

GEAR4MUSIC

CONSUMER DISCRETIONARY

14 November 2023

G4M.L

120p

Market Cap: £25.2m

SHARE PRICE (p)



12m high/low

166p/83p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	£(18.1)m (at 30/09/23)
Enterprise value	£43.3m
Index/market	AIM
Next news	Update - 18 January
Shares in issue (m)	21.0
Chairman	Ken Ford
CEO	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

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Switching the levers to protect profitability against a challenging trading backdrop

G4M's interim results clearly reflect the group's previously expounded prioritisation of improved gross margins and lower costs over revenue growth against a difficult market backdrop. The former goal delivered an 80bps increase in gross margin, while the cash savings initiatives announced in October will bear fruit from H2 and beyond. Hence, despite G4M resetting FY24E revenue expectations to £144m (vs FY23's £152m), the FY24E adjusted profit outlook remains in line with consensus market expectations.

- Interim results – as per trading update guidance.** G4M's interim results were in line with the detailed half-year trading update of last month in terms of revenues (£62.6m, down 5.5%), gross profit (£17.0m, a gross margin of 27.1%, +80bps over H1 FY23) and net debt (down £3.7m at £18.1m vs £21.8m at the end of H1 FY23). Reported profit measures, including the one-off £0.5m cost associated with the £4.0m cash savings initiatives announced last month, were below those reported last year. On an adjusted basis, G4M reported a 6% increase in EBITDA to £2.9m (from £2.7m in H1 FY23), delivering an adjusted EBITDA margin of 4.6%, up 50bps on last year. G4M expects net debt and on-hand inventory (£34.5m, excluding £4.4m of stock in transit) to reduce further by end-FY24E.
- Adjusting the trading model – focus on bottom-line protection.** The interim results clearly underline the shift in the business model laid out previously by G4M. With a clear focus on protecting profitability, G4M has been rebuilding gross margins and delivering a programme of cost savings to mitigate the impact of a weak consumer environment, most notably in Europe, and lower top-line revenues. The full impact of these cost savings will come through from H2 FY24E, extending into FY25E as well, with the business looking to move to a lower-cost operating model.
- Profit forecasts unchanged – in line with consensus expectations.** G4M has guided FY24E revenue to £144m, in expectation of similar trading dynamics in H2 as seen in H1. The combination of higher gross margin and cost savings offset the lower top line, such that the underlying FY24E profit outlook remains in line with consensus market expectations. Our FY24E profit forecasts remain unchanged, with the small upgrades to our FY25E figures reflecting primarily cost savings benefits. Our new forecasts see net debt expectations further reduced to £11.4m and £9.0m, respectively, compared with £12.5m and £11.0m previously.

FYE MAR (£M)	2021	2022	2023	2024E	2025E
Revenue	157.5	147.6	152.0	144.0	155.0
Adj EBITDA	19.8	11.2	7.4	10.0	12.0
Fully Adj PBT	14.6	5.0	-0.4	1.4	2.8
Fully Adj EPS (p)	59.7	17.3	-3.0	4.8	9.6
EV/Sales (x)	0.3x	0.3x	0.3x	0.3x	0.3x
EV/EBITDA (x)	2.2x	3.9x	5.9x	4.3x	3.6x
PER (x)	2.0x	6.9x	N/A	25.2x	12.5x

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.

Recalibrating the trading model

G4M has shown its ability to react to the prevailing economic headwinds and weak consumer environment by recalibrating its trading model to protect bottom-line profitability and shareholder returns. Such a change had long been signposted by the group as a likely move, and this was duly confirmed in last month's H1 trading update, with the strategic prioritisation of gross margin and cost efficiencies over revenue growth in a challenging market.

The identified £4.0m cash savings identified comprise £1.6m of P&L cost savings and a £2.4m reduction in capitalised software development team savings. The P&L savings are mostly salaries, totalling £1.1m (including £0.1m of software development team salaries). The remaining £0.5m of administrative cost savings includes £0.3m of European payment card processing savings.

It is important to note that the review of labour and general overheads is ongoing, so further savings could potentially be found in H2 and beyond. A significant area of spending being carefully managed and reviewed is marketing, where G4M is seeking to realise an AI (Artificial Intelligence) driven reduction in marketing spend as a percentage of sales by FY25E.

The ongoing development of the group's proprietary e-commerce platform remains an important factor in driving growth. While G4M's annual internal development team cost will moderate to £2.8m per annum based on the current team size from H2 FY24E, this will be complemented by an annual outsourced cost investment of £0.5m. The combination of both internal and external resources in this area provides a good degree of flexibility with regard to future development projects.

