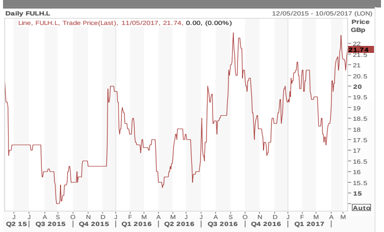
15th May 2017

hardman&co

Consumer leisure



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	FUL
Price (p)	21.5
12m High (p)	21.5
12m Low (p)	15.5
Shares (m)	572
Mkt Cap (£m)	123
EV (£m)	129
Free Float*	47%
Market	AIM

**As defined by AIM Rule 26*

Description

Owner of fast-growing UK restaurant chains Franco Manca and The Real Greek. Also, Bukowski Grill Soho outlet, as yet at an early stage.

Company information

Exec Chairman	David Page
MD	Nabil Mankarious
CFO	Nick Wong

020 7902 9790
www.fulhamshore.com

Key shareholders

Directors	39.0%
N. Mankarious (dir)	19.7%
S Wasif	14.9%
D Page (dir)	14.1%
G Mascoli	5.0%
P Solari.	4.0%

Next event

July-17	Final results
Sept-17	AGM
Dec-17	Interim results

Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com

The Fulham Shore

Rising dough

Fulham Shore's proven management team is expanding both its main brands, Franco Manca and The Real Greek, ahead of expectations. FY17 saw a 55% rise in restaurants open, to 45. We estimate 60 by end FY18, more than double the end FY16 figure. The authentic, good value, casual dining experience produces average ROCE at restaurant level of over 20%. Most openings are in Headline EBITDA profit from month one. The 3rd April trading update highlighted trading in line with (ambitious) expectations, which is in comparison to many other US and UK brands, which have found the past year difficult. Fulham Shore has clearly demonstrated robust, strong growth, expanding from London and out to provincial locations, with eventual potential for franchise, a third brand and international expansion.

- **Strategy:** Fulham Shore owns now 47 restaurants (set to rise to 60 this year): this leaves significant scope. For example, Pizza Express UK has over 400 outlets. This rapid expansion can be delivered profitably, including all opening costs. We model two brands: there may be scope for a third, possibly Asian or other. cuisine.
- **Trading:** On 3rd April 2017, Fulham Shore stated that FY17E results will be in line with (ambitious) expectations. The accelerated opening programme (upgraded to 16 new restaurants in FY17) naturally has raised pre-opening costs.
- **Valuation:** For FY19E, we estimate £13.2m EBITDA excluding pre-opening costs. The EV/EBITDA rating stands at 13.0x). This compares with recent PE transactions taking place in the 10 – 15x range, for businesses with lesser growth potential. Currently the expansion leads to negative free cash flow but flexibility of growth rates is retained, so cash generation potential is strong.
- **Risks:** Debt increases over the next two years, given the rapid rate of expansion. Were FY20E to see a similar rate of expansion (c.15 restaurants), stable margins would lead to cash outflows reversing. Eating out is a discretionary market. Costs are rising for the sector – from ingredients and labour, through to rates.
- **Investment summary:** There are surprisingly few successful, quoted investment vehicles offering participation in this growing global industry. The team running Fulham Shore has the potential to expand the business significantly further. Initial targets could exceed 150 restaurants. Note private equity sector interest.

Financial summary and valuation

Year end Mar (£m) [1] 12 month equiv from 9 month accounting period	**2015** [1]	**2016**	**2017E**	**2018E**	**2019E**
Sales	11.1	29.3	40.0	62.0	79.5
Restaurants year end	18	29	45	60	75
EBITDA pre share based, pre-open costs	1.7	5.2	7.1	10.3	13.2
EBITA pre share based, pre-open costs	1.0	3.3	4.3	6.0	7.7
Interest	0.0	0.0	-0.2	-0.4	-0.4
PBTA pre share based, pre-open costs	1.0	3.2	4.1	5.7	7.3
PBT reported post all costs (incl acqn)	0.0	0.4	0.7	1.6	3.1
EPS (Adj. before share based, amortisation, pre-open costs) (p)	0.3	0.5	0.6	0.9	1.1
Net cash	3.0	-3.3	-6.3	-10.6	-12.3
P/E (x)	70.0	43.0	33.0	24.5	19.4
EV/EBITDA (post pre-open costs) (x)	57.1	33.3	27.2	16.4	13.0

Nil dividends. PBT and EBIT stated PRE brand amort (£0.8m FY16) Source: Hardman & Co Research

Table of Contents

Executive summary

This document initiates our full research coverage of Fulham Shore.

Appetising growth

Breadth of potential for growth – provincial, food on the go, shopping centres

Much potential to grow for many years

Fulham Shore's two brands have significant growth potential. Of the 45 restaurants, seven are provincial, with the first The Real Greek outside London being the 2014 opening of Windsor. Franco Manca's first opening in this category was Guildford, 2016. With proven success now in both London and in provincial towns and cities, there is breadth of scope. Food 'on the go' has been a modest component but is rising. Furthermore, a number of restaurants are now in shopping centres, providing another distinct stream of income. We model 47% of restaurants being in provincial locations end FY19E. The brands both have exciting potential over and above the 75 restaurants total we estimate to be open by end FY19.

The team running Fulham Shore has the potential to expand the business significantly further. Initial targets, Hardman believes, could exceed 50 restaurants at The Real Greek and approach 100 at Franco Manca – with the potential for an additional brand.

We chart the number of restaurants open during part or full year, below.

