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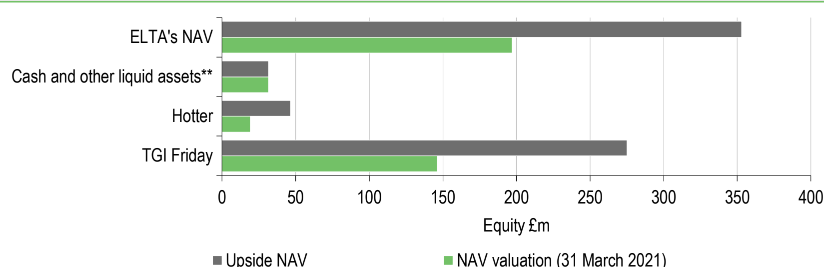
Electra Private Equity

Introducing Hostmore and Unbound brands

Investment trusts
Special situations – private equity

On 16 September, Electra Private Equity (ELTA) issued a trading update for its largest remaining hospitality brands, Fridays and 63rd+1st, and named the board members for Hostmore, the parent company of those brands. ELTA's board confirmed its intention to demerge Fridays – the largest of the two operating businesses (74% of ELTA's NAV) – onto the Main Market of the London Stock Exchange (initially announced in May), early in Q421. The board aims to transition the remaining company, Hotter Shoes (10% of ELTA's NAV), to AIM, renaming it Unbound. ELTA has been following a realisation strategy since October 2016, when it had a market cap of c £1.1bn, and has since returned c £2bn to shareholders. Since our initiation note published in December 2020, ELTA's NAV has appreciated c 45% from £135m to £197m. The market capitalisation of c £222m and a c £320m management valuation for Hotter and TGI Fridays (excluding cash, see below) implies further upside for ELTA's share price.

ELTA's NAV – management's valuation scenarios*



Source: ELTA, Edison Investment Research, at 31 August 2021. Note: Please see our initiation note for details. *ELTA's management intends to use cash and other liquid assets for transaction costs and to support the balance sheet of both businesses for listing (ie debt reduction).

Key points

- As per the board's intention, we expect ELTA to cease to exist as an investment trust during Q421. ELTA's performance over one year and shorter periods has responded very positively to the strategic and operational efforts within the group over the past two years, including the ongoing progress of the realisation of assets, with Sentinel sold in April 2021 (proceeds of £22.2m).
- The chart above indicates the significant upside potential for both the TGI Friday and Hotter businesses, implied by ELTA management's valuation. Management believes that both businesses, having been resilient throughout the pandemic, have to date built significant valuation upside to be realised (see TGI Friday and Hotter sections below for details). Management bases its valuation upside rationale on the two intended transactions (see above) being implemented before the end of the 2021 year.
- Over the last nine months, ELTA's management has realised much of the upside we highlighted in the scenario analysis in our initiation note, and the increased NAV of £196.9m at 31 March 2021 reflects its efforts.
- ELTA's strategy remains the realisation of assets in the best possible way for shareholders. Further updates will be provided by the company in due course.

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27 September 2021

Price	**570.0p**
Market cap	**£222.2m**
NAV*	**£196.9m**
NAV* per share	514.3p
Premium to NAV	10.8%

*Including income. As at 31 March 2021.

Yield	N/A
Ordinary shares in issue	38.2m
Code	ELTA
Primary exchange	LSE
AIC sector	Private Equity

52-week high/low*	670.0p	172.3p
NAV** high/low	514.3p	353.4p

*A-shares. **Including income.

Gearing

Net cash (estimated) at 31 August 2021 (includes other liquid assets)	£31.5m

Fund objective

Electra Private Equity's (ELTA) investment objective is to follow a realisation strategy, which aims to crystallise value for shareholders through balancing the timing of returning cash to shareholders with maximisation of value. ELTA intends to use cash and other liquid assets for transaction costs and to support the balance sheet of TGI Fridays and Hotter Shoes businesses for listing.

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Edison profile page

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Strategy, outlook and business update

Investment strategy and management expectations

ELTA's investment objective remains to follow a realisation strategy, which aims to crystallise value for shareholders, through balancing the timing of returning cash to shareholders with maximisation of value. The reported net asset value (NAV) of £196.9m as at 31 March 2021 (see Exhibit 1) remains unchanged (at the publication date of this report), but increased by 46% from £135.1m on 30 September 2020 (see our initiation note). In this report, we reiterate (unchanged) management valuation scenarios and the impact of applying sector multiples to these scenarios.

