EDISON

Hostmore

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Initiation of coverage

Travel & leisure

The strategic transformation of the iconic Fridays brand operations in the UK provides Hostmore with not only the prospect of strong earnings generation but the model for future investments on the Hostmore platform. Fridays' own resources (a coherent strategy, robust finances and experienced management with a record of delivery) should marry well with growth opportunities on COVID-19 fallout, notably an unusually favourable property market and material reduction in competition. An EV/EBITDA of 6x FY22e and at a sharp discount to that of its peers (we estimate c 11x average) ignores Fridays' strong rejuvenation prospects, backed by our forecast of 2022 financials already well ahead of pre-pandemic levels.

Year end	Revenue (£m)	EBITDA reported (£m)	EBITDA pre-IFRS 16 (£m)	PBT* (£m)	EPS* (p)	EV/reported EBITDA (x)
12/19	214.8	45.5	25.6	7.4	N/A	N/A
12/20	129.1	23.5**	1.7**	(12.2)**	N/A	N/A
12/21e	150.0	35.0**	18.5**	(0.2)**	(0.2)	9.2
12/22e	242.0	50.5	29.5	15.0	10.2	6.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Including UK government COVID-19 grants: 2020 £19.1m and 2021 £14.8m.

Host of opportunities

COVID-19's exacerbation of longstanding structural difficulties in UK hospitality has shown up an undeniable growth opportunity for well-funded operators such as Hostmore. The increasing availability of prime sites at ever cheaper prices and on more flexible terms and the erosion of competition (industry sources estimate potential loss at up to 30% of restaurants) contrast with pre-pandemic overcapacity, , intense cost pressures and narrow margins, compounded by Brexit-led uncertainty. Surviving companies have strengthened finances and accelerated the implementation of initiatives, such as the use of technology in managing labour costs and driving customer loyalty. Current challenges of rising costs and staff shortages are being mitigated by scale and career initiatives.

Fridays payday

Confirmation of sales back to pre-COVID-19 levels since 17 May reopening and 3% ahead of the market, a strong opening programme and myriad brand initiatives offer the prospect of significant investment payoff. For 2022 our assumption of 4% like-for-like revenue growth, born of trading momentum, higher menu pricing and Q1 VAT benefit, translates to a EBITDA margin on a par with 2019, as our expected gross margin gain is offset by pressures on admin expenses. While unwinding of COVID-19 accruals will temper good cash generation, we expect net bank debt at end 2022 to be just £26m, or below 1x pre-IFRS 16 EBITDA, even after six openings.

Valuation: Attractive

On 6x 2022e EV/EBITDA Hostmore is at a marked discount to that of its peers (we estimate c 11x average). Given their proven success (eg recent higher sales growth rates), this is understandable but ignores Fridays strong rejuvenation prospects.

4 November 2021

Price	**115p**
Market cap	**£145m**

Net bank debt (£m), adjusted for COVID-19 accruals, at August 2021	36
Shares in issue	126.1m
Free float	100%
Code	MORE
Primary exchange	LSE
Secondary exchange	N/A

Business description

Hostmore has been newly formed to provide a platform for the development of hospitality brands. Its current operations are Fridays, a UK nationwide chain of American-styled casual dining restaurants (85 sites), and 63rd+1st, a new cocktail-led bar and restaurant brand (two sites).

Next events

2021 final results	Early 2022

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Edison profile page

Hostmore is a research client of Edison Investment Research Limited

Investment summary: Full menu!

Company description: Developer and operator of hospitality brands

Hostmore was formed in April 2021 to provide a platform for the operation and development of hospitality brands following its demerger from Electra Private Equity and listing on the Main Market of the London Stock Exchange in November 2021. On its demerger Electra shareholders were entitled to receive three Hostmore shares for each Electra share. Its current operations are the exclusive UK franchise for Fridays, the long-established American-themed casual dining brand with over 12m covers and 85 sites across the UK, and 63rd+1st, a new sophisticated cocktail-led bar and restaurant (two sites). Planned expansion is c eight net openings a year as well as the addition of complementary growing early-stage businesses and other experience-led leisure concepts.

Valuation: Attractive

On c 6x 2022e EV/EBITDA Hostmore trades at a clear discount to the c 11x average of peers Restaurant Group, Fulham Shore and Loungers. While this is due partly to the earlier financial periods of the latter two, when recovery from the pandemic was less advanced, it also reflects markedly higher recent sales growth rates by Loungers and Fulham Shore in particular and the challenge for Hostmore to prove itself. This may be exaggerated, given experienced management's comprehensive measures, early signs of payoff and singular potential of the brand.

Sensitivities

Hostmore's sensitivities include:

- Geopolitical events and natural disasters such as COVID-19 can have a significant impact on profitability. Hostmore has throughout the pandemic shown operational flexibility and resilience (ie it has been busy when it is open and has driven changes to operational practices when not.
- Execution risk in terms of expansion. However, for the foreseeable future conditions should be favourable as the capital cost of new investments, and the consequential trading, benefit from changes in the landlord approach to attracting businesses with a strong credit covenant.
- The company is at risk of disruption to the supply chain owing to reliance on third-party providers and of increased competition for staff as a result of COVID-19 and Brexit. However, this has been materially mitigated by the high number of applications being received and the localisation of major ingredients.
- Hostmore is reliant on its continued relationship with TGIF Fridays in the United States for the use of the brand. However, any risk of termination of its franchise agreement is considered low owing to the improved working relationship that the management team has fostered.

