Company Note

Interims

29 June 2021

Corporate

Current price	**3.25p**
Sector	**Support Services**
Code	**REAT.L**
AIM	**AIM**

Share Performance

	1m	3m	12m
REAT.L	-4.4%	+58.5%	+120.3%

Source: Thomson Reuters, Allenby Capital

Share Data		
Market Cap (£m)		**16.5**
Shares in issue (m)		**508.0**
52 weeks	High	Low
	3.675p	**0.95p**
Financial year end		**September**

Source: Company Data, Allenby Capital

Key Shareholders	
Octopus Investments Noms	16.82%
Helium Rising Stars Fund	15.85%
Premier Miton	7.95%
Jonathan Whitmore	5.19%
George Stavrinidis	3.26%
Directors	1.18%

Source: Company Data, Allenby Capital

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REACT Group plc (REAT.L)

Comfortably on track to meet 2021 forecasts

REACT Group plc (REACT), the leading specialist cleaning and decontamination company, has announced its results for the half year to March 2021. They do not include any contribution from the acquisition of Fidelis (completed on 26 March 2021) but do include the assets and liabilities for Fidelis at 31 March 2021. Strong progress has been achieved across the business with good growth in revenues, a 733bps rise in gross margin and a significant increase in underlying EBITDA. The Group remains well funded with cash at end March of £771k, stated after the cash payment of the initial consideration for Fidelis of £1.5m. At this stage we are making no changes to our 2021 expectations with the Group comfortably on track to meet our forecasts.

- **Strong growth in all financial metrics** – for the half year, REACT reported strong growth in activity and demonstrated the benefit of operational gearing on the business. There was a 20% rise in revenue to £2.5m, a 46% increase in gross profit to £1.0m with an impressive improvement in gross margin from 33.2% to 40.6%. Underlying EBITDA increased from £85,000 to £345,000 and underlying PBT rose from £50,000 to £343,000.

- **Cash still comfortable after paying the initial consideration for Fidelis** – The initial cash consideration of £1.5m for Fidelis was paid on 29 March from the Group's own resources still leaving the Company with a comfortable cash balance of £771,000 at the half year, which we have forecast to rise to around £900,000 by the September year end.

- **Opportunities and challenges** – During the period, COVID-19 created both opportunities and challenges for REACT with the pandemic generating additional reactive decontamination work and consultancy advice while the slowdown in economic activity resulted in a reduction in contracted emergency cleaning incidents.

- **Second half to reflect a full six-month contribution from Fidelis** – The acquisition of Fidelis was concluded at the end of March and consequently H2 will include a full six-month contribution from the acquisition which we expect to boost underlying EBITDA by c.£295,000. In addition, REACT's material 3-year contract award, announced in April, serves to reinforce the short-term outlook, although we have not included any contribution from this given the uncertainty regarding take-on timing.

- **No change to forecasts** – There are no changes to our 2021 forecasts at this stage although we would repeat our earlier observation that on a full year run rate basis, just doubling the Fidelis contribution results in indicative Group revenues of c.£10m, underlying EBITDA of c.£1.15m and EPS of c.0.17p. A strong start to H2 has been made with record trading achieved by Fidelis in April and May and consequently, we believe REACT remains comfortably on track to achieve our full year forecasts.

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.

Equity Research

Results for the 6 months to 31 March 2021

EXHIBIT 1: FINANCIAL SUMMARY

	H1 2021	H1 2020	% change	2020 full year
	£000	£000		£000
PROFIT AND LOSS				
Revenue	2,509	2,091	*20.0%*	4,360
Gross profit	1,018	695	*46.5%*	1,449
margin	*40.57%*	*33.24%*	*22.1%*	*33.23%*
Underlying EBITDA	**369**	**85**	*334.1%*	**261**
margin	*14.7%*	*4.1%*	*261.8%*	*6.0%*
Depreciation & Amortisation	-51	-22	*131.8%*	-50
Finance	25	-13		-23
Underlying PBT	**343**	**50**	*586.0%*	**188**
Tax	0	0		0
Underlying post tax profit	343	50		188
Underlying basic EPS (p)	0.07	0.01	*471.5%*	0.04
Underlying fully diluted EPS (p)	0.06	0.01	*487.6%*	0.04
BALANCE SHEET				
Non-current assets	4,104	279	*1371.0%*	286
Current assets (excluding cash)	1,790	1,112	*61.0%*	1,089
Cash	771	306	*152.0%*	1,783
Total current assets	**2,561**	**1,418**	*80.6%*	**2,872**
Total assets	6,665	1,697	*292.8%*	3,158
Current liabilities	-2,469	-741	*233.2%*	937
Non-current liabilities	-1,734	-37	*4586.5%*	30
Total liabilities	**-4,203**	**-778**	*440.2%*	**967**
Net current assets	92	677	*-86.4%*	1,935
Net assets	**2,462**	**919**	*167.9%*	**2,191**
CASH FLOW				
Working capital movement	*134*	*-199*		*18*
Cash generated by operating activities	408	-112		281
Cash outflow from investing activities	-1,405	-7		-42
Cash inflow/(outflow) from financing activities	-15	-15	*0.0%*	1,104
Net cash inflow/(outflow)	**-1,012**	**-134**	*655.2%*	**1,343**
Net cash at start of period	1,783	440	*305.2%*	440
Net cash at end of period	**771**	**306**	*152.0%*	**1,783**