On that subject, G4M's second-hand model, although still in its early stages, continues to deliver good returns and was extended with its launch in Europe in H1. Enjoying margins commensurate with own-brand products, growth in this channel will be margin accretive at the group level, supporting the initiative to prioritise gross margins alongside cost reductions. There are currently 12,000 products available for trade-in, with the majority of sellers on the platform taking credit towards their next purchase with G4M rather than an immediate cash payment.

AV.com, the group's home audio-visual channel, is planned to follow onto the second-hand platform later in 2024. An AV.com own brand is also to be launched shortly, further supporting its development across European markets. As with the group's music showrooms, the AV showroom facility in Bacup has been upgraded to attract and support new brands. A German showroom has also been opened to complement the online channel.

Gross margin enhancement will be supported through a combination of factors, though principally through a continuing shift to higher-margin SKUs. These in essence comprise the group's own brands, together with second-hand and digital products.

While the consumer backdrop remains challenging, G4M believes it is well prepared ahead of the seasonal peak and has stated that the underlying FY24E profit outlook remains in line with consensus market expectations (adjusted EBITDA of £9.8m and adjusted PBT of £1.2m). Our forecasts remain unchanged at £10.0m and £1.4m, respectively.

Interim results

The following table gives an overview of G4M's H1 financial performance over the past five years. We believe it is still useful and worthwhile to include the FY20 results representing the most recent pre-pandemic trading period. This enables investors to compare subsequent periods with a base year unaffected by the positive trading benefits seen in FY21 and the subsequent unwinding of those windfall benefits in FY22. To that end, not only have we presented the change in performance to the prior-year period (FY23) but also to the most recent pre-pandemic period (FY20).

The headline results reflect the performance outlined in last month's post-close trading update covering the H1 period, and as summarised on the front page of this note. It should be noted that the following table summarises the **unadjusted reported** results, which include £0.5m of one-off redundancy costs associated with the realisation of the £4.0m cash savings initiatives announced last month. The only H1 FY24E adjusted figures in the table are the adjusted loss before tax and adjusted EBITDA figures in the final two rows. The adjusted loss before tax figure of £1.4m compares with the reported loss before tax figure of £1.9m. The adjusted EBITDA figure £2.9m compares with the reported EBITDA figure of £2.4m, and actually rose by 6% compared with the prior year.

Overview of G4M reported H1 FY24 results against prior periods (£m unadjusted unless otherwise stated)

	H1 FY20	H1 FY21	H1 FY22	H1 FY23	H1 FY24	FY24 change on FY23 on FY23 (%)		FY24 change on FY20 on FY20 (%)	
UK sales	24.8	36.7	36.7	35.5	36.5	1.0	(3%)	11.7	47%
International sales	24.6	33.5	28.0	30.8	26.1	(4.7)	(15%)	1.5	6%
Total sales	49.4	70.2	64.7	66.3	62.6	(3.7)	(6%)	13.2	27%
Product sales	47.2	66.8	61.6	63.3	59.9	(3.4)	(5%)	12.7	27%
Product gross profit	14.0	21.9	19.7	19.5	18.5	(1.0)	(5%)	4.5	32%
<i>Product gross margin</i>	29.6%	32.8%	32.0%	30.9%	30.9%	<i>n.c.</i>		<i>+130bps</i>	
Gross profit	12.5	20.1	18.1	17.4	17.0	(0.4)	(2%)	4.5	36%
<i>Gross margin</i>	25.2%	28.6%	28.0%	26.3%	27.1%	<i>+80bps</i>		<i>+190bps</i>	
Operating costs :									
Marketing	(3.9)	(3.7)	(4.4)	(4.6)	(4.3)	0.3	(6%)	(0.4)	10%
Labour	(4.7)	(5.5)	(6.1)	(7.0)	(6.9)	0.1	(1%)	(2.2)	47%
Europe/other	(1.9)	(2.4)	(2.8)	(3.0)	(3.4)	(0.4)	7%	(1.5)	79%
Total opex	(10.5)	(11.6)	(13.3)	(14.6)	(14.6)	0.0	10%	(4.1)	39%
EBITDA	2.0	8.5	4.8	2.7	2.4	(0.3)	(12%)	0.4	20%
<i>EBITDA margin</i>	4.0%	12.1%	7.4%	4.1%	3.8%	<i>-30bps</i>		<i>-20bps</i>	
Total DA	(1.8)	(2.1)	(2.4)	(3.0)	(3.3)	(0.3)	11%	(1.5)	83%
Operating profit	0.2	6.4	2.4	(0.3)	(0.9)	(0.7)		(1.1)	
<i>Operating profit margin</i>	0.5%	9.1%	3.7%	(0.4%)	(1.5%)	<i>-110bps</i>		<i>-200bps</i>	
Financial expenses	(0.5)	(0.7)	(0.5)	(0.8)	(1.0)	(0.2)		(0.5)	
Pre tax profit	(0.3)	5.8	1.9	(1.0)	(1.9)	(0.9)		(1.6)	
Diluted EPS (p)	(0.7)	23.4	5.1	(5.3)	(7.4)	(2.1)		(6.7)	
Exceptionals					(0.5)				
Adjusted pre tax profit	(0.3)	5.8	1.9	(1.0)	(1.4)	(0.4)		(1.1)	
Adjusted EBITDA	2.0	8.5	4.8	2.7	2.9	0.2		0.9	

