

Appreciate Group

Gaining momentum

Q3 trading update

Financial services

12 January 2021

Price **33p**

Market cap **£61m**

Net cash (£m) at 31 December 2020 33.5

Shares in issue 186.3m

Free float 100%

Code APPS

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 7.3 22.6 (47.2)

Rel (local) 2.9 8 (42.1)

52-week high/low 65p 24p

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

Year-end trading update 29 April 2021

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Sales performance continued to improve in the seasonally important Q321 period. Core billings were well ahead of the prior year and December was the strongest month ever. Management is confident H221 will see the normal swing back to profitability, with the full-year performance at least in line with its expectations that underlay the H121 reinstatement of dividends. Accelerated digitalisation of the business has mitigated the effects of the pandemic, supported the Q321 progress, and positions it well for sustainable growth beyond the current financial year.

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	6.9	9.7
03/20	419.9	112.7	11.4	4.9	0.00	6.7	0.0
03/21e	360.9	93.5	4.2	1.9	1.20	17.1	3.6
03/22e	392.3	101.0	7.1	3.1	1.50	10.7	4.5

Note: *Billings is a non-statutory measure of sales defined as the face value of voucher sales and the net amount of value loaded on prepaid cards/digital products. **PBT is adjusted for exceptional items. ***EPS is fully diluted and adjusted for exceptional/non-recurring items.

Strong Q3 growth led by digital

Core underlying billings (excluding Christmas Savings billings, which are driven by fulfilment of the annual order book) were up 13.1% to £96.3m in Q321 (three months to 31 December 2020) compared with Q320 and December (billings of £45.5m/+41.7%) was Appreciate Group's (APP's) strongest month ever. Continuing momentum in digital sales drove the Q3 growth with an almost four-fold increase to £22.5m (Q320: £5.9m). The free cash position increased to £33.5m from £24.9m at H121. Although the latest lockdown measures may delay some revenue and profit recognition until customers have more opportunity to redeem their products, management expects the full-year performance to be at least in line with its mid-range scenario described in the 2020 annual report.

Well placed for further growth

APP has continued to progress its strategic business plan, aimed at 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 progress made to date, enhancing operating systems and processes and putting a greater focus on digital products and services, mitigated the pandemic's effects in H121 and is delivering growth in Q3 by positioning the group to better exploit existing industry trends and deliver sustainable growth. Business simplification has continued with the wind-down/sale of FMI, contract packing and the Irish businesses, allowing management to focus on driving the core business.

Valuation: Not yet anticipating recovery

Our forecasts and modified DCF valuation of 60p per share are unchanged. The DCF looks through the near-term suppression of earnings by the pandemic and 'one-time' cash flow adjustment from business mix changes away from paper vouchers to card/digital. It implies a calendar year 2021 P/E of c 21x and yield of 3.3%, reasonable in a 'peer group' context and in view of APP's growth ambitions.

Additional details

Steady progress in billings since April low

Exhibit 1 shows the steady progress of core underlying billings from April 2020 when the pandemic lockdown was first introduced. Core underlying billings includes the Corporate business and Highstreetvouchers.com (HSV) but excludes Christmas Savings. Christmas savings billings are driven by Christmas order despatches, primarily in the second half of the year, from an order book built primarily in the first half of the year. Positively, the Christmas 2020 order book has ended up c 8% lower year on year compared with earlier indications of c 10%. Also not included in Exhibit 1 is c £12m of billings in respect of the free summer school meals partnership with Iceland, one-off in nature and relatively low margin. Including this, core billings were £166.0m in the nine months to end-December 2020, at a similar level to the first nine months of FY20.

Exhibit 1: Steady progress in billings since April low

Corporate and HSV billings (£m)	Apr	May	June	July	Aug	Sept	H121	Oct	Nov	Dec	Q321	9M21
FY21	5.0	7.4	8.6	11.8	10.2	14.9	57.9	24.0	26.8	45.5	96.3	154.2
FY20	14.0	13.7	13.8	14.4	12.4	13.0	81.2	26.4	26.6	32.1	85.1	166.3
YoY change	-63.9%	-46.5%	-37.5%	-17.6%	-17.7%	+14.8%	-40.2%	-9.3%	0.9	41.7	13.1%	-7.3%

Source: Appreciate Group

Corporate billings were up 12% in Q320, including a 42% y-o-y increase in December driven by clients rewarding employees, with record levels of business from new clients during the quarter. Billings via Highstreetvouchers.com were up 36% y-o-y in Q321. The strong growth in digital product was supported by the promotion of Love2shop e-codes and the launch of the Love2shop contactless digital card. Enhancements to digital marketing led to APP achieving an increased share of search demand volume in the core gift card category during November and December. Performance compared with the prior year also reflects improvements in core online systems that in FY20 forced a curtailment in order intake, including the temporary imposition of a minimum order value, as a result of volume and load issues. Further improvements are planned during FY21 through the implementation of the new enterprise resource planning system that will provide a more robust and scalable system to support future growth.