Source: React

Financial performance

In the first half of the current financial year, REACT grew revenues by 20% to £2.5m against the comparative period in 2020, driven by strong demand in the healthcare, rail and facilities management sectors with growth also starting to emerge from housing associations.

However, gross profit grew at a faster rate than revenues, 47% ahead of the comparative and resulting in a significant rise in Group gross margin from 36.2% in H1 last year to 40.6%.

As can be seen in Exhibit 2 below, the 20% increase in Group revenue was due in large part to a more than doubling of revenues associated with Ad Hoc decontamination and cleaning work, whereas revenues from Contract Maintenance and Contract Reactive were broadly unchanged year on year (yoy).

EXHIBIT 2: SEGMENTAL ANALYSIS

	H1 to March 2021								H1 to March 2020			
	Contract Maint £000	% chg	Contract Reactive £000	% chg	Ad Hoc £000	% chg	Total £000	% chg	Contract Maint £000	Contract Reactive £000	Ad Hoc £000	Total £000
Revenue	764	*4.8%*	802	*-10.9%*	943	*104.1%*	2,509	*20.0%*	729	900	462	2,091
Gross profit	272	*18.8%*	272	*-9.0%*	474	*183.8%*	1,018	*46.5%*	229	299	167	695
GP margin	*35.6%*	*13.3%*	*33.9%*	*2.1%*	*50.3%*	*39.1%*	*40.6%*	*22.1%*	*31.4%*	*33.2%*	*36.2%*	*33.2%*
Admin expenses	-259	*21.6%*	-259	*-6.5%*	-451	*191.0%*	-969	*50.2%*	-208	-272	-152	-632
Statutory OP	13	*-18.8%*	13	*-40.9%*	23	*91.7%*	49	*-2.0%*	21	27	15	63
OP margin	*1.7%*	*-22.5%*	*1.6%*	*-33.7%*	*2.4%*	*-6.1%*	*5.8%*	*-20.4%*	*2.9%*	*3.0%*	*3.2%*	*9.1%*

Source: React

Looking more closely at the segmental contributions, while Contract Maintenance margins increased by 420bps to 35.6% and Contract Reactive by 70bps to 33.9%, the outstanding contributor to the increase in gross profit was the Ad Hoc business which posted a yoy rise in gross profit of 184% to £474,000 and an increase in margins of 1,412bps from 36.2% to 50.3%.

Margin sustainability

The question is to what extent have these yoy changes been influenced by one-off COVID-19 opportunities and challenges and where will margins revert to when some sense of normality returns to business activity.

We would certainly expect to see a resumption of growth in Contract Reactive which reported an 11% yoy decline in revenues (although a modest improvement in margins) as economic activity rebounds as well as a continuation of growth in Contract Maintenance. Both should also benefit from operational gearing in the business.

Ad Hoc work is more difficult to judge as although one would expect COVID-related activity to diminish, management makes the point that the quality of the Group’s work in this area has been recognised by its customers, enhancing the REACT brand and resulting in increased engagement with both new and existing customers.

Consequently, as work on COVID-19 decontaminations slows down, regular emergency cleaning activity will return and because (in-part) of the Group’s response to COVID-19 it should benefit from expanding opportunities from a broader and stronger customer base.

Accordingly, assuming a steady reduction in COVID-related Ad Hoc work, we would expect gross margins to begin to revert to a more normal level in H2, with management suggesting that underlying margins in the business are now running at between 30-35% range and significantly higher than those reported a couple of year ago under the previous management team.

Costs and earnings

Looking further down the P&L we note that excluding exceptional items, administrative costs were kept under tight control, rising by just 6.7% to £651,000 and falling by 11% as a percentage of revenue to 26%. During the period the Group expanded its investment in sales and marketing automation tools which has had the result of improving the quality of sales engagement and sales productivity. Management notes that this is beginning to yield results, opening up new opportunities, broadening the engagement with customers, and improving both the size and visibility of the sales pipeline.

Benefitting from the higher revenue, gross margin and effective cost control, underlying EBITDA increased by 334% to £369,000 and after depreciation and amortisation charges underlying operating profit rose by 405% to £318,000. Interest income of £25,000 (H1

2020: charge of £13,000) resulted in underlying profit before tax of £343,000 (H1 2020: £50,000). Underlying basic EPS rose to 0.69pwhile fully diluted EPS was 0.61p.