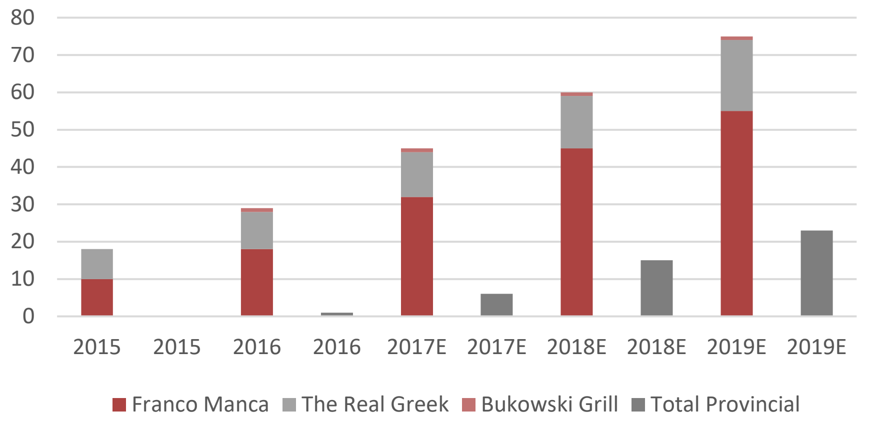
- Sales profiles through the opening then maturity cycle are now well established and the group now has seven restaurants outside London, all of which have traded to plan. Bournemouth opens this week in Debenhams.
- We anticipate the large majority of new openings to be provincial UK locations. We note (twitter) that a new opening is anticipated in Edinburgh this year.
- Growth in London has included shopping centre concessions (Westfield, Debenhams), which is important as regards the breadth of ways the market is addressed (added to which the concession restaurants – which have their own entrances – have been proven to enhance the centre). This mode can also be used provincially – as in in Bournemouth and Reading, which are set to open shortly. We note Debenhams' recent comments that is seeks 30 food concessions (of various brands) by October 2017.

Number of Fulham Shore restaurants open during part or full year ….

To give context: Pizza Express has over 400

Note Fulham Shore reaches increasingly into the provinces now on

At an exciting early stage of growth, expanding outside London



Source: Hardman & Co Research

Central and regional teams now enhanced

In the past year, the central team has been enhanced by HR, marketing/PR, financial and operational functions. These have been taken on both to 1) assess suitable new sites nationwide and 2) manage the growing estate. For robust management of the restaurants, area managers are responsible each for 5-10 restaurants, with 'area chefs' to ensure consistency. It is important that Fulham Shore invests in the people and systems to roll out its significant growth and includes its staff in the success of the business. The majority of Fulham Shore staff are shareholders, with SIPPs and options for most chefs. Fulham Shore has always paid at least the National Living Wage, including under 25s, and all gratuities have always been kept by staff waiting on tables.

Central and regional teams now enhanced

The group is in a position potentially to franchise out the concepts carefully, internationally.

Funding the growth

Arithmetic new opening growth rates result in free cash inflow by FY20E even with ongoing expansion

FY20E onwards, with the growing cash flow from the opened restaurants (we model a steady rate of 15 new openings per annum), this would result in free cash flow turning positive. This trend is already visible (see chart, thick line). The rising numbers of restaurants generate rising cash inflow and the outflow related to openings we model as remaining broadly constant. There is a crossover, with free cash flow turning positive, FY20E. In the meantime, debt structures are in place.

Debt facilities increased but peaks at some 130% of operating cash flow, so a robust ratio

As of its 3rd April trading update, Fulham Shore stated "To aid both our increased expansion plans and the strengthening of our central team we have agreed increased facilities with our bank, HSBC, from £6.5m to £15.0m. These new bank facilities have been negotiated at our previously agreed terms and rates." For the year ends FY17-19, we see debt as between 116% and 133% of operating cash flow, with likely falls FY20E and thereafter.

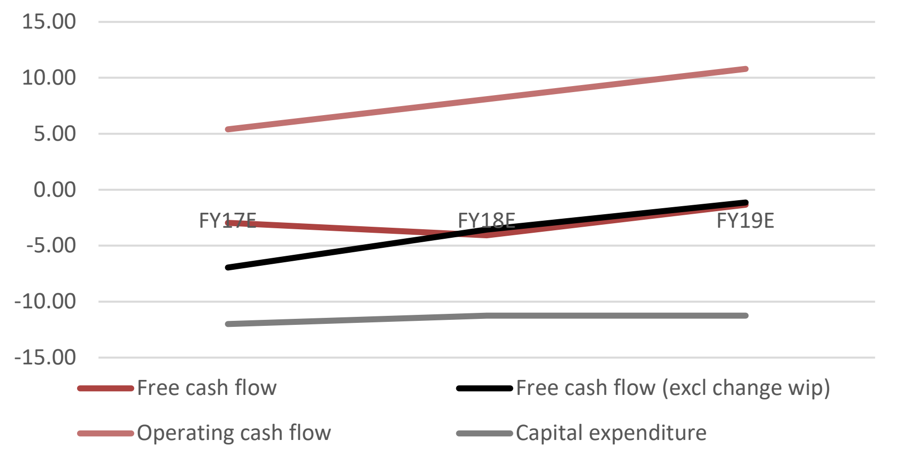
Operating cash flow doubles FY19E vs FY17E

- Significant steady rise in Operating cash flow (+100% FY19E vs FY17E's £5.2m).
- Stripping out the wip effects, free cash flow in significantly and steadily rising towards a positive figure immediately beyond FY19E. Free cash flow is distorted by wip, which we estimate has seen £4m inflow FY17E (in part as a function of the large number of openings immediately prior to year end).

FY17E has seen a rise in trade creditors (related to the openings at year end)….

…. Stripping out this significant benefit to FY17E, the free cash flow line exhibits steady growth

Cash flow trends



Source: Hardman & Co Research

The model is now predictable, with a track record established for restaurants' trading (one open for nine years and nine opened for over three years), so we are confident modelling the restaurant income. With 45 opened, we are confident that the fit-out costs are running to budget. 15% operating cash flow as % sales was achieved in FY16. We model this reducing to 13% FY18E – we believe this is conservative and achievable.

Management will ensure growth rates are robust and manageable. Stable capex is anticipated (in the £11.25m to £12m annual range FY17E to FY19E).

The growth path makes Fulham Shore attractive both to public market and private equity 'constituencies'

Appetising valuation

The management is expanding its two-brand fledgling growth nationally, with a 'three figure quantum of restaurants' being on the horizon.

The FY19E rating is usefully below recent industry private equity transactions

The Fulham Shore FY19E EV/EBITDA (before pre-opening costs) rating is at the lower end of recent PE transactions which have taken place within the (historic) 10 – 15x range. This, furthermore, is for businesses with lesser growth potential. With Fulham Shore at the stage of strong and sustained expansion, a premium is deserved, over and above.

Free cash flow is being invested into growth. Prior to this, the free cash flow yield is an undervalued 9%

Fulham Shore's 'underlying' free cash flow is significant. FY19E 'underlying' free cash flow yield (22p) is over 9%, on 2.0p 'underlying' free cash flow per share, which is a figure excluding capital expenditure on new restaurants and (the more modest) amount of pre-opening costs on new restaurants. Currently the expansion leads to negative free cash flow but flexibility of growth rates is retained, so cash generation potential is strong.

