

GB Group

Factoring in COVID-19 disruption

GB Group's (GBG's) year-end trading update confirmed a strong performance in FY20, despite COVID-19 restrictions in Asia Pacific having a modest impact in Q4. Although the lockdown restrictions are boosting demand for online products and services, not all verticals are benefiting (eg travel, transport). We have revised our FY21 and FY22 forecasts to reflect lower levels of usage-based revenues and new business as well as reductions to operating costs. We estimate that the company has ample funds to manage through the disruption and in the longer-term should be a beneficiary of increasing amounts of business shifting online.

Year end	Revenue (£m)	EBITA* (£m)	PBT* (p)	Diluted EPS* (p)	DPS (p)	P/E (x)
03/18	119.7	26.3	25.8	13.5	2.7	48.9
03/19	143.5	32.0	31.3	15.4	3.0	42.7
03/20e	198.9	47.0	43.7	17.1	0.0	38.4
03/21e	174.6	29.9	27.0	10.6	2.0	62.1
03/22e	187.4	37.9	35.3	13.8	2.6	47.7

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

FY20 beats expectations despite COVID-19 disruption

GBG expects to report FY20 revenues of £199m (+38.7% y-o-y, +10.6% organic constant currency) and EBITA of £47m, ahead of both our and consensus forecasts. This was despite revenues in Asia Pacific seeing a modest negative effect from COVID-19 restrictions since January. Net debt declined by 47% y-o-y to £35m (net debt/EBITDA 0.7x). The company has put processes in place to service customers remotely and is implementing a series of measures to control the cost base and manage cash during the crisis, including not paying a dividend for FY20.

Reflecting weaker demand in FY21

GBG is seeing mixed performance across products, verticals and geographies. Usage-related revenues are likely to be hit by substantially weaker end-customer demand in verticals such as travel, leisure and transport and mixed levels of demand in other verticals such as gaming and ecommerce. We would also expect lower levels of new business until lockdown restrictions are lifted and customers have more visibility on their own businesses. We have reduced our forecasts to reflect a revenue decline of 12.2% in FY21 before a partial recovery to growth of 7.3% in FY22. This results in a cut to our normalised diluted EPS forecasts of 40.6% and 29.9% respectively. Despite these cuts, we continue to forecast a reduction in net debt, shifting to net cash by the end of FY22, and with access to an additional £105m of debt, the company should be well funded to weather the disruption.

Valuation: Reflects long-term growth prospects

Using a reverse DCF and our revised forecasts for FY21/FY22, we estimate that the share price is factoring in mid-teens revenue growth and operating margins of c 23% from FY23, at the upper end of pre-COVID-19 expectations.

FY20 trading update

Software & comp services

22 April 2020

Price 658p
Market cap £1,278m

Net debt (£m) at end FY20* 35.0
*Excluding finance leases.

Shares in issue 194.2m

Free float 98.7%

Code GBG

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	27.8	(8.6)	9.3
Rel (local)	16.6	24.2	43.6
52-week high/low		800p	474p

Business description

GB Group is a specialist in identity data intelligence. Its products and services enable its customers to better understand and verify their customers and employees and are used across a range of fraud, risk management, compliance and customer on-boarding services. With headquarters in the UK, GB operates across 16 countries, has customers in 72 countries and generates more than 57% of revenues internationally.

Next events

FY20 results June

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FY20 trading update

GBG has issued a trading update that confirms it expects to report the following for FY20. Revenues are expected to be 3.3% ahead of our forecast and 1.4% ahead of consensus. At the EBITA level, GBG also expects to report ahead of our and consensus forecasts, with a margin of 23.6% compared to our 22.8% forecast. Net debt reduced faster than we forecast and the company noted that net debt/EBITDA was 0.7x at year-end (down from 1.9x a year ago). GBG reported that organic revenues of £158m increased 10.6% y-o-y on a constant currency basis.

