

# GEAR4MUSIC

## CONSUMER DISCRETIONARY

18 January 2024

**G4M.L**

145p

Market Cap: £30.4m

### 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	£48.5m
Index/market	AIM
Next news	FY update - April
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](http://www.gear4musicplc.com)

GEAR4MUSIC IS A RESEARCH CLIENT OF  
PROGRESSIVE

### ANALYSTS

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## Strong Q3 gross margin progress in line with new operating model priorities

G4M's pattern of trading across the Q3 peak period (to 31 December) closely mirrored that seen in H1. UK revenues were marginally higher, while total group revenues were 6% lower than last year, reflecting the challenging market conditions in Europe. A strong 260bp advance in gross margin more than offset the revenue decline, delivering a £0.4m increase in gross profit against Q3 FY23. Combined with cost reductions that were in line with Board expectations, the group continues resolutely to focus on its objective of prioritising profitability over top-line growth. This in turn ensures that G4M is well positioned to deliver profitable growth in FY25E.

- Revenue details – resilient UK trading, Europe remains challenging.** The pattern of revenue generation in Q3 FY24 was almost identical to that delivered in H1. While group revenue was down 6% in both periods, UK Q3 revenues were 1% higher (compared with a 3% rise in H1) and Europe and Rest of the World Q3 revenues were 14% lower. This was a small improvement on the 15% decline of H1 but reflects the continuing challenges of the European market. Following more subdued trading in October and early November, the anticipated return to the historical norm for Christmas trading did indeed see more robust trading over the Black Friday period, with peak revenues achieved in the week before Christmas.
- Gross margin – rebuilding strongly.** The strongest aspect of the Q3 trading performance, in our view, was the successful and planned rebuilding of gross margins. In conjunction with cost reductions, these are the operating priorities to offset lower revenues and protect profitability. Q3 saw a 260bp advance in gross margin to 28.2% compared with 25.6% in Q3 FY23. H1 delivered an 80bps improvement to 27.1%. We calculate the cumulative 9M gross margin increase to be 160bps to 27.6%.
- Forecasts unchanged – well positioned for profitable growth in FY25E.** With January trading to date in line with Board expectations, FY24E EBITDA and net debt reduction remain in line with consensus market expectations. These stand at group revenue of £144m, adjusted EBITDA of £9.8m, adjusted PBT of £1.2m and net debt of £11.6m. With commendable progress made on raising gross margins while reducing costs and net debt, the lower-cost operating model should provide a more solid base for profitable growth in FY25E.

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)	2.5x	4.3x	6.6x	4.9x	4.0x
PER (x)	2.4x	8.4x	N/A	30.4x	15.1x

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.

## Q3 and 9M trading details

The following table provides an overview of G4M's revenue and gross profit/margin performance for both Q3 and the cumulative nine-month (9M) periods. The 9M revenue figures are calculated, being the sum of the H1 revenue figures and the Q3 trading update figures. For the 9M period, the gross profit and gross margin percentage figures have been calculated by Progressive.

### Q3 and 9M trading performance details – FY20 to FY24

Sales (£m)	Q3 FY24	Q3 FY23	Q3 FY22	Q3 FY21	Q3 FY20	9M FY24	9M FY23	9M FY22	9M FY21	9M FY20
UK	26.2	26.0	26.0	23.0	20.9	62.7	61.5	62.7	59.7	45.7
International	20.2	23.5	21.2	29.2	19.4	46.3	54.3	49.2	62.7	44.0
<b>Total</b>	<b>46.4</b>	<b>49.5</b>	<b>47.2</b>	<b>52.2</b>	<b>40.3</b>	<b>109.0</b>	<b>115.8</b>	<b>111.9</b>	<b>122.4</b>	<b>89.7</b>
Change on prior year period (%)	Q3	Q3	Q3	Q3	Q3	9M	9M	9M	9M	9M
UK	1%	0%	13%	10%	n.a.	2%	-2%	5%	31%	n.a.
International	-14%	11%	-27%	51%	n.a.	-15%	10%	-22%	43%	n.a.
<b>Total</b>	<b>-6%</b>	<b>5%</b>	<b>-10%</b>	<b>30%</b>	<b>n.a.</b>	<b>-6%</b>	<b>3%</b>	<b>-9%</b>	<b>36%</b>	<b>n.a.</b>
Gross profit (£m)	13.1	12.7	13.4	15.6	10.6	30.1	30.1	31.5	35.7	23.1
Gross margin (%)	28.2%	25.6%	28.4%	29.9%	26.2%	27.6%	26.0%	28.2%	29.2%	25.6%

