EDISON

Park Group

Trading update

Investing for faster growth

Financial services

In a trading update, management says FY19 trading exceeded its expectations, driven by Corporate business, and it expects similar trends in the current year. Reported profitability in FY19 and FY20 will be negatively affected by costs associated with implementing the strategic business plan, with little of the benefit expected until FY21 and beyond, and also IFRS 15 effects. We expect management to provide more details of the potential for enhanced growth and efficiency with the full-year results.

Year end	Billings* (£m)	Revenue (£m)	Adj. PBT** (£m)	EPS*** (p)	DPS (p)	P/E (x)	Yield (%)
03/17	404.5	119.6	11.9	5.1	2.90	12.6	4.5
03/18	412.8	111.1	12.6	5.5	3.05	11.7	4.8
03/19e	420.7	111.2	12.5	4.9	3.20	13.1	5.0
03/20e	445.5	117.5	11.7	5.1	3.35	12.6	5.2

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.

Investment cost will reduce near-term earnings

Park says the strong trading performance was driven by the Corporate business, with the Consumer business ‘broadly stable’ and growth particularly strong in higher-margin cards. IFRS 15 will defer some of the profitability benefit to future reporting periods and, including higher strategic planning costs, FY19 PBT before an exceptional £1.25m non-cash property write-down related to the head office move will be slightly below market consensus. In FY20 the strategic investment cost will have a net £2.0m impact before the net benefits emerge from FY21. Park has a debt-free balance sheet and cash-generative business model to support this investment phase, and our DPS forecasts are unchanged. Our FY19 PBT forecast (before the FY19 exceptional charge) reduces to £12.5m (was £12.8m) and FY20 to £11.7m (was £14.3m).

Focus, efficiency and growth

The strategic business plan that the new management team presented in December highlights the strong market potential in multi-retailer redemption products, led by card and digital formats, and the strengths of Park’s existing offering. Park will accelerate the investment in digital enablement, the driver of its growth in past 10 years, to capture more of this market potential while increasing efficiency through streamlining and simplification of products and processes. Using that same technological and product capability, Park plans a new product to further penetrate the consumer market, a £2bn+ market opportunity where its current penetration is minimal compared with its dominant position in the Christmas savings market and strong position in the business sector.

Valuation: Attractive yield and medium-term growth

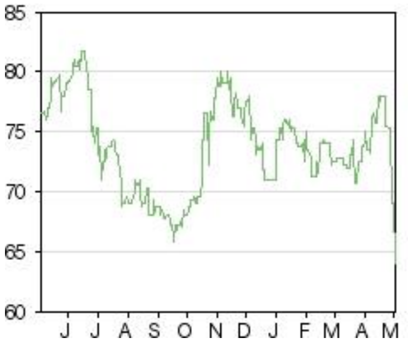
For now we leave our fair value, based on a modified DCF and P/E relative comparison, unchanged at 87p (see page 3 for more details). Near-term earnings will be held back by strategic investment cost, but the goal is faster medium-term growth. Meanwhile, the attractive dividend yield is well covered by earnings.

3 May 2019

Price	**64p**
Market cap	**£119m**

Net cash (£m) as at 30 September 2018	32.5
Shares in issue	186.3m
Free float	100%
Code	PKG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(14.7)	(12.9)	(15.2)
Rel (local)	(14.6)	(16.8)	(12.8)
52-week high/low		81.75p	64.00p

Business description

Park 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

FY19 results	12 June 2019

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Edison profile page

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Further details from the trading update

FY19: More profitable mix, but greater profit deferral

Given the acceleration in higher-margin card billings late in the FY19 year, management estimates the additional profit deferral for the year at c £0.5m. The impacts of IFRS 15 are explained in detail in our post-interim results update and although there is some deferral of income recognition compared with the old accounting standard, there is no impact on cash flow or the profit that is ultimately reported. The re-stated historical financial statements previously provided by the group show an average annual IFRS 15 pre-tax profit deferral over the four years to end-FY18 of c £0.4m, or c 3%.

Reflecting the underlying trading performance, despite the additional profit deferral and an additional c £0.5m of costs relating to investment in the new strategic business plan (c £0.3m in H119), management expects profit before tax and exceptional items will only be marginally below market consensus (revenues of £112m and PBT of £12.9m) for FY19.