Exhibit 1: GBG FY20 trading update

£m	FY20e	FY20e	FY20a	Diff		y-o-y	y-o-y
	Edison	Consensus		Edison	Consensus	Reported	Organic constant currency
Revenues	192.6	196.3	199.0	3.3%	1.4%	38.7%	10.6%
EBITA*	44.0	44.6	47.0	6.8%	5.4%	46.7%	
EBITA margin	22.8%	22.7%	23.6%				
Net debt	41.0	N/A	35.0	-14.6%			

Source: GB Group, Edison Investment Research *Excludes amortisation of acquired intangibles, exceptional items and share-based payments.

COVID-19 limited impact on FY20 performance

The company noted that it started to see the impact of COVID-19 restrictions in China from January and more broadly in Asia Pacific from February, with a modest negative effect on revenues. This implies that group organic growth would have been higher than 10.6% without the pandemic. The group's Chinese operations are now coming out of shutdown.

Factors influencing customer demand in FY21

The company noted that it is seeing mixed performance across customer verticals, products and geography. Some business areas continue to experience growth while others are seeing a decline in demand.

GBG sells its services in three ways: as a licence (typically renewable annually), based on transactions processed (eg ID checks, location look-ups), or via project/services. In FY19, revenues were split out as 52% from licences, 39% from transactions and 9% from services. The split varies by division as follows:

Exhibit 2: Revenue by type per division, FY19

	Fraud	Identity	Location	Unallocated	Group
Licences	94%	21%	76%	0%	52%
Transactions	0%	78%	23%	0%	39%
Services	6%	1%	1%	100%	9%
FY20e revenue contribution	16%	54%	26%	4%	100%

Source: GB Group

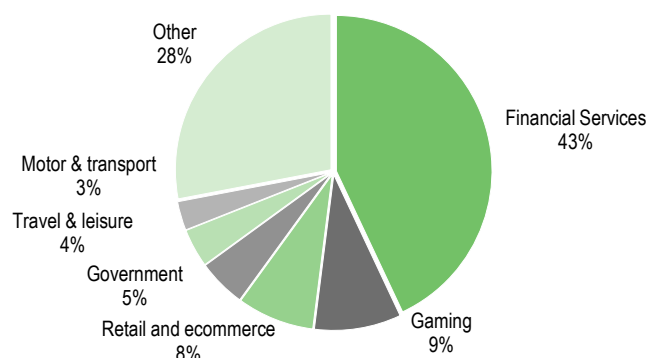
We would expect the **Fraud** division to be relatively better off in FY21 as the bulk of its revenues are generated from licences and it has a large proportion of revenues from Asia Pacific. While some customers may decide not to renew licences, we estimate that the majority are likely to retain them in anticipation of business recovering.

The **Identity** business, which we estimate generates around half of group revenues, has the highest proportion of usage-based revenues. As customers see reducing demand from their end customers, this will reduce the revenues earned by GBG.

The **Location** business has around a quarter of revenues from usage-based contracts so should see less impact from lower demand.

The chart below shows the split of H120 revenues by vertical:

Exhibit 3: GB Group revenues by vertical, H120



Source: GB Group

Certain verticals are seeing a substantial drop in demand, such as travel and leisure, motor and transport, and this is likely to affect transaction revenues for both the identity and location businesses. The financial services sector is likely to see lower demand for new products/accounts in the short term while end customers focus on retaining their jobs and preserving their cash. Other segments such as retail & e-commerce and gaming are seeing mixed performance. While online retail demand is much higher, not all retailers are able to cope with demand for both supply chain and staff safety reasons and are gating or suspending online business. Certain types of online gaming are likely to see increased demand (casinos, poker) as people have more time at home, but on the other hand, there is no sport to bet on. The government segment could see increased numbers applying to various departments for economic support. Demand for new employee checks is likely to fall as companies institute hiring freezes.

