

GEAR4MUSIC

CONSUMER DISCRETIONARY

9 September 2022

G4M.L

133p

Market Cap: £27.8m

SHARE PRICE (p)



12m high/low

990p/133p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(24.2)m (at 31/03/22)
Enterprise value	£52m
Index/market	AIM
Next news	H1 update - 20 Oct
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

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Lack of visibility on consumer sentiment upturn prompts more prudent guidance

Gear4music's AGM trading update has reported sales growth in Q1 against tough comparatives. Trading over July and August was, however, impacted by the combination of extremely hot weather and the cost of living crisis, which has dampened discretionary consumer spending. While sales growth has picked up in September, the company believes it prudent to rein back full-year expectations given the prevailing market conditions. G4M is pointing to FY23E revenue of c.£155m with EBITDA of £9m.

- Positive Q1 – with softer-than-expected Q2.** G4M achieved Q1 sales growth against tough comparatives, despite a weaker consumer environment, to start the year well. A return to more-normalised trading patterns was expected to see lower levels of demand over the summer months, but July and August were weaker than anticipated because of the weather and economic factors mentioned above. September trading has improved, but against a still uncertain consumer backdrop ahead of the peak trading season, G4M is prudently guiding to a lower FY23E outturn.
- Good progress from investments – European hubs and AV.com.** G4M has reported strong results from last year's investment in extending its European hub infrastructure. AV.com is also reported as continuing to make good progress following its integration on the G4M platform.
- Forecast revisions – prudent moderation of expectations.** We have revised our FY23E forecasts to be broadly in line with G4M's guidance. Our outer-year forecasts for FY24E and FY25E have also been revised to reflect the lower base for FY23E. Summary details can be seen below, with further commentary overleaf. The current cost of living crisis, resulting from a convergence of global factors, has undoubtedly dampened consumer spending and confidence, as shown by the most recent GfK consumer confidence index hitting an all-time low. It remains too early to judge the extent to which government measures to mitigate the cost of living crisis will support an uplift in areas of discretionary consumer expenditure, but G4M remains well-positioned and funded to deliver on its medium- and longer-term growth strategy, in our view.
- Next newsflow.** G4M will give an H1 trading update on 20 October, with its interim results for the period to be published on 15 November.

FYE MAR (£M)	2021	2022	2023E	2024E	2025E
Revenue	157.5	147.6	155.6	171.1	188.4
Adj EBITDA	19.8	11.2	8.9	11.9	14.6
Fully Adj PBT	14.6	5.0	1.1	3.3	5.4
Fully Adj EPS (p)	59.7	17.3	3.9	11.3	18.4
EV/Sales (x)	0.3x	0.4x	0.3x	0.3x	0.3x
EV/EBITDA (x)	2.6x	4.6x	5.8x	4.4x	3.6x
PER (x)	2.2x	7.7x	33.7x	11.7x	7.2x

Source: Company Information and Progressive Equity Research estimates.

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Forecast revisions

While trading patterns have been broadly in line with expectations, including some realignment of demand from the summer to winter months, it appears that the trends have been slightly more negative on the downside and less positive on the recent upside than expected. Approaching the peak trading period, with its more operationally geared benefits, G4M has sensibly opted to prudently revise full-year expectations. Trading in July and August was adversely impacted by a combination of factors, including extremely hot weather across Europe, heightened consumers fears of a cost of living squeeze from inflationary price pressures, not only for energy but also food and other essentials, and a return to holidays and leisure activities as Covid restrictions have eased.

The government's announcement on freezing the energy price cap will help to allay consumers' fears on the cost of living crisis but will not banish them completely. The measure will hopefully see consumer confidence improve from its current low level, which in turn may drive retail sales and help to deliver a more positive peak trading period for retailers. It remains too early to make this call however, hence G4M's prudent decision to moderate market expectations.

We have revised our estimates across our forecasting horizon, not just for FY23E, assuming a more prudent rate of recovery from the lowered FY23E base. Our FY23E forecast reflects the company's guidance. Our revenue reduction of 6% still equates to FY23E sales growth of just over 5% against FY22. G4M is clearly seeing positive results from its extended European distribution centre network. With the newer hubs better stocked than at launch, in terms of both breadth and depth of inventory, we assume that not only the host countries (Spain and Republic of Ireland) but also adjacent markets are delivering improved sales performance.

The following table summarises our headline revisions for the period up to FY25E. Top-line sales performance is around 5% lower for all forecast years, but with greater reductions at EBITDA and PBT levels. The latter also have a knock-on impact on forecast levels of year-end net debt across the period, though the company retains good headroom within its facilities and covenants within our new forecasts.

