UP Global Sourcing Holdings PLC

Brand strength reaps rewards

7th September 2020

Better than expected sales revenue and profits, substantial growth in the online business, robust finances and a strong start to FY2021 were salient features of UPGS's FY2020 year-end trading statement, which was released today. Despite Covid-19 challenges, their brand portfolio and distribution strength show clear, positive momentum: evidenced by resuming dividends and repayment of furlough monies.

In spite of the Covid-19 pandemic, UPGS's sales achieved their second highest ever level in FY2020. With a fall of only 6.1% to £115.7m they beat expectations, which were revised upwards as recently as 6th July in our report "Equity Development – Brisk Growth Rate Supports Higher Valuation." Furthermore, excluding furlough credits EBITDA at £10.4m and pre-tax profits at £8.2m were both ahead of expectations as well as recording only low single digit declines from FY2019.

Online business was a stellar performer in FY2020 and grew sales by 47.2% to £16.7m to represent 14.5% of group revenue compared with 9.2% last year. Indeed, implied second half online revenue made up 19% of group sales, which was close to the stated target of 20%. Aside from financial benefits, online strength tends to endorse the attractiveness and quality of the UPGS brand portfolio.

Financially, UPGS continues to strengthen. The company's net debt reduced from £14.4m to £3.8m in FY2020, of which only £1.1m was attributable to suspension of the 1.16p interim dividend. Profitability and improved overall working capital management (net receivables and stock turn) were the key drivers of the group's net cash generation. Bank facility headroom is a very comfortable £21.3m.

Confidence – supported by brand and distribution strength - is the over-riding feature of today's statement. FY2021 started well with an order book ahead of the same time last year. Moreover, the company is able to repay its Job Retention Scheme (furlough) money of £0.5m and reinstate the interim dividend, for payment in October. UPGS has waived its use of Government Time to Pay and VAT deferment facilities.

Our valuation metrics suggest scope for more upside as revenue and earnings grow with international demonstrating strong potential. As a result, we raise our fair value for the shares from 100p to 150p. At this price key valuation multiples would be only a 1.1x EV/sales ratio and a 17x P/E ratio based on FY2022 forecasts.

Key Financials

Year to 31st July	2018A	2019A	2020E	2021E	2022E
Revenue (£'000)	87,571	123,257	115,700	122,642	130,001
Revenue growth (%)	-20.4%	40.8%	-6.1%	6.0%	6.0%
EBITDA (adj)	6,280	10,720	10,388	11,062	11,745
EPS adjusted diluted (p)	5.0	8.1	7.9	8.4	8.9
DPS (p)	2.7	4.1	3.9	4.2	4.5
EV/EBITDA (x)	15.9	9.3	9.6	9.0	8.5
P/E ratio (x)	21.1	13.0	13.4	12.5	11.8
Yield	2.6%	3.9%	3.7%	4.0%	4.3%

Source: Company historic data, ED estimates

Company Data

EPIC	UPGS
Price (last close)	105p
52 weeks Hi/Lo	119p/30p
Market cap	£86m
Net debt	£4m

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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Investment case

Today's trading statement is consistent with the overall investment case for UPGS. The group's combination of brand management, sourcing and distribution skills should deliver near term revenue growth at, or in excess of, mid-single digits and on an underlying cash positive basis.

Despite Covid19, demand for the company's flagship brands – including **Beldray, Salter and Russell Hobbs** - remained robust in FY2020, which enabled the company to report a 12.5% five years compound growth rate in net sales. This positive view is confirmed by order growth so far in FY2021 being ahead of a year earlier.

Trading statement highlights

UPGS ended the year on a strong note. Having revised sales expectations upwards in earlier trading statements (8th June 2020 and 6th July 2020), today's release revealed that sales revenue, EBITDA, and pre-tax profits were all ahead of our most recent guidance.

The £115.7m sales revenue number for FY2020 compared positively with company guidance for the number to be at least £111m, while EBITDA at £10.4m compared favourably with guidance of above £9.6m. Pre-tax profits at £8.2m beat guidance of above £7.4m. Additionally, the group's online performance was strong.

Financially, UPGS is performing well. **Net debt fell by a substantial £10.6m** of which only £1.1m of the decrease was attributable to the company's decision to suspend its interim dividend and £0.5m came from the furlough scheme. Moreover, bank facility headroom rose to £21.3m from £10.1m a year earlier.