Company response to COVID-19

The company is taking various measures to manage its way through the crisis:

- Staff are working remotely, providing support to customers and, where there is customer demand, selling remotely.
- Staff pay is frozen, accrued bonuses for executive management for FY20 will be suspended and only essential recruitment will be allowed.
- Project spend is being assessed and only those projects vital to the company's long-term performance will be undertaken.
- The company will not pay a dividend for FY20 – we had estimated this would cost £6.5m in FY21.

Outlook and changes to forecasts

The company is not in a position to give guidance for FY21. We have revised our forecasts to reflect the following:

- We have upgraded our FY20 estimates to match the revenue and EBITA disclosed in the trading update,
- We have reduced our FY21 and FY22 revenue forecasts by 18.3% and 21.1% respectively. We assume that Identity sees a bigger reduction as it has more exposure to usage-based contracts, while Fraud is much less affected due to the location of its customer base and because it is license-based. Overall, we forecast a 12.2% revenue decline in FY21. We assume the business starts to recover in FY22 and factor in growth of 7.3%.

- We maintain gross margins and assume that the company is able to reduce its cost base through the measures discussed above. This results in a reduction in our EBITA forecast of 38.2% in FY21 and 28.5% in FY22.
- We have cut our FY20 dividend forecast to zero and reduced our dividend forecast for FY21 from 3.8p to 2.0p and for FY22 from 4.3p to 2.6p, maintaining a c 20% pay-out ratio. Clearly, if the decline in business is worse than we are forecasting, the FY21 dividend could also be at risk.
- Assuming the company is able to cut its cost base and achieve our EBITA forecasts, we expect net debt to reduce by £22m over the year (previous forecast was for a £27m reduction). This equates to a net debt/EBITDA ratio of 0.4x by the end of FY21. The company noted that it has debt headroom of £75m plus an unused £30m accordion.

Exhibit 4: Changes to forecasts

£m	FY20e				FY21e				FY22e			
	previous	new	change	y-o-y	old	new	change	y-o-y	old	new	change	y-o-y
Revenues	192.6	198.9	3.3%	38.6%	213.9	174.6	(18.3%)	(12.2%)	237.5	187.4	(21.1%)	7.3%
Gross profit	139.6	144.2	3.3%	34.2%	155.5	127.0	(18.3%)	(12.0%)	173.4	136.8	(21.1%)	7.7%
Gross margin	72.5%	72.5%	0.0%	(2.4%)	72.7%	72.7%	0.0%	0.2%	73.0%	73.0%	0.0%	0.3%
EBITDA	47.9	50.8	6.1%	49.1%	52.4	33.9	(35.3%)	(33.2%)	57.2	42.1	(26.4%)	24.1%
EBITDA margin	24.9%	25.5%	0.7%	1.8%	24.5%	19.4%	(5.1%)	(6.1%)	24.1%	22.5%	(1.6%)	3.0%
EBITA	44.0	47.0	6.6%	46.6%	48.4	29.9	(38.2%)	(36.3%)	53.0	37.9	(28.5%)	26.7%
EBITA margin	22.9%	23.6%	0.7%	1.3%	22.6%	17.1%	(5.5%)	(6.5%)	22.3%	20.2%	(2.1%)	3.1%
PBT	40.8	43.7	7.2%	39.4%	45.5	27.0	(40.6%)	(38.1%)	50.4	35.3	(29.9%)	30.7%
EPS - normalised, diluted (p)	16.0	17.1	7.2%	11.2%	17.8	10.6	(40.6%)	(38.2%)	19.7	13.8	(29.9%)	30.4%
EPS - reported (p)	7.4	8.6	15.8%	11.4%	10.2	2.8	(72.1%)	(66.9%)	12.2	6.2	(48.9%)	119.8%
Net debt/(cash)	47.5	41.6	(12.4%)	(37.3%)	20.2	20.0	(1.1%)	(51.8%)	(10.3)	1.5	(114.8%)	(92%)
Net debt/(cash) excl. lease liabilities	41.0	35.2	(14.4%)	(47.0%)	13.8	13.6	(1.6%)	(61.3%)	(16.7)	(5.9)	(64.9%)	(143%)
Net debt/EBITDA (x)	1.0	0.7			0.4	0.4			N/A	N/A		

Source: Edison Investment Research

Valuation

The table below shows GBG's valuation metrics versus ID management peers.

