

## Synergistic acquisition of musicMagpie

9 October 2024

AO has announced a recommended cash offer for consumer technology re-commerce leader musicMagpie. We believe this is an exciting opportunity for AO, given musicMagpie's expertise and trusted brand in consumer technology re-commerce, with over 9m customer contacts.

AO is offering 9.07p per share, equating to £10m cash and a c. £24m Enterprise Value which, in our view, appears good value at c. 0.2x EV/LTM Revenues and 3.4x EV/LTM EBITDA.

Whilst we do not, at this stage, forecast the consolidated profit impact of musicMagpie, we see scope for the acquisition to be value-accretive in the medium term.

### A sustainability-led £10m acquisition of musicMagpie...

musicMagpie is a circular economy pioneer providing customers with a smart, sustainable and trusted way to buy, rent and sell refurbished consumer technology, disc media and books. It resold nearly 400,000 consumer technology products in FY23 and c.8.4m books and disc media generating FY23 revenues of £137m. The company has been given the London Stock Exchange's Green Economy Mark as well as garnering over 293,000 Trustpilot reviews with a high average 4.4\* rating.

These values very much align with AO's own customer-centric, sustainability driven business model.

AO is already a market leader in recycling white electricals goods such as washing machines with its own state-of-the-art recycling facilities. This acquisition will augment AO's recycling and refurbishment offer for consumers with, for example, increased options for trading-in their old mobile phones.

As AO believes customers will increasingly look to more sustainable ways to buy, repair and reuse consumer technology this acquisition can position AO at the forefront of consumer trends.

### ...with synergies to drive growth and profitability

AO is retaining musicMagpie's senior management team, including its CEO and co-founder Steve Oliver and will work with the team to leverage synergies across the combined group.

This will include benefits from a larger combined customer base and from enabling musicMagpie to leverage AO's trade-in volumes of mobile phones and other electronics. AO will undertake a 6-month evaluation process post-acquisition, and we anticipate the acquisition can prove value-accretive in the medium term.

#### Company Data

EPIC	LSE: AO.
Price (last close)	108.5p
52 weeks Hi/Lo	118p/62p
Market cap	£624m
ED Fair Value / share	140p
Net debt incl. leases FY24	£31m

AO World are a research client of Equity Development

#### Share Price, p



Source: ADVFN

#### Description

Founded in 2000 by CEO John Roberts, AO World ("AO") has grown to be the leading online retailer of major domestic appliances ("MDA") such as washing machines and fridges with 16% market share. The company also sells a wide variety of small domestic appliances ("SDA"), televisions ("AV"), mobile phones, consumer electricals and laptops.

With a focus on brilliant service and two-person delivery, installation and recycling, the group has received over 500,000 Trustpilot reviews with an impressively high average score of 4.8/5. The group has also invested in its own recycling centre ensuring customers' electronic waste is dealt with responsibly.

#### Caroline Gulliver (Analyst)

0207 065 2690

[caroline.gulliver@equitydevelopment.co.uk](mailto:caroline.gulliver@equitydevelopment.co.uk)

#### Hannah Crowe

0207 065 2692

[hannah@equitydevelopment.co.uk](mailto:hannah@equitydevelopment.co.uk)

## A strategic and sustainability-led acquisition of musicMagpie

### Acquisition details

- AO announced a recommended cash offer for musicMagpie (“MM”) on 2 October 2024.
- The 9.07p per share offer valued the equity in MM at £9.98m and was a 58% premium to MM's average closing price in the month before the “Latest Practicable Date”.
- AO received irrevocable undertakings from shareholders representing 42% of the share capital, including 12.3% from musicMagpie's directors.
- The acquisition will be implemented as a court-sanctioned scheme of arrangement and is expected to become “Effective” during calendar 1Q2025.

