

GEAR4MUSIC

CONSUMER DISCRETIONARY

21 April 2022

G4M.L

360p

Market Cap: £75.4m

SHARE PRICE (p)



12m high/low

1,010p/360p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(13.4)m (at 30/09/21)
Enterprise value	£88.8m
Index/market	AIM
Next news	Prelims - June 2022
Shares in Issue (m)	21.0
Chairman	Ken Ford
Chief Executive	Andrew Wass
CFO	Chris Scott

COMPANY DESCRIPTION

Gear4music is a leading international online retailer of musical instruments and equipment.

www.gear4musicplc.com

GEAR4MUSIC IS A RESEARCH CLIENT OF
PROGRESSIVE

ANALYSTS

David Jeary

+44 (0) 20 7781 5306

djeary@progressive-research.com



www.progressive-research.com

Weaker end to year; outlook moderated to reflect broader consumer uncertainty

G4M has released its FY22 full-year trading update. Widely reported macroeconomic factors impacting consumer confidence have seen weaker-than-expected sales in February and March. While gross margin has remained strong, this has resulted in lower sales and EBITDA relative to consensus expectations. With overhead cost pressure compounding weaker consumer confidence, especially in H1 FY23E, we believe accordingly that it is prudent to revise outer year forecasts, summarised in the table below and detailed within this note. Strong stock levels will support G4M's distribution capability, particularly in the new European distribution centres.

- Trading update details.** While G4M's full-year trading update showed revenues down 6% against the exceptional performance of FY21, this represented a 23% increase over the pre-Covid FY20 year. Weaker-than-expected sales in February and March into the year-end mean FY22 sales are around £1.6m or 1.1% lower than consensus expectations. UK sales rose 5% while Europe and Rest of World sales fell 18% against FY21, although they were up 34% and 11%, respectively, against FY20. Gross margin of 27.8% is strong, with G4M retaining over half of the margin gain achieved in FY21. The lower sales figure translates into an EBITDA of £11.0m compared with consensus market expectation of £12.0m. With regard to the future, inventory levels are strong across all distribution centres, which will support sales conversion in FY23E.
- Outlook.** The shorter-term outlook for G4M is characterised by the pincer effect of weaker consumer expenditure and operating cost inflation. Discretionary consumer expenditure is under pressure from price inflation in food, energy and tax increases in the UK. These inflationary pressures are in turn fuelling wage inflation for all retailers, which like consumers are also having to cope with increased energy and other costs.
- Forecasts.** In light of this outlook and the lower FY22 base detailed above, we feel it is prudent to revise our forecasts for FY23E and FY24E. These include the AV Distribution acquisition, which will be run as an additional AV.com domain within the group. While G4M is continuing to forecast double-digit sales growth in FY23E and FY24E, our revisions equate to mid-single-digit turnover decreases on previous guidance. These result in FY23E and FY24E EBITDA falling 21% and 22%, respectively, to £11.9m and £14.0m. Fuller details of these changes are outlined overleaf.

FYE MAR (£M)	2020	2021	2022E	2023E	2024E
Revenue	120.3	157.5	147.6	165.0	180.9
Adj EBITDA	7.8	19.8	11.0	11.9	14.0
Fully Adj PBT	3.1	14.6	4.8	3.8	5.2
Fully Adj EPS (p)	12.2	59.7	18.5	14.7	20.1
EV/Sales (x)	0.7x	0.6x	0.6x	0.5x	0.5x
EV/EBITDA (x)	11.5x	4.5x	8.1x	7.5x	6.4x
PER (x)	29.4x	6.0x	19.4x	24.5x	17.9x

Source: Company Information and Progressive Equity Research estimates.

This publication should not be seen as an inducement under MiFID II regulations.

Please refer to important disclosures at the end of the document.

Choppy waters ahead in the short term

G4M's FY22 performance will deliver an adjusted EBITDA of £11.0m on a reported basis, translating into an EBITDA margin of 7.5%. While down against the exceptional performance as a Covid beneficiary in FY21, compared with the pre-Covid performance in FY20 this represents a 42% increase with a two-year compound growth rate (CAGR) of just under 20%. The EBITDA margin is some 100bps above that achieved in FY20. This marks very solid progress on a smoothed basis, with further progress set to be underpinned by investments in incremental distribution centres on the continental European mainland to mitigate post-Brexit difficulties. European trading should continue to improve from the extended infrastructure base laid down, especially now that higher stock levels have been built up and established.