Financials: Self-funding

Resumption of Fridays' strong growth record post-COVID-19 thanks to strategic transformation is management's goal. Progress to date is promising with clear restaurants market outperformance since reopening on 17 May (3% according to Coffer CGA Business Tracker). Finances are resilient with low net debt (1.5x net bank debt/EBITDA) on the eve of pandemic and a cash-generative model, which we forecast to cut net bank debt/EBITDA to below 1x by end 2022 despite funding expansion. Medium-term guidance of mid-teens pre-IFRS 16 EBITDA margin compares with 12% pre-pandemic. The financial year is to December, with 2021 finals due in early 2022.

Hostmore's ambition to host more brands may reasonably be expected to be funded by Fridays.

Company description: Developer and operator of hospitality brands

Hostmore was formed in April 2021 to provide a platform for the operation and development of hospitality brands following its demerger from Electra Private Equity and listing on the Main Market of the London Stock Exchange in November 2021. As an already established, well-funded operator of the iconic Fridays brand in the UK, highly experienced management with a record of delivery views ample opportunity for growth in a favourable post-pandemic environment, accentuated by COVID-19 fallout. This will be through continued enhancement of Fridays, the development of its second brand, 63rd+1st, new franchise territories and the addition of complementary promising early-stage brands.

Capitalising on That Fridays Feeling

Fridays, Hostmore's predominant business for now, holds exclusive UK rights to use one of the world's leading casual dining brands under its agreement with TGI Fridays. Consequent high brand awareness, comprehensive training and support and access to industry best practices from such a proven franchisor with operations in over 50 countries are fundamental to Fridays as key competitive strengths. The company has the right to renew for an unlimited number of five-year terms (next at end 2024).

Born of the eponymous original casual dining bar and grill in 1960s New York, Fridays offers authentic American food, an innovative cocktail list and a high level of service at its 85 restaurants across the UK. Notwithstanding high brand awareness since its successful introduction here in 1986 under different ownership (Whitbread), the business was recently renamed Fridays in order to reinforce the brand's promise of a renowned social experience, that is 'In Here, It's Always Friday.' The estate is diversified both geographically, for example 28% in the north of England and 15% in the South East, and by type of location (two-thirds of sites in retail parks and shopping centres and just 14% standalone). The average size is 6,800 sq ft, varying from 5,000 to over 9,000 sq ft. In line with increasing demand for outdoor dining in the light of COVID-19 permanent outside trading space, the size of four restaurants has been added at sites in the south of England. The customer base is broad with the core demographic (40%) those aged between 20 and 29, followed by those in their 30s (28%). As an acknowledged leader in the UK branded casual dining market, pre-pandemic spend per week per store at £49,000 was twice that of the average of its peers, reflecting premium pricing and strong spend per head as well as scale and efficiency.

Refreshing the strategy

The rebranding was one of a series of significant initiatives led by a new management team to enhance the core offering and develop additional revenue streams. Despite the pandemic, widespread implementation of measures followed a comprehensive business review at the start of 2020 and the appointment as CEO of Robert Cook. He joined from Virgin Active, 'the world's leading health club,' where he was credited with rapid and successful extension of an already iconic brand. Under his leadership a new wellness concept 'Beyond Movement' broadened the company's offer from sporting fitness into body maintenance, nutrition and mental wellbeing. This followed almost 30 years in hospitality, notably as CEO of Malmaison Hotels and Du Vin, which he grew from four hotels to 27, and then as CEO of De Vere group's Village Hotels and COO of Macdonald Hotels. Robert Cook is backed by a considerably strengthened management team.

As part of Fridays' '**4D Strategy**' (dine in, delivery, digital and drive in), initial key measures already effected in support of That Fridays Feeling include:

- A new brand identity (ie the renaming from TGI Fridays to Fridays), a new logo, updated colours (red and white stripes and sports shirt, which is recyclable) and a new typeface.
- 'Famous at Fridays': as a nod to the chain's heritage, a focus on established favourite dishes (the Famous Fridays burger, loaded potato skins and pot stickers) and the restitution of classic cocktails (top 10 in the UK previously not on offer), which had become downplayed as Fridays became more of a family proposition than a whole evening venue. At 13 restaurants (c 15% of the estate) in larger cities at first, now being rolled out across the estate.
- Healthier recipes, with high-quality ingredients from known suppliers.

