



PERFORMING

Gear4music (Holdings) plc
Annual Report and Accounts 2018

With a track record of growth and continued international expansion, Gear4music is the UK's largest retailer of musical instruments and equipment.

Gear4music has a progressive e-commerce strategy built on the specialist knowledge of a niche market, enabled through platform development, international expansion and supply chain evolution.

Strategic Report

- 01 Highlights
- 02 At a glance
- 04 Chairman's Statement
- 06 Market overview
- 10 Investment case
- 12 Business model
- 14 Strategy and our progress
- 16 Strategy in action
- 18 Chief Executive's statement
- 20 Platform features
- 22 Key performance indicators
- 24 Financial review
- 26 Our people
- 28 Risks and uncertainties

Corporate Governance

- 34 Corporate governance report
- 38 Board of Directors
- 40 Directors' report
- 42 Statement of Directors' responsibilities in respect of the Annual Report and the Financial Statements

Financial Statements

- 43 Independent Auditor's report
- 48 Consolidated Statement of Profit and Loss and Other Comprehensive Income
- 49 Consolidated Statement of Financial Position
- 50 Consolidated Statement of Changes in Equity
- 51 Consolidated Statement of Cash Flows
- 52 Notes (forming part of the Financial Statements)
- 76 Company Balance Sheet
- 77 Company Statement of Changes in Equity
- 78 Notes to the Company Financial Statements (forming part of the Financial Statements)

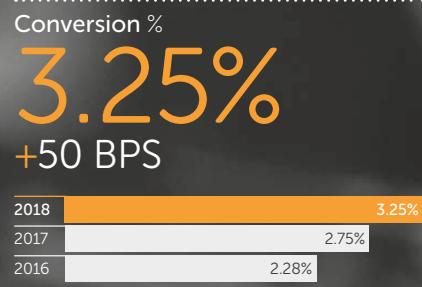
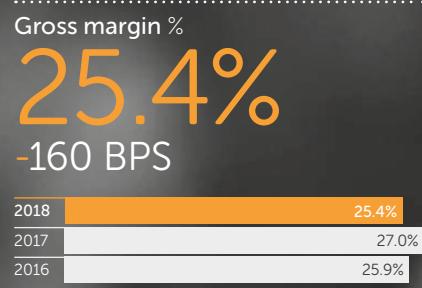
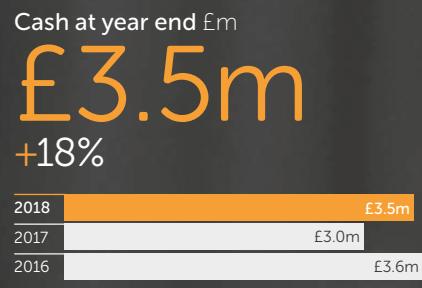
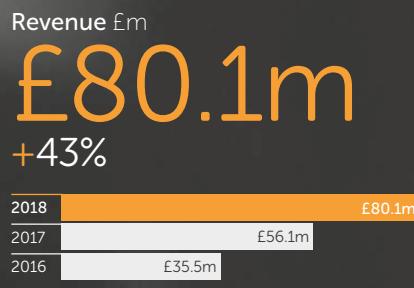


FIND OUT MORE:
www.gear4music.com
www.gear4musicplc.com

Highlights

Operational highlights

- Growth strategy continues to deliver results: 27% UK revenue growth and 69% internationally
- Over 16.9m website visitors, with improved conversion rates for the third successive year
- Swedish and German distribution centres scaled up well during the year, adding capacity to enable future growth
- Raised £4.2m equity growth capital in May 2017



At a glance

OUR ARRANGEMENT

Gear4music is an e-commerce retailer selling over 44,700 SKUs across all major categories of musical instruments and music equipment. The products are sourced from over 790 manufacturers, and range from kazoos costing less than £1, to digital pianos, drum kits and guitars costing thousands of pounds.



Our key strengths

- 1 Track record of success – long-term revenue and market share growth
- 2 Bespoke and proprietary e-commerce platform delivers competitive advantage
- 3 Specialist knowledge facilitates strong relationships with customers and suppliers
- 4 Well-developed and wide-ranging product ranges
- 5 Efficient logistics system

Our numbers

Total number of customers
1,522,000

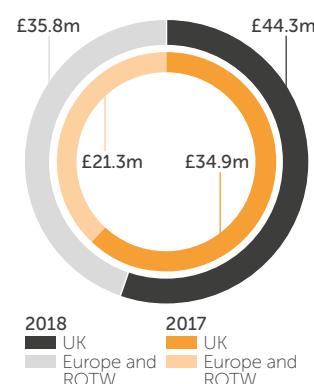
Number of active customers
475,000

Number of websites
20

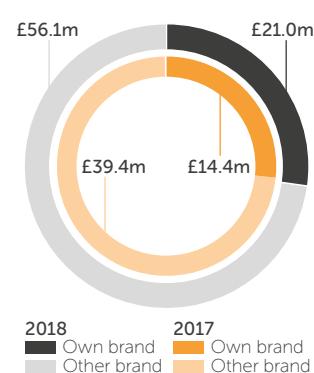
Number of languages
15

Number of currencies
9

Turnover by geography



Product split



Our product range



Leading brands

Other brands



YAMAHA **Roland**
Fender **Gibson**

behringer **SENNHEISER**

SHURE **KORG**

Marshall **CASIO**

NI **Focusrite**

MAPEX **SONOS**

Own brands



Chairman's statement



It has been a year of significant progress against our strategic priorities whilst delivering continuing strong revenue growth. We are confident and excited for the year ahead.

Ken Ford | Chairman and Non-Executive Director

I'm pleased to report another year of success and progress.

Revenue growth continues to be strong, with 43% growth reflecting the efforts of our dedicated and talented team. It is the passion and knowledge of our people that define who we are and how our customers interact with us.

We continue to make progress on our mission to become a leading global retailer of musical instruments and equipment. The Group is establishing a track record for delivering excellent revenue growth and being profitable through the phases of the investment cycle. EBITDA of £3.5m includes an additional £1.1m of local overheads associated with the European distribution centres compared with FY17, which was required to deliver the capacity for Gear4music to become a £100m+ revenue business.

We are well established in our UK domestic market and the business delivered 27% revenue growth whilst still only accounting for an estimated 6% of the total market. The much-publicised channel shift towards e-commerce retail and associated increased levels of online penetration, provide confidence in our approach and business model.

International growth represents a major opportunity for the Group – revenue of £35.8m represented growth of 69%, which followed 124% growth in the prior year, demonstrating good momentum. We only have an estimated 1% share of the European market and will continue to invest significant effort and resource to improve and increase our global reach.

The Head Office move in September 2017 went smoothly and added much-needed office space, enabling recruitment into key teams to support strong, sustained growth.

Given the investments scheduled for FY19 to support continued growth, the Board has decided not to declare a dividend for FY18 and will again review its policy in the next financial year.

Future success will come from a strong and continuously improving customer proposition. This will be achieved by investing in our technology, our infrastructure, and our people. As Andrew details in his CEO's statement, a lot has changed in the business during the period and we have much more planned. We are looking into FY19 and beyond with confidence.

Ken Ford
Chairman and Non-Executive Director
2 July 2018



OUR PERFORMANCE

Market overview

AMPLIFYING

The top ten European retail markets for musical instruments and music equipment (including the UK) are worth an estimated £4.3bn and are undergoing a profound shift towards online retail.



Market overview

Global

In December 2017, Music Trades estimated the global music products market in 2015 to be \$15.9bn, including a \$7.8bn US market and \$5.8bn European market.

European

The top ten European retail markets for musical instruments and music equipment (including the UK) are estimated to be worth approximately £4.3bn, and are undergoing a profound shift towards online retail.

The largest retailer serving the European musical instruments and equipment market is Thomann.de, based in Germany, with a 2017 reported turnover figure of approximately £700m. Other competitors in the European market include Musicstore.de (Germany),

4Sound (Sweden), Bax Shop (Netherlands) and Woodbrass (France).

UK

Music Trades estimated the UK market is growing at 2%, and the top six retailers account for an estimated 24% of the UK market (2017: 22%), with a long-tail of small independent shops, pure play online retailers, general merchandisers and department stores. An estimated 24% of the UK market is already online as the sector experiences the channel shift away from physical stores.

The Board believes that the current dynamics of the UK competitive landscape, in particular the significant degree of fragmentation with no large or dominant retailers, presents a consolidation opportunity. Whilst acquisitions do not form a core part of the current strategy, opportunities are reviewed on an ad hoc basis.

Top European markets

| Country | Estimated market size (£m)* |
|-------------------|-----------------------------|
| Germany | 1,194 |
| France | 863 |
| UK | 749 |
| Italy | 578 |
| Netherlands | 202 |
| Austria | 181 |
| Spain | 166 |
| Switzerland | 142 |
| Sweden | 107 |
| Norway | 83 |
| Total size | 4,265 |

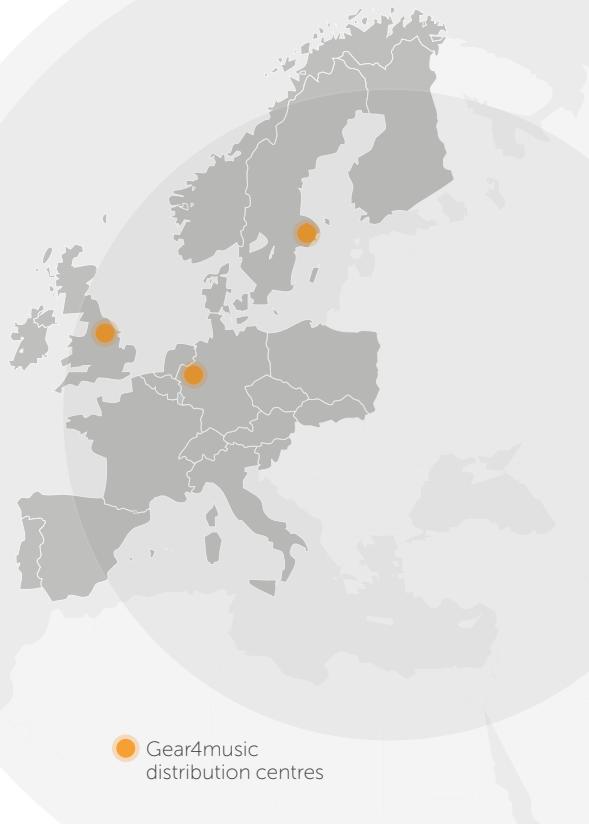
* Management estimate

Our business

Overview

Gear4music is about making quality music gear more accessible and affordable for all musicians. Our mission is to become the best musical instrument and equipment retailer in Europe and we believe we can achieve this by leveraging technology to deliver an industry-leading customer experience, providing the products our customers want delivered to them quickly and efficiently.

Our specialist market knowledge has already helped us to become the largest retailer in the UK, and we are making good progress in Europe. A bespoke e-commerce platform allows us to efficiently operate 20 websites, in 15 languages and nine currencies, and as we develop this platform further, widen our product ranges and increase our marketing reach and brand recognition, we strongly believe we can continue to grow our share of the £4.3bn European market and expand our reach beyond this.



| Website | Country | Currency | Languages |
|-----------------------|----------------|-----------------|----------------------------------|
| www.gear4music.com | UK | Pound Sterling | English |
| www.gear4music.ie | Ireland | Euro | English |
| www.gear4music.fr | France | Euro | French, English |
| www.gear4music.es | Spain | Euro | Spanish, English |
| www.gear4music.pt | Portugal | Euro | Portuguese, English |
| www.gear4music.de | Germany | Euro | German, English |
| www.gear4music.be | Belgium | Euro | Dutch, French, German, English |
| www.gear4music.nl | Netherlands | Euro | Dutch, English |
| www.gear4music.dk | Denmark | Danish Krone | Danish, English |
| www.gear4music.no | Norway | Norwegian Krone | Norwegian, English |
| www.gear4music.se | Sweden | Swedish Krona | Swedish, English |
| www.gear4music.fi | Finland | Euro | Finnish, English |
| www.gear4music.it | Italy | Euro | Italian, English |
| www.gear4music.ch | Switzerland | Swiss Franc | German, French, Italian, English |
| www.gear4music.at | Austria | Euro | German, English |
| www.gear4music.pl | Poland | New Zloty | Polish, English |
| www.gear4music.cz | Czech Republic | Czech Crown | Czech, English |
| www.gear4music.si | Slovenia | Euro | Slovenian, English |
| www.gear4music.sk | Slovakia | Euro | Slovak, English |
| www.gear4music.com/us | USA | US Dollar | English, Spanish |

Market overview continued

Scandinavian expansion



Since the opening of our Swedish distribution centre, our customer proposition throughout Scandinavia has continued to improve, driven by lower cost next-day delivery services across much of the territory, and new purchasing opportunities as a result of our local showroom. In direct response to strong, sustained revenue growth, the decision has been taken to expand our Swedish operations by moving into a new building on the same business park that is double the footprint and twice the height of our existing building.

Our Scandinavian performance has been very strong, and moving to the new property will further strengthen our competitive position. The new property is owned by our existing landlord, and we have negotiated to leave our current property without penalty. We expect a smooth transition, and anticipate the new building will become fully operational before the 2018 peak season.

Growth in Scandinavian revenue:

114%

AMP

LIVING



Scandinavian performance and prospects are very strong, and moving to the new property will strengthen our position. As the new property is owned by our existing landlord, we can stay local, leave our current property without penalty, and transition between properties whilst only paying one rent.

Robert Newport | Projects Director

Investment case

Gear4music is well positioned to capitalise on the opportunities available within its markets, due to our unique competitive advantages and barriers to entry:



FOR MORE INFORMATION
PAGE 12-15

Competitive advantages and Barriers to entry

- We are an agile, predominantly online retailer, and have an increasingly well-recognised brand
- We are the UK's largest retailer of musical instruments and music equipment
- 'Gear4music' is the number one search term driving traffic in the category 'Music Shops' (source: Hitwise)
- Our bespoke e-commerce platform provides a high degree of operational flexibility and scalability which the Directors believe cannot easily be replicated
- A strong own-brand offering has been developed over 15 years, and has established a reputation for 'good' and 'better' quality products at affordable prices, whilst providing enhanced margin opportunities
- We have developed long-term relationships with the major branded musical instrument and music equipment manufacturers, placing us in a strong position during a period of retailer consolidation
- We have proven and scalable distribution capabilities allowing next-day delivery throughout the UK, Scandinavia and Northern Europe
- The Directors and senior management have an intimate knowledge of the musical instrument and music equipment market

Key strengths

Track record of success – long-term revenue and market share growth

- Revenues have increased every year since launch in 2003
- 43% revenue growth in FY18, building on 58% revenue growth in FY17, and 46% in FY16
- Momentum stepped up following capital injections in 2012 and 2015
- Strong European growth validates website roll-out strategy
- Database of 1.9m registered users, with active customers increasing by 39%

Bespoke and proprietary e-commerce platform delivers competitive advantage

- Invested £5.9m to date
- End-to-end solution encompassing all aspects of trading operations
- Intellectual Property owned by Gear4music
- Currently supports 20 websites in 15 languages and nine currencies
- Ability to rapidly respond to changing customer behaviours and expectations
- Capability to expand into new markets
- Capacity to handle significantly increased volumes and website traffic
- Additional functionality in continuous development
- Software development team brought in-house in FY17 to facilitate closer integration and cost-effective future development

Specialist knowledge facilitates strong relationships with customers and suppliers

- Strong, committed and experienced management team
- Employees with in-depth specialist knowledge
- Expertise means Gear4music is trusted by major musical instrument and music equipment brands
- Offers a wide range of choice to customers and provides specialist advice during and after the sales process

Well-developed product ranges

- Over 44,700 products from over 790 brands
- Reputation for quality and value for money
- Over 2,600 own-brand SKUs, developed over a 15-year period
- Provide enhanced margin opportunities as volumes increase

Efficient logistics systems

- Currently operates from three modern facilities with a combined 245,000 square feet footprint
- Plans in place to increase Group capacity to c.£150m
- The most appropriate courier delivery services are automatically selected from more than 4,200 permutations depending on the weight, size, value and destination of the goods being purchased



Business model

IN TUNE

Gear4music is an online retailer of musical instruments and music equipment, operating 20 websites in 15 languages and 9 currencies.

Gear4music is about making quality music gear more accessible and affordable for all musicians.



Our products

At the year end we listed over 44,700 products from over 790 manufacturers.

Branded products

Gear4music has developed long-term partnerships with many well-recognised brands within the music products industry, who rely on the specialist product knowledge of Gear4music's staff, the high standard of customer service that Gear4music provides, and the high standard of presentation both online and at the Gear4music showrooms.

Own-brand products

Ongoing development of Gear4music's own-brand product range has been a focus since Gear4music.com was launched in 2003, and now covers a wide and varied range with over 2,600 products listed.

Our service

We believe that achieving a very high degree of customer satisfaction is fundamental to sustained long-term growth, and we are committed to continually improving the service experienced by our customers.

We leverage our technology and empower our specialist staff to ensure key touchpoints deliver a market-leading experience, and monitor our progress carefully using independent sources such as Trustpilot.

Multilingual support for overseas customers in non-English speaking countries continues to be a key investment focus, and a prerequisite for many of the Group's dealership agreements when selling outside the UK.

Ongoing product training is routinely undertaken to ensure staff have relevant and up-to-date knowledge to enable them to advise customers.

Our customers

Customer overview

Gear4music's customer base is primarily (over 95%) made up of private individuals, from beginners and parents buying musical instruments and music equipment for their children, through to professional musicians. Customers tend to be the end-users of our products.

On 28 February 2018 we had 1.9m people registered on our database (28 February 2017: 1.4m), of which 474,600 are active customers (being customers who have purchased from Gear4music during the last 12 months).

As the Group rapidly increased its European business it acquired a further 408,500 new customers (FY17: 288,900), and 105,000 customers returned to us to place at least one follow-up order. Average order value in FY18 was £127, up from £124 in FY17, and £116 in FY16.

How we work

We believe a successful e-commerce business requires a unique combination of talented staff, excellent products, efficient systems, robust physical operations and reliable delivery partners.

Staff

We have a strong, committed and experienced management team, working alongside passionate staff with in-depth knowledge of their specialist area of focus.

Products

Our own-brand product ranges have taken over 15 years to develop, working with some of the best manufacturers from around the world to ensure we build on our reputation for great quality at affordable prices. In addition, we have built strong relationships with the industry's biggest brand names, including Yamaha, Roland, Fender and many more.

Premises

The Group currently operates from 301,000 square feet of operational space – 185,000 square feet in York, 72,000 square feet in Germany, 38,000 square feet in Sweden, and 6,000 square feet in Manchester. Following growth of over 100% in Scandinavia during FY18, we will be increasing operational space in Sweden by 40,000 square feet ahead of the FY19 seasonal peak, which will provide up to four times the current capacity.

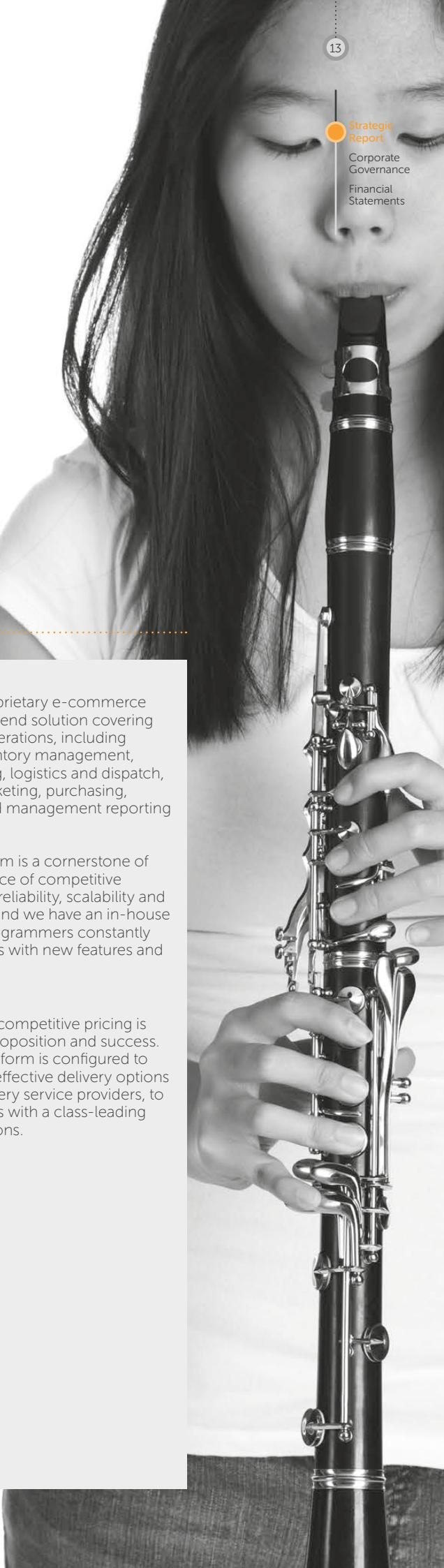
Systems

Our bespoke and proprietary e-commerce platform is an end-to-end solution covering all aspects of retail operations, including website content, inventory management, multi-currency pricing, logistics and dispatch, CRM, automated marketing, purchasing, customer receipts and management reporting (see page 21).

