

# GEAR4MUSIC

## CONSUMER DISCRETIONARY

6 April 2023

### G4M.L

88p

Market Cap: £18.5m

#### SHARE PRICE (p)



12m high/low

390p/85p

Source: LSE Data (priced as at prior close)

#### KEY DATA

Net (Debt)/Cash	£(14.5)m (at 31/03/23)
Enterprise value	£33m
Index/market	AIM
Next news	Prelims - June
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](http://www.gear4musicplc.com)

GEAR4MUSIC IS A RESEARCH CLIENT OF  
PROGRESSIVE

#### ANALYSTS

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## Forecasts cut on weaker trading, but net debt reduction beats market expectations

Weaker-than-expected Q4 trading, notably in February and March against soft comparatives, has resulted in G4M guiding to an FY23E EBITDA outturn of between £7.3m and £7.7m, below market expectations. Gross margin of 25.7% (vs 27.8% in FY22) reflected inventory reduction in a tough trading environment. However, year-end net debt of £14.5m is £3m better than expectations of £17.5m, and comfortably within G4M's borrowing facility.

- Full-year trading update – weaker year-end sales and margin than expected.** While group sales rose by 3% across the whole of FY23, led by European and Rest of World sales growth of 8%, the performance in February and March fell below expectations for both sales and gross margin. UK sales came in around 1% lower than the FY22 figure. The continued squeeze on discretionary consumer expenditure held back sales, with gross margin down 210bps to 25.7%. The latter reflected the planned reduction in inventory levels, albeit exacerbated by the challenges of a difficult trading environment. FY23E EBITDA is now expected to land in the range of £7.3m to £7.7m, below market expectations of £8.9m. However, G4M has exceeded expectations with regard to net debt reduction, with FY23 year-end net debt at 31 March of £14.5m (FY22: £24.2m), around £3m better than consensus of £17.5m.
- More positive outlook – bolstered by launch of second-hand trade-in platform.** In March 2023, G4M entered the second-hand market for musical instruments and equipment, with the soft launch of its proprietary second-hand trade-in system. A key marketing proposition to, and benefit for, consumers of the system is the provision of instant trade-in prices. As of 3 April, this extended to 7,500 products; a figure that will continue to grow over time. With gross margin anticipated to be above group average, though not at own-brand levels, this should be a positive driver for future performance with only very modest levels of cannibalisation anticipated.
- Forecast revisions – return to more profitable growth expected.** Along with good progress anticipated from further initiatives at AV.com, G4M believes it is well positioned to return to profitable growth over the medium term from the revised expectations for FY23E. The key headlines of our forecast revisions are outlined in the table below and the more detailed financial summary in this note. EBITDA and PBT growth are forecast to translate into further net debt reductions in FY24E and FY25E.

FYE MAR (£M)	2021	2022	2023E	2024E	2025E
Revenue	157.5	147.6	152.0	161.1	173.9
Adj EBITDA	19.8	11.2	7.5	10.0	12.0
Fully Adj PBT	14.6	5.0	-0.3	1.4	2.7
Fully Adj EPS (p)	59.7	17.3	-1.0	4.9	9.3
EV/Sales (x)	0.2x	0.2x	0.2x	0.2x	0.2x
EV/EBITDA (x)	1.7x	2.9x	4.4x	3.3x	2.8x
PER (x)	1.5x	5.1x	N/A	18.1x	9.4x

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.

## Weak end of year trading takes its toll

While falling shy of profit expectations at EBITDA and PBT levels, principally because of the more subdued level of consumer demand resulting from lower levels of discretionary income in the prevailing inflationary economic environment, G4M has delivered strongly in terms of both inventory and net debt reduction. These goals have long been flagged by management. While the inventory reduction was achieved at some cost to the achieved gross margin in the challenging retail environment, this has been a contributory factor to the quantum of net debt reduction to the year-end figure of £14.5m. This figure is some £3m better than market expectations and comfortably within the group's revolving credit facility (RCF) of £35m.

### Trading details

Despite weak trading comparatives in Q4 22, sales revenues in Q4 23E fell short of management expectations, most notably in February and March 2023. This was a repeat of the prior FY22 financial year, which also saw disappointing sales performance in February and March. This said, as the following table shows, G4M managed a small overall year-on-year (yoy) increase in Q4 23 sales of 1%, following the 2% yoy growth delivered in Q4 22.

