7th November 2017

hardman&co

South West Leisure Limited

Single company EIS report

Summary

South West Leisure ("SWL") is raising money to finance the acquisition and redevelopment of a bar/restaurant in Chiswick, West London.

	Positives	Issues
Why Invest	**Strategy:** Asset backed prime leisure location in West London with opportunity to add value through development of private rooms.	**Competition:** There is huge competition in the London eating out market; it is a question of getting the concept and execution right.
The Management	**Team:** Experienced team behind the redevelopment of the Harcourt in Marylebone and four other London sites.	**Track record: T**here are no issues about the management team that cause us any concern.

Nuts & Bolts

- **Share Issue:** Open offer issue for 5.0 million shares at £1 per share i.e. raising £5m gross.
- **Offer**: The offer has been launched and will close on 21/11/17.
- **Exit Strategy:** Expected exit is most likely through a trade sale.

Specific Issues

- **Current trading environment:** After years of growth the London eating out market has recently seen a modest downtick in comparable sales, possibly reflecting the build up of consumer debt and economic uncertainty. The Chiswick property is not expected to re-open until next July by which time things might have improved. Importantly though, with the ownership of the freehold, it has the advantage over most of its competition of not paying rent.

Consultant information

Pre-money valuation	£0m
Target fundraise	£5m
Post money valuation	£5m

Risks

- **Generic:** SWL is a relatively small unquoted company. There will be no formal market in the shares. It is not intended that there will be any capital returns or dividends paid in at least the first three years. There can be no guarantee that the investment will be successful, that an exit will be achieved or there will be any value to be distributed.
- **Specific:** Getting eating out concepts right is not easy. SWL have secured a prime site and has a team that has demonstrated its ability with the redevelopment of the Harcourt, nevertheless there is no guarantee that the success can be repeated. Should it re-open against a backdrop of a serious economic downturn it would make achieving the financial projections very difficult in the short term.

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Factsheet

South West Leisure Limited		
Product name		South West Leisure Limited
Tax eligibility		EIS
Type of product		Single company equity issue
Term		N/A
Sectors		Leisure
Diversification		
Number of companies		1
(Expected) Gini coefficient		1
Fees	**Amount**	**Paid by**
Professional related to offer	c£23,000	The company
Advisor fee facilitation		Yes, IFAs paid 3.5% of the initial 5% manager fee
Manager fee amounts		5% of funds raised plus 2% annually and 25% of the upside
HMRC Advance Assurance		Granted
Reporting		Monthly data available on dedicated website
Minimum investment		£50,000
Minimum raise[1]		£500,000
Fundraising target		£5,000,000
Expected Closing date		21/11/17
Expected exit method		Most likely a trade sale

Source: Ducalian Capital, Hardman & Co research

[1] This has already been surpassed

Offering

South West Leisure Limited ("SWL") is a new company making an offer of shares in a single company that will fund the development of a property acquired in Chiswick High Road. The open offer is for 5,000,000 shares in the company at £1 each, looking to raise £5,000,000 in total.

The investment adviser, Ducalian Capital ("Ducalian"), has put together an experienced management team to carry out the redevelopment.

There is no specific exit plan or timetable: but the management believe that the most likely exit would be a trade sale to a hospitality business.

Summary of Risk Areas

Note: In addition to the specific ones commented on below there are generic risks from investing in EIS or unquoted companies.

Development

SWL intend to spend £1.64m over two phases fitting out the premises. This is a reasonably substantial project that inevitably brings risks of mistakes or cost overruns. There are however no significant structural changes planned and the team has considerable experience of carrying out these sorts of projects.

Operations

Nothing out of the ordinary is planned for the operation of the bar/restaurant that would imply unusual risks.

Competition

London, South West London and Chiswick, all have substantial competition in the eating and drinking out market. There may be some oversupply in the area of chain restaurants but there is always room for an independent standalone proposition. The issue is not the element of local competition, but getting the concept and the execution right, as the potential market is so enormous.

