

# Park Group

Innovating to grow earnings and cash

Business overview

Financial services

This note provides an update on Park's strategy for growth and progress with key product and distribution initiatives. High levels of investment in e-commerce, over many years, have transformed the business, broadening the product range and attracting new customers via expansion into new areas through innovation and technology. The strategy continues to deliver sustained growth in earnings and dividends, and the business model is highly cash generative, allowing Park to operate without debt. Interest earnings on substantial cash balances make Park a beneficiary from higher rates.

Year end	Billings* (£m)	PBT** (£m)	EPS** (p)	DPS (p)	P/E (x)	Yield (%)
03/16	385.0	11.9	5.2	2.75	15.7	3.4
03/17	404.5	12.4	5.3	2.90	15.3	3.6
03/18e	432.3	13.2	5.6	3.05	14.5	3.7
03/19e	462.9	14.3	6.1	3.20	13.4	3.9

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. \*\*PBT and EPS (fully diluted) are on a statutory basis.

## New initiatives providing opportunities

Constant innovation has supported steady growth in Christmas Savings and has allowed the corporate business, based around incentive and rewards services, to grow strongly into what is a very large target market (£5.6bn pa as defined by the UK Giftcard & Voucher Association). This innovation continues in the corporate business, with the roll-out of Evolve, a live online platform providing organisations with a quick, easy and reliable way to reward employees or customers by way of digital rewards codes via email or SMS. Love2shop Worldwide, a partnership with Carlton Group of Canada, gives Evolve a worldwide capability, with obvious medium-term potential. Around two-thirds of Christmas Savings transactions are already made using a mobile device and the new mobile app makes the process faster, easier and more convenient, targeting a broader customer base and increased order levels.

## Interims confirmed forecast growth

The interim results in late November provided an update on positive operational developments and reported good levels of order growth, requiring no change in our group forecasts. The business is highly seasonal with c 75% of sales and all of the profits generated in H2. Against this background, there were timing effect impacts on the seasonal loss (which widened versus last year) and shareholder cash flow (which was lower despite growth in overall cash balances), but we expect these to unwind during H2. The interim dividend was increased by 5%.

## Valuation: Still below fair value

Our fair value is unchanged at 88p per share. It is based on our absolute (DCF) valuation of 86p per share and a P/E relative comparison, with businesses that share similar characteristics, of 90p per share or c 15x 2018e calendar earnings. The benefit of a 50bp rise in interest rates is equivalent to c 6% of PBT over time.

13 February 2018

**Price** 81.25p  
**Market cap** £151m

Net cash (£m) at 30 September 2017 5.4  
(excludes £194.2m of cash held in trust in respect of customer liabilities)

Shares in issue 185.6m

Free float 98.2%

Code PKG

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (6.3) (4.4) 0.9

Rel (local) 1.3 (1.1) 1.0

52-week high/low 90.0p 76.0p

### Business description

Park Group is a specialised financial services business and is one of the UK's leading multi-retailer voucher and prepaid gift card businesses, focused on the corporate gift and Christmas savings markets. Sales are generated through the internet, a direct salesforce and agents.

### Next events

FY18 preliminary results June 2018

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## Innovative, well-established financial services business

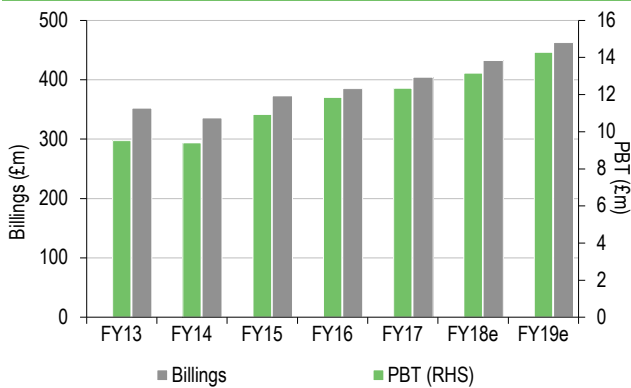
Park Group is a UK-based, specialised financial services business. It is a UK leader in the provision of prepaid gift cards, multi-retailer gift vouchers and digital rewards services, a market that the UK Giftcard & Voucher Association estimates to be worth more than £5.6bn per year. These products and services are distributed by Park through its corporate and consumer businesses. In the corporate business they are used to supply more than 31,000 businesses with a range of incentive and reward products, often tailor made. In the consumer business they are purchased by more than 430,000 individual customers using prepayment plans that provide an effective, disciplined and convenient way to budget for Christmas. The majority of sales are now generated online, which complements and supports traditional distribution through a direct salesforce and agents. Income is generated from the service fees paid to Park by partner retailers, leisure and other service providers, based on the face value of money spent via Park's cards and vouchers. Interest is earned on all prepaid cash until the obligation to the redeemers has been settled.

**Exhibit 1: Park Group retailers, customers, products and distribution**

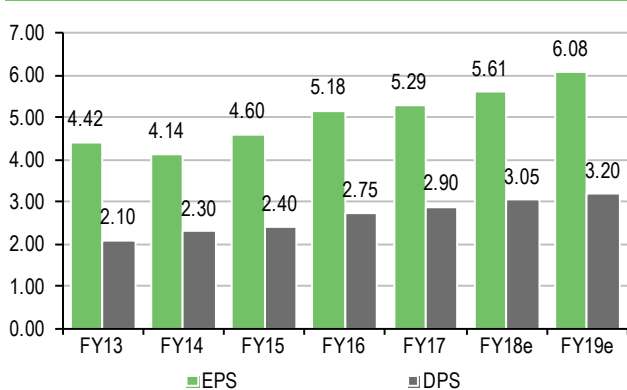
	Retail partners	
	Drive awareness and footfall	
	Corporate customers	Consumer customers
<b>Proposition</b>	Gift cards, prepaid cards, vouchers and services to corporate customers in the incentive and reward market.	Christmas Savings scheme: Customers purchase vouchers, prepaid cards and gifts on a 45-week prepaid instalment plan. Gift cards and vouchers.
<b>Channels</b>	Sales team, online, telephone, mobile.	Catalogue, online, telephone, mobile.
<b>Client benefits</b>	Incentivise & reward employees and/or customers with standard or customised, multi- or single-retailer vouchers, gift cards and e-codes.	Provide convenience in budgeting for and buying gifts for Christmas and other occasions.
	Administer ongoing reward programmes online.	
<b>Brands</b>	Love2shop Business Services, highstreetvouchers.com, Love2shop, flexecash, Engage, Evolve.	Park Christmas Savings Club.
<b>Enablers</b>	Vouchers, e-codes, flexecash, Mastercard, various web-based platforms	

Source: Park Group, Edison Investment Research

Park's business has been transformed over a number of years as it has harnessed the opportunity for product and distribution innovation provided by fast-developing digital technologies, allowing it to reach new customers, in new markets, with a constantly developing product offering. The group's IT spend runs at c £600k pa, with a total spend including technical support of more than £3.5m, a significant commitment in relation to its size. As a result, it has built a strong track record of growth in sales, profits and dividends, which we expect to see continue as the group benefits from growth in the digital platform that has been created and recent new product and distribution initiatives.