Short-term prospects will, however, be tempered by the inflationary pressures emerging globally and adversely affecting most industries as well as consumer confidence and discretionary spending. The impact of rising food and energy costs, compounded in the UK by rising taxes, will inevitably squeeze consumer expenditure, most likely on more discretionary items. Against such a backdrop, maintaining or better still growing market share becomes a key objective for retailers. G4M's outlook remains positive in this regard, given its increasing product ranges, its recently opened distribution centres in Spain and Ireland, and the integration of its AV acquisition and the recently launched AV.com onto its proprietary platform, where it will operate as an additional and complementary domain.

Trading details

The following table details the full-year sales performance of G4M over the last three years. This enables comparison against the pre-Covid FY20 trading period as well as the tough comparative FY21, when G4M was a beneficiary of the Covid lockdowns and people working from home. We have also extrapolated the Q4 sales figures for these three years, and calculated the respective growth performances, both year on year and against Q4 FY20 for the FY22 Q4 period.

Trading update details and prior-year comparisons						
Sales (£m)	FY22	FY21	FY20	Q4 FY22	Q4 FY21	Q4 FY20
UK	82.6	78.7	61.8	19.9	19.0	16.1
International	65.0	78.8	58.5	15.8	16.1	14.5
Total	147.6	157.5	120.3	35.7	35.1	30.6
Change on prior year period (%)	FY22	FY21	FY20	Q4 FY22	Q4 FY21	Q4 FY20
UK	5%	27%	n.a.	5%	18%	n.a.
International	-18%	35%	n.a.	-2%	11%	n.a.
Total	-6%	31%	n.a.	2%	15%	n.a.
Change over FY20 period (%)	FY22			Q4 FY22		
UK	34%			24%		
International	11%			9%		
Total	23%			17%		
Gross margin (%)	27.8%	29.5%	25.9%	n.a.	n.a.	n.a.

Source: G4M, Progressive Equity Research

It can be seen that despite the European and total group sales being down for FY22, by 18% and 6%, respectively, against the prior FY21 year, they were up 11% and 23% against the more comparable pre-Covid FY20 year. In Q4, UK sales rose 5%, and were up 24% against the equivalent period in FY20. Non-UK sales were down 2% in Q4 but increased by 9% over Q4 FY20. Group sales rose 2% in total in Q4, up 17% on a two-year basis.

The gross margin performance has been strong, showing a gain of 190bps over FY20. While this was down on last year's exceptional figure, G4M has delivered on its objective to retain a substantial proportion of last year's gain of 360bps. Over 50% of that gain has been retained in FY22.

Ahead of this update, G4M believes that consensus market expectations were for turnover of £149.2m, with EBITDA of £12.0m. Turnover has fallen just 1% shy of consensus, with EBITDA down £1m against expectations. This figure is stated after inclusion of £0.2m of one-off M&A costs, and £0.3m of share option costs.

Forecast changes

The following table includes the summary headline changes for our forecasts over the FY22E to FY24E period. These now include the AV Distribution acquisition, which will be run as an additional (AV.com) domain within the group. AV.com has been recently launched and will make a full-year contribution in FY23E. G4M is still forecasting good double-digit revenue growth for FY23E and FY24E, though lower than previously forecast. Our forecast revisions consequently show mid-single-digit turnover decreases compared with our previous forecasts. Our gross margin forecasts show erosion of 50bps and 40bps, respectively, for FY23E and FY24E to 27.4% and 27.5%, though comfortably ahead of FY20's level of 25.9%. These changes result in EBITDA falling 21% and 22%, respectively, to £11.9m and £14.0m. Higher DA and financial charges lead to a greater impact at the PBT and EPS level in FY23E and FY24E in particular.

Summary of key forecast changes

£m unless stated	FY22E			FY23E			FY24E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	150.5	147.6	(2%)	171.7	165.0	(4%)	190.9	180.9	(5%)
Adj EBITDA	12.1	11.0	(9%)	15.1	11.9	(21%)	17.8	14.0	(22%)
Fully adj PBT	5.6	4.8	(14%)	7.6	3.8	(50%)	9.7	5.2	(46%)
Fully adj EPS (p)	21.5	18.5	(14%)	29.4	14.7	(50%)	37.5	20.1	(46%)

Source: Progressive Equity Research estimates

We have assumed an increase in balance sheet inventory to just under £43m for FY22E, with the group looking to support sales conversion across all its distribution centres, but particularly the most recently opened ones in Spain and Ireland to complement those in Germany and Sweden. This, together with the AV Distribution acquisition, is the key driver of our forecast cash outflow in FY22E, resulting in year-end net debt of around £24m. It should, of course, be remembered that unlike fashion or food retailers, there is effectively no stock risk to G4M from this higher inventory level. Indeed, the company has a proven track record of being able to manage its inventory levels, such that we assume a reduction in overall inventory in FY23E.

