

Corporate

 Current price **2.05p**

 Sector **Support Services**

 Code **REAT.L**

 AIM **AIM**

Share Performance



Source: Thomson Reuters, Allenby Capital

Share Data

 Market Cap (£m) **10.2**

 Shares in issue (m) **498.5**

52 weeks High Low

2.25p 0.725p

 Financial year end **September**

Source: Company Data, Allenby Capital

Key Shareholders

Octopus Investments Noms 17.14%

Helium Rising Stars Fund 16.17%

Premier Miton 8.10%

Jonathan Whitmore 5.29%

George Stavrinidis 3.32%

Source: Company Data, Allenby Capital

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REACT Group plc (REAT.L)

Fidelis adds scale and enhances 2021 EPS by c.41%

REACT Group plc (REACT), the leading specialist cleaning, decontamination and hygiene company, has announced the acquisition of **Fidelis Contract Services (Fidelis)**, a successful commercial cleaning, hygiene and facility support service business. It has been acquired for an initial consideration of **£1.7m** financed through the Group's own resources with a deferred element of up to **£3.05m**. Maximum consideration is capped at **£4.75m** and is based on **4.75x EBITDA**. This maiden acquisition is an important step in REACT's growth strategy and its ambition to become a leading player in the provision of specialist cleaning, decontamination and hygiene services. The acquisition is expected to be complementary and immediately earnings enhancing, raising our FY2021 EPS forecast by **41%** from **0.10p to 0.14p**.

- Fidelis Contract Services** – Fidelis was founded in 2010 and is a successful, well-established commercial cleaning, hygiene and facilities support business, based in Birmingham with coverage across England and Wales. Its focus is on the education, healthcare and associated industries where it provides contract cleaning and hygiene services which include daily housekeeping, washroom, building & caretaker and specialist services such as kitchen and duct cleaning, industrial deep cleaning and pest control.
- Little overlap in service provision or customer base** – The two businesses are complementary with little overlap in either service provision or customer base. Each provides expertise in their respective specialisms to create a combined business of scale with REACT's revenues primarily generated through reactive work while Fidelis focuses on contracted maintenance cleaning.
- High level of recurring income from long-term contracts** - Fidelis generates most of its revenues through long-term contracts of 3-5 years duration with a strong record of contract renewals. Around 87% of Fidelis' turnover is generated from recurring revenues.
- EPS forecasts raised by 41%** – Our 2021 forecast for the pre-acquisition REACT Group is unchanged but the addition of Fidelis for 6 months, increases our EBITDA forecast by 53% from **£555k to £850k** and EPS by 41% from **0.10p to 0.14p**.
- Earnings enhancement 70% on a full year run rate basis** – While this increase in EPS is impressive, on a full year run rate basis, just doubling the Fidelis contribution results in indicative Group revenues of **c.£10m**, EBITDA of **c.£1.15m** and EPS of **c.0.17p**, the latter a full 70% higher than our initial EPS forecasts for REACT for FY 2021.
- A very positive first step in REACT's growth strategy** - We view this maiden acquisition very positively. It broadens the scope of REACT's business proposition, increases the diversity of its service offering with significant cross-selling opportunities and is immediately earnings enhancing. We continue to anticipate further strong growth from the Group, both organically and through further complementary acquisitions.

Year End: September

(£000)	2018A	2019A	2020A	2021E
REVENUE	3,295	3,103	4,360	7,818
EBITDA	(601)	(131)	261	850
PROFIT/(LOSS) BEFORE TAX	(614)	(178)	188	784
EPS (p)	(0.21)	(0.04)	0.04	0.14
PER (x)	-	-	48.1	14.4
EV/EBITDA (x)	-	-	32.2	11.2
NET CASH	423	440	1,783	896

Source: REACT Group plc; Allenby Capital. Allenby Capital acts as Nomad and Broker to REACT Group plc (REAT.L). Please refer to the last page of this communication for all required disclosures and risk warnings.

Fidelis Contract Services

Founded in 2011 and based in Birmingham...

Background and activities

Fidelis Contract Services (Fidelis) was incorporated in June 2011 and is a commercial cleaning and hygiene and facility support services company with headquarters in Birmingham.

...servicing customers across England & Wales

It provides services to customers across England and Wales ranging from daily housekeeping and washroom hygiene services through to building and caretaker services. It is also able to provide specialist services such as kitchen & duct cleaning, industrial deep cleaning, pest control and barrier matting for flooring in buildings. It offers these services to a diverse range of sectors with particular strength in education, healthcare, and associated industries.

