UP Global Sourcing

Brands positioned for sustainable growth

8th February 2021

A strong performance from the group's largest brand, Beldray, further growth in the online and supermarket channels, and the ability to offset increased Chinese shipping rates were key features of UP Global Sourcing's FY2021 trading statement. Moreover, the company's financial position continues to improve with both relatively low year end net debt and ample facilities headroom. We raise both our sales and profit forecasts in this report.

UPGS's **sales revenue increased by 11.4% to £75.4m** in the six months to end-January 2021. Moreover, net bank debt shrank to £1.5m from £3.8m at the end of FY2020 and £11.2m at the same stage a year earlier. The company announced funding headroom of £25.5m. Cookware, laundry, cleaning, floor care and kitchen electrical products all traded strongly.

Today's announcement included raised guidance for the FY2021 financial year. Having increased our forecasts as recently as 14th December in a research update Beldray Leads the Way, we raise our FY2021 sales estimate again from £130.5m to £136.8m and our FY2021 profit forecast (EBITDA) from £12.4m to £12.8m. If our assessment is correct, the company will have recorded **a 5.6% compound annual sales growth rate since 2017** – itself a strong year.

Beldray's strong performance is consistent with the company's brands being well positioned for further growth. Indeed the brand represented 28% of group sales revenue in FY2020 and encapsulates UPGS's ability to deliver attractive "feel good" brands at affordable prices. Moreover, Beldray's success augurs well for the smaller owned brands **Intempo**, **Progress** and **Kleeneze** (which combined were 9% of group sales last year) and also for licensed brands **Salter** and **Russell Hobbs**: 22% and 10% respectively.

Brisk sales growth in the online and supermarket channels tends to confirm positive brand management in our view. These channels rely heavily on brand strength to grow, largely because they arguably offer a more "level playing field" between competing brands as well as in the supermarket channel having effectively to fight for retail selling space.

Fair Value

The valuation of UPGS remains undemanding. Based on our revised estimates, UPGS trades on a 0.9x EV/sales ratio and its shares on a 13.4x prospective P/E ratio. Moreover, given the company's growth credentials, a 3.8% yield looks attractive. We continue to argue at this stage of growth for **a current fair value of at least 150p / share**, which is 11% above their current level.

Key Financials					
Year to 31st July	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
Revenue (£'000)	87,571	123,257	115,684	136,848	144,992
Revenue change	-20.4%	40.8%	-6.1%	18.3%	6.0%
EBITDA (£'000) (adj)	6,280	10,720	10,363	12,800	13,669
EPS adjusted (p)	5.0	8.1	7.9	10.1	10.9
DPS (p)	2.7	4.1	4.0	5.1	5.4
EV/EBITDA (x)	19.0	11.1	11.5	9.3	8.7
P/E ratio (x)	27.1	16.6	17.1	13.4	12.4
Yield (%)	2.0%	3.0%	3.0%	3.8%	4.0%

Source: Company Historic Data, ED estimates

Company Data

EPIC	UPGS
Price (last close)	135p
52 weeks Hi/Lo	149p/28p
Market cap	£111m
ED Fair Value/share	150p
Proforma net debt	£2m

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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Brands positioned for sustainable growth

Investment case summary

UPGS's investment case focuses on the company's ability to deliver "feel good" brands into its end-consumers' homes at affordable prices. Led by Beldray, the company's brand portfolio should have successfully delivered sales growth at a 5.7% compound annual growth rate in the four years to FY2021, assuming that our revised forecasts are matched.

A near 6% growth rate for UPGS in turbulent times should be seen as a highly impressive outcome, in our view. In particular, the company sells consumer products into mature market economies where trend GDP growth rates tend to be significantly lower than 6%. However, investors do enjoy the relative comfort factor of stable exchange rates and a well-managed retail customer base, with increased emphasis on the online and supermarket channels.

Trading statement highlights

UPGS grew sales at a brisk 11.4% pace in the first half of FY2021, which ended on 31st January 2021. The company highlighted that sales to the online and supermarket channels performed particularly well. These channels increased their share of group revenue. We summarise trading statement highlights in Figure 1.

As we highlighted in a 3rd November report Ultimately There's Brand Value, online and supermarkets increased their combined share of group sales between FY2017 and FY2020 from 18% to 39%, with online being close to its long-term 20% target in H2 2020.