For example we estimate 15 new restaurants to be opened FY19. With a fit out and property cost of circa £0.8m per restaurant, and with pre-opening costs of some £0.1m per restaurant, the cash outflow of £1.6m modelled for FY19E would become some £12m cash inflow FY19E if openings were to be halted, a 2.0p per share 'nil openings or underlying' free cash flow.

Recycling cash flow is attractive but in due course a dividend will be paid

This strength indicates that the Fulham Shore board will at some stage review its dividend policy which, currently, is for none to be paid. The current situation is a function of the expansion opportunities and the ROCE (20%+) achieved from recycling capital into such expansion. This is set to be maintained but by FY20E the significant change will be a likely move (under the current two-brand position) to a positive free cash flow.

Current trading

Neither Franco Manca nor The Real Greek has experienced material impact from UK consumer caution. Management is well aware of the benefit of the focus on robust menu price points (average spend pre VAT and service is just over £9 at Franco Manca and slightly higher at The Real Greek), locations, ambience and offering all mean that a wide range of market conditions can be addressed positively. Further, the fixed cost base – particularly with reference to property costs – is deployed efficiently, again placing both brands in a position to trade with confidence in a potentially increasingly value conscious UK consumer spending environment.

We note that Whitbread on 25th April stated: "Costa has also seen positive like for like sales growth, although we remain cautious and expect a tougher consumer environment than last year." Given a downward share move on the day, this was worse than expected.

Comptoir on 12th April stated "During the first quarter of 2017 we have experienced the UK consumer being cautious. Trading in January and February, traditionally the Company's quietest months, was below expectations, however, we saw improved trading in March."

Clearly these are all distinct brands but the confidence of the 3rd April 2017 Fulham Shore trading update can be explained by the baked-in brand strengths. Clearly as the Fulham Shore Brands expand, the breadth brings stability and expertise (to infill that broadened footprint) but also increases exposure to broader market trends. The management team has always bene focused on risk management and the past year has seen investment in the broader management team, with that issue at the top of the agenda.

Operational review

Strong trading and prospects

Profit and pre-tax 'in line with market expectations' for FY17, even after enhanced pre-opening costs

Trading is strong: The current trading update of 3rd April 2017 was positive, building on previous positive updates. The six months' figures announced in December 2016 for example characterised the first half thus: "It has been a busy and successful 6 months for the Group." H1 sales rose 43% and we anticipate 37% for the full year (which is a 31% sales rise H2 vs prior H2).

Trading was stated to be 'in line with market expectations' which we take as referring to sales and headline EBITDA expectations.

These confirmed market expectations are evidence of the strength of margins and trading despite sector-wide headwinds on costs.

Two openings brought forward from FY18 to FY17

We anticipate a £0.65m PBT after all costs including pre-opening, but this is post a raised figure (of £1.9m) for pre-opening costs, prompted by accelerated openings. These were referred to in the 3rd April statement by Fulham Shore. "Towards the end of the financial year in March 2017 we opened two Franco Manca pizzeria, at Crossrail Place in Canary Wharf and next to Russell Square underground station in Bloomsbury, London. These pizzeria were intended to be part of our 2017/18 opening programme but due to the efforts of the Franco Manca opening team and our building contractors we have opened them earlier than planned. As a result of this and a four month delay to the Franco Manca Victoria opening, our pre-opening costs for the year were higher than we anticipated."

We understand Canary Wharf is the third Franco Manca to have two ovens.

Increased banking facilities ….

This confidence underpins an acceleration to the ambitious opening programme. The 3rd April update also stated "To aid both our increased expansion plans and the strengthening of our central team we have agreed increased facilities with our bank, HSBC, from £6.5m to £15.0m. These new bank facilities have been negotiated at our previously agreed terms and rates." This was anticipated but confirms the plan to continue expanding nationally in selected locations.

…. On the two-brand expansion policy we anticipate end FY19E being the peak for debt

Fulham Shore is expanding substantially. As discussed page 4, we see a two-brand expansion programme leading to a peak in debt end FY19E, with positive free cash flow thereafter, despite a maintained opening programme beyond.

The leadership team is experienced in gauging optimal growth rates to minimise risk. Delivering the sites, managing a rising number of restaurants and keeping the menu and food quality attractive as the brands expand all require: 1) a strong proposition and 2) tight monitoring. These factors are major potential risks to emerging growth brands.

1) **Strong proposition**: food is good quality using fresh ingredients including sourdough base prepared at the restaurant (for Franca Manca) and a significant element of ingredients sourced from Greece at The Real Greek. Menu pricing is good (i.e. below many other national operators), no risk appears regarding pricing point constraints. On a broader level, the move to the provinces enables growth across a wide range of sites (including department stores' seven year concessions), so the very best (not the most easily obtained or the most expensive) can be selected.

Franco Manca Menu Page 1

PIZZAS

1
TOMATO, GARLIC & OREGANO
£4.95

2
TOMATO, MOZZARELLA, BASIL
£6.40

3
COURGETTES, BASIL, MOZZARELLA, BUFFALO RICOTTA, FRANCO & CANTARELLI GRANA (No tomato)
£7.35

4
GLOUCESTER OLD SPOT HAM (Home Cured), MOZZARELLA, BUFFALO RICOTTA, WILD MUSHROOMS (Little tomato) £7.35

5
TOMATO, GARLIC, OREGANO, CAPERS, OLIVES*, ANCHOVIES & MOZZARELLA £7.25

6
TOMATO, CURED ORGANIC CHORIZO (Dry & semi-dry) & MOZZARELLA £7.55

EXTRA TOPPINGS FROM £0.50 TO £1.75

SALAD

MIXED LEAF SALAD £2.45
with alfalfa sprouts, Franco's dressing

FRANCO & CANTARELLI GRANA, OLIVES* & MIXED LEAVES £3.55

*please watch out for the very occasional olive stone

FRANCO MANCA

SOURDOUGH PIZZA

Our pizza is made from slow-rising sourdough and is baked in a wood burning oven at 500°c (900°F). The slow levitation and blast cooking process lock in the flour's natural aroma and moisture giving a soft and easily digestible crust. As a result, the edge (cornicione) is excellent and shouldn't be discarded.
This system was originally developed by the Greek settlers who in the 5th century BC founded Neapolis (New Town). They adapted a pre-existing baking tradition to develop this new 'Pita', which through experimentation, luck and linguistic distortions, became pizza. This recipe has been developed under the leading light of Marco Parente and Giuseppe Mascoli.