Reported FY19 profits will also be affected by an exceptional non-cash impairment charge of c £1.25m. This is related to the group's previously announced decision to move the majority of its core operations to new offices in Liverpool city centre (fulfilment and redemption activities will remain at the current site, along with separated hamper production) from the existing site at Valley Road, Birkenhead. The move is intended to provide the core activities with access to a wider talent pool, benefiting from an existing hub of like-minded fintech businesses in central Liverpool. Management anticipates the additional premises costs will fairly quickly be mitigated by productivity improvements and that the potential sale or subletting of vacated space in Birkenhead should also accelerate the pay-back period. The lease has been signed and the move is expected to take place in late summer 2019.

FY20 will see a step up in strategic investment cost

Park anticipates the trends experienced in the FY19 year that ended 31 March will continue in FY20, with good growth in the Corporate business, partially offset in the Consumer business by a slower Christmas savings market. In the latter, Park began taking customer orders late in 2018 for Christmas 2019, and will by now have a reasonable sense of Christmas savings activity for the year. As well as a challenging retail environment, the slowdown highlights some of the more structural issues that the strategic business plan aims to address. Strategic investment cost (net of the initial benefits) is expected to be c £2.0m in FY20, which will result in lower profitability in the current year but this is expected to increase growth and earnings thereafter. The FY20 investment costs include the impact of running two sites as the group transitions the core activities to the new offices, as well as additional technology and marketing investment.

Progress with the strategic plan

Park reports good progress through the initial steps of the strategic business plan, which aims to enhance how the group works with consumers, businesses and retailers, and will give more details with the FY19 full-year results announcement in June.

Continuing senior hires include a new chief transformation officer, a human resources director and an interim head of marketing. Towards the goal of becoming an organisation anchored on digital products and processes, a new enterprise resource planning system has been selected and is expected to provide scalability, resilience and efficiency.

Leadership continuity

We welcome the announcement that the non-executive chairman, Laura Carstensen, has agreed to continue in her role for another three years from June 2019. She has significant experience of the group, having been appointed to the board as a non-executive director in September 2013 and becoming non-executive chairman in June 2016. As chairman she has helped steer the group through a period of significant management renewal and change, including the appointment of Ian O’Doherty as CEO in January 2018, Tim Clancy as CFO in August 2018 and a number of other senior executives. The new management team set out its strategic plans for the group in December 2018.

Financials

Taking account of management guidance in the trading statement, we have slightly reduced our forecasts for FY19 PBT and revenues before the exceptional write-down by c 3%, to £12.5m (from £12.8m) and £111.2m (from £114.3m), respectively. The revenue reduction substantially relates to the product mix changes discussed above rather than customer activity or billings. The small reduction in forecast billings (less than 1%) reflects a revised assumption of flat billings in the Consumer business rather than slight growth.

Our revised FY20 forecast captures the negative impact of the additional costs related to implementing the strategic business plan but little to none of the benefits expected by management on a medium-term basis. To better reflect this, we will extend our forecasting period with the annual results in June.

Exhibit 1: Forecast revisions

	Billings (£m)			Revenues (£m)			Adjusted PBT* (£m)			Diluted EPS (p)			DPS (p)		
	New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change
03/19e	420.7	422.3	-0.4%	111.2	114.3	-2.7%	12.5	12.8	-2.6%	4.9	5.6	-12.3%	3.20	3.20	0.0%
03/20e	445.5	449.5	-0.9%	117.5	119.5	-1.7%	11.7	14.3	-18.1%	5.1	6.2	-18.2%	3.35	3.35	0.0%

Source: Edison Investment Research. Note: *PBT adjusted for FY19 exceptional items.

We have made no changes to our forecast DPS growth, with a good level of dividend cover maintained despite the reduction in forecast EPS.

Valuation

Our approach to valuing Park is to consider 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 that are engaged in activities that provide some overlap with Park. We would not go so far as to call this a peer group comparison because no such listed group exists. Park’s 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. Our last published fair value, based on the simple average of these two measures points, was 87p per share.

