half-year. Germany represented 9.8% of group sales in the six months, compared with 8.7% a year earlier.

Furthermore, the recent acquisition of **Petra**, while small, suggests that future acquisitions should both broaden the company's international footprint and accelerate growth. **UPGS already has a strong track record of acquiring and accelerating businesses and their brands within the UK.** Success in replicating M&A internationally would both expand the company's regional footprint and add an element of "option value" to the business that is not currently priced into the shares.

Other developments which **bode well for the post-Pandemic period** include the company's raised profile as a champion of its local community in Oldham (Greater Manchester), its long-standing support of ESG principles, and the use of its virtual showroom as a means of generating sales. There is strong evidence that Covid-19 lockdowns have raised awareness for local sensitivities, environmental protection, and the ability to conduct both B2B as well as B2C business remotely.

Attractive ratings

UPGS's valuation appears undemanding in the light of the management's ability to make it prosper during prolonged periods of Covid-19 related lockdown, the shift in distribution channels, Germany as a core region and potential for further M&A. Our assessment of fair value rises to **200p / share**, which would equate to an 18.0x prospective 2022 P/E ratio that better reflects track record and prospects.

Key Financials

Year to 31st July	2018A	2019A	2020A	2021E	2022E
Revenue (£'000)	87,571	123,257	115,684	137,000	145,158
Revenue change	-20.4%	40.8%	-6.1%	18.4%	6.0%
EBITDA (£'000) (adj)	6,280	10,720	10,363	13,034	13,912
EPS adjusted (p)	5.0	8.1	7.9	10.2	11.1
DPS (p)	2.7	4.1	4.0	5.1	5.5
EV/EBITDA (x)	21.8	12.8	13.2	10.5	9.8
P/E ratio (x)	31.4	19.3	19.8	15.4	14.1
Yield (%)	1.7%	2.6%	2.5%	3.3%	3.5%

Source: Company Historic Data, ED estimates

Company Data

EPIC	UPGS
Price (last close)	157p
52 weeks Hi/Lo	173p / 51p
Market cap	£129m
ED Fair Value / share	200p

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.

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Broadening the scope for growth

Investment case

The investment case for UPGS remains the ability of the company to grow its portfolio of beautiful products - i.e. quality, affordable, well established brands - **for every home**. However, the company's ability to accelerate an already brisk pace of expansion should continue to be enhanced by the successful development of new channels and new geographic regions. Online is now targeted to be 30% of sales.

Germany, which now accounts for 9.8% of group sales and 31.3% of International, augurs well for this route to growth. Moreover, the establishment of new regional sales hubs implies broader scope for making value enhancing acquisitions.

UPGS's flexibility and willingness to embrace what we consider to be "modern approaches to doing business" places the company well to prosper in a post pandemic economy and developments in the consumer market in our opinion. For example, Covid19 appears set to accelerate the practice of working from home, online business to business activity, core regional values and environmental awareness.

This report includes revised forecasts for UPGS based on raised guidance for full year profits and an updated relative valuation. We maintain our FY2021 sales forecast at £137m but increase EBITDA from £12.8m to £13.0m. We take this opportunity, based on the company's consistent ability to deliver on message throughout the Covid19 pandemic and its improved positioning for the post pandemic period, to raise our assessment of fair value for the shares from 150p to 200p.

Interim results

Sharply higher profits were the salient feature of UPGS's interim results. Sales and net financial position data were released with the company's half-year trading statement on 8th February 2021. Moreover, the company remains on track to orient its business more towards online and supermarkets as well as making meaningful progress in Germany.

In the first half of FY2021 the company raised its underlying EBITDA margin from 10.7% a year earlier to 11.6% despite a corresponding fall in gross margins from 23.6% to 22.8% due to factors such as shipping rates, which gives a clear idea of commitment to cost control within the business as well as effective targeting of distribution channels within its stated four commercial pillars: international retailers, supermarkets, online platforms, and discounters. We summarise key interim results data in Figure 1:

Figure 1 - UPGS FY2021 H1 financial highlights

All figures in £m	FY2020 H1	FY2021 H1	Change
Revenue	67.7	75.4	11.4%
Online revenue	7.7	11.8	53.6%
International revenue	23.5	23.6	0.5%
German revenue	5.9	7.4	25.7%
Underlying EBITDA	7.2	8.8	20.8%
Underlying EBITDA margin	10.7%	11.6%	+90bps
Underlying pre-tax profit	6.2	7.7	24.4%
Net bank debt	11.2	1.5	-9.7
Net bank debt/EBITDA (underlying)	1.0x	0.1x	-0.9x
Bank facility headroom	13.2	25.6	12.4
Underlying EPS (p)	5.9	7.3	23.7%
Interim dividend per share (p)	1.16	1.69	45.7%

Source: Company data

Brands, channel shift, International

Brands

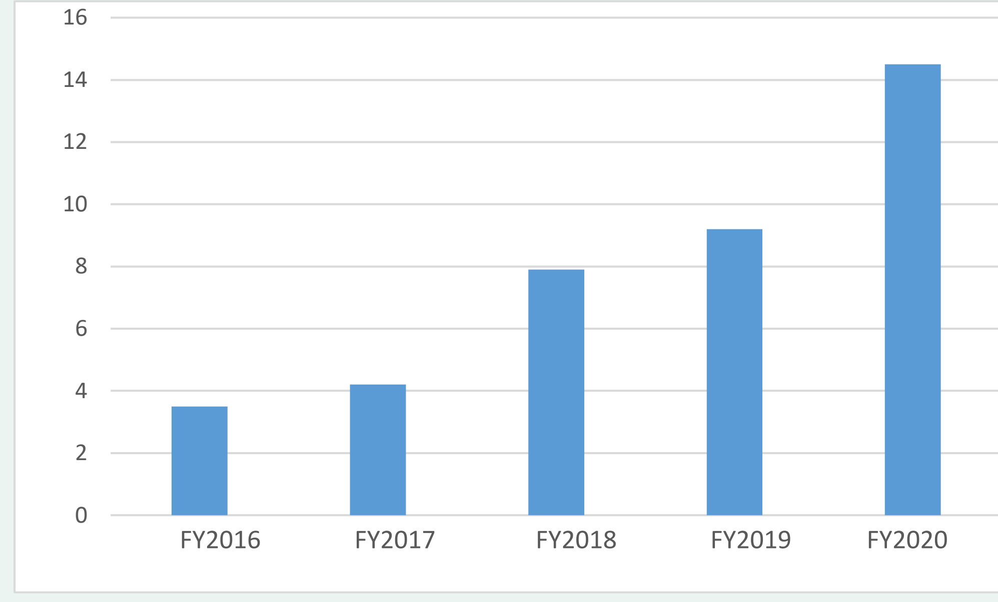
UPGS looks well placed to grow against a post pandemic socio-economic backdrop. The company benefits from having a portfolio of established and intelligently managed brands led by **Beldray** and the licensed brands **Russell Hobbs** and **Salter**, which are positioned as affordable "feel good" products for every home. As a result, they should be less susceptible to any economic uncertainty than relatively more expensive competitors while still enhancing the quality of life at home – i.e. a place where its customers have become more used to spending time during lockdown.

Channel shift

Moreover, the channel shift towards online and supermarkets, as well as being an endorsement of the quality of the company's brands, positions it well for how shoppers may be expected to purchase items going forward. The notable financial casualties in retail during the pandemic have tended to be larger store formats with high street location rather than supermarkets.

Meanwhile, online has flourished both as a segment and for UPGS itself with the **target total for online as a portion of group sales raised from 20% to 30%** in the first quarter of this calendar year. In the first half of FY2021 online as a portion of total sales increased to 15.6% of total revenue from 11.3% in the first half of FY2020 and 14.5% of the whole of FY2021. We summarise recent years' online sales progression as a portion of total in Figure 2. The long term evolution of all four pillars of UPGS's distribution channels was commented on in detail in our 3rd November 2020 report Ultimately, There's Brand Value

Figure 2 – UPGS's 5 years record for online sales as a portion of total (%)



Source; Company data

International

A growing international presence adds fuel to UPGS's post pandemic growth prospects with Germany showing signs of being an important template. Germany boasts clear critical mass and has potential to be a cornerstone of M&A activity outside the United Kingdom. We note the company's ability to acquire brands and nurture them to growth. For example, in the latest full financial year **Intempo** generated £5m in sales revenue, **Progress** generated £4m and **Kleeneze** became a £1m brand.