DRINKS

TENUTE NORMANNO'S ORGANIC WINES
Indigenous Sicilian varieties.
BIANCO (Catarratto)
ROSSO Unfiltered (Nero d'Avola)
750ml £15.50, 175ml £4.15

CARLINDEPAOLO'S REGINA DI FIORI
No chemical pesticides, herbicides or fertilisers.
BIANCO (Cortese, Favorita & Arneis)
ROSSO (Dolcetto, Barbera & Croatina)
750ml £16.50, 175ml £4.25

FRANCESCO CIRELLI'S ORGANIC FARM
BIANCO (Trebbiano d'Abruzzo)
ROSÉ (Montepulciano)
ROSSO (Montepulciano)
750ml £18.50, 175ml £4.60

BUBBLES FROM FOLICELLO
Metodo ancestrale, organic, biodynamic, so guilt free indulging.
BIANCO (Pignoletto, Montu & Trebbiano)
LAMBRUSCO (Grasparossa di Castelvetro)
750ml £20.00, 175ml £5.25

BEERS
NO LOGO Craft Brewed lager 330ml £3.45
Pale Ale 330ml £3.45

CIDER
NO LOGO Medium Dry
330ml £3.45

SOFT DRINKS
Organic lemonade 250ml £2.20
Orange or apple juice (English) 250ml £2.55
Ferrarelle Naturally Sparkling Water 500ml £2.00
Filtered water free of charge
Espresso Gianni Frasi flame roasted beans £1.60

For information on allergens please just ask

ALL TIPS GO TO THE STAFF

Source: Franco Manca current menu

Franco Manca Menu Page 2

MENU NOTES

SOME VEGETABLES YOU ARE LIKELY TO SEE IN OUR SPECIALS:

TOMATOES
A summer fruit, we have a great selection of tomatoes for our daily specials; San Marzano Dell'Agro Sarnese-Nocerino D.O.P., Piennolo from Vesuvio D.O.P. and yellow tomatoes.

COURGETTES
We start again with Italian and Spanish in June and we will get a good crop of Uk courgettes in September. Some flowers will also arrive intermittently.

RED & YELLOW PEPPERS
From Italy mostly, and some from Uk in early September. These are sweet and scented.

AUBERGINE
If the season is ok again in August we will have some from the Isle of Wight.

ON YOUR PIZZA

MOZZARELLA – SOMERSET.
SOFT GOAT'S CURD – WHITE LAKE DAIRY.
STILTON – COLSTON BASSETT.
CURED CHORIZO – MARTINEZ SOMALO, LA RIOJA.
ORGANIC TOMATOES – SOUTH OF ITALY.
MEATS – GLOUCESTERSHIRE.
CURED MEAT – LANGHIRANO, EMILIA ROMAGNA.
WILD CAPERS – ANTONINO CARAVAGLIO, SALINA.
KALAMATA OLIVES – GREECE.
ARTICHOKES AND SPECIAL TOMATOES – SAN NICOLA DEI MIRI, GRAGNANO , CAMPANIA

COFFEE PURE ARABICA, DOUBLE SELECTION – BERRY AND BEANS – FLAME ROASTED BY GIANNI FRASI IN FIFTY KILOS BATCHES. ONE MACHINE, ONE FAMILY, FOUR GENERATIONS. PUTTING ESPRESSO BACK ON THE SMALL MAP.

Special daily pizzas might contain ingredients not mentioned in this menu.

SOME PEOPLE SAY…

"FRANCO MANCA'S PIZZAS ARE THE BEST IN BRITAIN." William Skidelsky, The Observer

"TO UNDERSTAND HOW WONDROUS COOKING IN A WOOD-BURNING OVEN CAN BE, TREAT YOURSELF TO A PIZZA AT FRANCO MANCA IN BRIXTON, SOUTH LONDON. HERE, PIZZA-MAKING HAS BEEN ELEVATED TO AN ART FORM, AND THE CHARCOAL-FLECKED MARGHERITAS THAT COME OUT OF THE INFERNO-LIKE DEPTHS OF ITS OVENS ARE REGULARLY VOTED THE BEST IN THE COUNTRY." Tony Turnbull, The Times

"IF YOU ONLY EAT ONE PIZZA THIS YEAR, MAKE SURE IT'S FRANCO MANCA" Tatler

FRANCO MANCA
at Brixton Market
www.francomanca.co.uk

Source: Franco Manca current menu

2) **Delivery of the expansion programme**: to deliver this, the team needs to be right. FY17 has seen the central team enhanced. These have been taken on both to 1) assess suitable new sites nationwide and 2) manage the growing estate (HR and also oversight of the customer offering). Area managers are responsible each for 5-10 restaurants. 3) Fulham Shore recruits great people to give the best experience. Staff retention and incentivisation is key. Over 70% staff at The Real Greek and Franco Manca are (respectively) Greek and Italian.

Upgrade to FY18E Hardman sales and profits estimates…..

We have therefore upgraded top line and EBITDA FY18 estimates

For full analysis of financial trends, see pages 9 – 14.

FY18's sales growth was estimated by Hardman & Co at 35% (as of September 2016 publication). We have raised this figure to 55% (£40m FY17E sales and £62m FY18E sales).

…. This upgrade is despite the likely policy to absorb some of the inevitable current cost rises

FY18E profits: we have raised estimates since our September 2016 report from £2.2m (post all costs) to £2.7m. Our EBITDA estimate before pre-opening costs and share-based payments is raised from £10.0m in our previous estimates to £11.0m now. Not only is Fulham Shore coping solidly with rising costs and accelerating openings but also we anticipate only modest inflation in the menu and achieved prices. Therefore this profit upgrade is less than might initially be expected from a rise in sales estimates from £54m to £62m for FY18E. We consider Fulham Shore to be maximising its resilience to any potential market slowdown, but maintaining quality and absorbing some cost rises (which – see page 21 RISKS – should be less than much of the competition suffers).