No change to forecasts

We have made no changes to our forecasts set out in detail in our December [update note](#). The progress in Q321 suggests that FY21 billings may exceed our forecast but this may be offset in terms of revenues by the further pandemic restrictions, which are likely to slow the redemption of products by customers; slower redemption of multi-retailer redemption products delays the recognition of revenues and earnings, although only deferring this to future periods.

The increased free cash position at 31 December 2020 of £33.5m is above the level that we forecast for end-FY21 (£21.8m) and will have benefitted from the billing of unregulated voucher product in the run-up to Christmas. The despatched vouchers will act as a drag on free cash as they are redeemed. As explained in our December update note and in more detail in our September [outlook note](#), we expect the growth of higher margin but less immediately cash generative regulated card/digital product (versus paper vouchers) to act as a temporary drag on reported cash flows during the next two years, but this one-time adjustment is allowed for within our DCF valuation. The recently arranged £15.0m revolving credit facility remains undrawn and ready to support growth.

Exhibit 2: Financial summary

Year end 31 March	£'000s	2015	2016	2017	2018	2019	2020	2021e	2022e	2023e
PROFIT & LOSS										
Consumer billings		196,796	208,352	216,771	232,635	232,096	222,207	194,416	192,532	197,463
Corporate billings		176,091	176,679	187,741	180,151	194,805	197,650	166,500	199,800	219,720
Total Billings		372,887	385,031	404,512	412,786	426,901	419,857	360,916	392,332	417,183
Revenue		85,769	100,556	119,637	111,054	110,394	112,724	93,461	100,995	107,429
Cost of sales		(59,193)	(72,030)	(89,944)	(79,628)	(79,117)	(79,778)	(67,760)	(72,211)	(76,275)
Gross profit		26,576	28,526	29,693	31,426	31,277	32,946	25,702	28,784	31,155
Gross margin as % billings		7.1%	7.4%	7.3%	7.6%	7.3%	7.8%	7.1%	7.3%	7.5%
Distribution costs		(2,761)	(2,909)	(2,940)	(3,002)	(2,934)	(2,838)	(1,805)	(1,765)	(1,669)
Administrative expenses excluding depreciation & amortisation		(14,914)	(15,176)	(16,348)	(15,702)	(16,007)	(18,377)	(17,887)	(17,850)	(18,052)
EBITDA		8,901	10,441	10,405	12,722	12,336	11,731	6,010	9,168	11,434
Depreciation & amortisation		0	0	0	(1,405)	(1,394)	(1,659)	(2,113)	(2,350)	(2,350)
Operating profit before exceptional items		8,901	10,441	10,405	11,317	10,942	10,072	3,897	6,818	9,084
Exceptional items		0	0	0	0	(1,210)	(3,676)	(989)	0	0
Operating profit		8,901	10,441	10,405	11,317	9,732	6,396	2,908	6,818	9,084
Net Interest		1,245	1,457	1,470	1,270	1,572	1,304	263	296	322
Profit Before Tax & exceptional items		10,146	11,898	11,875	12,587	12,514	11,376	4,161	7,114	9,406
Profit before tax		10,146	11,898	11,875	12,587	11,304	7,700	3,172	7,114	9,406
Tax		(2,284)	(2,177)	(2,361)	(2,398)	(2,422)	(2,189)	(603)	(1,352)	(1,787)
Profit after tax (IFRS)		7,862	9,721	9,514	10,189	8,882	5,511	2,569	5,762	7,619
Average number of shares (m)		182.5	183.7	183.9	185.3	186.0	186.3	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	186.3	186.3	186.3