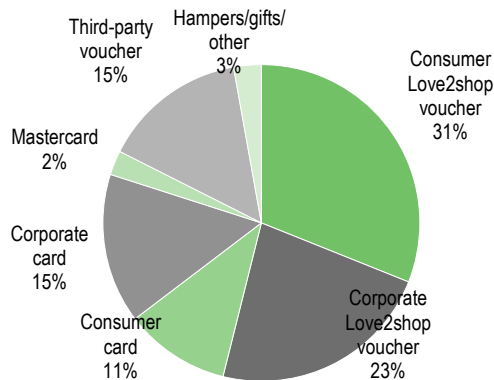
**Exhibit 2: Billings and PBT history and forecasts (£m)**


Source: Park Group, Edison Investment Research. Note: Billings is a non-statutory definition of sales.

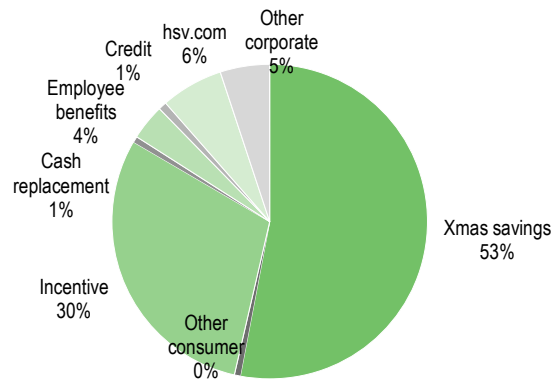
**Exhibit 3: EPS\* and DPS history and forecasts (p)**


Source: Park Group, Edison Investment Research. Note: \*EPS is IFRS fully diluted.

Park partners with leading retail brands to provide its customers, both consumer and corporate, with a broad and attractive choice of shops, restaurants and attractions at which to redeem the range of flexible prepaid gift cards, e-codes and vouchers that it supplies. The retailers have an interest in the additional revenues that the partnership brings to them and, in return, provide Park with service fees, representing the gross margin reported by the group. Park-branded cards and vouchers, to be redeemed with its retail partners, represented c 80% of total billings of c £405m in the last full year (Exhibit 4). Billings through the consumer business represented 54% of the total and corporate billings were 46% of the total. Billings also include retailer-branded, third-party gift vouchers, physical products including a small amount of hampers, travel services through Park's own full-service travel agency, and prepaid Mastercard product, for which Park became a licensed issuer in 2017.

**Exhibit 4: Billings by product (£m, FY17)**


Source: Park Group, Edison Investment Research. Note: Billings is a non-statutory definition of sales.

**Exhibit 5: Billings by market (£m, FY17)**


Source: Park Group, Edison Investment Research. Note: Billings is a non-statutory definition of sales.

## In-house prepaid card infrastructure driving growth & innovation

Park's own-branded Love2shop voucher is the UK's leading multi-retailer gift card and prepaid card brand, with high levels of customer awareness. It is accepted by 184 retail partners (as at 30 September 2017) with more than 20,000 outlets across the UK and Republic of Ireland (RoI). However, it is prepaid cards that are driving growth, producing compound annual growth in billings of 14% in the past three years, while Love2shop voucher sales are broadly flat.

Park's FCA-authorised prepaid card offering includes both physical and digital cards, and is driven by its proprietary flexecash card infrastructure, developed in house over a three-year period and

first introduced in 2010. The introduction of flexecash was one of the most significant developments in recent years and card sales continue to be a major driver of underlying growth. Sales of flexecash rose 16% in FY17 compared with overall growth of 5%, and reached 26% of the total. Indications from H118 are that strong growth is continuing in the current year. The number of retail partners accepting the card is lower than for vouchers due mainly to the systems upgrading required by some other smaller redeemers, but it has steadily grown to reach 99 retail brands (as at 30 September 2017) covering c 13,000 outlets, and Park works hard to continually add selected retailers.

Historically, the redemption of cards, like vouchers, has only been possible in Park's "closed-loop" network of retail partners from which it receives service fees. However, in 2016 Park began to sell a Mastercard product, for "open-loop" use at a broader range of outlets. Customers have proved willing to pay a premium for this added flexibility and, despite the absence of service fees, margins are similar to other products. In January 2017 Park became a licensed Mastercard issuer and plans further product introductions. The first Mastercard to be offered (the Your Choice card) is a digital card that can be used online at selected retailers. The offering will be expanded in the coming months to physical cards that can be used at any retailer accepting Mastercard, both online and in store. Mastercard sales in FY17 were £10.1m or 2% of the total and we would expect this to increase as new product is introduced and new markets addressed.

Compared with vouchers, the card provides a broader, more flexible product offering that can be tailored to the customer and serviced online, while providing a secure and convenient alternative for customers to use. End-users can access online retailers using e-codes, obtained from the cardholders' e-wallet account, or a digital Mastercard version of flexecash. Increasingly, partner retailers have begun to accept the existing flexecash card online; starting with Argos, this now includes Virgin Experience and Park expects other retail partners to follow.

## **Corporate and Consumer business overview**

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As discussed above, the consumer and corporate businesses are best seen as distribution channels for a substantially common product set. They nevertheless address different customer groups, operating in different market conditions, in unique ways and it is worth reviewing each in turn.

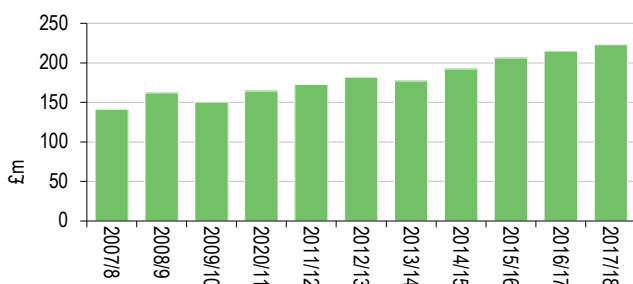
### **Consumer business: Innovating to broaden customer base**

Digital investment has completely transformed the consumer business over the years in terms of products, distribution and interaction with customers. The effects are to broaden the appeal of this long-established business while improving efficiency. It effectively represents Park Christmas Savings plus a small amount of other income generated by third-party use of the group's cold storage and packaging facilities, and accounted for 54% of FY17 sales and 47% of operating profit before central costs. Christmas Savings customers purchase vouchers and prepaid cards, gifts and, in a minority of cases, hampers, on a 45-week prepaid instalment plan. Park is the UK market leader in Christmas savings, and it also has a relatively small business in the Republic of Ireland, operating under the Park Ireland brand.

