

Appreciate Group

Positioning for market recovery

The COVID-19 pandemic had a modest impact on Appreciate Group's FY20 results, which were in line with revised guidance. The impact on FY21 will be material and although there is a clear ongoing recovery in customer activity, peak Q3 trading will be crucial. No FY20 DPS was declared, but ongoing investment for medium-term digital-based growth should position the group well for the expected continuing recovery.

Year end	Billings* (£m)	Revenue (£m)	Adj. PBT** (£m)	EPS*** (p)	DPS (p)	P/E (x)	Yield (%)
03/19	426.9	110.4	12.5	4.8	3.20	6.7	10.0
03/20	419.9	112.7	11.4	3.0	0.00	10.9	N/A
03/21e	339.8	87.1	3.9	1.7	1.00	19.0	3.1
03/22e	377.9	100.6	7.1	3.1	1.50	10.5	4.7

Note: *Billings is a non-statutory measure of sales defined as the face value of voucher sales and the amount of value loaded onto prepaid cards, less any discount given to customers. **PBT is adjusted for exceptional items. ***EPS is fully diluted on a statutory basis. FY20 adjusted EPS was 4.93p compared with 5.43p in FY19.

FY20 in line with revised guidance

Trading for the first 11 months of FY20 was in line with earlier expectations until the first impacts of COVID-19 were felt in March, reducing billings by c £2.0m and profitability by c £0.3m due to slower customer redemptions. In line with revised guidance, adjusted PBT was £11.4m (FY19: £12.5m) before £3.7m of previously flagged exceptional items. The impact of the pandemic on the current year will be material and, to preserve cash while maintaining investment for medium-term growth, no dividend was declared in respect of FY20 despite an end-FY20 free cash balance of c £30m. The strategic business plan made good progress, aimed at enhancing long-term growth by accelerating digitalisation, improving efficiency, broadening customer appeal and deepening market penetration.

Well placed to benefit from market recovery

Ahead of the seasonally important Q3 (in the run-up to Christmas), management is not yet providing guidance but expects the recovery in billings from a low point in April to continue and says that it is currently ahead of its base case scenario for the year. Our tentative forecasts are updated and FY21e PBT is increased due to higher margins driven by an increasingly rapid shift to more profitable card and digital product. Reflecting on the general economy, we have tempered our FY22 recovery expectations. The group's continuing strategic investment and a new £15m flexible debt facility leave it well placed to benefit from market recovery, focused on more profitable card and digital product. Although the mix shift away from vouchers is a drag on near-term operational cash flow, this is captured upfront in our discounted cash flow model and has no impact on valuation.

Valuation: Uncertainty weighs on valuation

COVID-19 adds uncertainty to near-term forecasting and impedes reliable anticipation of the benefits of the strategic business plan. Our modified discounted cash flow (DCF) valuation falls to 60p (from 64p), a level which would represent 22x depressed forecast calendar 2021 EPS, consistent with comparator stocks.

FY20 results and outlook

Financial services

3 September 2020

Price **32.1p**

Market cap **£59m**

Net cash (£m) at 31 March 2020 29.6

Shares in issue 186.3m

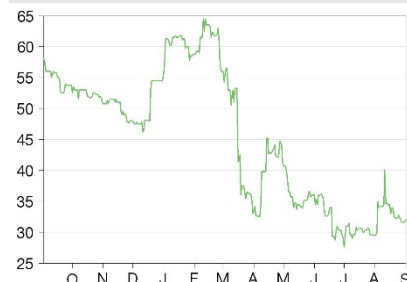
Free float 100%

Code APPS

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 7.0 (10.8) (44.7)

Rel (local) 8.9 (7.5) (32.9)

52-week high/low 65p 28p

Business description

Appreciate Group is a specialised financial services business and is the UK's leading provider of multi-retailer redemption products to the corporate and consumer markets. Consumers can access these products directly through its market-leading Christmas Savings offering. Corporate customers use these products to supply a range of incentive and reward products, often tailor made.

Next events

FY21 half-year results 24 November 2020

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**Appreciate Group is a
research client of Edison
Investment Research Limited**

UK leader in multi-redemption cards and vouchers

Appreciate Group is the UK's leading multi-retailer redemption product provider (cards, digital and vouchers) to the corporate and consumer markets. The UK market is large (the UK Gift Card & Voucher Association estimates just under £7bn per year) and growing, while fragmentation provides ample scope for market share gains.

The group's consumer-facing brands meet a range of prepayment and gifting needs, while products delivered to business customers support engagement by helping them to reward and recognise their customers and employees. Own brand, in-house, multi-retailer redemption products (pre-paid cards, digital equivalents and vouchers), accepted by a wide range of carefully selected retail partners, account for the majority of sales (c 84% of the total in FY20), but the group also offers third-party sourced single retailer products (eg M&S gift cards). The majority of group sales are generated online, which complements and supports traditional distribution through a direct salesforce and agents. Most income is generated from the service fees paid to Appreciate by partner retailers, leisure and other service providers, based on the face value of money spent in their outlets. Interest is earned on all prepaid cash until the obligation to the redeemers has been settled.