Source: G4M, Progressive Equity Research

Further detail is also provided in these full interim results on product sales, the product margin and the main components of operating costs. The reported gross profit and gross margin percentage are stated after net carriage costs (income received minus total carriage costs) are deducted from the product gross profit achieved on product sales (ie excluding other income, including carriage income from customers).

Revenues

Total group revenue fell back by 5.5% to £62.6m. The star performer within this was the UK market, where revenue rose by 3.0% to £36.5m. G4M's market share was consequently some 20bps higher at 9.3%. European revenue in H1 accounted for £25.0m of total International revenue of £26.1m, which was 15% down in the period. While this translated into a 0.3% market share decline in Europe for G4M to 1.3%, the European market – with an estimated value of £4.2bn – remains a major growth opportunity for the group.

Gross profit

With product gross margin flat at 30.9% against H1 FY23, it was some 150bps higher than that achieved in H2 FY23. The 80bps increase in the overall group gross margin to 27.1% results from a relative reduction in delivery costs. This reflects the higher AOV (average order value), which translated into fewer deliveries overall, and a higher proportion of UK sales, where delivery costs are generally lower than in Europe.

Operating costs

Excluding the one-off charge of £0.5m relating to the group's £4.5m cash savings initiatives, total administrative expenses decreased by 1.7% to £17.8m. However, as a percentage of sales they grew from 27.4% to 28.5%, given the decrease in total revenue.

Marketing and labour costs fell by 6% and 1%, respectively, in H1, with their combined share relative to total revenue falling to 63% from 65% in H1 FY23. Carefully managed marketing costs remained flat as a percentage of revenue at 6.9%. Labour costs fell despite an 8% average salary increase, reflecting the reduction in average headcount of 72. As at 30 September 2023, the group headcount stood at 434, which was 20% lower than the figure of 541 on 30 September 2022. These figures include the software development team, where the majority of redundancies have occurred.

Local administration costs incurred at the European distribution centre increased by 4% (£1m) to £2.5m, being the net effect of higher inflation and lower activity levels.

The total combined depreciation and amortisation charge increased by 11% to £3.3m, of which £1.8m related to amortisation of the group's proprietary bespoke e-commerce platform. The rate of increase in the amortisation charge relating to the platform will drop back from H2, given the £2.5m reduction in annual software development costs (of which £2.4m relates to reduced annual capitalisation together with a £0.1m direct P&L saving). As a result of the changes from this restructuring, it should be noted that the annualised capitalisation run rate based on the current software development team amounts to £2.8m, compared with – and lower than – the associated £3.1m amortisation charge in FY23.

Finance charges

Finance expenses were £0.2m higher at £1.0m, due to a higher level of bank interest at £0.8m (£0.5m) driven by rising interest rates. The interest on lease liabilities was broadly unchanged at £0.2m.

Profit measures

The combined impact of the above factors resulted in modest declines in all reported/unadjusted profit measures: EBITDA, operating profit and loss before tax. On an adjusted/underlying basis, these declines were mitigated when adding back the £0.5m exceptional charge, with operating profit broadly flat, and adjusted EBITDA actually rising by 6% to £2.9m (from £2.7m). The adjusted loss before tax came in at £1.4m, compared with last year's loss of £1.0m.

Cash flow and balance sheet

There was a working capital outflow of £2.9m in the period, compared with a £5.2m inflow in H1 FY23. Following its successful efforts to better align stockholding with revenues in FY23, H1 FY24E has returned to a more usual trading pattern with a build-up in inventory leading into the peak Christmas trading season. This resulted in a £4.6m outflow as inventory increased since 31 March. Inventory levels were, however, £4.4m (10%) lower at £39.0m on 30 September 2023 compared with £43.4m on 30 September 2022.

Trade and other payables were 7% (£1.4m) higher at £20.3m than last year, reflecting stock deals on pre-agreed terms. Relative to the FY23 year-end position, H1 FY24E saw a £2.3m cash inflow relating to trade and other payables, together with a small outflow of £0.6m arising from the increase in trade and other receivables.