The following table details the Q4 and FY sales performance over the past four years, thereby enabling comparison with FY20, the last year of normal trading patterns pre-Covid. The Q4 sales performance has been derived from the FY sales figures and our calculation of the 9M performance.

It is worth noting the three-year growth delivered over FY20. These show the UK has delivered a 33% increase over that period, with European and the Rest of World sales up 20%, giving a group increase of some 26%, equating to a three-year compound annual growth rate (CAGR) of 8.1%. The CAGRs for UK and European & International sales over that period are 9.9% and 6.2%, respectively.

#### Trading update details and prior-year comparisons – full year and Q4

Sales (£m)	FY23	FY22	FY21	FY20	Q4 FY23	Q4 FY22	Q4 FY21	Q4 FY20
UK	82.0	82.6	78.7	61.8	20.5	19.9	19.0	16.1
International	70.0	65.0	78.8	58.5	15.7	15.8	16.1	14.5
<b>Total</b>	<b>152.0</b>	<b>147.6</b>	<b>157.5</b>	<b>120.3</b>	<b>36.2</b>	<b>35.7</b>	<b>35.1</b>	<b>30.6</b>
Change on prior year period (%)	FY23	FY22	FY21	FY20	Q4 FY23	Q4 FY22	Q4 FY21	Q4 FY20
UK	-1%	5%	27%	n.a.	3%	5%	18%	n.a.
International	8%	-18%	35%	n.a.	-1%	-2%	11%	n.a.
<b>Total</b>	<b>3%</b>	<b>-6%</b>	<b>31%</b>	<b>n.a.</b>	<b>1%</b>	<b>2%</b>	<b>15%</b>	<b>n.a.</b>
Change over FY20 period (%)	FY23	FY22			Q4 FY23	Q4 FY22		
UK	33%	34%			27%	24%		
International	20%	11%			8%	9%		
<b>Total</b>	<b>26%</b>	<b>23%</b>			<b>18%</b>	<b>17%</b>		
Gross margin (%)	25.7%	27.8%	29.5%	25.9%	n.a.	n.a.	n.a.	n.a.

Source: G4M, Progressive Equity Research

Year-end FY23 gross margin of 25.7% compares with our derived 9M gross margin calculation of 26.0%, implying an estimated gross margin of around 25% in Q4 23.

## Forecast changes

The following table summarises the key headline changes to our forecasts for the period FY23E to FY25E. Our FY23E forecasts are as outlined in the group's year-end trading update. For the outer years, we have adopted more conservative assumptions in terms of both sales growth and gross margin evolution. For FY24E, our sales forecast is predicated on a growth rate of 6%, followed by 8% in FY25E. The assumptions behind our higher forecast growth rate in FY25E include greater operational leverage of the proprietary second-hand platform across more territories and a higher number of products, along with further progress from AV.com as it gains higher awareness and traction within European markets.

On the gross margin front, we assume an increase of 100bps to 26.7% in FY24E, followed by a 50bps increase in FY25E to 27.2%. These increases reflect some unwinding of the impact of reducing inventories in FY23E, together with the benefits of the higher-margin second-hand trading platform leading to gross margin accretion as its sales participation increases over time. We also assume continued vigilance with regard to the operating cost base over this period.

### Summary of key forecast changes

£m unless stated	FY23E			FY24E			FY25E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	155.6	152.0	(2%)	171.1	161.1	(6%)	188.4	173.9	(8%)
Adj EBITDA	8.9	7.5	(16%)	11.9	10.0	(16%)	14.6	12.0	(18%)
Fully adj PBT	1.1	(0.3)	(126%)	3.3	1.4	(57%)	5.4	2.7	(49%)
Fully adj EPS (p)	3.9	(1.0)	(126%)	11.3	4.9	(57%)	18.4	9.3	(49%)
Net debt	(17.9)	(14.5)	(19%)	(17.0)	(12.5)	(27%)	(12.1)	(10.9)	(11%)

Source: Progressive Equity Research estimates

The table also shows our forecasts of continued progress in reducing net debt as profits move up over our forecast horizon.