During the past two years a new senior management team has been implementing a strategic growth plan that seeks to accelerate growth and improve efficiency over the medium term. FY20 and FY21 are years of significant implementation for the plan, which gives greater focus to the core multi-retailer redemption offering, where the scale of the market provides significant potential, and greatly accelerates the digitalisation of products and delivery, in step with market trends, enhancing the attractiveness, accessibility and reach of the offering, and tapping into new market segments. Appreciate recently announced the discontinuation of hamper production, the historic core of the business but now a very small, non-core share of sales. The strategic acceleration of the shift to digital product promises faster medium-term growth and enhanced margins although, as we explain below, cash generation is less positive than has traditionally been the case with paper vouchers. As voucher sales decline, near-term cash flow is reduced, but our discounted cash flow valuation model has always anticipated this, and the impact is neutral. Appreciate recently agreed a flexible unsecured borrowing facility on favourable terms that will fund working capital needs during seasonal peaks and support expected future growth.

Results for the year to 31 March 2020 (FY20)

Trading for the first 11 months of FY20 was in line with earlier expectations until the first impacts of COVID-19 were felt in March. In line with updated guidance, the FY20 impact of the pandemic was relatively modest, reducing billings by c £2.0m and profitability by c £0.3m due to slower customer redemptions, deferring earnings recognition. The impact on the current year will be more significant, as we discuss below, and to preserve cash while maintaining investment for medium-term growth, no dividend was declared in respect of FY20. The company plans to return to its previous dividend policy as soon as it is appropriate (we forecast a 1p per share DPS in the current year). Meanwhile, significant progress was made with the strategic business plan, which seeks to adapt the business for future growth with a greater focus on digital products and delivery. While depressing near-term sales growth, the pandemic is actually providing an additional boost to this trend and the company's continuing investment should see it well placed to benefit from the expected market recovery, delivered off a more robust and scalable platform.

Exhibit 1: Summary of FY20 financial performance

£m unless stated otherwise	FY20	FY19	FY20/FY19	Edison FY20 forecast	FY20 actual vs Edison forecast
Consumer billings	222.2	232.1	-4.3%	229.5	-3.2%
Corporate billings	197.7	194.8	1.5%	204.0	-3.1%
Total billings	419.9	426.9	-1.7%	433.5	-3.2%
Revenue	112.7	110.4	2.1%	118.1	-4.6%
Cost of sales	(79.8)	(79.1)	0.9%	(84.8)	-5.9%
Gross profit	32.9	31.3	5.3%	33.3	-1.2%
Distribution costs	(2.8)	(2.9)	-3.3%	(2.8)	0.7%
Admin costs	(20.0)	(17.4)	15.1%	(20.4)	-1.8%
Adjusted operating profit (before exceptional)	10.0	10.9	-8.2%	10.1	-0.4%
Net finance income	1.3	1.6	-17.0%	1.4	-9.7%
Adjusted profit before tax (before exceptional)	11.4	12.5	-9.3%	11.5	-1.6%
Exceptional*	(3.7)	(1.2)		(3.4)	
Reported PBT	7.7	11.3		8.2	
Tax	(2.2)	(2.4)		(1.5)	
Net profit after tax	5.5	8.9	-38.0%	6.6	
Basic EPS (p)	2.96	4.78	-38.1%	3.54	
Diluted EPS (p)	2.96	4.77	-38.0%	3.53	
DPS (P)	0.00	3.20		1.00	
Total cash - including monies held in trust	132.3	136.1		141.8	
Period-end group cash (excluding overdraft)	29.6	34.6		28.8	

Source: Appreciate Group historical data, Edison Investment Research forecast. Note: *FY20 exceptional item relates to goodwill impairment, redundancy costs and impairment of fixed assets. There was also a £101k non-recurring write-down of obsolete stock. FY19 exceptional item relates to impairment of fixed assets.

Brief overview of FY20 results

The key drivers of the FY20 financial results were as follows:

- Group billings fell slightly (1.7%) to £419.9m (FY19: £426.9m), with growth in Corporate billings more than offset by weakness in Consumer. COVID-19 had a limited impact on the year, reducing billings by c £2m.
- Revenues increased by 2.1% due to a higher mix of third-party products, reported on a 'gross basis' under IFRS accounting compared with the 'net' treatment of in-house multi-redemption products.
- The share of higher-margin card and digital product continued to increase (and the share of paper product reduce) with a positive impact on gross margin, which increased from 28.4% to 29.2%.
- The increase in administrative costs included £1.5 strategy implementation costs (mainly related to the group relocation, IT upgrades and rebranding) as well as higher amortisation reflecting the increased IT investment. The majority of strategy implementation costs are likely to fall away in the current year, although these are not treated as non-recurring in the adjusted PBT calculation (see below).
- Finance income earned on free cash balances as well as segregated customer cash balances reduced with lower market-wide interest rates despite a slight rise in average FY cash balances during the year (£177m versus £174m).
- Adjusted PBT was £11.4m compared with £12.5m in FY19. This excludes £3.6m of previously flagged exceptional items, as well as a £0.1m write-off of obsolete stocks. Reported PBT was £7.7m compared with £11.3m in FY19. The mainly non-cash exceptional and non-recurring items included:
 - £1.9m of impairments against the group's former main site at Valley Road ahead of the £3.2m sale that completed after the period end, in August.
 - £1.3m of goodwill impairment in respect of the FMI subsidiary, a brand engagement agency that operates in the events market and which has been badly affected by COVID-

19, and an intangible asset representing acquired customer lists relating to the hamper business that will now be discontinued.

- £0.4m of redundancy costs relating to the reorganisation of the group's marketing department, refocusing on digital marketing and away from traditional media, and £0.1m of obsolete stock impairment costs relating to the hamper business discontinuation.