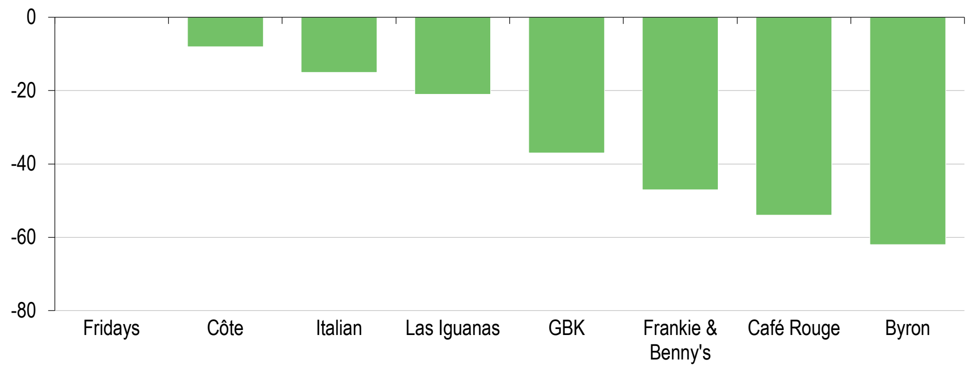
These **Dine In** initiatives have been complemented by the following ambitious brand extensions:

- **Delivery** to home from all restaurants except for the recent Lincoln opening via partners (Deliveroo and Just Eat from 72 outlets) and Fridays itself. The delivery-only dark kitchen 'Jailbreak Chicken', launched in March, already operates in a third of Fridays stores, allowing the company to address a new quick service restaurant market. Further dark brand concepts are envisaged.
- Fridays' **digital** channels are meeting the growing demand for high quality 'at home' pre-packaged food and drinks via a broadening of the Fridays at Home offer at a majority of sites: 'Butcher's Boxes' (typically 16 portions of steaks, ribs, burgers and sausages, delivered frozen on Thursdays for home cooking at the weekend; prices from £75 to £95), DIY meal kits (Fridays favourites such as chicken strips, ribs and glazed burger in portions of four or two, respectively £40 and £25), 'Cocktails at Home' (ready to serve packs of six or four – all the same – for £24 or £18 or individually for £6.50) and Party Packs for celebrations. Fridays branded American Pilsner and prosecco are also widely available on other digital channels, including Amazon, while franchise approval is expected for the sale of Fridays branded water and wine-in-a-can. Another digital service, click & collect takeaway, is now available at most locations. A customer loyalty programme, Stripes, is accessible through the Fridays Rewards app (739,000 signed up at September 2021, up over 10% since June).
- **Drive in** sites at high footfall service stations are under consideration (typical assumed dwell time c 15 minutes) as a low-cost initiative. This is part of a longer-term plan to develop quick service restaurant sites in order to broaden Fridays' market.
- The launch of a second brand, **63rd+1st**, a cocktail-led bar and restaurant, in May 2021 in Cobham, Surrey, with a second opening in Glasgow in September. Although visibly different from Fridays (typically c 40% smaller at 4,000 sq ft, a focus on adults with the bar at its heart and the plus motif to represent the New York street grid), the aim is still to cater for guest affection for the original brand, for example the feel of a Manhattan loft and high-level service. Importantly, it also meets changing market trends, notably the growing appeal of local/community all-day venues reflective of the popularity of boutique hotel and members' club environments. The Cobham site (previously Carluccio's) has 96 covers with outdoor dining for a further 20. Deemed by management as 'a huge opportunity to drive further growth,' 63rd+1st is intended to be expanded across the UK and possibly internationally. At least 10 sites are envisaged by the end of 2023, with an imminent opening in Harrogate.

The strong get stronger

Corporate initiatives aside, Fridays' fortunes will be determined by its ability to take advantage of widely-perceived unprecedented growth opportunities as a result of pandemic fallout. While Fridays' estate held steady during COVID-19, as did those of Wagamama and Nando's, there were step-change reductions, for example by direct competitors Byron and Gourmet Burger Kitchen (62% and 37% respectively, according to the Local Data Company), in the 18 months to June 2021 (see Exhibit 1). Frankie & Benny's saw a halving in the number of its stores via a company voluntary arrangement (CVA). The Italian restaurant market, with sites that Fridays itself identifies as typically suitable for its own purposes, is estimated to have contracted by 15%.

Exhibit 1: Change in sites in 18 months to June 2021 at selected UK branded casual dining chains (%)

