UP Global Sourcing Holdings

Well placed for sales growth acceleration in H2

29th March 2023

UPGS's interim results strongly suggest that the company is well placed for sales growth acceleration in H2 and to meet current market expectations. Online sales in H1 increased by 78% to represent 26% of group total, which is positive as this distribution channel has a smaller skew to H1 than others. Moreover, UPGS's brands continue to demonstrate an ability to gain market share and grow through volume rather than pricing. We reiterate our 250p fair value for the shares.

UPGS's interim results confirmed 2% first half sales growth to £87.6m which included a 78% increase in online sales. Gross profit margins increased from 24.4% to 24.7% while EBITDA was unchanged at £11.2m. Adjusted EPS fell by 5% in the period but the interim dividend increased by 6%, reflecting the underlying financial strength of the business. Our relative valuation in this report highlights a superior UPGS yield compared to its peer group.

Ongoing improvements in brand performance are an important component of the UPGS growth story. Salter showed the largest increase with a 35% gain, most of which was organic and aided by the current popularity of devices such as air-fryers with the benefit of UPGS now wholly owning the UK's oldest housewares brand. Importantly, UPGS's brand strength enables the company to gain market share and thus drive sales growth through volume not pricing.

Brand strength is a key component of UPGS's strength in online. The 78% increase in online revenue implied it was 26% of group sales in the period, not far short of the company's 30% long-term target for the channel which was upgraded from 15% in February 2021 at an investor event. Online sales not only deliver higher gross margins but also have less skew into H1: hence the potential for a marked acceleration in H2 sales expansion.

UPGS maintains significant headroom for revenue growth outside the UK. We note that, while international sales fell in the first half, underlying developments look positive. The Petra brand is making strong headway in the early stages of UPGS's ownership, and the company reported strong feedback from its return to the Ambiente Trade Fair in Frankfurt in February 2023. An inability to attend trade events during Covid lockdowns was likely to have constrained international sales.

We maintain our view that the company's current valuation does not fairly reflect UPGS's three key growth drivers - brands, online & supermarkets distribution, and international. With external headwinds easing, an H2 acceleration is in prospect. In addition, growth is volume driven off a strong financial base. **We base our 250p fair value / share assumption on an FY2023 EV/sales ratio of 1.5x, 12x EV/EBITDA and 16.6x P/E.**

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 adjusted (£'000)	**9,915**	**13,291**	**18,750**	**20,176**	**21,680**
EPS adjusted (p)	8.3	11.1	14.7	15.1	15.4
DPS (p)	**4.0**	**5.0**	**7.1**	**7.5**	**7.7**
EV/EBITDA (x)	15.0	11.2	7.9	7.4	6.8
P/E ratio (x)	**17.5**	**13.0**	**9.8**	**9.6**	**9.4**
Yield	2.7%	3.5%	4.9%	5.2%	5.3%

Source: Equity Development estimates, Company historic data

Company Data

EPIC	UPGS
Price (last close)	140p
52 weeks Hi/Lo	174p/90p
Market cap	£121m
ED Fair Value / share	250p

Share Price, p

Source: LSE

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.

Chris Wickham (Analyst)
0207 065 2690
chris@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

Well placed for sales growth acceleration in H2

Today's H1 FY2023 results announcement confirmed the 2% sales growth reported in the company's 14th February 2023 trading update, which we commented on in our report Online drives first half growth. The company also reconfirmed its expectations that full year market consensus expectations – which are broadly similar to our own forecasts – will be met. As a result, **we leave our full year FY2023 sales revenue, EBITDA and EPS forecasts unchanged**.

This report looks first at the interim results themselves before commenting in more detail on UPGS's vigorous focus on its brands, the importance and success of online and growth headroom. In addition, we highlight the investment case in our valuation section for **a business which is capable of gaining market share and growing volumes rather than seeking price inflation as a route to growth**.