### Background to musicMagpie's search for a partner

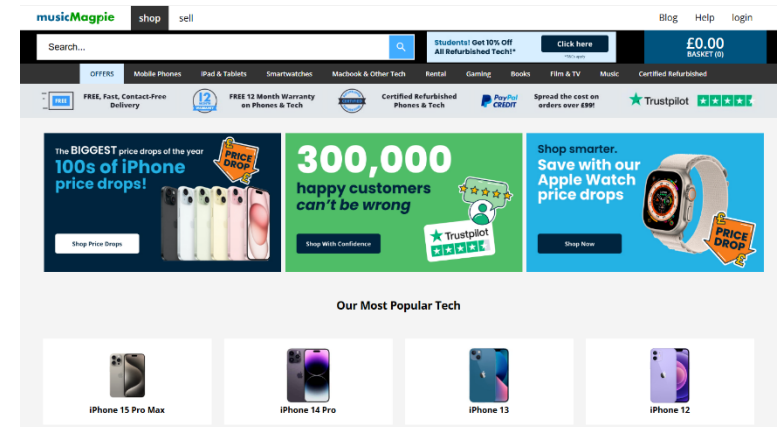
- musicMagpie floated on AIM in April 2021 and made good progress on its strategy, including growing its consumer tech rental service to 32,700 subscribers as at 31 May 2024. However, this growth has required capital, leading to net debt of £13.8m as at 31 May 2024.
- At the same time, the weak macro-economic environment and pressures on consumer spending over the last two years, combined with consumers' willingness to seek value and consider buying pre-owned products, has led to increased competition. A number of consumer brands, retailers and online platforms have introduced or enhanced their own take-back and re-sell circular economy options.
- So, in 2023 musicMagpie decided to seek a partner to help with financial strength and potentially operational synergies.

Source: Company recommended cash offer statement, 2 October 2024

### musicMagpie: a pioneer in consumer tech re-commerce

- musicMagpie was founded in 2007 by CEO Steve Oliver as a circular economy pioneer, providing customers with a smart, sustainable and trusted way to buy, rent and sell refurbished consumer technology (among other things, consumer technology is c.70% of group revenues).
- Its mission is to “unlock inventory in people's homes to further capitalise on the growth in second-use markets” and in FY23 it resold nearly 400,000 consumer technology products and c.8.4m books and disc media.
- The company has been given the London Stock Exchange's Green Economy Mark as well as garnering over 293,000 Trustpilot reviews with a high average 4.4\* rating. This aligns with AO's own focus on exceptional customer service.

### You can buy, sell and rent a wide range of technology



Source: Company website, 2 October 2024

## AO's rationale for the acquisition

### More sustainable options for customers & buying benefits

- As AO believes customers will increasingly look to more sustainable ways to buy, repair and reuse consumer technology this acquisition will position AO at the forefront of consumer trends and will help mitigate the impact of this potential shift.
- AO considers musicMagpie to be a high-quality and leading operator in the consumer electronics re-commerce market with well-established operational platforms, a well-invested refurbishing facility and a strong technology stack.
- AO is already a market leader in recycling white electricals goods such as washing machines with its own state-of the-art recycling facilities. This acquisition will provide AO with the opportunity for further vertical integration of its reverse supply chain, giving better control over costs and will enhance customer options for trading-in their old mobile phones.
- It will enable AO to add more value to its customer offer in consumer technology, more akin to its full-service offer in white electrical goods that covers best assortment, price, next day delivery, premium installation, finance and recycling of products.
- musicMagpie will also be able to leverage AO's trade-in volumes (of mobile phones and electronics), which could lower its cost of acquisition, thus improving profitability. It currently sources from SMARTDrop kiosks at Asda, direct mail and from its US business.

Source: Company recommended cash offer statement, 2 October 2024

### Post-acquisition evaluation process to improve profitability

- AO intends to work with musicMagpie's management team to deliver attractive and sustained growth and development opportunities for the Combined Group.
- Together they will undertake an "Evaluation" to improve musicMagpie's financial performance, likely including a review of 1) the US operation, 2) arrangements with overlapping suppliers and 3) combined roles and responsibilities, among other things.
- AO does not anticipate any material reduction in headcount (beyond musicMagpie's existing process of reviewing costs which is expected to reduce headcount in its UK head office function by approximately 30 people). AO expects the Evaluation to complete within six months.
- AO recognises that musicMagpie's disc media and books business is in long-term decline but is showing some signs of stabilisation and delivers predictable cashflows, requiring only modest investment to sustain its performance.

