EDISON

Appreciate Group

Strategic progress with results in line

Interim results

Real estate

Appreciate Group (APP, formerly Park Group) performed well during H120 and is on track to meet the company's (and our) expectations for the year. Of greater significance, given the seasonality of the business, were the H1 operational developments and progress with the strategic business plan aimed at enhancing long-term growth by accelerating digitalisation, improving efficiency, broadening customer appeal and deepening market penetration. Management expects the benefits to show clearly from FY21. Meanwhile, the shares offer an attractive yield, with DPS well covered by earnings and supported by a debt-free balance sheet.

Year end	Billings* (£m)	Revenue (£m)	Adj. PBT** (£m)	EPS*** (p)	DPS (p)	P/E (x)	Yield (%)
03/18	412.8	111.1	12.6	5.5	3.05	8.6	6.5
03/19	426.9	110.4	12.5	4.8	3.20	9.8	6.8
03/20e	442.9	114.7	11.8	5.1	3.20	9.2	6.8
03/21e	462.7	120.3	13.4	5.8	3.35	8.1	7.1

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.

Good underlying H120 progress

Billings grew in both the Corporate and Consumer businesses versus H119 and strong growth in card/digital product improved margins. The seasonal pre-tax loss reduced to £1.3m (H119: £1.5m) including c £1m of net strategic investment plan costs. Around 85% of revenues are typically generated in H2, and all of the profits. Group cash flow was affected by the timing of transfers from customer funds held in trust, but total cash balances remained strong at £213m. DPS was held at 1.05p as expected, marking a pause in the progressive dividend policy as APP steps up investment and implements its growth plans. There are no material changes to our earnings estimates. Slower release of operating cash flow from the product mix shift to cards/digital has already been captured by our DCF valuation.

Strategic plan on target and on budget

APP has relocated to its new fit-for-purpose HQ and has adopted its new corporate name, better reflecting the product offering and group aspirations. It has also made good progress on rationalising its brand architecture and implementing technology upgrades, and trials have commenced on the new consumer-facing digital product, Giftli, that will target currently untapped areas of the market with a focus on a millennial customer base. A soft launch is expected before Christmas ahead of a full launch in the new year. Management continues to expect the full-year net investment costs related to the implementation of the strategic business plan to be c £2.0m, with P&L benefits of £2–5m pa after FY21.

Valuation: Attractive yield and medium-term growth

Our modified DCF valuation is reduced slightly from 90p to 87p. With near-term earnings suppressed by investment spend, the implied CY20e P/E at 90p is 18.0x and CY21e 16.0x, which we believe is reasonable, especially given the prospect of accelerated growth from FY21.

16 December 2019

Price	**47p**
Market cap	**£88m**
Net cash (£m) at 30 September 2019 (net of overdraft)	6.3
Shares in issue	186.3m
Free float	100%
Code	APPS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(5.7)	(13.7)	(34.8)
Rel (local)	(6.8)	(14.6)	(40.2)
52-week high/low		78.0p	46.2p

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

Interim DPS payment	6 April 2020

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Edison profile page

Appreciate Group is a research client of Edison Investment Research Limited

Strategic progress with results in line

Appreciate Group (APP, formerly Park Group) performed well during H120, evidenced by sales growth across both the consumer and corporate-facing businesses, increased margins, and reduced seasonal losses (c 85% of revenues are typically generated in H2, and all of the profits). Group cash flow was negatively affected by the timing of transfers from customer funds held in trust, but total cash balances remained strong at £213m. Additionally, the shift in product mix away from vouchers to cards, subject to Bank of England regulation in respect of segregated customer balances, slows the release of operating cash flow and is discussed in detail on page 8.

Positively, despite a more muted economic and retail background, the group is trading in line with management's (and our) expectations for the year. Perhaps of greater significance, however, given the seasonality of the group's business, are the H120 operational developments and progress with the strategic business plan. The plan was presented in December 2018 following a comprehensive review of the business, which identified a number of opportunities to build on existing strengths, accelerate growth and improve efficiency. The core multi-retailer redemption offering, where the scale of the market provides significant potential, is being given even greater focus and the digitalisation of the business has been significantly accelerated to enhance the attractiveness, accessibility, reach and delivery of existing products, tap new market segments and areas of demand, and enhance efficiency.

