EDISON

musicMagpie

Initiation of coverage

Buy more, sell more, rent more

Retail

musicMagpie (MMAG) provides a cost-effective and sustainable alternative to buying and selling consumer technology and physical media. Future growth is supported by the positive tailwinds of increasing awareness of sustainability issues and the growing importance of the circular economy. It has a significant growth opportunity from the rental of technology, which is expected to generate greater revenue and profit over the life of a device than an outright sale. The addition of the new recurring subscription revenue has the potential to accelerate annual revenue growth from mid- to high-single digits and significantly increase profitability (low-teens EBITDA margin from FY26). Our DCF-based valuation is 168p per share.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	EV/EBITDA (x)	P/E (x)
11/20**	153.4	13.9	9.2	10.5	0.0	3.1	4.3
11/21	145.5	12.2	7.9	6.1	0.0	3.5	7.4
11/22e	154.7	9.3	1.8	1.4	0.0	4.6	32.8
11/23e	166.1	11.3	1.4	1.0	0.0	3.8	43.7
11/24e	179.9	15.6	5.6	3.9	0.0	2.8	11.6

Note: *PBT, EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. ** exceptional COVID impact

An evolving business model

MMAG's business exposure has evolved quickly with a market-leading position in the UK, and an early-stage position in the United States, focused on three main product categories/divisions, Technology, Media (disc media) and Books, all with very different growth dynamics. New initiatives such as rental of smartphones and other consumer technology, offering new Apple products and the first moves to building relationships with corporates (versus consumers) suggest the addressable markets available to MMAG will continue to increase.

Forecasts: EBITDA growth expected from FY23

The business mix, before rental income, is capable of consistent mid-single-digit revenue growth. The transition to monthly subscriptions for consumer technology should accelerate overall medium-term growth rates and profitability but compresses growth in the near-term as it moves from one-off/upfront revenue to monthly revenue recognition with a significantly higher margin. We forecast 6–8% pa revenue growth in FY22–24, but the above near-term dampening effect of the transition to rental and lower 'outright' Technology gross profit will lead to lower FY22 EBITDA, before we expect EBITDA growth to resume from FY23. At end-FY21, MMAG had a net cash position of £1.8m. Its future cash generation and net financial position will be sensitive to the phasing and extent of capital investment required to support the expansion of its rental services.

Valuation: Fair value of 168p per share

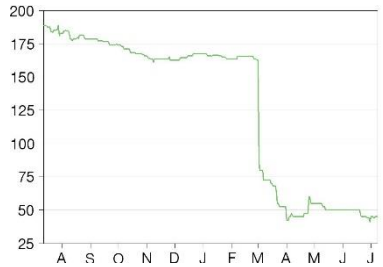
Our base case DCF-based valuation indicates a share price of 168p per share, significant upside from the current share price. Following a de-rating, MMAG's FY22e EV/EBITDA of 4.6x represents a discount to other UK consumer-facing online companies, but the uniqueness of MMAG's business model and category exposure means there are few direct peers with which to satisfactorily compare its valuation.

11 July 2022

Price	**45p**
Market cap	**£48m**

Net cash (£m) at 30 November 2021 (excluding IFRS 16 liabilities)	1.8
Shares in issue	107.8m
Free float	45.1%
Code	MMAG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(10.0)	(0.0)	(76.1)
Rel (local)	(4.7)	7.5	(75.9)
52-week high/low		189p	41p

Business description

musicMagpie is a leader of re-commerce in the UK and United States in consumer technology, books and disc media through its proprietary technology platform. It is expanding its offer into rentals of smartphones and other consumer technology, and widening its sourcing infrastructure.

Next events

H122 results	27 July 2022
FY22 results	March 2023

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Edison profile page

musicMagpie is a research client of Edison Investment Research Limited

Investment summary

Company description: Leading online re-commerce

musicMagpie (MMAG) is a leading online consumer re-commerce company with a current focus on buying and selling across three categories: consumer technology, media (ie disc media) and books. Its growth prospects are mainly driven by increasing consumer acceptance of circular economy models, a result of increasing environmental and sustainability concerns. The main geographic presence is the UK (79% of revenue in FY21), one of the more developed consumer re-commerce markets. It is the world's largest seller on Amazon and eBay by reference to volume of sales transacted on third-party platforms. It also has a less developed business in the United States. Over time, the product category focus has evolved and MMAG's technology will enable this to continue as consumer engagement with re-commerce increases. Historically, MMAG's relationship has been solely with consumers, and typically intermittent in nature. Recent initiatives indicate this is changing: the new offer of rentals of smartphones and other consumer technology aims to build recurring and more profitable revenue streams; new and enhanced digital marketing capabilities seek to stimulate new cross-selling opportunities; and the first move into corporate recycling opens up a new significant pool of potential product supply and revenue. Management guides to long-term double-digit revenue growth for Technology, countered by continued high-single-digit declines for Media, suggesting the current business mix is capable of mid-single-digit revenue growth, which may accelerate as Technology's importance to the group increases.

Financials

MMAG demonstrated strong revenue growth, with a CAGR of 8% in FY18–21, ahead of market growth estimates, due to growth in consumer numbers and repeat customers. This points to growing engagement with the circular economy and market share gains, and a further boost to demand during the COVID-19 pandemic. At the same time, refinement of the buying and selling processes led to significant gross margin enhancement (from c 23% in FY18 to c 30% in FY21). We forecast 6–8% pa revenue growth in FY22–24 despite further normalisation to pre-COVID-19 levels for Media and Books. We forecast that FY22 EBITDA will decline as the transition to building rental income - which is more profitable in the medium-term - dampens near-term growth, and reflecting recent trends in Technology outright gross margin, before growth resumes in FY23.

Valuation: Fair value of 168p per share

Our primary method of valuing MMAG is a discounted cash flow (DCF) analysis, with a fair value of 168p per share. Beyond our explicit forecast period we assume 5% annual revenue growth for 'outright' sales, fading down to c 4% growth by our terminal year, FY31, and rentals to increase revenue growth by 2–5% pa. The higher-margin subscriptions potentially increase the EBITDA margin from 8.4% in FY21 to c 21% by FY31. We use a WACC of 10% (risk free rate of 3%, risk premium of 6%, Beta of 1.2 (limited trading history), and little debt) and a 2% terminal growth rate.

Sensitivities

MMAG operates in markets with a wide range of competitors and the structural growth dynamics of the circular economy suggest that competitive pressures are likely to remain high. It is exposed to frequently changing product cycles and some product categories that are expected to demonstrate structural declines, such as disc media. As the circular economy evolves, MMAG's business exposure is likely to change as it seeks to increases the size of its addressable markets and the number of product categories offered. MMAG's US business is a relatively small business in a less well-developed re-commerce market, therefore this may be more difficult and expensive to develop than expected.

Company description: Consumer re-commerce

musicMagpie is a leading consumer re-commerce company in the UK and United States with a main current focus on consumer technology (mobile phones, tablets, MacBooks, smartwatches and consoles), disc media (CDs, DVDs and games) and books. Segmental disclosure includes revenue and a number of profit measures for the three categories under three divisions, Technology, Media and Books.

In the UK, it trades as musicMagpie, and in the United States as decluttr. In FY21, the UK represented 79% of MMAG's revenue, which reflects the UK is a more established business, and the UK consumer re-commerce market is more advanced.

MMAG's shares were admitted to AIM on 16 April 2021 at 193p, raising gross primary proceeds of £15m. The proceeds were used to fund investment in its rental business, SMARTDrop kiosks and IT development, and repay existing debt facilities.

Exhibit 1: IPO shares

	Shares (m)	Gross proceeds (£m)
Total shares in issue before IPO	100.000	
Primary shares	7.772	15.0
Secondary shares	49.416	95.4
Total placing shares	57.188	110.4
Total shares in issue post IPO	107.772	208.0

Source: musicMagpie Admission Document

The major shareholders before the admission and their holdings at 31 December 2021, excluding new institutional investors on the IPO, were as follows:

Exhibit 2: Shareholdings

	Prior to admission		31 March 2022	
	Number of shares (m)	% of issued shares	Number of shares (m)	% of issued shares
Northern Entities*	34.6	34.6	17.3	16.1
Steven Oliver**	16.6	16.6	13.4***	12.4***
Walter Gleeson*	10.2	10.2	7.2	6.7
Lloyds Development Capital	8.0	8.0	0.0	0.0
Ian Storey	3.8	3.8	3.7***	3.4***

Source: musicMagpie Admission Document and FY21 results. Note: *As defined in the admission document. **Includes concert parties. ***Includes Employee Benefit Trust.

musicMagpie's development

The company was founded in 2007 by Steve Oliver and Walter Gleeson with an initial focus on buying and selling pre-owned CDs and DVDs from and to its customers. From an online perspective the company developed its distribution by initially offering items on Amazon's websites in the UK (2008), the United States, France and Germany (2009), and then on eBay (2011). In 2012 the company entered the consumer technology market and also launched its US business. Its own online stores (www.musicmagpie.co.uk and www.decluttr.com) were launched in 2015 and 2017, respectively. Books were introduced in 2016.