Christmas Savings sales have grown fairly steadily over a number of years, despite a tough consumer environment for much of the period. In our view, Christmas is the last thing that Park's traditional customer base wants to cancel, and the savings discipline and the convenience of shopping that the programme brings are key attractions, generating strong customer loyalty. There have been just two setbacks in recent years. One was in 2009 in the wake of the financial and banking crisis as well as retail failures such as Woolworths; the other was in FY14 when a number of high-profile high street retailer failures such as HMV, at the peak of the Christmas Savings

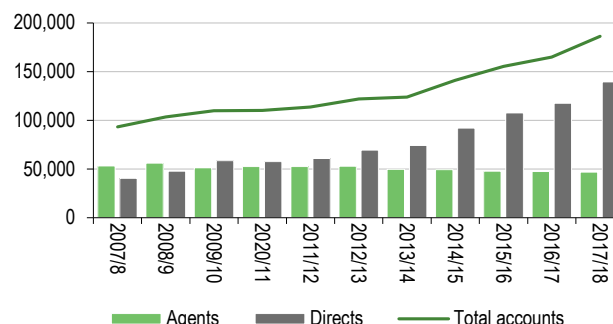
marketing campaign, had a negative impact on sentiment and created unwarranted fears about the security of store-branded gift cards.

**Exhibit 6: Christmas Savings sales trend\***



Source: Park Group. Note: \*Sales measured by billings. Excludes other consumer income and hsv.com, which was previously reported in consumer but is now reported in corporate.

**Exhibit 7: Increasing share of direct customers**



Source: Park Group

For a number of years, consumer sales were dominated by gift vouchers but, since the introduction of flexecash in 2010, card sales have steadily increased as a share of the total. In FY17, the Love2shop voucher represented 58% of sales (FY16: 62%) and prepaid cards, driven by the flexecash card engine, represented 20% (FY16: 18%). The balance of sales represents third-party retailer gift cards, a small amount of hampers and other physical goods, and the recently introduced Mastercard product that adds further open-loop product flexibility options.

Distribution was traditionally catalogue based and significantly reliant on local agents who would each collect orders from multiple customers. Exhibit 6 shows the steady rise in the number of accounts over the years, with an increasing proportion of these representing individual customers coming directly to Park. Although the number of agents has declined over the years, they are still very important to Park. Although agent accounts represented c 25% of all accounts at the end of FY17, because each agent represents multiple customers, the agency customers still represent almost two-thirds of all customers. As Park continues to invest to improve its direct appeal to a wider group of customers, it is conscious of the need to similarly support its agency distribution.

As well as more customers choosing to deal with Park directly, more of them are choosing to do so online (approaching 90% of new customer orders are placed on line), and the vast majority of those customers (c 85%) are doing so with a mobile device. Park supports this through social media networks such as Facebook (where followers are growing rapidly, to more than 100,000), Twitter and LinkedIn, using these to promote products, post promotional competitions and seek 'friend' referrals. It has found the site a useful early indicator of customer issues and concerns, allowing it to plan a timely response. Park's 'Ask Wanda' virtual assistant holds some 500 answers to possible customer questions and has been expanded to include 'live chat'. So as to better satisfy the customer demand to interact with Park via mobile, a new smart device app was first introduced in a pilot scheme in January 2017 and was rolled out fully for the Christmas 2018 marketing campaign. The app makes the mobile experience significantly faster, simpler and more convenient, and management believes it has the potential to significantly enhance customer engagement, improving retention, winning new customers through positive recommendation and increasing sales value per customer. The app leads customers through a convenient sign-up process, allowing them to plan their savings targets and choose the most suitable payments method. Once orders are placed, the app allows for regular, positive communication with the clients through notification alerts, encouraging savings patterns and prompting orders.

The H118 growth in billings of 6.3% (7.6% in Christmas Savings, partly offset by lower other income from third-party utilisation of the group's cold storage and packaging facilities) in part reflects the

early despatch of Christmas Savings orders. The Christmas Savings order book is built in the early months of the calendar year and was c 4% ahead y-o-y at the time of the interims in September 2017. This c 4% is a better guide to billings growth for the year as a whole. The seasonal operating loss of £2.0m (FY17: £1.3m loss) increased during the period which, in addition to the c £330k y-o-y reduction in other income, is attributed by management to a number of timing issues, amounting to c £350k, which should unwind by year end. Mastercard processing costs related to Park becoming a licensed Mastercard issuer have been spread fairly evenly across H1 and H2 with a negative impact on H1 of more than £200k.

Management expects continuing product enhancement and customer service innovations to continue to drive growth.

#### Exhibit 8: Consumer business financial summary

£000s	2015	2016	2017	2018e	2019e	H118	H218e
Christmas Savings	192,900	205,400	214,300	223,833	237,522	31,000	192,833
% change	8.5%	6.5%	4.3%	4.4%	6.1%	7.6%	4.0%
Other consumer	3,896	2,952	2,471	2,471	2,471	433	2,038
% change	4.4%	(24.2%)	(16.3%)	0.0%	0.0%	(43.3%)	19.4%
<b>Total billings</b>	<b>196,796</b>	<b>208,352</b>	<b>216,771</b>	<b>226,304</b>	<b>239,993</b>	<b>31,433</b>	<b>194,871</b>
% change	8.4%	5.9%	4.0%	4.4%	6.0%	6.3%	4.1%
Total revenues	164,682	169,875	174,184	178,901	183,025	23,924	154,977
Operating expenses	(158,749)	(163,052)	(167,724)	(172,353)	(176,125)	(25,918)	(146,435)
% change	1.8%	2.7%	2.9%	2.8%	2.2%	2.1%	2.9%
<b>Operating profit</b>	<b>5,933</b>	<b>6,823</b>	<b>6,460</b>	<b>6,548</b>	<b>6,900</b>	<b>(1,994)</b>	<b>8,542</b>
Operating profit/billings	3.0%	3.3%	3.0%	2.9%	2.9%	(6.3%)	4.4%
Operating profit/revenues	3.6%	4.0%	3.7%	3.7%	3.8%	(8.3%)	5.5%

Source: Park Group, Edison Investment Research

## Corporate business: Growing share and reaching new markets

The corporate business has a good track record of growth as digital investment has allowed it to create convenient and cost-effective solutions for customers, introduce innovative new products, and address new markets. In the UK it operates in a large and fragmented market, providing opportunities for market share gain. The UK Giftcard & Voucher Association estimates that around half of the £5.6bn annual UK sales are B2B, and that these have grown at a double-digit rate over the past five years. The launch of Love2shop Worldwide has given Park global capability for the first time.