As previously reported, the group has now successfully relocated its core operations to a new fit-for-purpose head office in Liverpool city centre and has renamed itself to better reflect its product offering and aspirations. The first phase of the new ERP system has been initiated and the new digital marketing platform has been implemented. Product developments include a new Mastercard gifting product with digital fulfilment and mobile wallet capability that is being tested through highstreetvouchers.com, while trials have commenced on the new consumer-facing digital product, Giftli, aimed at a new millennial audience. A soft launch of Giftli is planned imminently, before Christmas 2019.

Exhibit 1: Summary of H120 financials

£m unless stated otherwise	H120	H119	H120/H119	FY19
Consumer billings	40.1	35.7	12.5%	232.1
Corporate billings	80.1	73.3	9.3%	194.8
Total billings	**120.2**	**109.0**	**10.3%**	**426.9**
Revenue	**33.2**	**27.4**	**21.3%**	**110.4**
Cost of sales	(25.0)	(21.1)		(79.1)
Gross profit	**8.2**	**6.3**	**30.4%**	**31.3**
Distribution costs	(0.7)	(0.6)		(2.9)
Admin costs	(9.6)	(8.0)		(17.4)
Adj operating profit (before exceptional)	**(2.0)**	**(2.3)**		**10.9**
Net finance income	0.8	0.8		1.6
Adj profit before tax (before exceptional	**(1.3)**	**(1.5)**		**12.5**
Exceptional	0.0	0.0		(1.2)
Tax	0.2	0.3		(2.4)
Net profit after tax	**(1.0)**	**(1.2)**		**8.9**
Basic EPS (p)	(0.56)	(0.67)		4.78
Diluted EPS (p)	(0.56)	(0.67)		4.77
DPS (P)	1.05	1.05		3.20
Total cash - including monies held in trust	213.1	214.4		136.1
Period end group cash (exc overdraft)	6.3	32.5		34.6

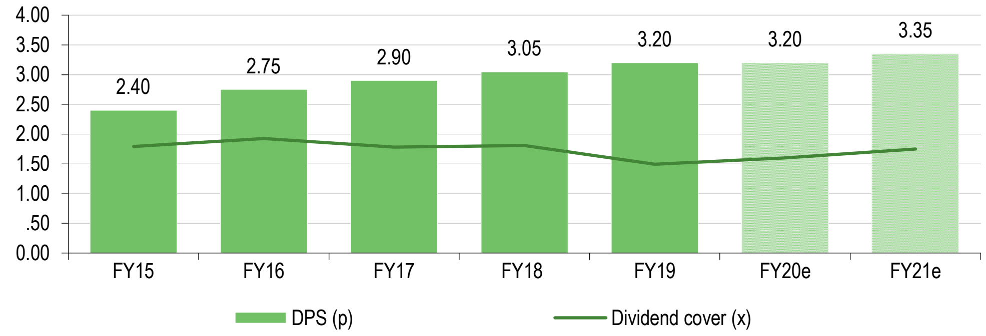
Source: Appreciate Group

Key features of the interim results were:

- **Billings,** a key performance indicator for the group, is a non-statutory 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, 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. H120 billings of £120.2m were 10.3% ahead of H119, with growth in both the Corporate and Consumer distribution channels. Corporate growth of 9.3% was driven by good levels of demand, including the impact of significant new customers. Consumer billings growth of 12.5% primarily reflected the faster dispatch of Christmas 2019 orders, shifting billings from H2 to H1, but also very strong growth (51.5%) in the direct-to-consumer channel, highstreetvouchers.com, resulting in a 49% year-on-year increase in customer numbers following website refinements to enhance the customer experience. For the full year, the company still expects Christmas savings to be marginally lower, reflecting the order book.