We believe this platform is a cornerstone of our business and source of competitive advantage, delivering reliability, scalability and unique functionality, and we have an in-house team of dedicated programmers constantly improving our systems with new features and functionality.

Delivery

Reliable delivery with competitive pricing is fundamental to our proposition and success. Our e-commerce platform is configured to select the most cost-effective delivery options from 13 different delivery service providers, to provide our customers with a class-leading range of delivery options.



Strategy and our progress

FINE TUNING

Our Strategy

Gear4music's strategy is built around four pillars of growth:



FOR MORE INFORMATION
VISIT OUR WEBSITE

Our strategic priorities

E-commerce Excellence



We will continue to develop and improve our e-commerce offering, optimising conversion and performance across our websites for both new and existing customers. Using a combination of cutting-edge technology, superior content and international marketing initiatives, we'll extend our reach and penetration into existing and new international territories.

Jonathan Meager | E-commerce Director



Overview

- Market-leading websites
- Intelligent digital marketing
- Evolving customer experience
- Build customer trust

Bespoke Platform Development



Our websites are driven by a bespoke and proprietary e-commerce platform that has the capacity to handle significantly increased volumes, and the capability to expand into new markets. Investment enables us to respond to changing customer behaviours and expectations, by rapidly developing new features and functionality to drive website traffic, increase conversion rates and maximise operational efficiencies and reliability. The system is designed to deliver competitive advantage.

Tom Walder | Chief Technical Officer



- Grow in-house development team
- Accelerate innovation
- Increase efficiency, traffic and conversion
- Reduce operational costs

International Expansion



We continue to develop and improve our customer proposition in each of the territories we operate. We'll achieve this by further localising our websites to drive traffic and improve conversion, expanding our multilingual customer service and marketing teams and, where the business case supports it, by opening distribution centres to improve delivery options and cut delivery times.

Robert Newport | Projects Director



- Territory-specific websites
- Localised customer experience
- Local procurement options
- Reduce delivery timescales and costs

Supply Chain Evolution



We will widen our supply chain reach to include purchasing inventory in different countries and currencies, whilst at the same time consolidating where possible and dealing directly with factories and manufacturers. We will continue to extend the number of products available to our customers, including those for next-day delivery, and to continue the expansion of our own-brand product ranges with new and exclusive products.

Gareth Bevan | Chief Commercial Officer



- Continuous product range extension
- Advance own-brand proposition
- Factory direct where possible
- Evolve logistics capability





Progress

Website visitors:

16.9m
+34%

Conversion rate:

3.25%
+50bps

Our marketing strategy continues to prove effective, with a 34% increase in website visitors, conversion rates improving by 50bps, and 30% more repeat customers.

As at June 2018, we have a GDPR-compliant database of 820,000 subscribers receiving regular email promotions. Our return on investment in marketing has been maintained, with spend as a proportion of revenue of 8.3% in FY18 and FY17.

Our excellent 9.5 Trustpilot rating from over 37,000 reviews is a reflection of our 'customer first' approach.

Website deployments:

242

System deployments:

286

We designed and deployed 242 website updates and 286 system upgrades during the period. Highlights included the launch of consumer finance in five European countries, enhancing our mobile check-out, launching a US Dollar website, cloudification of our entire platform, and a host of back-end functionality upgrades, including GDPR compliance.

International revenue growth:

69%

International revenue growth of 69% took revenues to £35.8m in what is an estimated \$15bn market. During the year we have expanded our multilingual customer service team, invested further into translation and marketing, and improved our local delivery and payment options.

Our distribution centres in Sweden and Germany continue to improve our local customer proposition in terms of delivery timescales and costs.

In March 2018 we opened our German showroom which, in addition to physically showcasing our products and building our brand in the locality, is creating additional buying opportunities in Euros from German distributors.

SKUs listed:

44,700
+21%

Own-brand SKUs:

2,600
+8%

At the year end we listed 44,700 products, which is up by 20% in 12 months. There are further opportunities to increase this significantly.

Own-brand product sales have continued to grow impressively, with 45% growth during FY18, building on the 58% growth achieved during FY17.

During the year we have expanded our own and other-branded Buying teams and now purchase inventory in Swedish Krona and Euros.

Strategy in action



FINE TUNING



//

We are continually looking for ways to improve our customer proposition and use data to better understand and improve the customer experience.

Jonathan Meager | E-commerce Director

E-commerce platform



Increase in website visitors:

34%

As a high-growth e-commerce business with international ambitions, effective marketing is critical to our success. Our approach to marketing is return-focused and heavily data-driven, enabling us to efficiently deliver revenue growth and build brand awareness.

Active customer numbers increased 39% over the last 12 months to 475,000, with a 34% increase in website visitors and a 50bps improvement in conversion.

Marketing spend as a proportion of revenue was 8.3% in FY18 and FY17, having been 8.7% in FY16 and 10.0% in FY15.

Chief Executive's statement



This has been a transformational year of investment for Gear4music. During the year, our European distribution centres became fully operational, we moved into our new Head Office and we raised an additional £4.2m of growth capital.

We accelerated investment in our employees, systems, marketing and customer proposition, to firmly establish ourselves as one of Europe's leading online retailers of musical instruments and music equipment.

Andrew Wass | Chief Executive Officer

Business review

We continue to make good progress on both our financial and commercial KPIs in our third year as a listed business:

Financial KPIs

| | FY18 | FY17 | Change |
|--------------------------|--------|--------|---------|
| Revenue* | £80.1m | £56.1m | +43% |
| UK revenue* | £44.3m | £34.8m | +27% |
| International revenue* | £35.8m | £21.3m | +69% |
| Gross margin | 25.4% | 27.0% | -160bps |
| Total admin expenses* | £18.4m | £12.5m | +47% |
| European admin expenses* | £1.5m | £0.5m | +220% |
| EBITDA | £3.5m | £3.6m | -3% |
| Cash at year end | £3.5m | £3.0m | +18% |

* See Note 2 on page 58; Segmental reporting

Commercial KPIs

| | FY18 | FY17 | Change |
|---------------------|---------|---------|--------|
| Website visitors | 16.9m | 12.6m | +34% |
| Conversion rate | 3.25% | 2.75% | +50bps |
| Average order value | £127 | £124 | +3% |
| Active customers | 475,000 | 340,000 | +39% |
| Products listed | 44,700 | 37,100 | +20% |

Distribution and property

Two years ago, we started the process of expanding our distribution network into Europe and doubling our distribution capacity to over £100m.

In readiness for continuing rapid growth, we need to increase capacity to ensure we can accommodate demand over the next two years. Our Scandinavian business has consistently performed exceptionally well since we opened our Swedish distribution centre in November 2016, growing by over 100% during

FY18. We have therefore taken the decision to expand our operations in Sweden, enabling us to increase capacity ahead of FY19's peak season.

We have agreed terms with our existing Swedish landlord to relocate from our current premises, without penalty, into a new 76,800 square feet building in the same area that we estimate has approximately four times the capacity of our existing site. Due to our portable infrastructure, virtually all assets from the existing site can be easily transferred to the new site.

We have also committed to a new ten-year lease at our existing distribution facility in York, where we will be increasing capacity by installing new storage and handling equipment. This will extend the operational lifespan of our UK distribution facilities, avoiding the need for major capital expenditure and significant additional leasehold costs in the short to medium term.

Capital expenditure for these two projects is expected to total £1.4m, and we estimate this will add c.£45m to our revenue capacity, taking our total distribution capacity to approximately £150m whilst improving our operational efficiency.

During FY19 we are also planning to refurbish the new Head Office building we acquired in June last year for £5.35m. We have completed the move and are pleased to report the building was independently revalued at £7.35m in February.

Strategy

We constantly review and refine our business model, which is built around four pillars of growth:

- E-commerce excellence
- Bespoke platform development
- International expansion; and
- Supply chain evolution.

E-commerce excellence

With nearly 17m website visitors, conversion rates improving by 50 bps, active customer numbers increasing to more than 474,000, and 30% growth in repeat customers, our e-commerce strategy continues to be highly effective.



FY18 has been a period of targeted investment that has impacted on short-term profitability. FY19 will be focused on generating returns from these investments, with the objective of delivering strong and sustainable revenue and profitability growth.

We move into the new financial year with a market-leading e-commerce platform, infrastructure and customer proposition. We are confident of achieving our objectives for FY19.

Andrew Wass | Chief Executive Officer

Our excellent 9.5 Trustpilot rating from over 37,000 reviews is a reflection of our 'customer first' approach, the incredible efforts of our team, and the attention to detail that is required to build customer trust and loyalty. We are constantly refining the platform and we will continue to learn from our customers and use our significant technical resource to design the new solutions required to satisfy an evolving market.

Bespoke platform development

Our bespoke e-commerce platform is the cornerstone of our success and a major competitor differentiator, and our development team have worked tirelessly to design and deploy 242 website updates and 286 system upgrades during the period.

Highlights included the launch of consumer finance in five European countries, enhancing our mobile check-out, launching a US Dollar website, cloudification of our entire platform, and a host of back-end functionality upgrades, including GDPR compliance. We have a pipeline of exciting features and upgrades we want to deploy during the next 12 months.

International expansion

With international sales growing by 69% to £35.8m during FY18 in what is a \$15bn market, expanding internationally continues to be a key area of opportunity and focus for the Group. Localising our websites and customer experience is at the core of our growth strategy, and during the last year we have expanded our multilingual customer service team, invested further into translation and marketing, and improved our local delivery and payment options.

In March 2018 we opened our German showroom which, in addition to physically showcasing our products and building our brand in the locality, is creating additional buying opportunities in Euros from German distributors.

Supply chain evolution

At the year-end we listed 44,700 products, which is up by 20% in 12 months, and we believe there are further opportunities to increase this significantly.

Own-brand product sales have continued to grow impressively, with 45% growth during FY18 to a total of £21m, building on the 58% growth achieved during FY17.

Logo update

After 15 years of excellent service, we have decided it's time to update the Gear4music logo, as featured in this Annual Report. Our websites will be updated with the new logo later in the year, along with a refreshed and modernised look and feel.

Outlook

Whilst profitability has been restricted during FY18 as a result of the investments made into our European operations and customer proposition to drive market share, we remain confident in our outlook for the coming year. As we continue to implement our long-term growth strategy during FY19, we expect to see ongoing strong revenue growth, alongside improving profitability and cash generation.

Andrew Wass
 Chief Executive Officer
 2 July 2018

Revenue:

£80.1m
+43%

EBITDA:

£3.5m
-3%



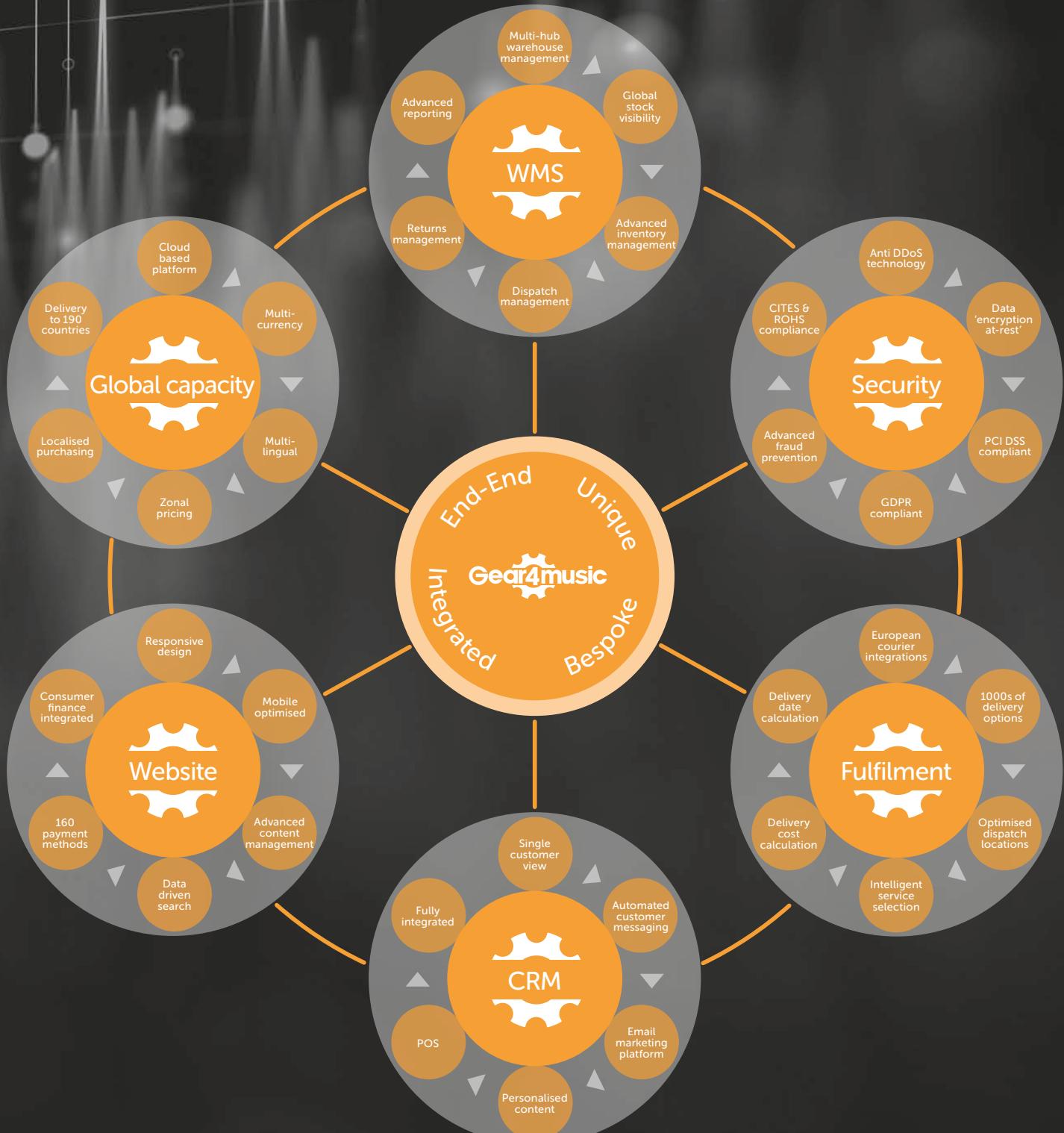
PLATFORM FEATURES

Our bespoke platform provides an end-to-end solution encompassing the whole business. Having software development in-house enables us to quickly and cost-effectively develop new features and functionality.

We have invested £5.9m over 12 years in developing a bespoke end-to-end e-commerce platform designed to meet our exact requirements. The 'front-end' websites are market leading localised sites that have responsive design and are multilingual and multicurrency, supported by robust, flexible, fully integrated back-office systems.

We have 34 software developers in the business working on a pipeline of exciting new developments and features.





Key performance indicators

INSTRUMENTAL

We measure ourselves against a number of KPIs that reflect the key trading trends and are linked to the strategic pillars of growth.

Financial

Revenue £m

£80.1m
+43%

| | |
|------|--------|
| 2018 | £80.1m |
| 2017 | £56.1m |
| 2016 | £35.5m |

Gross margin %

25.4%
-160bps

| | |
|------|-------|
| 2018 | 25.4% |
| 2017 | 27.0% |
| 2016 | 25.9% |

Cash £m

£3.5m
+18%

| | |
|------|-------|
| 2018 | £3.5m |
| 2017 | £3.0m |
| 2016 | £3.6m |

Commercial

Marketing return Marketing costs as % of total revenue

8.3%

| | |
|------|------|
| 2018 | 8.3% |
| 2017 | 8.3% |
| 2016 | 8.7% |

Unique visitors m

16.9m
+34%

| | |
|------|-------|
| 2018 | 16.9m |
| 2017 | 12.6m |
| 2016 | 10.1m |

Conversion %

3.25%
+50bps

| | |
|------|-------|
| 2018 | 3.25% |
| 2017 | 2.75% |
| 2016 | 2.28% |

Average Order Value ('AOV')

£127.33
+3%

| | |
|------|---------|
| 2018 | £127.33 |
| 2017 | £124.02 |
| 2016 | £115.74 |

SKUs listed

44,742
+21%

| | |
|------|--------|
| 2018 | 44,742 |
| 2017 | 37,122 |
| 2016 | 31,517 |



Customer

Customer experience
Trustpilot rank

9.5
-0.1

| | |
|------|-----|
| 2018 | 9.5 |
| 2017 | 9.6 |
| 2016 | 9.5 |

Total database size m

1.89m
+39%

| | |
|------|-------|
| 2018 | 1.89m |
| 2017 | 1.36m |
| 2016 | 0.99m |

Proportion of repeat customers %

22.1%
-160bps

| | |
|------|-------|
| 2018 | 22.1% |
| 2017 | 23.7% |
| 2016 | 25.5% |

Definitions

Unique visitors: A distinct person who visits a Gear4music site during a given period

Conversion: Total number of online orders divided by the total number of unique visitors

Average Order Value: Total revenue (gross of credit notes) divided by the total number of orders

Total database size: Number of people whose details are held on the Gear4music database

Proportion of repeat customers: Number of customers in the period who have placed more than one order



Financial review



Overview

The Group has delivered strong results during an investment period in European distribution to enable and drive future growth. European distribution centre administrative expenses of £1.5m compared with £0.5m in FY17 led to Operating profit of £2.0m (FY17: £2.6m).

Revenue

| | FY18 £000 | FY17 £000 | Change % |
|-----------------------|---------------|---------------|-------------|
| UK revenue | 44,258 | 34,865 | 27% |
| International revenue | 35,842 | 21,263 | 69% |
| Revenue | 80,100 | 56,128 | 43% |

Revenue increased by £24m in FY18 (FY17: £20.6m) equating to growth of 43%, building on growth of 58% and 46% in the last two years. Two-year revenue growth from FY16 to FY18 was 126% compared to 132% between FY15 and FY17.

UK revenue increased by £9.4m (27%) to £44.3m, giving the Group an estimated 5.9% market share in the UK. European growth continues to represent a significant opportunity and international revenue growth of 69% was further to 124% growth in FY17 and 73% in FY16.

The Group ships product outside Europe and in October 2017 the Group launched a US Dollar website, representing an important initial step in our plans for growth outside of Europe. Revenues from sales outside of Europe accounted for 1% of total revenue.

Revenue growth was evenly spread across the year, with 44% in H1 and 42% in H2.

| | FY18 £000 | FY17 £000 | Change % |
|-----------------------------|---------------|---------------|-------------|
| Other-brand product revenue | 56,075 | 39,351 | 42% |
| Own-brand product revenue | 20,947 | 14,449 | 45% |
| Other revenue | 3,078 | 2,328 | 32% |
| Revenue | 80,100 | 56,128 | 43% |

Last year we reported on good progress made in our own-brand business and own-brand revenue growth achieving the Group's ambition of keeping pace with the growth in other brands. In FY18 we are pleased to report further progress, with own-brand growth of 45% outpacing 42% growth in other brands, with £20.9m revenue coming from 2,629 SKUs (28 February 2017: 2,411). The proportion of revenue that came from own-brand products in FY18 increased to 26.2% (FY17: 25.7%).

Other revenue comprises carriage income, warranty revenue, and commissions earned on facilitating point-of-sale credit for retail customers. Warranty income is becoming an increasingly minor component of revenue, with related revenue falling from £315,000 in FY17 (0.6% of revenue), to £302,000 in FY18 (0.4% of revenue).

Gross profit

| | FY18 | FY17 | Change % |
|-----------------------------|---------------|---------------|----------------|
| Gross profit (£'000) | 20,319 | 15,145 | +34% |
| Gross margin | 25.4% | 27.0% | -160bps |

Strong revenue growth led to a £5.2m increase in gross profit on last year, with gross margin reducing from 27.0% to 25.4%, a result more in line with FY16 (25.9%).