G4M invested £2.4m in H1 in its proprietary platform compared with £2.8m last year, with software deployments including the European launch of the second-hand service offering, European third-party fulfilment and an enhanced website product configurator.

Capital expenditure relating to PPE (property, plant and equipment) amounted to just £36k in H1, compared with £0.6m in H1 FY23.

Net bank debt at the period-end stood at £18.1m, a £3.7m reduction compared with the £21.8m at the same point last year. Relative to the group's RCF (revolving credit facility) of £30m, this leaves comfortable headroom of £11.9m at what is a low point in the annual cash cycle.

Website and customer base data points

The financial performance of online retailers is the net result of many moving parts within their model and operations. These include, but are by no means limited to, website visitors, pages viewed, conversion rate from browsing to actual purchase, customer acquisition costs, number of purchases and order value.

This is no different for G4M. That having been said, the nature of G4M's product offering, combined with its lower levels of repeat purchasing, means that new customers are significantly more important to the group compared with retailers in more frequently purchased categories such as clothing or food. For this reason, it is of paramount importance for G4M to be profitable from its first customer purchase, as indeed it is. In H1, the customer acquisition cost rose to £16 (from £15 last year), but the unchanged £40 gross profit achieved on the increased average order of £161 (+9%) more than covered that cost to deliver immediate profitability. The sales lifetime value of the 12-month cohort also rose by 12% to £333 compared with H1 last year.

Website utilisation and conversion rates

	H1 FY20	H1 FY21	H1 FY22	H1 FY23	H1 FY24	FY24 % change	
						on FY23	on FY20
Unique website users (m)	13.4	15.2	13.5	9.1	9.8	7%	(27%)
UK users (m)	5.0	5.9	5.6	4.1	5.1	24%	2%
International users (m)	8.4	9.3	7.9	5.0	4.7	(6%)	(44%)
Total pages viewed (m)	90.6	75.1	59.6	50.8	55.6	9%	(44%)
Mobile traffic mix	65%	58%	65%	72%	68%	-400bps	300bps
Organic/direct traffic	38.0%	42.0%	38.0%	46.0%	51.0%	+500bps	+1300bps
Conversion rates:							
UK	4.78%	6.11%	6.39%	5.82%	4.37%	-145bps	-41bps
Europe	2.08%	2.60%	2.41%	4.22%	3.55%	-67bps	+147bps
Mobile	1.96%	2.64%	2.30%	2.81%	2.37%	-44bps	+41bps
Total	3.02%	3.90%	4.00%	4.90%	4.00%	-90bps	+98bps

Source: G4M, Progressive Equity Research

There was a 7% increase in unique website users in H1 to 9.8m, partially reversing the 32% decrease seen last year in H1. This increase was, however, primarily driven by the browsing and visits of customers with lower intent to purchase, and who came from direct and organic sources. With marketing being held as a percentage of sales, and AI (Artificial Intelligence) automated models seeking to maximise revenue at any defined level of return on investment, this directly resulted in a higher proportion of visitors from organic and direct sources; these increased from 46% to 51% of website traffic.

This shift to customers with a lower purchase intention was exacerbated by G4M choosing to hold some prices above the overall market level (as part of its gross margin prioritisation strategy), which resulted in lower rates of conversion. The overall rate of conversion fell 90bps to 4.0% but is still almost 100bps higher than in H1 FY20. Thus, while UK user numbers increased by 24% to 5.1m, the conversion rate fell back by 140bps to 4.4%. European user numbers declined, and conversion rates also fell back, by 67bps to 3.6%.

The mobile traffic mix fell back to 68% but remains the primary and dominant channel of access. Mobile conversion rates, always lower than other channels, saw a 44bps decline to 2.4%, though still some 41bps higher than achieved in H1 FY20.

Over the longer term, an increase in organic/direct traffic to the website is an important and positive development. Sales derived from organic/direct traffic are inherently more profitable than purchases achieved from the pay per click (PPC) channel. Costs per click have continued to rise given the competition for lower levels of traffic in the current challenging and more subdued economic climate.

While the number of unique visitors rose by 7%, the number of customers served declined by 11% to 341,000. This figure is 4% higher than in the last pre-pandemic H1 period in FY20.

Customer metrics

	H1 FY20	H1 FY21	H1 FY22	H1 FY23	H1 FY24	FY24 % change	
						on FY23	on FY20
Customers served ('000)	328	482	404	384	341	(11%)	4%
New customers ('000)	265	403	328	310	270	(13%)	2%
Proportion of repeat customers	26.9%	24.9%	24.4%	26.5%	26.3%	-20bps	-60bps
Email subscriber database ('000)	717	708	725	1408	1720	22%	139%
Average order value	£120	£117	£128	£151	£161	7%	34%

Source: G4M, Progressive Equity Research

The email subscriber base continues to expand, recording a 22% increase over the prior-year figure to now number 1.72 million subscribers. The proportion of repeat customers nudged back by 20bps to 26.3%.