- Statutory **revenues** increased by 21.3% compared with the prior year period, reflecting the growth in underlying billings as well as the mix of products. During H120, the group sold more third-party, single-retailer redemption product than in H119, and these are reported under IFRS 15 on a 'gross basis' (for an explanation see page 7) in contrast to the core own-branded, multi-retailer redemption products (83% of H120 billings and 85% of full year FY19), which are reported on a 'net basis'.
- **Gross profit** advanced by 30.4% to £8.2m, driven by increased billings and improved margins. Within the own-branded, multi-retailer offering, strong growth in card and digital billings were positive for gross margin and sufficient to offset the otherwise negative impact of increased billings of lower-margin, single-retailer redemption product in the period.
- **Administrative expenses** increased by £1.6m or c 20% including a c £1.0m impact from strategic plan implementation costs (management continues to expect c £2.0m on a full-year basis). The prior year period included c £0.3m of research costs.
- **Net finance income,** earned on total cash balances including customer monies that are held in trust, was broadly similar to the prior year period. The end-H120 total cash balance, including monies held in trust, was £213.1m (H119: 214.4m). The corporate cash balance, net of a small overdraft) was £6.3m compared with £32.5m at the end of the prior year period and £34.6m at end-FY19. The main driver of the reduction was the timing of corporate withdrawals from the Park Prepayment Protection Trust (PPP trust) where money was drawn down earlier in the previous year, negatively affecting the year-on-year comparison by c £20m. Additionally, the shift in product mix away from vouchers to cards slows the release of operating cash flow.
- The **seasonal loss reduced** to £1.3m (H119: £1.5m) on a pre-tax basis and £1.0m (FY19: £1.2m) on a net basis after tax. Adjusting this for the H120 strategic implementation costs, the reported pre-tax loss would have been £0.3m, a £0.9m improvement on the H119 result adjusted for the research costs incurred in that period.
- In line with our expectations for the full year, the **interim DPS was held at 1.05p**. The dividend policy remains progressive, linked to cash generation and we expect a pause in dividend growth in the current year as APP significantly steps up investment and implements the strategic business plan.

Exhibit 2: Dividend history and forecasts



Source: Appreciate Group historical data, Edison Investment Research forecasts

In its outlook statement, the group says that underlying trading prospects for H220 are unchanged, with the Corporate business continuing to grow and Christmas savings looking to capitalise on refreshed marketing plans, including a refreshment of the brand imagery and media strategy, as orders are built for Christmas 2020.

Strong progress with strategic business plan

APP's strategic business plan aims to accelerate growth by improving the customer experience, simplifying the product offering, making those products and services available to a wider customer base, and accelerating the development of digital platforms that can better capitalise on the strong customer-driven trend towards card and digital delivery (and away from paper). Progress in the period is set out below.

Accelerated digitalisation

APP has accelerated its IT investment in both back office functions and digital capability in order to improve both efficiency and functionality. The first phase of the new ERP system has been implemented, and further design and planning for subsequent phases in 2020 is underway. The group's data and infrastructure architecture has also been completely redesigned for progressive deployment to cloud-based and managed service provision that management expects to scale benefits, as well as increased efficiency and resilience.

Good progress has been made with the near-term goals of enhancing the capability of existing mobile apps, and providing mobile digital enablement and personalised e-delivery of e-codes. A new contactless-enabled digital gift card, delivered by email, SMS or WhatsApp for loading into the wallet app of a mobile phone is in pilot. The technology engine behind the digitally enabled card will dovetail with the new consumer gifting product that is now in the trial stage.

New consumer digital gifting product in trial

APP wants to broaden its customer appeal to drive faster growth, including the launch of new product targeting a broader customer base. Management's analysis of the marketplace highlights a particular opportunity from addressing the broader consumer market for a multi-redemption product, alongside the group's existing dominant position in the Christmas savings consumer segment and strong positions in the corporate market segments. Capturing an increased share of the 'other consumer' segment, where management estimates a current share of c 0.4%, represents a material opportunity for growth. A new consumer digital gifting product, Giftli, aimed at a new millennial audience, will target a part of this opportunity. In contrast to traditional gift cards and vouchers, by embedding the customer's own digital content, Giftli creates a highly personalised message/product to share with the recipient. APP believes this will especially appeal to its target customer base, with its above average familiarity and use of social media. A trial is underway and a soft launch is expected before Christmas ahead of a full launch in the New Year. Profitability of the product will continue to be driven by retailer service fees and interest earned on customer balances, although compared with Christmas savings these balances may be of shorter duration and potentially more variable.