Our modified DCF valuation has been based on fairly consistent assumptions for an extended period. It is a modified DCF in the sense that we include the interest earned by Park on segregated customer cash balances (but not on the group cash balance), as this is an integral part of the returns the company generates. The customer cash is excluded from the overall valuation and the voucher provisions balance as this will eventually flow out in settlement of vouchers that have been issued but not yet redeemed. Beyond the forecast period (currently up to end-FY20) we have grown free cash flow at 5% per year until year 10, enhanced by an assumed normalisation of interest rates to 3% from FY21. The terminal cash flow has valued at 10x and we have applied a discount rate of

10%. Given the impact of the strategic investment costs on our FY20 forecast, an unchanged DCF assumption set would see the DCF value per share reduce from 90p to 77p, but this would not capture any of the accelerated medium-term growth that management is targeting. By assuming two stages of growth, at 10% per year for four years after the forecast period, before reverting to 5%, the DCF value would again be 90p. We will review the DCF value when extending our forecast period after the full-year results in June.

Our relative value comparison recognises the lack of direct comparators to Park. In incentive and rewards products, Sodexo and Edenred are both much larger and more international than Park, and the overlap with Sodexo is limited; Sodexo Benefits and Rewards Services is only a minor part of Sodexo Group. We therefore extend the comparator group to include payments service providers and companies engaged in UK home collected credit services (HCC), directed at a customer group with some demographic/socioeconomic overlap between the traditional customer bases of Park's Christmas prepayments business (c 50% of Park). We recognise that the read-across is somewhat limited and note the difference between the savings nature of Park's Christmas prepayments business and the lending nature of HCC. Given Park has no credit risk and we believe it has less regulatory risk, we would expect a higher valuation.

In our last-published fair value of 87p, we made the judgement that c 14x calendar year 2019 earnings would represent a reasonable valuation objective. Given the drag of strategic investment cost on our FY19 forecast earnings, the same 14x multiple would imply a value of 70p, but this would take no account of the benefits that management targets from the investment. We believe a successful implementation of management's plans, leading to faster growth, increasing scale and a greater focus on digital payments services, has the potential to lift both earnings and valuation over time. On this basis, the 17.4x CY19e multiple implied by our last published fair value of 87p does not appear unreasonable, and we will review this with the full year results.

Exhibit 2: Listed comparator data

	Share price (local)	Market cap (£m)	P/E (x) CY 1	P/E (x) CY 2	EV/EBITDA (x) CY 1	EV/EBITDA (x) CY 2	Yield (%)
Incentive							
Edenred	41.4	8,507	30.6	27.2	16.5	15.0	2.08
Sodexo	102.2	12,942	19.1	17.6	11.4	10.7	2.69
Incentive average			24.9	22.4	14.0	12.8	2.38
Payment services							
Euronet Worldwide	148.2	5,904	21.2	18.2	11.8	10.2	
Wirecard	130.2	13,812	31.2	23.2	19.1	14.5	0.15
Payment services average			26.2	20.7	15.4	12.4	0.15
Home collected credit/consumer finance							
Morses Club	165.0	214	11.1	10.0	8.1	7.2	4.24
Non-standard Finance	52.4	164	7.8	5.3	8.1	6.5	4.96
Provident Financial	512.4	1,300	10.0	8.0		13.9	1.95
HCC/consumer finance average			9.6	7.8	8.1	9.2	3.72
Whole group average			18.7	15.6	12.5	11.1	2.68
Park Group	64.0	119	12.7	N/A	7.4	N/A	5.00

Source: Refinitiv. Note: Prices at 3 May 2019. Edison estimates for Park Group. Earnings data on a calendar year (CY) basis.