Finances

As it currently stands, SWL is relatively highly geared. It has acquired the Chiswick property for an all-in cost of around £4m with £1m to spend in the first phase. At the first close, Ducalian had raised £2.8m of equity with the balance funded by debt. Assuming the full £5m is raised the company will be on a very firm financial footing with less than £600,000 of debt and around £5m of net assets.

Management

Executive Team

The executive team is four people: two from Ducalian and two from the hospitality industry. The two Ducalian executives, James McCulloch and Robert Cherry, are both founders of Ducalian and have deep experience of raising capital and private wealth management.

On the operations side there is Henry Harris, an extremely successful chef who owned and ran the restaurant Racine in Knightsbridge between 2002 and 2015. In

2007 he took up the role of Chef Director for Soho House Group and is currently a consultant to the famous Groucho Club in Soho, London. He will be head of food and beverages.

The head of finance and operations is Shane Styles previously finance and operations manager at the Meredith Pub Group, which owned and operated some pubs and restaurants in London serving a similar market to the one SWL will be catering to, including the Portman and the Only Running Footman (now sold to a subsidiary of Greene King).

Non-executives

There are no non-executives.

Regulation

Industry

There are no particular regulatory issues affecting the business. The hospitality industry tends to pay at the lower end of the wage scale; this means that changes in the living wage can affect profitability.

Company

HMRC Advance Assurance has been granted.

Company Analysis

SWL has acquired an existing restaurant in Chiswick High Road, West London, to develop into a bar serving cocktails and craft beer and a restaurant providing high quality casual dining.

The freehold of the building, once a former police station, has been acquired for £3.75m (£4.06m including all costs) and is currently closed while the refurbishment takes place. It is due to re-open in July 2018.

The building is located at 210 Chiswick High Road, which is a long, busy thoroughfare full of a wide variety of retail offerings. It is in the Borough of Hounslow in West London.

210 Chiswick High Road

Source: Restaurant Property

The premises was run as a restaurant called Carvosso's. There is limited financial information about this, but it is believed to have been taking approximately £25k - £30k per week, and up to £40k in the summer months. It had a 4.0 rating on TripAdvisor (232 reviews) with 75% of reviewers ranking it Excellent or Very Good. This is evidence that it is a good, viable location. The owner manager decided to retire, hence the sale of the property.

The building totals 6,000 square feet of which just over half is on the ground floor including the internal courtyard. SWL says that the building is in good condition but the decoration is dated. It is intended to substantially remodel the interior. The front bar will be relocated and the remainder of the ground floor will be turned into an approximate 100-cover restaurant.

Upstairs (c1,400 sq. ft.) will also be redeveloped into an events space that can also be used as a bar or informal working space when not booked otherwise. The upstairs is planned to be launched in 2019, with further development expected in 2020.

The food offering will be designed by Henry Harris: former chef proprietor of Racine in Knightsbridge; Chef Director for Soho House Group; and also a consultant to the Groucho Club in Soho.

SWL believe that both high end casual dining and cocktail markets are underserved in this part of London.

Development

The initial development will be carried out in two phases with the first phase completing in July 2018 and the second phase scheduled to complete by the end of 2018, with some costs tripping over into 2019. The total cost of phase one is about £1.15m and the second phase is budgeted at £150k. Further development is scheduled in 2020 at a cost of £640k.

Development costs

£000	2018	2019	2020
Acquisition Costs			
Land & Property	3,750		
Stamp duty	215		
Fees	95		
Total	4,060		
Corporate Costs	273		
Development Costs	Phase 1	Phase 2	Phase 3
Fit Out	1,000	150	640
Fees	155	0	
Total	1,155	150	640
Project Costs	5,488	150	640
Working Capital	100		
Total Capital Requirement	**5,588**	**150**	**640**