The company particularly highlights its ability to convert profits into cash, which was aided by both improved working capital management and a more favourable inventory/sales ratio, or stock turn. We summarise the trading statement data below. UPGS is due to release full preliminary FY2020 results on Tuesday 3rd November 2020.

FY2020 trading statement highlights

£m	FY2019	FY2020	Change (%)
Sales Revenue	123.3	115.7	-6.1
UK and International online sales	11.4	16.7	47.2
Online sales as a portion of total	9.2%	14.5%	5.3pts
EBITDA (underlying)	10.7	10.4	-3.3
Pre-tax profit (underlying)	8.4	8.2	-2.7
Net bank debt	14.4	3.8	-£10.6m

Source: Company data

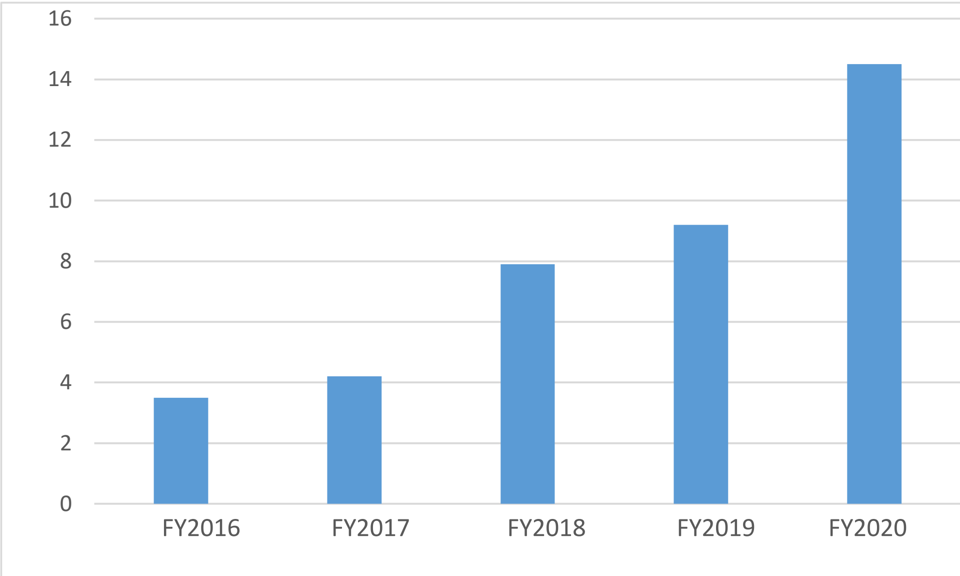
The importance of online

UPGS's stated target for online sales as a portion of total business is 20%. Online's progress, helped in part by lockdown, accelerated massively in the second half of FY2020 to produce an overall 14.5% proportion of sales figure having been 11.3% in H1. We thus infer that online sales as a portion of total in the second half of FY2020 was 19% - i.e. close to the stated target. The chart below shows updated progress of UPGS's online sales as a proportion of the total, which was as low as 3.5% five years ago.

Online is very important. Not only does it give the company greater control over its end-distribution and have useful implications for working capital and gross margins, but also online tends to endorse the integrity and relevance of the company's brand portfolio.

Brand management is central to any online offering and a relatively pure indicator of attractiveness to the consumer. For example, in contrast to traditional distribution channels, online brands cannot be assisted by favourable offer terms or on-shelf positioning.

Figure 2 – Online as a portion of total sales (%)



Source: Company data

Brand management

UPGS's management of a select group of "feel good" affordable products remains central to the company's success in being able to reach out to an expanding base of consumers. Its larger owned and licensed brands Beldray, Salter (excluding scales) and Russell Hobbs (excluding electrical) are supported by Intempo, Progress, Kleeneze and a further clutch of "premier" brands.

Aside from the stellar FY2020 H2 online performance, a further measure of what can be termed the company's "brand voltage" is the expanded reach of the brands within an enlarged customer base. The first half statement reported that the group's top two end-distribution customers accounted for 26.0% of sales compared with 34.8% in the same period last year.

While this partly reflected closures of non-essential stores in April and May 2020, the direction of travel and what facilitates it is clear – i.e. **an effective brand proposition**.

We think that this apparent improvement in brand voltage is central not only to how the company creates value, but also to the overall health of the business. **Stronger brands assist with robust pricing and market share**. In addition, they boost the amount of cash that the brands can generate, which is reflected in our earlier comments about working capital management and stock turnover.