Summary of headline forecasts revisions – FY23E to FY25E

£m unless stated	FY23E			FY24E			FY25E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	165.1	155.6	(6%)	181.0	171.1	(5%)	199.2	188.4	(5%)
Adj EBITDA	11.9	8.9	(25%)	14.0	11.9	(15%)	16.7	14.6	(12%)
Fully adj PBT	3.8	1.1	(70%)	5.2	3.3	(37%)	7.2	5.4	(25%)
Fully adj EPS (p)	13.1	3.9	(70%)	17.9	11.3	(37%)	24.7	18.4	(25%)

Source: Progressive Equity Research

The following table looks at the three-year compound annual growth rate (CAGR) up to FY25E. This still shows high-single-digit growth at both revenue and EBITDA level, at 8.5% and 9.3%, respectively. Following a drop in EBITDA margin in FY23E, our forecasts show recovery in the following two years, with the 7.8% EBITDA margin forecast for FY25E being 20bps above that achieved in FY22.

Forecast summary and 3-year CAGR to FY25E (£m unless stated)

	FY22	FY23E	FY24E	FY25E	3-yr CAGR
Revenue	147.6	155.6	171.1	188.4	8.5%
Gross profit	41.1	41.5	47.0	52.6	8.5%
<i>Gross margin (%)</i>	27.9%	26.7%	27.5%	27.9%	
Operating costs (exc DA)	29.9	32.6	35.2	37.9	8.2%
<i>Opex as % of turnover</i>	20.3%	21.0%	20.6%	20.1%	
EBITDA	11.2	8.9	11.9	14.6	9.3%
<i>EBITDA margin (%)</i>	7.6%	5.7%	6.9%	7.8%	
Operating profit	6.1	2.6	4.8	6.9	4.3%
<i>Operating margin (%)</i>	4.1%	1.7%	2.8%	3.7%	
Adjusted pre-tax profit	5.0	1.1	3.3	5.4	2.4%
Adjusted diluted EPS (p)	17.3	3.9	11.3	18.4	2.2%
Net cash/(debt)	(24.2)	(17.9)	(17.0)	(12.1)	

Source: Progressive Equity Research

G4M has a good track record of managing both inventory and costs, which should help to mitigate inflationary pressures. The company is well stocked, with many purchases secured at more favourable rates in the previous six to 12 months. This could provide good commercial opportunities in H2 and over the peak trading period. We would expect to see further strong management of variable costs, with lower marketing costs accruing from the lower levels of turnover. We understand that the sales mix has continued to adversely impact gross margin, with lower sales of higher-margin own-brand inventory. For this reason, we have reduced our gross margin assumption by 70bps in FY23E to 26.7% but have left our outer-year assumptions unchanged.

The following tables give fuller details of our forecasts.

Summary of profit & loss account and cash flow forecasts (£m unless stated)