The following tables show our more detailed profit & loss account, cash flow and balance sheet forecasts.

The group will announce its full-year results in June.

G4M – Summary of profit & loss account and cash flow forecasts

Profit and loss account	IAS17	IFRS16	IFRS16	IFRS16	IFRS16	IFRS16
Year to March	FY19 (13 m)	FY20	FY21	FY22E	FY23E	FY24E
Turnover	118.2	120.3	157.5	147.6	165.0	180.9
Cost of sales	(91.2)	(89.2)	(111.1)	(106.6)	(119.8)	(131.2)
Gross profit	26.9	31.2	46.4	41.0	45.2	49.8
<i>Gross margin (GM) (%)</i>	<i>22.8%</i>	<i>25.9%</i>	<i>29.4%</i>	<i>27.8%</i>	<i>27.4%</i>	<i>27.5%</i>
Operating costs	(26.9)	(27.1)	(30.9)	(35.3)	(39.9)	(43.0)
Operating profit	(0.0)	4.1	15.4	5.7	5.3	6.7
<i>Operating profit margin (%)</i>	<i>0.0%</i>	<i>3.4%</i>	<i>9.8%</i>	<i>3.9%</i>	<i>3.2%</i>	<i>3.7%</i>
Depreciation and amortisation	(2.3)	(3.7)	(4.3)	(5.294)	(6.6)	(7.3)
EBITDA	2.3	7.754	19.8	11.0	11.9	14.0
<i>EBITDA margin (%)</i>	<i>1.9%</i>	<i>6.4%</i>	<i>12.5%</i>	<i>7.4%</i>	<i>7.2%</i>	<i>7.7%</i>
Interest charge	(0.6)	(1.0)	(0.8)	(0.9)	(1.5)	(1.5)
Adjusted PBT	(0.6)	3.1	14.6	4.8	3.8	5.2
Exceptional charges	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	(0.6)	3.1	14.6	4.8	3.8	5.2
Adjusted diluted EPS (p)	(0.8)	12.2	59.7	18.5	14.7	20.1
Diluted EPS (p)	(0.8)	12.2	59.7	18.5	14.7	20.1
Dividend (p)	0.0	0.0	0.0	0.0	0.0	0.0
Cash flow	FY19 (13 m)	FY20	FY21	FY22E	FY23E	FY24E
Operating profit	(0.0)	4.1	15.4	5.7	5.3	6.7
Depreciation and amortisation	2.3	3.7	4.3	5.3	6.6	7.3
Inventory (increase)/decrease	(1.6)	(3.4)	(6.4)	(14.4)	8.1	(1.5)
Debtors (increase)/decrease	1.0	(0.8)	(1.1)	(0.0)	(0.3)	(0.3)
Creditors increase/(decrease)	0.5	3.3	2.6	1.8	(2.5)	0.8
Other	(0.3)	0.4	0.0	0.0	0.0	0.0
Operating cash flow	2.0	7.2	14.9	(1.6)	17.3	13.0
Interest	(0.4)	(0.8)	(0.8)	(0.9)	(1.5)	(1.5)
Tax	0.6	0.5	(1.9)	(0.9)	(0.7)	(0.9)
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Deferred tax	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	(4.5)	(3.6)	(4.4)	(10.7)	(7.0)	(7.0)
Trading cash flow	(2.3)	3.3	7.7	(14.1)	8.1	3.6
Acquisition of businesses	(0.4)	(0.4)	(0.2)	(11.5)	0.0	0.0
Disposal of businesses	0.0	0.0	0.0	0.0	0.0	0.0
Share issues	0.1	0.0	0.0	0.0	0.0	0.0
Currency effects, other	0.0	(1.0)	0.7	(1.1)	(1.1)	(1.0)
Net cash inflow/(outflow)	(2.5)	2.0	8.2	(26.7)	7.0	2.5
Net (debt)/cash	(7.5)	(5.5)	2.7	(24.0)	(17.0)	(14.5)