Basic EPS - IFRS (p)		4.3	5.3	5.2	5.5	4.8	3.0	1.4	3.1	4.1
Fully diluted EPS - IFRS (p)		4.3	5.2	5.1	5.5	4.8	3.0	1.4	3.1	4.1
Adjusted EPS (excludes exceptional/nonrecurring items)		4.3	5.2	5.1	5.5	4.8	4.9	1.9	3.1	4.1
Dividend per share (p)		2.40	2.75	2.90	3.05	3.20	0.00	1.20	1.50	2.10
Pay-out ratio (Adj. earnings)		55.7%	52.0%	57.1%	55.5%	67.0%	0.0%	62.1%	48.5%	51.4%
BALANCE SHEET										
Non-current assets		13,924	13,749	14,399	14,868	12,606	16,224	18,974	19,924	20,874
Goodwill		1,320	1,320	2,202	2,185	2,168	800	800	800	800
Other intangible assets		3,168	3,036	2,682	2,278	2,295	4,757	7,017	7,767	8,517
Property, plant, & equipment		8,143	8,003	7,688	7,684	6,216	2,662	2,942	3,142	3,342
Retirement benefit asset		1,293	1,390	1,827	2,721	1,927	4,206	4,206	4,206	4,206
Other non-current assets		0	0	0	0	0	3,799	4,009	4,009	4,009
Current assets		107,095	119,496	129,322	142,423	153,475	148,041	130,760	138,187	147,636
Inventories		3,186	2,182	2,632	3,808	4,574	2,840	2,000	2,500	2,500
Trade & other receivables		11,309	8,860	9,236	10,917	12,582	9,457	9,023	9,808	10,430
Monies held in trust		65,728	75,219	83,018	86,992	99,251	102,693	96,131	106,196	116,078
Cash & equivalents		26,333	32,735	34,236	40,311	36,868	29,632	21,776	17,852	16,798
Other current assets		539	500	200	395	200	3,419	1,831	1,831	1,831
Current liabilities		(121,545)	(128,164)	(133,789)	(142,604)	(148,818)	(140,665)	(123,547)	(128,398)	(133,601)
Trade & other payables		(77,688)	(83,135)	(87,201)	(94,592)	(61,191)	(57,150)	(50,167)	(54,926)	(59,240)
Tax payable		(671)	(262)	(424)	0	(580)	0	0	0	0
Provisions		(43,186)	(44,767)	(46,164)	(48,012)	(58,286)	(53,802)	(46,644)	(45,548)	(45,530)
Non-current liabilities		(2,907)	(1,881)	(1,118)	(662)	(553)	(5,253)	(5,456)	(5,456)	(5,456)
Deferred tax liability		(273)	(181)	(194)	(662)	(553)	(1,121)	(1,011)	(1,011)	(1,011)
Retirement benefit obligation		(2,634)	(1,700)	(924)	0	0	0	0	0	0
Lease liabilities							(4,132)	(4,445)	(4,445)	(4,445)
Net assets		(3,433)	3,200	8,814	14,025	16,710	18,347	20,731	24,257	29,453
Minorities		0	0	0	0	0	0	0	0	0
Shareholders' equity		(3,433)	3,200	8,814	14,025	16,710	18,347	20,731	24,257	29,453
CASH FLOW										
Operating Cash Flow		14,106	12,184	9,603	10,540	6,874	6,866	(4,287)	2,668	6,134
Net interest		1,176	1,339	1,539	1,267	1,497	1,640	263	296	322
Tax paid		(2,132)	(2,490)	(2,258)	(2,537)	(1,576)	(2,864)	(2,184)	(1,352)	(1,787)
Capex		(597)	(1,126)	(717)	(1,020)	(1,152)	(5,030)	(4,619)	(3,300)	(3,300)
Acquisitions/disposals		41	52	(875)	1	0	1	3,047	0	0
Dividends paid		(4,198)	(4,380)	(5,052)	(5,370)	(5,668)	(5,963)	0	(2,236)	(2,423)
Other		0	0	305	0	345	419	(77)	0	0
Net cash flow		8,396	5,579	2,545	2,881	320	(4,931)	(7,856)	(3,924)	(1,054)
Opening net (debt)/cash		14,842	23,238	28,817	31,362	34,243	34,563	29,632	21,776	17,852
Closing net (debt)/cash		23,238	28,817	31,362	34,243	34,563	29,632	21,776	17,852	16,798
Overdraft		3,095	3,918	2,874	6,068	2,305	0	0	0	0
Closing net (debt)/cash as per balance sheet		26,333	32,735	34,236	40,311	36,868	29,632	21,776	17,852	16,798

Source: Appreciate Group, Edison Investment Research

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