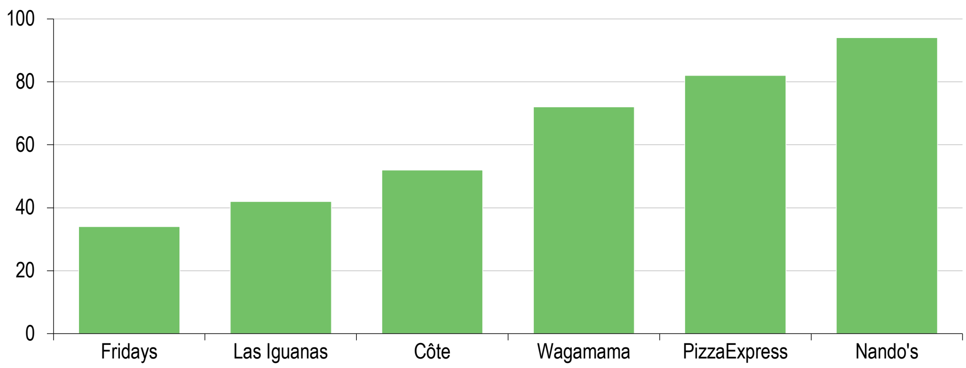


Source: The Local Data Company June 2021, Hostmore prospectus

Otherwise, UK food-led licensed premises have fallen by 11% (almost 5,000 sites) since March 2020, according to the recent CGA AlixPartners Market Recovery Monitor. Within casual dining the reduction is yet sharper at 20% (c 1,300 sites). Independent venues have suffered worse than managed groups, down 12% and 8% respectively for UK food-led licensed premises. Apparent stabilisation over the last quarter (just 1% fewer sites) is due to managed groups reinitiating expansion plans, suspended because of COVID-19, thereby masking the continued plight of independents. Moreover, consensus is that with the passing of bumper summer trading any recovery is fragile and may be derailed, given weakened finances, for example Coronavirus Business Interruption Loans and delayed creditor payments, and challenges, for example labour shortages, supply chain disruption and utility cost inflation, October's VAT increase (12.5% from 5% since July 2020) and the end of the furlough scheme. Forecasts of up to 30% contraction in UK restaurants compared to before COVID-19 may yet come to pass.

To put it in context, the pandemic only compounded longstanding structural difficulties from excess capacity, frequency of 'me too' product, rising costs and narrow margins. Uncertainty after the result of the EU referendum in 2016 made matters worse as erosion of consumer confidence led to increasing vacant retail space being rented out to restaurant operators on historically cheap debt. Like-for-like UK restaurant sales according to industry monitor Coffer CGA Business Tracker stalled in the two years before COVID-19. Such stagnation in sales and inflationary pressures (notably, business rates, the National Living Wage and food imports thanks to sterling weakness) proved a sorry mix for restaurant groups, which were already highly indebted.

Exhibit 2: Fridays' penetration rate in top 50 UK casual dining markets (selected)



Source: The Local Data Company June 2021, Hostmore prospectus

With only 34% penetration rate of UK's top 50 casual dining markets (by contrast, Nando's has 94% and PizzaExpress has 82%), Fridays has clear space to expand. The company's plan for eight openings a year on average suggests considerable long-term growth potential.

Moreover, the property market appears seldom to have been so propitious for those seeking to expand, as reiterated by David Page, chairman of Fulham Shore, in August 2021: 'Landlords are still facing a property glut. There are unlet premises all around the UK in unprecedented numbers. We believe that it will take many years to take up the slack.'

This has positive implications for Hostmore well beyond Fridays. By definition, the company is looking for franchise opportunities and early-stage businesses as well as experience-led leisure concepts, while innovating in-house, for example with 63rd+1st as an all-day venue where customers can work, rest and play or establishing restaurants in exclusive destinations and at one-off events.

Management

The company's senior management (see below) is backed by highly experienced operational management.

- **CEO: Robert Cook** joined Fridays in December 2019 from Virgin Active, 'the world's leading health club,' where he was CEO UK and a board member. This followed almost 30 years in hospitality, notably as CEO of boutique lifestyle hotel brands, Malmaison Hotels and Hotel du Vin, which he grew from four hotels to 27, and as CEO of De Vere Hotels and Resorts.
- **CFO: Alan Clark** was previously CFO of restaurant group D&D London after gaining international experience as CFO at Sandals Resorts (Jamaica) and CFO at luxury hospitality and real estate group, Hongkong and Shanghai Hotels. Before that he was finance director at Rocco Forte Hotels and at Malmaison and Hotel du Vin. He joined in March 2020.
- **Chair: Neil Johnson** has been executive chairman of Electra Private Equity (where Fridays was a key investment) since 2018 after serving as non-executive chairman since 2016. He is also chairman of QinetiQ, a leading science and engineering company operating primarily in defence and security markets. Among other previous directorships he was CEO of the RAC.

Sensitivities

- Geopolitical events and natural disasters such as COVID-19 can have a significant impact on profitability. Hostmore has throughout the pandemic shown both operational flexibility and resilience (ie it has been busy when it is open and has driven changes to operational practices when not, eg its investment in digitalisation).
- Execution risk in terms of expansion. However, for the foreseeable future conditions should continue to be favourable as the capital cost of new investments, and the consequential trading thereafter, benefit from changes in the landlord approach to attracting businesses with a strong credit covenant.
- The company is at risk of disruption to the supply chain owing to reliance on third-party providers and of increased competition for staff as a result of COVID-19 and Brexit. However, this has been materially mitigated by the high number of applications being received for vacancies available and the localisation of major ingredients such as beef and salmon from Argentina and Norway respectively.
- Hostmore is reliant on its continued relationship with TGI Fridays in the United States for the use of the brand. However, any risk of termination of its franchise agreement is considered low

owing to the improved working relationship that the management team has fostered and the significant contribution that the local business makes to the franchisor.

Valuation

Assuming 2022 to reflect a return to trading normality, we look at prospective EV/EBITDA multiples in that period for Hostmore and its closest listed competition, Restaurant Group, Fulham Shore and Loungers (for the latter, the year to March 2022 and April 2022 respectively). Owing to the lack of availability of forecast data we use last reported net debt, hence the Hostmore EV/EBITDA below differs marginally from that in the summary forecast table on page 1.