Our overarching expectation remains that underlying medium term sales growth for UPGS is around 6%. Clearly, the recorded number was lower in H1. However, there is **good reason to expect a sharp acceleration in H2** as we discuss below.

Interim results in more detail

Results highlights

Highlights from today's interim statement are summarised in Figure 1 with the salient sales improvement being the sharp increase in online sales which was reflected in a faster rise in gross profits. They increased by 3% and delivered a gross margin improvement from 24.4% to 24.7%.

Given that EBITDA was flat, despite an increase in overall sales, there was an implicit decrease in EBITDA margins in H1 – i.e. from 13.1% to 12.8%. This should be recoverable as trading conditions with the company's retailer distribution channels – notably discounters and multiple retailers – begin to normalize.

Investors should also note that the company was not immune to cost inflation in the short term for operating expenses at a time when there is no inflationary impact on the company's sales. UPGS's sales growth tends to be volume driven, which in turn augurs positively for sustainability and valuation.

The sales to retailers growth was clearly negative but in our view should be seen as temporary. It reflects a tough consumer goods environment domestically and evidence of post-pandemic overstocking both of which should ease going forward – i.e. into H2. UK overstocking appears to be easing sooner.

Figure 1 - Interim results highlights

All figures in £m (6 months to 31st January)	FY2022 H1	FY2023 H1	Change
Revenue	85.7	87.6	+2%
Online revenue	12.8	22.9	+78%
Sales to retailers	72.9	64.7	-11%
Gross profit	20.9	21.6	+3%
Gross margin	24.4%	24.7%	+0.3pps
Adjusted EBITDA	11.2	11.2	-
Adjusted EPS (pence)	9.1	8.6	-5%
Interim dividend per share (pence)	2.30	2.43	+6%
Net bank debt/adjusted EBITDA	1.3x	1.0x	-0.3x

Source: Company data

UPGS's financial position remains strong as evidenced by the improvement in net bank debt to adjusted EBITDA ratio. Cash conversion was strong in H1 at 114% in terms of operating cash to operating profit.

This financial strength is reflected in the company's commitment to continue to pay out dividends to its shareholders on a sustainable basis of 50% of EPS or twice covered.

Outlook statement

In today's statement, UPGS's board anticipates that its full-year sales revenue performance for FY2023 will be in line with current expectations, which are slightly ahead of our own expectations. We remain slightly above this consensus on EBITDA and adjusted EPS but not materially so.

Figure 2 – Equity Development forecasts and consensus for FY2023

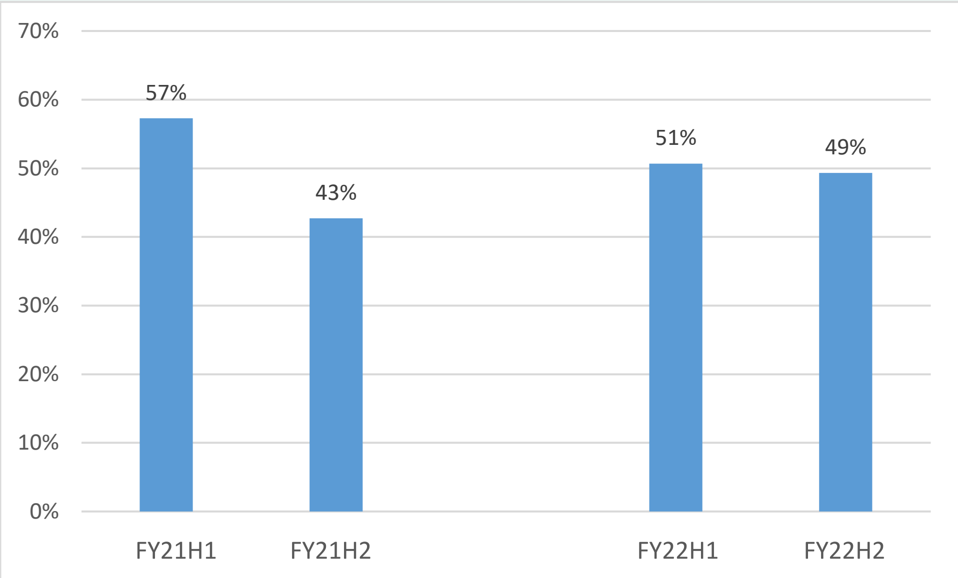
All figures in £m	ED	Consensus	Variance
Revenue	163.4	165.3	-1.1%
EBITDA	20.2	20.1	+0.4%
Adjusted EPS (pence)	15.1	14.8	+2.0%