Cash at the period end stood at £771,000 and stated after the initial cash consideration payment of £1.5m relating to the acquisition of Fidelis which concluded at the end of the period, thus making no contribution to first half results.

Growing opportunity from the consolidation of supply chains

It is becoming clear that REACT sees a material opportunity in the consolidation of supply chains for further growth in its business. This was exemplified by the recent award in April 2021 of a material new three-year contract to supply a range of reactive cleaning and decontamination services to one of the world's leading FM companies.

To recap, the contract was awarded after a formal tender process at industry standard margins but we believe also offers REACT opportunities for meaningful operational leverage as volumes rise. The revenue value of the contract is difficult to estimate but REACT believes that the customer has historically spent in the region of £2m pa on this category of work.

The contract provides cover to the customer's portfolio of over 2,000 site locations throughout mainland Great Britain and specifies REACT as the core vendor/vendor of choice.

This award forms part of the customer's strategy to consolidate supply chains in this category of work, from several hundred smaller suppliers to just one. We are aware that other large FM companies have similar unwieldy supply chains which could benefit from supplier consolidation and consequently we believe this contract could provide an important reference site.

The contract will inevitably take several months to reach maturity as the customer transitions its substantial number of locations which are currently serviced by numerous suppliers over to REACT and consequently, we have not factored in any contribution from this contract in the current financial year.

Fidelis

Fidelis was acquired on 26 March 2021 and provides services to customers across England and Wales ranging from daily housekeeping and washroom hygiene services through to building and caretaker services. It also provides 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 strengths in education, healthcare, and associated industries. 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.

The consideration was based on 4.75x EBITDA for the financial year ending 31 March 2022 with the maximum consideration capped at £4.75 million comprising an initial consideration of £1,700,000 (£1,500,000 in cash from the Company's existing cash resources and £200,000 through the issue of new ordinary shares.

Deferred consideration payments of 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 in cash 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 in cash subject to Fidelis achieving EBITDA of £1,000,000 in FY 2022.

Forecasts

The second half has started well with Fidelis reporting record trading months in April and May and of course H2 will include a full six-month contribution from the acquisition which we expect to boost underlying EBITDA by c.£295,000. With long-term contracts of between 3-7 years in length driving strong recurring income, the business is set well for H2 and the year(s) beyond.

For REACT H1 was very strong, however the start of H2 by contrast has experienced some softness in the reactive business as the country moves towards the end of lockdown. Whilst COVID-19 decontamination work has been reducing, the more typical reactive emergency cleaning work has been slow to pick up. A similar pattern emerged last year as the country went from full lockdown into a more relaxed period during the summer of 2020.

At that time, REACT had two soft months, which rapidly returned to some form of normality. Most recently, management has experienced the first few weeks of high demand returning, including a re-emergence of COVID-19 decontaminations. The contract maintenance business has continued well, with little or no impact from the issues surrounding the pandemic.

All of this, together with material post-period customer contract wins for REACT, announced on 20 April 2021, 26 April 2021, and 18 May 2021, support a strong positive outlook for the remainder of the year and well into the following.

While we are leaving forecasts unchanged at this stage, we are comfortable that the Group remains firmly on track to achieve our projections for the year to September 2021.

Financial summary and forecasts

EXHIBIT 3: FINANCIAL SUMMARY AND FORECASTS

Y/E September	FY 2018	FY 2019	FY 2020	FY 2021E
	£000	£000	£000	£000
PROFIT & LOSS				
Revenue	3,295	3,103	4,360	7,818
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
EBITDA	**-601**	**-126**	**261**	**850**
Underlying operating (loss)	-614	-178	211	784
Statutory profit/(loss) before tax	-1,951	-183	188	520
Underlying profit/(loss) before tax	**-614**	**-178**	**188**	**784**
Underlying net profit/(loss)	-614	-178	188	718
Weighted Average Shares (fully diluted)	287.30	415.41	506.36	568.32
Underlying EPS (p)	-0.21	-0.04	0.04	0.14
CASH FLOW				
Net cash inflow/(outflow) from operating activities	-625	34	281	692
Net cash inflow/(outflow) from investing activities	-18	-17	-42	-1,550
Net cash inflow/(outflow) from financing activities	435	0	1,104	-29
Net increase/(decrease) in cash and cash equivalents in the year	**-208**	**17**	**1,343**	**-887**
Cash and cash equivalents at end of period	**423**	**440**	**1,783**	**896**
BALANCE SHEET				
Assets				
Total non-current assets	290	255	286	369
Current assets				
Other (excluding cash)	1,141	718	1,089	2,000
Cash and cash equivalents	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**
Liabilities				
Total current liabilities	-793	-535	-937	-1,529
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**

Source: React; Allenby

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