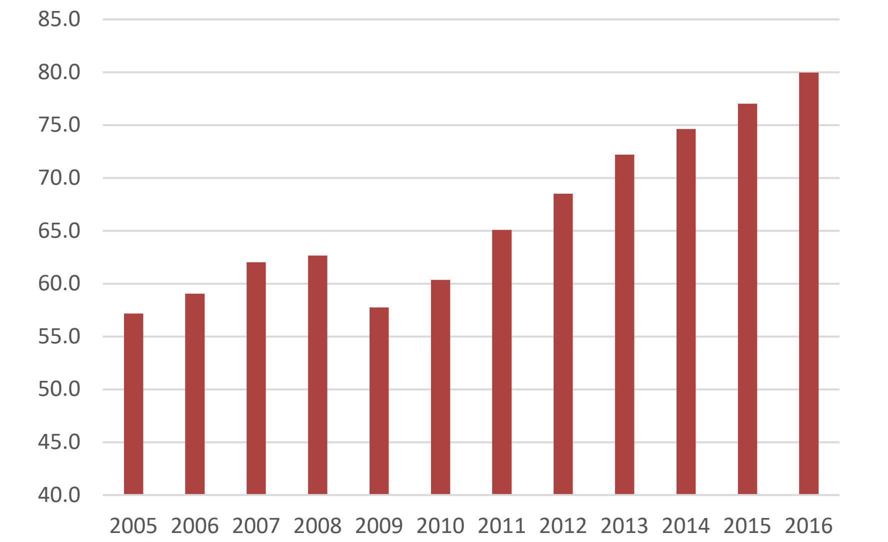
Source: Ducalian Capital

In total the whole project will cost approximately £6.3m with £100,000 allowed for working capital. About £0.5m is eaten up by stamp duty and professional fees (including the cost of raising the EIS finance).

The Eating out Market

The eating out market is a growth business, driven by demographics, wealth, cultural trends and opportunity. Since 2010 the UK market has grown at c4.8% annually.

Consumer spending on restaurants and cafes (£bn)



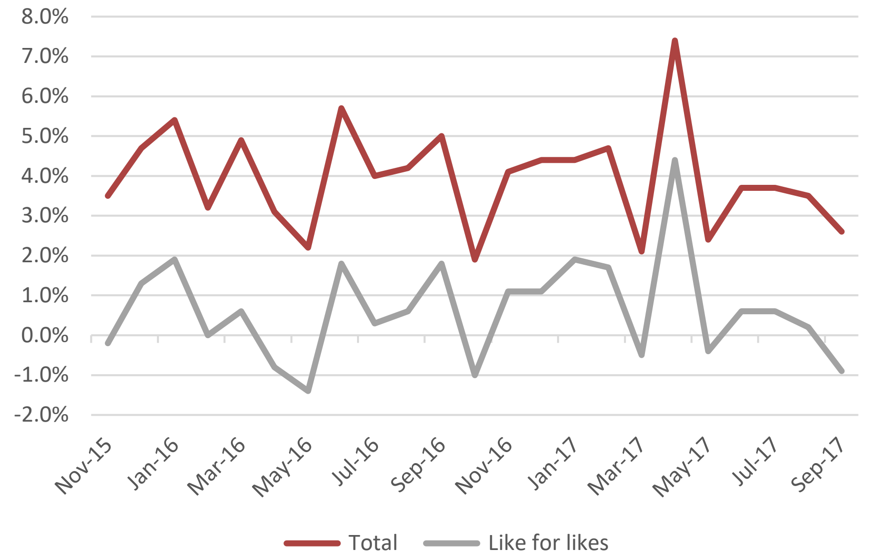
Source: Statista

The eating out market in London is disproportionately large with 44% of Londoners saying they eat out at least once a week, compared with 31% for the whole country. This is probably a function of wealth (richer), demographics (younger) and simply the vast range of opportunities in the capital.

Within the market as a whole there are all sorts of trends related to brands, fast food, ethnic cuisine etc. Fewer than 10% of the UK's 56,000+ restaurants are parts of chains – the vast majority are individual outlets.

Of course, while the eating out market is growing, so is the number of outlets offering dining opportunities. So the business per outlet shows a less confident trend.