It was founded by Lloyd Ansermoz and he will remain a material shareholder in the enlarged business and along with his colleagues at Fidelis, will remain an integral part of the management team going forward. Fidelis was majority owned by Lloyd Ansermoz and his wife Naomi.

High levels of recurring revenue with no customer dominating

The business benefits from high levels of recurring revenue (c. 87% of total revenues) and a good spread of customers with no one customer accounting for more than 8% of revenues and the top 10 customers representing c.50% of Fidelis's total revenues.

PBT of £0.25m for year to March 2020

Financials

For the year ended 31 March 2020, management accounts for Fidelis showed revenue of £3.3m and a profit before tax of £0.25m. Unaudited statutory accounts for the year ended 31 March 2020 showed gross assets of £0.8m.

Strong growth anticipated in current year

Clearly, with a March year-end, financial information for the year to March 2021 will not be available for some months. However, the terms of the acquisition (see below) would tend to indicate that Fidelis will achieve strong EBITDA growth over the level achieved in the year to March 2020.

Margins lower than those of REACT but equal to, if not better than, others in the industry

We do not believe that the gross margins achievable by Fidelis will be as high as those enjoyed by REACT (30-35%) given the specialist nature of the latter's services but are led to believe that they are in line with, if not somewhat superior to, the average margins achieved by competitors operating in similar markets at between 25%-30% gross.

Contracts typically of 3-5 years with a good record of renewals

Fidelis, while not offering services as specialised as REACT, does benefit from strong visibility of revenues with contracts typically of 3-5 years duration and with a good record of contract renewals and long-term customer relationships. It also enjoys strong recurring revenues which account for around 87% of total turnover, 85% of which derive from contracted maintenance cleaning and a small element from contracted reactive cleaning.

We understand that the impact of COVID-19 on the business during the year to March 2021 has been broadly neutral with some additional services being provided but at the same time, some services have been restricted.

Cash generation is believed to be strong with most invoicing being sent in advance of work commencing and as such debtor days are quite low and lower than those of REACT.

Acquisition terms

The acquisition of Fidelis is based on 4.75x EBITDA in the financial year ending 31 March 2022 (on a cash free, debt free basis with normalised working capital) with the maximum consideration capped at £4.75 million comprising:

- Initial consideration of £1,700,000, payable £1,500,000 in cash from the Company's existing cash resources and £200,000 through the issue of c.9.5m new ordinary shares at a price of 2.1p per share, with the vendors locked-in for a minimum of 24-months from the date of completion. The Consideration Shares will be issued to Lloyd Ansermoz and his wife.
- REACT SC has issued loan notes to the vendors of Fidelis for an amount totalling £85,422 with a coupon of 5%. The aggregate value of the loan notes will be reduced to the extent that Fidelis does not achieve EBITDA of c. £0.5 million in FY 2021 and will otherwise be repaid on 1 April 2022. The Loan Notes are guaranteed by REACT.
- Deferred consideration payments up to £3,050,000 will be payable subject to Fidelis achieving certain EBITDA performance targets in the current financial year ending 31 March 2021 and the following financial year ending 31 March 2022.

The first deferred consideration of up to £700,000 will be payable to the vendors of Fidelis in cash and will be paid in full subject to Fidelis achieving EBITDA of £500,000 in FY 2021. The second deferred consideration payment of up to £2,264,578 will be payable to the vendors of Fidelis in cash and will be paid in full subject to Fidelis achieving EBITDA of £1,000,000 in FY 2022. The Consideration Shares will be subject to a lock-in for a period of 24 months following completion of the Acquisition.

Rationale

Acquisition represents ambitions of management to grow the Group into a leading player...

This represents REACT's maiden acquisition and a major plank in the Group's growth strategy and is indicative of the ambition and determination of the new management team to grow REACT into a broadly based, operation and one of the most trusted names in the provision of specialist cleaning, decontamination, and hygiene services.

...through an organic and acquisitive growth strategy

This will be achieved through organic growth and through a buy and build strategy, the latter probably likely to be built on the Fidelis platform. Management sees good opportunities for cross-selling between the two operations but little in the way of cost savings or synergies believing that Fidelis will represent a differentiated service offering to that provided by REACT.