ELTA's board noted that the valuations of the two operating businesses as at 31 March 2021 reflected a high degree of judgement. Amid the pandemic, the resulting lockdowns and restrictions on the businesses, Fridays and Hotter, in particular, had to operate at below average capacity. Meanwhile, they continue to undergo restructuring and are following the reorientation plans put in place by new management from 2019. Disruption to the historical earnings of the comparator companies used in ELTA's internal valuation process has prompted the board to utilise published forward earnings multiples for sector peers in the consumer discretionary and industrial sectors.

As pointed out in ELTA's H121 report, the board believes that the published valuations were a reasonable reflection of Fridays and Hotter in March 2021, adjusted for the tough economic environment caused by the pandemic.

Exhibit 1: NAV reconciliation with two key investments* – TGI Fridays and Hotter Shoes

Investment	Sector	Projected % of UK revenue for 2021	Year of investment	Purchase price (£m)	Unrealised value* (£m)	Value (% of NAV)	Cum. value (% of NAV)
TGI Fridays	Consumer discretionary	100	2015	99	146.2	74%	74%
Hotter Shoes	Consumer discretionary	90	2014	84	19.2	10%	84%
Total					165.4	84%	
Other portfolio core assets					1.1	1%	85%
Other portfolio non-core assets					4.0	2%	87%
Total portfolio				183	170.5	0.9	
Liquid assets					4.5	2%	
Cash					22.2	11%	
Other non-core assets & liabilities					(0.4)		
Net asset value (NAV)					196.9	100%	

Source: Electra Private Equity as at 31 March 2021, Edison Investment Research at 24 September 2021. Note: *Company projections. See value analysis sections on the two businesses below.

Key points on the two remaining businesses

Both the Fridays and Hotter businesses have plans in place that aim to deliver long-term value creation.

Fridays' management aims to sustain and further develop its growth strategy. It has plans to win more market share in the casual dining market. ELTA's management is confident about the robustness of Fridays' business (to be demerged into Hostmore), with a strong pipeline of additional sites due to open in the remainder of 2021 and beyond. With 87 sites fully open in accordance with government guidance, Hostmore has returned to pre-pandemic sales levels for the 16 weeks following the resumption of indoor trading on 17 May. This is despite COVID-19 restrictions during 2021 and its still ongoing strategic transformation (see TGI Fridays section for more details).

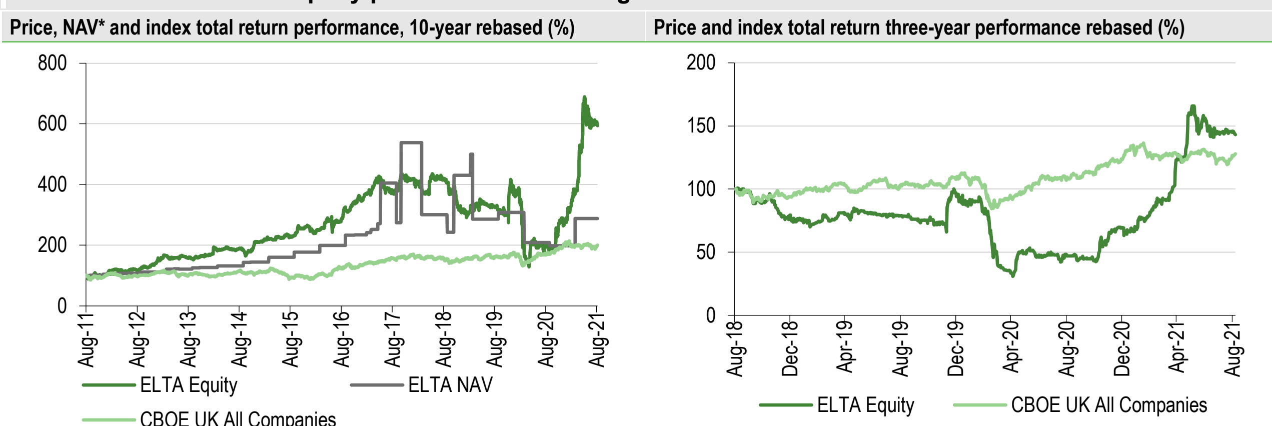
Hotter (to become Unbound) has delivered on the early stages of its plan following the change in its operating model last year. Its emphasis on the digital 'direct-to-consumer' channel continues to pay off, with 39% year-on-year UK online sales growth in the six months to July 2021, boosted by COVID-19-prompted restrictions on retail (see Hotter Shoes section for more details).