Source: Company data and Equity Development estimates

For UPGS to match the consensus revenue expectation, the company would have to generate 13.5% sales growth in H2 and, to match our own expectations, growth of 11%. **The prospect of a sharp upswing in H2 sales growth should be aided by the current strength of online sales because there should be some reduction in the skew of UPGS's sales into H1, which includes pre-Christmas trading.**

Our expectation is for a 54% / 46% H1 / H2 split in FY2023 compared with 56% / 44% recorded in FY2022, with the rapid growth of online and an implicit reduction in the H1 sales skew for online being an important component of the H2 sales acceleration. The reduction in online skew between FY2022 and FY2023 is summarised in Figure 3.

Figure 3 – Online H1 / H2 sales splits in FY2021 and FY2022



Source: Company data and Equity Development estimates

Winning in brand management

UPGS announced on 6th December 2022 the appointment of Tracy Carroll to the newly created role of Brand Director. She joined the company from Helen of Troy, an American designer, developer and marketer of consumer brands, where she served as Associate Marketing Director and achieved success in the UK with the development of the OXO homeware brand.

Her appointment is consistent with UPGS increasingly operating as and being perceived as a **mainstream brand manager** which builds sales volume and revenue through the ownership of a select portfolio of brands and investing in and promoting those brands accordingly. In our view, the creation of the role and her appointment were important steps forward.

Success in the supermarket and online channels, which have steadily increased as a portion of UPGS's sales, remain an important indicator in our view of the **strength of a company's brands.** These channels, particularly online, require brands to be able to compete on a level playing field basis. With online, there is open transparency between competing brands in terms of brand recognition, price and product specification.

Salter leads the way in H1

Salter was UPGS's star performing brand in H1 with a 35% sales increase. Moreover, with nearly a full half year of outright ownership in FY2022 H1 the brand's sales growth can be perceived as almost all organic. UPGS has demonstrated its ability to acquire a brand outright, transfer its management and distribution into its own system and deliver substantial growth.

The company's ability to use Salter (the UK's oldest homewares brand) to spearhead its air fryers and energy saving devices offering was a significant driver of growth for both the brand and UPGS's online sales in the period. Details of the acquisition can be found in our 25 June 2021 report UPGS acquires UK's oldest housewares brand.

Smaller brands also made progress

The overall H1 sales performance by brand is summarised in Figure 4. Clearly, Beldray and Russell Hobbs (licensed) were in negative territory while Salter and the smaller brands made progress.

However, it should be noted that all three of the larger homeware brands to some extent compete for the same share of wallet with UPGS's customer base. As a result, a marked acceleration in sales growth for energy saving devices might be expected to affect sales of the other brands.

Figure 4 - FY2022 H1 and FY2023 H1 sales by brand

All figures in £'000s	FY2022 H1	FY2023 H1	Change
Salter	26,097	35,219	+35.0%
Beldray	23,892	17,174	-28.1%
Russell Hobbs (licensed)	13,371	10,546	-21.1%
Progress	3,865	4,005	+3.6%
Kleeneze	1,266	1,547	+22.2%
Premier brands	**68,491**	**68,491**	**0.0%**
Other proprietorial brands	9,154	10,721	+17.1%
Own label and other	8,101	8,394	+3.6%
Total	**85,746**	**87,606**	**+2.2%**

Source: Company data

Furthermore, all of the licensed Russell Hobbs products are non-electrical and would not have been expected to participate in the recent surge of interest in energy saving devices. The Premier brands overall were unchanged, which tends to confirm their resilience against some of the challenges in retail to which we referred earlier.