Range development and margins

G4M has delivered further growth in the totality of its product portfolio, which is an important driver of customer interest and revenues. The total number of SKUs increased by 1,400 (+2%) to 63,900 lines compared with H1 FY23, but was a fall of 300 lines from the FY23 year-end figure of 64,200. This reduction resulted from the decision to remove a number of unprofitable and slow-moving lines. The H1 number of SKUs equates to a 21% increase over H1 FY21. The number of brands listed also increased in H1, growing similarly by 2% to 1,134 in total. Within these figures, AV.com has 6,300 SKUs listed, with 195 brands.

Evolution of total range and own-brand products							
	H1 FY20	H1 FY21	H1 FY22	H1 FY23	H1 FY24	FY24 % change	
						on FY23	on FY20
Total number of SKU's	52,700	55,200	60,500	62,500	63,900	2%	21%
Brands listed	889	894	951	1109	1134	2%	28%
Own brand performance :							
Own brand SKU's	3,300	3,600	3,900	4,250	5,200	22%	57%
Own brand SKU mix	6.3%	6.5%	6.4%	6.8%	8.1%	+134bps	+188bps
Own brand sales mix (product sales)	27.3%	27.5%	24.9%	23.7%	25.4%	+170bps	-190bps

Source: G4M, Progressive Equity Research

It is interesting to note that the key driver to the increase in the number of SKUs in H1 was own brands. These lines accounted for 950 of the total SKU increase of 1,450. The increase in own-brand SKUs over H1 FY23 was an impressive 22%. In fact, own-brand sales increased by 1.7% over H1 FY23 to £15.2m, almost recovering to the £15.3m delivered in H1 FY22. In contrast, other brand sales fell back 7.6% to £44.7m. Own brand as a percentage of total sales increased to 24.3% in H1 from 22.6% in H1 last year.

The recent peak in own-brand sales penetration (of total sales) was in FY20, when it reached 29.4%. Since then, it has fallen back steadily, accounting for 25.6% of total sales in FY23. With own-brand gross margins around 15 percentage points higher than that of third-party brands, it is pleasing to see the mix penetration of own brands starting to rise again. With their mix penetration typically lower in H1 than H2, we would expect to see the 24.3% penetration increase further for the full year. The benefits of this higher mix participation should translate into a higher gross margin percentage for the group. The 24.3% of total sales (and 25.4% of product sales) in H1 for own-brand lines was delivered from just 8.1% of total SKUs, using the H1 FY24 figures in the table above.

In H1, own-brand margins improved by 20bps to 44.1%, with other branded margins falling by 50bps. The net impact of these moves was a flat product margin of 30.9% compared with H1 FY23 but, more importantly, this represented a significant increase over the 29.4% delivered in H2 FY23. Historically, margins have traditionally increased in H2 periods over that delivered in H1. This was not the case in FY23, as product margin was of lesser importance, given G4M's increased focus on reducing inventory levels and net debt.

This success in growing own-brand product sales reflects a number of factors, including product development and a new brand architecture supported by a fresh approach to both branding and customer experience. G4M has made a concerted effort to enhance the identity and value of its own brands, including the use of lifestyle imagery and video content to support this mission. Attention has not only been paid to new lines, but existing lines have also been revisited and updated (often with higher specifications, new packaging, improved documentation). Price points have also been reviewed to ensure customers receive outstanding value on the group's own-brand products.

Some specific examples of own-brand developments include the G4M brand, which launched at the end of June 2023. This is a great value, premium music gear brand, with over 130 new products to be launched this year. Its range covers all categories with the exception of drums. Another recently introduced brand is Vision. Specifically designed to compete with third-party Amazon sellers, this brand covers categories including guitars, keyboards and drums. The premium Premier brand for drums and percussion continues to gain traction following several new product launches in FY23. The group has also concluded a licensing agreement to sell the Premier brand into the USA. G4M is also planning to launch an own brand for AV.com in the near future. This will focus on audio visual products for the home, with an initial focus on amplifiers, speakers and televisions.

Product group revenue mix

The following table shows the evolution of revenue by key product groups in H1 over the past four years, together with their respective mix participations.