The Group faced US Dollar-related cost push inflation towards the end of FY17 and into FY18, directly on own-brand products that are purchased in US Dollars and indirectly on other-branded products that the Group has to date predominantly purchased in Sterling, but the products are ultimately manufactured in US Dollars. Whilst this was mitigated to a degree through negotiation with suppliers and leveraging of economies of scale and passing on through price increases to customers where it made commercial sense, the net overall impact has been a reduction in gross margin in the financial year.

Against this backdrop of increasing intake costs, the Group continues to invest in its customer proposition in terms of competitive pricing, delivery options and costs.

Short and medium-term intake cost prospects are improving with the strengthening of Sterling, the Group's ability to source other-branded products in Swedish Krona and Euros, and further benefits of scale.

Local distribution centres have started to reduce delivery costs to customers into their domestic and adjacent markets, although to date this has been reinvested in our customer proposition and passed on to the customer.

Administrative expenses and Operating profit

| | FY18 £000 | FY17 £000 | Change % |
|--------------------------------------|-----------------|-----------------|--------------|
| UK administrative expenses | (16,823) | (12,050) | (40%) |
| European administrative expenses | (1,535) | (479) | (220%) |
| Total administrative expenses | (18,358) | (12,529) | (47%) |
| Operating profit | 1,961 | 2,616 | (25%) |

Total administrative expenses increased 47% compared to a 43% increase in revenue as the full-year effect and phased scaling-up of the Group's European distribution centres led to an additional £1.1m of European administrative expenses in FY18 over FY17. Administrative expenses incurred in the UK, which included Head Office and Buying functions, increased by £4.8m (40%).

In FY18, marketing costs of £6.7m (FY17: £4.7m) and labour costs of £6.3m (FY17: £4.3m) represented 71% of total administrative expenses.

Marketing costs in FY18 increased in line with the increase in revenue at 43% and as a percentage of revenue were in-line with FY17 at 8.3%. This level of return is as expected, given marketing decisions are heavily data and return driven and includes an element of investment into key target European markets where the Group is looking to build the brand and gain market share.

In FY18, labour costs increased 48% to £6.3m (FY17: £4.3m) as a result of a 49% increase in average headcount to support current and future growth. As explained in last year's Financial review, total labour costs as a percentage of revenue in FY18 increased to 7.9% from 7.6% in FY17, which is in line with FY16's 7.8%.

As expected, given where the Group is at in its investment cycle, FY18 EBITDA of £3.5m is £0.1m lower than last year and equates to 4.3% of revenues compared to 6.4% in FY17 and 4.7% in FY16.

Financial expenses of £461,000 (FY17: £47,000) includes a £265,000 net foreign exchange loss (FY17: £67,000 gain), and £178,000 interest (FY17: £47,000) principally relating to property-linked bank loans.

Profit before tax was £1.5m (FY17: £2.6m), which translates into an EPS of 6.7p (diluted EPS of 6.7p).

Cash flow and net debt

The cash flow statement for the financial year reflects the Group continuing to deploy growth capital to generate returns, by investing in stock and the e-commerce platform to improve the customer proposition and drive revenue.

| | FY18 £000 | FY17 £000 |
|--|--------------|--------------|
| Opening cash | 3,001 | 3,548 |
| Profit for the year | 1,386 | 2,314 |
| Movement in working capital | (3,123) | (3,518) |
| Depreciation and amortisation | 1,497 | 1,001 |
| Financial expense | 196 | 47 |
| Other operating adjustments | 201 | 267 |
| Net cash from operating activities: | 157 | 111 |
| Net cash from investing activities | (9,517) | (2,295) |
| Net cash from financing activities | 9,899 | 1,637 |
| Increase/(decrease) in cash in the year | 539 | (547) |
| Closing cash | 3,540 | 3,001 |

The business generated trading cash in the year and has invested funds raised in capital expenditure, and into working capital which can be unwound.

Stock increased by £5.4m (46%), broadly in line with revenue growth, whilst stocking the European distribution centres. This was partly funded by a £0.8m increase in stock loans and a £2.4m increase in trade payables.

Net cash from investing activities of £9.5m includes the £5.6m investment in the new freehold Head Office in June 2017, £1.8m other tangible fixed additions in York, Manchester and the European distribution centres, and £1.7m of software development. No finance leases were drawn against any of this expenditure.

Cash from financing activities of £9.9m includes a £6.0m increase in debt relating principally to bank loans linked to the freehold property purchase, and £4.2m net proceeds from the fund raise and exercise of a warrant in June 2017.

Balance sheet and net assets

The Group had a strong year-end balance sheet, with net assets of £18.9m (FY17: £11.7m), and £3.5m cash (FY17: £3.0m).

| | FY18 £000 | FY17 £000 |
|--------------------------------------|-----------------|-----------------|
| Software platform | 4,304 | 3,407 |
| Other intangible assets | 2,074 | 2,130 |
| Property, plant and equipment | 10,054 | 1,565 |
| Total non-current assets | 16,432 | 7,102 |
| Stock | 17,055 | 11,686 |
| Cash | 3,540 | 3,001 |
| Other current assets | 2,704 | 1,348 |
| Total current assets | 23,299 | 16,035 |
| Trade payables | (7,325) | (4,970) |
| Loans and borrowings | (3,914) | (2,621) |
| Other current liabilities | (3,591) | (2,409) |
| Total current liabilities | (14,830) | (10,000) |
| Loans and borrowings | (4,616) | (24) |
| Other non-current liabilities | (1,400) | (1,391) |
| Total non-current liabilities | (6,016) | (1,415) |
| Net assets | 18,885 | 11,722 |

Investment in the software platform in the year was £1.7m (FY17: £1.5m) to develop enhanced functionality and resilience, taking total investment to date to £5.9m and net book value to £4.3m (28 February 2017: £3.4m).

A freehold Head Office was acquired in June 2017 for £5.3m in an off-market transaction, with a further £0.3m of directly related costs being capitalised. Further to the Group's understanding of local rental values, an independent valuation was commissioned, resulting in a £1.7m upwards revaluation.

The Group had net debt of £5.0m at the financial year end, compared to net cash of £0.4m at the last financial year end, including £5.2m of debt related to the freehold property purchase outlined above, of which £4.6m is payable after one year.

Dividends

The Board remains confident in the cash-generative nature of the core business, but in light of the returns available from future growth, the Board does not consider it appropriate to declare a dividend at this time, but will continue to review this position on an annual basis.

Chris Scott
 Chief Financial Officer
 2 July 2018

Our people

ORCHESTRAL

We know that a team of talented and motivated individuals are the cornerstone of a successful business. We look to achieve this by growing our talent by recruiting only the best people and providing development opportunities with the scope for career progression.

At 28 February 2018 we employed 339 people across three countries, and many of them have first-hand musical instrument and equipment knowledge, playing in bands and producing their own music.

Our diverse workforce is a key attribute with different cultures, knowledge and skills making it a fantastic place to work. At 28 February 2018 our multi-national team spoke 15 different languages.

A business for musicians run by musicians

We are proud of our passionate staff with in-depth knowledge of their specialist area of focus. We offer generous staff discounts on musical products and equipment and in FY18 most of our team made a relevant purchase.

Recruitment and retention

We need to attract talent to support our growth plans, and offer competitive salaries and a range of benefits to help attract and retain great people (<https://www.gear4music.com/careers/why-gear>).

At 28 February 2018, 79 employees were participating in Group share option plans in recognition of their contribution to the continuing success of the business.

In FY18 our headcount increased by 31% from 259 to 339 and our retention levels are good.

Apprenticeships

We believe it is important to encourage young people into the workplace and provide training and development for the future. Working with recognised training providers we provide on-the-job training, resulting in a professional qualification fit for a modern workplace.

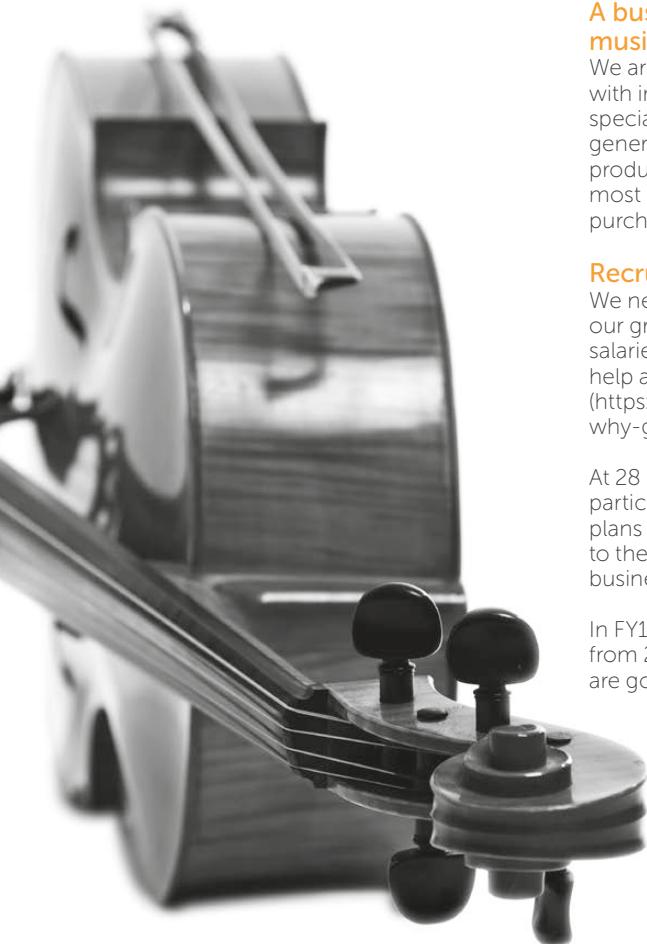
We aim to offer between five and ten apprenticeships per year across many parts of the business, including Retail, Warehousing, Graphic Design, Web Content and Marketing.

Gender pay gap report

As of April 2017, we are pleased to report that our mean gender pay gap (12.6%) is better than the national average (17.4%), and our median rate shows that the women's average hourly rate is higher than the men's.

The mean reflects the fact that the top three highest-paid employees are male. The median reflects that there are proportionally more females in the upper middle quartile and proportionally less females in the lower quartile.

- Women's hourly rate is 12.6% lower (mean) and 14.8% higher (median)
- Top salary quartile has 84.8% men and 15.2% women
- Upper middle salary quartile has 63.2% men and 36.8% women
- Lower middle salary quartile has 86% men and 14% women
- Lower salary quartile has 93.1% men and 6.9% women
- Women's bonus pay is 0% lower (mean) and 0% lower (median)
- 0.5% of men and 0% of women received bonus pay



Executive Board



Andrew Wass
CEO



Chris Scott
CFO



Gareth Bevan
CCO



FOR MORE INFORMATION
PAGES 38-39

Operational Board



Tom Walder
Chief Technical Officer
Joined Jan 2017



Jonathan Meager
E-commerce Director
Joined 2007



Robert Newport
Projects Director
Joined May 2016

Senior management



Swedish Commercial Manager
Joined Nov 2016



German Commercial Manager
Joined Mar 2017



Head of UK Buying
Joined May 2013



Digital Marketing Manager
Joined May 2016



Swedish Logistics Manager
Joined Sept 2016



German Logistics Manager
Joined Nov 2016



UK Logistics Manager
Joined 2005



Customer Service Manager
Joined 2005

Risks and uncertainties

The Board recognises that certain risks and uncertainties can have significant rewards for the prospects of the business, and as such require careful identification, evaluation and management.

The Board takes overall responsibility for risk management, with a focus on evaluating the nature and extent of significant risks, and formulating mitigations around the risks required to be taken in order to deliver the strategic objectives. The Audit Committee has responsibility for overseeing the

effectiveness of appropriate risk management processes and internal control systems. More detail of these processes is set out in the governance section.

The purpose of this section is to focus on the principal risks and uncertainties

to our business model that could impact on our achieving our strategic objectives, and our future performance.



FOR MORE INFORMATION
VISIT OUR WEBSITE

Operations

Risk



Description

Uncertainty in the UK and European economies following the UK's EU Referendum vote (Brexit), and potential impact on consumer confidence could affect the ability of the Group to maintain sales growth.
Controls on the freedom of movement of people may impact the availability of European workers in the UK.
European competitors may gain an advantage over the Group if higher duties are imposed on UK imports into the EU, or currencies move adversely to the Group.

Mitigation

Developments in the EU are being monitored subsequent to the UK's decision to leave the EU.
The Group has trading subsidiaries in Sweden and Germany and, if and when appropriate, trading arrangements could be adapted and these entities become standalone European retail businesses.
Competitor activity and offerings are reviewed regularly to remain abreast of market developments and identify competitive advantages.
Fluctuating exchange rates are regularly reviewed and operational and financial mitigations considered. Buying products and incurring other costs in Euros and Krona partly mitigates the risk.

Rapid growth



The Group's business has grown rapidly. Operations and practices adopted at earlier stages of the Group's development may be inappropriate for a business of an increased size and scale.
The Group may need to expand and enhance its infrastructure and technology and improve its operational and financial systems and procedures and controls in order to be able to match its growth. The Group may face challenges in matching the pace of its expansion with corresponding improvements and enhancements in its systems, controls and procedures. The Group will also need to expand, train and manage its growing employee base.

As detailed in the Governance section, the Plc and Operational Boards actively monitor and respond to developments, so as to maintain systems and practices that are appropriate for the operations and scale of the Group.

The Group continues to recruit into key management positions.

The Group has again expanded its Finance function, providing greater capacity and better segregation of duties, further improving the control environment.

Operations continued

Risk

New jurisdictions

Description

The Group's expansion into new jurisdictions may not be successful. Further expansion into markets outside the United Kingdom would expose the Group to a variety of risks, including different regulatory requirements, complications with staffing and managing foreign operations, variations in consumer behaviour, fluctuations in currency exchange rates, potential political and economic instability, potential difficulties in enforcing contracts and intellectual property rights, the potential for higher rates of fraud and adverse tax consequences.

The Directors have limited experience of the legal and regulatory regimes of jurisdictions outside the United Kingdom and their consequences for the Group's business. In addition, the Group will likely have to compete in new jurisdictions with companies already operating in the relevant market, which may understand the local market better than the Group.

To the extent that the Group overestimates the potential of a new geographic market, incorrectly judges the timing of the development of a new geographic market or fails to anticipate the differences between a new geographic market and the United Kingdom, the Group's attempt to expand into new geographic markets may be unsuccessful.

Mitigation

The Board will routinely direct Management to seek professional input into any such major developments. Advances into Europe will continue to be in a measured and capital efficient manner. The Group has local subsidiaries in Sweden and Germany and recruited local management familiar with local laws and regulations.

Technological changes

Unless the Group is able to respond to technological advances, e.g. through adapting and optimising Gear4music's websites, on a cost-effective and timely basis, it may not be able to effectively build and/or maintain a competitive advantage.

In FY17 the Group brought software development in-house to assert greater control and improve cost efficiency to help mitigate such risks. The Group continues to allocate a significant annual budget to software development.

Distribution centres

The Group operates three distribution centres and, as such, is not completely reliant on a single site. Any disruption to a distribution centre's efficient operation may have an effect on the Group's business. Distribution centres may suffer prolonged power or equipment failures, failures in their information technology systems or networks or damage from fires, floods, other disasters or other unforeseen events which may not be covered by or may exceed the Group's insurance coverage.

The Group operates from three locations, mitigating the risk of over-dependence on any single location. The Group, in conjunction with its insurance broker, ensures it maintains sufficient and appropriate insurance cover is in place. This includes Business Interruption cover. The Group has a formal disaster recovery plan in place that details actions in specific situations.

Risks and uncertainties continued

Operations continued

Risk

Description

Mitigation



The supply of product to customers in a timely manner is critical to the success of the Group. The Group therefore operates its own warehouses, run by senior management that have many years of experience in the sector. Rapid increases in revenue may require further expansion of current warehouse space. There is a risk that the Group may experience interruptions to the operation of these logistics and distribution networks that could prevent the timely or proper delivery of products, which could damage the Group's reputation, deter customers, prospective customers, suppliers and/or prospective suppliers.

The Group operates from three distribution centres, each with their own local logistics relationships, thereby reducing the dependency on any single site or local network.

There are regular reviews of capacity across locations and follow-up plans developed that the Board believes should allow the Group to fulfil an increasing number of orders from the existing sites and identify step-changes for consideration as and when required.

The Group maintains multiple delivery service providers to reduce the dependency on any single provider, and tracks service level agreements on an ongoing basis. This provides system flexibility to switch providers within a matter of days if required.



Changes to search engines' algorithms or terms of service could cause the Group's websites to be excluded from or ranked lower in natural search results. Search engines frequently modify their algorithms and ranking criteria which could impair the Group's Search Engine Optimisation ('SEO') activities. If the Group is unable to recognise and adapt quickly to such modifications in search engine algorithms, the Group could suffer a significant decrease in traffic and revenue.

The Group will continue to operate search engine optimisation activities that adhere to search engine guidelines.



The Group relies heavily on its IT infrastructure and e-commerce system, and in particular its websites. If any one or more of its websites were to fail or be damaged this could impact the Group's ability to trade. If the Group's IT and data security systems do not function properly there could be website slowdown or unavailability, loss of data, a failure by the Group to protect the confidential information of its customers from security breaches, delays in transaction processing, or the inability to accept and fulfil customer orders, which could affect the Group's business.

The Group seeks to mitigate this risk by investing in IT infrastructure, including robust cloud-based back-up systems.

The Group has a disaster recovery plan in place which has been designed to minimise the impact of data loss or corruption from hardware failure, human error, hacking or malware.

Brand and proposition

Risk



Description

Developing and maintaining the reputation of, and value associated with, the Group's brands is of central importance to the success of the Group. Brand identity is a critical factor in retaining existing and attracting new customers. The Group is reliant on its natural search result rankings and paid advertising as it seeks to build market share and attract new customers. Any failure by the Group to offer high-quality products across a range of instruments, manufacturers and price points, excellent customer service and efficient and reliable delivery, could damage its reputation and brands and could result in the loss of customer confidence and a reduction in purchases. Unfavourable publicity concerning the Group could also damage the Group's brands and its business. If the Group fails to maintain its brands or if excessive expenses are incurred in this effort, the Group's business may be affected.

Mitigation

Rigorous monitoring of customer feedback helps ensure issues are identified and rectified on a timely basis. Own-brand products are carefully selected and rigorously tested prior to initial order.



The UK and European retail market for musical instruments and music equipment is competitive. A number of competitors may have financial resources greater than those of the Group. Both Amazon and eBay sell musical instruments and music equipment.

The Group has a track record of successfully competing on a wide range of factors, including quality and range of products, price, product availability, product information, convenience, delivery options and service.

Risks and uncertainties continued

Resources and Relationships

Risk

Description

Mitigation

Supply and sale of third party branded products

The Group purchases products from a number of large global musical instrument and music equipment brand owners, and the Group's business depends on its ability to source a range of products from well-recognised brands on commercially reasonable terms.

The relationships between the Group and the third-party brand owners are generally based on annual contracts that the Group seeks to renew each year. The third-party brand owners may cease selling products to the Group on terms acceptable to it, fail to deliver sufficient quantities of products in a timely manner, terminate their relationship with the Group and enter into agreements with the Group's competitors, or experience raw material or labour shortages or increases in raw material or labour costs. Any disruption to the availability or supply of products to the Group or any deterioration to the terms on which products are supplied to the Group could affect its business.

Whilst sales of third party branded products accounted for approximately 70% of the Group's turnover in FY18 (FY17: 70%), the Directors do not consider that the Group is significantly reliant on any one or more major brand/brand owner.

The Directors believe that the relative size of the Group, its purchase volumes and the strength of its relationship with the brand owners, built over a prolonged period in many cases, make it unlikely that any such arrangements would be terminated.

Reliance on sub-contract manufacturers

The Group sub-contracts manufacture of its Own-brand musical instruments and equipment to independent third-party businesses in South-East Asia. Any disruption to supply or issues such as poor product quality could have an adverse impact on the Group's reputation.

The impact of any issues arising with sub-contractors' products is exacerbated by the lead times involved (12-16 weeks).

The Group has been successfully importing for over 15 years and has relationships with over 30 manufacturers providing re-sourcing options.

The Board believes that the Group has robust take-on and ongoing monitoring procedures covering areas such as quality control and delivery performance for new and existing sub-contract manufacturers that the Group seeks to adhere to rigidly.