On 6.5x 2022e Hostmore trades at a clear discount to the peer average of almost 11x. While this partly reflects the earlier financial periods of Fulham Shore and Loungers, when recovery from the pandemic was less advanced, it is also testimony to the proven success of their strategy, as evident in markedly superior recent sales growth rates to Fridays. From reopening on 17 May to the start of October, Loungers achieved 27% like-for-like sales growth on 2019 against Fridays' 11% (both including the VAT benefit). Fulham Shore's last reported revenue was up by 33% in the three weeks to 26 September, albeit not like-for-like. Hostmore has understandably yet to prove itself but investor caution at the challenge of Fridays' rejuvenation seems exaggerated, given experienced management's comprehensive measures, early signs of payoff and the singular potential of the brand.

Exhibit 3: Peer comparison of EV/EBITDA rating for 2022 or nearest equivalent financial period

IFRS 16	Share price	Market cap	Net debt/(cash) last reported	EV	EBITDA	EV/EBITDA
		£m	£m	£m	£m	x
Hostmore	**115p**	**145**	**181**	**326**	**50.5***	**6.5**
Loungers	280p	288	145	433	46.5**	9.3
Fulham Shore	17p	108	75	183	15.8***	11.6
Restaurant Group	86p	656	634	1,290	112.4*	11.5
Average						**10.8**

Source: Company accounts. Note: Priced at 3 November 2021. *Year to December 2022. **Year to April 2022. ***Year to March 2022.

Financials

Before the hiatus of COVID-19, which followed the market slowdown, Fridays had a long record of consistent top-line growth and double-digit percentage pre-IFRS 16 EBITDA margin, expanding successfully in favourable demand and supply conditions. In the decade to 2017 sales all but trebled, while EBITDA rose sevenfold. As market equilibrium increasingly checked growth, prompting widespread discounting by competitors, Fridays preferred to focus on retaining margins and differentiating by experience. With its pricing policy maintained, covers declined slightly but this was offset by higher average spend. The impact of these unfavourable market dynamics was compounded in 2018 by extreme weather and the football World Cup because at that time Fridays had minimal outside space during heatwaves and did not show TV sport. Although 2019 saw slight, partial recovery, this was thanks to the absence of the previous period's exceptional factors, with the first signs of competitor failure as a response to oversupply. Nevertheless 2019 financial metrics remained solid: EBITDA margin 12%, like-for-like sales growth 2% and net bank debt/EBITDA 1.5x. It was at this point that Fridays' comprehensive business review was initiated, sparking the company's rejuvenation.

We show EBITDA at pre-IFRS 16 level in our model (Exhibit 4) as well as reported since it is taken by the company as a key measure and offers a clear comparison with the pre-pandemic performance.

Exhibit 4: Revenue and EBITDA analysis

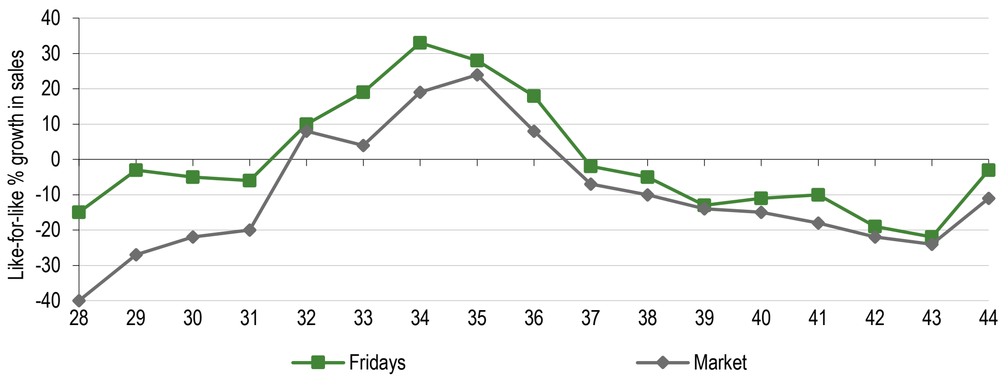
Year end 31 December (£m)	2019	H120*	H220**	FY20***	H121****	H221e	FY21e	FY22e
Sites (period end)	87	85	85	85	87	88	88	94
Revenue								
Existing (80 sites)	193.2	46.0	67.0	113.0	34.7	96.3	131.0	201.5
Change	+2%	N/A	N/A	-42%	-25%	+44%	+16%	+54%
Additions (sites)	14.9 (9)	5.5	8.7	14.2 (9)	4.6	12.9	17.5 (13)	40.5 (19)
Disposals	7.2	1.1	0.7	1.8	0.5	0.5	1.0	-
Other	(0.4)	(0.2)	0.3	0.1	0.2	0.3	0.5	-
Dine in	211.7	45.9	68.7	114.6	28.7	101.8	130.5	229.0
Change	+3%			-46%	-38%	+48%	+14%	+87%
Dine out	3.1	6.4	7.7	14.1	11.0	8.0	19.0	12.5
Change	+13%			4x	+72%	+4%	+35%	-31%
Other	-	Neg.	0.4	0.4	0.2	0.3	0.5	0.5
Total	214.8	52.4	76.7#	129.1#	39.9#	110.1#	150.0#	242.0
Gross Profit	168.1	40.7	62.2	102.9	32.2	88.8	121.0	190.0
Margin	78%	78%	81%	80%	81%	81%	81%	79%
Admin expenses	(122.8)	(51.1)	(48.9)	(100.0)	(40.6)	(60.7)	(101.3)	(140.0)
Share of revenue	57%	98%	64%	78%	102%	55%	68%	58%
Other income:								
- Government grants	-	11.9	7.2	19.1	14.8	-	14.8	-
- Other	0.2	Neg.	1.5	1.5	0.1	0.4	0.5	0.5
EBITDA								
Reported	45.5	1.4	22.1	23.5	6.5	28.5	35.0	50.5
Lease expenses	(20.2)	(11.0)	(9.5)	(20.5)	(9.5)	(6.5)	(16.0)	(21.0)
Other	0.2	Neg.	(1.5)	(1.5)	(0.3)	(0.2)	(0.5)	Neg.
Pre-IFRS 16	25.6	(9.5)	11.2	1.7	(3.3)	21.8	18.5	29.5
Margin, before govt grants	11.9%	-	5.2%	-	-	19.8%	2.5%	12.2%