Exhibit 2: Reconciliation of reported to adjusted PBT			
£m		FY20	FY19
Reported PBT		7.7	11.3
Add back:			
Impairment of property, plant & equipment (Valley Road site)		0.2	1.2
Impairment of assets held for sale (Valley Road site)		1.7	
Impairment of goodwill		1.3	
Impairment of obsolete stock		0.1	
Redundancy costs		0.4	
Adjusted PBT		11.4	12.5

Source: Appreciate Group

- Statutory net income of £5.5m was c 38% lower than in FY19 and diluted EPS was 2.96p. Free cash at year-end was just under £30m but, with the impact of the pandemic on current year trading still uncertain ahead of the peak Q3 trading period, no final dividend was declared (and no dividend paid for the year) so as to maintain financial flexibility. The board hopes to return to its existing dividend policy as soon as is possible and this has typically seen a c 50% distribution of earnings weighted c one-thirds to H1 and c two-thirds to H2.
- Since year-end, Appreciate has agreed a £15m five-year unsecured revolving credit facility that will provide additional financial flexibility and support the expected growth of card and digital product, higher margin than vouchers but less immediately cash generative. The group has also completed the sale of its largely vacated Valley Road site for £3.2m, in line with the end-FY20 valuation.

More detail by product and business division

Looking more closely at the trends by business division and product, we note the following:

- Consumer billings were 4.3% lower at £222.2m or 53% of the total. Lower Christmas savers billings (for Christmas 2019) mainly reflect the continued decline of agency distribution business, partly offset by growth in direct customers. Total Christmas savers customers declined 7.4% to 396k. Appreciate was disappointed with the billings performance in other consumer, down 2.3% for the year after a very strong H120 performance, negatively affected by online systems limitations (both volume and load issues), which forced a curtailment in order intake, including the temporary imposition of a minimum order value. Ongoing IT infrastructure investment should prevent any recurrence.

Exhibit 3: Consumer billings stable with good growth in other consumer			
£m	FY20	FY19	Change
Christmas savers	204.8	213.6	-4.1%
Other consumer	8.4	8.6	-2.3%
Multi- and single retailer subtotal	213.2	222.2	-4.1%
Other income	9.0	9.9	-9.0%
Total Consumer billings	222.2	232.1	-4.3%

Source: Appreciate Group

- Corporate billings grew 1.5% to £197.7m, or 47% of the total, benefiting from new business and a good level of repeat business. Customer incentives and staff rewards showed good progress, but employee benefits was affected by the online systems issues referred to above, as well as trade credit restrictions in respect of one client. Intermediary business continues to be managed down as Appreciate prefers to go direct to customers. The total number of corporate clients served by the group increased by c 13% to c 42k.

Exhibit 4: Corporate billings driven by incentive and reward growth

£m	FY20	FY19	Change
Customer incentives	45.3	40.2	12.7%
Intermediaries	48.0	54.7	-12.2%
Staff rewards	82.8	75.3	10.0%
Employee benefits	17.2	20.8	-17.3%
Multi- and single retailer subtotal	193.3	191.0	1.2%
Other income	4.4	3.8	14.5%
Total Corporate billings	197.7	194.8	1.5%

Source: Appreciate Group

- The group's own multi-retailer billings (cards, vouchers and digital) remained the main source of billings (84.4%), although the share of lower-margin, third-party single retailer product increased due to a difference in the accounting treatment for VAT year-over-year.

Exhibit 5: Billings growth focused on core multi-retailer offering

£m	FY20	FY19	Change
Multi-retailer	354.3	362.4	-2.2%
Single retailer	52.9	50.8	4.1%
Multi- and single retailer subtotal	407.2	413.2	-1.5%
Other income	12.7	13.7	-7.6%
Total billings	419.9	426.9	-1.6%

Source: Appreciate Group

By product, card and digital billings showed good growth and paper product continued to decline. These mix changes reflect structural changes in the marketplace and the group's strategy, and the higher margin earned on cards and digital product is positive for ultimate profitability. We expect the trend to continue in the current year, given an additional boost by the pandemic.

Exhibit 6: Increasing share of card billings

£m	FY20	FY19	Change
Paper	170.2	200.0	-14.9%
Card	218.4	197.1	10.8%
Digital	17.7	16.1	9.9%
Total multi- and single retailer billings (before account fees)	406.4	413.2	-1.6%

Source: Appreciate Group

- Despite lower billings, revenues were slightly higher, up 2.1% to 112.7m, driven by the increase in third-party single retailer product that is reported on a gross basis (reflecting the full face value of the product rather than the trading margin) under IFRS. Lower in-house, multi-retailer redemption product revenues reflected both lower billings and slower redemption, deferring more revenue and profit into the future.

Exhibit 7: Marginal decrease in revenues reflects IFRS 15

£m	FY20	FY19	Change
Multi-retailer ('net')	37.9	41.1	-7.9%
Single retailer ('gross')	62.1	55.6	11.8%
Multi- and single retailer subtotal	100.0	96.7	3.4%
Other income ('net')	12.7	13.7	-7.2%
Total revenues	112.7	110.4	2.1%

Source: Appreciate Group

Strategic progress

During FY20, the group made tangible progress on its strategic business plan, announced in December 2018, including relocating offices, implementing new technologies, trialling new digital products, and changing the company name and branding. All these initiatives will contribute towards the aim of building a more robust and scalable business model, capable of capitalising on growth opportunities in the large and fragmented market in which the group operates.

The move of most operations to new offices in Liverpool’s city centre has enabled the creation of a more collaborative and effective working culture, while providing access to a broader and more skilled pool of potential employees. The substantially vacated site at Valley Road has now been sold with the limited continuing requirements for space leased back.