**Financial Summary: Gear4music**

Year end: March (£m unless shown)

	2021	2022	2023E	2024E	2025E
<b>PROFIT &amp; LOSS</b>					
Revenue	157.5	147.6	152.0	161.1	173.9
Adj EBITDA	19.8	11.2	7.5	10.0	12.0
Adj EBIT	15.5	6.1	1.3	3.1	4.4
Reported PBT	14.6	5.0	(0.3)	1.4	2.7
Fully Adj PBT	14.6	5.0	(0.3)	1.4	2.7
NOPAT	13.4	4.6	1.0	2.3	3.2
Reported EPS (p)	59.7	17.3	(1.0)	4.9	9.3
Fully Adj EPS (p)	59.7	17.3	(1.0)	4.9	9.3
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
<b>CASH FLOW &amp; BALANCE SHEET</b>					
Operating cash flow	15.0	(4.1)	19.6	12.4	11.9
Free Cash flow	9.8	(14.1)	11.1	3.5	3.2
FCF per share (p)	46.8	(67.2)	53.1	16.9	15.1
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)	9.6	2.0	1.6
Overdrafts / borrowings	(3.5)	(28.0)	(24.5)	(21.0)	(20.5)
Cash & equivalents	6.2	3.9	10.0	8.5	9.7
Net (Debt)/Cash	2.7	(24.2)	(14.5)	(12.5)	(10.9)
<b>NAV AND RETURNS</b>					
Net asset value	34.3	38.0	36.3	35.8	36.3
NAV/share (p)	163.8	181.5	173.1	170.9	173.3
Net Tangible Asset Value	23.9	18.2	14.6	12.8	12.4
NTAV/share (p)	114.2	87.0	69.7	61.0	59.3
Average equity	28.0	36.2	37.9	38.3	39.9
Post-tax ROE (%)	17.9%	(0.8%)	3.7%	7.1%	0.0%
<b>METRICS</b>					
Revenue growth		(6.2%)	3.0%	6.0%	8.0%
Adj EBITDA growth		(43.3%)	(33.1%)	33.2%	19.9%
Adj EBIT growth		(60.3%)	(78.2%)	128.8%	42.5%
Adj PBT growth		(65.8%)	(106.0%)	(573.6%)	91.5%
Adj EPS growth		(71.1%)	(106.0%)	(573.6%)	91.5%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		4.2%	0.9%	1.9%	2.5%
<b>VALUATION</b>					
EV/Sales (x)	0.2	0.2	0.2	0.2	0.2
EV/EBITDA (x)	1.7	2.9	4.4	3.3	2.8
EV/NOPAT (x)	2.5	7.2	33.3	14.6	10.2
PER (x)	1.5	5.1	N/A	18.1	9.4
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	53.1%	(76.3%)	60.3%	19.2%	17.1%

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

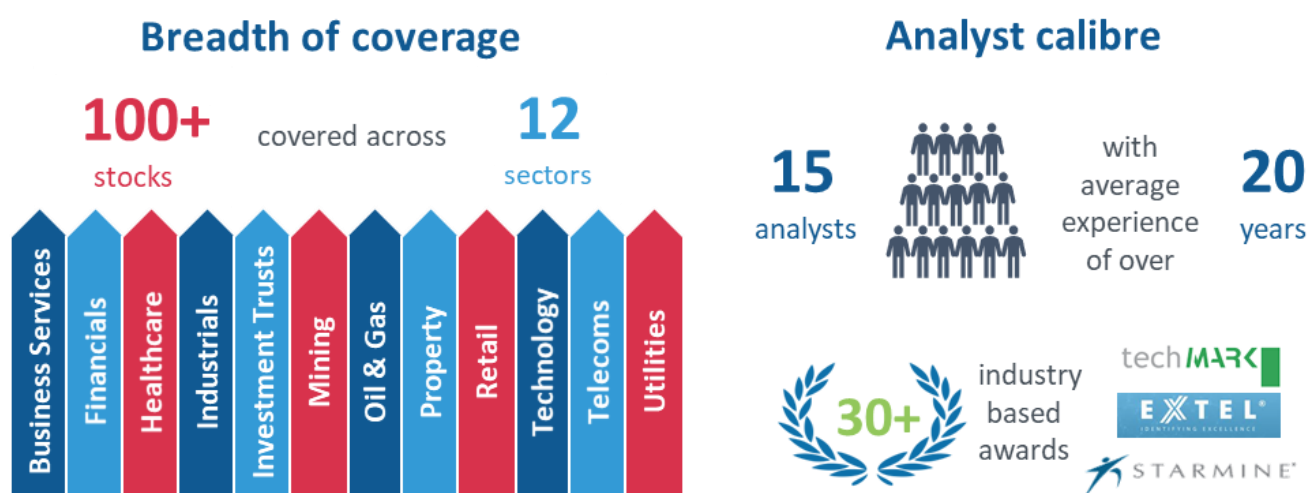
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