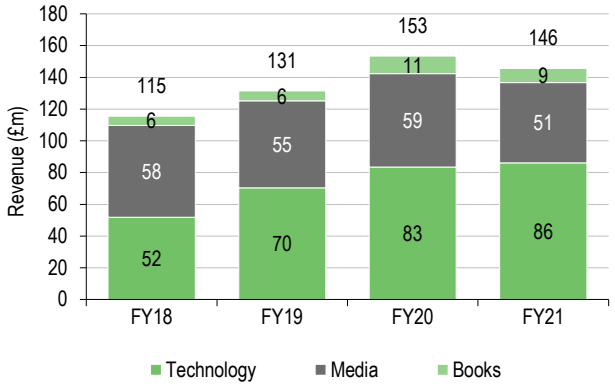
The company also developed a physical presence with the launch of its first 'That's Entertainment' retail outlet in 2009, which quickly grew to over 30 stores by 2011, before management decided to close its retail outlets in 2018 in order to focus on online. MMAG currently has wholesale partnerships with a number of high street retailers such as ASDA.

In 2020/21, MMAG launched three UK-focused initiatives that are expected to drive further revenue growth with three key aims from customers, 'buy more, sell more, rent more', while enhancing MMAG's profitability. For 'buy more' and 'sell more', two initiatives are focused on increasing the potential sources of products that can be on sold: the SMARTDrop kiosk, in which sellers can easily recycle phones in partner retail locations in a quicker/more efficient way; and Magpie Circular, a first

step that introduces MMAG's trade-in offer to corporates. For 'rent more', the October 2020 launch of smartphone rentals, and the February 2022 expansion of the service to other consumer technology products such as tablets, gaming consoles, MacBooks and wearables, is focused on building recurring revenue, with significantly higher EBITDA over the life of the device, as opposed to the outright sale historically pursued by MMAG. Our estimates suggest MMAG's rental activities are likely to be the most significant driver for future growth in revenue and profits.

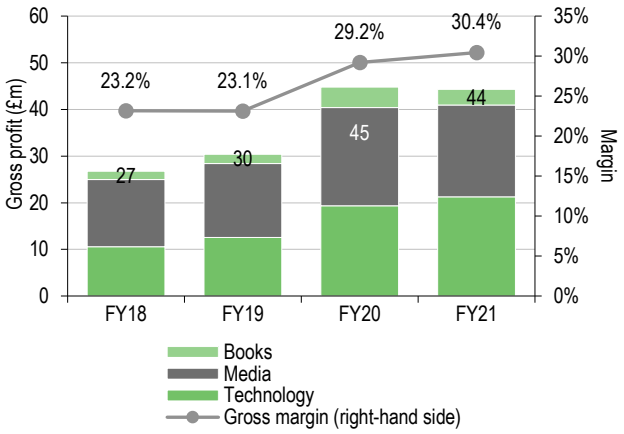
MMAG builds brand awareness via advertising on television, online and through social media. It proactively promotes personalised offers to its existing customer base by targeted emails.

Exhibit 3: Revenue profile



Source: musicMagpie

Exhibit 4: Gross profit



Source: musicMagpie

Since being introduced to the offer, Technology has become the largest source of revenue. At £86m in FY21 it represented c 59% of the group total, while Media and Books represented 35% and 6%, respectively. The average gross margin has improved, from 23.2% in FY18 to 30.4% in FY21, due to higher margins for all categories (except for Books in FY21) offset by mix changes. With respect to mix changes, the increasing importance of Technology (lower average percentage margin but higher cash profit) and Books (higher average percentage margin) have been positive for the overall gross profit and/or margin, offset in part by the declining importance of Media (higher average percentage margin).

musicMagpie's business model

MMAG's core consumer circular business model can be broken down into four constituent parts: buy, receive, refurbish and sell/rent.

Exhibit 5: musicMagpie's circular business model

Source: musicMagpie

Buy

Potential customers input the details of the products they would like to sell on the company's website, app or at the self-service SMARTDrop (see below) kiosks (in the case of technology). The process is more straightforward for media and books than for technology. For books and disc media, MMAG provides an instantaneous quote, which is valid for 28 days, after the customer provides the book's International Standard Book Number (ISBN) or details of the CD and without questioning the item's condition. For technology, the process is slightly more involved as the customer is required to provide a view on the condition of the products (good, poor or faulty, with MMAG providing a simple guide to what qualifies as good, poor etc), which is later verified by the company. This is important given the likely more variable product conditions that can affect performance, larger ticket size and potential greater margin risk, and the quote is valid for 21 days. If the customer accepts the quoted price, there are a range of delivery options to the company's warehouse, depending on the value of the products: technology products are mainly handled via Royal Mail given the higher values of products involved; and a courier service is mostly used for media and books with collection from either the customer's house or the courier's drop point. The courier and postal fees are borne by MMAG. When customers use MMAG's SMARTDrop kiosks, the kiosks have the technology to inspect the item and check its provenance and functionality so that customers can be paid within minutes.

MMAG's purchasing strategy is to only buy products it is confident of selling at an acceptable margin while minimising stock obsolescence. The success of this strategy can be seen in the improved gross margin (from c 23% in FY18 to c 29% in FY20 and c 30% in FY21), while inventory days have remained broadly stable.

The offer price to the customer is generated by MMAG's proprietary purchasing algorithm, ALIVE, in conjunction with the proprietary sales algorithm, WARP. See 'Proprietary technology drives the buy and sell processes' section for how MMAG's technology platform and warehouse management system help maintain dynamic and competitive pricing.

Receive

On receipt of the products at the company's warehouse (typically within two days in the UK and seven days in the United States), they are quality checked and graded by the team. When an item has been checked and graded, the customer is paid via bank transfer or PayPal.

Disc media are checked and, if MMAG decides it cannot sell the product, it is recycled responsibly.

The condition and functionality of each technology product is checked, as well as its provenance, that is whether the customer is the genuine owner and whether the product is lost or stolen etc. Any data stored on the device are wiped to an Asset Disposal and Information Security Alliance standard. The company protects itself from receiving stolen goods by only paying customers via bank transfer etc and having their full contact details. If the product's condition is worse than expected a revised offer will be made, which the customer has 14 days to accept or decline; if declined the item is returned to the customer free of charge.

Refurbish

Refurbishment of technology products including in the case of smartphones repairs to screens and boards, and component replacement including batteries if below a set standard.

For disc media, refurbishment is restricted to replacement of damaged protective cases and buffing of the discs. Books are not refurbished.

Sell/Rent

Sales are made through MMAG's own websites and smartphone apps, marketplaces such as Amazon and eBay (it is the world's largest seller on those platforms by volume and feedback) and a recently announced agreement to sell technology products on Back Market (see Sell more section), and a small minority by wholesale partnerships in the UK. MMAG has a 14-day return policy on all sales, as long as the product is returned in the same condition and consumer technology products have a 12-month warranty, which is an important differentiating part of MMAG's offer versus some competitors, for example peer-to-peer sales websites.

MMAG's recent move in to offering rentals of technology is discussed later.

Trusted brand

Management believes its trusted brand (average Trustpilot rating of 4.6 for the UK business with c 220k reviews, and 4.5 for the US business with 21k reviews at 4 March 2022), given the high level of quality control and speed/ease of dealing with and receiving money, are key determinants of its appeal to customers relative to its peers.

MMAG has the highest number of seller reviews on both Amazon and eBay with over 10m on each of the platforms, with highly positive feedback scores.

Proprietary technology drives the buy and sell processes

The company's technology platform and warehouse management system platform have been developed in house. They ultimately drive the buying and selling price decisions for each product so the trading margin is optimised and stock obsolescence is minimised.

The company's core 'buying' technology, ALIVE, has data including over 10 years of MMAG's transactions and information on 2.5m products that drives the instantaneous decision on whether to buy a product and the price that should be offered. The 'selling' technology, WARP, optimises the selling price and handles the product listing across the different sales channels, with interfaces to Amazon and eBay, which enables management to see competitor availability prices and decide where the best price can be achieved.

Group infrastructure

In the UK, MMAG operates from two processing and distribution centres and the head office in Stockport. In FY20, the UK sites, which cover 170k square feet, processed approximately 16m items. The larger site (Hazel Grove, 110k square feet) focuses on processing technology and disc media and the smaller site (Macclesfield, 60k square feet) focuses on books.

MMAG's US operation is much smaller in scale, operating from a processing and distribution facility covering 60k square feet. In FY20, it processed four million items, one quarter of the amount handled by the UK.

Management estimates the infrastructure (UK and US) can support a doubling of the growing technology revenue base, assuming some space re-allocation from media (expected to contract over the long term), so there is no pressing need to consider infrastructure changes.

Buy more, Sell more, Rent more

Having outlined the MMAG's core operations above, below we highlight the new initiatives that management believes should drive the company's future growth. MMAG has distilled its strategies under the three pillars of 'Buy more', 'Sell more' and 'Rent more', each of which is described below.

Buy more

In order to increase MMAG's sourcing of products from more customers, it has begun the rollout of SMARTDrop kiosks which make it easier for consumers to transact with the company, and purchasing used technology from corporates

SMARTDrop kiosks: Making life easier for customers

The SMARTDrop kiosk trials were launched in November 2020, primarily as a way of enhancing MMAG's sourcing opportunities by making it easier for consumers to transact with MMAG and as another way of overcoming consumer apathy. Management estimates each UK household has 11 devices 'left in drawers', equivalent in value to £16bn.