The company's most recent acquisition was Petra in Germany which we discussed in a 15th February 2021 report Petra Acquisition to Enhance International Business. Having significant operations in the country was useful both as a tool for finding the target, but also for securing a deal at the right price. The Petra acquisition was not classed as a significant transaction under Chapter 10 of the listing rules.

Figure 3 - Sales by region in FY2020 H1 and FY2021 H1

All figures in £m	FY2020H1	% total	FY2021H1	% total	YOY Change
UK	44.2	65.2%	51.7	68.6%	17.1%
Germany	5.9	8.7%	7.4	9.8%	25.7%
Rest of Europe	16.9	24.9%	15.0	19.9%	-11.0%
USA	0.4	0.6%	0.5	0.7%	33.5%
Rest of World	0.4	0.6%	0.7	0.9%	87.6%
Total	**67.7**	**100.0%**	**75.4**	**100.0%**	**11.4%**

Source: Company data

Positioning UPGS for a modern customer base

We think that UPGS's successful operating performance should be complemented by the company's commitments to its local community, the implementation of a positive Environmental, Social & Governance Strategy (ESG) and its use of virtual showroom technology in doing business. These 3 "top down" strategies leave UPGS well positioned for a modern customer base.

Local champion

A significant number of consumer-facing multi-national companies enjoy strong local roots. Examples include Nestle's strong connections with Vevey in Switzerland, Procter & Gamble in Cincinnati, USA and WalMart in Bentonville, USA. UPGS states clearly that the company is committed to being active within its local community in Oldham, Greater Manchester, in the UK.

Advantages of being a **"local champion"** include a strong local identity for some of the company's emerging brands, some of which have distinct Northern characteristics and origins as well as access to some of the best local talent when it comes to recruitment. The company actively engages with Oldham's "World of work" month both through Oldham University and at local school level.

Moreover, the positive local press the company receives from its activities to support the local community, reinforce these bonds. During the Covid19 pandemic and lockdown the company formed schemes to assist both financially challenged members of its local community with donations, as well as NHS key workers.

Consistent with the company's ESG commitments, which include diversity, we note the appointment of two female members to the main board which now comprises eight directors.

ESG and UPGS's green strategy

On 25th March 2021 Equity Development hosted an investor seminar entitled ESG - From Best Intentions to Real Change, which highlighted that from 10th March 2021 the much anticipated EU Sustainable Finance Disclosure Regulation (SFDR) obligations will apply. Our expectation is that, despite the UK no longer being an EU member, its companies will wish to comply with the organisation's directives – a view supported by statements from senior members of the country's national government.

There is clear evidence that UK listed companies are increasingly realising the imperative to look after **all stakeholders' interests**, with transparent ESG policies and actions.

UPGS's senior management already embraces this opinion. One salient initiative to date is the "Buy me & plant a tree" initiative as part of UPGS's "Happy Earth Day" message, whereby the company matches purchases of its products with newly planted trees.

Given that the company is importing a sizable number of products which are shipped to Western Europe from China it makes sense to offset this environmental footprint – transported goods – with a genuinely green initiative.

UPGS publicly updates the broader business and investor community with regard to ESG initiatives on its LinkedIn page to which we attach a hyperlink LinkedIn - Ultimate Products. An online advertisement for the company's 22 April "Happy Earth Day" initiative is shown in Figure 4.

Figure 4 – UPGS "Happy Earth Day" initiative

Source: Company LinkedIn page

Virtual showroom

UPGS's use of virtual showroom technology which we showcased on 2nd December 2020 virtual showroom tour enables its retail customers to view and assess the benefits of the company's brands and products remotely.

As the company expands its selling footprint internationally, use of a virtual showroom should become more important and help reduce travel costs and carbon footprint for the company and its customers.

Developments in the consumer market

UPGS hosted a Capital Markets Day for stock-market commentators and investors on 16th February 2021, which highlighted **eight important developments in the consumer market.** The company articulated specific opportunities to meet consumers' requirements in responses to these identifiable developments, some of which have been accelerated by Covid19 and should become more obvious in its aftermath. We address each in turn.