Source: G4M, Progressive Equity Research estimates

G4M – Summary of balance sheet forecasts

Balance sheet	IAS17	IFRS16	IFRS16	IFRS16	IFRS16	IFRS16
Year to March	FY19 (13 m)	FY20	FY21	FY22E	FY23E	FY24E
Tangible fixed assets	10.8	20.2	19.1	18.3	17.3	16.1
Intangible fixed assets	7.8	9.1	10.4	16.6	18.0	18.9
Investments and other	0.0	0.0	0.0	0.0	0.0	0.0
Total fixed assets	18.6	29.3	29.5	34.9	35.3	35.0
Stock	18.7	22.0	28.4	42.8	34.7	36.2
Trade and other debtors	1.7	2.5	3.6	3.6	3.9	4.2
Deferred tax	0.0	0.0	0.0	0.0	0.0	0.0
Cash and short term deposits	5.3	7.8	6.2	2.0	5.5	4.5
Current assets	25.6	32.4	38.2	48.4	44.0	44.9
Total assets	44.2	61.6	67.7	83.3	79.3	79.9
Trade and other payables	(11.5)	(14.4)	(18.9)	(20.7)	(18.2)	(19.0)
Borrowings	(8.6)	(9.9)	(0.6)	0.0	0.0	0.0
Other current liabilities	0.0	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)
Current liabilities	(20.1)	(25.5)	(20.6)	(21.8)	(19.3)	(20.1)
Borrowings	(4.3)	(3.4)	(2.9)	(12.7)	(9.2)	(5.7)
Other non-current liabilities	(1.1)	(11.0)	(9.8)	(9.8)	(9.8)	(9.8)
Non-current liabilities	(5.4)	(14.5)	(12.8)	(22.5)	(19.0)	(15.5)
Total liabilities	(25.5)	(40.0)	(33.4)	(44.4)	(38.3)	(35.7)
Net assets	18.7	21.6	34.3	38.9	41.0	44.2

Source: G4M, Progressive Equity Research estimates

Financial Summary: Gear4music

Year end: March (£m unless shown)

PROFIT & LOSS	2020	2021	2022E	2023E	2024E
Revenue	120.3	157.5	147.6	165.0	180.9
Adj EBITDA	7.8	19.8	11.0	11.9	14.0
Adj EBIT	4.1	15.5	5.9	5.6	7.0
Reported PBT	3.1	14.6	4.8	3.8	5.2
Fully Adj PBT	3.1	14.6	4.8	3.8	5.2
NOPAT	3.5	13.4	4.8	4.6	5.7
Reported EPS (p)	12.2	59.7	18.5	14.7	20.1
Fully Adj EPS (p)	12.2	59.7	18.5	14.7	20.1
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET	2020	2021	2022E	2023E	2024E
Operating cash flow	7.2	14.9	(1.6)	17.3	13.0
Free Cash flow	3.3	7.7	(14.1)	8.1	3.6
FCF per share (p)	15.9	36.6	(67.1)	38.6	17.0
Acquisitions	(0.4)	(0.2)	(11.5)	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.0	0.0	0.0
Net cash flow	2.0	8.2	(26.7)	7.0	2.5
Overdrafts / borrowings	(13.4)	(3.5)	(12.7)	(9.2)	(5.7)
Cash & equivalents	7.8	6.2	2.0	5.5	4.5
Net (Debt)/Cash	(5.5)	2.7	(10.7)	(3.7)	(1.2)
NAV AND RETURNS	2020	2021	2022E	2023E	2024E
Net asset value	21.6	34.3	38.9	41.0	44.2
NAV/share (p)	103.2	163.7	185.7	195.3	210.9
Net Tangible Asset Value	12.5	24.0	22.3	22.9	25.3
NTAV/share (p)	59.8	114.3	106.6	109.4	120.7
Average equity	20.2	27.9	36.3	39.8	43.5
Post-tax ROE (%)	72.4%	17.2%	10.5%	13.1%	16.6%
METRICS	2020	2021	2022E	2023E	2024E
Revenue growth	1.8%	30.9%	(6.3%)	11.8%	9.6%
Adj EBITDA growth	239.8%	154.9%	(44.4%)	8.2%	17.4%
Adj EBIT growth	8146.0%	275.3%	(61.8%)	(5.2%)	25.1%
Adj PBT growth	(605.4%)	373.9%	(67.1%)	(20.7%)	36.9%
Adj EPS growth	(1670.4%)	388.3%	(68.9%)	(20.7%)	36.9%
Dividend growth	N/A	N/A	N/A	N/A	N/A
Adj EBIT margins	3.4%	9.8%	4.0%	3.4%	3.9%
VALUATION	2020	2021	2022E	2023E	2024E
EV/Sales (x)	0.7	0.6	0.6	0.5	0.5
EV/EBITDA (x)	11.5	4.5	8.1	7.5	6.4
EV/NOPAT (x)	25.6	6.6	18.3	19.3	15.4
PER (x)	29.4	6.0	19.4	24.5	17.9
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	4.4%	10.2%	(18.6%)	10.7%	4.7%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