Exhibit 3: Financial summary

Year end 31 March	£000s	2015	2016	2017	2018	2019e	2020e
PROFIT & LOSS		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
		Re-stated	Re-stated	Re-stated	Re-stated		
Consumer billings		196,796	208,352	216,771	224,542	224,542	233,421
Corporate billings		176,091	176,679	187,741	188,244	196,136	212,102
Total Billings		372,887	385,031	404,512	412,786	420,678	445,522
Revenue		85,769	100,556	119,637	111,054	111,213	117,503
Cost of sales		(59,193)	(72,030)	(89,944)	(79,628)	(79,478)	(83,680)
Gross profit		26,576	28,526	29,693	31,426	31,735	33,822
Gross margin as % billings		7.1%	7.4%	7.3%	7.6%	7.5%	7.6%
Distribution costs		(2,761)	(2,909)	(2,940)	(3,002)	(2,734)	(3,119)
Administrative expenses		(14,914)	(15,176)	(16,348)	(15,702)	(16,572)	(19,135)
EBITDA		8,901	10,441	10,405	12,722	12,428	11,569
Depreciation & amortisation		0	0	0	(1,405)	(1,428)	(1,365)
Operating profit before exceptional items		8,901	10,441	10,405	11,317	11,000	10,204
Exceptional items		0	0	0	0	(1,250)	0
Operating profit		8,901	10,441	10,405	11,317	9,750	10,204
Net Interest		1,245	1,457	1,470	1,270	1,507	1,523
Profit Before Tax & exceptional items		10,146	11,898	11,875	12,587	12,507	11,727
Profit before tax		10,146	11,898	11,875	12,587	11,257	11,727
Tax		(2,284)	(2,177)	(2,361)	(2,398)	(2,139)	(2,228)
Profit after tax (IFRS)		7,862	9,721	9,514	10,189	9,118	9,499
Average number of shares (m)		182.5	183.7	183.9	185.3	185.9	186.3
Fully diluted average number of shares (m)		184.7	187.2	187.2	185.9	187.0	187.3
Basic EPS - IFRS (p)		4.3	5.3	5.2	5.5	4.9	5.1
Fully diluted EPS - IFRS (p)		4.3	5.2	5.1	5.5	4.9	5.1
Dividend per share (p)		2.40	2.75	2.90	3.05	3.20	3.35
Pay-out ratio		55.7%	52.0%	56.1%	55.4%	65.3%	65.7%
BALANCE SHEET							
Non-current assets		13,932	13,749	14,399	14,868	13,821	13,821
Goodwill		1,320	1,320	2,202	2,185	2,185	2,185
Other intangible assets		3,168	3,036	2,682	2,278	2,158	2,158
Property, plant, & equipment		8,143	8,003	7,688	7,684	6,357	6,357
Retirement benefit asset		1,293	1,390	1,827	2,721	3,121	3,121
Other non-current assets		8	0	0	0	0	0
Current assets		107,095	119,496	129,322	142,423	141,781	152,278
Inventories		3,186	2,182	2,632	3,808	3,862	4,091
Trade & other receivables		11,309	8,860	9,236	10,917	10,517	11,138
Monies held in trust		65,728	75,219	83,018	86,992	90,044	96,519
Cash & equivalents		26,333	32,735	34,236	40,311	36,086	39,259
Other current assets		539	500	200	395	1,271	1,271
Current liabilities		(121,545)	(128,164)	(133,789)	(142,604)	(136,017)	(142,722)
Trade & other payables		(77,688)	(83,135)	(87,201)	(94,592)	(89,590)	(94,698)
Tax payable		(671)	(262)	(424)	0	0	0
Provisions		(43,186)	(44,767)	(46,164)	(48,012)	(46,428)	(48,023)
Non-current liabilities		(2,907)	(1,881)	(1,118)	(662)	(662)	(662)
Deferred tax liability		(273)	(181)	(194)	(662)	(662)	(662)
Retirement benefit obligation		(2,634)	(1,700)	(924)	0	0	0
Net assets		(3,425)	3,200	8,814	14,025	18,923	22,715
Minorities		0	0	0	0	0	0
Shareholders' equity		(3,425)	3,200	8,814	14,025	18,923	22,715
CASH FLOW							
Operating Cash Flow		14,106	12,184	9,903	10,540	10,196	11,194
Net interest		1,176	1,339	1,539	1,267	1,298	1,523
Tax paid		(2,132)	(2,490)	(2,258)	(2,537)	(3,215)	(2,228)
Capex		(597)	(1,126)	(717)	(1,020)	(1,167)	(1,260)
Acquisitions/disposals		41	52	(875)	1	0	0
Dividends paid		(4,198)	(4,380)	(5,052)	(5,370)	(5,759)	(6,056)
Other		0	0	5	0	490	0
Net cash flow		8,396	5,579	2,545	2,881	1,843	3,173
Opening net (debt)/cash		14,842	23,238	28,817	31,362	34,243	36,086
Closing net (debt)/cash		23,238	28,817	31,362	34,243	36,086	39,259
Overdraft		3,095	3,918	2,874	6,068	0	0
Closing net (debt)/cash as per balance sheet		26,333	32,735	34,236	40,311	36,086	39,259

Source: Park Group, Edison Investment Research

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