UPGS's branded product portfolio looks well placed to prosper in a post-pandemic consumer environment. The price positioning of the brands is well suited to a period of economic uncertainty and the names are well supported and well established. **They provide consumers with a "feel good" factor at affordable prices.**

The offering is capable of performing well in diverse distribution channels. UPGS historically highlighted its four pillars approach to distribution via: discounters, supermarkets, multiple store retailers and online. Aside from online, a feature of FY2020 has been the company's **success within supermarkets relative to discounters** – i.e. its brands are capable of matching the profile required by what is naturally a higher selling price channel.

Financials and valuation

Forecasts

This report includes our update forecasts for income statement, balance sheet and free cash flow in FY2021 and FY2022. What they reflect is the underlying revenue growth of the business, ongoing adherence to cost control and improved working capital management.

We expect 6.0% sales growth in both FY2021 and FY2022. The central message is one of at least mid-single digit sales revenue growth, which is in itself a brisk pace. We factor some caution about economic uncertainty in the aftermath of Covid-19 into our estimates.

Moreover, there is scope further ahead for international growth significantly to exceed current expectations. So far the salient component of international expansion was the opening of a showroom in Germany in April 2018.

Moreover, we expect online to increase to a higher portion of the overall business irrespective of when and how anti Covid-19 measures finally end. The channel is not only trending upwards in importance overall but has also grown materially in status for UPGS itself. Our key income statement projections are summarised below.

Income statement projections

£m	FY2020E	FY2021E	FY2022E
Sales Revenue	115.7	122.6	130.0
EBITDA (underlying)	10.4	11.1	11.7
Pre-tax profit (underlying)	8.2	8.7	9.2
EPS (adjusted fully diluted) *	7.9	8.4	8.9

*Note – * FY2020 EPS is estimated based on today's trading statement*
Source: Company data and Equity Development estimates

Valuation

UPGS's shares have performed extremely well since their trough in April 2020, when uncertainty associated with Covid-19 was at its most intense. Moreover, the shares are in positive territory year to date having closed last year at 92.5p.

However, there is a credible case that UPGS's shares should move to higher multiples based on sales and profits than in the past two years. This view can be justified by the company's clear flexibility and speed of responses to Covid19 and lockdown, the significant increase in online's importance, and overall cash generation.

We include a relative valuation below. Finding comparator companies for UPGS is a challenge because of its distinct combination of sourcing, brand management and distribution activities within the business mix. However, we believe the shares should trade at a premium to our selected peer group in our view based on EV/sales. We suggest a 1.1x multiple of FY2021 sales is appropriate, which would translate to **a share price of 150p**.

At 150p UPGS would be trading on an EV/EBITDA ratio of 12.3x and a 17x P/E based on our updated estimates for FY2022, both of which seem reasonable for a company not only with brisk sales growth but an increasing portion of business done online.

A valuation based on free cash flow also looks supportive. Underlying annual free cash flow appears to be of the order of around £5.0m which, with a 150p share price, would imply a healthy free cash flow yield of around 4%.

We compare UPGS's valuation based on FY2020 with a select group of household brand manufacturers and online distributors below:

Relative Valuation

	Share price (pence)	Shares (m)	Mkt cap (£m)	Net debt (£m)	EV (£m)	Sales 2020 (£m)	EV/ sales (x)	EBITDA 2020 (£m)	EV/ EBITDA (x)	EPS 2020 (p)	P/E 2020 (x)	P/E 2021 (x)	DPS 2020 (p)	Yield (%)
Accrol Group*	48	195	94	25	118	139	0.9	12.9	9.2	n/a	n/a	n/a	n/a	n/a
Gear4Music*	550	21	113	2	115	147	0.8	11.0	10.5	18.0	30.6	26.2	n/a	n/a
Luceco	180	161	289	13	303	161	1.9	32.1	9.4	n/a	n/a	n/a	3.0	1.7%
Portmeirion Group**	386	14	53	19	72	93	0.8	9.9	7.3	55.0	7.0	n/a	8.0	2.1%
UPGS	**105**	**82**	**86**	**13**	**100**	**116**	**0.9**	**10.4**	**9.6**	**7.9**	**13.4**	**12.5**	**3.9**	**3.7%**
Warpaint	68	77	52	-4	49	51	1.0	7.6	6.4	n/a	n/a	n/a	5.0	7.3%
Average							1.0		8.7		17.0	19.4		3.7%

Source: Company data, financial websites and Equity Development estimates
*Note - *FY2021 **FY2019*
UPGS dividend includes the postponed and restored interim in FY2020

Investor Access

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