UK pub and restaurant sales change over last 12 months



Source: Coffer Peach Business Tracker

Note: the spike in April was caused by Easter moving to April from March the previous year

Other headwinds facing the restaurateur include rising property rates, rising wages and increasing raw material costs. On top of all this, the market is obviously also subject to economic trends and if (when) interest rates rise again this could have a downward impact on restaurant spending.

The immediate macro-background is therefore uncertain. SWL has a major advantage over most of its competitors – it owns its own freehold and so is not paying rent which is typically around 10%-15% of a restaurant's overheads, or half the profits. If the economic circumstances deteriorate badly, much of the competition will founder long before SWL does.

The real risk for SWL is not the macro economic climate, it is the execution of the concept that matters: can the team create an attractive proposition that will draw customers from Chiswick and beyond? We are not in a position to judge that, the best clue to likely success is to look at the team's track record.

Management track record

The same management team behind the Coach & Horses in Clerkenwell, the Truscott Arms in Maida Vale and The Harcourt in Marylebone will be in charge of developing the Chiswick property. The Clerkenwell and Maida Vale properties don't open until next year, but the Harcourt opened in April 2016 and is very successful.

The Harcourt

The Harcourt is based in a Grade II listed building in Marylebone, central London that formerly housed the pub The Harcourt Arms. After being acquired by another Ducalian EIS scheme, it was remodelled and reopened in April 2016 as a bar with restaurant and a Scandinavian theme. It has two main public rooms and three private dining rooms. They managed to gain some additional planning permission to expand the usable space which pushed the budget up and the opening back but it is now trading well over the original budget and looks on track to deliver approximately £1m of revenue in calendar 2017. It turned over £700k in the eight months of 2016.

On TripAdvisor, 62% rank it Excellent and 20% Very Good.

Two other points of interest from the Harcourt: it is achieving gross margins of around 70% which is what we would expect and what is in the financial projections for Chiswick; and the increased use of the private rooms has pushed up the spend per head very noticeably. In the first four months of this year spend was about £30-£35, in the past few months that has risen to £45-£50. It demonstrates very clearly that private rooms, if successful, can boost profitability substantially.

Financial Projections

The projections provided by the company are given in the table below.

Financial projections for South West Leisure 2018-22

£000	2018	2019	2020	2021	2022
Sales - food & beverage	759	1,690	1,950	2,210	2,340
Sales - private rooms	0	133	161	419	434
Total sales	**759**	**1,823**	**2,111**	**2,629**	**2,774**
Less cost of sales - food & beverage	-243	-507	-546	-619	-655
Less cost of sales - private rooms	0	-27	-32	-84	-87
Total cost of sales	**-243**	**-534**	**-578**	**-703**	**-742**
Gross profit - food & beverage	516	1,183	1,404	1,591	1,685
Gross profit - private rooms	0	106	129	335	347
Total gross profit	**516**	**1,289**	**1,533**	**1,926**	**2,032**
Wage costs	-254	-525	-606	-638	-649
Variable overheads	-167	-381	-457	-516	-550
Fixed overheads	-39	-78	-78	-78	-78
EBITDA	**56**	**305**	**392**	**694**	**755**
Other costs					
Depreciation	-15	-30	-30	-30	-30
Loans interest	-14	-27	-45	-60	-60
Annual management charge	-50	-100	-100	-100	-100
Total other costs	-79	-157	-175	-190	-130
Profit before tax	**-22**	**148**	**217**	**504**	**625**
Gross profit percentage - f&b	68%	70%	72%	72%	72%
Gross profit percentage - rooms		80%	80%	80%	80%
Staff cost as % of turnover	33%	31%	31%	25%	24%
EBITDA as % of turnover	7%	17%	19%	26%	27%
Revenue per week (£000)	29	35	41	51	53

Source: Ducalian Capital

Investors should note the following points when assessing these.