Dependence on key personnel

The loss of any key individual or the inability to attract appropriate personnel could impact upon the Group's future performance.

Should the Group fail to retain or attract suitably qualified and experienced personnel, it may not be able to compete successfully.

In FY17 three further directors were appointed to the board of Gear4music Limited, and an Operational Board formed to focus on all trading and commercial matters.

The Board continues to recruit into key management positions as and when positions are identified.

The Senior Management team is compensated through a combination of market-rate salary and longer-term share-based incentives to align key people's remuneration with the continued success of the Group.



Corporate governance report

Corporate Governance Codes

The Board recognises the value and importance of high standards of corporate governance and since IPO has adopted many aspects of the UK Corporate Governance Code ('the Code') so far as the Board considers them appropriate and practical for a group Gear4music's size. Following due consideration of the recent changes to the AIM rules, the Board has committed to adopt the QCA Corporate Governance Code. More details on implementation and disclosure will appear on the Group's Plc website in due course.

The Board of Directors and Committees of the Board of Directors

The Board, which is headed by the Chairman, comprises five Directors, of which three are Executive and two are Non-Executive, providing a broad range of relevant skills and experiences. The Board considers Ken Ford and Dean Murray to be 'independent' Non-Executives under the criteria identified in the Code. Directors' profiles are detailed on pages 38 and 39.

The Board met regularly throughout the year with ad hoc meetings held when required.

The Role of the Board

The role of the Board is to provide leadership to the Group and to ensure the obligations of being a public company are adhered to. The Board bears collective responsibility for delivering ongoing success through the

development of appropriate strategies that are aligned to the Group's objectives, and deliverable with due consideration of risk and the resources available. The Board is also responsible for ensuring that a framework of effective controls is in place.

The division of responsibilities between the Chairman and the Chief Executive Officer is clearly defined. The Chairman is responsible for ensuring the effectiveness of the Board and setting its agenda. The Chairman has no involvement in the day-to-day running of the business. The Chief Executive Officer has direct charge of the Group on a day-to-day basis, and the Executive team has collective responsibility for the implementation of the Group's strategies and is accountable to the Board for the financial and operational performance of the Group.

There are certain matters that are reserved for the Board's consideration and these include, but are not limited to matters of strategy, key commercial developments, risk management, the consideration and approval of budgets, significant capital expenditure and recruitment, acquisitions and disposals, and the approval of financial statements.

The formal Board agenda includes an Executive report detailing the commercial, operational and financial performance of the Group. Further to formal Board meetings, the Board receives weekly key trend information covering all trading aspects of the business.

The Board determines the fees paid to Non-Executive Directors.

The performance of the Board is evaluated informally on an ongoing basis with reference to all aspects of its operation including, but not limited to, the appropriateness of its skill level, the way its meetings are conducted and administered (including the content of those meetings), the effectiveness of the various Committees, whether Corporate Governance issues are handled in a satisfactory manner, and whether there is a clear strategy and objectives.

A new Director, on appointment, is briefed on the activities of the Group. Professional induction training is also given as appropriate. The Chairman briefs Non-Executive Directors on issues arising at Board meetings if required, and Non-Executive Directors have access to the Chairman at any time. Ongoing training is provided as needed. Directors are continually updated on the Group's business and on insurance and on issues covering pensions, social, ethical, environmental and health and safety by means of Board reports.

In the furtherance of his duties or in relation to acts carried out by the Board or the Group, each Director has been informed that he is entitled to seek independent professional advice at the expense of the Group. The Group maintains appropriate cover under a Directors' and Officers' insurance policy in the event of legal action being taken against any Director.

Each Director is appraised through the normal appraisal process. The Chief Executive Officer is appraised by the Chairman, the Executive Board members by the Chief Executive Officer, and the Non-Executive Board members by the Chairman. Each Director has access to the services of the Company Secretary if required.

The Non-Executive Directors are considered by the Board to be independent of management and are free to exercise independence of judgement. They receive no other remuneration from the Group other than the Directors' fees.

The Board is supported by, and receives recommendations from, two committees – an Audit Committee and a Remuneration Committee.

It is recognised that the Code does not treat the Chairman as independent and it is considered best practice that he should not sit on the Audit or Remuneration Committees. The Board, however, takes the view that as the number of Non-Executive Directors is only two, including the Chairman, his participation will continue as the Committees gain the benefit of his external expertise and experience in areas which the Group considers important.

The table below shows the number of Board meetings and Audit Committee and Remuneration Committee meetings held in the period from 1 March 2017 to the date of approval of the Annual Report and Accounts. The table also shows the attendance of each Director:

Re-election

At each Annual General Meeting one-third (or whole number less than one-third) of the Directors will retire by rotation. In addition, Directors are subject to re-election at the Annual General Meeting following their appointment.

Shareholder communications

The Chief Executive Officer and Chief Financial Officer regularly meet with institutional shareholders to foster a mutual understanding of objectives. The Directors encourage the participation of all shareholders, including private investors, at the Annual General Meeting and as a matter of policy the level of proxy votes (for, against and vote withheld) lodged on each resolution is declared at the meeting.

The Annual Report and Accounts is published on the Company's investor website and can be accessed by shareholders.

Internal controls

The Board is responsible for the Group's system of internal controls and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Group highlights potential financial and non-financial risks which may impact on the business as part of the monthly management reporting procedures. The Board receives these monthly management reports and monitors the position at Board meetings.

The Board confirms that there are ongoing processes for identifying, evaluating and mitigating the significant risks faced by the Group. The processes have been in place from 1 March 2017 to the date of approval of the Annual Report and Accounts and are consistent with the guidance for Directors on internal control issued by the Turnbull Committee.

The Group's internal financial control and monitoring procedures include:

- clear responsibility on the part of line and financial management for the maintenance of good financial controls and the production of accurate and timely financial management information;
- the control of key financial risks through appropriate authorisation levels and segregation of accounting duties;
- detailed monthly budgeting and reporting of trading results, balance sheets and cash flows, with regular review by management of variances from budget;
- reporting on any non-compliance with internal financial controls and procedures; and
- review of reports issued by the external auditor.

The Audit Committee, on behalf of the Board, reviews reports from the external auditor together with management's response regarding proposed actions. In this manner they have reviewed the effectiveness of the system of internal controls for the period covered by the accounts.

On 1 March 2017, the Group formed an Operational Board with the appointment of three further Directors to the trading subsidiary, Gear4music Limited. The Operational Board analyses and discusses operational and commercial matters, and identifies any material matters to escalate to the Plc Board. The Operational Board met seven times in the financial year.

| Director | Role | Board meetings | Audit Committee meetings | Remuneration Committee meetings |
|--------------|------------------------|----------------|--------------------------|---------------------------------|
| Ken Ford | Non-Executive Chairman | 9/9 | 3/3 | 3/3 |
| Andrew Wass | CEO | 9/9 | | |
| Chris Scott | CFO | 9/9 | 3/3 | 3/3 |
| Gareth Bevan | CCO | 9/9 | | |
| Dean Murray | NED | 9/9 | 3/3 | 3/3 |

Corporate governance report continued

Audit Committee report

Overview

The Audit Committee ('the Committee') is established by, and is responsible to, the Board. It has formally delegated duties and responsibilities and has written terms of reference. Its main responsibilities are:

- to monitor and be satisfied with the truth and fairness of the Group's financial statements before submission to the Board for approval, ensuring their compliance with the appropriate accounting standards, the law, and the AIM Rules;
- to monitor and review the effectiveness of the Group's system of internal control;
- to make recommendations to the Board in relation to the appointment of the external auditor and their remuneration, following appointment by the shareholders in general meeting, and to review and be satisfied with the auditor's independence, objectivity and effectiveness on an ongoing basis; and
- to implement the policy relating to any non-audit services performed by the external auditor.

Membership of the Audit Committee

Dean Murray is the Chairperson of the Committee and the other member is Ken Ford, both of whom are Non-Executive Directors and have wide experience in regulatory and risk issues.

Role and operation of the Audit Committee

The Committee is authorised by the Board to seek and obtain any information it requires from any officer or employee of the Group, and to obtain external legal or other independent professional advice as is deemed necessary by it.

Meetings of the Committee are held at least twice per year and the auditor is invited to these meetings. The Committee meets once (usually during January) to discuss and agree the scope for the forthcoming external audit, and again (usually during April) to review the findings of the external audit in relation to internal control and the financial statements. At this meeting, the Committee carries out a full review of the year-end financial statements and of the audit, using as a basis the Report to the Audit Committee prepared by the external auditor and taking into account any significant accounting policies, any changes to them and any significant estimates or judgements. Questions are asked of management of any significant or unusual transactions where the accounting treatment could be open to different interpretations.

The Committee receives reports from management on the effectiveness of the system of internal controls. It also receives from the external auditor a report of matters arising during the course of the audit which the auditor deems to be of significance for the Committee's attention. The statement on internal controls and the management of risk, which is included in the Annual Report, is approved by the Committee.

The 1998 Public Interest Disclosure Act ('the Act') aims to promote greater openness in the workplace and ensures 'whistle blowers' are protected. The Group maintains a policy in accordance with the Act which allows employees to raise concerns on a confidential basis if they have reasonable grounds in believing that there is serious malpractice within the Group. The policy is designed to deal with concerns, which must be raised without malice and in good faith, in relation to specific issues which are in the public interest and which fall outside the scope of other Group policies and procedures. There is a specific complaints procedure laid down and action will be taken in those cases where the complaint is shown to be justified. The individual making the disclosure will be informed of what action is to be taken and a formal written record will be kept of each stage of the procedure.

The external auditor is required to give the Committee information about policies and processes for maintaining their independence and compliance regarding the rotation of audit partners and staff. The Committee considers all relationships between the external auditor and the Group to ensure that they do not compromise the auditor's judgement or independence, particularly with the provision of non-audit services.

External auditor and non-audit services

Fees in relation to services provided by the external auditor in FY18 and FY17 were:

| £000 | FY18 | FY17 |
|-------------------|-----------|------------|
| Audit fee | 50 | 40 |
| Tax fees | 17 | 60 |
| Total fees | 67 | 100 |

The Committee has considered the ratio of audit fees to non-audit fees and is satisfied with the independence and objectivity of the auditors, KPMG LLP.

Remuneration Committee report

As an AIM-listed company, Gear4music (Holdings) plc is not required to comply with Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The content of this report is unaudited unless stated.

Membership of the Remuneration Committee

During the year, the Remuneration Committee comprised Ken Ford and Dean Murray. They have no personal financial interest in the Group except for fees in relation to their holding of office and their shareholdings as disclosed, with no potential conflict of interests and no day-to-day involvement of the Group.

The Remuneration Committee reviews the performance of the Executive Directors and makes recommendations to the Board on matters relating to remuneration, terms of service, granting of share options and other equity incentives.

The Remuneration Committee meets at least twice a year.

Remuneration policy

The remuneration policy is designed to attract, retain and motivate high-calibre executives to ensure the Group is managed successfully to the benefit of shareholders.

Share ownership is encouraged and all the executives are interested in the share capital.

In setting remuneration levels, the Committee takes into consideration remuneration levels and practices in other companies of a similar size and in similar sectors.

Non-Executive Directors

Remuneration of the Non-Executive Directors is determined by the Executive Directors. Non-Executive Directors are not entitled to pensions beyond the required statutory minimums, annual bonuses or employee benefits, nor are they entitled to participate in share option arrangements relating to the Company's shares.

Each of the Non-Executive Directors has a letter of appointment stating his annual fee and that his appointment is initially for a term of three years. Their appointment may be terminated with one month's notice.

Their fees are reviewed annually and set in line with prevailing market conditions and at a level which will attract and retain individuals with the necessary experience and expertise to make a significant contribution to the Group's affairs.

Directors' remuneration

The normal remuneration arrangements for Executive Directors consist of basic salary and private medical insurance. The CEO is also entitled to a car allowance and a pension allowance. Four Directors, including the CEO, are enrolled in the Group workplace pension scheme.

All Executive Directors have service agreements terminable by the Company with six months' notice.

Directors' interests

Details of the Directors' shareholdings are included in the Directors' report on page 40.

Directors' share options

There are EMI and CSOP share incentive plans in place for Chris Scott and Gareth Bevan, and equivalent discretionary cash bonus plans for Andrew Wass, to reward the Executives for delivering success to the mutual benefit of shareholders, and specifically to promote continuing earnings growth.

The first awards were made on 31 May 2016, further to the announcement of the Company's FY16 annual trading results and following due consideration by the Remuneration Committee. These awards vested on 31 May 2018.

Second awards were made on 30 June 2017, further to the announcement of the Company's FY17 annual trading results and following due consideration by the Remuneration Committee. Subject to continued employment and meeting performance conditions, these awards are scheduled to vest on 31 May 2020.

Further awards are expected to be made following the announcement of the FY18 results.

Total remuneration

The remuneration of each of the Directors of the Group for the year ended 28 February 2018 is set out below. These values are included within the audited accounts.

| | Basic salary £000 | Benefits £000 | Pensions £000 | Total FY18 £000 | Total FY17 £000 |
|--|----------------------|------------------|------------------|--------------------|--------------------|
| Executive | | | | | |
| Andrew Wass | 195 | 2 | 3 | 200 | 189 |
| Chris Scott | 147 | 1 | 3 | 151 | 141 |
| Gareth Bevan | 123 | 1 | 11 | 135 | 112 |
| Non-Executive | | | | | |
| Ken Ford | 34 | – | – | 34 | 33 |
| Dean Murray | 32 | – | – | 32 | 31 |
| Peter Armitage ¹ (resigned 19 October 2016) | – | – | – | – | 19 |
| Total | 531 | 4 | 17 | 552 | 525 |

¹ Peter Armitage was KCP's appointed Investment Director and resigned on 19 October 2016 on the sale of KCP's final shareholding in the Group.

Board of Directors

Eric (Ken) Ford

Chairman and Non-Executive Director

Age 68

Ken was previously Chief Executive of Teather & Greenwood, the investment bank, becoming Deputy Chairman and Chairman of Corporate Finance. Ken brings a strong understanding of shareholder value, strategic planning and corporate transactions. Mr Ford is a former Chairman of the Quoted Companies Alliance (QCA) and member of the EU Advisory Committee to the Corporation of London. Fellow of the Chartered Securities Institute. Ken's previous directorships include Aberdeen Asset Management and Morgan Grenfell.

Ken is currently Chairman of AIM-quoted companies System1 Group plc and Scientific Digital Imaging plc.

Ken is Chairman of the Remuneration Committee and a member of the Audit Committee.

Andrew Wass

Chief Executive Officer

Age 47

Andrew has over 20 years' business management experience, having founded Gear4music Limited (then called Soundpro Limited) in 1995. In 1998 he began selling IT systems for the audio recording market before launching 'Gear4music' in 2003. Since then Andrew has retained overall responsibility for driving the Group's growth.

Between 1992 and 1998, Andrew set up and ran his own recording studio business, having studied Popular Music and Sound Recording at the University of Salford. Andrew is a keen pianist.

Christopher (Chris) Scott

Chief Financial Officer and Company Secretary

Age 42

Before joining Gear4music in October 2012, Chris was the Finance Director at Officers Club, overseeing the sale of the business to Blue Inc.

Chris joined KPMG LLP in Leeds in 1997, qualified as a Chartered Accountant in 2000 and went on to spend nine further years in their advisory practice, including a year on secondment at Barclays Bank. He holds an Executive Masters in Business Administration.

Gareth Bevan**Chief Commercial Officer**

Age 40

Gareth joined Gear4music in July 2012. He was previously at DV247, the largest UK-based musical equipment retailer at that time, where he was responsible for purchasing, sales and marketing. He has 19 years' experience in musical equipment retail.

**Dean Murray****Non-Executive Director**

Age 55

Dean joined the Board of Gear4music in March 2012 as a Non-Executive Director and originally as Chairman. Dean is a Chartered Accountant, former Chief Financial Officer and Chief Operating Officer of Myriad Childrenswear Group, and is currently a Director of M.S. Team Limited, and Chairman of BHID Group Limited, Construction Materials Online Limited, Yumi International Limited and Weird Fish Holdings Limited.



Dean is Chairman of the Audit Committee and a member of the Remuneration Committee.



Directors' report

The Directors present their report and the audited financial statements for the year ended 28 February 2018.

Principal activity

The principal activity of the Group is the retail of musical instruments and equipment, through 20 Gear4music-branded websites in 15 languages, and showrooms in York, Sweden and Germany. It retails own and other branded products.

Business review and future developments

An overview of the Group's operation is included in the Strategic Report section of the Annual Report and Accounts on pages 2 to 32. This report includes sections on strategy and markets and considers key risks and key performance indicators.

A review of the Group's current operations and future developments is covered in the Chief Executive Officer's and Chief Financial Officer's reports.

Financial results

Details of the Group's financial results and position are set out in the Consolidated statement of profit and loss and other comprehensive income, other primary statements and notes to the accounts on pages 48 to 83.

Dividends

The Directors do not recommend the payment of a dividend (FY17: nil).

Going concern

After making enquiries, the Directors have confidence that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Annual Report and Accounts. This is described in more detail in Note 1.

Directors

The Directors who served on the Board and on Board Committees during the year are set out on pages 38 to 39. One-third of the Directors are required to retire at the Annual General Meeting and can offer themselves for re-election.

Information on Directors' remuneration and share option rights is given in the Remuneration Committee report on pages 36 to 37.

Significant shareholders

The Company is informed that, at 13 April 2018, individual registered shareholdings of more than 3% of the Company's issued share capital were as follows:

| | Number of shares | % of issued share capital |
|--------------------------|------------------|---------------------------|
| Andrew Wass | 7,161,993 | 34.3% |
| BlackRock Investment Mgt | 1,953,133 | 9.4% |
| Old Mutual plc | 1,506,244 | 7.2% |
| Octopus Investments | 1,152,422 | 5.5% |
| Seneca Investment Mgrs | 899,281 | 4.3% |
| Hargreave Hale | 799,968 | 3.8% |
| AXA Investment Mgrs | 706,200 | 3.4% |

Directors' shareholdings

The beneficial interests of the Directors in the share capital of the Company at 28 February 2018 were as follows:

| | Number of shares | % of issued share capital |
|--------------------------------|------------------|---------------------------|
| Executive Directors | | |
| Andrew Wass | 7,161,993 | 34.3% |
| Gareth Bevan | 100,382 | 0.5% |
| Chris Scott | 90,462 | 0.4% |
| Non-Executive Directors | | |
| Dean Murray | 199,520 | 1.0% |
| Ken Ford | 20,000 | 0.1% |

At the financial year end, Chris Scott and Gareth Bevan held share options over 9,978 shares each under the Director EMI plan, and over 2,288 shares each under the CSOP scheme. Andrew Wass has cash-settled options to an equivalent amount subject to the same performance conditions. Both plans and all awards are outlined in the Remuneration Committee report on pages 36 and 37, and on pages 71 to 74.

The middle market price of the Company's Ordinary shares on 28 February 2018 was 651.0 pence (28 February 2017: 660.0 pence), and the range in the year was 502.5 pence to 865.0 pence, with an average price of 707.0 pence.

Research and development

The Group capitalised £1.69m during the year (FY17: £1.48m) of software development costs relating to the in-house e-commerce software platform.

Financial instruments

The Group's policy and exposure to financial instruments is set out in Note 17 on pages 65 to 70.

Qualifying third-party indemnity

The Company has provided an indemnity for the benefit of its current Directors which is a qualifying third-party indemnity provision for the purpose of the Companies Act 2006.

Employee involvement

It is the Group's policy to involve employees in its progress, development and performance. Applications for employment by disabled persons are fully considered, bearing in mind the respective aptitudes and abilities of the applicants concerned. The Group is a committed equal opportunities employer and has engaged employees with broad backgrounds and skills. It is the policy of the Group that the training, career development and promotion of a disabled person should, as far as possible, be identical to that of a person who is fortunate enough not to suffer from a disability. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues.

Donations

During the year ended 28 February 2017 the Group made donations totalling £250 (FY17: £881).

Supplier payment policy and practice

The Group does not operate a standard code in respect of payments to suppliers. The Group agrees terms of payment with suppliers at the start of business and then makes payments in accordance with contractual and other legal obligations.

The number of creditor days outstanding at 28 February 2018 was 28 days (FY17: 26 days). This is a weighted average by invoice value, with reference to actual invoice and payment dates.