The concept is innovative and simple. Customers can drop off their smartphones in the kiosks, located in supermarkets, eliminating the need to make a journey to a post office or courier drop point, then receive immediate payment rather than having to wait as the kiosks have the technology to visually inspect and check the provenance and functionality of the technology. Customers can either initiate the selling process online and take the products to the kiosk, or initiate the whole process at the kiosk.

The trials began in 20 stores in the North-West of England and given the initial success, in September 2021 management announced a sustainability partnership with ASDA, including a nationwide rollout of the kiosks across c 300 stores. Management estimates this will provide access

to 90% of the population within a 15-minute drive, with rollout from March 2022 and expected completion in September 2022. In addition to the in-store presence, MMAG's services are promoted directly to ASDA's own online customers; ASDA's website had over 30 million site visits in February 2021 (source: Admission Document).

From a volume perspective, through September 2021, the company had traded c 3,000 devices through the kiosks, paying out over £800k to customers. By the end of FY21, c 5,300 smartphones had been traded with over £1.5m paid out to customers and in Q122 had increased to c 8,000 units, paying out £2.3m to customers. Importantly, so far and versus MMAG's online offering, the kiosks have attracted a younger customer than average, and the quality of the product sourced has improved (so has a higher price point): the average price paid per unit on Apple and Samsung devices during Q221 of £236 was a 41% premium to MMAG's average transaction. The most recent data imply a price paid of £283 (£1.5m/5,300 smartphones) to the end of FY21, and £287 (£2.3m/8,000 smartphones) to the end of Q122, due to the superior product mix.

The initiative appears to be helping overcome customer apathy, as intended, as internal data suggest nearly 40% of customers that use the kiosk stated they would not have sold their old device otherwise. For ASDA, research from the trial indicates it is attracting new customers to the store who go on to make a purchase there.

Magpie Circular: Sourcing from corporates, revenue potential

MMAG's corporate recycling initiative was soft-launched in February 2021, primarily as a means of increasing the potential sources of technology products (smartphones, tablets and Apple computers) that can be then sold on to its retail customer base. The corporate customers benefit from easier recycling of old technology, surety about the extent and quality of the data wipe, and enhancing their own environmental credentials.

Although it is still early days for the initiative, management is encouraged by its experiences in sourcing (having worked with companies including Dentsu Aegis, Deloitte, Zurich and adidas) and, significantly, it has become apparent corporates may become a good source of new revenue streams as a result of other recent initiatives across the group, diversifying MMAG away from its current consumer focus.

With respect to sourcing, there is growing interest from corporates to develop an ongoing relationship, for example MMAG agreeing to purchase the company's ageing technology on a multi-year basis rather than the current ad-hoc purchases by MMAG.

From a revenue perspective, management points to recent success with Deloitte, with whom it has a contractual relationship to recycle 25k iPhones on a three-year cycle.

Sell more

MMAG is platform agnostic as to whom it sells and how it sells. As already highlighted, the majority of sales go through its own sites and apps, and marketplaces (Amazon and eBay), but it is looking to expand its reach into other platforms, as evidenced by the April 2022 agreement for MMAG to sell consumer electronic products (smartphones, games consoles, tablets, wearables and MacBooks) on Back Market's UK marketplace (end-April 2022) and US marketplace (mid-May 2022). Back Market is a Paris-based marketplace for buying and selling technology products, with six million customers and a presence in 16 countries, mainly in Europe but also in the UK and the United States. In May 2021, it raised $355m of funding followed by a further $510m in January 2022 at an implied company valuation of $5.7bn to help further its growth aspirations. As a marketplace, it operates with no inventory and does not carry out the refurbishment process as MMAG does.

The company has few non-financial KPIs, which reflects the dynamics of the different product categories (mix, volume and price) and, in part, the initiatives that are expected to stimulate future

demand are relatively new. From recent presentations, we note MMAG has enjoyed strong growth in customer numbers, from 7.1m customer registrations at the IPO to 7.5m at end FY21, and there has been consistent growth in the proportion of repeat customers (from 27% of the total in FY16 to 50% in FY20).

Historically, there has been limited cross-sell between the customers that buy and sell using MMAG, and between the different product categories, due to a lack of visibility between the different channels and categories. Exhibit 6 shows the percentage of customers buying and selling across the product categories and the overlap between them, from July 2018 to 2020. At the category level there was very limited overlap between customers that both buy and sell: 1.2% of customers that sold technology through MMAG also bought technology and just 4.1% (those highlighted in the green box below) of customers have bought and sold technology or media at least once. In aggregate, 51% of customers who sold any category through MMAG did not buy anything MMAG during the sampled time period and 45% of customers that bought did not sell a product.

Exhibit 6: Cross-sell between buy and sell, and technology and media in UK

		Sell				
		Tech	Media	Both	None	Σ
Buy	Tech	1.2%	0.3%	0.2%	20%	22%
	Media	0.7%	1.0%	0.3%	23%	25%
	Both	0.2%	0.1%	0.1%	2.0%	2%
	None	26%	19%	5.5%		51%
	Σ	28%	20%	6.1%	45%	100%

Source: musicMagpie. Note: Sample July 2018 to July 2020.

Therefore, management believes there are significant cross-selling opportunities, while recognising that a high proportion of customers are likely to be interested in only buying or selling. As a result, MMAG has invested in technology to better exploit its knowledge of its customer base and their transaction history. In December 2020, MMAG began using Exponea, a customer data and experience platform that unifies data to create a single view of each customer's activity. The platform then uses artificial intelligence to provide predictions and personalised product recommendations to customers to stimulate incremental demand through targeted marketing such as email campaigns and text messages. Management believes this is a significant improvement from its previous marketing, which was a standard email to all customers without any personalisation of the promotions.

In addition to the above, to increase the appeal of MMAG to new and existing customers, brand new Apple products are available for sale and to rent on the UK website, enabling customers to trade in or up to the latest Apple devices. The latest iPhone 13 is available from £31.99 a month.

Rent more

MMAG's smartphone rental business, Rent-a-Phone was launched in October 2020, and represented the company's first move into generating recurring revenue versus its traditional one-off transactional relationship in the core business. In February 2022, MMAG announced the extension of its rental offer to other consumer technology products, namely tablets, games consoles, MacBooks and wearables, following the popularity of the smartphone rental offer. Management sees potential to expand into other types of consumer technology in the future. As highlighted later (see Financials section), the rental business has the potential to increase MMAG's

revenue growth profile (we estimate adding 2–5% to annual revenue growth rates) and significantly improving its profitability (from FY21 adjusted EBITDA margin of 8.4% to low-teens and above from FY26).

The smartphone subscription is for at least 12 months, with an option to then either upgrade, renew or return the phone. More than 9,000 stock keeping units (SKUs) are currently available to rent on the UK website.

The consumer benefits from a relatively inexpensive upfront cost (first month subscription is paid in advance before despatch of the device) to access more desirable and up-to-date editions of a full range of smartphones, with greater flexibility of options at the end of the rental period. Monthly rental fees start at £8.99 for a refurbished phone, £11.99 for a console, £12.99 for an iPad and £19.99 for a MacBook. The latest iPhone 13 is available from £31.99/month.

MMAG benefits financially from a recurring revenue stream, hopefully over a number of years as the customer extends or renews the subscription with the same or another phone, as well as the ultimate on-sell revenue of the product if it is no longer rented by a customer. Through this, the customer essentially becomes MMAG's supplier. By definition, the length of time that a phone can be rented is limited by the time its operating system is kept up to date by the phone manufacturer, and there is an inter-play between how long the phone can be rented and the ultimate selling price. From a customer relationship management perspective, management also expects to benefit from the ability to cross-sell its other product offers given regular opportunities to interact with customers.

Since its launch, the service has generated strong sequential (month-on-month) growth in the number of subscriptions, reaching c 4.4k subscriptions at the end of March 2021 and 7.5k at the end of May 2021 by which time it was building at 50+ rentals per day and momentum was increasing. By the end of FY21, there were 13.5k active subscribers, after allowing for customers that had either defaulted before the end of the first year or left the service after year one. The number of active subscribers increased to c 19k by the end of February 2022, taking the forward order book to £2.2m.

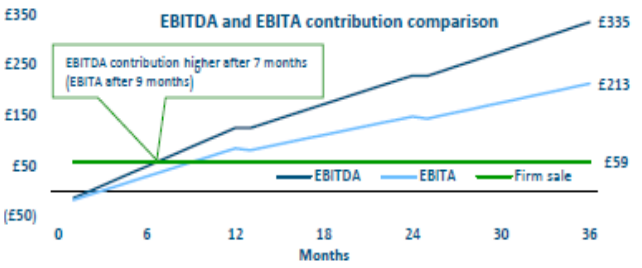
Exhibits 7 and 8 demonstrate management's initial estimates at the time of the IPO of the relative economics of a smartphone sale versus a three-year subscription, with monthly subscription revenues indicated gross and net of VAT.