The group invested £3.0m in upgrading IT infrastructure in FY20 as part of an ongoing programme. Implementation of a new enterprise resource planning (ERP) system is progressing well despite some COVID-19 delays and is on track for implementation in 2021. Management expects the new ERP to provide the scalability, resilience and efficiency required for more seamless and automated back office support functions across the business. Deployment of cloud-based technology is expected to save costs and further improve reliability.

Significant steps have been taken to make it easier to work with customers, particularly in the digital space, and this has accelerated during the lockdown. New e-gift cards and e-codes have been added including additional brands that are especially relevant in lockdown conditions. In a successful pilot, the new ‘Select’ contactless-enabled digital gift card generated c £1.0m of billings and is being made available to corporate clients.

The greater focus on digital product dovetails with existing trends in the marketplace that have been accelerated by the pandemic. As noted above, the group’s multi-redemption card/digital billings exceeded voucher billings for the first time in FY20 and digital redemptions more than doubled to £9.7m. In the current year, until end July, digital billings have tripled to £18m and digital redemptions have grown by 135%.

Current year financials and forecasts

Significant COVID-19 impact but billings recovering

The COVID-19 pandemic had a relatively modest impact on FY20, but will materially affect the current year by reducing customer orders and slowing redemptions. Billings fell sharply in April as the lockdown took effect but have since begun to steadily improve. As at the end of July, underlying billings were down 41% year to date. The performance of total billings includes the short-term impact of the partnership with Iceland to provide access to the Department of Education free school meals national voucher scheme during the summer weeks. Management indicates that on a full-year basis the Iceland deal will add c £10m to billings but with a low single-digit margin.

Exhibit 8: Underlying billings have begun to recover*

	Apr-20	May-20	Jun-20	Jul-20	Ytd
Underlying billings	-64%	-47%	-38%	-18%	-41%
Billings including Iceland impact	N/A	N/A	-35%	41%	-25%

Source: Appreciate Group. Note: *Corporate and other consumer billings.

Positively for margin, a larger share of billings year to date is represented by core own-brand, multi-retailer redemption products, and within this by card and digital product.

Due to the closure of shops and other redemption outlets during the lockdown, redemption rates have reduced. In the current year, up to 31 July, the overall rate of redemption was 39% lower compared with the same period in FY20, with a sharp fall in physical redemption (-54%) partly offset by strong growth (+169%) in online redemptions. Slower redemptions defer the recognition of revenues and profits for the core multi-retailer redemption products, but the delay in customer spending has a positive impact on cash flow.

Company not yet providing forward-looking guidance

There is a strong seasonality to APP's business with more than 70% of billings and all profits generated in the second half of the year (with H1 seasonally loss-making), particularly focused on Q3. The seasonality is particularly marked in the Consumer business (more than 80% of billings in H2) given the importance of Christmas savers. The Christmas savers order book for the current year (Christmas 2020), which will be the driver of Consumer billings in the current year, was effectively built before the pandemic took hold and subsequent order cancellations continue to run in line with historical trends. The Christmas savers order book is nevertheless lower than in the previous year (-9%), reflecting pressures on traditional agency distribution.

Ahead of the peak Q3 trading, the company continues to feel it inappropriate to provide forward-looking guidance. In addition to the uncertain development of the economy, the potential for a second wave of the pandemic, continuing social distancing constraints, and the winding down of the hamper business all represent additional operational risks.

However, Appreciate has provided details on several scenarios that it has modelled in order to assess the potential impact of the pandemic on its results of the group going forward and says that it is currently trading slightly ahead of its base case scenario. The base case assumed a 60% decline in corporate and other consumer billings in Q121 (compared with the actual outcome of -48%) followed by a gradual recovery to -25% by Q4. The recovery is assumed to continue in the first two quarters of FY22, with year-on-year increases of 40%. Subject to its independent order and billings pattern, Christmas savers' billings are assumed to be 11% lower in FY21. While each of the scenarios points to a positive cash position including the new £15m revolving credit facility (RCF) by end-FY21, the base case does not show a need for any RCF drawing, to fund resumed growth in billings, focused on card and digital product, until July 2021 and for a short period, with offsetting positive cash flow emerging by September 2021.

Our own forecasts are updated

We have updated our own tentative forecasts, increasing our FY21 PBT forecast (with no anticipated adjustments required) despite very slightly trimming billings and revenue forecasts. The PBT increase is driven by an expectation of higher gross margin, in line with FY20 performance, resulting from the product mix shift towards more profitable card and digital product. For FY22, we have trimmed the strength of the assumed billings and revenue recovery, reflecting an anticipation that the economy will be slower to bounce back.

Exhibit 9: Summary of billings forecast

£m	New		Old		Change	
	FY21	FY22	FY21	FY22	FY21	FY22
Consumer billings	195.7	203.6	202.2	217.0	-3.2%	-6.2%
Corporate billings	144.1	174.3	138.8	220.3	3.8%	-20.9%
Total billings	339.8	377.9	341.0	437.3	-0.3%	-13.6%

Source: Edison Investment Research

We forecast a reinstatement of DPS payments in respect of FY21 and continued growth in FY22, albeit at a slower rate than previously forecast.