- That **more time will be spent in the home compared with pre-Covid19 times** presents a key opportunity for homeware brands.
- **Home cooking is here to stay** should be seen as an opportunity for Salter, Russell Hobbs, Progress and the newly acquired Petra brand in Germany.
- **Cleaning and hygiene will remain a priority**, which is an opportunity for Beldray and Kleeneze.
- The **increase in online is structural not temporary** is matched by the company targeting online to be 30% of the business's sales revenue and expecting to achieve that target.
- **Expenditure will be more considered** suits UPGS's focus on brands that deliver value. Note that the company's mantra is "beautiful products for every home."
- **Covid has led to retail insolvencies but also retail winners.** These winners are UPGS's customers.
- **Retailers will favour reliable suppliers.** Being a reliable supplier is a core competence of UPGS, which implies that this development plays to the company's strengths.
- **Brexit requires an ability to manage complexity.** This is what UPGS does every day. It is a core competence of a company which both sources and distributes internationally while achieving both sales growth and margin expansion.

Overall, this checklist confirms the benefits of UPGS broadening its scope for growth through a combination of an expanding portfolio of strong owned, licensed and acquired brands, distribution channel shifts and broader international scope while continuing to conduct business in a modern fashion – i.e. embracing ESG and technology.

The overriding implication is that growth should be sustainably brisk and profitable.

Valuation and financials

Upgrading fair value to 200p

We are upgrade our fair value for UPGS's shares to 200p. This positive view is based on the following key points, most of which have been covered earlier in this report.

- UPGS has in our view fully demonstrated its transition from a sourcing company to a brand manager with both its established brands and emerging brands continuing to grow.
- The company's channel shift away from discounters towards supermarkets and online – which is facilitated by its brands – puts it in stronger control of product positioning.
- Equity markets place a higher value on brand owners than pure sourcing and distribution companies because the intellectual property associated with brands
- M & A. Demonstrable brand management capability should be rewarded with an element of "option value" because of the potential to make value enhancing acquisitions of newly available brands on an ongoing basis.
- International is an established platform and one with significant scope for addressable market expansion as well as M & A.
- UPGS's announcements made between 8th June 2020 and 8th February 2021 included 5 upgrades to sales and profit guidance with a further upgrade to guidance incorporated in today's interim results announcement.
- Valuation relative to a carefully selected peer group of listed companies appears undemanding at 200p

Relative valuation

UPGS's valuation relative to a select peer group is summarised in Figure 5. Despite an exciting outlook, the shares only trade broadly in line with the average of this group of companies on EV/EBITDA, have a lower P/E ratio, and a superior dividend yield.

Figure 5: Relative Valuation

	Share price	Shares	Mkt cap	Net debt	EV	Sales	EV/ sales	EBITDA	EV/ EBITDA	EPS	P/E	DPS	DY
	(p)	(m)	(£m)	(£m)	(£m)	2021 (£m)	(x)	2021 (£m)	(x)	2021 (p)	(x)	2021 (p)	(%)
Accrol Group	67	311	207	5	212	153	1.4	15.6	13.6	n/a	n/a	50.0	nmf
Gear4Music	925	21	194	0	199	157	1.3	18.7	10.6	32.0	28.9	n/a	n/a
Luceco	321	154	495	12	507	198	2.6	39.2	12.9	15.0	n/a	7.0	2.2
Portmeirion Group**	610	14	85	-3	82	90	0.9	10.7	7.7	38.0	16.1	12.0	2.0
UPGS	**157**	**82**	**129**	**8**	**137**	**137**	**1.0**	**13.0**	**10.5**	**10.2**	**15.4**	**5.1**	**3.3**
Warpaint	125	77	96	-6	87	49	1.8	6.0	15.1	n/a	n/a	5.0	2.5
Average							**1.5**		**11.7**		**20.1**		**2.5**

Source: ADVFN, MarketScreener and Equity Development estimates, Prices as at close 29 April 2021

Financial forecasts

Brisk 6% long term sales growth, improving margins and positive underlying free cash flow are the salient features of our financial forecasts. In FY2021 we leave our sales revenue number unchanged at £137m but raise our EBITDA estimate from £12.8m to £13.0m in light of comments made by the company in its statement.