Disclosure of information to auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware and each Director has taken all the steps that he or she ought to have taken to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor

Further to the conclusion of a competitive tender process for audit services, the Group reappointed KPMG as auditors. A resolution for the reappointment of KPMG LLP as auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board

Chris Scott

Chief Financial Officer
 2 July 2018

Registered office: Kettlestring Lane, Clifton Moor, York,
 YO30 4XF

Statement of Directors' responsibilities in respect of the Annual Report and the Financial Statements

The Directors are responsible for preparing the Strategic report, the Directors' report and the financial statements and the Group and parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent Company financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange, they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRSs as adopted by the EU') and applicable law and have elected to prepare the parent Company financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent Company and of their profit or loss for that period. In preparing each of the Group and Parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant, reliable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent Company financial statements, state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic report and a Directors' report that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditor's Report

To the members of Gear4music (Holdings) plc

1 Our opinion is unmodified

We have audited the financial statements of Gear4music (Holdings) plc ('the Company') for the year ended 28 February 2018 which comprise the Consolidated Statement of Profit and Loss and Other Comprehensive Income, Consolidated Statement of Financial Position, Consolidated Statement of Changes in Equity, Consolidated Statement of Cash Flows, Company Balance Sheet, Company Statement of Changes in Equity and the related notes, including the accounting policies in Note 1.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 28 February 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed entities. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

| | |
|---|--|
| Materiality: Group financial statements as a whole | £104,800 (2017: £135,000) |
| | 5% of normalized profit before tax (2017: 5% of profit before tax) |

| | |
|-----------------|--|
| Coverage | 100% (2017: 100%) of Group profit before tax |
|-----------------|--|

Risks of material misstatement vs 2017

| | | |
|------------------------|---|----|
| Recurring risks | Capitalisation of development costs | ▲ |
| | Revenue recognition – returns provision | ◀▶ |
| | Existence of revenue and associated costs | ◀▶ |
| | Recoverability of Parent company loan to subsidiary | ◀▶ |

Independent Auditor's Report continued

To the members of Gear4music (Holdings) plc

2 Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

| The risk | Our response | |
|---|--|--|
| <p>Capitalisation of internal development costs (£1.7m; 2017: £1.5m)</p> <p>Note 1.10 (accounting policy) and Notes 9 and 22 (financial disclosures)</p> | <p>Accounting treatment The Group invests heavily in the software platform.</p> <p>Following the acquisition of the software development team at the end of the prior period, there is an increased level of judgement involved in assessing whether the criteria set out in accounting standards for the capitalisation of such costs had been met – in particular the capitalisation of internal staff costs.</p> | <p>Our procedures included:</p> <ul style="list-style-type: none"> • Accounting analysis: assessing whether the Group's accounting policies are in line with relevant accounting standards; • Personnel interviews: we corroborated Management's judgement that all developers work solely on the development, rather than the maintenance of the platform, through discussions with Directors outside of the finance function to understand the scope of work performed by the development team; and • Testing application: for a sample of internal staff costs capitalised in the period review the individual's job description for evidence that the staff work solely on development of the platform. |
| <p>Revenue recognition – returns provision (Provided within total Group revenue of £80.1m; 2017: provided within total Group revenue of £56.1m)</p> <p>Note 1.15 (accounting policy) and Note 22 (financial disclosures)</p> | <p>Subjective estimate The Group generates revenue through the sale of goods and extended warranties through its websites.</p> <p>Customers have the right to return the goods within 30 days of delivery. Should customers return any goods, the Group will refund the associated revenue relating to the returned goods. There is a risk that judgements made by Management in calculating the level of provision recorded at the period end for returns could result in a material error in reported revenues and profits.</p> | <p>Our procedures included:</p> <ul style="list-style-type: none"> • Methodology implementation: reviewing the methodology used to calculate the returns provision based on our understanding of the business; • Historical comparison: assessing the key assumption driving the calculation above, being historical returns rates, against actual returns as a proportion of sales made during the 2017/18 financial period; • Test of detail: comparing the value of actual returns made in the 30-day returns period post year end, relating to sales recognised in the financial year against the provision made by management; and • Assessing transparency: considering the adequacy of the Group's disclosures about the degree of subjectivity involved in determining the year-end returns provision. |

| | The risk | Our response |
|---|--|---|
| Timing of revenue and associated costs (Included within total Group revenue of £80.1m; 2017: included within total Group revenue of £56.1m) Note 1.15 (accounting policy) and Note 2 (financial disclosures) | <p>Accounting treatment</p> <p>The Group offers extended warranties of up to six years on certain products to customers for additional consideration. The Group recognises warranty revenue on dispatch of the goods. Accounting standards require that consideration received for such extended warranty periods should be spread evenly over the warranty period.</p> <p>The Group recognises warranty and product revenue on dispatch of goods. Accounting standards require product revenue and associated cost of sales to be recognised when the risks and rewards have transferred to the customer which is considered to be on delivery.</p> <p>Errors in the timing of recognising revenue and associated costs could be material.</p> | <p>Our procedures included:</p> <ul style="list-style-type: none"> • Independent re-calculation: re-calculation of management's assessment of i) the estimated financial impact of recognising warranty income on dispatch of associated goods rather than spreading revenue evenly over the extended warranty period and ii) the estimated financial impact of recognising product revenue and associated cost of sales on dispatch rather than on delivery to determine whether the combined impact is material; • Test of detail: assessing the appropriateness of Management's assumptions used in these calculations by comparing to courier service level agreements and based on our knowledge of the business and industry, gained from performing our other audit procedures; and • Test of detail: agreeing sales and dispatch data used in these calculations to underlying records. |
| Recoverability of Parent company's loan to subsidiary (£10.7m; 2017: £6.9m) Refer to Note 1.5 (accounting policy) and Note 6 (financial disclosures). | <p>Low risk, high value</p> <p>The carrying amount of the Parent company's loan to its subsidiary represents 75% (2017: 68%) of the Company's total assets. The recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the Parent company financial statements, this is considered to be the area that had the greatest effect on our overall Parent company audit.</p> | <p>Our procedures included:</p> <ul style="list-style-type: none"> • Re-performance: re-performance of Management's calculation of the amortised cost calculation to determine its accuracy; • Test of detail: agreeing inputs into this calculation such as book value and repayment terms to loan agreements and subsidiary accounts and considering the appropriateness of the effective interest rate applied; and • Test of detail: Comparing the carrying amount of the total loan balance with the relevant subsidiaries', comparing the carrying amount of the loan with the expected value of the business based on a suitable multiple of the subsidiaries' forecast profit before tax. |

Independent Auditor's Report continued

To the members of Gear4music (Holdings) plc

3 Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £104,800 (2017: £135,000), determined with reference to a benchmark of profit before tax (PBT), normalised by averaging over the last two years due to fluctuations in the business cycle, of £2.1m. Materiality represents 5.0% of the benchmark (2017: 5% reported profit before tax).

Materiality for the parent Company financial statements as a whole was set at £57,200 (2017: £135,000), determined with reference to a benchmark of Company total assets, of which it represents 0.4% (2017: 1%).

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £7,040 in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's four (2017: four) reporting components, including the parent Company, we subjected two (2017: two) to full-scope audits for Group purposes and two (2017: two) to specified risk-focused audit procedures. The latter were not individually significant but were included in the scope of our Group reporting work in order to provide further coverage over the Group's results. All procedures were undertaken by the Group audit team at the Group's head office based in York.

The components within the scope of our work accounted for the percentages illustrated opposite.

4 We have nothing to report on going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least 12 months from the date of approval of the financial statements. We have nothing to report in these respects.

5 We have nothing to report on the other information in the Annual Report

The Directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

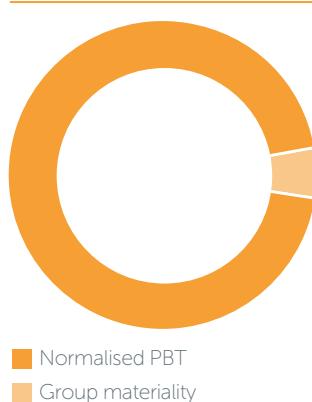
Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and Directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the Directors' report;
- in our opinion, the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Normalised profit before tax
£2.1m (2017: reported profit before tax £2.3m)



Group materiality
£104,800
(2017: £135,000)

£104,800
Whole financial statements materiality (2017: £135,000)

£100,000
Range of materiality at two components (£57,200–£100,000)
(2017: £134,000–£135,000)

£7,040
Misstatements reported to the Audit Committee (2017: £4,875)

Group revenue



Group profit before tax



Group total assets



Full-scope for Group audit purposes 2018
Specified risk-focused audit procedures 2018
Full-scope for Group audit purposes 2017
Specified risk-focused audit procedures 2017

6 We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects

7 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 42, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

8 The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Katharine L'Estrange (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1 Sovereign Square
Sovereign Street
Leeds
LS1 4DA

2 July 2018

Consolidated Statement of Profit and Loss and Other Comprehensive Income

| | Note | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|-------|---|---|
| Revenue | | 80,100 | 56,128 |
| Cost of sales | | (59,781) | (40,983) |
| Gross profit | | 20,319 | 15,145 |
| Administrative expenses | 2,3,4 | (18,358) | (12,529) |
| Operating profit | 3 | 1,961 | 2,616 |
| Financial income | 6 | – | 67 |
| Financial expense | 6 | (461) | (47) |
| Profit before tax | | 1,500 | 2,636 |
| Taxation | 7 | (114) | (322) |
| Profit for the year | | 1,386 | 2,314 |
| Other comprehensive income | | | |
| Items that will not be reclassified to profit or loss: | | | |
| Revaluation of property, plant and equipment | 8 | 1,716 | – |
| Deferred tax movements | 11 | (203) | – |
| Items that are or may be reclassified subsequently to profit or loss: | | | |
| Foreign currency translation differences – foreign operations | | 2 | 10 |
| Total comprehensive income for the year | | 2,901 | 2,324 |
| Basic profit per share | 5 | 6.7p | 11.5p |
| Diluted profit per share | 5 | 6.7p | 11.4p |

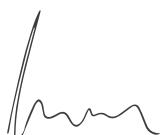
The accompanying notes form an integral part of the financial statements.

Consolidated Statement of Financial Position

| | Note | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|------|---|---|
| Non-current assets | | | |
| Property, plant and equipment | 8 | 10,054 | 1,565 |
| Intangible assets | 9 | 6,378 | 5,537 |
| | | 16,432 | 7,102 |
| Current assets | | | |
| Inventories | 12 | 17,055 | 11,686 |
| Trade and other receivables | 13 | 2,704 | 1,348 |
| Cash and cash equivalents | 14 | 3,540 | 3,001 |
| | | 23,299 | 16,035 |
| Total assets | | 39,731 | 23,137 |
| Current liabilities | | | |
| Other interest-bearing loans and borrowings | 15 | (3,914) | (2,621) |
| Trade and other payables | 16 | (10,916) | (7,379) |
| | | (14,830) | (10,000) |
| Non-current liabilities | | | |
| Other interest-bearing loans and borrowings | 15 | (4,616) | (24) |
| Other payables | 16 | (751) | (1,069) |
| Deferred tax liability | 11 | (649) | (322) |
| | | (6,016) | (1,415) |
| Total liabilities | | (20,846) | (11,415) |
| Net assets | | 18,885 | 11,722 |
| Equity | | | |
| Share capital | 18 | 2,087 | 2,016 |
| Share premium | 18 | 13,055 | 8,933 |
| Foreign currency translation reserve | 18 | 12 | 10 |
| Revaluation reserve | 18 | 1,424 | – |
| Retained earnings | 18 | 2,307 | 763 |
| Total equity | | 18,885 | 11,722 |

The Notes 1 to 22 form part of these financial statements.

These financial statements were approved by the Board of Directors on 2 July 2018 and were signed on its behalf by:



Andrew Wass
Director
2 July 2018



Chris Scott
Director
2 July 2018

Company registered number: 07786708

Consolidated Statement of Changes in Equity

| | Note | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|------|---|---|
| Share capital | | | |
| Opening | | 2,016 | 2,016 |
| Issue of share capital | | 71 | – |
| At 28 February 2018 | 18 | 2,087 | 2,016 |
| Share premium | | | |
| Opening | | 8,933 | 8,933 |
| Issue of shares | | 4,278 | – |
| Share issue costs | | (156) | – |
| At 28 February 2018 | 18 | 13,055 | 8,933 |
| Foreign currency translation reserve | | | |
| Opening | | 10 | – |
| Other comprehensive income | | 2 | 10 |
| At 28 February 2018 | 18 | 12 | 10 |
| Revaluation reserve | | | |
| Opening | | – | – |
| Freehold property revaluation | | 1,716 | – |
| Deferred tax movement | | (292) | – |
| At 28 February 2018 | 18 | 1,424 | – |
| Retained earnings | | | |
| Opening | | 763 | (1,590) |
| Share-based payment charge | 19 | 69 | 39 |
| Deferred tax prior year adjustment re: share-based payments | 11 | 89 | – |
| Profit for the year | | 1,386 | 2,314 |
| At 28 February 2018 | 18 | 2,307 | 763 |
| Total equity | 18 | 18,885 | 11,722 |

The accompanying Notes form an integral part of the financial statements.

Consolidated Statement of Cash Flows

| | Note | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|-------|---|---|
| Cash flows from operating activities | | | |
| Profit for the year | | 1,386 | 2,314 |
| Adjustments for: | | | |
| Depreciation and amortisation | 3,8,9 | 1,497 | 1,001 |
| Foreign exchange losses | | 2 | 10 |
| Financial expense | 6 | 196 | 47 |
| Loss on sale of property, plant and equipment | | 6 | – |
| Share-based payment charge | | 69 | 39 |
| Taxation | 7 | 114 | 322 |
| | | 3,270 | 3,733 |
| Increase in trade and other receivables | 13 | (1,356) | (608) |
| Increase in inventories | 12 | (5,369) | (4,780) |
| Increase in trade and other payables | 16 | 3,602 | 1,870 |
| | | 147 | 215 |
| Tax paid | 7 | 10 | (104) |
| Net cash from operating activities | | 157 | 111 |
| Cash flows from investing activities | | | |
| Proceeds from sale of property, plant and equipment | | 19 | – |
| Acquisition of property, plant and equipment | 8 | (7,443) | (717) |
| Capitalised development expenditure | 9 | (1,693) | (1,478) |
| Acquisition of a business | 9 | (400) | (100) |
| Net cash from investing activities | | (9,517) | (2,295) |
| Cash flows from financing activities | | | |
| Cash from share issue | | 4,193 | – |
| Proceeds from new borrowings | 17 | 5,986 | 1,878 |
| Interest paid | | (178) | (47) |
| Payment of finance lease liabilities | | (102) | (194) |
| Net cash from financing activities | | 9,899 | 1,637 |
| Net increase/(decrease) in cash and cash equivalents | | 539 | (547) |
| Cash and cash equivalents at beginning of year | | 3,001 | 3,548 |
| Cash and cash equivalents at end of year | 14 | 3,540 | 3,001 |

The accompanying Notes form an integral part of the financial statements.

Notes (forming part of the Financial Statements)

General information

Gear4music (Holdings) plc is a public limited company, is incorporated and domiciled in the United Kingdom, and is listed on the Alternative Investment Market ('AIM') of the London Stock Exchange.

The Group financial statements consolidate those of the Company and its subsidiaries (collectively referred to as the 'Group'). The parent Company financial statements present information about the Company as a separate entity and not about its Group.

The principal activity of the Group is the retail of musical instruments and equipment.

The registered office of Gear4music (Holdings) plc (company number: 07786708), Gear4music Limited (company number: 03113256) and Cagney Limited (dormant subsidiary; company number: 04493300) is Kettlestring Lane, Clifton Moor, York YO30 4XF.

The Group has two trading European subsidiaries: Gear4music Sweden AB and Gear4music GmbH, and one dormant European subsidiary, Gear4music Norway AS. All three are 100% subsidiaries of Gear4music Limited.

1 Accounting policies

1.1 Basis of preparation

The financial statements have been prepared in accordance with the AIM rules for Companies, and apply the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ('Adopted IFRSs') and make amendments where necessary in order to comply with the Companies Act 2006. The Company has elected to prepare its parent Company financial statements in accordance with FRS 102; these are presented on pages 76 to 83.

The Group's accounting policies are set out below and have been applied consistently in the consolidated financial statements. Subjective judgements made by the Directors in the application of these accounting policies that could have significant effect on the financial statements are considered in Note 22.

Accounting period

The financial statements presented cover the years ended 28 February 2018 and 28 February 2017.

Measurement convention

The financial statements have been prepared on the historical cost basis except for the following assets and liabilities that are stated at their fair value:

- Land and buildings

1.2 Adoption of new and revised standards

Various new or revised accounting standards have been issued which are not yet effective. The key ones affecting the Group are described below. The Group does not intend to early adopt these standards.

- IFRS 9 'Financial instruments' will be effective for the year ending February 2019 onwards. IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities, a new basis for recognising provisions based on expected credit losses, and simplified hedge accounting. The Group has considered the impact of IFRS 9 and, given the nature of the Group's business, its debt structure and absence of hedging, adoption is not expected to have a material impact on the Income Statement or Balance Sheet.
- IFRS 15 'Revenue from contracts with customers' will be effective for the year ending February 2019 onwards, and is not expected to materially impact on the Group's profit. The significant majority of the Group's revenue comes from products sales made direct to customers at standard prices and estimates are already made of anticipated returns.
- IFRS 16 'Leases' will be effective for the year ending February 2020. IFRS 16 fundamentally changes the accounting for leases by lessees and eliminates the current IAS 17 dual accounting model, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases and, instead, introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting.

The Group has four leased properties (in York, Manchester, Sweden and Germany) and a small number of warehouse equipment on operating leases. The minimum lease commitments on these at the financial year end are disclosed in Note 20 and these leases will be recognised on balance sheet once this standard is adopted. Warehouse equipment leases have £7,992 of lease commitments remaining and these are scheduled to be repaid in full in the financial year ended February 2019, and as such will only be relevant for comparative purposes.

On the adoption of IFRS 16, lease agreements will give rise to both a right-of-use asset and a lease liability for future lease payables. The right-of-use asset will be depreciated on a straight-line basis over the life of the lease. Interest will be recognised on the lease liability, resulting in a higher interest expense in the earlier years of the lease term. The total expense recognised in the Income Statement over the life of the lease will be unaffected by the new standard. However, IFRS 16 will result in the timing of lease expense recognition being accelerated for leases which would be currently accounted for as operating leases.

1 Accounting policies continued

1.2 Adoption of new and revised standards – IFRS 16 continued

There will be no impact on cash flows, although the presentation of the Cash Flow Statement will change significantly, with an increase in cash flows from operating activities being offset by an increase in cash flows from financing activities. The Group is working to ensure that relevant data is collected and key assumptions such as discount rates are duly considered and agreed. The Group will take all necessary steps to comply with the requirements of IFRS 16 and expects to make further disclosure in the next Annual Report.

1.3 Going concern

The Group's business activities and position in the market are described in the Strategic Report. The Directors believe that given the Group has significant financial resources and has demonstrated continued strong revenue growth and there is a good level of underlying profitability from operating activities, the Group is well placed to manage its business risks.

The Group's policy is to ensure that it has sufficient facilities to cover its future funding requirements. Short-term flexibility is available through trade finance and overdraft facilities. At 28 February 2018, the Group had £3.6m of cash and bank balances and on 10 May 2018 the Group's bankers, HSBC, confirmed that the Group's trade finance and overdraft facilities had been approved for renewal at £6m (FY2017: £4m) for a further 12 months. HSBC has confirmed the Group met its covenants in FY2018.

Having duly considered all of these factors and having reviewed the forecasts for the coming year including the investments outlined in the CEO's statement, the Directors have a reasonable expectation that the Group has adequate resources to continue trading for the foreseeable future, and as such continue to adopt the going concern basis of accounting in preparing the financial statements.

1.4 Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing control, the Group takes into consideration potential voting rights that are currently exercisable. The acquisition date is the date on which control is transferred to the acquirer. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated.

1.5 Foreign currency

International transactions that are denominated in foreign currencies are recorded in the respective foreign currencies, and translated into the functional currency of the Group, Sterling, at the exchange rate ruling at the date of the transaction. Translational accounting gains and losses are recognised in the income statement in the period they arise.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to the Group's presentational currency, Sterling, at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated at an average rate for the year where this rate approximates to the foreign exchange rates ruling at the dates of the transactions. Exchange differences arising from this translation of foreign operations are reported as an item of other comprehensive income and accumulated in the translation reserve.