Beldray – the company's proprietorial brand for laundry, floorcare, heating and cooling - was cited as the standout performer in FY2021 H1. Beldray's brand voltage is clearly important for UPGS's investment case. Not only is it the largest brand in the group but its success also confirms the company's ability to manage brands effectively and position them for growth.

UPGS's finances continue to look robust. End-period net debt was £1.5m compared with a pre-pandemic £11.2m a year earlier. Funding headroom was reported to be £25.5m compared with £13.2m a year earlier. Both measures improved since the end of the previous financial year.

Chinese shipping rates clearly received significant press attention in recent months with a further potential flurry ahead of this week's Chinese New Year holiday on 12th February. However, at this stage there appears no reason for investors to be concerned about any material impact on profits which have anyway been guided upwards.

We think that the trading statement's tone is consistent with UPGS being a well-managed company both operationally and strategically, as well as being attractively positioned for sustainable expansion. Looking forward, we continue to believe that the company can deliver 6% underlying sales growth.

Figure 1 - Trading statement highlights

All figures in £m	H1 2020	H1 2021	Change
Group revenues	67.7	75.4	11.4%
Net bank debt	11.2	1.5	-86.6%
Funding headroom	13.2	25.5	93.2%

Source: Company data

Forecasts upgraded

UPGS raised its guidance for FY2021 in today's trading statement to be "ahead of current expectations" and stated that it expects current year sales revenue to be above £135m compared with £115.7m last year and that underlying EBITDA will be in excess of £12.6m compared with £10.4m last year. Adjusted pre-tax profits will be above £10.3m compared with £8.2m last year, according to the statement.

We revise upwards our FY2021 forecasts accordingly and summarise these upward revisions in Figure 2. In FY2022 we forecast 6.0% sales growth, which is our assumed long-term underlying growth rate. Despite the challenges associated with Covid19 both for a company which sources from China and sells into the UK, German and European retail systems, **there have been consistent upgrades to the company's guidance in recent months.**

Figure 2 - Forecast revisions for FY2021

All figures in £m	Old	New	Increase
Sales revenue	130.5	136.8	4.9%
EBITDA (adjusted)	12.4	12.8	3.3%
Pre-tax profit (adjusted)	10.0	10.5	5.2%
EPS (adjusted)	9.6	10.1	5.2%

Source: ED estimates

Brands positioned for growth

As mentioned above, Beldray was the standout performer in the first half of FY2021. Being the company's largest and wholly owned brand, its growth is clearly important. However, we continue to argue the case for other owned brands within the portfolio to grow. In particular, the company continues to perform well across a range of categories in which its brands are suited to being marketed as affordable feelgood products.

Owned brands Intempo, Progress, Kleeneze and the licensed brands Salter and Russell Hobbs might all be expected to continue to grow alongside Beldray given their common overall positioning.

Furthermore, a number of the company's categories traded strongly in the first half as consumers – probably incentivised to some extent by anti-Covid19 measures – prioritised spending on what the company believes is a range of quality homeware products. Noted categories included cookware, laundry, cleaning, floorcare and kitchen electrical products.