Source: G4M, Progressive Equity Research

This table stretches back to FY20, representing the last normalised trading year before the Covid pandemic struck. The FY21 periods clearly showing how G4M was in the minority of companies as a beneficiary of the accompanying lockdowns, with FY22 showing some unwinding against the exceptional trading levels achieved in FY21. In this context, G4M's longer-term progress can be seen by comparing the FY24 and FY20 figures, in terms of both revenue and gross margins.

On the revenue front, the group has achieved a 5% four-year CAGR (compound annual growth rate) for the 9M period since FY20. This has been led by its domestic UK market, which delivered a CAGR of 8.2% over this period. Reflecting the current difficult market conditions in Europe, the CAGR for International operations was a more modest 1.3%.

As described above, the most impressive element of the Q3 trading performance was the 260bp increase in G4M's gross margin to 28.2%. This is 200bps higher than the figure achieved in Q3 FY20 and just 20bps shy of the figure achieved in FY22. The 9M gross margin percentage of 27.6% is likewise some 200bps above that achieved in FY20, with the £30.1m gross profit figure (flat on FY23) delivering a four-year CAGR of 6.9% since 9M FY20. For reference, our FY24E gross margin percentage forecast stands at 27.4%.

Given the company's comments on FY24E performance remaining in line with market consensus expectations, we leave our forecasts unchanged, following the revisions made at the interims stage (see our [note](#)). For reference, we include the following tables, which show our FY24E and FY25E forecasts in fuller detail.

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

<b>Profit and loss account</b>						
<b>Year to March</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24E</b>	<b>FY25E</b>
<b>Revenue</b>	<b>120.3</b>	<b>157.5</b>	<b>147.6</b>	<b>152.0</b>	<b>144.0</b>	<b>155.0</b>
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)
<b>Operating profit</b>	<b>4.1</b>	<b>15.4</b>	<b>6.1</b>	<b>1.3</b>	<b>3.1</b>	<b>4.7</b>
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)
<b>EBITDA</b>	<b>7.8</b>	<b>19.8</b>	<b>11.2</b>	<b>7.4</b>	<b>10.0</b>	<b>12.0</b>
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)
<b>Adjusted PBT</b>	<b>3.1</b>	<b>14.6</b>	<b>5.0</b>	<b>(0.4)</b>	<b>1.4</b>	<b>2.8</b>
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
<b>Adjusted diluted EPS (p)</b>	<b>12.2</b>	<b>59.7</b>	<b>17.3</b>	<b>(3.0)</b>	<b>4.8</b>	<b>9.6</b>
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
<b>Cash flow</b>						
<b>Year to March</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24E</b>	<b>FY25E</b>
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
<b>Operating cash flow</b>	<b>7.2</b>	<b>15.0</b>	<b>(4.1)</b>	<b>20.2</b>	<b>12.5</b>	<b>10.7</b>
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)
<b>Trading cash flow</b>	<b>3.3</b>	<b>9.8</b>	<b>(14.1)</b>	<b>11.6</b>	<b>4.7</b>	<b>4.0</b>
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)
<b>Net cash inflow/(outflow)</b>	<b>2.0</b>	<b>8.3</b>	<b>(26.9)</b>	<b>9.6</b>	<b>3.1</b>	<b>2.4</b>
<b>Net (debt)/cash</b>	<b>(5.5)</b>	<b>2.7</b>	<b>(24.2)</b>	<b>(14.5)</b>	<b>(11.4)</b>	<b>(9.0)</b>