But the growth of both Kleeneze (impressive) and Progress reaffirms our confidence that UPGS is in a position to identify, acquire and grow underdeveloped brands. The most recent example was Petra which was acquired in February 2021 and is delivering on the key messages which we outlined in our report at the time of the acquisition - Petra acquisition to enhance international business. With £2m of sales, Petra's strong early headway is reflected in the 17% growth of "other proprietorial brands" in H1.

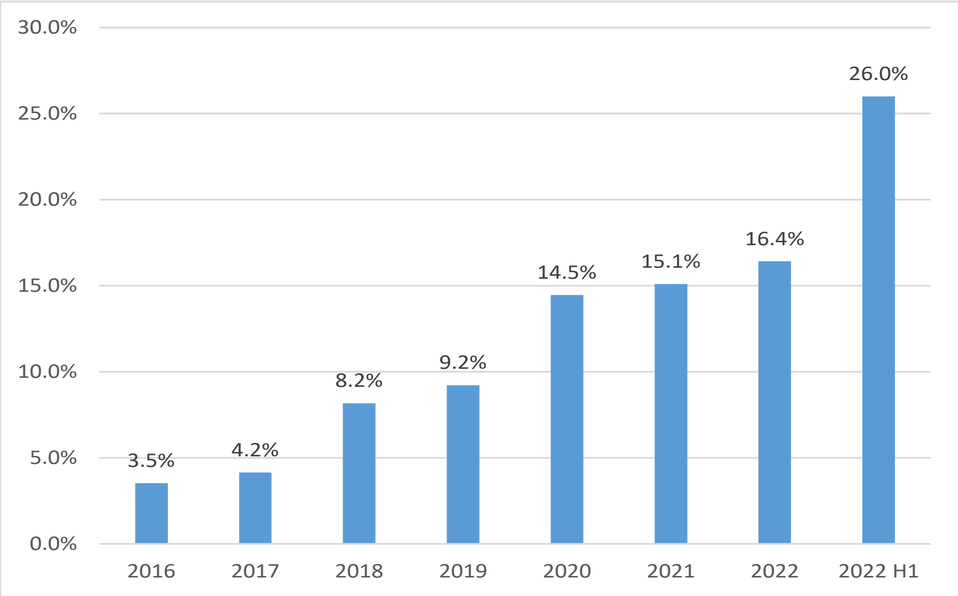
Clicks not bricks

The seasonality benefits – i.e. reduced sales skew into H1 – of having an increase in the proportion of sales driven by the online channels were covered in the results section of this report and illustrated in Figure 3.

Other important considerations include the higher gross margin deliverable by online sales relative to "bricks & mortar" distributors, and the ability of the channel to be a major source of growth acceleration between the H1 and H2 – i.e. what is required to meet our own and consensus forecasts.

UPGS publicly upgraded its internal target for online as a portion of the overall business at a Capital Markets Day on 16th February 2021 when the longer term objective was raised from 15% to 30%. Already this figure came close to its target in H1 when the achieved number was 26%. We summarise the progress of online as a portion of the business in Figure 5.

Figure 5 – Online as a portion of group sales – FY2016 to FY2023H1



Source: Company data

Online is currently largely a domestic distribution channel for UPGS. Going forward, investors should expect progress to be made internationally. We believe that, at this stage, the company is exploring the opportunity to expand Continental European online sales from their current arguably negligible level. International online sales should be seen as part of the company's significant headroom for growth.

H1 sales revenue by distribution channel is summarised in Figure 6. Online and multiple-store retailers were the only channels that grew in UPGS's H1, which is consistent with stock levels being insufficiently depleted in some areas of the retail system – i.e. as discussed earlier in this report.