Trusted management gauging the optimal rate of growth and menu pricing

So, we model that Fulham Shore will choose to apply modest if any menu price inflation. This is an important element of the brands and, in any case, offers great scope to react to developments without having 'hands tied'. We note that one of the main peer-group trading 'casualties' in the UK sector in 2016 (The Restaurant Group) is suffering now that it has to cut its prices significantly, having aggressively raised them in recent years.

Gross margins taking slight strain from supporting the strength of proposition to customers

We therefore model gross margins falling from 45.3% FY16 to 43.6% FY18E. Our modelled reduction is due to: 1) the programme to maintain the cash margin; and 2) cost increases in national living wage, the apprenticeship levy and pension contributions. Delivery fees also affect the gross margin as costs are taken above this line, with the net outcome being more favourable, in addition to boosting revenue. The trend we anticipate is a sideways FY17E vs FY16; step down in FY18E then sideways FY19E. See page 12.

The main drivers: attractive menu price points and efficient use of space in good locations

Strong occupancy is important to the model

There are a number of reasons Fulham Shore's brands are stand out performers. Certain other UK (and indeed US) restaurant businesses are finding life more difficult in 2016 and 2017 to date. However, for Fulham Shore:

- menu price points are well priced, which generates strong occupancy;
- menus offer quality ingredients, even picking wild garlic;
- restaurant floorplates are optimised; these do not require large sites;

- where large spaces are available, Fulham Shore will look at presenting both brands (for example in Reading and Soho).

- Most restaurants trade at or near capacity after the relatively short initial 'ramp-up'. This capacity-optimisation is important regarding efficient covering of fixed costs, particularly property costs (and also assists the ambience and the table staff remuneration).

One of the outcomes of benefitting from experienced management is that financial ratios for the two existing brands are very similar. Franco Manca restaurants tend to be slightly smaller than The Real Greek, but both achieve similar gross margins (43.6% FY18E) and restaurant level ROCE (over 20% pretax).

- The successful formulae, including the utilisation efficiencies, generate restaurant EBITDA margins of 24% and ROCE over 20% (both pre the PLC central costs assumed by Hardman & Co). This delivers group profits despite the start-up costs of strong growth.

Franco Manca's London restaurants typically benefit from high occupancy from day one (with the pre-publicity of a now well known brand, via Twitter and word of mouth, etc). With the normal tail-off in post launch weeks, they nonetheless are mature before end year one. The Real Greek restaurants are mature within year two, but we suspect some of FY17E sales growth has been from strong expansion at several of The Real Greek restaurants with the space to serve more covers into the strong London restaurant market evident in the past year.

Rapid growth, yet approaching 90% current trading from restaurants opened over a year

Whilst we estimate 78% of FY16 sales derive from restaurants open during the entire period, by FY18E we estimate 92%, with 93% for FY19E. There is an element of growth potential, in the period we are modelling, from growth in the mature restaurants but this is limited. Our assumptions are based on menu price rises being de minimis, however there is a significant pricing gap versus competitors.

Even now, only a ninth size of Pizza Express by UK restaurant numbers

All this results in growth which is strong and also sustainable. Sales growth is 55% in the current year; it is 260% in past two years.

Financial model

The roll-out model

Operating cash flow rising meaningfully and steadily (we estimate +26% FY17E and +50% FY18E)….

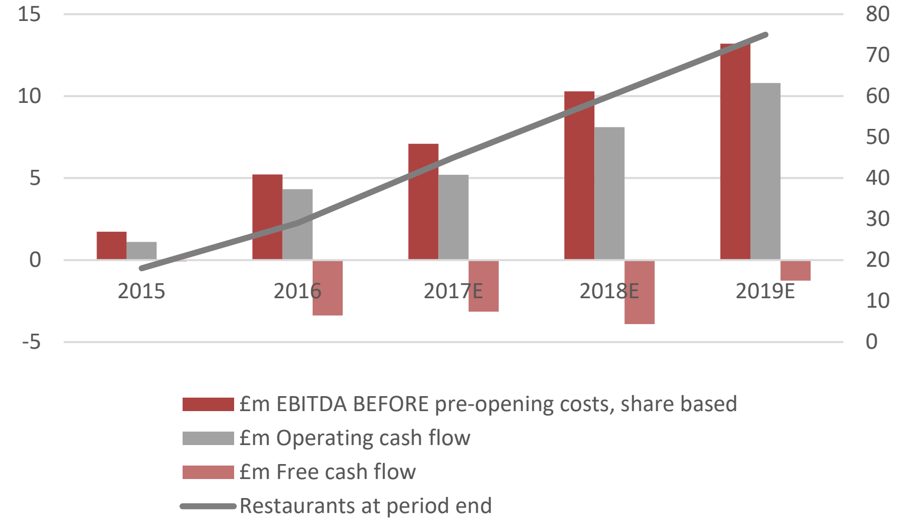
Investment into strong restaurant roll-out (page 3 chart) is well established but, as yet, at an early stage of the journey. It results in negative free cash flow but as the growth in the estate generates increasing cash (page 4 chart), its expansion becomes self-financing. The profitability, even after the pre-opening costs and the increased central costs, has been consistently positive since inception (FY15) – a function of the rapid move to profitability of the new restaurants and the success of the established estate. We like the way steady (arithmetic) growth is accompanied (by FY19E) by reducing outflow of free cash, with every indication this may turn positive shortly thereafter.

…. Same for EBITDA (+26%, +52% respectively)….

Assisted by newly opened restaurants' rapid delivery of profits….

…. Whilst free cash flow is negative this reduces significantly FY19E. By FY20E (on a two-brand strategy) free cash flow likely positive

The expansion programme's effect on cash flow



Source: Hardman & Co Research

FY17's growth in number of restaurants, at 17, was higher than expected as of our September 2016 research. The robust operational and financial models, allied to the strong restaurant trading has encouraged the Board top progress its expansion plans actively.

Updating the roll-out figures

The group ended the financial year with 45 restaurants, including 32 Franco Manca and 12 The Real Greek. So, by our very broad analysis, it is only 30% done. Recall that this is for two brands and Fulham Shore has indicated its capacity to take a third brand along this expansion journey. There are no current plans regarding a third brand besides the trialling of Bukowski.