Exhibit 10: Performance versus expectations and estimate revisions

	Billings (£m)			Revenues (£m)			Adjusted PBT (£m)*			Diluted EPS (p)			DPS (p)		
	Act.	F'cast	Diff.	Act.	F'cast	Diff.	Act.	F'cast	Diff.	Act.	F'cast	Diff.	Act.	F'cast	Diff.
Mar-20	419.9	433.5	-3.2%	112.7	118.1	-4.6%	11.4	11.5	-1.4%	3.0	3.5	-16.1%	0.00	1.00	n.m.
	New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change
03/21e	339.8	341.0	-0.3%	87.1	87.9	-1.0%	3.9	3.2	22.7%	1.7	1.4	22.7%	1.00	1.00	0.0%
03/22e	377.9	437.3	-13.6%	100.6	112.6	-10.6%	7.1	9.3	-23.5%	3.1	4.0	-23.5%	1.50	2.75	-45.5%

Source: Edison Investment Research

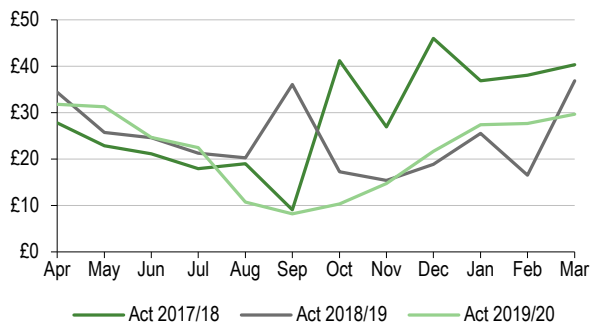
Cash flow and borrowing

The continuing strong growth in the share of card/digital products and the relative decline in own voucher products, both as a share of the total and in absolute terms, is positive for profitability and to be welcomed. However, in the near term it has the effect of reducing operational cash flow. This is not because card/digital products consume cash to any significant extent; rather it is because the lower-margin voucher products are cash generative, so long as sales are rising.

As a non-regulated product (unlike card/digital), although customer balances in respect of own voucher sales are segregated, at the point of despatch/billing the cash may be transferred to the corporate cash balance. The majority will eventually be paid out to retail partners once the vouchers have been redeemed, but meanwhile sits with the company and is offset by an equivalent balance sheet provision. Customer card/digital cash balances are strictly segregated within the e-money trust until such time as 'contractual ownership' passes to Appreciate. The change in contractual ownership most commonly occurs at redemption and in this respect is in line with revenue and profit recognition. However, revenue recognition in respect of 'breakage' (where there is anticipation that the card balance will never be redeemed) is determined by observed redemption patterns and this is likely to differ from cash emergence over the short term, with cash emergence typically lagging revenue recognition when billings/sales are increasing.

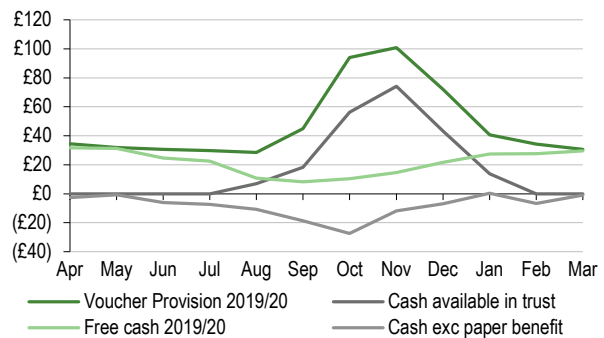
During FY20, own voucher billings (paper) declined from £200m (48% of the total) to £170m (42% of the total) and the voucher provision balance reduced from £36.3m to £30.2m, representing a cash outflow of £6.1m. We forecast a continued decline in voucher billings over the next two years, both in absolute terms and as a share of the total (to less than 30%), and forecast a further halving of the provision balance. This is the main driver of our forecast reduction in the group cash balance. It is worth noting that in our DCF valuation (see below), we deduct upfront the value of the voucher provision balance and so its anticipated decline is neutral to valuation.

Exhibit 11: Free cash (£m)



Source: Appreciate Group

Exhibit 12: Free cash 2019/20 (£m)



Source: Appreciate Group

Total cash balances, combining free cash and segregated customer cash, normally peak in September/October, ahead of Christmas. The peak in FY20 was £234.6m, only very slightly below FY19. Free cash tends to be weakest around the same time (Exhibit 11), as stocks are built, but then increases again as orders are despatched, particularly in respect of vouchers as described above. Exhibit 12 shows that with the declining share of vouchers in sales, the swings in free cash have become somewhat more muted. It also shows that without the benefit of cash temporarily released from vouchers, free cash would have been negative around October 2019.

In August, to provide additional financial flexibility to drive medium-term growth of higher-margin but less immediately cash-generative card and digital product, Appreciate agreed a £15m unsecured five-year revolving credit facility on favourable terms (1.65% above Libor on drawn balances). The agreement includes an accordion option to extend the facility by an additional £10m. Consistent with our billings growth and mix forecasts, we anticipate that this may be first used during FY22,

when we expect sales volumes to be recovering quite strongly, led by card and digital product, and with the positive cash effect of vouchers further diminishing. Our expectation is that, at least initially, it will be used during peak funding periods and so does not appear on our forecast balance sheet at end-FY22.

Aide memoire: Revenue recognition under IFRS 15

Under IFRS accounting, there is a distinction between sales where Appreciate has control over the promised good or service, acting as 'principal', and those where it is simply arranging for another party to provide the good or service, acting as 'agent'. In the case of own-branded, multi-retailer redemption product, the group acts as an agent. For third-party, single-retailer redemption products and all other goods and services, the group acts as principal. When acting as an agent, revenues are recorded on a net basis representing the service fees receivable from the retailers/redemption partners. When acting as principal, revenues are recorded on a gross basis. For third-party, single-retailer redemption products, this means that revenues are equivalent to the face value of the voucher or card less any discounts. In the case of services provided by the group, revenues represent the values invoiced.