The corporate business accounted for 46% of FY17 sales and 53% of operating profit before central costs. It supplies a range of products including Park's own vouchers and prepaid cards as well as individual retailer-branded vouchers and travel services, mainly used by corporate customers for incentive and reward schemes as well as for on-sale to their own customers. Since October 2016, the corporate business also includes Fisher Moy International (FMI), a specialist in brand engagement consultancy. At a cost of just under £1m, the FMI acquisition was modest but strategic. It works with a number of larger, blue-chip clients and provides Park with the opportunity to engage with a much broader and larger pool of corporates. It also gives the group a physical presence in the south of England. Highstreetvouchers.com is the UK's leading online gift card and voucher retailer. It has grown steadily and strongly since it was launched in 2004 with 80% of sales coming from corporate clients. Management looks for new innovations to maintain growth. Love2shop.co.uk is the online ordering, transaction and servicing site for the own-branded Love2shop product range.

Park has traditionally provided low-cost and flexible incentive and rewards schemes to the UK SME market. Unlike many competitors, it is not reliant on charging fees for these packages as it earns revenues through the use of its own voucher and card product. Additionally, Park has invested in online servicing capability that improves both the service offering and efficiency. Engage, launched in 2016, is an online digital platform for the corporate incentive and reward market that allows



corporate users to create and control tailor-made modular web or smart device-based programmes for their customers or staff, providing real-time information to the customer on uptake and progress.

The Evolve platform, which was launched in the UK in June 2016, was well received by Park's customer base and has recently been made available globally since May 2017 via the establishment of Love2shop Worldwide. It is a live online platform providing organisations with a quick, easy and reliable way to reward employees or customers who may be on the move. It can be fully branded to the organisation and delivers reward by way of digital rewards codes via email or SMS in a convenient and cost-effective way. At the time the interim results were released in November 2017, the number of businesses that had purchased codes since launch had reached 249, generating £3.6m in sales. An indication of growing momentum is that 192 clients purchased codes in H118. The global roll-out of Evolve has been made possible by a partnership with Carlton Group of Canada, an engagement and rewards specialist with a strong international footprint that allows it to deliver country-specific rewards in 150 countries utilising a catalogue of branded rewards that is available in 39 different languages. The ability to deliver product on an international basis is key and Love2shop Worldwide will now be able to offer a digitally based rewards programme, utilising the Evolve platform, on a worldwide basis. The new capabilities are initially being offered to Park's existing UK corporate clients before being rolled out into new territories. Growing the sales of Evolve is a major focus for the group and management believes that there is a significant opportunity to be exploited.

FMI has had a slow start and generated a c £100k operating loss during H118. However, it is now fully integrated as the customer engagement arm of Love2shop Business Services, it has been profitable over recent months and, with the support of the Love2shop sales and marketing team, is showing early progress in broadening the take-up of Park's incentive and reward offering to a broader and larger corporate universe. Among new business won is a multi-country online rewards programme for a major European car manufacturer and a rewards mandate with a UK trade programme, with a potential value of more than £2m pa and offering significant corporate communication and engagement opportunities.

#### Exhibit 9: Corporate business financial summary

£000s	2015	2016	2017	2018e	2019e	H118	H218e
Incentive	107,600	111,000	120,700	132,770	143,392	50,700	82,070
% change	23.3%	3.2%	8.7%	10.0%	8.0%	8.6%	10.9%
Credit	20,400	3,900	3,400	3,230	3,230	1,000	2,230
% change	(28.9%)	(80.9%)	(12.8%)	(5.0%)	0.0%	(16.7%)	1.4%
hsv.com	20,800	23,900	25,500	28,050	31,416	10,300	17,750
% change	23.1%	14.9%	6.7%	10.0%	12.0%	(1.9%)	18.3%
Cash replacement	3,900	3,300	2,500	3,000	3,150	1,200	1,800
% change	62.5%	(15.4%)	(24.2%)	20.0%	5.0%	50%	6%
Employee benefits	10,100	14,600	14,800	17,020	18,722	7,100	9,920
% change	62.9%	44.6%	1.4%	15.0%	10.0%	18%	13%
Other corporate	13,291	19,979	20,841	21,883	22,977	3,730	18,153
% change	2.2%	50.3%	4.3%	5.0%	5.0%	6.3%	4.7%
<b>Total billings</b>	<b>176,091</b>	<b>176,679</b>	<b>187,741</b>	<b>205,953</b>	<b>222,887</b>	<b>74,030</b>	<b>131,923</b>
% change	14.0%	0.3%	6.3%	9.7%	8.2%	7.7%	10.8%
Revenue	128,647	132,670	136,743	138,499	141,823	50,779	87,720
% change	18.9%	3.1%	3.1%	1.3%	2.4%	4.9%	-0.7%
<b>Operating expenses</b>	<b>(122,182)</b>	<b>(126,673)</b>	<b>(129,512)</b>	<b>(130,771)</b>	<b>(133,172)</b>	<b>(49,731)</b>	<b>(81,040)</b>
% change	18.2%	3.7%	2.2%	1.0%	1.8%	5.1%	-1.4%
Operating profit	6,465	5,997	7,231	7,728	8,651	1,048	6,680
Operating profit/billings	3.7%	3.4%	3.9%	3.8%	3.9%	1.4%	5.1%
Operating profit/revenues	5.0%	4.5%	5.3%	5.6%	6.1%	2.1%	7.6%

Source: Park Group, Edison Investment Research

The corporate business' good track record of growth in recent years becomes more apparent if adjusted for the run-down in sales to home-collected credit (HCC) operators, and particularly to Provident Financial. Credit sales overall are now small and Park expects no impact from the

ongoing problems experienced by Provident Financial. Management looks for growth to continue, with new products and services targeting new markets and larger businesses.

H118 billings growth was 7.7%, with a number of important new customers added in the period. Management reports that its online platforms are proving popular with corporates, and in particular the control that the self-service features provide. Operating profit was at a similar level to the prior year despite the negative FMI contribution in the period, some front-loading of promotional costs, and business mix effects (increased card sales, but deferring profit recognition, and more third-party product such as Amazon e-codes, where margins are lower).