Performance and discount

Exhibit 2 illustrates the considerable improvement in ELTA's performance since November 2020 and its particular acceleration in 2021. In the last few months, the company has been executing its realisation strategy, and the increased NAV and narrowing discount reflect the value generated. Its performance during 2020 suffered materially, as the market discounted the hospitality industry and restaurant shares in Q1, after the pandemic hit and lockdown was imposed in the UK.

Exhibit 2 shows that ELTA's price return was superior to UK equities over the past three and 10 years. Exhibit 3 demonstrates that ELTA's NAV outperformed the CBOE UK All Companies and MSCI Europe indices over six months, one year and 10 years.

Exhibit 2: Investment company performance to 31 August 2021



Source: Refinitiv, Edison Investment Research. Note: *NAV is backward looking.

Exhibit 3: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to CBOE UK All Companies	(3.1)	(9.0)	82.5	153.6	14.4	33.7	203.5
NAV relative to CBOE UK All Companies	(3.6)	0.8	44.2	16.7	(24.3)	(9.1)	45.5
Price relative to MSCI Europe	(2.0)	(14.3)	57.8	137.5	14.1	33.9	134.2
NAV relative to MSCI Europe	(2.5)	(5.1)	24.6	9.3	(24.5)	(8.9)	12.3

Source: Refinitiv, Edison Investment Research. Note: Data to end-August 2021. Geometric calculation.

We provide a peer comparison in Exhibit 4, including Dunedin Enterprise and JPEL Private Equity, which are also in realisation mode, and the peer average of 11 (including ELTA) London-quoted, private equity, closed-end funds of funds. Over one year, ELTA's NAV returned 38.1%, outperforming the peer group average of 28.0% and ranking third over three and five years.

ELTA currently trades on a double-digit premium of 10.8%. This compares with the 8.1% discount of the peer group average and 12.3.% and 22.8% discounts for Dunedin Enterprise and JPEL Private Equity, respectively.

Exhibit 4: Peer group comparison at 24 September 2021

	Market cap £m	NAV TR 1 year (%)	NAV TR 3 year (%)	NAV TR 5 year (%)	NAV TR 10 year (%)	Discount/ premium (%)	Ongoing charge (%)*	Perf. fee	Net gearing (%)	Dividend yield (%)
Electra Private Equity	**222.1**	**38.1**	**(5.2)**	**24.6**	**154.1**	**10.8**	**1.8**	**No**	**99**	**0.0**
Dunedin Enterprise Ord	90.0	31.1	35.2	85.8	90.1	(12.3)	1.3	No	95	0.4
JPEL Private Equity	45.2	14.8	5.6	32.5	71.0	(22.8)	1.3	Yes	78	0.0
Average of 11 (incl. ELTA)	119.1	28.0	11.9	47.6	105.1	(8.1)	1.5		91	0.1
ELTA's rank (of 11 peers)	**1**	**1**	**3**	**3**	**1**	**1**	**1**		**1**	**2**

Source: Morningstar, Edison Investment Research. Note: Performance to 24 September 2021. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. The ongoing charge excludes carried interest. *Please note that in some of the peers, the ongoing charge may not fully capture the charges levied on the underlying funds.

ELTA's two remaining portfolio holdings

TGI Fridays (74% of ELTA's NAV): UK nationwide chain of American-styled casual dining restaurants

Exhibit 5: TGI Fridays investment summary

Total cost: £142m (including December 2014 £99m, July 2017 £2m and August 2017 £35m)

Source: ELTA at end March 2021

Born of the eponymous original casual dining bar and grill in 60s New York, TGI Fridays offers authentic American food, an innovative cocktail list and a high level of service at its 86 restaurants across the UK. Notwithstanding high brand awareness, the business has been renamed Fridays to reinforce the brand's promise of its well-known 'Friday Feeling' experience. Fridays holds exclusive UK rights to use the brand under its agreement with its American parent, from which it was acquired by ELTA in 2014. A new cocktail-led bar and restaurant brand, 63rd+1st, was launched in May. The intended demerger into Hostmore, the newly formed parent company of these brands, and its stock market listing are confirmed to be on track for early Q421.