The two business are complementary with good cross-selling opportunities

The Fidelis business is predominantly contract maintenance work and will complement REACT's focus on reactive business and is expected to be immediately earnings enhancing. The business combination provides a strong platform for future growth with the enlarged business being positioned to bid for much larger contracts than had been the case previously, thus significantly increasing the prospect of organic growth opportunities. As noted earlier, a key strategy will be to cross-sell REACT's specialist cleaning and decontamination services into Fidelis' customer base and for Fidelis to offer its services to REACT's clients. The Board believes that the combination of REACT's recent organic growth and the Fidelis acquisition leaves the Group well positioned to deliver material growth in the current financial year.

Forecasts remain prudently based**Forecasts**

We have previously positioned our forecasts prudently given the ongoing COVID-19 pandemic and the consequent uncertainty of markets and this remains the case for the Group as enlarged by Fidelis.

Fidelis has a March year end and REACT a September year end. Therefore, Fidelis will be consolidated for the whole of REACT's second half, incorporating the first half of Fidelis' financial year to March 2022.

Forecasts for the enlarged Group show EBITDA rising by 53% and EPS by 41%

EBITDA forecasts for the enlarged Group incorporate our existing projections for REACT, together with a conservative view of Fidelis' contribution, in essence increasing our current forecast EBITDA by 53% from £555,000 to £850,000 with profit before tax rising by 55% to £784,000m and EPS increasing from our original forecasts of 0.10p to 0.14p.

EXHIBIT 1: CHANGES TO FORECASTS

	REACT	Fidelis	Enlarged Group	Enhancement
	£000	£000	£000	%
Revenue	5,160	2,658	7,818	51.5%
Gross profit	1,850	725	2,575	39.2%
margin	35.9%	27.3%	32.9%	-8.1%
EBITDA	555	295	850	53.2%
margin	10.8%	11.1%	10.6%	1.1%
PBT	505	279	784	55.2%
EPS (p)	0.10		0.14	40.8%

Source: React; Allenby

Cash position, post-acquisition remains comfortable at c.£0.85m

REACT's cash position on 30 September 2020 was £1,783,000 and the initial cash element of the consideration will reduce the current cash position by £1,500,000. Our FY 2021 pre-acquisition year-end cash forecast for REACT was £2,012,000, however, with the addition of Fidelis' profits and the cash generative nature of its operations, our revised year-end cash position for the enlarged Group now stands at a still comfortable £896,000, with no borrowings.

The first deferred consideration payment is scheduled to be payable in October 2021, thus falling into REACT's financial year to September 2022. The second deferred consideration payment will be paid in instalments between September 2022 and March 2024.

Indicative full year run rate for the enlarged Group**Indicative run-rate shows revenues of c.£10m, EBITDA of £1.15m and EPS of 0.17p – an EPS increase of 70% over original forecasts for REACT**

Whilst we are not offering forecasts for 2022 at this stage, it is nevertheless informative for investors to be aware of what the indicative run rate of the enlarged Group, merely assuming a doubling of the Fidelis six-month contribution, would be. On this basis, we arrive at a combined revenue run rate for the enlarged Group of c.£10m, EBITDA of c.£1.15m and EPS of 0.17p, thus offering a more informative picture of the REACT Group's revenues and profits on a current year basis.

At the current share price this would translate to a price/earnings ratio of 11.8x 2021 earnings and an EV/EBITDA of 8.3x, with the strong likelihood of further growth in FY 2022. We believe this provides a clearer view of the significantly earnings-accretive nature of this acquisition.

Encouraging outlook

REACT has made significant advances in a short period of time following the appointment of its new Board. We are very encouraged with the progress that has been made to date and anticipate the Group, as enlarged by Fidelis, to demonstrate strong growth in all metrics in the current year. For FY2022, with Fidelis in for a full 12 months, even stronger progress should be possible although at this stage, given the continuing uncertainty still surrounding the COVID-19 pandemic, we are not yet offering forecasts for that year.