Exhibit 3: APP's existing market position

£m	Market size	APP share
Consumer		
Christmas savings	300	74.0%
Other Consumer	2,600	0.4%
Total consumer	**2,900**	**8.0%**
Business		
Incentives	830	6.9%
Employee benefits	730	5.2%
Staff rewards	1,400	6.6%
Total business	**2,960**	**6.3%**

Source: UK Gift Card & Voucher Association data, Appreciate Group estimates

Financials

Strategic plan financials unchanged

In H120, the implementation costs for the strategic business plan were c £1m and management has not changed its guidance that profits will be negatively affected by c £2.0m, net of savings achieved. This includes c £1m of investment in the new consumer market product, £0.8m in temporary overlapping property costs resulting from the relocation of the core operations and £1.0m in technology-related costs, offset by cost benefits of £0.8m realised during the year.

Additional IT capex to support implementation of the strategic plan is expected to be c £4.0m over the next two years, with a three-year payback period. Property capex related to the migration of the core activities to central Liverpool will be c £1.5m in the current (FY20) year, but management expects the disposal of redundant property assets to generate proceeds of c £5.0m in FY21. The Valley Road site is now carried as a 'held for sale' asset, indicating management's expectation of a timely exit.

No material change to earnings estimates

We have made no material changes to our forecasts for the current year and next, shown in Exhibit 4.

Exhibit 4: Estimate revisions

	Billings (£m)			Revenues (£m)			Adj. PBT (£m)			Diluted EPS (p)			DPS (p)		
	New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change
03/20e	442.9	442.5	0.1%	114.7	113.8	0.8%	11.8	11.8	0.1%	5.1	5.1	0.1%	3.20	3.20	0.0%
03/20e	462.7	462.5	0.0%	120.3	117.5	2.3%	13.5	13.3	1.4%	5.8	5.8	1.4%	3.35	3.4	0.0%

Source: Edison Investment Research

Our key forecasting assumptions include:

- **Billings growth driven by Corporate.** We expect the Corporate business to continue to drive billings growth, focused on incentive and rewards products, with modest growth in Consumer, comprising continued strong growth in direct (hsv.com) sales and slight growth in the larger Christmas savings business in FY21. We have not allowed for any material impact from the strategic business plan or any contribution from the planned new consumer product during the forecast period.

Exhibit 5: Billings by business segment

£m	FY19	FY20e	FY21e	Change	
				FY20e	FY21e
Corporate	194.8	210.1	226.8	7.8%	7.9%
Consumer	232.1	232.8	235.9	0.3%	1.3%
Group	**426.9**	**442.9**	**462.7**	**3.8%**	**4.5%**

Source: Appreciate Group historical data, Edison Investment Research forecasts

- **We expect gross profit to increase at a faster rate than either billings or revenues.** This is driven by the increasing share of higher-profitability, multi-redemption product in our forecast sales mix, and implicitly assumes no change in product margins or redemption patterns.

Exhibit 6: Gross profit development

£m unless stated otherwise	FY19	FY20e	FY21e
Billings	426.9	442.9	462.7
Revenue	110.4	114.7	120.3
Cost of sales	(79.1)	(81.1)	(84.8)
Gross profit	**31.3**	**33.6**	**35.5**
% change in gross profit	-0.5%	7.5%	5.6%
Gross margin on billings	7.3%	7.6%	7.7%
Gross margin on revenues	28.3%	29.3%	29.5%

Source: Appreciate Group historical data, Edison Investment Research forecasts

- Further, reflecting management's strategic focus and supported by industry trends, we expect multi-redemption product growth to be driven by card/digital formats and for paper vouchers to decline in terms of overall share as well as in absolute terms. The switch appears to be happening at a faster pace than we previously assumed and is also positive for margin although it does slow the release of operating cash flow. We discuss this in detail below but note that the impact on our discounted cash flow (DCF) valuation analysis is minimal.