Generic disclaimer: *Generally, management projections, particularly for revenue, are at the optimistic end of likely outcomes. The planning fallacy can significantly affect timescales, and even those that are successful usually have delays somewhere that adversely affect revenue progress or increase costs.*

Specific Comments

Hardman & Co has been supplied with a detailed financial model covering the period to the end of 2022. We would make the following observations:

Subject to the economy not deteriorating dramatically the revenue expectations do not seem over-optimistic to us. For the second half of 2018 revenue is expected to be around £30k per week, rising to £35k in 2019 and just over £40k in 2020.

Gross margins at 70% are standard for this sort of operation.

Wages are expected to be around a third of sales for the first three years when the private rooms business is projected to tick up significantly when they fall to c25%. Assuming the revenue growth does come through these assumptions seem readily achievable.

The other assumptions for variable overheads – e.g. utilities, laundry, marketing etc. – also seem very reasonable to us.

Deducted from operating profits is £100k annually representing Ducalian's annual management fee of 2% of funds raised (assuming the full £5m is subscribed). The fee is indexed to CPI, but that is assumed to be zero in the financial projections.

The total initial investment is around £5.55m including £100k of working capital as the business builds up to cash flow break even. This is planned to be funded with £5m of equity and a £600k bank loan. In the interim, SWL has funded the purchase of 210 Chiswick High Road with the initial equity raised and a £600k bridging loan. It is currently negotiating with several banks to replace the bridge with a senior loan. The terms are likely to be around 3.5%+ base, 15 years including one year of interest only payments.

So the business will be almost entirely ungeared (net) through to the end of 2018 if the full £5m is raised. The second phase of the investment will cost another £600k and this will be financed by drawing down on the loan facility. Even so the gearing against the assets and the projected cash flow is, in our view very modest.

Manager incentive fees

The manager, Ducalian, will receive 25% of the profits once the original investment has been returned to shareholders. So, in the event of a trade sale, Ducalian will receive 25% of any net proceeds above the initial investment (assumed to be £5m). If the capital is returned to the investors by, for example, dividends, then, once these in aggregate exceed the initial investment, Ducalian will receive 25% of the net profits annually until the business is sold.

Exits

Ducalian expects to exit the business by way of a trade sale after at least three years. A typical valuation for such a deal would reflect the freehold ownership of the site and might see an EBITDA multiple in the range of 12x-18x.

In the table below we show a simple example of how the multiple including the freehold might work. It takes an assumed rent of £150k – which is a 4% yield on the value of the property when it was acquired. We subtract the rent from the projected EBITDA in 2022 of £750k to get an adjusted EBITDA figure of £600k and put that on 12.5x. The combined EBITDA multiple is thus calculated as 15x, or a capitalisation rate of 6.7%.

Illustrative composite capitalisation rate

£000	Value	Capitalisation	Multiple
EBITDA	750		
Rent	-150		
Adj EBITDA	600		
Property	3,750	4.0%	25.0
Business	7,500	8.0%	12.5
Total	11,250	6.7%	15.0

Source: Hardman & Co Research

In its UK Pubs review of March 2016, CBRE, a leading real estate services company, estimated that the yield (i.e. capitalisation rate of adjusted EBITDA) for a London Independent Pub was around 5.25%. In 2010 it had been as high as 7.5%. In its July 2017 UK Pubs property trends report that yield remained unchanged at 5.25%.

The actual multiple paid will be a function of all sorts of things: the state of the economy, interest rates, demand for freehold bar/restaurants and whether there is any competition for the property. Plus, of course, the specific individual characteristics of the business.

In the table below we set out a range of scenarios which shows the valuation of the business depending on the combined EBITDA multiple and the level of EBITDA being generated. We have included a wide range of possibilities to reflect the unknowability of the future.