Exhibit 7: Sale versus rental example

Firm Sale vs Rental	Firm Sale		Per Month		Rental *	"Break Even"
	£				£	Months
Net Sale Price	£290	Primary Rental	20	17	£200	
		Secondary Rental	16	13	£160	
		Tertiary Rental	12	10	£120	
Total revenue	£290	Total revenue			£480	
Trading margin	£90	Trading margin			£480	
Gross Margin	£78	Gross Margin			£364	
EBITDA contribution	£59	EBITDA contribution			£335	6.75
EBITA contribution	£59	*EBITA contribution*			£213	9.21

Source: musicMagpie IPO presentation

Exhibit 8: Relative contributions of sale versus rental



Source: musicMagpie IPO presentation

An outright sale of a smartphone in the example given generates revenue of £290, trading profit of £90 (margin 31%), gross profit of £78 (margin c 27%), EBITDA of £59 (margin c 20%) and EBITA of £59 (margin 20%). In this example, over the (estimated) three-year life, management estimates a subscription should generate significantly higher revenue and profitability than an outright sale: revenue of £480, trading profit £480 (margin 100% with no cost of sale, the smartphone is capitalised as an asset and depreciated over the estimated useful life of the device), gross profit of £364 (margin c 76%), EBITDA of £335 (margin c 70%) and EBITA of £213 (margin 44.3%). The near-term dampening effect on year-one revenue is highlighted by a comparison of the revenue recognised of the rental of £200 versus an outright sale of £290. However, offsetting this,

management estimates the EBITA of a subscription is higher than an outright sale after nine months.

MMAG's FY21 results included full disclosure for revenue and profitability of outright sales (ie one-off) and rental income, and the total for the whole of Technology.

Exhibit 9: Technology revenue and profit

£m	FY20 Outright	FY20 Rental	FY20 Technology	FY21 Outright	FY21 Rental	FY21 Technology
Revenue	83.491	0.005	83.496	84.245	1.809	86.054
Growth year-on-year				0.9%	36080.0%	3.1%
Gross profit	19.363	0.004	19.367	19.973	1.311	21.284
Gross margin	23.2%	80.0%	23.2%	23.7%	72.5%	24.7%
Contribution (after direct labour)	15.703	0.004	15.707	15.985	1.311	17.296
Contribution margin	18.8%	80.0%	18.8%	19.0%	72.5%	20.1%

Source: musicMagpie

Just after the first anniversary of the smartphone rental launch, FY21 rental revenue of £1.8m represented more than 1% of group revenue (c £145.5m) and the gross profit and contribution after direct labour of £1.3m was c 3% of group gross profit (£44.3m) and c 4% of group contribution (£32.1m). The significantly higher rental margins (gross margin 72.5% and contribution 72.5%) than for outright sales (23.7% and 19.0%, respectively) highlight the potential improvement for group margins if management can further scale the rental business successfully.

Market overview

The overall growth of the circular economy is being driven by increasing awareness of environmental and sustainability issues across society, by individuals, corporates and governments. The growing circular economy is an established megatrend.

In order to reduce consumer apathy and get consumers more engaged with the growing circular economy, corporates with an online focus, such as MMAG, and the traditional offline/hybrid retailers are helping to raise consumer awareness and increasing the convenience of participating in the circular economy.

E-waste

E-waste is discarded electronic products with a battery or plug, such as mobile phones, tablets or computers. The failure to recycle e-waste means precious materials, such as gold, silver and platinum, cannot be reused, and there are environmental issues when the products go in landfill or are incinerated.

According to MMAG's FY21 results presentation, 53 million tonnes of e-waste is generated globally each year, and this figure is expected to double by 2050 as it is the fastest-growing stream of waste. The fact that only c 17% of global 2019's e-waste was documented as formally collected and recycled shows there is much more that can be done to reduce and recycle e-waste.

Turning to how MMAG's activities have benefitted the environment, management estimates that in FY21 its UK media and tech customers and trade partners helped to save over 50k tonnes of CO_2 by selling to and buying from the company, the equivalent of heating c 18.2k homes for a year.

Market growth forecasts: Technology to the fore

The markets for pre-owned products in its core categories in the UK and US were worth £9bn in FY20, of which the UK was £1.6bn and the US was £7.1bn (source: Admission Document). Therefore, with FY21 UK revenue of c £115m and US revenues of c £30m, MMAG's revenue share was c 7% in the UK, and c 0.4% in the US, subject to rounding. At the IPO, management quoted

UK market shares of 7% in smartphones and 5% in media and books, and US shares of 0.5% and 0.3% respectively. The low market shares suggest significant potential to grow in both countries.

In descending order, according to independent third-party research commissioned by management (source: Admission Document), medium-term annual market growth rates for the product categories are forecast to be Technology 15%, Books stable/low growth and Media negative 5–10%. Using FY20's revenue mix, that is, pre the inclusion of rental income, this range of category growth rates would translate to total addressable market growth rates of c 4–6%. As Technology's relative contribution increases in future, the weighted average growth rate would be expected to grow. As highlighted earlier, growing rental income will likely dampen MMAG's outright revenue growth while the active subscriber and revenue base builds.

The same independent third-party research provided estimated growth rates for the pre-owned technology markets in the UK and United States from 2020–24 of 14–16%, versus growth rates of 20–22% from 2017–20.

Exhibit 10: Pre-owned technology markets

£m	2017	2020	2024	CAGR 2017–20	CAGR 2020–24
UK pre-owned technology	**500**	**900**	**1,500**	**22%**	**14%**
o/w smartphones		700	1,100		12%
o/w other consumer technology		200	400		19%
US pre-owned technology	**2,100**	**3,600**	**6,500**	**20%**	**16%**
o/w smartphones		2,500	4,400		15%
o/w other consumer technology		1,100	2,100		18%
Total pre-owned technology	**2,600**	**4,500**	**8,000**	**20%**	**15%**
o/w smartphones		3,200	5,500		14%
o/w other consumer technology		1,300	2,500		18%

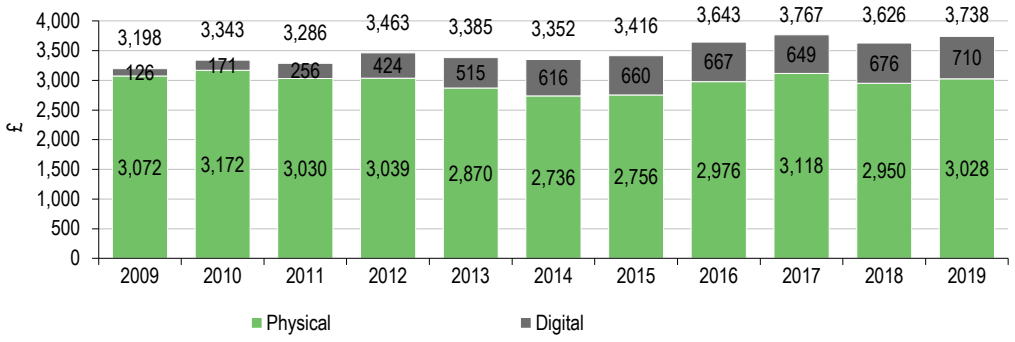
Source: musicMagpie. Note: Other consumer technology is games consoles, smartwatches, tablets and laptops.

The pre-owned markets for all consumer technology products enjoy common structural drivers, which are replacement cycles and increasing price, the latter reinforcing the attractions of pre-owned products. Smartphones are also benefiting from an increasing trend of decoupling of handsets from carrier contracts. The above estimates do not include estimates for MMAG's potential category expansion into new product types, for example wireless headphones.

Management expects the markets for pre-owned and new disc media will continue to decline given the disruption to physical media from the move to digital, as in recent years (see below), albeit the former has been more resilient due to lower absolute prices. There will continue to be a market for disc media so long as the playing technology (CD players, consoles, PCs, DVDs, used cars) to read them is useable and users do not substitute across to other media. So long as the new disc market continues to exist, the available inventory for the pre-owned disc media will continue to grow, therefore the size of the pre-owned market depends on the extent to which new/existing consumers engage. Management believes there is still good money to be made in books and media well into the future whilst recognising the structural challenges. The research estimates (source: Admission Document) that from 2017–20, the combined new disc media markets in the UK and United States declined at an average rate of c 12% (from £9.6bn to £6.5bn), while the pre-owned media markets declined at average rates of c 13% in the UK (from £300m to £200m) and c 10% in the US (from £1.1bn to £800m). Therefore, MMAG's Media revenue appears to have outperformed the estimated market growth rates in recent years, with revenue decline of c 6% in FY20, before growing by c 8% in FY21 and a further c 3% in H121, helped by new demand during the COVID-19 pandemic (more time to clear houses, more time to commit to media and the closure of alternate physical distribution such as libraries and charity shops).

Management expects the UK and US markets for pre-owned books to be relatively flat over the medium term, despite competing digital formats and the increasing attractions of alternate media and entertainment. This expectation is supported by historical data.

Exhibit 11: UK book sales



Source: Statista

From 2009–19, the UK book market grew at a CAGR of c 2% (from £3.2bn to £3.7bn), within which physical book revenue was broadly stable and digital has provided all of the absolute growth. MMAG has consistently outperformed wider market growth in recent years, helped more recently by the COVID-19 pandemic, as was the case for disc media. Following revenue growth of c 11% in FY19, the COVID-19 pandemic helped to boost MMAG's Books revenue by c 74% in FY20 and a further c 10% in H121. As expected by management, the revenue run-rate returned to more normalised, that is pre-COVID-19, levels in H222, declining by c 43% to £3.6m, taking the year-on-year decline for FY21 to c 21%.