As anticipated, expansion outside London of Franco Manca has been secured – Guildford, Brighton and Southampton. The Real Greek in Winsor was 'trailblazing' and is a success. Franco Manca is also about to expand into the island of Salina near Sicily (via a franchise with its founder). We estimate 75 restaurants by end fiscal 2019. For illustrative comparison, UK Pizza Express is well over 400 restaurants.

London remains the key market – each restaurant with its own dynamic but common themes of good utilisation and returns

Sales for the Group are estimated at just over 90% London and within this market we see scope to open a modest number of Franco Mancas. Further, The Real Greek is likely to be benefitting from raising its number of covers served (Franco Manca restaurants, being smaller in area, tend to be not far from their realistic capacity constraints). Outside London we anticipate significant growth for Franco Manca whilst The Real Greek is set to open outside London in FY18: Bournemouth and Reading. An important factor is providing good food at good value points.

Revenue estimates

FY17E

FY17E's sales growth is estimated at 36.5%, nearly all from organic roll-out as the restaurants mature relatively rapidly (Franco Manca in particular).

FY18E

Good visibility to FY18E top line as 1) mature restaurants trade predictably; 2) roll-out visibility high in coming 12 months (+)

We estimate £62m sales, derived from 60 restaurants (with 45 open throughout). Over 90% sales are estimated to derive from these 45.

Within the 3rd April trading update, Fulham Shore outlined planned openings in FY18E. "Subject to site availability we expect to end our 2018 financial year with 60 restaurants, comprising 45 Franco Manca, 14 The Real Greek and 1 Bukowski Grill franchise." Fulham Shore stated that it "ended the financial year with 45 restaurants, comprising 32 Franco Manca, 12 The Real Greek and 1 Bukowski Grill franchise."

We consider these numbers to be realistic and have made assumptions on revenue per restaurant and on opening schedules as per table below. This indicates:

We emphasise the high proportion of sales deriving from 'mature' restaurants

- We estimate £57m or 92% of the total £62.0m revenue assumed for the year is derived from restaurants open during the full period. We consider this an important figure, with a high proportion of the sales estimate being from existing trading locations. By comparison, we estimate (Hardman) 78% FY16 sales derived from restaurants open during the entire period.

- Estimates for revenue per restaurant per annum are Hardman's alone but are derived from assessment of the historic figures for revenue, opening dates and restaurant numbers. We estimate The Real Greek reaches higher sales at maturity, but that maturity takes longer to achieve versus Franca Manca. The number of covers at The Real Greek is consistently greater than Franca Manca.

Breakdown of revenue assumptions FY18E

Brand name	Number restaurants	Months trading during the period	£m Estimated revenue per average month	£m Total estimated annual revenue in this category
Franco Manca open at start period	32	12	0.10	39.0
Franco Manca opened during year	13	4 [1]	0.08	4.0
The Real Greek open at start period	12	12	0.12	17.0
The Real Greek opened during year	2	6 [1]	0.08	1.0
Bukowski Grill open at start period	1	12	0.08	1.0
Total	60	na	na	62.0

Source: Hardman & Co Research

Just over £1m pa revenue per restaurant

[1] Note to table above: It is important to note that whilst all figures in the table above are Hardman estimates, the profile of openings during the year is assumed by Hardman in these data points purely for modelling purposes.

Breaking out Hardman's revenue estimates by brand and as per opening programme timings

Estimates for revenue per month are lower for restaurants opened during the year than those trading throughout. This reflects the build-up of covers served in the initial weeks post opening. The discount is not, we consider, substantial as the formats have shown the propensity to rapid build post opening.

Openings at start FY18….

Two (Franco Manca) pizzerias were opened just prior to the year end, March 2017, so there is a minor amount of sales derived from outlets yet to mature, within that £57m figure. These were at Brighton Marina and Putney, London.

Franco Manca Putney sold 1376 pizzas in the first three days (source: Twitter). London Franco Mancas, we estimate, reach near maturity within two to three months and achieve strong numbers immediately. The effect of these 'build up periods' from these two pizzerias at the start of FY18E is therefore de minimis. Richmond, London, opens imminently: a larger site in an ex police station.

….Delivery

Our figures take account of the rise in sales potential through anticipated rising use of Deliveroo. This is a small quantum as yet – but it is noteworthy that a specific 'Roobox' has been opened adjacent to the Canary Wharf restaurant but with a dedicated kitchen and separate entrance. (Clearly delivery revenue achieves a lower gross margin and EBITDA margin given the delivery fee). For busy delivery sites, it is important for the dine-in experience to keep tight controls over courier traffic through the restaurant.

We also note the possibility of larger restaurants in some locations outside London but that total revenue for such locations is unlikely to be higher; indeed, we assume slightly lower revenue.

Certain provincial locations may however have higher average spend per customer, allied to probably slightly lower cover turns than London. Trends are at an early stage in this regard, but the financial model for FY18E and indeed FY19E is not overly affected by these relatively minor variations. Provincial locations may well however have a lower likelihood of paying lease premiums to find good locations, but, again, this is a de minimis effect. Finally, we note there is a slight element of group sales to 'food on the go' now, at all locations.

FY19E

New openings 7% total revenue

Our total sales estimate is £79.5m based on a 7% increment of sales from restaurants opened during FY19E (or approximately 10 new restaurants trading for approximately six months).

New openings add £5.5m, we estimate. Were revenue to be derived only from the 60 restaurants estimated to be open by end March 2018 (i.e., those open throughout FY19E), the Hardman estimate totals £53m Franco Manca, £20m The Real Greek - a total of £74m including additionally the one Bukowski. The Franco Manca figure makes the assumption that provincial restaurant sales are 15% below the average London restaurant. We may revise this as more of a track record emerges.

Profit margin estimates

The drivers comprise:

Efficiency – high occupancy helps significantly

- An offering which is attractive to customers and thus maximise operating efficiencies and consistency between restaurants and brands.

Rising central costs

- Central costs were raised notably during FY17E (from £1.2m FY16 to £1.7m FY17E and £2.1m FY18E). This takes the structure to the 'next level' being rolled out currently. They include investment in the team (for example, HR/Marketing/Property, etc.) to ensure that each brand has sufficient resources to grow at the right pace.