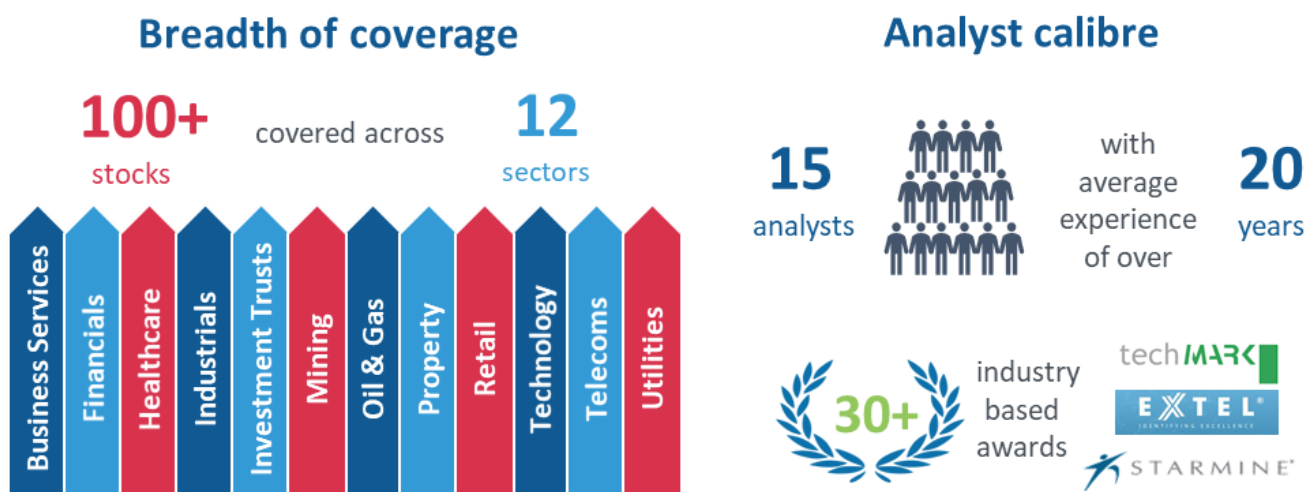
Copyright 2022 Progressive Equity Research Limited (“PERL”). All rights reserved. Progressive’s research is commissioned by the subject company under contract and is freely available to the public and all institutional investors. Progressive does not offer investors the ability to trade securities. Our publications should not, therefore, be considered an inducement under MiFID II regulations. PERL provides professional equity research services, and the companies researched pay a fee in order for this research to be made available. This report has been commissioned by the subject company and prepared and issued by PERL for publication in the United Kingdom only. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable; however, PERL does not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of PERL at the time of publication, and any estimates are those of PERL and not of the companies concerned unless specifically sourced otherwise. PERL is authorised and regulated by the Financial Conduct Authority (FCA) of the United Kingdom (registration number 697355).

This document is provided for information purposes only, and is not a solicitation or inducement to buy, sell, subscribe, or underwrite securities or units. Investors should seek advice from an Independent Financial Adviser or regulated stockbroker before making any investment decisions. PERL does not make investment recommendations. Any valuation given in a research note is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. PERL does not undertake to provide updates to any opinions or views expressed in this document.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom. It has not been prepared in accordance with the legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research.

PERL does not hold any positions in the securities mentioned in this report. However, PERL’s directors, officers, employees and contractors may have a position in any or related securities mentioned in this report. PERL or its affiliates may perform services or solicit business from any of the companies mentioned in this report.

The value of securities mentioned in this report can fall as well as rise and may be subject to large and sudden swings. In addition, the level of marketability of the shares mentioned in this report may result in significant trading spreads and sometimes may lead to difficulties in opening and/or closing positions. It may be difficult to obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance.



To arrange a meeting with the management team, or for further information about Progressive, please contact:

Keith Hodgskiss
+44 (0) 20 7781 5300
khodgskiss@progressive-research.com