Exhibit 7: Billings by product

£m	FY19	FY20e	FY21e
Paper	200.0	163.0	147.9
Card	197.1	218.8	242.0
e-Code	16.1	47.2	58.3
Total multi and single retailer billings	413.2	428.9	448.2
Other billings	13.7	14.0	14.5
Total billings	426.9	442.9	462.7

Source: Appreciate Group historical data, Edison Investment Research forecasts

- Our forecasts for administrative costs reflect management's guidance of a net £2.0m in strategic business plan implementation costs in FY20. We expect some of this to fall away in FY21, partly offset by increased marketing spend on new products.
- We expect interest income to grow modestly, driven by continued growth in total cash balances (monies held in trust and shareholder cash), and reflecting order and billings growth, particularly cards. We assume a similar c 0.9% margin on balances to that earned in FY19.
- Our operating cash flow assumptions are discussed in detail below. Additionally, our shareholder cash flow forecasts reflect the additional IT investment (£4.0m over two years) and property investment/disposal (£1.5m investment in FY20 and £5.0 disposal proceeds in FY21) guided to by management, and the recurring depreciation and amortisation effects are captured in our income statement forecasts. We forecast shareholder cash (ie excluding monies held in trust) to reduce to £32.4m in the current year (FY19: £34.6m) and increase to £40.3m in FY21 including the c £5.0m proceeds from disposal of the Valley Road site.

Revenue accounting: Aide memoire

IFRS 15 (Revenue from contracts with customers) became effective for annual reporting periods beginning on or after 1 January 2018 and APP reported under IFRS 15 for the first time in FY19, on a full retrospective method, providing restated financial statements from the beginning of FY15. All of the financial analysis presented in this note is on a consistent IFRS 15 basis. Historically, the accounting treatment for prepaid cards and vouchers differed and adoption of IFRS 15 put revenue recognition for the group's own-branded, multi-retailer redemption products on a similar basis. The effect was to reduce reported revenues, although ultimate profitability and cash flow was unchanged. There was also a timing impact, with IFRS 15 leading to a deferment of revenue and operating profit in respect of all the group's multi-retailer redemption products. Given the dominance of own-branded, multi-retailer product in the sales mix, IFRS 15 has brought welcome consistency, although important differences remain in terms of the accounting treatment for third-party, single-retailer redemption product, as well as the other goods and services that the group provides.

The issue is dealt with in detail in the group's annual report and below we provide a brief overview.

'Net' versus 'gross' revenue recognition

The key distinction is between sales where APP 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. This is why 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.

Timing of revenue recognition

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 APP will never be redeemed. 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.

Exhibit 8: Revenue recognition under IFRS

Multi-retailer redemption vouchers		
Revenues	Service fee	On redemption
	Breakage	On redemption
Customer discounts	Netted against revenue	On dispatch
Multi-retailer redemption cards & e-codes		
Revenue	Service fee	On redemption
	Card fees	As levied
	Breakage (cards with no right of redemption)	On redemption
	Breakage (cards with right of redemption)	On and after expiry
Customer discounts	Netted against revenue	On dispatch
Third-party vouchers, cards, & e-codes		
Revenue	Value invoiced to customers	Date received by customer

Source: APP Group

Operating cash flow emergence is changing

IFRS 15 has no impact on the ultimate profitability and operating cash flow that emerges over time, although it does have some short-term timing effects. Of more significance is the difference between the timing of cash emergence between regulated (ie APP's own multi-retailer redemption cards/digital products, which fall under the Bank of England e-money rules) and unregulated product (APP's own multi-retailer redemption vouchers). The rapid growth of card/digital sales and what we believe will be a continued reduction in voucher sales, both as a share of the total and in absolute terms, is positive for profitability but has the effect of reducing operational cash flow in the near term. Much of this is already captured within our DCF analysis, which deducts an amount of cash, equal to the balance sheet voucher provision, recognising that this will eventually be transferred to retail partners in settlement of customer voucher redemptions.