Competitors

In the 'Sell' part of the process, MMAG's commercial competitors include other online re-commerce specialists (Mazuma Mobile, Envirofone, Ziffit), the original equipment manufacturers (eg Apple and Samsung), mobile network operators (eg Vodafone and EE), offline trade-in/retailers and peer-to-peer marketplace sites (eg Amazon, Back Market and eBay). In addition, other alternatives for re-commerce include charities and car boot sales, where there may be considered to be more of a social or personal motivation. MMAG is platform agnostic as to whom it sells and how it sells.

In the 'Shop' part of the process, MMAG also competes with the peer-to-peer sites mentioned above, as well as offline and online retailers (eg Argos, Carphone Warehouse and Mobile Phone Direct) who are also increasing their focus on re-commerce.

According to management-commissioned third-party research (source: Admission Document) in FY20, in the re-commerce markets its brand awareness was third in the UK (behind eBay and Amazon) and sixth in the United States where there is no established re-commerce competitor of any scale. Management believes the scale of decluttr is similar to that of MMAG when the market was at a comparable stage. In the United States, the majority of pre-owned smartphone sales are made via the network operators, manufacturers and retailers and this has restricted inbound volume to decluttr. To grow its smartphone business, management has recently entered trade-in partnerships with Macworld, Red Pocket Mobile and 9to5Mac.

Management

Martin Hellawell – non-executive chairman: Martin became chairman of MMAG in April 2021, on MMAG's IPO. Since April 2018, he has been the chair of Softcat, a leading UK provider of IT infrastructure technology and services. Before becoming the chair of Softcat, he spent 12 years as the chief executive and marketing director, during which time he led the company through its IPO. He is also the chair of Raspberry Pi Trading, a senior independent director of Team17 Group and a trustee of Bloomfield Trust.

Steve Oliver – group CEO and co-founder: Steve co-founded MMAG in 2007 with Walter Gleeson, who continues to act as a consultant to MMAG. Before founding MMAG, Steve joined Music Zone Services in September 2000, first as finance director and then managing director until 2007. Steven joined Famous Retail as interim managing director and in March 2008 he was appointed managing director of The Fragrance Shop before leaving to focus on MMAG full time in late 2009.

Ian Storey – group COO: Ian joined MMAG in January 2013, became CFO in January 2015 and became COO on the IPO in 2021. Before joining MMAG Ian gained the ACA qualification and held finance roles at iSoft (from 2002), and Ultimate Products, now known as UP Global Sourcing (from 2006 to 2012, including as finance director (2006–2010), and other roles including executive buying director).

Matthew Fowler – group CFO: Matthew joined MMAG's board on 20 April 2022. Before joining, from 2016 he was CFO of genedrive, an AIM-listed molecular diagnostics company, having spent eight years as group financial controller of Scapa Group, three years as finance manager of British Nuclear Group and qualifying as a chartered accountant with Deloitte & Touche.

Alison Littley – non-executive senior independent director: Alison is a non-executive director at Xaar, Norcros and Osborne Group, and chair of the remuneration committee at all three. She has held senior management positions at Diageo and Mars and was chief executive officer at Buying Solutions, an agency to HM Treasury.

Dave Wilson – non-executive director: Dave stepped down from being CEO and CFO of GB Group, the global identity data intelligence company, and retired at the end of June 2021 to focus on non-executive roles. He is non-executive chairman of LBG Media. He has a strong background in managing business growth, previously holding international and operational board level positions with companies including Envirofone.com, Codemasters, Fujitsu and Technology.

Sensitivities

We believe the key risks to MMAG's performance are as follows:

- **Competitive pressures:** MMAG has many competitors in the buy and sell segments, some competitors have significantly more funding available to them and the structural growth dynamics of the circular economy suggest that competitive pressures are likely to remain high.
- **Rapidly changing product cycles:** consumer-facing products are subject to rapidly changing product cycles and changes that may severely alter the growth outlooks for those categories. In disc media, MMAG is exposed to a declining category, with a rate of decline that may accelerate. The market for pre-owned products is determined by the rate of new product development, therefore MMAG is dependent on the rate of innovation of new products by third parties.
- **Development of Technology subscriptions:** the company's growth profile and free cash generation is very dependent on its success at developing Technology rentals, which have an expected higher revenue and EBITDA margin over the life of a device to counter the expected structural decline for disc media. The growth of rental revenue dampens near-term revenue growth and profitability as one-off sales are substituted for long-term revenue and each device is capitalised on the balance sheet.
- **Changing business exposure and addressable markets:** MMAG's business exposure is likely to change as it seeks to increases the size of its addressable markets and product categories offered.
- **Increasing regulation:** the company is subject to laws and regulation that affect how companies conduct business online (eg consumer protection, information security and advertising) and regarding environmental and health and safety laws. With the increasing

importance of both to governments and consumers, it is likely that regulations and laws will continue to increase.

- **Developing internationally:** decluttr is a relatively small business in a re-commerce market that is in its relative infancy, which presents the potential risks of failing to execute on management's growth strategy and that greater investment than expected is required to deliver on the growth strategy. Although we believe management has no aspirations to diversify geographically, new markets with similar characteristics as existing markets may become more interesting.
- **Foreign currency exposure:** MMAG's US business presents the risk that reported financials will be positively or negatively affected by translation. The company does not hedge its transaction or translation exposure.
- **Free float and major shareholders:** MMAG's major shareholders include the founders and connected parties, and Northern Entities, a venture capital firm that initially invested in MMAG in 2015. Combined these shareholdings represent c 54.9% of the issued shares.

Financials

Income statement

MMAG demonstrated strong revenue growth from FY18 (£115.5m) through FY20 (£153.4m) and further into H121 (2.3% y-o-y to £72.8m) as revenue in all product categories increased due to the underlying structural drivers highlighted earlier, ahead of management's commissioned estimates of market growth, and with the apparent boost to demand during the COVID-19 pandemic that began in H120 (period ended May 2020).

FY21 revenue declined by c 5% to £145.5m, in line with management's expectations, as Technology continued to grow (+3% y-o-y) despite the dampening effect of new rental income (outright revenue +0.9%), and growth rates normalised for Media (-14% y-o-y) and Books (-21% y-o-y) towards pre-COVID-19 levels. On a combined basis, Media and Books revenue declined by c 15% in FY21 to £59.5m, versus guidance of c 10%. FY21's revenue was c 11% ahead of FY19's pre-COVID-19 levels of £131.5m.

Exhibit 12: Summary income statement

£m	FY18	FY19	H120	H220	FY20	H121	H221	FY21	FY22e	FY23e	FY24e
Revenue	115.5	131.5	71.1	82.2	153.4	72.8	72.7	145.5	154.7	166.1	179.9
Growth y-o-y (%)		13.8	N/A	N/A	16.6	2.3	(11.6)	(5.1)	6.3	7.4	8.3
Outright sales			39.4	44.1	83.5	39.4	44.9	84.2	96.9	106.6	117.2
Rental income			0.0	0.0	0.0	0.3	1.5	1.8	6.0	12.1	19.1
- Technology	51.8	70.4	39.4	44.1	83.5	39.7	46.4	86.1	102.9	118.7	136.4
- Media	58.0	54.8	27.1	31.7	58.8	28.0	22.7	50.7	44.6	40.2	36.1
- Books	5.7	6.3	4.6	6.4	11.0	5.1	3.6	8.7	7.2	7.3	7.3
Trading profit	N/A	N/A	36.9	45.4	82.4	41.5	36.3	77.8	75.3	80.7	87.7
Trading margin %	N/A	N/A	51.9	55.3	53.7	57.1	49.8	53.5	48.7	48.6	48.8
Gross profit	26.8	30.4	19.1	25.7	44.8	23.7	20.5	44.3	42.9	47.5	53.2
Gross margin (%)	23.2	23.1	26.9	31.2	29.2	32.6	28.2	30.4	27.7	28.6	29.6
Operating costs	(24.2)	(25.8)	(13.6)	(17.3)	(30.9)	(17.5)	(14.6)	(32.1)	(33.6)	(36.2)	(37.6)
Growth y-o-y (%)		6.8			19.6	28.4	(15.4)	3.9	4.6	7.9	3.8
EBITDA	2.6	4.6	5.5	8.4	13.9	6.2	5.9	12.2	9.3	11.3	15.6
EBITDA margin (%)	2.2	3.5	7.7	10.2	9.0	8.6	8.2	8.4	6.0	6.8	8.7
Depreciation and amortisation	(2.8)	(2.6)	(1.3)	(1.3)	(2.6)	(1.5)	(2.2)	(3.7)	(7.0)	(9.3)	(9.4)
Normalised operating income	(0.2)	2.0	4.2	7.1	11.3	4.8	3.7	8.5	2.3	2.0	6.2
Normalised margin (%)	(0.2)	1.5	5.9	8.6	7.4	6.6	5.1	5.8	1.5	1.2	3.4
Exceptionals/ share-based payments	(0.6)	(0.7)	(0.7)	(1.0)	(1.7)	(21.5)	(0.5)	(22.0)	(0.5)	(1.0)	(1.5)
Operating income	(0.8)	1.3	3.5	6.1	9.6	(16.7)	3.2	(13.5)	1.8	1.0	4.7
Operating margin (%)	(0.7)	1.0	5.0	7.4	6.3	(23.0)	4.4	(9.3)	1.2	0.6	2.6

Source: musicMagpie, Edison Investment Research

H122 trading and outlook: Expected moderation

FY21 ended strongly with record sales in the UK and US during Black Friday. The sales momentum continued in to Q122, however, as the period progressed volumes and trade-in activity moderated in line with consumer trends. The H122 (end May 2022) trading update confirmed a modest c 2% year-on-year decline in revenue to £71.3m (£72.8m in H121). Strong growth in Technology revenue of 15.9% to £46.0m (£39.7m in H121) partially compensated for the previously flagged normalisation of Media and Books revenue, a decline of 23.6% to £25.1m from H121's £33.1m, a period that benefited from increased sales due to COVID-related lockdowns. Adjusted EBITDA of £2.6m in H122 compares with H121's £6.2m, reflecting the strength of growth in rental subscriptions and the decline in revenue, and was in line with management's expectations, with confidence in achieving full year expectations.