Source: G4M, Progressive Equity Research estimates

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

<b>Balance sheet</b>						
<b>Year to March</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22</b>	<b>FY23</b>	<b>FY24E</b>	<b>FY25E</b>
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
<b>Total fixed assets</b>	<b>29.3</b>	<b>29.5</b>	<b>41.0</b>	<b>41.3</b>	<b>40.2</b>	<b>37.0</b>
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
<b>Current assets</b>	<b>32.4</b>	<b>38.3</b>	<b>53.3</b>	<b>43.3</b>	<b>37.4</b>	<b>36.2</b>
<b>Total assets</b>	<b>61.6</b>	<b>67.7</b>	<b>94.3</b>	<b>84.6</b>	<b>77.6</b>	<b>73.2</b>
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)
<b>Current liabilities</b>	<b>(25.5)</b>	<b>(20.6)</b>	<b>(17.4)</b>	<b>(18.8)</b>	<b>(16.3)</b>	<b>(14.8)</b>
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)
<b>Non-current liabilities</b>	<b>(14.5)</b>	<b>(12.8)</b>	<b>(38.9)</b>	<b>(28.6)</b>	<b>(25.1)</b>	<b>(21.6)</b>
<b>Total liabilities</b>	<b>(40.0)</b>	<b>(33.4)</b>	<b>(56.3)</b>	<b>(47.4)</b>	<b>(41.4)</b>	<b>(36.5)</b>
<b>Net assets</b>	<b>21.6</b>	<b>34.3</b>	<b>38.0</b>	<b>37.2</b>	<b>36.3</b>	<b>36.8</b>

Source: G4M, Progressive Equity Research estimates

**Financial Summary: Gear4music**

Year end: March (£m unless shown)

	2021	2022	2023	2024E	2025E
<b>PROFIT &amp; LOSS</b>					
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
<b>CASH FLOW &amp; BALANCE SHEET</b>					
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)
<b>NAV AND RETURNS</b>					
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%
<b>METRICS</b>					
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%
<b>VALUATION</b>					
EV/Sales (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	2.5	4.3	6.6	4.9	4.0
EV/NOPAT (x)	3.6	10.7	23.8	20.9	14.1
PER (x)	2.4	8.4	N/A	30.4	15.1
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	32.2%	(46.3%)	38.2%	15.5%	13.1%

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

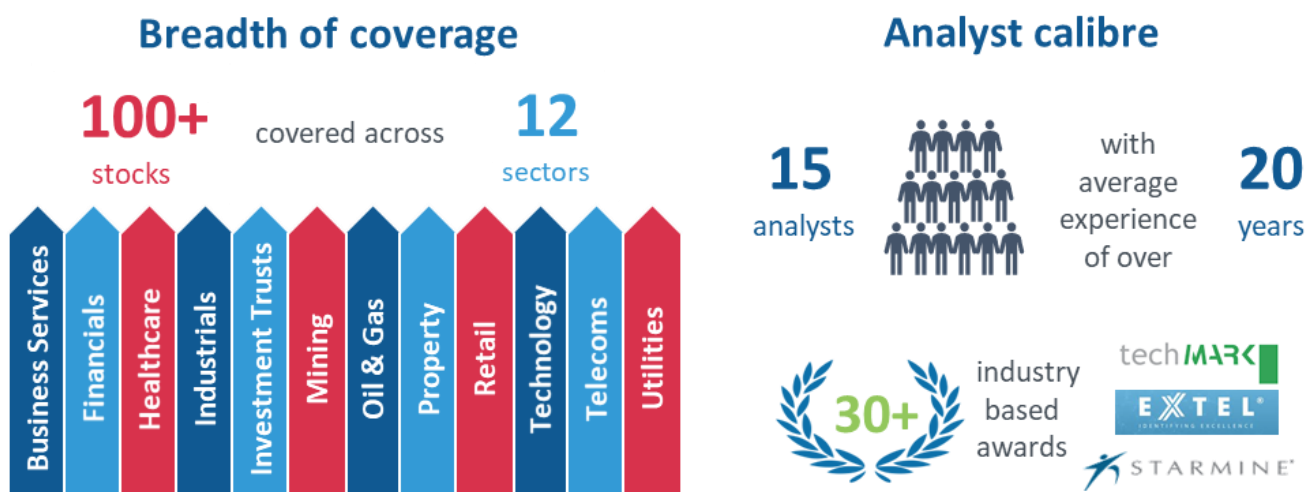
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