Hostmore, as we now refer to the hospitality businesses, has seen a pleasing return to pre-pandemic sales levels for the 16 weeks since the resumption of indoor trading on 17 May. This is despite continued COVID-19 restrictions for much of the period and represents a clear outperformance (3.9%) versus the market, as shown by the Coffer CGA Business Tracker. Still recovering dine-in volumes have been offset by a significant growth in delivery, the resilience of which since restaurant reopening confirms a clear shift in consumer behaviour towards hospitality at home. Including the benefit of the VAT reduction (5% against 20% in 2019), Hostmore's reported like-for-like sales growth was 11.8%, reflecting an acceleration to 15.2% in the seven weeks after the lifting of most legal restrictions on social contact on 19 July.

Plenty more to come

This is impressive as Fridays is still in the course of strategic transformation under new management, as highlighted in June at Hostmore's capital markets day. While testimony to the early success of initial key measures to enhance the core Fridays offering and develop additional revenue streams, sales growth is therefore understandably less than that recently reported by Wagamama, The Restaurant Group's flagship brand and acknowledged by Hostmore management as a fellow winner in UK casual dining, ie 21% in a similar period (15 weeks from 17 May). Fridays' renaming apart, 'Famous At Fridays' (a focus on favourite dishes and classic cocktails) has been introduced at 13 restaurants in larger cities and is now being rolled out across the estate. Ambitious brand extensions via delivery and digital channels requiring minimum investment include delivery predominantly through Deliveroo and Just Eat, as well as its delivery-only dark brand, 'Jailbreak Chicken,' a broadening of the 'Fridays at Home' offer, eg pre-packaged food and drinks and takeaway at a majority of sites, and a customer loyalty scheme, Stripes, through the Fridays Rewards app (668,000 users at June 2021). Astute estate management has added permanent outside trading space, the size of four restaurants, at sites in the south of England.

Cash generation from June to August has also been strong (£12.5m), with current net debt of £36m against £46m at December 2020 despite cash burn during Q121 lockdown. The consequent rise in liquidity headroom from c £20m reported at March 2021 and a cash-generative model should comfortably allow for planned expansion of about eight sites per year, largely from 2022 (there are two imminent 63rd+1st openings following the brand's successful launch in May). A cash conversion ratio of 91% from June to August equates to EBITDA of £13.7m, which is 42% of management's pro forma full-year EBITDA projection of £32.7m based on demand at 2019 levels.

Continued optimism despite sector challenges

Given the difficulty of predicting when trading will return to normal, we support management's approach of using 2019 sales levels as the base for a pro forma assessment of potential annual profitability.

Management's confidence in this zero like-for-like growth scenario appears reasonable. First, market conditions were already difficult in 2019 owing to chronic overcapacity in the sector, significant cost pressures, particularly owing to labour costs, and consumer uncertainty on the eve of Brexit. The COVID-19-led reduction in supply and competition (widely estimated to be at least 20%) yields a more benign trading environment, complemented by the growing availability of properties at increasingly lower rents, as confirmed by restaurant operators. Second, there is the expected benefit of Hostmore's own wide-ranging brand extension initiatives, already largely implemented and bearing early fruit in recent sustained market outperformance, as noted above. In particular, delivery and takeaway show sustained market strength despite the full return of dining in, with sales up 70% on August 2020 when COVID-19 restrictions were in place and now a significant 27% of total restaurant sales, according to the Hospitality at Home Tracker from CGA and Slerp. Wagamama has also reported this channel's resilience with current sales still more than half those during the peak of the third lockdown in the UK (Q121) and more than double pre-pandemic levels. Industry consensus is that delivery is set to stay as an important incremental business stream, with growth of 20% over the next three years forecast by Lumina Intelligence.

Management's confidence has been borne out with Hostmore like-for-like sales since 17 May, net of the VAT reduction, on a par with 2019 despite a standing start and persisting restrictions. Although dine-in volumes remain below 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. The phased normalisation of the VAT rate by April 2022 (up from 5% to 12.5% on 1 October), while influential in practice, does not affect pro forma assumptions, which are net of VAT.