Functional currency

The consolidated financial statements are presented in Sterling, which is the Group's functional currency.

1.6 Classification of financial instruments issued by the Group

Following the adoption of IAS 32, financial instruments issued by the Group are treated as equity only to the extent that they meet the following two conditions:

- (a) they include no contractual obligations upon the Company (or Group as the case may be) to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company (or Group); and
- (b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

Notes (forming part of the Financial Statements) **continued**

1 Accounting policies continued

1.6 Classification of financial instruments issued by the Group continued

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in this financial information for called-up share capital and share premium account exclude amounts in relation to those shares.

1.7 Non-derivative financial instruments

Non-derivative financial instruments comprise investments, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Trade and other receivables

Trade and other receivables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses.

Trade and other payables

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose only of the cash flow statement.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributed transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method.

1.8 Property, plant and equipment

Certain classes of property, plant and equipment as stated below are stated at cost less accumulated depreciation and accumulated impairment losses.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Depreciation is charged to the income statement on either a straight-line basis or a reducing balance basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives are as follows:

- Plant and equipment 4-5 years straight line
- Fixtures and fittings 20-25% on reducing balance
- Motor vehicles 25% on reducing balance
- Computer equipment 3-5 years straight line

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

Leases in which the Group assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and less accumulated impairment losses. Lease payments are accounted for as described below in 1.16.

Land and buildings are stated at fair value.

Revaluation

Revaluations are made with reference to independent, third-party professional inspection of the site. Independent valuations will be sought on a regular basis such that the carrying value does not materially differ from its fair value.

Surpluses which arise from the revaluation exercise are included within other comprehensive income (in the revaluation reserve) unless they are reversing a revaluation adjustment which has been recognised in the income statement previously, in which case an amount equal to a maximum of that recognised in the income statement previously is recognised in income.

Where the revaluation exercise gives rise to a deficit, this is reflected directly within the income statement, unless it is reversing a previous revaluation surplus against the same asset, in which case an amount equal to the maximum of the revaluation surplus is recognised within other comprehensive income (in the revaluation reserve).

1 Accounting policies continued

1.9 Business combinations

All business combinations are accounted for by applying the acquisition method. Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group.

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the fair value of the existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

Costs related to the acquisition are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration are recognised in profit or loss.

Goodwill impairment testing

Goodwill is not amortised but tested annually for impairment. For the purpose of impairment testing, the goodwill is allocated to cash-generating units, or ('CGU'). Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment is tested reflects the lowest level at which goodwill is monitored for internal reporting purposes.

1.10 Intangible assets

Software platform

Computer software development costs that generate economic benefits beyond one year and meet the development asset recognition criteria as laid out in IAS 38 'Intangible assets', are capitalised as intangible assets.

These costs include the payroll costs of employees directly associated with the development of the software platform, and other direct external material and service costs. Costs are capitalised only where there is an identifiable development that will bring future economic benefit. All other website and maintenance costs are expenses in the statement of comprehensive income.

Capitalised software development costs are amortised over their estimated useful lives and charged to administrative expenses in the statement of comprehensive income.

Other intangible assets

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred. Other intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and less accumulated impairment losses.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets from the date they are available for use. The estimated useful lives are as follows:

- Brand 10 years; and
- Software platform 3-8 years

1.11 Inventories

Inventories are stated at the lower of cost and net realisable value ('NRV'). Cost is based on the first-in, first-out principle and includes expenditure incurred in acquiring the inventories and other costs in bringing them to their existing location and condition. Stock is neither fashionable nor perishable.

A provision is made in respect of inventories as follows:

- 100% against returns stock found to be faulty that is retained to be used for spare parts on the basis there is no direct NRV; and
- a provision for the expected product loss on dealing with returns stock.

Notes (forming part of the Financial Statements) **continued**

1 Accounting policies continued

1.12 Impairment excluding inventories and deferred tax assets

Financial assets (including receivables)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows. The effect of discounting is not material. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, the recoverable amount is estimated each year at the same time.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the 'cash-generating unit'). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash-generating units, or ('CGUs'). Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment is tested reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

An impairment loss would be recognised if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. No impairments have been recognised in the periods presented.

1.13 Employee benefits

Defined contribution plans

A defined contribution pension plan is a post-employment benefit plan under which the Group pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement in the periods during which services are rendered by employees.

Share-based payment transactions

Share-based payment arrangements in which the Group receives goods or services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the Group.

The grant date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The fair value of the options granted is measured using the Black-Scholes model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

Share-based payment transactions in which the Group receives goods or services by incurring a liability to transfer cash or other assets that is based on the price of the Group's equity instruments are accounted for as cash-settled share-based payments. The fair value of the amount payable to employees is recognised as an expense, with a corresponding increase in liabilities, over the period in which the employees become unconditionally entitled to payment. The liability is remeasured at each balance sheet date and at settlement date. Any changes in the fair value of the liability are recognised as personnel expense in profit or loss.

1.14 Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects risks specific to the liability.

1 Accounting policies continued

1.15 Revenue

Revenue from the sale of goods and delivery receipts is recognised upon dispatch from the warehouse.

Revenue is measured at the fair value of the consideration received, including freight charges and duty where applicable, excluding discounts, rebates, VAT and other sales taxes or duty. Returns are dealt with on receipt of the product into the warehouse which triggers an automatic credit, and an estimate for returns is provided for at the year end.

The Group offers retail point-of-sale credit on orders over £50, through agreements with external credit providers. The Group does not retain any credit risk and commissions are recognised within revenue on recognition of the credit sale. In the year ended 28 February 2018 this income totalled £112,000 (FY2017: £102,000). No discount is offered on any sales made through this credit provider.

1.16 Expenses

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Exceptional items

Items which are significant by virtue of their size or nature and which are considered to be non-recurring are classified as exceptional operating items. Such items are included within the appropriate consolidated income statement category but are highlighted separately in the notes to the financial information. Exceptional operating items are excluded from the profit measures used by the Board to monitor and measure the underlying performance of the Group.

Government and other forms of grant

Government and other grants from third parties are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as a reduction in the costs incurred, on a systematic basis over the periods that the costs, for which it is intended to compensate, are expensed. Where the grant relates to an asset, it is recognised on a systematic basis over the UEL of the related asset.

Financing income and expenses

Financing expenses comprise interest payable and finance leases recognised in profit or loss using the effective interest method, unwinding of the discount on provisions, and net foreign exchange losses that are recognised in the income statement (see foreign currency accounting policy). Financing income comprises interest receivable on funds invested and net foreign exchange gains.

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method.

1.17 Taxation

Tax on the profit or loss for the year comprises current and deferred tax.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. A temporary difference on the initial recognition of goodwill is not provided for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amounts of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

1.18 Segmental reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. The Group's Chief Operating Decision Maker has been identified as the Board of Directors.

Notes (forming part of the Financial Statements) *continued*

2 Segmental reporting

The Group's revenue and profit was derived from its principal activity, which is the sale of musical instruments and equipment.

In accordance with IFRS 8 'Operating segments', the Group has made the following considerations to arrive at the disclosure made in these financial statements. IFRS 8 requires consideration of the Chief Operating Decision Maker ('CODM') within the Group. Operating segments have been identified based on the internal reporting information and management structures within the Group. Based on this information it has been noted that the CODM reviews the business as one segment and receives internal information on this basis. Therefore, it has been concluded that there is only one reportable segment.

Revenue by geography

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------------|---|---|
| UK | 44,258 | 34,865 |
| Europe and Rest of the World | 35,842 | 21,263 |
| | 80,100 | 56,128 |

Administrative expenses by geography

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------------|---|---|
| UK | 16,823 | 12,050 |
| Europe and Rest of the World | 1,535 | 479 |
| | 18,358 | 12,529 |

Revenue by product category

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|----------------------|---|---|
| Other-brand products | 56,075 | 39,351 |
| Own-brand products | 20,947 | 14,449 |
| Other | 3,078 | 2,328 |
| | 80,100 | 56,128 |

3 Expenses

Included in profit/loss are the following:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|---|---|
| Depreciation of tangible fixed assets | 645 | 391 |
| Amortisation of intangible assets | 852 | 610 |
| Amortisation of government grants | 31 | 31 |
| Loss on disposal of property, plant and equipment | 6 | – |
| Rentals under operating leases – land and buildings | 973 | 466 |
| Rentals under operating leases – plant and machinery | 11 | 11 |
| Auditor remuneration – audit of financial statements | 50 | 40 |
| Auditor remuneration – other | 17 | 60 |

4 Staff numbers and costs

The average number of persons employed (full-time equivalents) by the Group (including Directors) during the period, analysed by category, was as follows:

| | Year ended 28 February 2018 No. | Year ended 28 February 2017 No. |
|--------------------------|--|--|
| Administration | 130 | 87 |
| Selling and distribution | 183 | 123 |
| | 313 | 210 |

The aggregate payroll costs of these persons were as follows:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|---|---|
| Wages and salaries | 5,428 | 3,808 |
| Equity-settled share-based payments (see Note 19) | 69 | 39 |
| Cash-settled share-based payments (see Note 19) | 8 | 57 |
| Social security costs | 701 | 333 |
| Contributions to defined contribution plans | 126 | 33 |
| Amounts paid to third parties in respect of Directors' service | – | 19 |
| | 6,332 | 4,289 |

Directors' remuneration is disclosed in Note 3 of the Notes to the Company Financial Statements on page 81.

5 Earnings per share

Diluted profit per share is calculated by dividing the net profit for the period attributable to Ordinary shareholders by the weighted average number of Ordinary shares outstanding during the period plus the weighted average number of Ordinary shares that would be issued on the conversion of all dilutive potential Ordinary shares into Ordinary shares.

| | Year ended 28 February 2018 | Year ended 28 February 2017 |
|---|-----------------------------------|-----------------------------------|
| Profit attributable to equity shareholders of the parent (£000) | 1,386 | 2,314 |
| Basic weighted average number of shares | 20,713,281 | 20,156,339 |
| Dilutive potential Ordinary shares | 88,155 | 79,288 |
| Diluted weighted average number of shares | 20,801,436 | 20,235,627 |
| Basic profit per share | 6.7p | 11.5p |
| Diluted profit per share | 6.7p | 11.4p |

6 Finance income and expense

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|---|---|
| Finance income | | |
| Net foreign exchange gain | – | 67 |
| Total finance income | – | 67 |
| Finance expense | | |
| Bank interest | 169 | 29 |
| Finance leases | 9 | 18 |
| Net foreign exchange loss | 265 | – |
| Fair value movement on deferred consideration | 18 | – |
| Total finance expense | 461 | 47 |

Notes (forming part of the Financial Statements) continued

7 Taxation

Recognised in the income statement

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|---|---|
| Current tax expense | | |
| UK corporation tax | 4 | 104 |
| Overseas corporation tax | 10 | – |
| Adjustments for prior periods | (24) | – |
| Current tax expense | (10) | 104 |
| Deferred tax expense | | |
| Origination and reversal of temporary differences | 79 | 203 |
| Deferred tax rate change impact | – | (7) |
| Adjustments for prior periods | 45 | 22 |
| Deferred tax expense | 124 | 218 |
| Total tax expenses | 114 | 322 |

The corporation tax rate applicable to the Company was 19.08% in the year ended 28 February 2018 and 20% in the year ended 28 February 2017. Reductions to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Company's future current tax charge accordingly. The deferred tax assets and liabilities at 28 February 2018 have been calculated based on these rates.

Reconciliation of effective tax rate

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|---|---|
| Profit for the period | 1,386 | 2,314 |
| Total tax charge | 114 | 322 |
| Profit excluding taxation | 1,500 | 2,636 |
| Current tax at 19.08% (2017: 20.00%) | | – |
| Tax using the UK corporation tax rate for the relevant period | 286 | 527 |
| Non-deductible expenses | 32 | (189) |
| Difference between current and deferred tax rates | (8) | (38) |
| Adjustments relating to prior year – deferred tax | 45 | 22 |
| Adjustments relating to prior year – current tax | (24) | – |
| R&D claim additional deduction | (219) | – |
| Impact of overseas tax rate | 2 | – |
| Total tax charge | 114 | 322 |

8 Property, plant and equipment

| | Plant and equipment £000 | Fixtures and fittings £000 | Motor vehicles £000 | Computer equipment £000 | Land and buildings £000 | Total £000 |
|--|--------------------------|----------------------------|---------------------|-------------------------|-------------------------|---------------|
| Cost | | | | | | |
| At 1 March 2016 | 463 | 1,464 | – | 329 | – | 2,256 |
| Additions | 90 | 443 | 64 | 120 | – | 717 |
| Balance at 28 February 2017 & 1 March 2017 | 553 | 1,907 | 64 | 449 | – | 2,973 |
| Additions | 234 | 1,384 | 29 | 162 | 5,634 | 7,443 |
| Disposals | – | – | (31) | – | – | (31) |
| Revaluation | – | – | – | – | 1,716 | 1,716 |
| Balance at 28 February 2018 | 787 | 3,291 | 62 | 611 | 7,350 | 12,101 |
| Depreciation and impairment | | | | | | |
| At 1 March 2016 | 180 | 618 | – | 219 | – | 1,017 |
| Depreciation charge for the year | 113 | 218 | 6 | 54 | – | 391 |
| Balance at 28 February 2017 & 1 March 2017 | 293 | 836 | 6 | 273 | – | 1,408 |
| Depreciation charge for the period | 151 | 394 | 15 | 85 | – | 645 |
| Disposals | – | – | (6) | – | – | (6) |
| Balance at 28 February 2018 | 444 | 1,230 | 15 | 358 | – | 2,047 |
| Net book value as at 28 February 2018 | 343 | 2,061 | 47 | 253 | 7,350 | 10,054 |
| Net book value as at 28 February 2017 | 260 | 1,071 | 58 | 176 | – | 1,565 |

Freehold property revaluation

On 30 June 2017, the Group acquired a freehold office premises at Holgate Park, York for £5.30m. Total amounts capitalised on acquisition were totalled £5.63m.

At 28 February 2018, the freehold property was revalued at market value using information provided by an independent chartered surveyor. The valuation was carried out in accordance with the provisions of RICS Appraisal and Valuation Standards ('The Red Book').

Leased assets

At 28 February 2018, the net carrying amount of leased tangible fixed assets was £98,000 (2017: £232,000), and the accumulated depreciation against leased assets was £286,000 (2017: £265,000).

Security

The Group's bank borrowings are secured by fixed and floating charges over the Group's assets.

9 Intangible assets

| | Goodwill £000 | Software platform £000 | Brand £000 | Total £000 |
|--|---------------|------------------------|------------|--------------|
| Cost | | | | |
| At 1 March 2016 | 417 | 3,367 | 564 | 4,348 |
| Additions | 1,431 | 1,478 | – | 2,909 |
| Balance at 28 February 2017 & 1 March 2017 | 1,848 | 4,845 | 564 | 7,257 |
| Additions | – | 1,693 | – | 1,693 |
| Balance at 28 February 2018 | 1,848 | 6,538 | 564 | 8,950 |
| Amortisation | | | | |
| At 1 March 2016 | – | 884 | 226 | 1,110 |
| Amortisation for the year | – | 554 | 56 | 610 |
| Balance at 28 February 2017 & 1 March 2017 | – | 1,438 | 282 | 1,720 |
| Amortisation for the year | – | 796 | 56 | 852 |
| Balance at 28 February 2018 | – | 2,234 | 338 | 2,572 |
| Net book value as at 28 February 2018 | 1,848 | 4,304 | 226 | 6,378 |
| Net book value as at 28 February 2017 | 1,848 | 3,407 | 282 | 5,537 |

The amortisation charge is recognised in Administrative expenses in the profit and loss account.

Notes (forming part of the Financial Statements) *continued*

9 Intangible assets continued

Goodwill

On 19 March 2012, goodwill arose on the acquisition of the entire share capital of Gear4music Limited (formerly known as Red Submarine Limited).

On 1 January 2017, goodwill arose on the acquisition of a software development team from Venditan Limited, the team responsible for the development of the Group's proprietary software platform. This transaction is outlined in detail in last year's Annual Report.

Goodwill balances are denominated in Sterling.

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---------------------------|---|---|
| Gear4music Limited | 417 | 417 |
| Software development team | 1,431 | 1,431 |
| | 1,848 | 1,848 |

Impairment testing

In accordance with IAS 36, 'Impairment of assets', the Group reviews the carrying value of its intangible assets. A detailed review was undertaken at 28 February 2018 to assess whether the carrying value of assets was supported by the net present value-in-use calculations based on cash flow projections from formally approved budgets and longer-term forecasts.

Intangible assets comprise goodwill, the Gear4music brand name, and the proprietary software platform.

A Cash Generating Unit ('CGU') is defined as the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups thereof. The Group is deemed to have a single CGU to which the goodwill, the software platform and the brand are allocated. An impairment review has been performed on this CGU. The recoverable amount of this CGU has been determined based on value-in-use calculations. In assessing value in use, a five-year forecast to 28 February 2023 was used to provide cash flow projections that have been discounted at a pre-tax discount rate of 10%. The cash flow projections are subject to key assumptions in respect of revenue growth, gross margin performance, overhead expenditure and capital expenditure. Management has reviewed and approved the assumptions inherent in the model:

- Revenue forecasts based on growth by geographical market, at a range of growth levels based on market size and estimate of opportunity, trends, specific projects underway, and Management's experience and expectation.
- Product costs are assumed to be broadly flat and gross margins are forecast to improve from FY18 towards those achieved in FY17.
- Wage increases are a function of recruitment and a person-by-person review of current staff, with a range of percentage increases.

No impairment loss was identified in the current year (FY17: £nil). The valuation indicates significant headroom and therefore a terminal growth rate assumption has not been needed to be applied in order to support the valuation of this CGU. Any reasonably possible change in other key assumptions, including the discount rate, would not result in an impairment of the related goodwill or other intangible assets.

10 Investments in subsidiaries

The Company has the following investments in subsidiaries which are included in the consolidated results of the Group:

| Subsidiaries | Registered office address | Registered number | Class of shares held | Ownership |
|----------------------|---|-------------------|----------------------|------------------|
| Gear4music Limited | Kettlestring Lane, Clifton Moor, York YO30 4XF | 03113256 | Ordinary | 100% |
| Cagney Limited | Kettlestring Lane, Clifton Moor, York YO30 4XF | 04493300 | Ordinary | 100% via G4M Ltd |
| Gear4music Sweden AB | Tallbacksgatan 16 B, 195 72 Rosersberg, Stockholm County, Sweden | 559070-4762 | Ordinary | 100% via G4M Ltd |
| Gear4music GmbH | c/o BMH Brautigam&Partner Rechtsanwalte, Schluterstr. 37, 10629 Berlin, Germany | HRB 29067 | Ordinary | 100% via G4M Ltd |
| Gear4music Norway AS | PO Box 2734, Solli, 0204 Oslo, Norway | 917 313 210 | Ordinary | 100% via G4M Ltd |

Investment in share capital is £4,550 in Sweden, £21,660 in Germany and £2,806 in Norway.

All Group companies have 28 February financial year ends.

Cagney Limited and Gear4music Norway AS are dormant companies.

11 Deferred tax assets and liabilities

Movement in deferred tax during the year

| | At 1 March 2017 £000 | Recognised in other comprehensive income £000 | Recognised in income £000 | At 28 February 2018 £000 |
|---|----------------------------|---|---------------------------------|-----------------------------------|
| Temporary differences on intangibles, property, plant and equipment | (352) | (292) | (139) | (783) |
| Carried forward tax losses | 30 | – | 2 | 32 |
| Share-based payments | – | 89 | 13 | 102 |
| | (322) | (203) | (124) | (649) |

Movement in deferred tax during the prior year

| | At 1 March 2016 £000 | Recognised in income £000 | At 28 February 2017 £000 |
|-------------------------------|----------------------------|---------------------------------|-----------------------------------|
| Property, plant and equipment | (350) | (2) | (352) |
| Carried forward tax losses | 246 | (216) | 30 |
| | (104) | (218) | (322) |

12 Inventories

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|----------------|---|---|
| Finished goods | 17,055 | 11,686 |

The cost of inventories recognised as an expense and included in cost of sales in the period amounted to £55.7m (£38.0m in the year ended 28 February 2017).

Management has included a provision of £79,879 (28 February 2017: £69,500), representing a 100% provision against returns stock subsequently found to be faulty, that is retained to be used for spare parts on the basis there is no direct NRV, and a provision based on the expected product loss on dealing with returns stock.