As a result, changes in the mix of sales will significantly affect the revenues reported as well as the gross margin (on revenues), but does not change the gross profit that will ultimately be earned. For this reason, billings is our preferred measure of customer activity and our preferred measure of 'sales'. It represents the gross value of vouchers, cards, and other goods and services provided and, unlike statutory revenues, it is unaffected by changes in business mix between multi-retailer redemption product and other goods and services, including single retailer cards, vouchers and e-codes.

Revenues are recognised when control over the good or service has been transferred to the customer. In the case of multi-retailer redemption vouchers, cards and digital products, service fees are recognised at redemption, ie when the product is 'spent' with one of the group's retail partners. For single-retailer redemption products, revenues are generally recognised when they are received by the customer. A certain proportion of the vouchers and cards sold by and distributed by Appreciate will never be redeemed and for multi-retailer redemption products (but not for third-party, single-retailer redemption product) where the customer has no right of redemption (ie cannot request a refund of unspent balances), this 'breakage' represents an additional source of revenue and earnings, and is recognised in proportion to the rate of redemption. Rather than breakage being recognised on unredeemed balances, cards with a right of redemption are subject to account fees that are recognised as levied on or after the expiry of the card.

Valuation

A satisfactory direct valuation comparison of Appreciate Group with quoted competitors is not possible. There are no direct comparators for the Christmas savers business, and competitor employee benefits and service providers are either private companies or relatively small parts of larger groups, complicating any attempt at a relative valuation approach. In incentive and rewards products, Sodexo and Edenred are both much larger and more international, and the overlap between Appreciate and Sodexo is limited (Sodexo Benefits and Rewards Services is only a minor part of Sodexo Group). With that in mind, our valuation approach continues to combine a potential absolute valuation, based on a modified DCF analysis, alongside a relative value based on a comparison with a selected group of listed stocks which are engaged in activities that provide some overlap with Appreciate.

Our DCF value is 60p, down slightly from 64p due to our FY22 forecast reduction. It continues to include a two-stage growth model to better capture (albeit imperfectly) the expected recovery from

COVID-19 and medium-term benefits of the strategic business plan investment. Given that our near-term forecasts are suppressed by investment spending and the pandemic, it is difficult to attach a target multiple, but we note that the 60p DCF value implies a CY20 P/E multiple of 30.0x and a CY21 P/E multiple of 22x. Although high as a result of near-term earnings pressures, we believe these multiples are reasonable in the context of the comparator stocks, notwithstanding the relatively low market capitalisation and implied lower liquidity.

DCF value of 60p

Our modified DCF valuation differs from a standard DCF in that we include the interest earned on segregated customer cash balances (but not on the group cash balances), recognising that this is an integral part of the returns the company generates. The customer cash is excluded from the overall valuation and we also exclude the voucher provisions balance, as this will eventually flow out in settlement of vouchers that have been issued but not yet redeemed. Our key assumptions have been held constant for an extended period, including an assumed 10% discount rate and 10x terminal multiple. Our two-stage growth assumption comprises three years of 10% growth beyond the two-year forecast period (to end-FY22), followed by a reversion to a long-term growth rate of 5% up until year 10. We continue to assume an eventual 'normalisation' in interest rates and assume a stepped increase in market deposit rates to 1.5% in FY23 and 3% from FY24 and, as noted above, we deduct upfront from the DCF valuation the amount of voucher provisions (£30.2m at end-FY20) on the basis that the matching cash is only temporarily available to the group, albeit on a revolving basis. As a result, the expected further decline in the voucher provision balance, and the negative impact on near-term operating cash flow, has no impact on our DCF valuation.

'Comparator' relative valuation

Our quoted 'comparator' group includes both Sodexo and Edenred, and also the prepaid card and payments service providers Euronet Worldwide, Fleetcor Technologies, Green Dot Corp, and EML Payments (we previously included Wirecard but have removed it due to its accounting issues).

Exhibit 13: : Listed comparator data

	Share Price (local)	Market Cap (£m)	P/E (x) CY20	P/E (x) CY21	EV/EBITDA (x) CY20	EV/EBITDA (x) CY21	Dividend Yield (%)
Edenred SA	43	9428.7	20.2	17.5	39.1	32.1	1.5
Sodexo SA	60	7734.7	10.3	7.9	26.1	15.2	4.9
Incentive average			15.2	12.7	32.6	23.6	3.2
FleetCor Technologies	250	15703.0	18.9	16.0	22.6	19.2	N/A
Green Dot Corp	55	2194.6	17.1	14.2	29.9	24.7	N/A
EML Payments	3	630.1	5.2	3.5	34.5	27.0	N/A
Euronet Worldwide Inc	102	3990.9	23.7	11.2	53.5	N/A	N/A
Prepaid card and payment services average			16.2	11.2	35.1	23.6	N/A
Total group average			15.9	11.7	34.3	23.6	3.2
Appreciate Group	32	59.8	8.4	7.5	16.0	11.8	3.1

Source: Refinitiv. Note: Edison estimates for Appreciate Group. Earnings data on a calendar year (CY) basis. Appreciate's yield is based on Edison forecast FY21 DPS. Appreciate's enterprise value (EV) excludes voucher provision balance from cash. Prices as at 1 September 2020.