## musicMagpie's recent trading

### Highlights from musicMagpie's latest 1H24 results

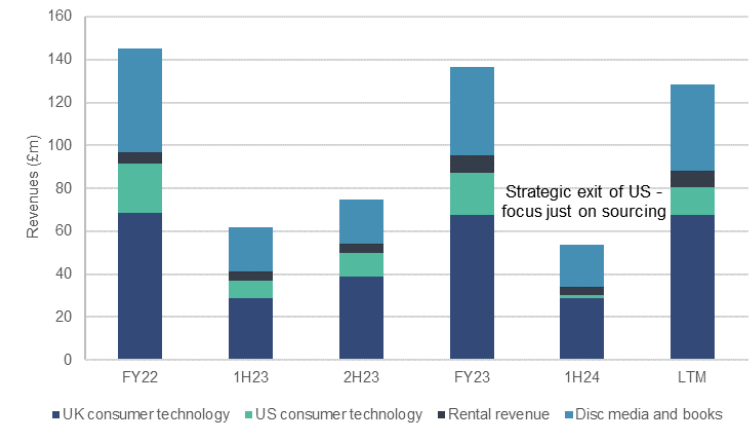
- musicMagpie announced interim results for the 6 months ended 31 May 2024 on 28 June 2024.
- Group revenue of £53.8m was £8m or 13% lower than 1H23 but c.£7m of this was due to the pull back from US consumer technology sales as the company converted the US to a sourcing only operation. Revenues for the last twelve months (LTM) were £128m versus £137m in FY23.
- UK consumer technology revenues (53% of group) were marginally up at £28.7m and rental revenue was marginally down at £3.8m, with active subscribers falling from 37,100 in November 2023 to 32,700 at 31 May 2024.
- Meanwhile though Disc Media and Books revenues (37% of group) fell 5.7% to £19.7m, this decline was slower than in previous years.

Source: musicMagpie's 1H24 results

### Operating losses stabilising

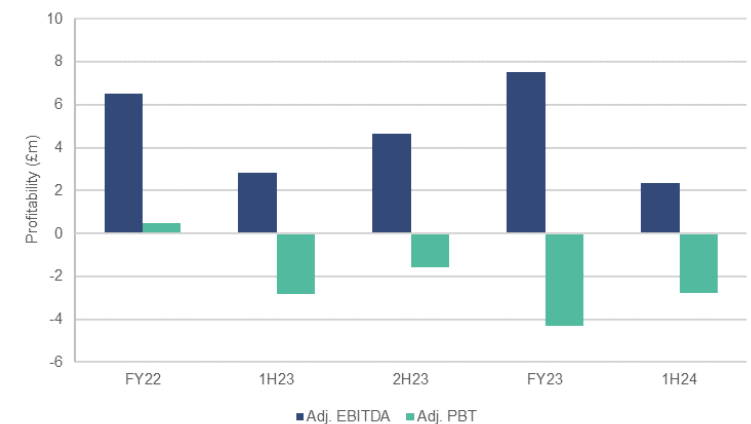
- In FY23 musicMagpie made £7.5m EBITDA but a £4.3m adjusted PBT loss, and a £6.8m PBT loss after exceptional items.
- Hence, given the continuing challenging trading environment, the group has already started focussing on costs and delivered a £2.4m reduction in overheads in 1H24, leading to stable PBT losses of c.£2.8m in 1H24, with a likely further improvement to come in 2H24E (which also benefits from Black Friday trading).
- As mentioned above, AO will work with musicMagpie's management team to improve profitability.
- Hence AO's acquisition cost of c.£24m Enterprise Value equates to only c.0.2x EV/LTM Revenues and 3.4x LTM EV/EBITDA.

### musicMagpie's split of sales (£128m in LTM to 31 May 24)



Source: Company historic data, ED forecasts and analysis

### musicMagpie already on a journey to reducing costs



Source: Company historic data, ED forecasts and analysis

## Over the medium term

The addition of musicMagpie's activities could potentially add c.9%-10% to Group Revenues and EBITDA; but any impact on PBT will depend upon post-acquisition evaluation outcome.