Exhibit 5: Peer valuation metrics

	Rev growth (%)		EBIT margin		EV/Sales		EV/EBIT		P/E		Div yield	
	Yr1	Yr2	Yr1	Yr2	Yr1	Yr2	Yr1	Yr2	Yr1	Yr2	Yr1	Yr2
GBG	(12.2)	7.3	17.1	20.2	7.5	7.0	43.9	34.6	62.1	47.7	0.3	0.4
Ave ID Management	5.8	7.8	20.9	24.4	2.3	2.0	66.4	22.5	-50.6	29.5	1.8	2.1
Median ID Management	4.0	6.0	24.7	26.0	2.1	1.8	15.4	15.0	17.7	21.4	1.6	2.0

Source: Edison Investment Research, Refinitiv (as at 21 April) Note: Yr 1 for GBG is FY21e

GBG trades at a premium to its ID management peer group on a P/E basis, reflecting its strong growth track record and high recurring revenues. Comparison against peer valuations at this point is complicated by the fact that not all peers have updated the market in relation to COVID-19.

Using our new forecasts and rolling forward by a year to start from FY21, we have performed a reverse DCF to calculate the assumptions being factored into the share price. Using a WACC of 7.5% and a long-term growth rate of 3%, we estimate the current share price is factoring in revenue growth of 14.2% per year from FY23 with an EBIT margin of 23%. This is at the upper end of the group's revenue and margin targets pre-COVID-19 and is not unrealistic considering the ongoing shift to online for both consumers and businesses.