Revenues and revenue mix by product group (£m and %)

	Revenue by product group (£m)				Revenue mix by product group (%)			
	FY21	FY22	FY23	FY24	FY21	FY22	FY23	FY24
Guitars	22.7	19.8	17.9	16.7	34%	32%	28%	28%
Keys	13.8	10.3	9.1	8.3	21%	17%	14%	14%
Live & PA	8.3	12.0	16.2	15.3	12%	20%	26%	26%
Drums	5.9	5.3	6.1	6.2	9%	9%	10%	10%
Studio	11.3	9.0	7.3	6.1	17%	15%	12%	10%
Orchestral	3.9	3.8	3.7	3.4	6%	6%	6%	6%

Source: G4M, Progressive Equity Research

With the exception of drums (+2%), revenue fell in all product groups compared with last year. The greatest decline was seen in Studio products, comprising mixers, headphones, monitors and interfaces), with revenue down 15% compared with H1 FY23. This category has been in a steady decline in terms of both revenue and revenue participation over the past four years. Studio saw its mix participation fall by 2% to 10% in the period, with the mix participation of all other categories stable.

Forecasts

The following table shows our new forecasts for FY24E and FY25E. It should be noted that the FY24E forecasts show figures throughout adjusted for the £0.5m one-off exceptional cost associated with the £4.5m cash savings initiatives.

The main change therefore relates to rebased sales revenues. G4M has guided to a figure of £144m for FY24E. Our FY25E revenue forecast of £155m is predicated on an unchanged revenue growth forecast of 8%. Our previous revenue forecasts were £161.1m and £174.0m for FY24E and FY25E, respectively.

Other changes relate to gross margin percentage and operating costs, with the latter including an annualised £0.4m amortisation charge, which results from the £2.5m reduction in software development team salaries, virtually all of which is capitalised rather than charged directly to the P&L account. Our FY24E forecast includes some £0.2m benefit from this lower charge, with the benefits full accruing from H2 FY24E.

Following the 80bps gain in gross margin percentage delivered in H1, we have raised our FY24E gross margin percentage to 27.4% (from 26.7%) and our FY25E margin to 27.5% (from 27.2%). It could be argued therefore that our FY25E margin forecast is conservative, with risk weighted to the upside, given G4M's ongoing focus on this metric and the favourable mix shift to own brands with their enhanced gross margins.

Forecast summary and 2-year CAGR to FY25E (£m unless stated)

	FY22	FY23	FY24E	FY25E	2-yr CAGR
Revenue	147.6	152.0	144.0	155.0	0.7%
Gross profit	41.1	39.0	39.5	42.6	3.0%
Gross margin (%)	27.9%	25.7%	27.4%	27.5%	
Operating costs (exc DA)	29.9	31.7	29.5	30.6	(1%)
Opex as % of turnover	20.3%	20.8%	20.5%	19.8%	
Adjusted EBITDA	11.2	7.4	10.0	12.0	17.6%
EBITDA margin (%)	7.6%	4.8%	6.9%	7.7%	
Adjusted operating profit	6.1	1.3	3.1	4.7	53.5%
Operating margin (%)	4.1%	0.8%	2.2%	3.0%	
Adjusted pre-tax profit	5.0	(0.4)	1.4	2.8	
Adjusted diluted EPS (p)	17.3	(3.0)	4.8	9.6	
Net cash/(debt)	(24.2)	(14.5)	(11.4)	(9.0)	

Source: G4M, Progressive Equity Research

With operating costs (excluding depreciation and amortisation) declining as a percentage of revenue, we forecast EBITDA margins to rise by 210bps to 6.9% for FY24E and by a further 80bps to 7.7% in FY25E. This margin increase is broadly mirrored at the operating profit level, although slightly moderated at the PBT level due to small increases in our forecast finance charges.

The combination of higher gross margins and cost savings offset the lower top line, such that our underlying FY24E profit outlook is unchanged with EBITDA of £10.0m, remaining broadly in line with consensus market expectations struck at £9.8m. Our FY24E PBT forecast remains unchanged at £1.4m (with consensus of £1.2m). The modest upgrades to our FY25E operating profit (£0.5m to £4.7m) and PBT (£0.1m to £2.8m) figures primarily reflect cost savings benefits. Our FY25E adjusted EBITDA forecast, as for FY24E, remains unchanged (at £12.0m).

Our new forecasts see net debt expectations further reduced to £11.4m and £9.0m, respectively, compared with £12.5m and £11.0m previously.

The following tables give fuller details of our forecasts.

Next news

The next newsflow will be the Christmas trading update on 18 January 2024.

