

GEAR4MUSIC

CONSUMER DISCRETIONARY

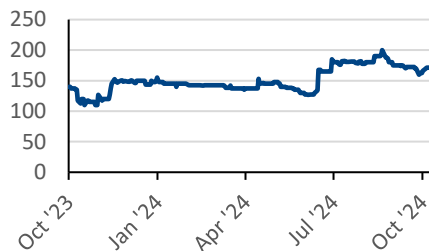
22 October 2024

G4M.L

172p

Market Cap: £36m

SHARE PRICE (p)



12m high/low

200p/110p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	£(14.5)m (at 30/09/24)
Enterprise value	£50.5m
Index/market	AIM
Next news	Interims, 19 November
Shares in issue (m)	21.0
Chairman	Andrew Wass
CEO	Gareth Bevan
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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Gently growing into the new Growth Strategy

G4M's H1 trading update to 30 September shows a sequential step-up in quarterly revenue performance, with further growth momentum achieved in October to date. The H1 reported loss (LBT) is expected to deliver an improvement of around £0.7m over H1 FY24, despite total revenues being slightly down and a small decrease in gross margin percentage. This points to good cost management and financial discipline. The UK has performed well, the second-hand platform is showing strong traction with customers, and the group has reduced H1 net debt by a further £3.6m.

- H1 revenues – down 1% in a half of two halves.** G4M's revenues are on an improving trend in the year to date. Q1 saw group revenues down 4%, with an improvement to 1% growth in Q2, and 'further growth momentum' seen in October trading to date. The UK delivered growth of 4% in H1, while Europe and Rest of the World revenues dropped back 9%. The latter was adversely impacted by some teething problems with G4M's new third-party Artificial Intelligence (AI) based marketing system, as were own-brand revenues and overall marketing efficiency. These issues have now been resolved. Gross margin eased back 40bps to 26.7% but is still some 150bps above the pre-Covid level of 25.2% seen in H1 FY20. H1 gross profit is therefore expected to be £16.5m against £17.0m in H1 FY24.
- Net debt – a further H1 reduction.** The seasonal inventory build ahead of the November-December peak trading period typically sees net debt rise from the 31 March financial year-end. However, G4M has delivered another impressive net debt reduction of £3.6m to £14.5m as at 30 September 2024 (vs £18.1m on 30 September 2023).
- Other news – acquisition, and new Marketing Director.** G4M has acquired Studiospares, an online retailer of upper-end studio equipment and accessories with a strong own-brand mix, for £150k. The purchase price includes the brand, IP and other assets of the company. G4M has also appointed a new Marketing Director to support the growth strategy.
- Forecasts – full-year outlook unchanged.** With the group well configured for peak trading and improving revenue momentum, the Board believes the full-year outlook remains aligned with consensus market expectations (EBITDA of £11.7m, PBT of £2.8m). Interim results will be published on 19 November, with the group expecting reported EBITDA of £2.9m and a reported loss before tax of £1.2m, both ahead of last year.

FYE MAR (£M)	2022	2023	2024	2025E	2026E
Revenue	147.6	152.0	144.4	154.9	159.1
Adj EBITDA	11.2	7.4	9.9	11.7	13.1
Fully Adj PBT	5.0	-0.4	1.1	2.8	4.4
Fully Adj EPS (p)	17.3	-3.1	5.2	9.4	14.8
EV/Sales (x)	0.3x	0.3x	0.3x	0.3x	0.3x
EV/EBITDA (x)	4.5x	6.9x	5.1x	4.3x	3.8x
PER (x)	9.9x	N/A	33.3x	18.3x	11.6x

Source: Company Information and Progressive Equity Research estimates.

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

Easing into the new Growth Strategy

Having successfully pivoted to focus on margins and cost reductions – rather than top-line growth – to protect bottom-line profitability in FY24, G4M unveiled a refreshed and updated strategy to drive profitable growth in FY25. The H1 results outlined in this trading update could be argued to fall marginally shy of this objective, although delivering a similar level of adjusted profitability to the prior year H1 results from a lower revenue and gross profit base is laudable, in our view.