Exhibit 6: Financial summary

	£'000s	2015	2016	2017	2018	2019	2020e	2021e	2022e
March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS									
Revenue		57,283	73,401	87,468	119,702	143,504	198,929	174,635	187,379
Cost of Sales		(16,448)	(17,606)	(20,302)	(27,092)	(36,060)	(54,706)	(47,675)	(50,592)
Gross Profit		40,835	55,795	67,166	92,610	107,444	144,224	126,959	136,787
EBITDA		11,844	14,772	18,734	28,741	34,080	50,810	33,940	42,124
Operating Profit (before amort. and except.)		10,790	13,428	17,006	26,311	32,031	46,962	29,909	37,902
Acquired intangible amortisation		(1,986)	(2,501)	(4,022)	(7,885)	(10,316)	(19,300)	(17,100)	(16,500)
Exceptionals		(1,629)	(94)	(1,410)	(2,143)	(4,003)	(301)	0	0
Share of associate		(10)	0	0	0	0	0	0	0
Share based payments		(971)	(1,245)	(994)	(2,375)	(2,287)	(2,516)	(2,767)	(3,044)
Operating Profit		6,194	9,588	10,580	13,908	15,425	24,845	10,042	18,358
Net Interest		(266)	(270)	(498)	(508)	(689)	(3,280)	(2,880)	(2,580)
Profit Before Tax (norm)		10,524	13,158	16,508	25,803	31,342	43,682	27,029	35,322
Profit Before Tax (FRS 3)		5,928	9,318	10,082	13,400	14,736	21,565	7,162	15,778
Tax		(1,127)	(178)	668	(2,746)	(2,583)	(4,960)	(1,647)	(3,629)
Profit After Tax (norm)		8,314	10,395	13,206	20,642	24,760	33,635	20,813	27,198
Profit After Tax (FRS 3)		4,801	9,140	10,750	10,654	12,153	16,605	5,515	12,149
Average Number of Shares Outstanding (m)		119.1	122.7	131.6	150.6	158.1	193.8	194.5	195.0
EPS - normalised (p)		7.0	8.5	10.0	13.7	15.7	17.4	10.7	14.0
EPS - normalised and fully diluted (p)		6.7	8.2	9.9	13.5	15.4	17.1	10.6	13.8
EPS - (IFRS) (p)		4.0	7.4	8.2	7.1	7.7	8.6	2.8	6.2
Dividend per share (p)		1.9	2.1	2.4	2.7	3.0	0.0	2.0	2.6
Gross Margin (%)		71.3	76.0	76.8	77.4	74.9	72.5	72.7	73.0
EBITDA Margin (%)		20.7	20.1	21.4	24.0	23.7	25.5	19.4	22.5
Operating Margin (before GW and except.) (%)		18.8	18.3	19.4	22.0	22.3	23.6	17.1	20.2
BALANCE SHEET									
Fixed Assets		51,238	59,364	105,653	170,284	433,585	428,113	409,883	392,161
Intangible Assets		45,296	54,113	98,753	161,372	420,137	411,363	394,163	377,563
Tangible Assets		2,829	2,234	2,856	4,700	4,815	10,296	9,266	8,144
Other fixed assets		3,113	3,017	4,044	4,212	8,633	6,454	6,454	6,454
Current Assets		33,186	36,189	48,914	61,121	76,404	111,696	120,335	140,487
Debtors		17,408	23,774	30,569	37,969	54,874	73,007	64,091	68,768
Cash		15,778	12,415	17,618	22,753	21,189	38,348	55,903	71,377
Other		0	0	727	399	341	341	341	341
Current Liabilities		(30,784)	(32,559)	(44,444)	(56,942)	(71,822)	(90,436)	(81,132)	(80,758)
Creditors		(24,305)	(30,927)	(36,436)	(56,100)	(70,302)	(87,390)	(78,086)	(77,712)
Contingent consideration		(5,733)	(1,050)	(7,122)	(45)	(79)	0	0	0
Short term borrowings		(746)	(582)	(886)	(797)	(1,441)	(3,046)	(3,046)	(3,046)
Long Term Liabilities		(7,506)	(6,593)	(15,940)	(16,711)	(116,707)	(103,358)	(94,789)	(86,294)
Long term borrowings		(3,643)	(3,160)	(11,499)	(8,451)	(85,447)	(76,880)	(72,880)	(68,880)
Contingent consideration		(895)	0	0	0	0	0	0	0
Other long term liabilities		(2,968)	(3,433)	(4,441)	(8,260)	(31,260)	(26,478)	(21,909)	(17,414)
Net Assets		46,134	56,401	94,183	157,752	321,460	346,015	354,297	365,596
CASH FLOW									
Operating Cash Flow		11,684	13,397	16,305	31,620	27,779	51,064	33,551	37,073
Net Interest		(266)	(282)	(498)	(545)	(689)	(3,256)	(2,880)	(2,580)
Tax		(337)	(248)	(2,193)	(3,247)	(2,930)	(10,047)	(6,217)	(8,124)
Capex		(2,011)	(1,762)	(2,227)	(2,018)	(1,625)	(2,800)	(2,900)	(3,000)
Acquisitions/disposals		(18,672)	(12,263)	(36,840)	(70,363)	(255,101)	(82)	0	0
Financing		10,954	790	24,755	56,668	157,339	327	0	0
Dividends		(1,955)	(2,277)	(2,775)	(3,582)	(4,049)	(5,782)	0	(3,894)
Net Cash Flow		(603)	(2,645)	(3,473)	8,533	(79,276)	29,424	21,554	19,474
Opening net debt/(cash)		(11,846)	(11,389)	(8,673)	(5,233)	(13,505)	65,699	41,578	20,023
Finance leases initiated		0	0	0	0	0	(6,425)	0	0
Other		146	(71)	33	(261)	72	1,122	0	0
Closing net debt/(cash)		(11,389)	(8,673)	(5,233)	(13,505)	65,699	41,578	20,023	549

Source: GB Group, Edison Investment Research

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