## Management and governance

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The group is currently led and controlled by a board consisting of the non-executive chairman, three executive directors and two non-executive directors. The executive board includes the CEO, group finance director and the managing director of Park Retail. This team has been in place for many years, together managing Park through its transformation and development, but has begun a process of significant change. Ian O'Doherty became CEO and joined the board on 1 February 2018, replacing Chris Houghton, retiring from the group after more than 30 years of service, and who had held the position of CEO since 2012. The CFO, Martin Stewart, has also indicated that he will leave Park after 13 years in his position, although this will not take effect until August 2018, once a replacement has been found and an orderly handover completed.

Ian O'Doherty has a strong background in financial services, specifically in banking, payments and card services, which appears well suited to leading the continued development of the business. He spent 28 years at MBNA, most recently as chairman and CEO of MBNA Ltd in the UK, between 2008 and 2017. During this time he oversaw the re-engineering of MBNA's digital capabilities and reorganised the business, leading it through the financial crisis and subsequent sale (for £1.9bn) to Lloyds Banking Group in 2017.

The non-executive chairman is Laura Carstensen, who was elected to the board in September 2013 and became chairman in June 2016. She is a former partner in City law firm Slaughter and May and a former member and deputy chairman of the UK Competition Commission (now the Competition and Markets Authority). The other two non-executive directors are Michael de Kare-Silver, who joined the board in September 2013, and John Gittins, who joined the board in September 2016 and has more than 20 years' experience as a CFO across various sectors and territories. Brief biographies of the executive board members and chairman are on page 16.

## Financials: Strongly cash generative

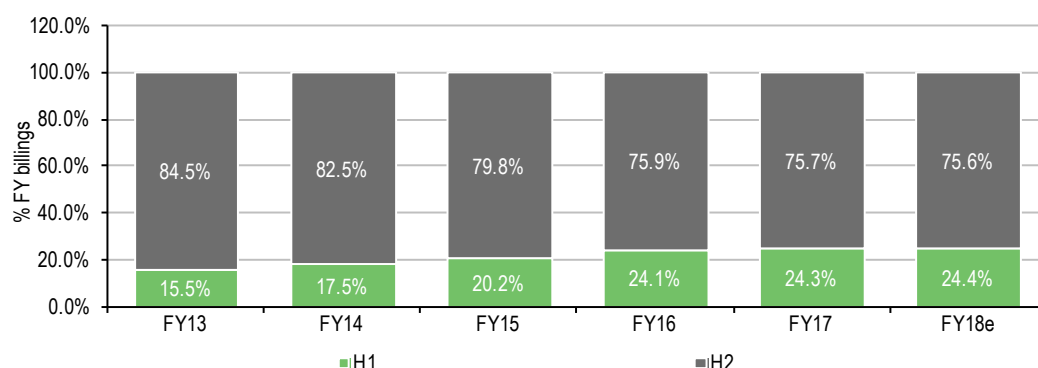
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Park reported its interim results for the six months ending 30 September 2017 in late November. Because of the highly seasonal nature of Park's business, in our opinion these are best viewed as a guide to underlying business trends and direction, particularly in orders. We have covered the trends within the consumer and corporate businesses in the section above but note that they reveal the extent of the seasonality. More than 75% of sales, and all of the profits, are generated in the second half of the year, which includes the important Christmas trading period. The first half is significant in building the order book, but is traditionally loss making. Digitalisation of the business and changes in customer behaviour have seen the share of total annual sales (defined as billings) generated in H1 increase steadily, from less than c 15% in FY13 to more than 24% (we forecast 24.4% in the current year), while the seasonal H1 pre-tax loss has also trended down over time. However, the extent of remaining seasonality in the business continues to create volatility in first-



half reported earnings and cash flow. H118 was no exception, with the normal seasonal pre-tax loss increasing to £1.6m (H117: £0.8m), although still well down on the £3.0m reported in H113.

**Exhibit 10: The seasonality of sales\***



Source: Park Group, Edison Investment Research. \*Note: Sales defined as billings.

In brief, the group highlights from H118 were:

- Billings increased by 7.3% compared with H117, up 7.7% in corporate and 6.3% in consumer. Consumer billings growth was ahead of order growth (c 4%), which reflects accelerated shipments of Christmas orders, a timing issue between H1 and H2.
- Accounting revenues (+3.1%) grew at a slower pace than billings, reflecting an increasing share of prepaid cards in the mix of billings and the differing accounting treatment of the two, explained in detail on page 11. In aggregate, across both the consumer and corporate businesses, voucher billings were c 4% lower y-o-y, while card billings were c 17% higher, limiting revenue growth and deferring gross profit recognition into H2.
- The seasonal pre-tax loss increased in H118 compared with H117, to £1.6m compared with £0.8m, which management attributes mostly to the disproportionate impact on H1 profits of the continued growth in the business, and the costs to support that growth, in relation to the revenues reported in H1. Administrative costs (as reported by the company, including depreciation, amortisation and share-based payments) were 14.5% up in H1 compared with our forecast of 8.0% for the year as a whole. We expect the timing issues that affected H1, both revenue and costs, to rebalance by year-end.
- Total cash balances at end-H118 were at a similar level to end-H117 (£199.6m v £198.7m) and, substantially reflecting seasonality, were significantly ahead of end-FY17. However, the split between the shareholder cash balance and customer cash held in trust was noticeably different this year, with the shareholder cash balance declining to £5.4m. Similar to the reported earnings position, the shareholder cash position reflects a number significant timing distortions that we expect to unwind by year-end. Earlier customer deliveries brought forward stock purchases into H1. The increase in segregated cash balances included an impact from a higher share of cards in billings, deferring revenue recognition and cash flow until H2, and a slower release of cash from the Christmas savings trust. The latter largely reflects a desire to optimise treasury yields and can be seen in the c 12% growth in Christmas savings trust balances compared with the underlying c 4% order growth.
- Cash balances (including customer funds held in trust) continued to increase after the period end, peaking in November at a record £229m (FY17: £217m). Interest earnings are yet to benefit from the rise in interest rates at the very short end of the yield curve and were actually slightly lower in the period (£0.7m versus £0.8m) despite the increase in average cash balances.
- The interim dividend was increased by 5.3% to 1.0p per share

**Exhibit 11: H118 summary**

£000s	H118	H117	FY17
Consumer	(1,994)	(1,349)	6,460
Corporate	1,048	1,095	7,231
Central & property costs	(1,291)	(1,331)	(2,810)
<b>Operating profit/(loss)</b>	<b>(2,237)</b>	<b>(1,585)</b>	<b>10,881</b>
Interest income	666	825	1,472
<b>PBT</b>	<b>(1,571)</b>	<b>(760)</b>	<b>12,353</b>
Tax	298	152	(2,452)
<b>Net profit</b>	<b>(1,273)</b>	<b>(608)</b>	<b>9,901</b>
Cash held in trust	194,240	169,411	83,018
Shareholder cash balance (net of overdraft)	5,392	29,259	31,359
<b>Total cash positions</b>	<b>199,632</b>	<b>198,670</b>	<b>114,377</b>

Source: Park Group

## No change to forecasts – timing impacts to unwind

We have made no material changes to our group forecast after the interim results, although within this we have slightly reduced our consumer business forecast with a corresponding uplift in corporate. The change was driven by a rebalancing of our billings forecast between the two. We do not yet incorporate the changes relating to the adoption of IFRS 15 applicable from FY19 (see section on page 11 re IFRS 15).