Source: Company data, Edison Investment Research. Note: *National lockdown from 20 March to 28 June; **National lockdown from 5 November to 2 December; ***245 days' trading; ****National lockdown from 1 January until 26 April in Scotland and 17 May in England; #Boosted by VAT reduction from 20 July 2020 and menu price increases.

2020: Good when allowed to trade

The headline figures for 2020 make harsh reading as a result of COVID-19 restrictions curbing average trading days to 245 (ie 15 weeks of spring lockdown, four weeks of phased re-opening, four weeks of Eat Out to Help Out and eight weeks of increasing controls, culminating in a second English lockdown (four weeks)). Higher menu pricing in expectation of Brexit-led cost pressures and not passing on July's VAT reduction to customers helped limit the decrease in dine in sales to 46%, as did the company's rapid development of dine out as a new revenue source (£14m, which is almost five times that of 2019). Indeed, as Exhibit 5 shows, Fridays' weekly like-for-like sales growth consistently outperformed the market from the end of the first lockdown in early July until the second lockdown at the start of November.

Exhibit 5: Fridays' weekly like-for-like % growth in sales from July 2020 reopening until November lockdown



Source: Fridays, Coffer CGA Business Tracker

In terms of profit, effective management of payroll and variable costs including rent concessions, business rates relief and franchise royalty fee reduction (3% against customary 4%) was notable in total admin expenses' share of sales in H220 (64%) being not materially different from that of pre-pandemic 2019 (57%). Other income of £20.6m relates predominantly to government grants under the Coronavirus Job Retention Scheme.

2021e: Another strong reopening

Forecasting revenue for H2 is awkward as the comparative was subject to exceptional factors, that is Eat Out to Help Out in August when sales were at one point over 30% up on 2019 and the reimposition of COVID-19 restrictions in October and lockdown in November. In turn the current period is buoyed by the prospect, health situation permitting, of a strong Christmas season (typically, five busy weeks, each with an extra £1m revenue) unlike last year as well as an additional trading week as H1 was closed earlier than usual to facilitate the Hostmore demerger. A further complication is the tapering of the reduction in VAT rate back to 12.5% from 1 October compared with 5% for the bulk of H220. As Hostmore (when part of Electra) has not disclosed an H219 revenue number, which we could compare with Fridays' positive trading statement (up 11% on 2019 since 17 May), we add back the missed sales from a month of national lockdown to H220 like-for-like sales, that is 180 /150 days × £67m = £80m + plus an allowance for COVID-19 tier restrictions in October and December last year. There are then broadly compensating adjustments for the VAT change, Christmas and the extra week.

Although dine-in volumes remain behind pre-pandemic levels despite a boost from staycations and pent-up demand on reopening, lingering consumer caution is understandable and may well abate, while average spend has increased as customers treat themselves. We expect dine out sales to be similar to H220, given the clear resilience of delivery, reflecting a shift in customer behaviour (as discussed for 2022).

In terms of profit, we assume a similar gross margin (81%) in H2 to the two prior half-year periods, given the VAT benefit. Also lease expenses should be substantially lower year-on-year owing to further landlord concession agreements, which explains our reduction by a third, boosting pre-IFRS 16 EBITDA. Importantly, no government grants are assumed in H221 as trading is normal.

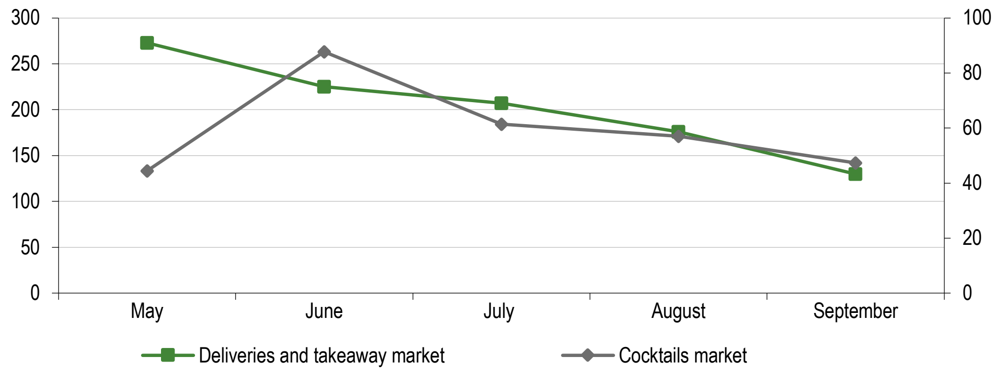
Consequently, there are a lot of moving parts but, boosted by lease concessions and the VAT cut, the H221 pre-IFRS 16 EBITDA margin, without COVID-19 government grants, may approach 20%, which is almost double pre-pandemic levels and well ahead of management's mid-teens % medium-term guidance.