Customer card/digital cash balances are strictly segregated within the e-money trust until such time as 'contractual ownership' passes to APP. 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' 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. Other than through redemption, the change in contractual ownership and the transfer of cash from the e-money trust to the APP corporate cash balance will occur at the expiry of the card and (where the customer has a right to redeem unspent balances) as card fees are levied and accrue to APP. Management comments that redemption rates for card/digital products are currently lower than for vouchers, and this is likely to increase the near-term cash drag from card/digital sales growth.

Although customer voucher cash balances are similarly segregated within the Christmas prepayments protection trust they may be transferred to the APP corporate cash balance at the point of despatch/billing. Revenue recognition at the point of redemption will typically occur a short time afterwards. During this period, the corporate cash balance includes the expected future payments to retailer partners that will be due at redemption, represented on the balance sheet by a provision balance. If voucher sales reduce, this 'cash float' and provision balance can be expected to reduce, and if APP were to cease voucher sales the provision balance would be expected to run down altogether, matched by a similar cash outflow. For this reason, our DCF valuation excludes an amount equal to the voucher provision even though ongoing sales of vouchers continue to support APP's corporate cash position.

At the end of FY19, balance sheet provisions amounted to £58.3m comprising a voucher provision of £36.3m and a card provision of £22.0m in respect of corporate gifted cards where the cardholder has no right of redemption. The card provision represents the expected liability to retailers and is matched by cash held within the e-money trust (not, as the case with the voucher provision, by corporate cash). By H120 the total provision balance had grown to £66.4m, including some seasonal fluctuations. No breakdown of the H120 balance is available but given the reduction in paper format billings (we believe this is all APP own-product vouchers) from £50.2m in H119 to £45.2m in H120 we believe that voucher provision balance will have declined while the card balance, driven by strong growth, will have increased. The reduction in the voucher provision balance represents cash paid out to retailer partners and had the effect of reducing operating cash flow. The increase in the card provision is similarly matched by cash, but cash held within the e-money trust, and did not contribute to operational cash flow.

As a result of the accelerated shift in sales mix, we now forecast that working capital movements will consume a little more than 100% of EBITDA (£11.7m) in FY20 driven by a c £9m run-off of voucher provisions. Allowing for the capital expenditure items noted above as well as dividend payments, our forecast cash balance at end-FY20 is now £25.0m (previously £33.7m). We expect a slower run-off of the voucher provision in FY21 (£2.4m) and our revised cash balance is £29.8m (previously £42.3m). Our forecast for net operational cash flow in FY21 represents c 85% of EBITDA, a conversion ratio that we expect to be sustainable.

Valuation

Despite the progress with the strategic plan and an in line financial performance, Appreciate shares have trended down over recent months such that the current year (FY20) P/E is 9.2x and the fully covered dividend represents a yield of 6.8%. The shares appear low valued compared with our revised absolute DCF valuation of 87p (previously 90p), which we cross-reference to a relative valuation compared with a selected group of listed stocks that are engaged in activities which provide some overlap.

Our modified DCF valuation differs from a standard DCF in that we include the interest earned by APP 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 in full, as this will eventually flow out in settlement of vouchers that have been issued but not yet redeemed. For this reason, the accelerated run-off of the voucher provision has no impact on our DCF valuation. Our key assumptions have been held constant for an extended period, and we continue to include two stages of growth so as to better reflect the near-term drag and subsequent potential upside from the strategic business plan. For the first three years after the forecast period (to end-FY21), we grow the free cash flow at 10% pa and then revert to the assumed long-term growth rate, unchanged at 5%, up until year 10. We assume an eventual normalisation in interest rates with a stepped increase from our near-term forecast return on cash balances of 0.9% to 1.5% in FY22 and 3% from FY23. The terminal cash flow is valued at an unchanged 10x and we have applied a discount rate of 10%.