Summary forecasts – P&L account and cash flow (£m unless otherwise stated)

Profit and loss account						
Year to March	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	120.3	157.5	147.6	152.0	144.0	155.0
Cost of sales	(89.2)	(111.1)	(106.5)	(113.0)	(104.6)	(112.4)
Gross profit	31.2	46.4	41.1	39.0	39.5	42.6
Gross margin (GM) (%)	25.9%	29.4%	27.9%	25.7%	27.4%	27.5%
Operating costs	(27.1)	(30.9)	(35.1)	(37.8)	(36.3)	(38.0)
Adjusted operating profit	4.1	15.4	6.1	1.3	3.1	4.7
Operating profit margin (%)	3.4%	9.8%	4.1%	0.8%	2.2%	3.0%
Depreciation and amortisation	(3.7)	(4.4)	(5.1)	(6.1)	(6.8)	(7.3)
Adjusted EBITDA	7.8	19.8	11.2	7.4	10.0	12.0
EBITDA margin (%)	6.4%	12.6%	7.6%	4.8%	6.9%	7.7%
Interest charge	(1.0)	(0.8)	(1.1)	(1.7)	(1.8)	(1.9)
Adjusted PBT	3.1	14.6	5.0	(0.4)	1.4	2.8
Exceptional charges	0.0	0.0	0.0	0.0	(0.5)	0.0
Profit before tax	3.1	14.6	5.0	(0.4)	0.9	2.8
Adjusted diluted EPS (p)	12.2	59.7	17.3	(3.0)	4.8	9.6
Diluted EPS (p)	12.2	59.7	17.3	(3.0)	3.1	9.6
Dividend (p)	0.0	0.0	0.0	0.0	0.0	0.0
Cash flow						
Year to March	FY20	FY21	FY22	FY23	FY24E	FY25E
Operating profit (unadjusted)	4.1	15.4	6.1	1.3	2.6	4.7
Depreciation and amortisation	3.7	4.4	5.1	6.1	6.8	7.3
Inventory (increase)/decrease	(3.4)	(6.4)	(14.2)	11.1	5.1	0.4
Debtors (increase)/decrease	(0.8)	(1.2)	0.3	0.0	0.5	(0.3)
Creditors increase/(decrease)	3.3	2.7	(2.2)	1.9	(2.5)	(1.4)
Other	0.4	0.1	0.8	(0.2)	0.0	0.0
Operating cash flow	7.2	15.0	(4.1)	20.2	12.5	10.7
Interest	(0.8)	(0.8)	(1.1)	(1.7)	(1.8)	(1.9)
Tax	0.5	(0.0)	(2.7)	(0.5)	(0.2)	(0.7)
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)	(6.3)	(5.8)	(4.1)
Trading cash flow	3.3	9.8	(14.1)	11.6	4.7	4.0
Acquisition of businesses	(0.4)	(0.2)	(10.4)	(0.4)	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)	(1.6)	(1.6)	(1.6)
Net cash inflow/(outflow)	2.0	8.3	(26.9)	9.6	3.1	2.4
Net (debt)/cash	(5.5)	2.7	(24.2)	(14.5)	(11.4)	(9.0)

Source: G4M, Progressive Equity Research

Summary forecasts – Balance sheet (£m unless otherwise stated)

Balance sheet						
Year to March	FY20	FY21	FY22	FY23	FY24E	FY25E
Tangible fixed assets	20.2	19.1	21.2	19.2	17.8	15.6
Intangible fixed assets	9.1	10.4	19.8	22.0	22.5	21.4
Investments and other	0.0	0.0	0.0	0.0	0.0	0.0
Total fixed assets	29.3	29.5	41.0	41.3	40.2	37.0
Stock	22.0	28.4	45.5	34.4	29.3	28.9
Trade and other debtors	2.5	3.6	3.8	4.5	4.0	4.3
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	4.5	4.1	3.0
Current assets	32.4	38.3	53.3	43.3	37.4	36.2
Total assets	61.6	67.7	94.3	84.6	77.6	73.2
Trade and other payables	(14.4)	(18.9)	(16.2)	(17.6)	(15.1)	(13.7)
Borrowings	(9.9)	(0.6)	0.0	0.0	0.0	0.0
Other current liabilities	(1.1)	(1.1)	(1.2)	(1.1)	(1.1)	(1.1)
Current liabilities	(25.5)	(20.6)	(17.4)	(18.8)	(16.3)	(14.8)
Borrowings	(3.4)	(2.9)	(28.0)	(19.0)	(15.5)	(12.0)
Other non-current liabilities	(11.0)	(9.9)	(10.8)	(9.6)	(9.6)	(9.6)
Non-current liabilities	(14.5)	(12.8)	(38.9)	(28.6)	(25.1)	(21.6)
Total liabilities	(40.0)	(33.4)	(56.3)	(47.4)	(41.4)	(36.5)
Net assets	21.6	34.3	38.0	37.2	36.3	36.8

Source: G4M, Progressive Equity Research

Financial Summary: Gear4music

Year end: March (£m unless shown)