Forecasts for the consumer and corporate businesses are shown in detail in the sections above. At the group level and on the current basis of accounting, we are forecasting 7% billings growth for this year and next, and for similar growth in gross profit (gross margin on billings maintained at c 7.5%). Within this we look for card billings to continue to represent a larger share (growing c 35-40% pa) and limiting reported revenue growth (to c 2%), but continuing to lift gross profit as a share of revenues. Despite continuing investment, we look for operating profit to grow slightly faster than gross profit and for next year we anticipate some benefit to interest revenues from higher average cash balances.

## Cash generation for dividends and investment with balance sheet strengthened

Park is a highly cash-generative business with no debt. Historically, Park's operational cash flow has been allocated between strengthening the balance sheet, investment in growing the business (partly capitalised but also expensed) and funding the progressive dividend payments shown in Exhibit 3. Exhibit 12 shows how the balance sheet has developed and strengthened over the years, with the equity position moving from a substantial negative to positive, and with a substantial net current liability position all but closing. Other than a £4.2m (net) equity issue in FY14 to fund growth, this has all been achieved out of retained earnings and positive cash flow.

Although in a positive equity position since 2016, for many years it funded its growing business from working capital with the balance sheet reporting negative equity. The latter reflected historical goodwill and other write-offs from the early 2000s, related to an unsuccessful diversification effort before the current, focused growth strategy was adopted, and captured none of the goodwill value inherent in the continuing business. The business model is based on cash being received from customers upfront, in return for prepaid cards and vouchers, and then being paid out, less service fees (Park's margin), to the redeemers that accept the vouchers and prepaid cards at their outlets.

Customer prepayments are segregated, substantially so in the case of Christmas savings in the voluntary Park Prepayment Protection Trust (PPPT) or, in the case of prepaid cards, fully segregated as required by the regulator (the FCA) within the e-money Trust. The PPPT was set up in 2007 in the wake of the Farepak collapse to provide reassurance to customers. The trust deed allowed Park, under the supervision of the trustees, to access some of the accumulated balances

on a limited basis to meet operating costs and working capital needs in the business period. Management indicates that it no longer accesses these funds for working capital.

**Exhibit 12: Summary balance sheet development**

£000s	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Current assets	30,700	34,442	43,440	54,327	65,290	68,549	84,484	106,998	119,365	129,182
Current liabilities	(68,234)	(69,750)	(78,520)	(88,252)	(94,658)	(93,901)	(100,848)	(118,190)	(124,808)	(130,038)
Net current assets/(liabilities)	(37,534)	(35,308)	(35,080)	(33,925)	(29,368)	(25,352)	(16,364)	(11,192)	(5,443)	(856)
Shareholders' equity	(31,712)	(28,546)	(30,058)	(20,120)	(15,700)	(11,328)	(4,135)	(167)	6,425	12,425

Source: Park Group, Edison Investment Research

As noted above, we expect the timing impacts on H118 cash flow to unwind during H2. Our forecast shows end-FY18 shareholder cash (net of overdraft) at £32.6m (FY17: £31.4m). Park typically distributes a little more than 50% of earnings and, with substantial balance sheet strengthening behind it, we would expect future dividend policy to be driven primarily by the prospects for organic investment and/or external acquisition opportunities. However, this strong and growing cash balance needs to be seen in the context of the provision for outstanding vouchers and, although the dividend policy is progressive, we do not believe that investors should anticipate any substantial change in the payout ratio over the near term. The provision represents the cash that is expected to be paid to retailers over time in respect of vouchers that have been issued to customers but are yet to be redeemed at retailer outlets. There is also a smaller provision for corporately issued (rather than individually issued) cards where there is no right of redemption for unspent balances. This will not happen overnight and the size of the provision balance cash is, among other things, driven by ongoing voucher sales. However, over time, we expect prepaid cards to continue to take sales share from vouchers.

## Cards versus vouchers and IFRS 15 update

The introduction of IFRS 15 will see accounting treatment for prepaid cards and vouchers, currently very different, converge. Park will report under IFRS 15 for the first time in respect of the financial year ending 31 March 2019 and is likely to provide initial guidance on the impact with the current year (FY18) results in June 2018.

Currently, voucher revenue is recorded when the vouchers have been despatched to the customer, generating revenues that equal the amount paid by the customer for the voucher (typically the face value) and a gross profit margin that represents the service fees receivable from the retailers/redemption partners at the same time; a provision is made for the redemption liability arising. For cards, the revenue recognised is generally much lower, representing only the fees charged to cardholders and service fees receivable from retailers/redemption partners. There is also a timing difference, with card revenues and profits recognised later than similar voucher-based customer transactions. Where the cardholder has the right of redemption, revenue is recognised when amounts are deducted from values held on cards, ie when cards are redeemed at retailers/redemption partners or when charges are levied.

In short, card 'sales' to customers generate much lower reported revenues than vouchers, but are recorded as 100% gross profit margin, while profit recognition may be delayed. To provide greater clarity, the group reports the (non-statutory accounting) measure of billings. It represents the face value of voucher sales and the amount of value loaded onto prepaid cards, net of any discounts given to customers, and as such provides a consistent measure of customer sales activity in any period. The effect can be seen in the 4.9% pa compound growth in revenues in the three years to FY17 compared with 6.4% in billings, with the gross margin (on revenues) increasing from 8.3% to 9.7%.

**Exhibit 13: Accounting treatment of vouchers versus prepaid cards (illustration)**

£	Voucher	Prepaid card
Billings	100	100
Revenue	100	8
Cost of sales	(92)	0
Gross profit	8	8
Gross margin on revenue	8%	100%

Source: Park Group, Edison Investment Research

Exhibit 13 shows how £100 of billings generates very different accounting revenues depending on whether it is a voucher or prepaid card, although assuming all card balances are spent in the same accounting period as the voucher sale, the gross profit contribution is the same. However, in reality, it is unlikely that all card balances will be spent in the same accounting period, deferring gross profit (and a similar amount of revenue). As card balances grow, so too does the deferral. Accumulated, unspent customer card balances are held on balance sheet within the segregated e-Money Trust, a regulatory requirement. The balance as at H118 was £29.5m, representing almost £2.5m of deferred gross profit (and revenue) that will be reported in future accounting periods.