Our relative value comparison recognises the lack of direct comparators to APP, most of which are either private companies or relatively small parts of larger groups. Sodexo and Edenred are both much larger and more international than APP, 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 (HCC) services, directed at a customer group with some demographic/ socioeconomic overlap between the traditional customer bases of the group's Christmas prepayments business (c 50% of APP). We recognise that the read-across is somewhat limited and note the difference between the savings nature of APP's Christmas prepayments business and the lending nature of HCC. Given APP has no credit risk and we believe it has less regulatory risk, we would expect a higher valuation.

The strategic business plan has a distorting impact on the near-term earnings comparison as well as affecting near-term cash flow, but even if we apply the 90p per share DCF value to our calendarised forecasts for APP, the 2019 (CY1) P/E would be 18.0x and that for 2020 (CY2) 16.0x. These are not materially different from the overall average shown in Exhibit 8 and well below the incentive and rewards and payments services average. The overall average is suppressed by the HCC rating.

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 multiples implied by our DCF value of 90p per share appear entirely reasonable.

Exhibit 9: Listed comparator data

	Share price (local)	Market cap (£m)	P/E (x) CY1	P/E (x) CY2	EV/EBITDA (x) CY1	EV/EBITDA (x) CY2	Yield (%)
Incentive							
Edenred	44.3	9,000	32.1	28.3	19.1	17.0	1.9
Sodexo	105.0	12,924	20.0	18.5	11.3	10.6	2.8
Incentive average			**26.0**	**23.4**	**15.2**	**13.8**	**2.4**
Payment services							
Euronet Worldwide	154.5	6,265	22.1	19.1	12.7	11.0	
Wirecard	104.5	10,779	24.2	18.1	13.9	10.4	0.2
Payment services average			**23.1**	**18.6**	**13.3**	**10.7**	**0.2**
Home collected credit/consumer finance							
Morses Club	122.0	160	9.6	8.0	7.6	6.6	6.4
Non-standard Finance	17.7	55	3.7	2.7	7.5	6.0	14.7
Provident Financial	444.6	1,113	9.5	8.4			2.2
HCC/consumer finance average			**7.6**	**6.4**	**7.5**	**6.3**	**7.8**
Whole group average			**17.3**	**14.7**	**12.0**	**10.3**	**4.7**
Appreciate Group	48.0	89	9.6	8.5	7.0	6.3	6.7

Source: Refinitiv. Note: Edison estimates for APP Group. Note: Earnings data on a calendar year (CY) basis. Prices at 16 December 2019.