The rental business has continued to demonstrate strong growth, with c 24k active subscribers at end H122 versus c 19k at end Q122, 13.5k at end FY21 and 7.5k at end H121. The growth highlights the appeal of the rental offer, which may become even more so given the challenging economic backdrop and outlook for consumer discretionary income due to inflationary pressures from utility bills and national insurance increases. The forward contracted order book was £2.2m at end Q122.

Consumer Technology revenues for Q122 were in line with management's expectations, but management noted a trend towards lower sales volumes at a higher average selling price and an increase in the proportion of products sourced from intermediary wholesale partners, which was expected to compress the gross margin on outright sales by four percentage points in FY22. The H121 trading update confirmed that margin performance during the period was in line with the revised expectations for the full year.

The H121 Technology revenue performance reflected the expected near-term dampening of Technology outright revenue growth from the new rentals. Management expects a gradual acceleration of growth in the UK as the incremental rental revenue increases to complement underlying market growth.

At the Q122 stage, management highlighted that disc media revenue had performed in line with management's expectations, ie a long-term underlying decline of close to 10% pa. In addition, Books revenue had maintained at levels seen in H221 with expectations it will remain at this level for the remainder of the year, consistent with its outlook for the medium-term of remaining relatively stable. Management believes both categories will continue to provide a good level of profitability and cash generation.

At the end of Q121, as already highlighted, there was ongoing momentum in trading through the SMARTDrop kiosks, with a cumulative 8,000 units traded at a cost of £2.3m, versus c 5,300 smartphones at a cost of £1.5m at end FY21.

Revenue: Mid-single-digit growth guidance

As highlighted previously, management's estimates of market growth rates for the product categories would indicate a weighted average market growth profile of 4–6%, using FY20's pre-rental business mix, increasing as Technology's importance to the group grows. As rental income grows, it should be incremental to group revenue growth. Our forecast of c 6–8% revenue growth in FY22–24 is consistent with management's medium-term guidance.

We forecast Technology revenue growth of c 20% to £103m in FY22, 15% growth to £119m in FY23 and further 15% growth to £136m in FY24, to c 89% of total group revenue in the final year. For outright sales, we assume 15% growth in FY22 (helped by the rollout of SMARTDrop kiosks and the launch of corporate recycling) and 10% growth thereafter, lower than the anticipated mid-teens market growth rates indicated earlier, recognising the substitution effect of new rentals. For rental income, we assume the number of active subscribers grows from 13.5k at the end of FY21 and 24k

at the end of H122, to c 36k by end FY22, c 62k by FY23, and c 89k by end FY24 that is, net new additions of c 23k, 25k and 27k pa, respectively. The growing number of active subscribers at the period ends reflects an increase in gross customer additions per day to 80, 100 and 120 respectively and a modest annual reduction in the rate of defaults of new customers in the first year (starting at 10% in FY22) and churning customers after the first year (starting at 25% in FY22). We assume revenue per active subscriber per month of £20 in FY22, which increases by 3% thereafter. These assumptions lead to forecasts for rental income of £6m in FY22 (+230% y-o-y), £12m in FY23 (+102% y-o-y), and £19m in FY24 (+58% y-o-y).

We forecast revenue declines for Media of 12% to £45m in FY22, and declines of 10% in both FY23 (to £40.2m) and FY24 (to £36.2m). Our FY22 forecast represents a decline of c 2% versus H221's revenue of £22.7m when annualised.

For Books we forecast a revenue decline of c 18% in FY22 to £7m, which is equivalent to H221's revenue of £3.6m on an annualised basis, and thereafter assume modest growth of c 1% pa. It represents c 5% of our FY22 group revenue forecast and will become a gradually less significant part of the group as Technology increases. Management believes there is still good money to be made in Books and Media well into the future whilst recognising the structural challenges, given the variable operating costs and ability to transfer resources to focus on the higher growth offered by Technology.

Profitability: Driven by mix changes and new costs

The historical strong revenue growth, improved sourcing and mix changes led to an improvement in the overall gross margin from 23.2% in FY18 to 29.2% in FY20 and 30.4% in FY21.

Broadly, the higher gross margins are due to a combination of better optimisation of prices between channels, better product selection (restricting purchases to products that have a better chance of selling with optimal margin versus previously taking items MMAG was less confident of selling), and a greater proportion of sales through MMAG's store versus third-party channels (thus saving commissions). Management also believes it has been able to buy at lower prices than competitors given its brand strength, guarantee of payment and the customer experience offered.

In the Admission Document, management guided to a similar gross margin for FY21 as FY20 (29.2%) but reported an improvement to 30.4%, and for growth thereafter due to margin enhancement for the Technology segment as rentals increase. In addition, management anticipates gross margins across Media and Books will remain resilient despite the expected revenue decline. Since the Admission Document, Rent-a-Phone has continued to grow strongly, which should be helpful for both gross and operating margins. As highlighted above, given trends in Q122, management anticipates the gross margin for technology outright sales in FY22 will reduce by four percentage points.

For all categories, except Technology outright sales as guided above, we assume a stable trading margin (selling price less buying price of the item), which along with the growing contribution of higher-margin Technology rental income, leads to a reduction in the gross margin to 27.7% in FY22 before resuming growth to 28.6% in FY23 and 29.6% in FY24. As a result, in absolute terms, we forecast a 3% decline in FY22's gross profit to £43m, before 11% growth in FY23 and 12% growth in FY24.

Below gross profit we assume inflationary growth for operating costs, including 6% growth in the National Minimum Wage in FY22 and higher marketing costs as MMAG increases spend on brand and promoting its new rental and SMARTDrop kiosk initiatives. As Media revenues decline, we assume its operating cost base naturally reduces. This leads to estimated EBITDA margins of 6.0% in FY22, 6.8% in FY23, and 8.7% in FY24, and normalised operating margins of 1.5% in FY22, 1.2% in FY23, and 3.4.% in FY24 versus 5.8% in FY20. The lower margin in FY22–24 is due to mix changes, central cost investment and higher depreciation charge on the capitalised smartphones.

FY21 bore the costs of the exceptional IPO expenses (£3.9m) and the vesting of options on the IPO (£17.4m). We accrue £1.5m of share-based payments in future years.

Following the IPO, which raised gross proceeds of £15m, there was a net cash position of £1.8m at the end of FY21. In FY22, its interest expense predominantly relates to its IFRS 16 liabilities as well as platform fees.

The company has no plans to pay a dividend as management intends to re-invest profits and cash generated in developing and expanding the business.