Falling depreciation (% sales)

- Depreciation and amortisation is estimated to fall from 10.0% of sales FY17E, 8.2% FY18E, 7.9% FY19E. It was 8.5% of sales (nine months) to end March 2015 and 9.4% FY16. The fall in the ratio in recent years is a function of the rise in the ratio of sales from restaurants open through the full year to those derived from new openings. Whilst we estimate 78% of FY16 sales derive from restaurants open during the entire period, by FY18E we estimate 92%, with 93% for FY19E.
- Whilst The Real Greek sales per restaurant are slightly above Franco Manca, margins are similar.
- We focus on reported profits but these are impacted by a number of factors, not least pre-opening costs. Clearly pre-opening costs are real cash-backed costs, but are falling as a % of the total sales let alone profits.

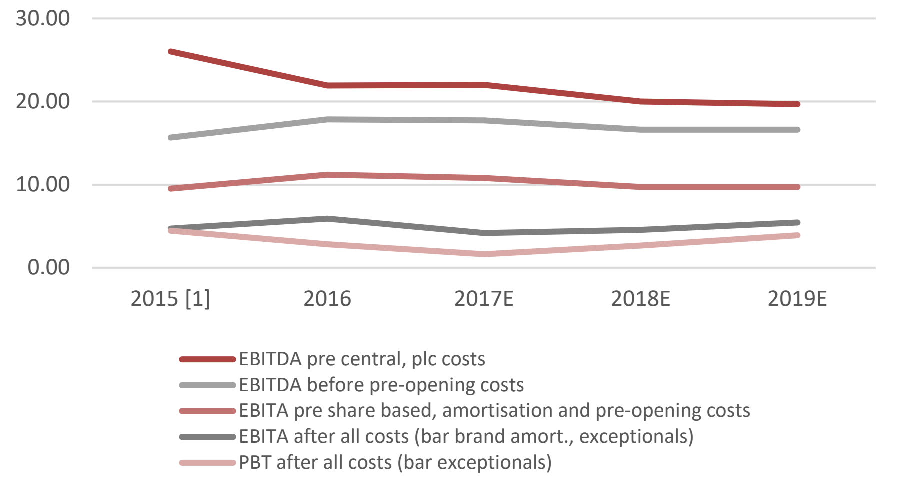
Pre-opening cost trends broadly sideways from the FY17E high, so reducing % sales

- Pre-opening costs stood at 3.1% sales for FY16, rising to 4.7% FY17E as 16 restaurants were opened in FY17 vs 11 in FY16. One restaurant in FY17E had a slightly delayed opening. We estimate 15 new openings during the current FY18 period. The pre-opening costs to total revenue ratio falls to 3.5% in FY18E and 3.1% FY19E as per our estimates.

FY19E downward trend is driven by our estimate of 200bps fall in EBITDA (pre central costs) margins….

This fall is driven by estimated cost rises, deliberately not fully matched by menu price increases

Margin trends



[1] 2015 is 9 months to 29th March *Source: Hardman & Co Research*

- The above chart (FY16 – FY19E) in tabular form is as follows.

Breakdown of revenue assumptions FY18E				
Margins %	**2016**	**2017E**	**2018E**	**2019E**
EBITDA pre central, plc (and pre-opening) costs	21.95	22.00	20.00	19.69
EBITDA before pre-opening costs	17.85	17.75	16.61	16.60
EBITA pre share based, brand amort, pre-opening	11.19	9.80	9.71	9.71
EBITA after all costs (bar brand amort, exceptional) [1]	5.90	3.17	4.55	5.43
PBT after all costs (bar exceptionals)	2.83	0.62	2.66	3.90
Pre opening costs as % sales	-3.10	-4.75	-3.55	-3.02

[1] Exceptionals comprise corporate acquisition related costs *Source: Hardman & Co Research*

The margin trends can be summarised as follows

- Gross margins fall from 45.3% FY16 to 43.6% FY18E in our model. The trend we anticipate is a sideways FY17E vs FY16; step down in FY18E then sideways FY19E.

Gross margin (modest) step down in current year – maximising competitiveness

Costs for the restaurant industry are rising. For Fulham Shore specifically, we estimate near half of ongoing operating costs (all these figures exclude central, fit out, lease-premiums and pre-opening costs) are labour-related, next largest ingredients, then rental costs. Business rates (at an estimated slightly over 5% total costs) are rising significantly (circa 15% over a two-year period). With the restaurants tending to be efficiently used (covers served per square foot) and requiring good but not 'trophy' sites, Fulham Shore is less exposed to rising lease costs (both potential lease premiums to acquire a site and the rent) and the business rates revaluation costs.

Analysis page 14 charts….

- EBITDA pre central, plc costs. We estimate a 200bps fall in FY18E and nil FY19E. Costs are rising: wages, business rates, ingredients. We assume only a minor part of these are passed to customers through menu price increases. We model a rise in aggregate in wages and business rates in the two years combined as a little over 2%. In absence of other cost savings / efficiencies or menu price rises this would result in gross (and EBITDA) margins falling slightly more.

- EBITDA before pre-opening costs. This 'outperforms' the ratio above as the pre-opening costs (as a proportion) are falling in FY18E in particular.

- Fulham Shore aims to cover £ cost changes where possible, but the percentage margin will be impacted despite the £ cost being covered.

- EBITA pre share based, brand/ acquisition based amortisation and pre-opening costs. The trend direction matches the ratio above.

- EBITA after all costs (bar brand amortization and exceptionals). This rises more than the ratio above as the brand amortization cost is assumed to remain constant at £0.82m pa.

- PBT after all costs (bar exceptionals). This bears fixed amounts such as brand amortization so at low margin levels (FY16, FY17E) the figure is distorted downwards to a greater degree.

The table also shows pre-opening costs (which of course are real, cash based, costs) which, we consider, illustrates their significant quantum in a group context. These are essential when growing the brands clearly.

- Illustratively only, FY19E in the absence of any pre-opening costs would be as follows in the table below. EBITA would total £8.45m FY19E in the absence of pre-opening costs

Illustratively: FY19E excluding pre-opening costs

EBITA margins FY19 are estimated at 5.43%. Were no openings to be made, these margins would be 8.45%

Effect of pre-opening costs

Margins %	2019E	2019 illustration no opening costs
EBITDA pre central, plc costs	19.69	19.69
EBITDA before pre-opening costs	16.60	16.60
EBITA pre share based, brand amort, pre-opening	9.71	9.71
EBITA after all costs (bar brand amort, exceptional)	**5.43**	**8.45**

Source: Hardman & Co Research

- As shown, above, the EBITA margins FY19 are estimated at 5.43%. Were no openings to be made, these margins would be 8.45%
- Our estimate for FY19E EPS is 1.08p **EX**cluding the cost of pre-opening, which is 0.76p **IN**cluding the pre-opening costs.