On management's base assumption of zero like-for-like top-line growth, pro forma EBITDA (pre-IFRS 16 as in 2019) was projected in May 2021 to grow by 28% to £32.7m (see Exhibit 6). This absolute rise of £7.1m from £25.6m in 2019 derives in part from net openings in 2019, that is a full year contribution rather than part-year from five stores opened during 2019 less three removed (one closed in 2019 and two in 2020), which explains the stated £12m rise in pro forma sales despite flat like-for-like assumptions. The bulk of the projected EBITDA gain is due to changes in the cost base, including labour efficiency cost savings (already implemented) and other fixed implemented cost savings (mainly rent reductions). However, we are mindful of the impact of increasing sector challenges, namely inflationary pressures on food and drink and utilities, as well as labour availability leading to rising costs. Management states its confidence in 'continuing to manage COVID-19-related challenges well'.

£13.7m EBITDA in the 16 weeks from 17 May looks to support management's pro forma full-year base EBITDA projection of £32.7m. Moreover, it is not unreasonable to foresee annual like-for-like sales growth rates of up to 10% which, with margin gain, could drive a rise in EBITDA of over 60% on 2019 demand levels, according to management's EBITDA projections (see Exhibit 6).

Exhibit 6: Management's pro forma scenarios based on 2019 demand levels

	2019 actual	0% revenue growth	5% revenue growth	10% revenue growth
Revenue (£m)	214.8	226.8	237.9	249.3
Pre-IFRS 16 EBITDA (£m)	25.6	32.7	36.5	41.3

Source: Company accounts

These growth scenarios take no account of Fridays' site expansion plans (weighted from 2022, about eight openings a year, which is 9% of the current estate). The noted availability of attractive sites at increasingly cheaper prices should allow this to be achieved satisfactorily.

Valuation

Assuming 2020 is a trading aberration and using pre-IFRS 16 numbers for easier peer comparison, management's NAV of Fridays at £146.2m at March 2021 suggests an EV/EBITDA multiple of 5.6x on pro forma zero like-for-like growth on 2019 (see Exhibit 7). On a similar basis, that is pre-COVID-19 reported results, its closest listed competitors Loungers and Fulham Shore, trade on significantly higher multiples (almost 17x and 14x, respectively). For Restaurant Group, we have used the midpoint of its 'illustrative' and wide-ranging (£110–125m) EBITDA 'capability' on 2019 sales levels, hence some potential downside.

Exhibit 7: Peer comparison of EV/EBITDA rating, assuming return to 2019 sales levels

Pre-IFRS 16	Share price	Management valuation (£m)	Historical net debt/ (cash) (£m)	EV (£m)	Historical EBITDA (£m)	EV/EBITDA (x)
Hostmore*		**146 (Mar 21)**	**36 (Aug 21)**	**182**	**Pro forma 32.7**	**5.6**
		Market cap			25.6	7.1
Loungers**	287p	295	18 (July 21)	313	18.8	16.6
Fulham Shore***	19p	118	(3) (Aug 21)	115	8.3	13.9
Restaurant Group*	115p	881	200 (June 21)	1,081	118§	9.2
Various Eateries****	85p	76	(8) (June 21)†	68	5.3‡	12.8
Average						**13.1**

Source: Company accounts. Note: Priced at 20 September 2021. *Year to December 2019. **Year to April 2020. ***Year to March 2020. ****Year to September 2020. §Midpoint of management's 'illustrative' October 2020 indication of annualised EBITDA post restructuring on 2019 sales. ‡Adjusted run rate EBITDA.

Given the comprehensive restructuring ahead of its September 2020 IPO, we admit a caveat about our computed rating for Various Eateries. Even so, its very listing amid the pandemic endorses the opportunity for well-funded hospitality businesses, and its latest update at end June reported 'extremely strong' trading. In summary, the blended average of 13x EV/EBITDA for four of its peers is more than twice that of Hostmore on management's valuation at March 2021 when conditions were of course markedly less positive than now. The multiple falls to 4x on management's 'best-case', pro forma 10% like-for-like growth trading assumptions.

Hotter Shoes (10% of ELTA's NAV at 31 March 2021): A digitally led UK shoe manufacturer with a focus on customised comfort

Exhibit 8: Hotter investment summary

Total cost: £118m (including January 2014 £84m, 2017 £5m, 2018 £19m and 2019 £7.5m)

Source: ELTA at end March 2021

Hotter specialises in the design and manufacture of stylish comfort footwear (with 1.6m pairs manufactured in 2019, making it the UK's largest shoe manufacturer). It is renowned for its product quality and innovation as well as customer service, epitomised by its pioneering digital Footprint 3D fit technology, use of BASF's Infinergy foam inserts and over 40 width and size combinations via its Comfort Lab. Hitherto, the target market has been females over 55 with specific fit and comfort needs; while this is a favourable constituency and will continue to be a target, Hotter aims to broaden its proposition significantly by working with partners to sell a range of products (notably active lifestyle, wellbeing and health) and brands to the entire 55+ demographic. Sales are primarily through direct to consumer channels (81% in the half to July 2021) with a limited retail exposure (c 20 outlets). 10% of sales are in the US, where Hotter has a profitable and scalable operation.