Profit and loss account	IFRS16	IFRS16	IFRS16	IFRS16	IFRS16	IFRS16
Year to March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Revenue	120.3	157.5	147.6	155.6	171.1	188.4
Cost of sales	(89.2)	(111.1)	(106.5)	(114.1)	(124.0)	(135.8)
Gross profit	31.2	46.4	41.1	41.5	47.0	52.6
<i>Gross margin (GM) (%)</i>	<i>25.9%</i>	<i>29.4%</i>	<i>27.9%</i>	<i>26.7%</i>	<i>27.5%</i>	<i>27.9%</i>
Operating costs	(27.1)	(30.9)	(35.1)	(38.9)	(42.3)	(45.7)
Operating profit	4.1	15.4	6.1	2.6	4.8	6.9
<i>Operating profit margin (%)</i>	<i>3.4%</i>	<i>9.8%</i>	<i>4.1%</i>	<i>1.7%</i>	<i>2.8%</i>	<i>3.7%</i>
Depreciation and amortisation	(3.7)	(4.4)	(5.1)	(6.3)	(7.1)	(7.8)
EBITDA	7.8	19.8	11.2	8.9	11.9	14.6
<i>EBITDA margin (%)</i>	<i>6.4%</i>	<i>12.6%</i>	<i>7.6%</i>	<i>5.7%</i>	<i>6.9%</i>	<i>7.8%</i>
Interest charge	(1.0)	(0.8)	(1.1)	(1.5)	(1.5)	(1.5)
Adjusted PBT	3.1	14.6	5.0	1.1	3.3	5.4
Exceptional charges	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	3.1	14.6	5.0	1.1	3.3	5.4
Adjusted diluted EPS (p)	12.2	59.7	17.3	3.9	11.3	18.4
Diluted EPS (p)	12.2	59.7	17.3	3.9	11.3	18.4
Dividend (p)	0.0	0.0	0.0	0.0	0.0	0.0
Cash flow	FY20	FY21	FY22	FY23E	FY24E	FY25E
Operating profit	4.1	15.4	6.1	2.6	4.8	6.9
Depreciation and amortisation	3.7	4.4	5.1	6.3	7.1	7.8
Inventory (increase)/decrease	(3.4)	(6.4)	(14.2)	9.7	0.4	(1.3)
Debtors (increase)/decrease	(0.8)	(1.2)	0.3	(0.5)	(0.4)	0.1
Creditors increase/(decrease)	3.3	2.7	(2.2)	(1.6)	(0.1)	2.4
Other	0.4	0.1	0.8	0.0	0.0	0.0
Operating cash flow	7.2	15.0	(4.1)	16.6	11.7	15.8
Interest	(0.8)	(0.8)	(1.1)	(1.5)	(1.5)	(1.5)
Tax	0.5	(0.0)	(2.7)	(0.3)	(0.9)	(1.4)
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	(3.6)	(4.4)	(6.2)	(7.0)	(7.0)	(6.5)
Trading cash flow	3.3	9.8	(14.1)	7.8	2.4	6.4
Acquisition of businesses	(0.4)	(0.2)	(10.4)	0.0	0.0	0.0
Disposal of businesses	0.0	0.0	0.0	0.0	0.0	0.0
Share issues	0.0	0.0	0.0	0.0	0.0	0.0
Currency effects, other	(1.0)	(1.3)	(2.4)	(1.5)	(1.5)	(1.5)
Net cash inflow/(outflow)	2.0	8.3	(26.9)	6.3	0.8	4.9
Net (debt)/cash	(5.5)	2.7	(24.2)	(17.9)	(17.0)	(12.1)

Source: Gear4music, Progressive Equity Research estimates

Summary of balance sheet forecasts (£m unless stated)

Balance sheet	IFRS16	IFRS16	IFRS16	IFRS16	IFRS16	IFRS16
Year to March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Tangible fixed assets	20.2	19.1	21.2	20.0	18.6	16.5
Intangible fixed assets	9.1	10.4	19.8	21.7	23.0	23.9
Investments and other	0.0	0.0	0.0	0.0	0.0	0.0
Total fixed assets	29.3	29.5	41.0	41.7	41.7	40.4
Stock	22.0	28.4	45.5	35.8	35.4	36.7
Trade and other debtors	2.5	3.6	3.8	4.4	4.8	4.7
Deferred tax	0.0	0.0	0.0	0.0	0.0	0.0
Cash and short term deposits	7.8	6.2	3.9	6.7	4.0	8.4
Current assets	32.4	38.3	53.3	46.8	44.2	49.8
Total assets	61.6	67.7	94.3	88.5	85.9	90.2
Trade and other payables	(14.4)	(18.9)	(16.2)	(14.6)	(14.5)	(17.0)
Borrowings	(9.9)	(0.6)	0.0	0.0	0.0	0.0
Other current liabilities	(1.1)	(1.1)	(1.2)	(1.2)	(1.2)	(1.2)
Current liabilities	(25.5)	(20.6)	(17.4)	(15.9)	(15.8)	(18.2)
Borrowings	(3.4)	(2.9)	(28.0)	(24.5)	(21.0)	(20.5)
Other non-current liabilities	(11.0)	(9.9)	(10.8)	(10.8)	(10.8)	(10.8)
Non-current liabilities	(14.5)	(12.8)	(38.9)	(35.4)	(31.9)	(31.4)
Total liabilities	(40.0)	(33.4)	(56.3)	(51.2)	(47.6)	(49.5)
Net assets	21.6	34.3	38.0	37.4	38.3	40.7

Source: Gear4music, Progressive Equity Research estimates

Financial Summary: Gear4music

Year end: March (£m unless shown)