The H1 performance and outline profit results would appear to have been held back by some initial issues with the newly introduced third-party AI-based marketing system, which had a negative impact in three areas:

- Own-brand revenues
- European revenues
- Overall marketing efficiency

The impacts on these three areas have not been quantified specifically, though some of the 40bps decline in gross margin and the 9% decline in European and Rest of the World revenues can undoubtedly be attributed to these teething issues. We would assume that less efficient marketing had some adverse cost implications, making the delivery of flat adjusted EBITDA (and improved reported EBITDA, which included £0.5m of exceptional redundancy costs in H1 FY24) even more impressive from the lower gross profit base.

New software launches almost invariably throw up some early snagging issues before remedies are introduced for smoother future operations. Most importantly, the group reports that these issues have now been resolved ahead of the peak November and December trading months, which typically account for around a quarter of annual sales. The other factor boding well for peak trading is the positive momentum for revenues. Moving from -4% in Q1 to +1% in Q2, and an implied stronger growth figure for the first three weeks of October, points potentially to a more positive growth outturn for H2 and the FY25E financial year. This said, there remains uncertainty over the strength of consumer confidence and disposable income, which will be further influenced by the measures announced in the upcoming Budget on 30 October.

H1 revenue and gross profit performance (£m unless otherwise stated)

Revenue:	H1 FY25E	H1 FY24E	% change on H1 FY24
UK sales	38.0	36.5	4%
Europe/RoW sales	23.7	26.1	(9%)
Total sales	61.7	62.6	(1%)
Gross profit:	16.5	17.0	(3%)
<i>Gross margin (%)</i>	<i>26.7%</i>	<i>27.1%</i>	<i>-40bps</i>
Adjusted EBITDA	2.9	2.9	
Adjusted (loss) before tax	(1.2)	(1.4)	
Net debt	14.5	18.1	

Source: G4M, Progressive Equity Research

The star of the show in H1, as last year, was the home UK market, which delivered a 4% increase in revenues. Since the last H1 trading period pre-Covid in the FY20 financial year to 31 March 2020, the UK market has delivered a five-year compound annual growth rate (CAGR) of just under 9% in terms of revenue growth. Indeed, the £38.0m reported for H1 FY25E exceeds the £36.7m achieved in both H1 FY21 and H1 FY22 when G4M was benefitting from the tailwinds of Covid. Group H1 revenue has seen a five-year CAGR since FY20 of 4.5%, notwithstanding the weaker performance of Europe and Rest of the World.

Gross margin eased back 40bps to 26.7% from 27.1% in H1 FY24 but was still some 40bps ahead of the gross margin percentage achieved in H1 FY23 (26.3%). The group H1 gross margin of 26.7% is also 150bps above the pre-Covid level of 25.2% seen in H1 FY20

The table above also shows the adjusted EBITDA and loss before tax expected by G4M for the period, compared with that achieved last year. This shows a maintained adjusted EBITDA performance despite the £0.5m lower level of gross profit expected in the current year. With no adjustment required for exceptional costs in H1 FY25E, the reported EBITDA will be identical to the adjusted figure. In H1 FY24, G4M incurred £0.5m of one-off costs associated with redundancies, primarily within its software development team, with reported EBITDA being some £0.5m lower at £2.4m.

G4M has said that it expects an improvement of £0.7m in the reported LBT to £1.2m compared with the same period in FY24. In the presumed absence of exceptional costs in H1 FY25E, we have assumed that the adjusted LBT will be identical at £1.2m.

The acquisition of Studiospares Europe Limited continues the trend of G4M seeking out quality brands to build out its portfolio of own brands. These deliver much superior gross margins to the group average and third-party brands, and are therefore beneficial to the margin mix, as well as helping to provide competitive differentiation in the marketplace.

With the Board believing the full-year outlook remains aligned with consensus market expectations (revenue of £154.7m, EBITDA of £11.7m, PBT of £2.8m), our forecasts are unchanged.

G4M will publish its interim results on 19 November.