Income statement and forecasts

EXHIBIT 2: INCOME STATEMENT AND FORECASTS

Y/E September	£000 FY 2018A	£000 FY 2019A	£000 FY 2020A	£000 FY 2021E
UNDERLYING				
Revenue	3,295	3,103	4,360	7,818
Cost of sales	-2,602	-2,218	-2,911	-5,243
Gross profit	693	885	1,449	2,575
margin	21.0%	28.5%	33.2%	32.9%
Admin costs	-1,294	-1,011	-1,258	-1,725
as a % of revenue	39.3%	32.6%	28.9%	22.1%
EBITDA	-601	-126	261	850
margin	-18.2%	-4.1%	6.0%	10.9%
Depreciation & Amortisation	-13	-52	-50	-66
Underlying operating profit/(loss)	-614	-178	211	784
margin	-18.6%	-5.7%	4.8%	10.0%
Interest	0	0	-23	0
Underlying profit/(loss) before tax	-614	-178	188	784
Tax	0	0	0	-66
Underlying post tax profit/(loss)	-614	-178	188	718
STATUTORY				
Underlying operating profit/(loss)	-614	-178	211	784
Exceptional items	-1,337	-5	0	0
Interest	0	0	-23	0
Statutory profit/(loss) before tax	-1,951	-183	188	784
Tax	0	0	0	-66
Statutory post tax profit/(loss)	-1,951	-183	188	718
WAS (m)	287.298	415.408	441.292	503.258
WAS FD (m)	287.298	415.408	506.357	568.323
Year-end shares (m)	415.408	415.408	498.509	508.006
Underlying EPS (p)	(0.21)	(0.04)	0.04	0.14
Statutory EPS (p)	(0.68)	(0.04)	0.04	0.14

Source: React; Allenby

Cash Flow and forecasts

EXHIBIT 3: CASH FLOW AND FORECASTS

Y/E September	£000 FY 2018A	£000 FY 2019A	£000 FY 2020A	£000 FY 2021E
Operating profit/(loss)	-1,951	-183	188	784
Depreciation	1,350	52	50	50
Share based payments	0	2	3	3
Loss on disposal of fixed assets	10	-3	1	0
<i>(Increase)/decrease in receivables</i>	-649	441	-371	-455
<i>(Decrease)/increase in payables</i>	615	-275	389	310
Net change in WC	-34	166	18	-145
Finance	0	0	21	0
Net cash inflow/(outflow) from operating activities	-625	34	281	692
Acquisition	0	0	0	-1,500
Disposal of fixed assets	20	8	2	0
Capital expenditure	-38	-25	-44	-50
Net cash outflow from investing activities	-18	-17	-42	-1,550
Proceeds from share issues	420	0	1,246	0
Expense of share issues	-33	0	-113	0
Other loans	69	0	0	0
Other loan repayments	-21	0	0	0
Principal paid on lease liabilities	0	0	-29	-29
Net cash inflow/(outflow) from financing activities	435	0	1,104	-29
Increase/(decrease) in cash	-208	17	1,343	-887
Cash at start of year	631	423	440	1,783
Cash at end of year	423	440	1,783	896

Source: React; Allenby

Balance Sheet and forecasts

EXHIBIT 4: BALANCE SHEET AND FORECASTS

	£000	£000	£000	£000
Y/E September	FY 2018A	FY 2019A	FY 2020A	FY 2021E
Non-current assets				
Intangible assets	174	174	174	273
PP&E	116	81	85	69
Right of use assets	0	0	27	27
Total non-current assets	290	255	286	369
Current assets				
Trade & other receivables	1,141	718	1,089	2,000
Cash	423	440	1,783	896
Total current assets	1,564	1,158	2,872	2,896
Total assets	1,854	1,413	3,158	3,265
Current liabilities				
Trade payables	-793	-535	-924	-1,450
Lease liabilities	0	0	-13	-13
Tax	0	0	0	-66
Total current liabilities	-793	-535	-937	-1,529
Non-current liabilities				
Deferred tax	0	0	0	0
Lease liabilities	0	0	-30	-30
Total non-current liabilities	0	0	-30	-30
Total liabilities	-793	-535	-967	-1,559
Net current assets	771	623	1,935	1,367
Net assets	1,061	878	2,191	1,706
Balance Sheet Ratios				
	£000	£000	£000	£000
Y/E September	FY 2018A	FY 2019A	FY 2020A	FY 2021E
Long-term financial debts	-	-	-	-
Short term financial debts	-	-	-	-
Gross (debt)	-	-	-	-
Cash and cash equivalents	423	440	1,783	896
Net (debt) / cash	423	440	1,783	896
Acid test (Current Assets less inventory / Current Liabilities)	2.0	2.2	3.1	1.9

Source: React; Allenby

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