The proposed new parent company for Hotter is Unbound Group (to be renamed from Electra as Electra's only remaining corporate investment following the demerger of Hostmore). Assuming shareholder approval, Unbound is due to move to AIM at the end of 2021.

Hotter's reshaping as a largely digital 'direct-to-consumer' business is continuing to pay off, with 39% year-on-year UK online sales growth in the six months to July 2021, albeit boosted by restrictions on retail because of COVID-19. With its targeted operating model now in place following

2020's retail de-risking with the closure of 70% of the UK estate, management is actively addressing opportunities in terms of both its core customers (product needs beyond comfort and fit) and a broader offering, initially for example menswear and safety shoes according to industry requirements. An improved digital marketing, personalisation and loyalty scheme, facilitated by a new app in Q121, is allowing enhanced management of a loyal customer base (4.6 million, with 100,000 added annually). The shops have been newly restyled as Technology Centres.

Strong online momentum

With Hotter's financial period under review marred by COVID-19 restrictions, it is more meaningful to look at the performance of direct channel sales, which are key to the new operating model, and at management's various revenue growth assumptions, using FY20 (the year to January 2020) sales levels as a base for a pro forma assessment of potential annual profitability. The aforementioned 39% increase in UK year-on-year direct to consumer sales in the half to July 2021 follows double-digit percentage year-on-year sales growth for most of 2020 after the March lockdown. With management's base case of 10% annual growth therefore well supported, 20% growth may be closer to the mark, even if flattered by COVID-19 retail constraints. The assumption of flat sales at the retained stores may be cautious, given their selection as optimum sites and recent conversion into Technology Centres. It is also encouraging, in terms of profit, that overall gross margin rose from 53% to 63% in the half to July 2021 and that EBITDA for the seven months from October 2020 exceeded management's pro forma EBITDA of £5.4m for FY20 by 8%.

Exhibit 9: Management's pro forma scenarios based on FY20 demand levels

Year-end 31 January (£m)	2020 actual	Direct channel revenue growth assumptions		
		10% growth	15% growth	20% growth
Direct channels	41.0	45.1	47.2	49.2
% of revenue	68%	70%	71%	72%
Retail and wholesale	19.5	19.5*	19.5*	19.5*
Revenue	60.5	64.6	66.7	68.8
EBITDA	5.4	7.3	8.3	9.2
Margin	8.9%	11.3%	12.4%	13.4%

Source: Hotter accounts. Note: *10% reduction estimated by management to reduce EBITDA by £0.2m.

Valuation

Management's valuation of Hotter of £19.2m at March 2021 (more than trebling from £5.8m at September 2020) suggests an EV/EBITDA multiple of 4.3x pro forma 10% direct channel sales growth on FY20, using management forecasts. Notwithstanding residual retail exposure and the risk of executing planned business enhancements, such a rating appears unduly low. Favourable macro trends, specifically the target over-55 demographic with increasing disposable incomes and digital literacy, in addition to a coherent corporate strategy (largely in place) and proven management are grounds for optimism, while there is considerable scope to monetise Hotter's comprehensive database, which provides direct access to valuable customers and the opportunity to add related products and services.

Exhibit 10: Peer comparison of EV/EBITDA rating, assuming return to FY20 sales levels

	Valuation*	Net debt*	EV	EBITDA	EV/EBITDA
	£m	£m	£m	£m	x
Hotter	19.2	12.0	31.22	**Pro forma 7.3****	**4.3**
				Historical 5.4***	5.8
PE (private equity) EMEA exits (consumer discretionary) in the 15 months to Sept 20 average****					11.1

Source: ELTA. Notes: *At March 2021. **Base case 10% sales growth scenario. ***Year to January 2020 adjusted for rationalisation of retail estate as a result of August 2020 CVA. ****S&P Global Market Intelligence as of November 2020.

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