IFRS 15 will move the accounting treatment for Park's own prepaid vouchers (54% of FY17 billings) onto the same basis as cards (26%), although the treatment of third-party vouchers, hampers and gifts (19%) will remain the same. The impacts are mitigated by the fact that a high proportion of the vouchers sold/billed in any year, particularly when Christmas related, are in fact redeemed in that same year, triggering an IFRS 15 revenue recognition. We have not yet incorporated these changes into our forecast. In broad terms, the impacts on the reported numbers are likely to be:

- Revenues recorded for own vouchers will show a material decline.
- Ultimate gross profit and cash flow will be unaffected but the reported group gross margin will increase materially towards the 100% that will be reported on cards and own vouchers (but not hampers and other goods or third-party vouchers).
- Revenue and profit recognition deferral will slightly reduce the reported numbers in period one and the deferral of previously recognised profits will reduce equity.

## Valuation

Our approach to valuation is to consider both a potential absolute value based on a modified DCF analysis as well as a relative value based on a comparison with a selected group of listed stocks. The average of the two measures points to a fair value of 88p per share, unchanged from when we last [published](#).

Our modified DCF valuation is unchanged at 86p. It is modified in the sense that we include the interest earned by Park on segregated customer cash balances (but not on the group cash balance), as this is an integral part of the returns generated by Park. The customer cash itself is excluded from the overall valuation, and also the voucher provisions balance as this will eventually flow out in settlement of vouchers that have been issued and accounted for in earnings but not yet redeemed. For now, our forecasts go out to March 2019, and beyond this we grow free cash flow at 5% until year 10, enhanced by an assumed normalisation of interest rates to 3% in FY20. The terminal cash flow is valued at 10x, and we use a discount rate of 10%. The terminal value represents 46% of the total 86p value. A 1% increase in the assumed discount rate, a reduction in the terminal multiple to 9.0x, or a 1% reduction in the long-term growth rate reduces the value by c 8%, 5%, or 5% respectively. We note that the current share price could be said to be assuming a long-term growth in free cash flow of just more than 3% pa.

Competitor employee benefits and service providers to Park are either private companies or relatively small parts of larger groups, complicating any attempt at a relative valuation approach. Sodexo and Edenred are both much larger and more international than Park, and the overlap with

Sodexo is limited; Sodexo Benefits and Rewards Services is a minor part of Sodexo Group. Because Park's traditional Christmas prepayments customer base (c 50% of Park) has historically had some socioeconomic overlap with that of the HCC lenders, we also show valuation data for these. We would expect a premium rating for Park as it does not have similar credit risk, and we believe it has less regulatory risk. On this basis of a premium to the HCC companies but a discount to the larger incentive-related peers, our judgement is that a multiple of at least 15x prospective 2018e calendar earnings 31 March year-end), or 90p per share, is a fair objective.

**Exhibit 14: Peer valuation comparison**

	Share price (local ccy)	Market cap (£m)	P/E (x)		Prospective dividend yield (%)	Share price performance			
			Current year	Next year		One month	Three months	12 months	From 12- month high
Incentive									
Park Group	81	151	14.5	13.4	3.7	-6%	-4%	2%	-7%
Edenred	25	5,256	25.2	23.1	3.1	2%	4%	21%	4%
Sodexo	100	13,389	17.7	16.6	2.8	-6%	-6%	-3%	-11%
Incentive average		6,265	19.1	17.7	3.2	-4%	-2%	7%	-5%
Home collected credit									
Provident Financial	672	996	13.9	7.5	0.0	-25%	-21%	-76%	-25%
Morses Club	125	162	11.8	10.0	5.4	-5%	-7%	5%	-2%
Non-Standard Finance	69	217	16.8	11.1	3.2	-8%	-8%	15%	-3%
HCC average		458	14.2	9.5	2.9	-13%	-12%	-19%	-10%
FTSE All-Share index	3950		13.7	12.8	4.1	-7%	-3%	0%	-6%

Source: Edison Investment Research, Bloomberg. Note: Consensus estimates for all except Park. Prices at 12 February 2018.

Source: Edison Investment Research, Bloomberg. Note: Consensus estimates for all except Park. Prices at 12 February 2018.

## Sensitivities

As discussed in the Financials section, our forecasts are based on current accounting standards and do not allow for the potential impacts of IFRS 15, to be applied from the beginning of FY18. We note the following fundamental sensitivities to the performance of the business and our forecasts:

- **The impact of interest rates on cash balances.** During the year, the group accumulates substantial cash balances in the Christmas Savings business, peaking around November/December. Park earns interest on these balances, accounting for 12% of FY17 reported PBT (and more than 30% in FY07 before the financial crisis and interest rate decline). We note that if Park had been able to earn an additional 50bp for a full year, the FY17 PBT would have increased by c 6%.
- **General economic growth.** Christmas Savings, although not immune to economic developments, has historically been robust, providing support and discipline to Christmas planning in difficult times. The corporate business depends on the health of the SME sector, although staff incentivisation can display countercyclical qualities. The historical growth of billings through an often challenging economic environment has benefited from constant investment in the service and product offering, providing the opportunity for market share gain in a substantial market.
- **Brand perception and customer confidence, especially in the Christmas Savings operation.** The group's Christmas Savings business is wholly dependent on the confidence of its customers and their willingness to make prepayments. Since the high-profile collapse of Farepak in 2007, the industry has moved to voluntary segregated customer balances, which should support customer confidence. As a regulated financial services product, card prepayments are 100% segregated by law.
- **Business continuity and IT systems.** The group is becoming increasingly reliant on digital sales and distribution, particularly relating to prepaid e-money card transactions. Any significant loss of transaction capability or breach of security could have a serious impact on group



performance and customer confidence. Park is ISO 27001 (the international standard for information management security systems) accredited.

- **Regulation.** As an FCA-regulated e-money issuer, the group would be affected by any changes in regulation of its prepaid card products. Christmas prepayment practices are covered by voluntary industry agreements, but any enforced changes in selling practices or customer protection could affect the group.