Financial Summary: Gear4music

Year end: March (£m unless shown)

	2022	2023	2024	2025E	2026E
PROFIT & LOSS					
Revenue	147.6	152.0	144.4	154.9	159.1
Adj EBITDA	11.2	7.4	9.9	11.7	13.1
Adj EBIT	6.1	1.3	3.3	4.6	5.9
Reported PBT	5.0	(0.4)	0.6	2.8	4.4
Fully Adj PBT	5.0	(0.4)	1.1	2.8	4.4
NOPAT	4.6	2.0	3.1	3.4	4.4
Reported EPS (p)	17.3	(3.1)	3.0	9.4	14.8
Fully Adj EPS (p)	17.3	(3.1)	5.2	9.4	14.8
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	(4.1)	20.2	13.5	10.8	14.0
Free Cash flow	(14.1)	11.6	8.2	4.2	6.9
FCF per share (p)	(67.2)	55.4	39.1	20.0	32.8
Acquisitions	(10.4)	(0.4)	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	(26.9)	9.6	7.2	2.4	5.0
Overdrafts / borrowings	(28.0)	(19.0)	(12.0)	(8.5)	(8.0)
Cash & equivalents	3.9	4.5	4.7	3.6	8.1
Net (Debt)/Cash	(24.2)	(14.5)	(7.3)	(4.9)	0.1
NAV AND RETURNS					
Net asset value	38.0	37.2	38.4	38.6	40.0
NAV/share (p)	181.5	177.5	182.9	184.0	190.9
Net Tangible Asset Value	18.2	15.2	16.3	16.9	18.8
NTAV/share (p)	87.0	72.4	77.8	80.6	89.8
Average equity	36.2	37.6	37.8	39.4	42.1
Post-tax ROE (%)	13.9%	(1.1%)	2.8%	7.1%	10.5%
METRICS					
Revenue growth	(6.2%)	3.0%	(5.0%)	7.3%	2.7%
Adj EBITDA growth	(43.3%)	(34.3%)	34.3%	18.4%	12.1%
Adj EBIT growth	(60.3%)	(78.8%)	152.5%	43.0%	27.4%
Adj PBT growth	(65.8%)	(108.1%)	(363.1%)	161.2%	58.0%
Adj EPS growth	(71.1%)	(117.9%)	(266.3%)	81.9%	58.0%
Dividend growth	N/A	N/A	N/A	N/A	N/A
Adj EBIT margins	4.2%	0.8%	2.3%	3.0%	3.7%
VALUATION					
EV/Sales (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	4.5	6.9	5.1	4.3	3.8
EV/NOPAT (x)	11.1	24.8	16.4	14.7	11.5
PER (x)	9.9	N/A	33.3	18.3	11.6
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	(39.2%)	32.3%	22.8%	11.7%	19.1%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

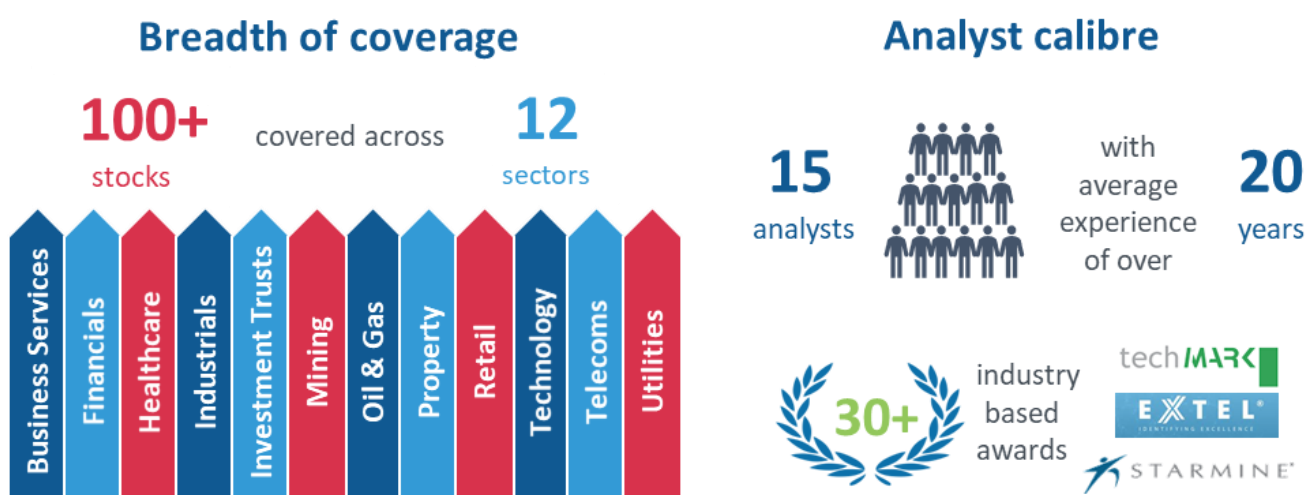
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