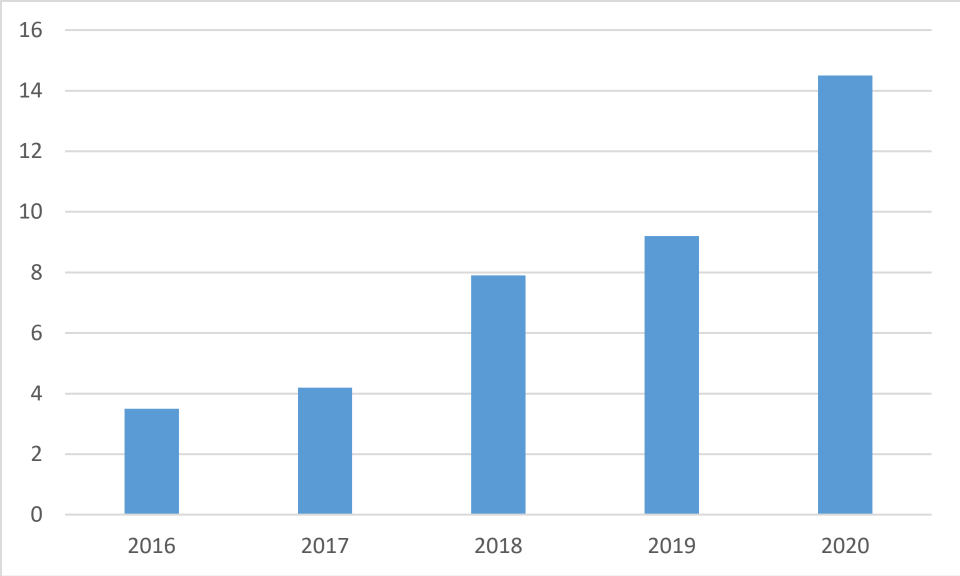
Distribution channels

Sales to online and supermarket channels continued to grow in the first half of FY2021, which is reassuring given some notable shifts in large retail operators' businesses **away from traditional formats towards online**. A salient example was the announcement on 25 January 2021 that online retailer Boohoo would be acquiring High Street retailer Debenhams.

UPGS' distribution strategy appears well positioned to match this trend. Ahead of a further strong online performance in the first half of FY2021, we noted the consistent growth in online sales as a portion of group sales revenue.

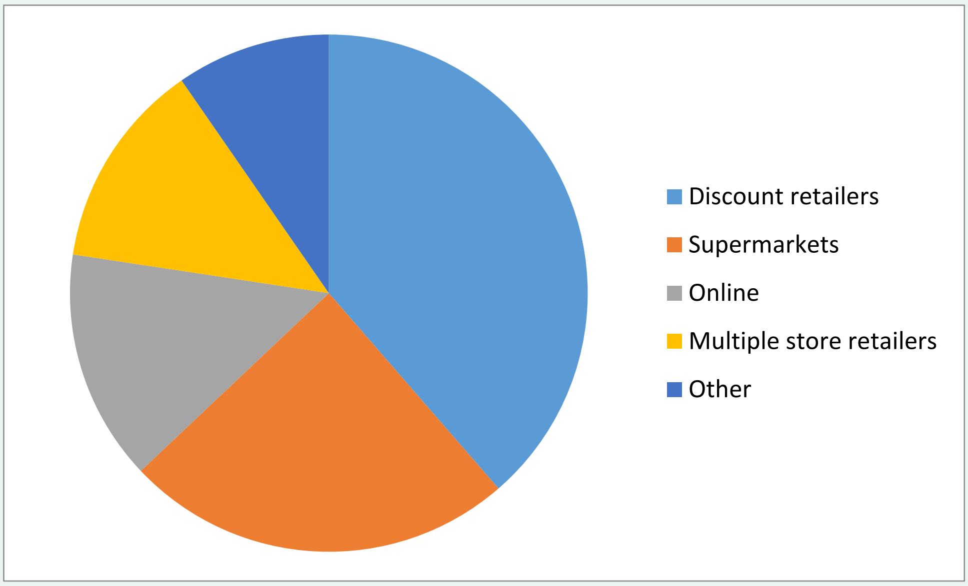
Indeed, UPGS's longer term 20% target for online sales as a portion of total was nearly reached in the second half of FY2020 when the proportion was at 18%. Recent years' trends are summarised in Figure 3 and the overall breakdown of sales by strategic pillar, or channel, in FY2020 is shown in Figure 4.

Figure 3 – Online sales as a % portion of total



Source: Company data

Figure 4 – FY2020 sales breakdown by strategic pillar



Source: Company data

Financials and valuation

Financial forecasts

We include our revised UPGS financial forecasts in Figures 5 to 7. Aside from the upgraded sales and profit numbers in our income statement projections, we highlight expectations that net overall debt will be around £8.5 at the end of FY2021 with the potential to decline in FY2022 and FY2023.

Finance costs are expected to remain at around £0.7m, largely because they reflect the volume driven impact of invoice discounting and import loan finance rather than being a pure reflection of average net debt.

Importantly, UPGS continues to convert net earnings into free cash flow on an underlying basis.