	2021	2022	2023E	2024E	2025E
PROFIT & LOSS					
Revenue	157.5	147.6	155.6	171.1	188.4
Adj EBITDA	19.8	11.2	8.9	11.9	14.6
Adj EBIT	15.5	6.1	2.8	4.9	7.0
Reported PBT	14.6	5.0	1.1	3.3	5.4
Fully Adj PBT	14.6	5.0	1.1	3.3	5.4
NOPAT	13.4	4.6	2.1	3.6	5.2
Reported EPS (p)	59.7	17.3	3.9	11.3	18.4
Fully Adj EPS (p)	59.7	17.3	3.9	11.3	18.4
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	15.0	(4.1)	16.6	11.7	15.8
Free Cash flow	9.8	(14.1)	7.8	2.4	6.4
FCF per share (p)	46.8	(67.2)	37.2	11.2	30.5
Acquisitions	(0.2)	(10.4)	0.0	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	8.3	(26.9)	6.3	0.8	4.9
Overdrafts / borrowings	(3.5)	(28.0)	(24.5)	(21.0)	(20.5)
Cash & equivalents	6.2	3.9	6.7	4.0	8.4
Net (Debt)/Cash	2.7	(24.2)	(17.9)	(17.0)	(12.1)
NAV AND RETURNS					
Net asset value	34.3	38.0	37.4	38.3	40.7
NAV/share (p)	163.8	181.5	178.2	182.6	194.3
Net Tangible Asset Value	23.9	18.2	15.7	15.2	16.9
NTAV/share (p)	114.2	87.0	74.8	72.7	80.4
Average equity	28.0	36.2	38.5	40.1	43.3
Post-tax ROE (%)	17.9%	3.2%	8.6%	13.4%	0.0%
METRICS					
Revenue growth		(6.2%)	5.4%	9.9%	10.1%
Adj EBITDA growth		(43.3%)	(20.2%)	32.6%	23.4%
Adj EBIT growth		(60.3%)	(54.6%)	77.1%	42.4%
Adj PBT growth		(65.8%)	(77.2%)	187.2%	63.4%
Adj EPS growth		(71.1%)	(77.3%)	187.2%	63.4%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		4.2%	1.8%	2.9%	3.7%
VALUATION					
EV/Sales (x)	0.3	0.4	0.3	0.3	0.3
EV/EBITDA (x)	2.6	4.6	5.8	4.4	3.6
EV/NOPAT (x)	3.9	11.4	25.2	14.3	10.0
PER (x)	2.2	7.7	33.7	11.7	7.2
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	35.3%	(50.7%)	28.1%	8.5%	23.0%

Source: Company information and Progressive Equity Research estimates

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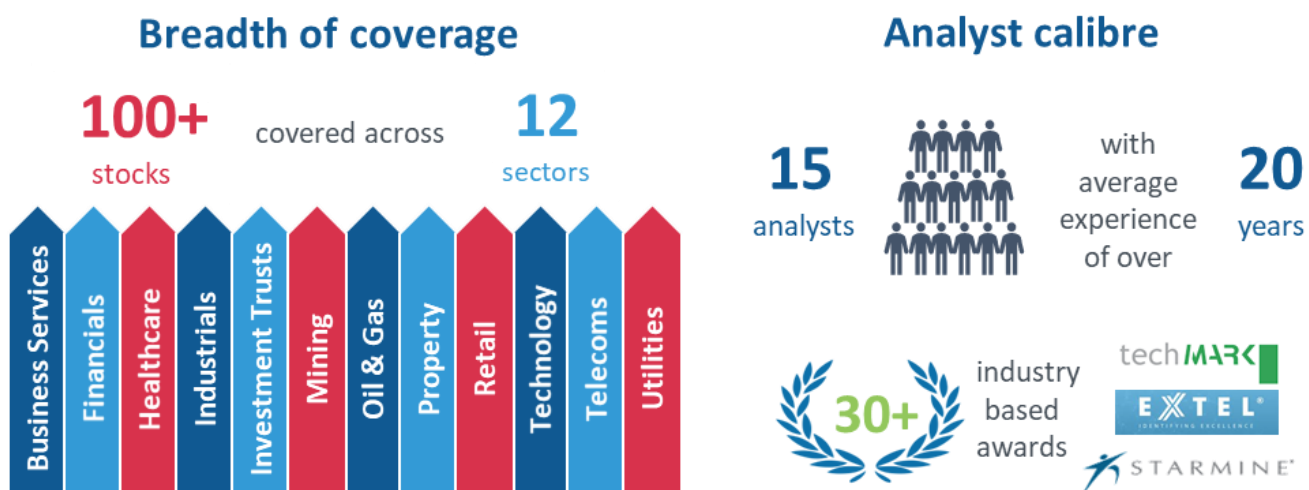
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