

Gear4music (Holdings) Plc



Good Rhythm – Headroom to Grow

23rd January 2020

Today's Gear4music trading statement reports a buoyant end to the 2019 calendar year with sales advancing by 7%. Moreover, higher gross margins confirmed the benefit of a raised focus on profitable growth while fully invested logistics and warehousing augurs well going forward. Given a reassuringly positive message on full year FY2020 figures, valuation looks supportive.

Gear4music's latest trading statement refers to the two months to 31st December 2019. These key Christmas trading months saw brisk sales growth in both the UK and Continental Europe, which advanced by 6% and 7% respectively to generate a 7% overall gain. Overseas business edged up slightly as a portion of group sales to 47.8%.

Consistent with what we highlighted in our 12th November 2019 report "[Profitability Takes Centre Stage](#)," gross margins increased in the two month period to 26.5% from 23.9% a year earlier while gross profit overall rose by 18% to £8.0m. Importantly, the company achieved this previously stated objective while still gaining market share.

None of last year's unusually disruptive logistics and warehousing problems appear to have recurred in this year's key trading period. In particular, the company's upgraded logistics and IT infrastructure has coped well with the intensity of Black Friday/Cyber Monday. Dispatched consignments rose 34% from the comparable weekend in 2018.

Looking ahead, Gear4music is comfortable that its three distribution locations enjoy sufficient capacity headroom to enable the company to grow volume at a sustainable brisk pace without needing significantly higher spending on tangible assets.

Gear4music states that full year FY2020 profits should be at least in line with the board's expectations. Furthermore, investors should in our view note that a number of other UK consumer facing companies reported demand headwinds in this year's Christmas trading period. Whilst Gear4music references a focus back toward growth-oriented projects, it also appears well placed to deliver mature economy – i.e. lower risk – growth on profitable, cash flow basis using its new economy online distribution channel. Having upgraded our forecasts in the November report, we leave them unchanged.

However, the company's apparent comfort with consensus estimates and its warehouse capacity augurs well. To us, a rise from the current 0.5x to 0.8x in Gear4music's EV/sales valuation makes sense, implying a 450p share price.

Company Data

EPIC	G4M
Price (last close)	240p
52 week Hi/Lo	265p / 170p
Market cap	£52m

Share Price, p



Source: ADVFN

Description

Gear4music sells own-brand musical instruments and music equipment alongside premium third-party brands including Fender, Yamaha and Roland, to customers ranging from beginners to musical enthusiasts and professionals, in the UK, Europe and, more recently, into the Rest of the World.

Key financials

£'000s	2017A	2018A	2019A *	2020E**	2021E**
Revenue	56,128	80,100	118,155	121,500	143,070
EBITDA adj	3,617	3,458	2,282	5,738	7,953
EV/sales (x)	1.1	0.8	0.5	0.5	0.4
EV/EBITDA (x)	16.3	17.1	25.9	10.3	7.4
EPS (p)	11.5	6.7	-0.8	3.9	9.3
P/E (x)	20.9	35.8	nmf	61.6	25.8

* FY2019 was a 13-month fiscal year

** FY2020 and FY2021 are prepared on an IFRS16 basis

Sources: Company accounts data and Equity Development estimates

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Overall, Gear4music delivered on message in its latest trading statement. The company is well placed to generate further growth without any significant increase in tangible assets. Its enlarged warehousing and improved IT infrastructure appear to be working well. Consequently, the company should look to bolster sales growth profitably in FY2021.

Summary of Trading Statement

Key features of Gear4music's trading statement are summarised in Figure 1. What is important is that the company enjoyed brisk growth in its key trading period while still delivering on its stated objective of increasing margins and profits.

Figure 1 - 31st December 2019 Trading Update

All figures in £m	2 months to 31/2/18	2 months to 31/2/19	Increase
UK sales	15.0	15.9	6%
Europe & Rest of World sales	13.5	14.5	7%
Total sales	28.5	30.4	7%
Gross profit	6.8	8.0	18%
Gross margin (%)	23.9%	26.5%	260bps

Source: Company data

Relative valuation

We summarise a relative valuation for Gear4music in Figure 2. EV/sales is the most useful of the measures given the notably large variation in the profit performance of the companies. In our view, the current 0.5x EV/sales appears low for Gear4music's valuation given clarity of demand growth, and its ability to meet that demand without increasing capital expenditure.

Moreover, while we leave our estimates unchanged there is a clear case that the FY2020 number is more comfortably achievable. Hence, we argue for a higher 0.8x EV/sales valuation, compared with 0.6x previously, implying a 450p share price.

Figure 2 - Relative Valuation

Company	Share price (pence)	Shares o/s (m)	Market cap (£m)	Debt (£m)	EV (£m)	Sales 2020 (£m)	EV/sales 2020 x	EPS 2020 (pence)	EPS 2021 (pence)	P/E 2020 x	P/E 2021 x
AO World	79	458.3	364	38	402	1110	0.4	0.3	1.9	nmf	43.7
ASOS	2966	83.6	2480	75	2555	3130	0.8	56.9	83.3	53.3	36.4
Boohoo	314	1145.7	3592	7	3599	1185	3.0	5.2	6.6	59.9	47.4
Gear4music	240	20.7	50	9	59	122	0.5	3.9	9.3	63.9	26.8
Ocado	1335	671.5	8965	360	9325	1271	7.3	-15.0	-11.4	nmf	nmf
Average							2.4			59.0	38.5

Note: share prices refer to closing price 22nd January 2020
Source: Company data, ED estimates, markets.ft.com, ADVFN



Investor Access

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