- At this stage of the proposed transaction, and prior to AO's evaluation of the business, we are not yet consolidating any forecasts for musicMagpie into our historic AO forecasts and note the EV of c.£24m is less than 4% of AO's current enterprise value.
- Any eventual impact of Adjusted PBT will depend upon musicMagpie's existing plans to improve profitability, together with the outcome of the Evaluation process.
- As mentioned, AO can potentially access buying synergies from supplying musicMagpie with recycled consumer technology and may save some external advisor fees from consolidating a listed company (as a rule of thumb operating synergies can typically be 1%-2% of an acquired company's revenues).

## AO World investment attractions: a reminder

Investment Highlights	Risk Factors
<ul style="list-style-type: none"> <li>An excellent track record of UK revenue growth pre-COVID 21% CAGR FY11-FY20.</li> <li>5m additional customers shopped during COVID, experiencing AO's excellent customer service and total UK customer base is now c.12m.</li> <li>Over 500,000 Trustpilot reviews with an impressively high average score of 4.8/5.</li> <li>Plenty of scope to increase both major domestic appliances ("MDA") market share of 15% and market share in the wider £30bn Electricals market. Acquisition of musicMagpie to strengthen consumer technology customer offer.</li> <li>"Pivot to profit" strategy has been successful with 2H24 PBT margin of 3.8%.</li> <li>An experienced, founder-led, management team that has been with the business through both high growth years and more challenging times.</li> </ul>	<ul style="list-style-type: none"> <li>Macro-economic pressures on disposable income.</li> <li>Irrational competitive pricing behaviour.</li> <li>Cost inflation, particularly wage inflation, impacting margin expansion potential.</li> <li>Supply chain disruption.</li> </ul>
Forecast Drivers	Valuation Overview
<ul style="list-style-type: none"> <li>A more favourable macro-economic backdrop of improving UK consumer confidence, increasing mortgage approvals and lower inflation and interest rates.</li> <li>Increasing repeat AO customers, continuing the trend of the past decade, as AO extends its wider electricals product range, and more customers join AO's Five Star membership club.</li> <li>We assume revenue CAGR of 13% FY25E-FY27E, at the lower end of management's 10%-20% medium term ambition (pre musicMagpie)</li> <li>Operating leverage of fixed costs driving a doubling of Adj. PBT to £65m in FY27E, an Adj. PBT margin of 4.3%, below management's medium-term ambition of 5%.</li> <li>Improving profitability and low capex requirements driving over £100m of cumulative free cashflow (FY25E-FY27E), after the c.£24m acquisition of musicMagpie.</li> </ul>	<ul style="list-style-type: none"> <li>Trading on only 0.5x EV/Sales, 8.8x EV/EBITDA and c.18x PER (our existing forecasts, all Calendar 2025E – "Cal 25E").</li> <li>Offers higher 2-year revenue and profit growth than most peers (on our forecasts) and a strong balance sheet with financial net cash of over £40m.</li> <li>The undrawn revolving credit facility of £80m was recently extended with existing lenders until April 2027, providing plenty of liquidity.</li> <li>Our 'blue-sky' scenario, modelling the upper end of management's medium-term ambition of 20% CAGR in Revenues and a 5% Adj. PBT margin in FY26E, suggests PBT could triple to over £100m by FY27E (60% above our forecast).</li> <li>Our published Fair Value / share is 140p, a 5% cal 2025 FCF yield (pre-M&amp;A), equivalent to c.11x cal 2025 EV/EBITDA and c.23x cal 2025 PER, under 1x our EPS CAGR FY24E-FY26E.</li> </ul>



## Contacts

### **Andy Edmond**

Direct: 020 7065 2691

Tel: 020 7065 2690

[andy@equitydevelopment.co.uk](mailto:andy@equitydevelopment.co.uk)

### **Hannah Crowe**

Direct: 0207 065 2692

Tel: 0207 065 2690

[hannah@equitydevelopment.co.uk](mailto:hannah@equitydevelopment.co.uk)

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Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London EC2M 7EB

Contact: [info@equitydevelopment.co.uk](mailto:info@equitydevelopment.co.uk) | 020 7065 2690