Figure 6 - FY2022 H1 and FY2023 H1 sales by distribution channel			
All figures in £'000s	**FY2022 H1**	**FY2023 H1**	**Change**
Supermarkets	31,835	28,097	-11.7%
Online channels	12,835	22,904	+78.4%
Discount channels	25,109	21,063	-16.1%
Multiple-store retailers	9,220	10,966	+18.9%
Other	6,747	4,576	-32.2%
Total	**85,746**	**87,606**	**+2.2%**

Source: Company data

International – additional headroom for growth

UPGS's international credentials remain strong. **Between FY2014 and FY2022 overseas business doubled as a portion of overall sales revenue from 17.3% to 34.5%.** The retailer overstocking referred to earlier is particularly pertinent for the company's largest overseas market Germany and explains why business dropped by 25.0%. Elsewhere, Continental Europe delivered a positive result.

But underlying progress in Germany and other parts of Europe remain strong. As stated in the previous section there is currently negligible online activity in the region, so the company is reliant on growing its customer base within the larger scale operators and simultaneously its order book. H1 sales by geographical location are summarised in Figure 7.

Figure 7 - FY2022 H1 and FY2023 H1 sales by geographical location			
All figures in £'000s	**FY2022 H1**	**FY2023 H1**	**Change**
United Kingdom	56,718	62,569	+10.3%
Germany	11,771	8,825	-25.0%
Rest of Europe	14,866	15,642	+5.2%
Rest of the World	2,391	570	-76.2%
Total	**85,746**	**87,606**	**+2.2%**
International sales	29,028	25,037	-13.7%
International as a portion of total	**33.9%**	**28.6%**	

Source: Company data

UPGS continues to invest strongly in its international business, as evidenced by the company's return to the Ambiente consumer goods trade fair in Frankfurt in February this year. The fair, which proclaims to be the largest in its sector in Europe, is an important part of UPGS's strategy to grow brand awareness in the strategically important European market. International is clearly already important in its own right given an underlying run rate of close to one third of the business. However, it also represents significant headroom for UPGS to expand using its core competences – organic brand development and product distribution.

Outside organic growth, international should also be seen as a potential source of further value added in terms of M&A activity. That Petra – which was acquired for a non-disclosable sum – should already be delivering H1 sales of £2m confirms the company's ability opportunistically to acquire brand led businesses internationally in the way that it has done in the UK.

Valuation and financials

Relative valuation

Favourably valued by multiple measures

A relative valuation for UPGS based on a peer group of companies is shown in Figure 8. The company trades at a slight discount to this peer group on both EV/sales and EV/EBITDA and more pronounced discounts 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 component of the investment case, in our view. Moreover, we highlight that demand growth for the company's branded goods and its ability to meet that demand with product is unlikely to be constrained by its financial position.

The interim dividend was increased by 6% from a year earlier, which is consistent with our expectations for underlying sales revenue growth.

Volume driven growth argues positively for valuation

UPGS's revenue growth has historically been volume driven rather than through price inflation. The clearest example of this is the company's sharp increase in online sales in H1. Our assumption is that actual SKU by SKU price trends are probably trending slightly negatively – perhaps as much as 1%. If we are correct, the H1 sales revenue gain would have been driven by around 3% volume growth.

In our view, companies which generate volume driven growth in a category with relatively stable pricing deserve some valuation credit. In particular, they are demonstrating an ability to use their brand management and distribution skills to gain market share which is in itself a growth engine.