Sensitivities

As a result of the continuing COVID-19 pandemic and its uncertain effect on the economy and trading conditions, our forecast assumptions, set out in the financial section above, are best seen as tentative. In addition to pandemic-related risks, we note the following fundamental sensitivities to the performance of the business and our forecasts:

- **General economic growth:** the Christmas savers business has historically shown a generally resilient performance in time of economic stress, providing support and discipline to Christmas planning in difficult times. However, it is not fully immune and is also facing headwinds in its agency distribution business, currently offsetting growth in direct business. The corporate business depends much more on the health of the SME sector, although staff incentivisation can display countercyclical qualities. Given the fragmented nature of the UK market for prepaid gift cards, multi-retailer gift vouchers and digital rewards services, estimated by the UK Gift Card & Voucher Association to be worth almost £7bn per year and growing, there is ample opportunity for the group to benefit from market share gains even in a weaker market environment.
- **Business continuity and IT systems:** the group is currently investing significantly to upgrade its IT infrastructure, making it more robust and scalable as any significant loss of transaction capability or breach of security could have a serious impact on group performance and customer confidence. Appreciate has reported no online security issues and manages cyber security risks according to National Cyber Security Centre principles.
- **Regulation:** as an FCA-regulated e-money issuer, the group would be affected by any changes in regulation of its prepaid card products. Christmas prepayment practices are covered by voluntary industry agreements, but any enforced changes in selling practices or customer protection could affect the group.
- **Brand perception and customer confidence, especially in the Christmas savers business:** the group's Christmas savers business is dependent on the confidence of its customers and their willingness to make prepayments. Since the high-profile collapse of Farepak in 2007, the industry has voluntarily segregated customer balances, providing support to customer confidence. As a regulated financial services product, card prepayments are 100% segregated by law.
- **The impact of interest rates on cash balances:** during the year, the group accumulates substantial cash balances in the Christmas savers business, peaking around October/November, and earns interest on these balances. Historically, the contribution to PBT has been material, but with interest rates at such low levels the contribution diminished. We note that an additional 50bp earned for a full year would lift the gross interest contribution (before bank facility fees) to FY22e PBT from c 6% to c 11%.