Exhibit 10: Financial summary

Year end 31 March	£'000s	2015	2016	2017	2018	2019	2020e	2021e
PROFIT & LOSS								
Consumer billings		196,796	208,352	216,771	232,635	232,096	232,837	235,877
Corporate billings		176,091	176,679	187,741	180,151	194,805	210,085	226,778
Total Billings		372,887	385,031	404,512	412,786	426,901	442,922	462,655
Revenue		85,769	100,556	119,637	111,054	110,394	114,709	120,302
Cost of sales		(59,193)	(72,030)	(89,944)	(79,628)	(79,117)	(81,099)	(84,813)
Gross profit		26,576	28,526	29,693	31,426	31,277	33,610	35,489
Gross margin as % billings		7.1%	7.4%	7.3%	7.6%	7.3%	7.6%	7.7%
Distribution costs		(2,761)	(2,909)	(2,940)	(3,002)	(2,934)	(3,012)	(3,100)
Administrative expenses excluding depreciation & amortisation		(14,914)	(15,176)	(16,348)	(15,702)	(16,007)	(18,916)	(18,670)
EBITDA		8,901	10,441	10,405	12,722	12,336	11,682	13,719
Depreciation & amortisation		0	0	0	(1,405)	(1,394)	(1,484)	(1,930)
Operating profit before exceptional items		8,901	10,441	10,405	11,317	10,942	10,198	11,789
Exceptional items		0	0	0	0	(1,210)	0	0
Operating profit		8,901	10,441	10,405	11,317	9,732	10,198	11,789
Net Interest		1,245	1,457	1,470	1,270	1,572	1,563	1,598
Profit Before Tax & exceptional items		10,146	11,898	11,875	12,587	12,514	11,761	13,387
Profit before tax		10,146	11,898	11,875	12,587	11,304	11,761	13,387
Tax		(2,284)	(2,177)	(2,361)	(2,398)	(2,422)	(2,235)	(2,544)
Profit after tax (IFRS)		7,862	9,721	9,514	10,189	8,882	9,527	10,844
Average number of shares (m)		182.5	183.7	183.9	185.3	186.0	186.3	186.3
Fully diluted average number of shares (m)		184.7	187.2	187.2	185.9	186.1	187.3	187.3
Basic EPS - IFRS (p)		4.3	5.3	5.2	5.5	4.8	5.1	5.8
Fully diluted EPS - IFRS (p)		4.3	5.2	5.1	5.5	4.8	5.1	5.8
Dividend per share (p)		2.40	2.75	2.90	3.05	3.20	3.20	3.35
Payout ratio		55.7%	52.0%	56.1%	55.4%	67.0%	62.6%	57.6%
BALANCE SHEET								
Non-current assets		13,924	13,749	14,399	14,868	12,606	15,165	15,735
Goodwill		1,320	1,320	2,202	2,185	2,168	2,168	2,168
Other intangible assets		3,168	3,036	2,682	2,278	2,295	3,417	4,117
Property, plant, & equipment		8,143	8,003	7,688	7,684	6,216	2,455	2,325
Retirement benefit asset		1,293	1,390	1,827	2,721	1,927	1,923	1,923
Other non-current assets		0	0	0	0	0	5,202	5,202
Current assets		107,095	119,496	129,322	142,423	153,475	163,501	175,997
Inventories		3,186	2,182	2,632	3,808	4,574	4,673	4,839
Trade & other receivables		11,309	8,860	9,236	10,917	12,582	14,395	15,730
Monies held in trust		65,728	75,219	83,018	86,992	99,251	114,450	125,669
Cash & equivalents		26,333	32,735	34,236	40,311	36,868	25,017	29,759
Other current assets		539	500	200	395	200	4,966	0
Current liabilities		(121,545)	(128,164)	(133,789)	(142,604)	(148,818)	(152,628)	(160,813)
Trade & other payables		(77,688)	(83,135)	(87,201)	(94,592)	(89,952)	(88,584)	(90,218)
Tax payable		(671)	(262)	(424)	0	(580)	0	0
Provisions		(43,186)	(44,767)	(46,164)	(48,012)	(58,286)	(64,043)	(70,595)
Non-current liabilities		(2,907)	(1,881)	(1,118)	(662)	(553)	(5,819)	(5,819)
Deferred tax liability		(273)	(181)	(194)	(662)	(553)	(553)	(553)
Retirement benefit obligation		(2,634)	(1,700)	(924)	0	0	0	0
Net assets		(3,433)	3,200	8,814	14,025	16,710	20,219	25,100
Minorities		0	0	0	0	0	0	0
Shareholders' equity		(3,433)	3,200	8,814	14,025	16,710	20,219	25,100
CASH FLOW								
Operating Cash Flow		14,106	12,184	9,603	10,540	6,874	(422)	9,185
Net interest		1,176	1,339	1,539	1,267	1,497	1,687	1,598
Tax paid		(2,132)	(2,490)	(2,258)	(2,537)	(1,576)	(2,815)	(2,544)
Capex		(597)	(1,126)	(717)	(1,020)	(1,152)	(3,721)	(2,500)
Acquisitions/disposals		41	52	(875)	1	0	0	4,966
Dividends paid		(4,198)	(4,380)	(5,052)	(5,370)	(5,668)	(5,961)	(5,963)
Other		0	0	305	0	345	323	0
Net cash flow		8,396	5,579	2,545	2,881	320	(10,908)	4,742
Opening net (debt)/cash		14,842	23,238	28,817	31,362	34,243	34,563	23,655
Closing net (debt)/cash		23,238	28,817	31,362	34,243	34,563	23,655	28,397
Overdraft		3,095	3,918	2,874	6,068	2,305	1,362	1,362
Closing net (debt)/cash as per balance sheet		26,333	32,735	34,236	40,311	36,868	25,017	29,759

Source: Appreciate Group data, Edison Investment Research forecasts

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