We note that throughout the past twelve months **guidance was consistently upgraded** in company announcements. The forecasts for income statement, balance sheet and free cash flow are shown in Figures 6 to 8.

Figure 6: Income statement

All figures in £'000s	2019A	2020A	2021E	2022E
	re-stated			
Revenue	123,257	115,684	137,000	145,158
% change in revenue	40.8%	-6.1%	18.4%	6.0%
Gross profit	27,244	26,600	30,634	32,458
Gross margin (%)	22.1%	23.0%	22.4%	22.4%
EBITDA - underlying	10,720	10,363	13,034	13,912
EBITDA margin - underlying	8.7%	9.0%	9.5%	9.6%
Net financial expense	-810	-753	-700	-700
Pre-tax profit - reported	8,130	8,362	10,028	11,271
Pre-tax profit - adjusted	8,387	8,163	10,760	11,538
Taxation	-1,720	-1,747	-2,172	-2,423
Tax rate (%) - adjusted	20.5%	21.4%	20.2%	21.0%
Net income - adjusted	6,667	6,504	8,360	9,115
EPS - basic adjusted (p)	8.1	7.9	10.2	11.1
Dividend per share (pence)	4.1	4.0	5.1	5.5

Source: ED estimates, Company historic data

Figure 7: Balance Sheet

All figures in £'000s	**2019A**	**2020A**	**2021E**	**2022E**
Assets				
Intangible assets	98	86	86	86
Property, plant and equipment	4,993	5,065	6,003	5,141
Deferred tax	130	106	106	106
Total non-current assets	5,221	5,257	6,195	5,333
Inventories	20,399	16,022	18,100	18,878
Trade and other receivables	18,644	18,495	21,900	23,204
Derivatives	1,335	53	-	-
Cash and cash equivalents	122	329	329	329
Total current assets	40,500	34,899	40,329	42,411
Total assets	45,721	40,156	46,524	47,744
Liabilities				
Share capital	205	205	205	205
Share premium account	2	2	2	2
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	342	357
Retained earnings	11,227	15,527	18,754	23,297
Total equity	11,552	13,414	18,211	23,037
Trade and other payables	15,284	17,614	17,000	16,112
Derivative financial instruments	54	1,342		
Current tax	812	280		
Borrowings	14,567	3,903	8,460	6,492
Lease liabilities	793	710	710	710
Total current liabilities	31,510	23,849	26,170	23,314
Long term borrowings		89	89	89
Lease liabilities	2,659	2,804	2,054	1,304
Total non-current liabilities	2,659	2,893	2,143	1,393
Total equity and liabilities	45,721	40,156	46,524	47,744

Source: ED estimates, Company historic data

Figure 8: Free Cash Flow

All figures in £'000s	2019A	2020A	2021E	2022E
Profit for the period	6,410	6,615	7,856	8,848
Adjustments for:				
Finance costs (net)	816	753	700	700
Income tax expense	1,720	1,747	2,172	2,423
Depreciation and impairment	1,512	1,417	1,562	1,662
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	-2,423
Total	9,538	8,898	10,105	11,477
Working capital adjustments				
(Increase)/decrease in inventories	-3,932	4,377	-2,078	-778
Decrease/(increase) in receivables	-3,933	150	-3,405	-1,304
(Decrease)/increase in payables	2,947	2,339	-614	-888
Total	-4,918	6,866	-6,097	-2,970
Net cash from operations	4,620	15,764	4,008	8,508
Cash flows used in investing activities				
Purchase of intangible assets	-9			
PP&E	-711	-601	-2,500	-800
Proceeds from P, P & E disposals	18	12	14	15
Finance income	6			
Repayment of lease liabilities			-750	-750
Total	-696	-589	-3,236	-1,535
Free cash flow before financing	3,924	15,175	772	6,973
Interest paid	-702	-753	-700	-700
Free cash flow before dividends etc	3,222	14,422	72	6,273
Dividends paid	-2,428	-2,307	-4,629	-4,305
Purchase of own shares (EBT)	-1,649	-506		
Free cash flow after dividends etc	-855	11,609	-4,557	1,968

Source: ED estimates, Company historic data

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