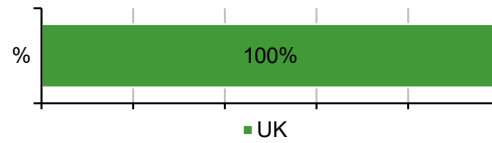
Exhibit 14: Financial summary

Year end 31 March	£'000s	2015	2016	2017	2018	2019	2020	2021e	2022e
PROFIT & LOSS									
Consumer billings		196,796	208,352	216,771	232,635	232,096	222,207	195,744	203,587
Corporate billings		176,091	176,679	187,741	180,151	194,805	197,650	144,094	174,322
Total Billings		372,887	385,031	404,512	412,786	426,901	419,857	339,838	377,909
Revenue		85,769	100,556	119,637	111,054	110,394	112,724	87,102	100,612
Cost of sales		(59,193)	(72,030)	(89,944)	(79,628)	(79,117)	(79,902)	(61,407)	(70,931)
Gross profit		26,576	28,526	29,693	31,426	31,277	32,822	25,695	29,680
Gross margin as % billings		7.1%	7.4%	7.3%	7.6%	7.3%	7.8%	7.6%	7.9%
Distribution costs		(2,761)	(2,909)	(2,940)	(3,002)	(2,934)	(2,838)	(2,039)	(2,267)
Administrative expenses excluding depreciation & amortisation		(14,914)	(15,176)	(16,348)	(15,702)	(16,007)	(18,377)	(18,000)	(18,500)
EBITDA		8,901	10,441	10,405	12,722	12,336	11,607	5,656	8,913
Depreciation & amortisation		0	0	0	(1,405)	(1,394)	(1,659)	(2,000)	(2,100)
Operating profit before exceptional items		8,901	10,441	10,405	11,317	10,942	9,948	3,656	6,813
Exceptional items		0	0	0	0	(1,210)	(3,552)	0	0
Operating profit		8,901	10,441	10,405	11,317	9,732	6,396	3,656	6,813
Net Interest		1,245	1,457	1,470	1,270	1,572	1,304	242	281
Profit Before Tax & exceptional items		10,146	11,898	11,875	12,587	12,514	11,376	3,898	7,094
Profit before tax		10,146	11,898	11,875	12,587	11,304	7,700	3,898	7,094
Tax		(2,284)	(2,177)	(2,361)	(2,398)	(2,422)	(2,189)	(741)	(1,348)
Profit after tax (IFRS)		7,862	9,721	9,514	10,189	8,882	5,511	3,157	5,746
Average number of shares (m)		182.5	183.7	183.9	185.3	186.0	186.3	186.3	186.3
Fully diluted average number of shares (m)		184.7	187.2	187.2	185.9	186.1	186.3	187.3	187.3
Basic EPS - IFRS (p)		4.3	5.3	5.2	5.5	4.8	3.0	1.7	3.1
Fully diluted EPS - IFRS (p)		4.3	5.2	5.1	5.5	4.8	3.0	1.7	3.1
Dividend per share (p)		2.40	2.75	2.90	3.05	3.20	0.00	1.00	1.50
Pay-out ratio		55.7%	52.0%	56.1%	55.4%	67.0%	0.0%	59.0%	48.6%
BALANCE SHEET									
Non-current assets		13,924	13,749	14,399	14,868	12,606	16,224	17,676	18,076
Goodwill		1,320	1,320	2,202	2,185	2,168	800	800	800
Other intangible assets		3,168	3,036	2,682	2,278	2,295	4,757	6,257	6,657
Property, plant, & equipment		8,143	8,003	7,688	7,684	6,216	2,662	2,662	2,662
Retirement benefit asset		1,293	1,390	1,827	2,721	1,927	4,206	4,158	4,158
Other non-current assets		0	0	0	0	0	3,799	3,799	3,799
Current assets		107,095	119,496	129,322	142,423	153,475	148,041	122,603	135,022
Inventories		3,186	2,182	2,632	3,808	4,574	2,840	2,500	3,000
Trade & other receivables		11,309	8,860	9,236	10,917	12,582	9,457	10,195	11,337
Monies held in trust		65,728	75,219	83,018	86,992	99,251	102,693	86,801	101,089
Cash & equivalents		26,333	32,735	34,236	40,311	36,868	29,632	22,841	19,329
Other current assets		539	500	200	395	200	3,419	266	266
Current liabilities		(121,545)	(128,164)	(133,789)	(142,604)	(148,818)	(140,665)	(113,522)	(122,768)
Trade & other payables		(77,688)	(83,135)	(87,201)	(94,592)	(61,191)	(57,150)	(46,218)	(51,396)
Tax payable		(671)	(262)	(424)	0	(580)	0	0	0
Provisions		(43,186)	(44,767)	(46,164)	(48,012)	(58,286)	(53,802)	(41,369)	(43,605)
Non-current liabilities		(2,907)	(1,881)	(1,118)	(662)	(553)	(5,253)	(5,253)	(5,253)
Deferred tax liability		(273)	(181)	(194)	(662)	(553)	(1,121)	(1,121)	(1,121)
Retirement benefit obligation		(2,634)	(1,700)	(924)	0	0	0	0	0
Lease liabilities							(4,132)	(4,132)	(4,132)
Net assets		(3,433)	3,200	8,814	14,025	16,710	18,347	21,504	25,076
Minorities		0	0	0	0	0	0	0	0
Shareholders' equity		(3,433)	3,200	8,814	14,025	16,710	18,347	21,504	25,076
CASH FLOW									
Operating Cash Flow		14,106	12,184	9,603	10,540	6,874	6,866	(5,945)	2,229
Net interest		1,176	1,339	1,539	1,267	1,497	1,640	242	281
Tax paid		(2,132)	(2,490)	(2,258)	(2,537)	(1,576)	(2,864)	(741)	(1,348)
Capex		(597)	(1,126)	(717)	(1,020)	(1,152)	(5,030)	(3,500)	(2,500)
Acquisitions/disposals		41	52	(875)	1	0	1	3,153	0
Dividends paid		(4,198)	(4,380)	(5,052)	(5,370)	(5,668)	(5,963)	0	(2,174)
Other		0	0	305	0	345	419	0	0
Net cash flow		8,396	5,579	2,545	2,881	320	(4,931)	(6,791)	(3,512)
Opening net (debt)/cash		14,842	23,238	28,817	31,362	34,243	34,563	29,632	22,841
Closing net (debt)/cash		23,238	28,817	31,362	34,243	34,563	29,632	22,841	19,329
Overdraft		3,095	3,918	2,874	6,068	2,305	0	0	0
Closing net (debt)/cash as per balance sheet		26,333	32,735	34,236	40,311	36,868	29,632	22,841	19,329

Source: Appreciate Group historical data, Edison Investment Research forecasts

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Revenue by geography


Note: Revenues for the group's small subsidiary in the Republic of Ireland are not separately disclosed but are immaterial in a group context.

Leadership team
Non-Executive Chairman: Laura Carstensen

Laura Carstensen became non-executive chairman on 3 June 2016, having been appointed to the board as a non-executive director on 23 September 2013. Her position as chairman was extended for three years with effect from 3 June. She is a former partner in city law firm Slaughter and May, a former member and deputy chairman of the UK Competition Commission (now the Competition and Markets Authority) and a former commissioner of the Equality and Human Rights Commission. She is the senior independent director of AJ Bell and a trustee of National Museums Liverpool.

Chief Executive Officer: Ian O'Doherty

Ian O'Doherty was appointed to the board and became CEO on 1 February 2018. He has a strong background in financial services, specifically in banking, payments and card services, having worked at MBNA for 26 years, most recently as chairman and CEO of MBNA in the UK, a position he held from 2008 to 2017. From 2015 to 2017, Ian was deputy chair of the UK Cards Association, having been a board member since 2008, and he was a member of the Interim Main Board of UK Finance (New Trade Association) from 2016 to 2017.

Chief Financial Officer: Tim Clancy

Tim Clancy was appointed to the board on 28 August 2018 and is the CFO. He is an associate of the Chartered Institute of Management Accountants and joined the group from Assurant Europe, the European subsidiary of the US-listed global insurance provider Assurant, where he was CFO. His previous roles include, from 2011 to 2013, FD of Lifestyle Services Group, an insurance administrator and outsourcing provider and, from 2009 to 2011, commercial FD of Shop Direct Group. Before then he spent over 10 years in the travel industry in many finance and general management roles including FD of Airtours and MD of Going Places.

Principal shareholders

	(%)
Premier Miton Group	11.25
Schroders	10.99
Artemis Investment Management	8.58
SFM UK Management	8.40
Unicorn Asset Management	7.09
Investec Wealth & Investment	5.06
Investec Asset Management	3.89

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