	2021	2022	2023	2024E	2025E
PROFIT & LOSS					
Revenue	157.5	147.6	152.0	144.0	155.0
Adj EBITDA	19.8	11.2	7.4	10.0	12.0
Adj EBIT	15.5	6.1	1.3	3.1	4.7
Reported PBT	14.6	5.0	(0.4)	0.9	2.8
Fully Adj PBT	14.6	5.0	(0.4)	1.4	2.8
NOPAT	13.4	4.6	2.0	2.3	3.4
Reported EPS (p)	59.7	17.3	(3.0)	3.1	9.6
Fully Adj EPS (p)	59.7	17.3	(3.0)	4.8	9.6
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)	20.2	12.5	10.7
Free Cash flow	9.8	(14.1)	11.6	4.7	4.0
FCF per share (p)	46.8	(67.2)	55.4	22.4	19.1
Acquisitions	(0.2)	(10.4)	(0.4)	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)	9.6	3.1	2.4
Overdrafts / borrowings	(3.5)	(28.0)	(19.0)	(15.5)	(12.0)
Cash & equivalents	6.2	3.9	4.5	4.1	3.0
Net (Debt)/Cash	2.7	(24.2)	(14.5)	(11.4)	(9.0)
NAV AND RETURNS					
Net asset value	34.3	38.0	37.2	36.3	36.8
NAV/share (p)	163.8	181.5	177.5	173.0	175.3
Net Tangible Asset Value	23.9	18.2	15.2	13.8	15.4
NTAV/share (p)	114.2	87.0	72.4	65.9	73.5
Average equity	28.0	36.2	37.6	37.6	38.9
Post-tax ROE (%)	52.4%	13.9%	(1.1%)	3.7%	7.2%
METRICS					
Revenue growth		(6.2%)	3.0%	(5.3%)	7.7%
Adj EBITDA growth		(43.3%)	(34.3%)	35.3%	20.4%
Adj EBIT growth		(60.3%)	(79.0%)	143.9%	48.1%
Adj PBT growth		(65.8%)	(108.1%)	(441.4%)	101.6%
Adj EPS growth		(71.1%)	(117.3%)	(259.3%)	101.6%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		4.2%	0.8%	2.2%	3.0%
VALUATION					
EV/Sales (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	2.2	3.9	5.9	4.3	3.6
EV/NOPAT (x)	3.2	9.5	21.2	18.6	12.6
PER (x)	2.0	6.9	N/A	25.2	12.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	39.0%	(56.0%)	46.2%	18.7%	15.9%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

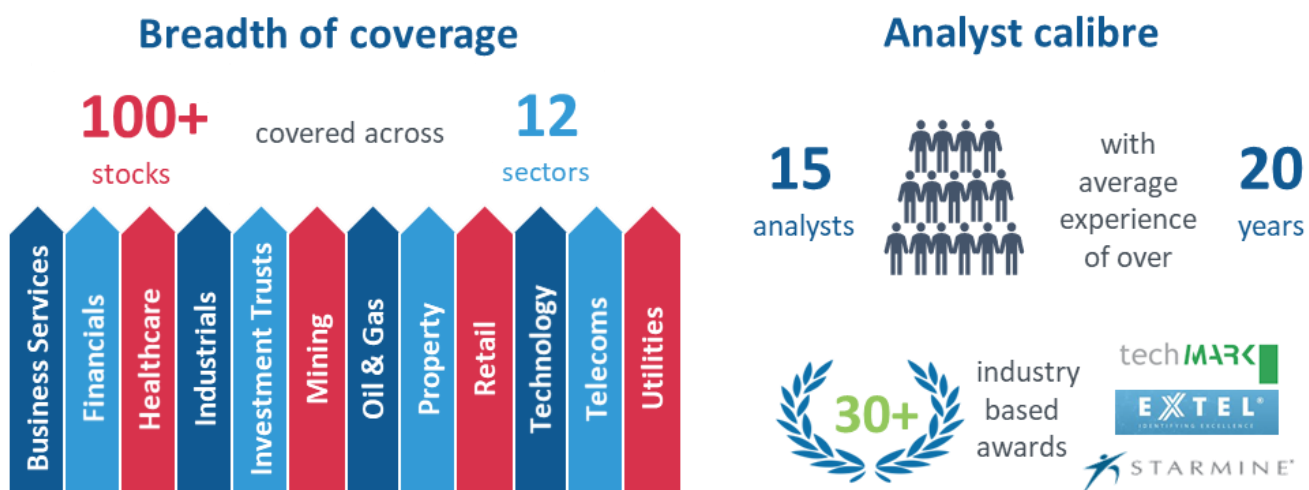
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