Cash flow and balance sheet

Exhibit 13: Summary cash flow

	FY18	FY19	H120	H220	FY20	H121	H221	FY21	FY22e	FY23e	FY24e
Operating cash flows	(0.0)	2.3	5.5	6.5	12.0	2.0	0.3	2.6	8.9	11.3	14.5
- Net income	(4.4)	(0.9)	2.6	6.0	8.6	(17.6)	5.5	(12.1)	1.3	0.4	3.0
- Depreciation and amortisation	2.8	2.6	1.3	1.3	2.6	1.5	1.8	3.3	7.0	9.3	9.4
- Working capital	(0.1)	(1.9)	0.5	(1.1)	(0.6)	(0.2)	(4.7)	(4.9)	(0.6)	(0.2)	(0.3)
- Tax paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.0)	(0.0)	(1.1)
Investing cash flows	(1.7)	(1.4)	(0.8)	(1.1)	(1.9)	(2.5)	(4.7)	(7.2)	(13.6)	(11.6)	(12.9)
- Capex	(1.7)	(1.4)	(0.3)	(0.2)	(0.4)	(1.6)	(2.8)	(4.4)	(9.6)	(9.1)	(10.4)
- Intangibles	0.0	0.0	(0.6)	(0.9)	(1.5)	(0.9)	(1.9)	(2.8)	(4.0)	(2.5)	(2.5)
Financing cash flows	2.7	0.1	(0.9)	(5.9)	(7.0)	1.9	0.4	2.3	2.9	1.8	(1.2)
- Equity issue	0.0	0.0	0.0	0.0	0.0	14.5	(0.0)	14.5	0.0	0.0	0.0
- Borrowings	4.0	2.4	0.0	(3.2)	(3.2)	(10.2)	1.0	(9.2)	4.0	3.0	0.0
Change in cash	1.0	1.1	3.8	(0.5)	3.1	1.4	(4.1)	(2.3)	(1.8)	1.5	0.3
Cash at end	1.0	2.0	5.8	5.4	5.1	6.4	2.4	2.9	1.1	2.6	2.9
Net debt/(cash) at end excl. IFRS 16	11.1	12.6	9.6	6.3	6.3	(6.4)	(1.8)	(1.8)	3.8	5.3	4.9
Free cash flow pre-interest	(1.7)	0.9	4.7	5.4	10.1	(0.5)	(4.5)	(4.6)	(4.7)	(0.3)	1.5
Free cash flow post-interest	(2.2)	(0.3)	4.2	3.2	7.4	(2.5)	(4.8)	(6.9)	(5.1)	(0.9)	0.9
Relative to sales:											
Operating cash flow	0.0%	1.8%	7.7%	7.9%	7.8%	2.7%	0.4%	1.8%	5.8%	6.8%	8.1%
Net income	(3.8%)	(0.7%)	3.6%	7.3%	5.6%	(24.2%)	7.5%	(8.3%)	0.8%	0.2%	1.7%
Working capital	(0.1%)	(1.4%)	0.7%	(1.3%)	(0.4%)	(0.2%)	(6.5%)	(3.4%)	(0.4%)	(0.1%)	(0.2%)
Capex	(1.4%)	(1.1%)	(0.4%)	(0.2%)	(0.3%)	(2.2%)	(3.9%)	(3.0%)	(6.2%)	(5.5%)	(5.8%)
Intangibles	0.0%	0.0%	(0.8%)	(1.1%)	(1.0%)	(1.3%)	(2.6%)	(1.9%)	(2.6%)	(1.5%)	(1.4%)
Total fixed asset investment	(1.4%)	(1.1%)	(1.2%)	(1.3%)	(1.2%)	(3.4%)	(6.5%)	(5.0%)	(8.8%)	(7.0%)	(7.2%)
Free cash flow pre-interest/sales %	(1.5%)	0.7%	6.6%	6.6%	6.6%	(0.8%)	(6.2%)	(3.2%)	(3.0%)	(0.2%)	0.9%
Free cash flow post-interest/sales %	(1.9%)	(0.2%)	5.9%	3.9%	4.8%	(3.5%)	(6.6%)	(4.7%)	(3.3%)	(0.5%)	0.5%

Source: musicMagpie, Edison Investment Research

There was a notable improvement in MMAG's operating and free cash flow generation from FY18 to FY20. Excluding interest payments, free cash flow improved from an outflow of £1.7m in FY18 to an inflow of £10.1m in FY20. The key driver to the improved cash flow generation was the company's higher profitability, offset in part by modestly higher investment in tangible and intangible assets. FY21's operating cash flow was negatively affected by the one-off costs for the IPO.

Working capital has represented a modest cash outflow on a consistent basis, which is impressive given the scale of the revenue growth from FY18 to FY20.

Our forecast for higher investment in tangible assets from FY22 reflects the capitalisation of devices for rentals (we assume £280 for each new phone in FY22–24) and the costs of rolling out the SMARTDrop kiosks (FY22 only). The capital investment leads to estimates of negative free cash flow in both FY22 and FY23.

Valuation

DCF-based valuation: 168p per share

Our primary valuation methodology is DCF as it captures the potential long-term growth of the business, specifically from MMAG's rental business, which is in its infancy. Beyond our explicit forecast period we assume 5% (between weighted average market growth rates of 4–6%) annual revenue growth for 'outright' (ie non-rental) revenue through FY25, before prudently fading down to 3.5% growth by our terminal year, FY31. The aggregated growth rates reflect:

- A gradual fade down for Technology outright revenue growth from 10% pa to 5% pa by FY31, lower than management's medium-term guidance of 10–15%.
- Declines of 15% pa for Media, also much lower than management's medium-term guidance of declines of 5–10% pa to be more conservative. This leads to Media contributing £12m revenue in FY31 (£51m in FY21) and just £2.3m contribution after direct labour.
- 1% growth pa for Books revenue to £8m in FY31 (£9m in FY21) and £2.3m contribution.

For rental income, we estimate strong growth in the active subscriber base from 13.5k at end FY21 to c 36k in FY22 and to 286k active subscribers by FY31. This reflects growing the daily gross additions from 60 in FY22 to 200 from 2027, namely increasing the rate of daily new additions by 20–40 pa. We also assume revenue per active subscribers increases by 3% pa, to £26.10 pm in FY31. These assumptions lead to estimated rental income of c £87m by FY31 so that it represents c 28% of group revenue. Our estimates for rental income increase MMAG's estimated revenue growth by 2–5% pa through FY31.

For outright revenue we assume a gradually reducing contribution after direct labour margin from 21.4% in FY21 to c 16% by our terminal year, which reflects a stable margin for Technology (c 15%), and declining margins for Media (c 19% in FY31 versus c 24% in FY21) and Books (c 27% in FY31 versus 29% in FY21). For Media and Books, we assume a stable gross margin and cost deleverage due to wage inflation. The growing contribution of rental income with a 70% estimated contribution after direct labour margin naturally increases the group margin from 22% in FY21 to 32% in FY31. In aggregate, our EBITDA margin increases from 8.4% in FY21 to 21.3% by FY31.

Using a WACC of 10% (risk-free rate of 3%, risk premium of 6% and Beta of 1.2, limited trading history, with low debt) and 2% terminal growth, our DCF-based valuation is c 168p per share. The table below shows the sensitivity of the DCF to changes in assumptions for the WACC and terminal growth rate.

Exhibit 14: DCF sensitivity (pence per share)

		Terminal growth rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
WACC	12.0%	112	120	131	145	162
	11.5%	120	130	143	158	179
	11.0%	130	141	156	174	199
	10.5%	141	154	171	193	223
	10.0%	153	**168**	188	215	253
	9.5%	166	184	208	241	288
	9.0%	182	203	232	273	333
	8.5%	199	225	261	312	392
	8.0%	220	251	295	360	470

Source: Edison Investment Research

The valuation is sensitive to the growth rate and timing of the active rental subscribers and the associated capex on signing a new customer. If we assume slower growth in rentals to c 157k active subscribers by FY31, the DCF valuation would reduce to c 141p per share. We reiterate our forecasts, which reflect more pessimistic assumptions for Technology outright revenue growth and declines in Media revenue growth than management expects, in order to be prudent on the valuation.

Peer group comparison: Trading at a discount

Below we show MMAG's valuation relative to UK consumer-facing companies that also predominantly operate online. We would highlight none of these are direct comparators given different business models, category mix and geographic exposures. All multiples are annualised to MMAG's November year-end, but sales growth rates and margins are for the individual company's financial year.

Exhibit 15: Peer valuations

Company	Year end	Price	Market Cap (local, m)	EV (local, m)	Sales growth FY1 (%)	Sales growth FY2 (%)	EBITDA margin FY1 (%)	EBITDA margin FY2 (%)	EV/ Sales FY1 (x)	EV/ Sales FY2 (x)	EV/ EBITDA FY1 (x)	EV/ EBITDA FY2 (x)	PE FY1 (x)	PE FY2 (x)
AO World PLC	Mar	40	189	292	(5)	(12)	0.7	1.6	0.20	0.21	16.3	10.0	N/A	61.4
ASOS PLC	Aug	983	974	1,390	4	11	4.9	5.8	0.33	0.30	6.5	5.0	20.7	13.7
boohoo group plc	Feb	60	749	805	2	13	4.4	6.0	0.40	0.36	8.2	6.4	26.6	19.1
Gear4music Holdings PLC	Mar	180	37	72	11	9	7.3	7.7	0.45	0.41	6.1	5.4	10.8	9.5
In The Style Group PLC	Mar	75	39	31	27	19	0.7	2.1	0.48	0.40	28.2	10.4	N/A	41.0
Made.Com Group PLC	Dec	44	172	89	(3)	7	(7.1)	0.8	0.25	0.23	N/A	120.6	N/A	N/A
Moonpig Group PLC	Apr	212	718	808	14	15	24.2	24.8	2.45	2.13	10.1	8.7	16.5	14.6
N Brown Group PLC	Feb	24	110	371	2	3	11.5	11.8	0.51	0.50	4.3	4.2	4.0	4.1
Naked Wines PLC	Mar	172	125	90	9	10	0.6	1.4	0.24	0.22	26.9	19.7	141.7	62.1
Sosandar PLC	Mar	19	41	34	139	46	(1.4)	5.2	0.88	0.64	25.2	11.0	40.9	15.6
THG PLC	Dec	82	1,011	1,321	21	20	6.1	7.5	0.51	0.43	8.2	5.8	N/A	N/A
Victorian Plumbing Group PLC	Sep	54	174	147	(0)	8	6.7	8.3	0.54	0.50	7.7	5.9	15.8	11.4
Virgin Wines UK PLC	Jun	78	43	27	(3)	12	9.8	10.1	0.37	0.33	3.7	3.2	8.4	7.5
High					**139**	**46**	**24.2**	**24.8**	**2.45**	**2.13**	**28.2**	**120.6**	**141.7**	**62.1**
Median					**4**	**11**	**4.9**	**6.0**	**0.45**	**0.40**	**8.2**	**6.4**	**16.5**	**14.6**
Low					**(5)**	**(12)**	**(7.1)**	**0.8**	**0.20**	**0.21**	**3.7**	**3.2**	**4.0**	**4.1**
musicMagpie PLC	Nov	45	48	43	6	7	6.0	6.8	0.28	0.26	4.6	3.8	32.8	47.1
Premium/ (discount) to peer group median									(38%)	(36%)	(43%)	(41%)	98%	223%

Source: Refinitiv, Edison Investment Research. Note: Priced at 8 July 2022.