13 Trade and other receivables

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|-------------------|---|---|
| Trade receivables | 1,645 | 1,123 |
| Prepayments | 1,059 | 225 |
| | 2,704 | 1,348 |

Trade receivables includes cash lodged with payment providers, Amazon and the Group's consumer finance partner, and UK and international education and trade accounts where standard credit terms are 30 days (see Note 17b).

14 Cash and cash equivalents

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|---|---|
| Cash and cash equivalents per balance sheet | 3,540 | 3,001 |
| Cash and cash equivalents per cash flow statements | 3,540 | 3,001 |

Notes (forming part of the Financial Statements) *continued*

15 Other interest-bearing loans and borrowings

This note contains information about the Group's interest-bearing loans and borrowings which are carried at amortised cost.

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--------------------------------|---|---|
| Non-current liabilities | | |
| Bank loans | 4,616 | – |
| Finance lease liabilities | – | 24 |
| | 4,616 | 24 |
| Current liabilities | | |
| Bank loans | 3,890 | 2,520 |
| Finance lease liabilities | 23 | 101 |
| | 3,913 | 2,621 |
| Total liabilities | | |
| Bank loans | 8,506 | 2,520 |
| Finance lease liabilities | 23 | 125 |
| | 8,529 | 2,645 |

Bank loans comprise a Trade Finance facility and term loans all provided by the Group's bankers, HSBC, and are secured by fixed and floating charges over the Group's assets.

The interest rate on 180-day import loans drawn under the Trade Finance agreement is 2.45% per annum over HSBC's Sterling base rate, and on an overdraft if and when drawn, is 3.25% over base. Interest on import loans is paid at the maturity of the relevant loan. Interest on an overdraft would be paid monthly in arrears. Trade finance and overdraft facilities were approved for renewal on 10 May 2018 for a 12-month period.

There are two term loans that were drawn around the time of the freehold property acquisition in June 2017:

- the first loan was for £3,727,500 equating to a 70% LTV against the property valuation and is a five-year loan with capital repayments scheduled over 20 years, and interest is 2.04% over LIBOR; and
- the second loan was for £1,797,500 and is a five-year loan with interest of 2.85% over LIBOR.

All borrowings are denominated in Sterling.

Finance lease liabilities

Finance lease liabilities are payable as follows:

| | Minimum lease payments At 28 February 2018 £000 | Interest At 28 February 2018 £000 | Principal At 28 February 2018 £000 |
|----------------------------|---|--|---|
| Less than one year | 24 | 1 | 23 |
| Between one and five years | – | – | – |
| | 24 | 1 | 23 |
| | Minimum lease payments At 28 February 2017 £000 | Interest At 28 February 2017 £000 | Principal At 28 February 2017 £000 |
| Less than one year | 106 | 5 | 101 |
| Between one and five years | 24 | – | 24 |
| | 130 | 5 | 125 |

Finance leases relate to assets located at the distribution centre in York, with net book values of £98,000 (28 February 2017: £232,000).

16 Trade and other payables

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------------------|---|---|
| Current | | |
| Trade payables | 7,325 | 4,970 |
| Accruals and deferred income | 1,456 | 1,151 |
| Deferred consideration | 393 | 393 |
| Government grants | 35 | 28 |
| Other taxation and social security | 1,707 | 837 |
| | 10,916 | 7,379 |
| Non-current | | |
| Accruals and deferred income | 169 | 100 |
| Deferred consideration | 555 | 938 |
| Government grants | 27 | 31 |
| | 751 | 1,069 |

Accruals at 28 February 2018 include:

- £446,000 (2017: £630,000) of rent accrued but not paid, being the difference in cash paid and the average rent charge as expensed, as per the commercial agreement reached with the landlord of the leasehold distribution centre at Clifton Moor, York. On 21 March 2018, the Group entered into a new 15-year lease with a 10-year clean break clause and, as such, this accrual will be released in full in FY19; and
- £161,000 accrual (2017: £100,000) relating to the estimated cash bonuses accrued relating to the Employee and Director share option schemes, and Director Cash Plan (see Note 19).

Deferred consideration is due in relation to the acquisition of the software development team in January 2017 and comprises ten quarterly instalments of £100,000 payable on 1 January/April/July/October. These amounts are valued in the accounts at fair value and subsequently amortised.

Government grants are being spread over the useful economic life of the associated asset and relate to Regional Growth Fund and Leeds City Enterprise Partnership grants towards the acquisition of various capital items. Grant conditions exist linked to job creation, and these criteria have been satisfied.

Deferred consideration is valued at fair value. The Directors consider the carrying amount of other 'trade and other payables' to approximate their fair value.

17 Financial instruments

Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and interest rate risk), credit risk and liquidity risk. The Group's policies on the management of liquidity, credit, interest rate and foreign currency risks are set out below.

The main purpose of the Group's financial instruments, which comprise of term loans, hire purchase, finance leases, cash and liquid resources and various items arising directly from its operations, such as trade receivables and trade payables, is to finance the Group's operations.

Risk management framework

Regular reviews of strategic risks are performed by the Board.

Exposure to foreign currency exchange rates is considered during the budgeting and forecasting processes, and throughout the year.

General commercial risk is considered at an annual insurance review in conjunction with an independent broker, and the appropriate insurance policies put in place.

Notes (forming part of the Financial Statements) **continued**

17 Financial instruments continued

Risk management framework continued

(a) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due.

The Group's policy is to ensure that it has sufficient and appropriately structured facilities to cover its future funding requirements. Short-term flexibility is available through import loans and overdraft facilities and the netting off of surplus funds. The carrying amounts are the amounts due if settled at the period end date. The contractual undiscounted cash flows include estimated interest payments over the life of these facilities.

At 28 February 2018, the Group had £3.6m of cash and bank balances.

| | Effective interest rate % | Carrying amount Year ended 28 February 2018 £000 | Face value Year ended 28 February 2018 £000 | Contractual cash flows | | | |
|----------------|---------------------------|--|---|--------------------------|-------------------|-------------------|-------------------------|
| | | | | Within 1 year £000 | 1-2 years £000 | 2-5 year £000s | Over 5 years £000 |
| Secured loans | 3.03 | 8,490 | 8,506 | 3,890 | 546 | 1,320 | 2,750 |
| Trade payables | – | 7,325 | 7,325 | 7,325 | – | – | – |
| | | 15,815 | 15,831 | 11,215 | 546 | 1,320 | 2,750 |

| | Effective interest rate % | Face value and carrying amount Year ended 28 February 2017 £000 | Total Year ended 28 February 2017 £000 | Contractual cash flows | | | |
|----------------|---------------------------|---|--|--------------------------|-------------------|-------------------|-------------------------|
| | | | | Within 1 year £000 | 1-2 years £000 | 2-5 year £000s | Over 5 years £000 |
| Secured loans | 2.7 | 2,520 | 2,537 | 2,537 | – | – | – |
| Trade payables | – | 4,651 | 4,651 | 4,651 | – | – | – |
| | | 7,171 | 7,188 | 7,188 | – | – | – |

(b) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations.

The Group faces low credit risk as customers typically pay for their orders in full on shipment of the product. Trade sales accounted for 2.0% of 2018 revenue (2017: 1.2%) but credit terms are rarely offered.

There are a small number of education accounts with schools and colleges that have 30-day terms (1.8% of 2018 revenue; 1.9% of 2017 revenue).

Funds lodged with Amazon, Digital River, Klarna and V12 Retail Finance totalling £557,000 on 28 February 2018 (28 February 2017: £394,000) are included in Trade debtors. Credit risk in relation to cash held with financial institutions is considered low risk, given the credit rating of these organisations.

(c) Interest rate risk

The Group's bank borrowings incur interest at variable rates of between 2.45% and 3.25% above the bank's base rate or LIBOR, which exposes the Group to interest rate risk. Loans are with UK-based institutions and denominated in Sterling.

At 28 February 2018, the Group had cash reserves of £3.6m and could utilise these funds to settle debts and mitigate any associated interest risk.

The Group's policy with regard to interest rate risk is to monitor actual and anticipated changes in base rates, and if deemed appropriate seek out alternative financing proposals to ensure retaining a competitive rate.

17 Financial instruments continued

Risk management framework continued

(c) Interest rate risk continued

Profile

At the balance sheet date, the interest rate profile of the Group's interest-bearing financial instruments was:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|---|---|
| Variable rate instruments | | |
| Cash | (3,540) | (3,001) |
| Bank loans | 8,506 | 2,520 |
| | 4,966 | (481) |
| Fixed-rate instruments | | |
| Finance leases | 23 | 125 |
| Total net financial liabilities/(assets) | 4,989 | (356) |

Sensitivity analysis

The calculations below assume that the change occurred at the balance sheet date and had been applied to risk exposures existing at that date. This analysis assumes that all other variables, in particular foreign currency rates, remain constant and considers the effect of financial instruments with variable interest rates.

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 | Impact on closing equity/ profit and loss | Impact on closing equity/ profit and loss |
|-----------------------------|---|---|---|---|
| Increase of 50 basis points | | | | |
| Decrease of 50 basis points | (29) | (6) | 29 | 6 |

(d) Foreign exchange risk

All borrowings are denominated in Sterling.

The Group sells into Europe and the Rest of the World in nine currencies, including Sterling, Euros and, more recently, US Dollars. In the year ended 28 February 2018, 43% (2017: 37%) of total revenue was in non-Sterling currencies, of which 46% (2017: 51%) was in Euros. Where costs (including local tax liabilities) are incurred in these respective currencies, currency balances are retained and payments made in these currencies, thereby mitigating any associated currency loss. The scaling up of the Group's distribution centres in Sweden and Germany has increased the proportion of liabilities denominated in Swedish Krona and Euros (see Note 2), further extending the natural hedge. Surplus foreign currency holdings are reviewed on a daily basis and balances in excess of expected liabilities are converted into Sterling, restricting the period between the transaction and the point of conversion, thereby reducing the transactional risk.

The Group purchases own-branded instruments and equipment from the Far East, transacting in US Dollars. The lead time from committed order to receipt of stock is typically 12-14 weeks, during which time the Group bears currency risk. The Group also trades with one supplier (2017: one supplier) on a trade credit basis with terms of 60 days. The Group has the trading platform ability and sufficient price flexibility to be able to pass on some adverse currency variances should it choose, and the Group generates enhanced margins on these products such that a proportion of these losses could be absorbed. The Group do not currently enter into forward contracts but reviews the situation and would consider committing to such a position should it make commercial sense to do so.

The strength of the US Dollar in the second half of FY17 and start of FY18 impacted on stock intake prices of the Group, directly on own-branded products and indirectly on other-branded products as, whilst the majority of stock had been purchased in Sterling, the branded manufacturers faced similar price inflation. The Group looks to mitigate such events by re-negotiating orders and investing in larger volumes to leverage increasing purchasing economies of scale.

Notes (forming part of the Financial Statements) *continued*

17 Financial instruments continued

Risk management framework continued

(d) Foreign exchange risk continued

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------------------|---|---|
| Trade and other receivables | | |
| Sterling | 312 | 255 |
| US Dollar | 740 | 510 |
| Euro | 88 | 64 |
| Other European currencies | 505 | 294 |
| | 1,645 | 1,123 |
| Cash and cash equivalents | | |
| Sterling | 2,746 | 2,486 |
| Euro | 309 | 205 |
| Other European currencies | 485 | 310 |
| | 3,540 | 3,001 |
| Trade payables | | |
| Sterling | 5,781 | 4,329 |
| US Dollar | 1,200 | 400 |
| Euro | 160 | 93 |
| Other European currencies | 184 | 148 |
| | 7,325 | 4,970 |
| Local sales tax | | |
| Sterling | (171) | (163) |
| Euro | 617 | 305 |
| Other European currencies | 842 | 552 |
| | 1,288 | 694 |

The Group's cash and cash equivalents are not sensitive to foreign exchange variations as currencies held are held to the extent they are required to settle a liability in that currency, or they are converted into Sterling.

Non-Sterling trade receivables include cash lodged with payment providers that is promptly settled. International trade debtors represent an immaterial amount such that the Group is not sensitive to associated foreign exchange variations.

Euro funds are retained to settle Euro-denominated payables. US Dollar-denominated trade payables are not currently bought forward against, but only represent a small exposure that can be otherwise managed, and the Group has started selling in US Dollars.

(e) Debt and capital management

The Group's objective when managing capital, which is deemed to be share capital, is to maximise the return on net invested capital while maintaining its ongoing ability to operate and guarantee adequate returns for shareholders and benefits for other stakeholders, within a sustainable financial structure.

The Group monitors its gearing ratio on a regular basis and makes appropriate decisions in light of the current economic conditions and strategic objectives of the Group.

There were no changes in the Group's approach to capital management during the period. The Group does not have any externally imposed capital requirements. The funding requirements of the Group are met by cash generation from trading, the utilisation of external borrowings, and the cash raised on placing of Ordinary shares.

17 Financial instruments continued

Risk management framework continued

(e) Debt and capital management continued

Fair values and carrying values of financial instruments

A comparison by category of the book values and fair values of the financial assets and liabilities of the Group at 28 February 2018 and 28 February 2017:

| | 28 February 2018 | 28 February 2017 | |
|-----------------------------|--------------------|--------------------|--------------------|
| | Book value £000 | Fair value £000 | Book value £000 |
| Trade and other receivables | 2,704 | 2,704 | 1,348 |
| Cash and cash equivalents | 3,540 | 3,540 | 3,001 |
| Bank loans | (8,506) | (8,490) | (2,520) |
| Finance lease liabilities | (23) | (24) | (126) |
| Trade and other payables | (10,719) | (10,719) | (7,117) |
| Deferred consideration | (1,000) | (948) | (1,400) |
| | (14,004) | (13,937) | (6,814) |
| | | | (6,759) |

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the table.

Trade and other payables and receivables

The fair values of these items are considered to be their carrying value as the impact of discounting future cash flows has been assessed as not material.

Cash and cash equivalents

The fair value of cash and cash equivalents is estimated as its carrying amount where the cash is repayable on demand. The fair value of short-term deposits is considered to be the carrying value as the balances are held in floating rate accounts where the interest rate is reset to market rates.

Long-term and short-term borrowings

Bank loans are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method.

Derivative financial instruments

The Group does not routinely enter into forward exchange contracts. The fair value of any material forward exchange contracts held would be calculated by management based on external valuations received from the Group's bankers.

Deferred consideration

The deferred consideration is assumed to be 100% payable. The consideration has been discounted to present value at 2.7%, being equivalent to the prevailing market rate of interest for a similar financial instrument.

Fair value hierarchy

The table below analyses financial instruments, measured at fair value, into a fair value hierarchy based on the valuation techniques used to determine fair value.

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Notes (forming part of the Financial Statements) continued

17 Financial instruments continued

Risk management framework continued

(e) Debt and capital management continued

Fair value hierarchy continued

| | Level 1 £000 | Level 2 £000 | Level 3 £000 |
|--------------------------------------|----------------------------|---|--------------------------------|
| 28 February 2018 | | | |
| Bank loans | – | (8,490) | – |
| Deferred consideration | – | – | (948) |
| | – | (8,490) | (948) |
| 28 February 2017 | | | |
| Bank loans | – | (2,520) | – |
| Deferred consideration | – | – | (1,331) |
| | – | (2,520) | (1,331) |
| Reconciliation of Level 2 fair value | | | |
| | At 1 March 2017 £000 | Net increase in bank debt £000 | At 28 February 2018 £000 |
| Bank loans | (2,520) | (5,970) | (8,490) |
| Reconciliation of Level 3 fair value | | | |
| | At 1 March 2017 £000 | Payment less unwound discount £000 | At 28 February 2018 £000 |
| Deferred consideration | (1,331) | 383 | (948) |

18 Share capital and reserves

| | Year ended 28 February 2018 Number | Year ended 28 February 2017 Number |
|--|---|---|
| Share capital | | |
| Authorised, called up and fully paid: | | |
| Ordinary shares of 10p each | 20,867,121 | 20,156,339 |

The Company has one class of ordinary share and each share carries one vote and ranks equally with the other ordinary shares in all respects, including as to dividends and other distributions.

On 18 May 2017, the Company completed the placing of 610,000 new Ordinary shares at a price of 690 pence per share, raising £4,209,000 in gross proceeds (£4,064,730 net proceeds). The Company also issued 100,782 new Ordinary shares pursuant to the full exercise of a warrant instrument and received a further £140,087 in gross proceeds (£125,887 net proceeds). A total 710,782 new Ordinary shares were admitted on 24 May 2017, taking the number of Ordinary shares in issue from 20,156,339 to 20,867,121, representing dilution of 3.5%.

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------|---|---|
| Share premium | | |
| Opening at 1 March | 8,933 | 8,933 |
| Issue of shares | 4,278 | – |
| Share issue costs | (156) | – |
| Closing at 28 February | 13,055 | 8,933 |

18 Share capital and reserves continued

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|---|---|
| Foreign currency translation reserve | | |
| Opening at 1 March | 10 | – |
| Translation gain | 2 | 10 |
| Closing at 28 February | 12 | 10 |
| Revaluation reserve | | |
| Opening at 1 March | – | – |
| Freehold property revaluation | 1,716 | – |
| Deferred tax | (292) | – |
| Closing at 28 February | 1,424 | – |

The revaluation reserve represents the unrealised gain generated on revaluation of the freehold office property on 28 February 2018. It represents the excess of the fair value over deemed cost.

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|----------------------------|---|---|
| Retained earnings | | |
| Opening at 1 March | 763 | (1,590) |
| Share-based payment charge | 69 | 39 |
| Deferred tax | 89 | – |
| Profit for the year | 1,386 | 2,314 |
| Closing at 28 February | 2,307 | 763 |

| Reserve | Description and purpose |
|-------------------|---|
| Retained earnings | Cumulative net profits recognised in the consolidated income statement. |

19 Share-based payments

There are four incentive schemes in place (2017: three):

- an Employees' EMI scheme;
- a Directors' EMI scheme relevant to Chris Scott and Gareth Bevan;
- two Directors' cash bonus plans relevant to Andrew Wass who, by virtue of his 34% shareholding, is cash rather than equity rewarded; and
- a CSOP scheme set up in the financial year as, by virtue of its size, the Group was no longer eligible for EMI.

The equity-settled share option plans are for qualifying employees of the Group, and options are settled in equity in the Company and subject to vesting conditions.

All equity-settled share options have an exercise price equal to the nominal value of the shares (10p) that the Company will subsidise by way of a bonus provided there are sufficient distributable reserves, and subject to certain conditions will vest on the third anniversary of the date of grant for initial awards on IPO, the second anniversary for other EMI awards, and the third anniversary for CSOP awards.

The fair value of the cash-settled liability is re-measured at each balance sheet date and settlement date.

Employee EMI Plan

The Board has responsibility for the operation of the Employee EMI Plan and may grant share options over shares to eligible employees. The Board has discretion to select participants in the Employee EMI Plan from eligible employees of the Group. Eligible employees will generally have been employed by the Group for more than three years at the time of award but could be a shorter period at the discretion of the Board.

Awards under the Employee EMI plan awards are only subject to service conditions.

Subject to continued employment, awards will normally be deemed to have been exercised at the end of the relevant vesting period.

Awards will be satisfied by the issue of new shares. The Company will grant a cash bonus to option holders in the month of exercise, the net value of which will be equivalent to the income tax, employee national insurance and the exercise price arising

Notes (forming part of the Financial Statements) continued

in relation to the awards.

19 Share-based payments continued

Director EMI Plan

The Remuneration Committee has responsibility for the operation of the Director EMI Plan and may grant share options over shares to eligible employees and retains discretion as to the operation of the plan.

Executive Directors of the Company are eligible to participate in the Director EMI Plan. Participation is at the discretion of the Remuneration Committee.

Awards under the Director EMI Plan may be exercisable at the end of the vesting period subject to meeting EPS-based targets between the date of grant and vest, and subject to service conditions.

Awards will be satisfied by the issue of new shares. The Company will grant a cash bonus to option holders in the month of exercise, the net value of which will be equivalent to the income tax, employee national insurance and the exercise price arising in relation to the awards.

Director Cash Plans

The Remuneration Committee has responsibility for the operation of the Director Cash Plan and may grant cash bonus awards over shares to eligible employees and retains discretion as to the operation of the plan.