2022e: Back to normal

Fridays assumes 2022 to be trading as normal. However, there will still be exceptional items such as VAT at 12.5% for Q1 and the unwinding of COVID-19 accruals/deferred payments.

Therefore we use pre-pandemic 2019 as a benchmark for 2022 forecasts, just as hospitality companies have been reporting. Notwithstanding unchanged like-for-like VAT adjusted sales on 2019 since the resumption of outdoor dining on 17 May despite pent-up demand and a staycation boost, a 4% like-for-like growth scenario in 2022 looks reasonable. First, base market conditions in 2019 were difficult owing to chronic overcapacity, significant cost pressures and consumer uncertainty on the eve of Brexit. The COVID-19 led reduction in competition (widely estimated at up to 30%) yields a more benign environment, complemented by the growing availability of properties at ever lower rents. Secondly, there is the expected marked benefit of Fridays' own wide-ranging brand extension initiatives, bearing early fruit in 3% market outperformance since 17 May. Delivery and takeaway show sustained market strength despite the full return of dine-in, with sales up 35% on September 2020 and 130% up on 2019 and still 29% of total restaurant sales, according to the Hospitality at Home Tracker from CGA and Slerp. Wagamama has confirmed this channel's resilience with current sales still more than half those during the peak of lockdown 3 (Q121) and more than double pre-pandemic levels. Industry consensus is that delivery will stay as an important incremental business stream, with growth of 20% over the next three years forecast by Lumina Intelligence. Our assumption of delivery and takeaway at 5% of Fridays sales may thus be cautious.

Exhibit 6: Growth in UK markets for deliveries and takeaway and cocktails versus 2019 from 17 May 2021 reopening of indoor dining to September 2021



Source: CGA Hospitality at Home Tracker, CGA Managed EPOS data

Cocktails, a Fridays staple, are also selling well, indeed according to CGA exceeding 2019 in most weeks since reopening with a doubling of 2019 drinks market share in August. Interest is now as high in rural areas as in city centre bars, while demand for pre-batched and draught cocktails likely follows drinking them during lockdown. Therefore, with some increase in menu pricing also a factor, we are comfortable with our assumption of 4% higher like-for-like sales. Our forecasts also allow for six openings in the period, which may be cautious in view of the company's target of eight new sites a year on average. A contribution of £7m sales (half-yearly £1.2m × 6) is envisaged.

As for profit, a return broadly to 2019 gross margin (78% against our forecast 81% this year) seems in order thanks to only three months of reduced VAT benefit and inflationary pressures in food and drink, which will offset the expected benefit of strong demand (+4% like-for-like). We look for 79% gross margin. As a balance, we assume 1% higher admin expenses' share of revenue on 2019 owing to rising labour and utilities costs. Also significantly, lease payments are set to resume pre-pandemic levels with a little extra for new stores. Our pre-IFRS 16 EBITDA margin is therefore marginally up on 2019.

Cash flow

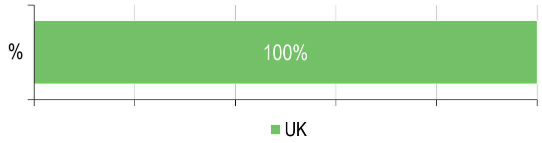
It is heartening that in 2020 at the height of COVID-19 net bank debt remained in check, at £28m in December 2020, down £11m in the year, albeit largely a function of VAT and rent deferrals, and of course government grants.

The current period should see significant negative working capital (we expect £12m) because of the unwinding of VAT arrears, agreed with HMRC, and landlord obligations in H2. We expect this to extend into early 2022, hence we look for £4m negative working capital next year. Lease payments in 2022 should be back at least at 2019 levels, as should capex. Nevertheless, our forecast is for net bank debt to fall by £3.5m (over 10%) to £26m at December 2022 (ie 0.9x pre-IFRS 16 EBITDA, compared with 1.5x before the pandemic).