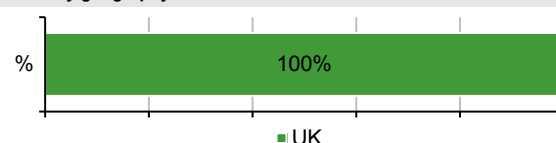
**Exhibit 15: Financial summary**

Year end 31 March	£'000s	2015	2016	2017	2018e	2019e
<b>PROFIT &amp; LOSS</b>		<b>IFRS</b>	<b>IFRS</b>	<b>IFRS</b>	<b>IFRS</b>	<b>IFRS</b>
Billings		372,887	385,031	404,512	432,257	462,880
Revenue		293,329	302,545	310,927	317,400	324,848
Cost of sales		(265,966)	(274,060)	(280,758)	(285,290)	(290,260)
Gross margin		27,363	28,485	30,169	32,110	34,589
Distribution costs		(2,761)	(2,909)	(2,940)	(3,015)	(3,086)
Administrative expenses		(13,057)	(13,150)	(14,274)	(15,661)	(17,074)
EBITDA		11,545	12,426	12,955	13,434	14,429
Depreciation & amortisation		(1,308)	(1,309)	(1,358)	(1,258)	(1,226)
Amortisation of acquired intangible, goodwill impairment, & impairment of investment property		(314)	(86)	(47)	(47)	(47)
Share-based payments		(235)	(631)	(669)	(350)	(350)
Exceptional operating income		0	0	0	0	0
Operating profit		9,688	10,400	10,881	11,778	12,806
Operating Profit (before amort. and except.)		10,237	11,117	11,597	12,175	13,203
Net Interest		1,245	1,457	1,470	1,376	1,473
Profit Before Tax (norm)		11,482	12,574	13,067	13,551	14,676
Profit before tax (IFRS)		10,933	11,857	12,351	13,154	14,279
Tax		(2,434)	(2,169)	(2,452)	(2,631)	(2,856)
Profit after tax (norm)		8,926	10,274	10,473	10,841	11,741
Profit after tax (IFRS)		8,499	9,688	9,899	10,523	11,424
Discontinued operations		0	0	0	0	0
Profit after tax (IFRS)		8,499	9,688	9,899	10,523	11,424
Average Number of Shares Outstanding (fully diluted) (m)		184.7	187.2	187.2	187.6	187.9
Basic EPS - IFRS (p)		4.66	5.28	5.38	5.68	6.15
Fully diluted EPS - IFRS (p)		4.60	5.18	5.29	5.61	6.08
EPS - normalised fully diluted (p)		4.83	5.49	5.59	5.78	6.25
Dividend per share (p)		2.40	2.75	2.90	3.05	3.20
Gross margin on billings (%)		7.3	7.4	7.5	7.4	7.5
EBITDA margin as % of billings		3.1	3.2	3.2	3.1	3.1
Operating margin (before GW and except) as % billings		2.7	2.9	2.9	2.8	2.9
<b>BALANCE SHEET</b>						
Fixed assets		13,932	13,749	14,399	14,205	14,069
Intangible assets		4,488	4,356	4,884	4,708	4,575
Tangible assets		8,143	8,003	7,688	7,669	7,667
Retirement benefit obligation		1,293	1,390	1,827	1,827	1,827
Other		8	0	0	0	0
Current assets		106,998	119,365	129,182	136,499	155,618
Debtors		14,937	11,411	11,928	12,521	12,945
Cash held in trust		65,728	75,219	83,018	91,392	100,179
Cash available to group		26,333	32,735	34,236	32,587	42,494
Current liabilities		(118,190)	(124,808)	(130,038)	(132,535)	(146,079)
Creditors		(75,004)	(80,041)	(83,874)	(85,473)	(94,312)
Provisions		(43,186)	(44,767)	(46,164)	(47,062)	(51,767)
Short-term borrowings		0	0	0	0	0
Long-term liabilities		(2,907)	(1,881)	(1,118)	(435)	249
Long-term borrowings		0	0	0	0	0
Deferred tax		(273)	(181)	(194)	(194)	(194)
Retirement benefit obligation		(2,634)	(1,700)	(924)	(241)	443
Net assets		(167)	6,425	12,425	17,733	23,857
Minorities		0	0	0	0	0
Shareholders' equity		(167)	6,425	12,425	17,733	23,857
<b>CASH FLOW</b>						
Operating Cash Flow		14,106	12,184	9,903	8,930	15,203
Net interest		1,176	1,339	1,539	1,376	1,473
Tax		(2,132)	(2,490)	(2,258)	(2,631)	(2,856)
Capex		(597)	(1,126)	(717)	(1,111)	(1,137)
Acquisitions/disposals		41	52	(875)	1	0
Financing		0	0	5	0	0
Dividends		(4,198)	(4,380)	(5,052)	(5,340)	(5,650)
Other		0	(3)	0	0	0
Net cash flow		8,396	5,576	2,545	1,224	7,033
Opening net (debt)/cash		14,844	23,241	28,817	31,362	32,587
Closing net (debt)/cash		23,241	28,817	31,362	32,587	39,620

Source: Company accounts, Edison Investment Research

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**Revenue by geography**

**Leadership team**
**Non-executive chairman: Laura Carstensen**

Laura was appointed to the board as a non-executive director on 23 September 2013 and became non-executive chairman on 3 June 2016. She is a former partner in City law firm Slaughter and May and a former member and deputy chairman of the UK Competition Commission (now the Competition and Markets Authority). She is a non-executive director and chair of the values and ethics committee of The Co-operative Bank. She holds two ministerial appointments, as a commissioner of the Equality and Human Rights Commission and as a trustee of National Museums Liverpool.

**CEO: Ian O'Doherty**

Ian O'Doherty joined the company on 2 January 2018, and was appointed CEO and joined the board on 1 February 2018 on receiving FCA approval. He brings a strong background in financial services, specifically in banking, payments and card services, having worked at MBNA for 26 years, from 2008-17, most recently as chairman and CEO of MBNA Ltd in the UK. From 2015-17 he was deputy chair of the UK Cards Association, having been a board member since 2008. He was a member of the interim main board of UK Finance, which represents more than 300 leading firms providing finance, banking, markets and payments-related services in or from the UK, from 2016 to 2017.

**Group finance director: Martin Stewart**

Martin Stewart joined Park and the board in 2004 and recently indicated that he will leave the company in August 2018. Previously he was group finance director at Eddie Stobart Group and has held various finance positions at UK Waste Management (including as finance director), Littlewoods, ICI and PricewaterhouseCoopers.

**MD Park Retail: Gary Woods**

Gary Woods joined Park Group through the acquisition of Chrisco Hampers in 1980 and joined the board in 1981. He has wide experience in a number of divisional roles throughout the group.

**Principal shareholders (as at 23 January 2018. Source: Park Group/RD:IR)**

	(%)
Schroder Investment Management	14.1%
Miton Asset Management	10.6%
BlackRock	10.5%
Soros Fund Management	8.9%
Artemis Investment Management	8.2%
Janus Henderson Investors	6.9%
Unicorn Asset Management	6.5%

**Companies named in this report**

Edenred SA (EDEN), Sodexo SA (SW), Provident Financial (PFG), Morses Club (MCL), Non-Standard Finance (NSF)

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