Business value - exit scenarios

	Capitalisation					
EBITDA, £000	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**
200	4,000	3,333	2,857	2,500	2,222	2,000
300	6,000	5,000	4,286	3,750	3,333	3,000
400	8,000	6,667	5,714	5,000	4,444	4,000
500	10,000	8,333	7,143	6,250	5,556	5,000
600	12,000	10,000	8,571	7,500	6,667	6,000
755	15,100	12,583	**10,786**	9,438	8,389	7,550
800	16,000	13,333	11,429	10,000	8,889	8,000
900	18,000	15,000	12,857	11,250	10,000	9,000

Source: Hardman & Co Research

Taking the table above we have then translated that into the proceeds an investor could expect for £100,000 gross investment. This is net of the 25% incentive fee taken by Ducalian above the £5m threshold, but ignores any disposal costs and the net working capital in the business (which should roughly cancel each other out).

Return to investors per £100k gross invested

	Capitalisation					
EBITDA, £000	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**
200	80	67	57	50	44	40
300	115	**100**	86	75	67	60
400	145	125	111	**100**	89	80
500	175	150	132	119	108	**100**
600	205	175	154	138	125	115
755	252	214	**187**	167	151	138
800	265	225	196	175	158	145
900	295	250	218	194	175	160

Source: Hardman & Co Research

We have not made any calculations on the return on the net investment, as this will depend on investors' individual circumstances.

The value achieved in any sale will reply on multiple factors as discussed above, but there will always be the freehold asset to support the valuation.

Given the lack of liquidity, investors will inevitably need to treat this as a long-term investment.

Ownership

South West Leisure is a new company and so the 5.0m ordinary shares will be 100% owned by the subscribers to the EIS.

In addition, there are 250 "A" shares; these are retained by the management. It is through the "A" shares that the management receives its 25% profit share above the £1 per share hurdle rate.

"A" shares have the same voting rights but do not qualify for dividends until the ordinary shareholders have had their capital returned in full.

Management

James McCulloch

Director

James has spent most of his career providing real estate solutions to the wealth management market. Such experience has included acting as an investment agent on UK and international commercial and residential developments, raising equity for commercial property syndicates and more recently acting as the property adviser in the acquisition of industrial property and freehold pubs, restaurants and bars. James is a Director at Ducalian Capital and as the Investment Director is responsible for identifying and analysing investment opportunities for the firm. James sits on the board of the Titan Group, City Space Storage and a number of leisure companies and focuses on growing their portfolios through acquisitions.

Henry Harris

Head of Food & Beverage

Henry has built a reputation as one of London's leading chefs. In 2002 Henry opened Racine in Knightsbridge as Chef Patron and won numerous awards including ITV French Restaurant of the Year, Tatler Most Consistently Excellent Award and Restauranteur's French Restaurant of the Year. In 2007 Henry took up the position of Chef Director for Soho House Group and is currently a consultant to the Groucho Club in Soho and a director of Harris Vintners.

Shane Styles

Head of Finance & Operations

Shane was previously finance & operations manager at the Meredith Pub Group, which owns and operates a number of iconic pubs and restaurants in London, including The Only Running Footman in Mayfair and the Portman in Marylebone. Shane oversaw every operational aspect of the business from book keeping and management accounting through to implementing operational procedures, recruitment and performance monitoring. Shane was a key part of the management team that helped turn The Only Running Footman into successful pub and restaurant businesses.

Robert Cherry

Director

Rob was a founder of Ducalian along with James McCulloch and James Hancock and spent most of his career providing financial and investment advice to high net worth and sophisticated individuals. As the Director of Private Equity, Rob is in charge of the capital raising team and has raised over £25m for industrial and leisure projects over the last few years. Rob works closely with Ducalian's cornerstone investors, financial advisors and intermediaries.

There are no non-executive directors.

Potential Conflicts of Interest

Although in the normal course of events many business relationships of its Directors are positives for a company, under some circumstances they may cause conflicts of interest. We note those that have been disclosed to us.

We have not identified any specific potential conflicts of interest. The managers are involved in running other properties but they are not in direct competition with the Chiswick property. It is possible that management attention could be distracted by problems at other venues but we view this risk as easily manageable.

Notes

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