Exhibit 7: Financial summary

£'k	2019	2020	2021e	2022e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT				
Revenue	214,800	129,100	150,000	242,000
Cost of Sales	(46,700)	(26,200)	(29,000)	(52,000)
Gross Profit	168,100	102,900	121,000	190,000
EBITDA pre-IFRS 16	25,600	1,700	18,500	29,500
EBITDA	45,500	23,500	35,000	50,500
Normalised operating profit	20,600	200	12,800	28,000
Amortisation of acquired intangibles	0	0	0	0
Exceptionals	1,600	(8,000)	0	0
Share-based payments	0	0	0	0
Reported operating profit	22,200	(7,800)	12,800	28,000
Net Interest	(13,200)	(12,400)	(13,000)	(13,000)
Joint ventures & associates (post tax)	0	0	0	0
Exceptionals	0	0	0	0
Profit Before Tax (norm)	7,400	(12,200)	(200)	15,000
Profit Before Tax (reported)	9,000	(20,200)	(200)	15,000
Reported tax	(2,000)	2,900	1,200	(2,000)
Profit After Tax (norm)	5,400	(9,300)	(200)	12,800
Profit After Tax (reported)	7,000	(17,300)	1,000	13,000
Minority interests	0	0	0	0
Discontinued operations	0	0	0	0
Net income (normalised)	5,400	(9,300)	(200)	12,800
Net income (reported)	7,000	(17,300)	1,000	13,000
Basic average number of shares outstanding (m)	N/A	N/A	126	126
EPS - basic normalised (p)	N/A	N/A	(0.16)	10.15
EPS - diluted normalised (p)	N/A	N/A	(0.16)	10.15
EPS - basic reported (p)	N/A	N/A	0.79	10.31
Dividend (p)	0.00	0.00	0.00	0.00
Revenue growth (%)	N/A	(39.9)	16.2	61.3
Gross Margin (%)	78.3	79.7	80.7	78.5
EBITDA Margin (%)	21.2	18.2	23.3	20.9
Normalised Operating Margin	9.6	0.2	8.5	11.6
BALANCE SHEET				
Fixed Assets	341,400	321,300	310,000	306,000
Intangible Assets	146,000	146,000	146,000	146,000
Tangible Assets	192,300	170,100	159,000	155,000
Investments & other	3,100	5,200	5,000	5,000
Current Assets	36,200	46,100	46,500	49,500
Stocks	1,300	700	1,500	1,500
Debtors	7,600	6,500	8,000	8,500
Cash & cash equivalents	27,100	37,200	35,000	37,500
Other	200	1,700	2,000	2,000
Current Liabilities	(35,300)	(51,700)	(43,200)	(37,400)
Creditors	(6,400)	(13,400)	(6,000)	(5,000)
Tax and social security	(4,800)	(6,000)	(6,000)	(6,000)
Lease liabilities	(12,700)	(17,700)	(18,000)	(14,500)
Short term borrowings	(1,100)	(1,400)	(1,500)	(1,500)
Other	(10,300)	(13,200)	(11,700)	(10,400)
Long Term Liabilities	(209,700)	(200,400)	(197,000)	(189,000)
Lease liabilities	(144,800)	(133,800)	(131,000)	(124,000)
Long term borrowings	(64,900)	(63,900)	(63,000)	(62,000)
Other long term liabilities	0	(2,700)	(3,000)	(3,000)
Net Assets	132,600	115,300	116,300	129,100
Minority interests	0	0	0	0
Shareholders' equity	132,600	115,300	116,300	129,100
CASH FLOW				
Op Cash Flow before WC and tax	45,500	23,500	35,000	50,500
Working capital	2,500	11,500	(12,000)	(4,000)
Exceptional & other	3,100	(700)	0	0
Tax	(1,600)	(1,000)	0	(1,000)
Net operating cash flow	49,500	33,300	23,000	45,500
Capex	(11,300)	(3,700)	(5,000)	(11,000)
Acquisitions/disposals	0	0	0	0
Net interest	(26,200)	(17,700)	(18,000)	(26,000)
Equity financing	0	0	0	0
Dividends	0	0	0	0
Other	(1,400)	(1,100)	(1,400)	(5,000)
Net Cash Flow	10,600	10,800	(1,400)	3,500
Opening net debt/(cash)	49,500	38,900	28,100	29,500
FX	0	0	0	0
Other non-cash movements	0	0	0	0
Closing net debt/(cash) excluding IFRS 16 lease liabilities	38,900	28,100	29,500	26,000
Lease liabilities	157,500	151,500	149,000	138,500
Closing net debt/(cash) including IFRS 16 lease liabilities	196,400	179,600	178,500	164,500

Source: Company accounts, Edison Investment Research

Contact details	Revenue by geography
126 Castle Street Edinburgh, EH2 3HT UK www.hostmoregroup.com	

Management team

CEO: Robert Cook	CFO: Alan Clark
Robert Cook joined Fridays in December 2019 from Virgin Active, 'the world's leading health club,' where he was CEO UK and a board member. This followed almost 30 years in hospitality, notably as CEO of boutique lifestyle hotel brands, Malmaison Hotels and Hotel du Vin, which he grew from four hotels to 27, and as CEO of De Vere Hotels and Resorts.	Alan Clark was previously CFO of restaurant group D&D London after gaining international experience as CFO at Sandals Resorts (Jamaica) and CFO at luxury hospitality and real estate group, Hongkong and Shanghai Hotels. Before that he was finance director at Rocco Forte Hotels and at Malmaison and Hotel du Vin. He joined in March 2020.
Chair: Neil Johnson	
Neil Johnson has been executive chairman of Electra Private Equity (where Fridays was a key investment) since 2018 after serving as non-executive chairman since 2016. He is also chairman of QinetiQ, a leading science and engineering company operating primarily in defence and security markets. Among other previous directorships he was CEO of the RAC.	

Principal shareholders	(%)
Witan Investment Trust	13.2
Fidelity International	11.0
M&G Plc	9.3
Stephen Welker	6.7
Aviva PLC	4.0
Crown Sigma UCITS	3.6

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