Figure 5 – Income statement

All figures in £'000s	2019A	2020A	2021E	2022E
Year to 31st July	re-stated			
Revenue	123,257	115,684	136,848	144,992
% increase in revenue	40.8%	-6.1%	18.3%	6.0%
Gross profit	27,244	26,600	31,475	33,348
Gross margin (%)	22.1%	23.0%	23.0%	23.0%
EBITDA - underlying	10,720	10,363	12,800	13,669
EBITDA margin - underlying	8.7%	9.0%	9.4%	9.4%
Net financial expense	-810	-753	-700	-700
Pre-tax profit - reported	8,130	8,362	9,794	11,028
Pre-tax profit - adjusted	8,387	8,163	10,526	11,295
Taxation	-1,720	-1,747	-2,210	-2,372
Tax rate (%) - adjusted	20.5%	21.4%	21.0%	21.0%
Net income - adjusted	6,667	6,504	8,316	8,923
EPS - basic adjusted (p)	8.1	7.9	10.1	10.9
Dividend per share (pence)	4.1	4.0	5.1	5.4

Source: ED estimates, Company historic data

Figure 6 – Balance sheet

All figures in £'000s/ Year to 31st July	**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	18,877
Trade and other receivables	18,644	18,495	21,900	23,203
Derivatives	1,335	53	-	-
Cash and cash equivalents	122	329	329	329
Total current assets	40,500	34,899	40,329	42,409
Total assets	45,721	40,156	46,524	47,742
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	18,489	22,887
Total equity	11,552	13,414	17,946	22,627
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	8,725	6,901
Lease liabilities	793	710	710	710
Total current liabilities	31,510	23,849	26,435	23,723
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	47,742

Source: ED estimates, Company historic data

Figure 7 - Free cash flow

All figures in £'000s	**2019A**	**2020A**	**2021E**	**2022E**
Year to 31st July				
Profit for the period	6,410	6,615	7,584	8,656
Adjustments for:				
Finance costs (net)	816	753	700	700
Income tax expense	1,720	1,747	2,210	2,372
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	-2,490	-2,372
Total	9,538	8,898	9,833	11,285
Working capital adjustments				
(Increase)/decrease in inventories	-3,932	4,377	-2,078	-777
Decrease/(increase) in receivables	-3,933	150	-3,405	-1,303
(Decrease)/increase in payables	2,947	2,339	-614	-888
Total	-4,918	6,866	-6,097	-2,969
Net cash from operations	4,620	15,764	3,736	8,317
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	500	6,782
Interest paid	-702	-753	-700	-700
Free cash flow before dividends etc	3,222	14,422	-200	6,082
Dividends paid	-2,428	-2,307	-4,622	-4,258
Purchase of own shares (EBT)	-1,649	-506		
Free cash flow after dividends etc	**-855**	**11,609**	**-4,822**	**1,823**

Source: ED estimates, Company historic data

Relative valuation

UPGS trades at a discount to the average of our identified peer group on the basis of all three multiple measures identified – i.e. **EV/sales, EV/EBITDA and P/E ratio**. Moreover, the company offers a superior yield to the average of this group.

Whereas there is scope for the company to re-rate upwards is in its ability to grow sustainably on a cash positive basis in mature market economies as well as to raise the portion of business transacted through supermarkets and online and thus raise perception as a branded consumer goods business.

Using 150p as a fair value would place the shares on an EV/sales multiple of 1.0x and a 14.8x P/E ratio. We summarise relative valuation in Figure 8.

Figure 8: Relative Valuation

	Share price	Shares	Mkt cap	Net debt	EV	Sales	EV/ sales	EBITDA	EV/ EBITDA	EPS	P/E	P/E	DPS	Yield
	(pence)	(m)	(£m)	(£m)	(£m)	2021 (£m)	(x)	2021 (£m)	(x)	2021 (p)	2021 (x)	2021 (x)	2021 (p)	
Accrol Group	62	311	193	5	198	153	1.3	15.6	12.7	n/a	n/a		50.0	nmf
Gear4Music	790	21	166	0	166	153	1.1	15.3	10.9	27.0	29.3		n/a	n/a
Luceco	260	154	401	8	409	188	2.2	37.9	10.8	15.0	17.3		6.0	2.3%
Portmeirion Group**	570	14	79	1	80	90	0.9	10.7	7.5	37.0	15.4		14.0	2.5%
UPGS	135	82	111	8	119	137	0.9	12.8	9.3	10.1	13.4		5.1	3.8%
Warpaint	87	77	66	-6	60	49	1.2	6.2	9.7	n/a	n/a		3.0	3.5%
Average							1.3		10.2		18.8			3.0%

Share prices are as at close 5th February 2021

Source: ADVFN, MarketScreener, various sites and Equity Development estimates

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