Executive Directors of the Company are eligible to participate in the Director EMI Plan or CSOP. An Executive Director who participates in the Director EMI Plan is not eligible to participate in the Director Cash Plan. Participation is at the discretion of the Remuneration Committee.

Awards under the Director Cash Plan are subject to performance conditions. Awards will be exercisable at the end of the relevant vesting period subject to EPS-based performance conditions and continued employment.

Awards will be settled in cash.

CSOP

The Board has responsibility for matters relating to employee members of the Plan and may grant share options over shares to eligible employees. Eligible employees will generally have been employed by the Group for more than three years at the time of award but could be a shorter period at the discretion of the Board. The Board has discretion to select participants from eligible employees of the Group.

The Remuneration Committee has responsibility for matters relating to Director members of the Plan and may grant share options over shares to eligible employees and retains discretion as to the operation of the plan. Executive Directors of the Company are eligible to participate in the plan. Participation is at the discretion of the Remuneration Committee.

Employee awards under the CSOP awards are only subject to service conditions. Directors' awards are subject to meeting EPS-based targets between the date of grant and vest, and subject to service conditions.

Subject to continued employment, awards will normally be deemed to have been exercised at the end of the relevant three-year vesting period.

Awards will be satisfied by the issue of new shares. The Company will grant a cash bonus to option holders in the month of exercise, the net value of which will be equivalent to the income tax, employee national insurance and the exercise price arising in relation to the awards.

19 Share-based payments continued

The terms and conditions of specific grants are as follows:

| Grant date/employees entitled | Method of settlement accounting | Number of instruments | Vesting conditions | Contractual life of options |
|---|---------------------------------|--|---|-----------------------------|
| Employee EMI Award 1 – Equity-settled award to eight key employees on IPO, granted by parent on 3 June 2015 | Equity | 23,383 | Continued employment | 3 June 2018 |
| Employee EMI Award 2 – Equity-settled award to one key employee, granted by parent on 17 February 2016 | Equity | 1,845 | Continued employment | 17 February 2018 |
| Employee EMI Award 3 – Equity-settled award to two key employees, granted by parent on 26 May 2016 | Equity | 9,433 | Continued employment | 26 May 2018 |
| Employee EMI Award 4 – Equity-settled award to 44 employees, granted by parent on 31 May 2016 | Equity | Initially 27,406; 3,816 forfeit; now 23,590 | Continued employment | 31 May 2018 |
| Director EMI Award 1a – Equity-settled award to Chris Scott and Gareth Bevan, granted by parent on 31 May 2016 | Equity | 19,956 | EPS-based performance criteria and continued employment | 31 May 2018 |
| Director Award 1b – Cash-settled award to Andrew Wass, granted by parent on 31 May 2016 | Cash | Cash equivalent to monetary result for the other Directors | EPS-based performance criteria and continued employment | 31 May 2018 |
| Employee CSOP Award 5 – Equity-settled award to 75 employees, granted by parent on 30 June 2017 | Equity | Initially 7,248; 390 forfeit; now 6,858 | Continued employment | 30 June 2020 |
| Senior Mgmt. CSOP Award 2a – Equity-settled award to Chris Scott and Gareth Bevan and two others, granted by parent on 30 June 2017 | Equity | 7,212 | EPS-based performance criteria and continued employment | 30 June 2020 |
| Director Award 2b – Cash-settled award to Andrew Wass, granted by parent on 30 June 2017 | Cash | Cash equivalent to monetary result for the other Directors | EPS-based performance criteria and continued employment | 30 June 2020 |

The number and weighted average exercise prices of share options are as follows:

| | Weighted average exercise price 2018 | Number of options 2018 | Weighted average exercise price 2017 | Number of options 2017 |
|--|--------------------------------------|------------------------|--------------------------------------|------------------------|
| Outstanding at the beginning of the year | Nil | 79,226 | Nil | 25,226 |
| Forfeited during the year | Nil | (1,409) | Nil | (2,795) |
| Exercised during the year | – | – | – | – |
| Granted during the year | Nil | 14,460 | Nil | 56,795 |
| Lapsed during the year | – | – | – | – |
| Outstanding at the end of the year | Nil | 92,277 | Nil | 79,226 |
| Exercisable at the end of the year | – | 1,845 | – | – |

No share options were exercised in the year. The first award was eligible for exercise on 17 February 2018 and awards totalling 76,362 are eligible for exercise in May-June 2018. The options outstanding at the year end have a nil exercise price and a weighted average contractual life of 0.57 years (28 February 2017: 1.25 years).

Notes (forming part of the Financial Statements) continued

19 Share-based payments continued

The fair values of employee share options were calculated using a Black-Scholes model along with the assumptions detailed below:

| Date of grant | Share price on date of grant (pence) | Exercise price (pence) | Volatility (%) | Vesting period (years) | Dividend yield (%) | Risk-free rate of interest (%) | Fair value (pence) |
|------------------|--------------------------------------|------------------------|----------------|------------------------|--------------------|--------------------------------|--------------------|
| 3 June 2015 | 143.0 | 0.0 | 1% | 3 | 0% | 0.70% | 143.0 |
| 17 February 2016 | 135.0 | 0.0 | 1% | 2 | 0% | 0.70% | 135.0 |
| 26 May 2016 | 132.5 | 0.0 | 11.8% | 2 | 0% | 0.45% | 132.5 |
| 31 May 2016 | 132.5 | 0.0 | 11.8% | 2 | 0% | 0.43% | 132.5 |
| 31 May 2016 | 132.5 | 0.0 | 11.8% | 2 | 0% | 0.43% | 132.5 |
| 30 June 2017 | 720.0 | 0.0 | 52.6% | 3 | 0% | 0.43% | 720.0 |
| 30 June 2017 | 720.0 | 0.0 | 52.6% | 3 | 0% | 0.43% | 720.0 |

The expected volatility is wholly based on the historic volatility (calculated based on the weighted average remaining life of the share options). The total expenses recognised for the year and the total liabilities recognised at the end of the year arising from share-based payments are as follows:

| | 2018 £000 | 2017 £000 |
|--|--------------|--------------|
| Equity-settled share-based payment expense | 69 | 39 |
| Cash-settled share-based payment expense | 8 | 57 |
| | 77 | 96 |
| Opening at 1 March | 104 | 8 |
| | 116 | 47 |
| Recognised in equity | 65 | 57 |
| Recognised as a liability | | |
| Closing at 28 February | 181 | 104 |

20 Commitments

Operating lease commitment

Non-cancellable operating lease rentals are payable as follows:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|----------------------------|---|---|
| Less than one year | 1,112 | 887 |
| Between one and five years | 4,635 | 3,103 |
| More than five years | — | — |
| | 5,747 | 3,990 |

Operating lease commitments relate to property leases of the distribution centre in York, the software development office in Manchester, and distribution centres in Sweden and Germany.

The lease on the York distribution centre was scheduled to end on 22 June 2020. On 21 March 2018, the Group entered into a new 15-year lease with a 10-year clean centre break clause.

21 Related parties

In FY18, 79 employees, including Chris Scott and Gareth Bevan, were granted a total of 14,460 equity-settled share options (2017: 56,795 options to 48 employees), and Andrew Wass was awarded a cash-settled option (see Note 19).

Transactions with key management personnel

The compensation of key management personnel is as follows:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---|---|---|
| Key management emoluments including social security costs | 503 | 470 |
| Company contributions to money purchase pension plans | 17 | 5 |
| | 520 | 475 |

Key management personnel comprise the Chairman, CEO, CFO and CCO. All transactions with key management personnel have been made on an arms-length basis.

Four Directors are accruing retirement benefits under a money purchase scheme (2017: four).

22 Accounting estimates and judgements

The preparation of consolidated financial information in conformity with IFRSs requires Management to make judgements, estimates and assumptions concerning the future, that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. These judgements are based on historical experience and Management's best knowledge at the time and the actual results may ultimately differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis and revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The estimates and assumptions that have significant risk of causing a material adjustment to the carrying value of assets and liabilities are discussed below:

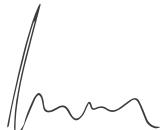
- An accrual for sales returns in the 30-day money back guarantee period is made based on historical returns and actual returns could vary from this estimate.
- Direct software development costs are capitalised as intangible assets. Judgement is applied in assessing the flow of future economic benefit, and in identifying which costs are capitalised and which are written off as an expense. Alternative judgement could result in certain costs being expensed.
- The basis for stock provision and by association the carrying value – given the nature of the products sold, product margins earned, and trading terms with suppliers, Management currently provide for faulty returns retained for spare parts, and an estimate of the product loss to deal with problem stock. At 28 February 2018 the provision is £79,879 (FY2017: £69,519) on gross stock of £16.97m (FY2017: £11.76m). There are no other provisions made.
- Assumptions inherent in the intangible asset and goodwill impairment review – such calculations require judgement relating to the appropriate discount factors and the short, medium and long-term growth prospects. The impairment test carried out is based on a five-year approved management forecast and a 10% discount rate (see Note 9).
- The useful life of tangible and intangible fixed assets – Management selected depreciation and amortisation periods appropriate to the assets held, and consistent with industry and accounting norm. Amortisation periods were independently reviewed as part of an intangible asset valuation exercise on IPO. Different UELs could be applied that would change the profit and loss charge and balance sheet carrying value.

Company Balance Sheet

| | Notes | 2018 | | 2017 | |
|---|-------|---------------|---------------|-------|--------|
| | | £000 | £000 | £000 | £000 |
| Fixed assets | | | | | |
| Investments | | | 3,517 | | 3,195 |
| Current assets | | | | | |
| Cash in hand and at bank | 7 | 17 | | 10 | |
| Debtors (including £10.74m (2017: £6.89m) due after more than one year) | 5,6 | 10,766 | | 6,910 | |
| | | 10,783 | (39) | 6,920 | (34) |
| Creditors: amounts falling due within one year | 8 | | | | |
| Net current assets | | | 10,744 | | 6,886 |
| Total assets less current liabilities | | | 14,261 | | 10,081 |
| Net assets | | | 14,261 | | 10,081 |
| Capital and reserves | | | | | |
| Called-up share capital | 9 | 2,087 | | 2,016 | |
| Share premium account | 9 | 13,055 | | 8,933 | |
| Profit and loss account | 9 | (881) | | (868) | |
| Shareholders' funds | | | 14,261 | | 10,081 |

The Notes 1 to 10 form part of these financial statements.

These financial statements were approved by the Board of Directors on 2 July 2018 and were signed on its behalf by:



Andrew Wass
Director
2 July 2018



Chris Scott
Director
2 July 2018

Company registered number: 07786708

Company Statement of Changes in Equity

| | Note | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|----------------------------|------|---|---|
| Share capital | | | |
| Opening | | 2,016 | 2,016 |
| Issue of share capital | | 71 | – |
| At 28 February 2018 | 9 | 2,087 | 2,016 |
| Share premium | | | |
| Opening | | 8,933 | 8,933 |
| Issue of shares | | 4,278 | – |
| Share issue costs | | (156) | – |
| At 28 February 2018 | 9 | 13,055 | 8,933 |
| Retained earnings | | | |
| Previous periods | | (868) | (756) |
| Shared-based payments | | 69 | 39 |
| Loss for the year | | (82) | (151) |
| At 28 February 2018 | 9 | (881) | (868) |
| Total equity | 9 | 14,261 | 10,081 |

The accompanying Notes form an integral part of the financial statements.

Notes to the Company Financial Statements (forming part of the Financial Statements)

1 Accounting policies

The Company's principal activity is to act as the holding company for the Group, whose principal activity is the retail of musical instruments and equipment.

1.1 Basis of preparation

These financial statements were prepared in accordance with Financial Reporting Standard 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland, ('FRS 102') as issued in August 2014. The amendments to FRS 102 issued in July 2015 and effective immediately have been applied. The presentation currency of these financial statements is Sterling. All amounts in the financial statements have been rounded to the nearest £1,000.

Under section 408 of the Companies Act 2006 the Company is exempt from the requirement to present its own profit and loss account.

In these financial statements, the Company is considered to be a qualifying entity (for the purposes of this FRS) and has applied the exemptions available under FRS 102 in respect of the following disclosures:

- reconciliation of the number of shares outstanding from the beginning to the end of the period;
- cash flow statement and related notes; and
- key management personnel compensation.

As the consolidated financial statements of the Company include the equivalent disclosures, the Company has also taken the exemptions under FRS 102 available in respect of the following disclosures:

- certain disclosures required by FRS 102.26 Share based payments; and
- the disclosures required by FRS 102.11 Basic financial instruments and FRS 102.12 Other financial instrument issues in respect of financial instruments not falling within the fair value accounting rules of Paragraph 36(4) of Schedule 1.

The Company proposed to continue to adopt the reduced disclosure framework FRS 102 in future periods.

Accounting period

The financial statements presented cover the years ended 28 February 2018 and 28 February 2017.

Measurement convention

The financial statements have been prepared on the historical cost basis.

Functional currency

The financial statements are presented in Sterling, which is the Company's functional currency.

1.2 Going concern

These financial statements are prepared on a going concern basis as explained on page 53.

1.3 Investment in subsidiaries

Investments in subsidiaries are stated at cost less any provision for impairment.

1.4 Classification of financial instruments issued by the Company

In accordance with FRS 102.22, financial instruments issued by the Company are treated as equity only to the extent that they meet the following two conditions:

- (a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company; and
- (b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in this financial information for called-up share capital and share premium account exclude amounts in relation to those shares.

1 Accounting policies continued

1.5 Basic financial instruments

Basic financial instruments comprise investments, other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Trade and other debtors

Other receivables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method, less any impairment losses.

Trade and other creditors

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributed transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method.

1.6 Impairment

Financial assets (including debtors)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows. The effect of discounting is not material. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the 'cash-generating unit').

An impairment loss would be recognised if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. No impairments have been recognised in the periods presented.

1.7 Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects risks specific to the liability.

Notes to the Company Financial Statements (forming part of the Financial Statements) continued

1 Accounting policies continued

1.8 Employee benefits

Defined contribution plans

A defined contribution pension plan is a post-employment benefit plan under which the Group pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement in the periods during which services are rendered by employees.

Share-based payment transactions

Share-based payment arrangements in which the Group receives goods or services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the Group.

The grant date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The fair value of the options granted is measured using the Black-Scholes model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

Share-based payment transactions in which the Group receives goods or services by incurring a liability to transfer cash or other assets that is based on the price of the Group's equity instruments are accounted for as cash-settled share-based payments. The fair value of the amount payable to employees is recognised as an expense, with a corresponding increase in liabilities, over the period in which the employees become unconditionally entitled to payment. The liability is remeasured at each balance sheet date and at settlement date. Any changes in the fair value of the liability are recognised as personnel expense in profit or loss.

1.9 Financial income and expenses

Financing expenses comprise interest payable and finance leases recognised in profit or loss using the effective interest method, unwinding of the discount on provisions, and net foreign exchange losses that are recognised in the income statement (see foreign currency accounting policy). Financing income comprises interest receivable on funds invested and net foreign exchange gains.

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method.

Dividend income is recognised in profit and loss on the date the Company's right to receive payment is established.

1.10 Taxation

Tax on the profit or loss for the year comprises current and deferred tax.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

2 Expenses

Included in profit/loss are the following:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|---|---|
| Auditor remuneration – audit of financial statements | 5 | 4 |
| Auditor remuneration – other | 17 | 60 |

3 Directors' remuneration

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|---|---|
| Directors' remuneration | 535 | 501 |
| Company contributions to money purchase pension schemes | 17 | 5 |
| Amounts paid to third parties in respect of Directors' service | – | 19 |
| | 552 | 525 |

There are four Directors (2017: four) for whom retirement benefits are accruing under a money purchase pension scheme.

The aggregate remuneration of the highest paid Director was £200,000 (2017: £189,000), including Company pension contributions of £3,049 (2017: £840) made to a money purchase scheme on their behalf.

4 Fixed asset investments

| | Subsidiary undertakings £000 |
|----------------------------|------------------------------------|
| Cost | |
| At 28 February 2017 | 3,195 |
| Capital contribution | 322 |
| At 28 February 2018 | 3,517 |

Investments in subsidiary undertakings are included in the balance sheet at cost less any provision for diminution in value. The Company has the following investments in subsidiaries:

| Subsidiaries | Registered office address | Registered number | Class of shares held | Ownership |
|----------------------|---|-------------------|----------------------|------------------|
| Gear4music Limited | Kettlestring Lane, Clifton Moor, York YO30 4XF | 03113256 | Ordinary | 100% |
| Cagney Limited | Kettlestring Lane, Clifton Moor, York YO30 4XF | 04493300 | Ordinary | 100% via G4M Ltd |
| Gear4music Sweden AB | Tallbacksgatan 16 B, 195 72 Rosersberg, Stockholm County, Sweden | 559070-4762 | Ordinary | 100% via G4M Ltd |
| Gear4music GmbH | c/o BMH Brautigam&Partner Rechtsanwalte, Schluterstr. 37, 10629 Berlin, Germany | HRB 29067 | Ordinary | 100% via G4M Ltd |
| Gear4music Norway AS | PO Box 2734, Solli, 0204 Oslo, Norway | 917 313 210 | Ordinary | 100% via G4M Ltd |

Cagney Limited and Gear4music Norway AS are dormant companies.

Notes to the Company Financial Statements (forming part of the Financial Statements) *continued*

5 Deferred tax assets

Movement in deferred tax during the year

| | At 1 March 2017 £000 | Recognised in income statement £000 | At 28 February 2018 £000 |
|-------------------|----------------------------|--|-----------------------------------|
| Unused tax losses | — | — | — |
| | — | — | — |

Movement in deferred tax during the previous year

| | At 1 March 2016 £000 | Recognised in income statement £000 | At 28 February 2017 £000 |
|-------------------|----------------------------|--|-----------------------------------|
| Unused tax losses | (128) | 128 | — |
| | (128) | 128 | — |

6 Debtors

Due within one year:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|---------------|---|---|
| Other debtors | 22 | 21 |
| | 22 | 21 |

Due after more than one year:

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------------------|---|---|
| Amounts owed by Group undertakings | 10,744 | 6,889 |
| | 10,744 | 6,889 |

The loan to Group undertakings is repayable in 12 months and 1 day from the year end. No interest is charged on the balance.

7 Cash and cash equivalents

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|--|---|---|
| Cash and cash equivalents per balance sheet | 17 | 10 |
| Cash and cash equivalents per cash flow statements | 17 | 10 |

8 Creditors: amounts falling due within one year

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|------------------------------|---|---|
| Trade creditors | 6 | 7 |
| Accruals and deferred income | 33 | 27 |
| | 39 | 34 |

9 Share capital and reserves

Share capital

| | Year ended 28 February 2018 Number | Year ended 28 February 2017 Number |
|---|---|---|
| Authorised, called up and fully paid Ordinary shares of 10p each | 20,867,121 | 20,156,339 |

The Company has one class of ordinary share and each share carries one vote and ranks equally with the other ordinary shares in all respects including as to dividends and other distributions.

On 18 May 2017, the Company completed the placing of 610,000 new Ordinary shares at a price of 690 pence per share, raising £4,209,000 in gross proceeds (£4,064,730 net proceeds). The Company also issued 100,782 new Ordinary shares pursuant to the full exercise of a warrant instrument and received a further £140,087 in gross proceeds (£125,887 net proceeds). A total of 710,782 new Ordinary shares were admitted on 24 May 2017, taking the number of Ordinary shares in issue from 20,156,339 to 20,867,121, representing dilution of 3.5%.

Share premium

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|-------------------------------|---|---|
| Opening at 1 March | 8,933 | 8,933 |
| Issue of shares | 4,278 | – |
| Share issue costs | (156) | – |
| Closing at 28 February | 13,055 | 8,933 |

Retained earnings

| | Year ended 28 February 2018 £000 | Year ended 28 February 2017 £000 |
|-------------------------------|---|---|
| Opening at 1 March | (868) | (756) |
| Share-based payment charge | 69 | 39 |
| Loss for the year | (82) | (151) |
| Closing at 28 February | (881) | (868) |

10 Related parties

In FY2017 Chris Scott and Gareth Bevan were granted 9,978 equity-settled share options each, and Andrew Wass was awarded an equivalent cash-settled option to result in the same monetary value being returned on vesting.

In FY2018 Chris Scott and Gareth Bevan were granted 2,288 equity-settled share options each, and Andrew Wass was awarded an equivalent cash-settled option to result in the same monetary value being returned on vesting.

Notes

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Geartech Holdings plc Annual Report and Accounts 2018