The UK online peers have derated significantly during the last 12 months as forecasts have been downgraded due to a combination of slowing revenue growth versus initial expectations and lower profits due to higher costs, eg freight. The latter is less of an issue for MMAG given its local sourcing. In addition, we believe WACCs have risen due to higher interest rates and likely greater required market risk premium.

Relative to the peers, MMAG's forecast revenue growth of c 6% in FY1 and c 7% in FY2 is more consistent than the group median (4% and 11% respectively) albeit there is a wide range of expectations. Our expected EBITDA margin for MMAG of 6.0% in FY1 and 6.8% in FY2 is comparable with the median of the peers, 4.9% in FY1 and 6.1% in FY2, but as indicated above, MMAG's EBITDA margin has potential to accelerate quickly as rental income grows.

MMAG is trading at a discount to the median of the other consumer-facing online companies when comparing EV/sales and EV/EBITDA multiples, but a premium when using P/E multiples.

Exhibit 16: Financial summary

£m	2018	2019	2020	2021	2022e	2023e	2024e
30-November	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue	115.5	131.5	153.4	145.5	154.7	166.1	179.9
Cost of Sales	(88.7)	(101.1)	(108.6)	(101.2)	(111.8)	(118.6)	(126.7)
Gross Profit	26.8	30.4	44.8	44.3	42.9	47.5	53.2
EBITDA	2.6	4.6	13.9	12.2	9.3	11.3	15.6
Normalised operating profit	(0.2)	2.0	11.3	8.5	2.3	2.0	6.2
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	(0.6)	(0.7)	(1.3)	(4.6)	0.0	0.0	0.0
Share-based payments	0.0	0.0	(0.4)	(17.4)	(0.5)	(1.0)	(1.5)
Reported operating profit	(0.8)	1.3	9.6	(13.5)	1.8	1.0	4.7
Net Interest	(1.5)	(2.1)	(2.1)	(0.6)	(0.5)	(0.6)	(0.6)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	(0.6)	(0.7)	0.0	0.0	0.0
Profit Before Tax (norm)	(1.7)	(0.2)	9.2	7.9	1.8	1.4	5.6
Profit Before Tax (reported)	(2.3)	(0.9)	7.0	(14.8)	1.3	0.4	4.1
Reported tax	0.0	0.0	1.6	2.7	(0.0)	(0.0)	(1.1)
Profit After Tax (norm)	(1.7)	(0.2)	10.5	6.4	1.5	1.1	4.2
Profit After Tax (reported)	(2.3)	(0.9)	8.6	(12.1)	1.3	0.4	3.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	(2.1)	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	(1.7)	(0.2)	10.5	6.4	1.5	1.1	4.2
Net income (reported)	(4.4)	(0.9)	8.6	(12.1)	1.3	0.4	3.0
Basic average number of shares outstanding (m)	N/A	N/A	100.0	104.9	107.8	107.8	107.8
EPS - basic normalised (p)	N/A	N/A	10.52	6.11	1.37	1.03	3.88
EPS - diluted normalised (p)	N/A	N/A	10.52	6.11	1.37	1.03	3.88
EPS - basic reported (p)	N/A	N/A	8.57	(11.56)	1.19	0.38	2.76
Dividend (p)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)		13.8	16.6	(5.1)	6.3	7.4	8.3
Gross Margin (%)	23.2	23.1	29.2	30.4	27.7	28.6	29.6
EBITDA Margin (%)	2.2	3.5	9.0	8.4	6.0	6.8	8.7
Normalised Operating Margin	(0.2)	1.5	7.4	5.8	1.5	1.2	3.4
BALANCE SHEET							
Fixed Assets	14.2	12.9	13.9	21.1	28.0	30.7	34.6
Intangible Assets	7.9	8.1	8.4	9.7	11.1	10.3	10.8
Tangible Assets	6.2	4.7	3.9	6.1	11.9	15.7	19.3
Investments & other	0.0	0.0	1.7	5.3	5.0	4.7	4.4
Current Assets	8.8	10.4	14.5	14.6	13.3	15.5	16.5
Stocks	4.8	6.2	6.8	8.0	8.3	8.6	9.0
Debtors	3.0	2.1	2.5	3.7	4.0	4.3	4.6
Cash & cash equivalents	1.0	2.0	5.1	2.8	1.1	2.6	2.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities	(12.5)	(13.2)	(18.7)	(9.0)	(8.9)	(9.2)	(9.7)
Creditors	(11.6)	(10.4)	(10.9)	(8.4)	(8.2)	(8.6)	(9.1)
Tax and social security	0.0	0.0	(0.1)	(0.3)	(0.3)	(0.3)	(0.3)
Short term borrowings	(0.1)	(2.0)	(7.0)	0.0	0.0	0.0	0.0
Other	(0.8)	(0.8)	(0.7)	(0.4)	(0.4)	(0.4)	(0.4)
Long Term Liabilities	(16.2)	(16.5)	(7.3)	(2.4)	(6.4)	(9.4)	(9.4)
Long term borrowings	(12.0)	(12.7)	(4.2)	(0.9)	(4.9)	(7.9)	(7.9)
Other long-term liabilities	(4.2)	(3.8)	(3.1)	(1.6)	(1.6)	(1.6)	(1.6)
Net Assets	(5.7)	(6.4)	2.4	24.3	26.1	27.5	32.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	(5.7)	(6.4)	2.4	24.3	26.1	27.5	32.0
CASH FLOW							
Op Cash Flow before WC and tax	2.6	4.6	13.9	11.8	9.3	11.3	15.6
Working capital	(0.1)	(1.9)	(0.6)	(4.9)	(0.6)	(0.2)	(0.3)
Exceptional & other	(2.5)	(0.3)	(1.3)	(4.2)	0.3	0.3	0.3
Tax	0.0	0.0	0.0	0.0	(0.0)	(0.0)	(1.1)
Net operating cash flow	(0.0)	2.3	12.0	2.6	8.9	11.3	14.5
Capex	(1.7)	(1.4)	(1.9)	(7.2)	(13.6)	(11.6)	(12.9)
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(0.4)	(1.2)	(2.7)	(2.3)	(0.5)	(0.6)	(0.6)
Equity financing	0.0	0.0	0.0	14.5	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	(0.8)	(1.0)	(1.1)	(0.7)	(0.6)	(0.6)	(0.6)
Net Cash Flow	(3.0)	(1.4)	6.3	6.9	(5.8)	(1.5)	0.3
Opening net debt/(cash)		11.1	12.6	6.3	(1.8)	3.8	5.3
FX		0.0	0.0	0.0	0.0	0.0	0.0
Other non-cash movements		1.5	(6.4)	(8.2)	5.6	1.5	(0.3)
Closing net debt/(cash)	11.1	12.6	6.3	(1.8)	3.8	5.3	4.9

Source: musicMagpie accounts, Edison Investment Research

Contact details	Revenue by geography (FY21)
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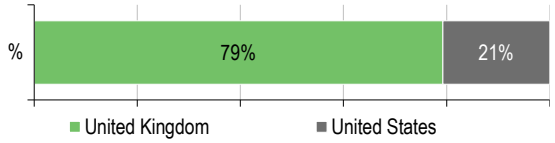

Non-executive chairman: Martin Hellawell	Group CEO and co-founder: Steve Oliver
Martin became chairman of MMAG in April 2021. Since April 2018, he has been the chair of Softcat, a leading UK provider of IT infrastructure technology and services. Prior to becoming the chair of Softcat, he spent 12 years as the chief executive and marketing director, during which time he led the company through its IPO. He is also currently the chair of Raspberry Pi Trading, a senior independent director of Team17 Group, and a trustee of Bloomfield Trust.	Steve co-founded MMAG in 2007. Prior to founding MMAG, Steve joined Music Zone Services in September 2000, firstly as finance director and then managing director until 2007. Steven joined Famous Retail as interim managing director, and in March 2008 he was appointed managing director of The Fragrance Shop, before leaving to focus on MMAG full time from late 2009.
Group COO: Ian Storey	**Group CFO: Matthew Fowler**
Ian joined MMAG in January 2013, became CFO in January 2015 and COO on the IPO in 2021. Before joining MMAG, he gained the ACA qualification and held finance roles at iSoft (from 2002), and Ultimate Products, now known as UP Global Sourcing (2006–12) including as finance director from 2006–2010, and other roles including executive buying director.	Matthew joined MMAG's board in April 2022. Before joining he was CFO of genedrive, an AIM-listed molecular diagnostics company from 2016, having spent eight years as group financial controller of Scapa Group, three years as finance manager of British Nuclear Group, and qualifying as a chartered accountant with Deloitte & Touche.

Principal shareholders	(%)
Northern Ventures	12.9
Canaccord Genuity Wealth Management	11.3
Liontrust Investment Partners	10.1
Steve Oliver (excluding holding in musicMagpie EBT)	9.9
Schroder Investment Management	9.8
Walter Gleeson	6.7

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