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

Figure 8 - Relative valuation

	Share price (p)	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 (x)	DPS 2023 (p)	YLD %
Accrol (ACRL)	32	100	61	161	230	0.7	15.5	10.4	1.8	17.3	0.4	1.2
Gear4Music (G4M)	86	19	34	53	155	0.3	8.9	5.9	3.8	22.6		
Luceco (LUCE) *	118	186	38	225	204	1.1	24.9	9.0	9.2	12.8	4.3	3.7
Portmeirion (PMP) *	368	52	6	58	110	0.5	14.7	3.9	52.0	7.1	17.3	4.7
Procook (PROC)	32	36	24	60	61	1.0	5.7	10.6		nm		
UPGS (UPGS)	**140**	**121**	**24**	**145**	**163**	**0.9**	**20.2**	**7.2**	**15.1**	**9.3**	**7.4**	**5.4**
Warpaint (W7L) *	201	154	-1	153	50	2.3	11.6	13.2	9.9	20.3	6.8	3.4
Average						**1.0**		**8.6**		**14.9**		**3.7**

** Refers to FY2022 data*

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

Financial forecasts

Given the company's comment in today's statement that the Board anticipates a full year performance in line with current expectations, we leave our forecasts broadly unchanged from our 14th February 2023 report Online drives first half growth, which was at the time of the company's FY2023 H1 trading update.

Our FY2023 sales revenue and EBITDA forecasts are left unchanged. However, we have increased our finance charge expectation and have therefore reduced our EPS forecasts for FY2023 and FY2024 accordingly, as mentioned earlier in this report.

We summarise our income statement, balance sheet and free cash flow projections for FY2023 and FY2024 in Figures 9, 10 and 11.

Figure 9 - 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	-1,400	-1,286
Pre-tax profit - adjusted	**11,150**	**15,843**	**16,660**	**18,228**
Taxation	-2,423	-3,120	-3,632	-4,967
Tax rate (%) - adjusted	21.7%	19.7%	21.8%	27.3%
EPS - basic adjusted (p)	**11.1**	**14.7**	**15.1**	**15.4**
Dividend per share (pence)	**5.0**	**7.1**	**7.4**	**7.7**

Source: ED estimates, Company historic data

Figure 10 - Balance sheet

All figures in £'000s

31st July year end	2021A	2022A	2023E	2024E
Assets				
Intangible assets	36,929	37,025	37,025	37,025
Property, plant and equipment	5,719	6,369	6,192	6,041
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**	**68,363**
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			
Borrowings	7,951	16,294	15,292	11,336
Lease liabilities	771			
Deferred consideration	990	987		
Total current liabilities	**39,383**	**47,912**	**45,631**	**41,547**
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	1,000	1,093
Retained earnings	18,788	26,102	32,616	39,247
Total equity	**32,055**	**43,493**	**48,004**	**55,198**
Total equity and liabilities	**91,445**	**109,074**	**109,136**	**111,430**

Source: Equity Development estimates, Company historic data

Figure 11 - Free cash flow

All figures in £'000s				
31st July year-end	**2021A**	**2022A**	**2023E**	**2024E**
Profit for the period	7,313	12,370	13,028	13,261
Adjustments for:				
Finance costs (net)	518	842	1,400	1,286
Income tax expense	2,423	3,120	3,632	4,967
Depreciation and impairment	1,607	2,044	2,094	2,144
Amortisation	16	22	16	16
Derivative financial instruments	-678			
Share based payments	228	403	403	403
Income taxes paid	-2,566	-2,345	-3,802	-4,967
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**	**12,269**	**14,537**
Cash flows used in investing activities				
Acquisition of a business	-30,578	-851	-1,000	
PP&E	-2,263	-1,843	-1,917	-1,993
Proceeds from P, P & E disposals	3			
Repayment of lease liabilities			-750	-750
Total	**-32,949**	**-2,694**	**-3,667**	**-2,743**
Free cash flow before financing	**-23,516**	**778**	**8,602**	**11,794**
Interest paid	-335	-850	-1,400	-1,286
Free cash flow before dividends etc	**-9,501**	**-72**	**7,202**	**10,508**
Dividends paid	-4,409	-4,830	-6,200	-6,553
Free cash flow after dividends etc	**-13,908**	**-4,529**	**1,002**	**3,955**

Source: ED estimates, company historic data

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

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More information is available on our website www.equitydevelopment.co.uk

Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London EC2M 7EB

Contact: info@equitydevelopment.co.uk | 020 7065 2690