ROCE at restaurant level

How the estimated 25% ROCE (incremental at restaurant level) is calculated

We estimate total costs at c£0.9m per site (c.90% of which, fit-out), £1.1m sales and up to £0.25m restaurant EBITDA, a pre-tax return on invested capital above 20% per annum.

A benefit of the nascent slowdown?

This figure is underpinned by the relative good value to end consumers, with Franco Manca average food cover price (ex VAT, ex tip) just over £9. See menu above. Even with a moderately slowing economy we do not see this figure or occupancies falling. Both brands have factored in acceptably robust wages (and all tips are disbursed) and minimum living wage is not an issue. Were the economy to grow solidly, there might be some upward pressure on lease costs (initial capital payment and ongoing lease) but there would be scope to work this through to modestly higher menu prices in a strong economy and with price points significantly below comparable chains.

Note the strong EBITDA margins vs comparator, Comptoir Group. We consider EBITDA margins to be very important and we also consider Comptoir Group to be the most similar peer-group comparator. For Comptoir Group, however, nonetheless we note its EBITDA margin is 12.6% vs 17.8% Fulham Shore (historic, before pre-opening costs). Comptoir has reined back its roll out programme since IPO.

Valuation

Fulham Shore's growth is undervalued. Its 16.4x EV/EBITDA for FY18E appears anomalously good value on this growth basis

Our conclusion (see charts overleaf) is that Fulham Shore's growth is undervalued by the market, particularly given our model showing growth can initially be debt funded then becomes self-funding – at least on the current two brands. Fulham Shore is a successful growth story, proven in its ability to achieve approaching 50 restaurants in two brands, faster than expectations. It has been consistently profitable despite all the costs of the expansion programme. Not only is there a paucity of UK quoted emerging growth restaurant brands in which to invest but there is an even shorter list of such brands which have been rolled out so successfully.

There are few comparables. These would include Tasty, Patisserie Holdings and Comptoir Group. Two of these have had their issues: particularly Tasty, with write-downs, and to a lesser degree Comptoir with its recent slowing of the opening programme and slightly cautious tone to current trading since the start of 2017, relatively shortly after its stockmarket float. No doubt both these positions are recoverable but Fulham Shore is shown in noticeably positive light. This will be proving attractive both to stockmarket investors but also to the private equity investors who have been active in this sector in recent years (see page 21).

Look at Private Equity transactions too

We consider both the UK quoted restaurant stocks and private equity transactions in the sector in recent years to be relevant, particularly as Fulham Shore is in a brand-build strategic phase.

We consider it important that Fulham Shore has built two brands without reporting start-up losses and that it has stated plans for a potential third. It is trialling Bukowski (through one franchise) whilst the third brand potential – were there to be a third brand – may or may not lie elsewhere.

Globally, investors struggle finding too many successful small restaurant brands in public hands. The US industry faces many challenges (in the quoted arena) – which, indeed among other things, illustrate the pitfalls Fulham Shore is structured to avoid. Certainly, the US experience is that even fast growing ostensibly successful brands have lower margins and ROCE than Fulham Shore and have less potential for profits. These appear to have used up investor patience.

Stock market peer group valuations

A sensible current valuation

Good current trading makes The Fulham Shore a 'stand-out' performer compared to most UK restaurant stocks and certainly compared to the large majority of US stocks. The 20%+ returns it makes at the restaurant level are attractive and provide essential fuel for reinvestment into growth. Crucially its strategic positioning of well-priced, authentic fresh ingredients in an enjoyable environment is clearly attractive to current casual dining tastes: strong word-of-mouth success supports a robust roll-out. There is a 'buzz' about the brand without 'managing' a social media following.

Overleaf, we assess ratings ranked by EPS growth year 2 vs historic.

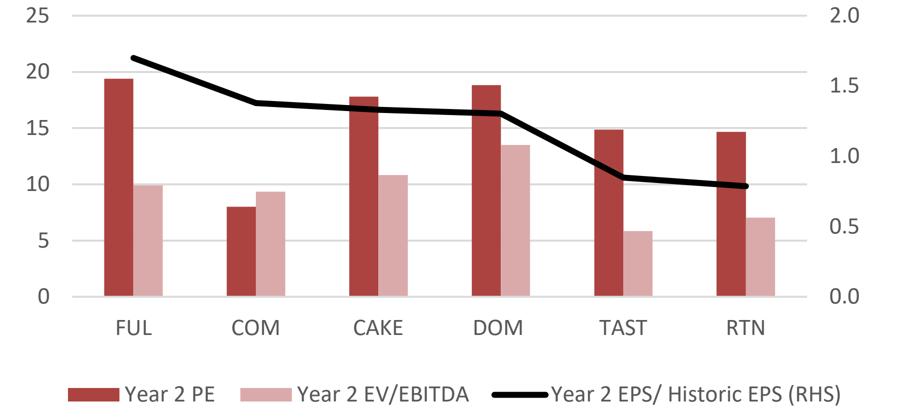
We also chart EV/EBITDA ratings vs EBITDA growth, both for FY18E and FY19E.

On page 21 we also assess Private Equity transactions in the UK restaurant sector. We consider the Private Equity arena to be influential in 'price discovery' for brands. Arguably more important than price is the success of the brand(s), so Fulham Shore is well placed in all regards.

Rating 'in-line' with or below successful competitors but Fulham Shore is earlier in its growth trajectory

CAKE: Patisserie Holdings
COMP: Comptoir Group
DOM: Domino's Pizza
RTN: Restaurant Group
TAST: Tasty Holdings

UK quoted restaurants valuations, listed in declining order of EPS growth



Source: Hardman & Co Research

NOTES: EPS, EBITDA Figures are stated BEFORE pre-opening costs (pre share-based)

Fulham Shore 'historic' EPS used is to y/e March 2017: 0.64p. Prior, FY16, was 0.49p.

We do not include Richoux Group (RIC), the owner and operator of 18 restaurants under the Richoux, Dean's Diner, Villagio, and Friendly Phil's brands – as its turnover is small, at £13.3m last year

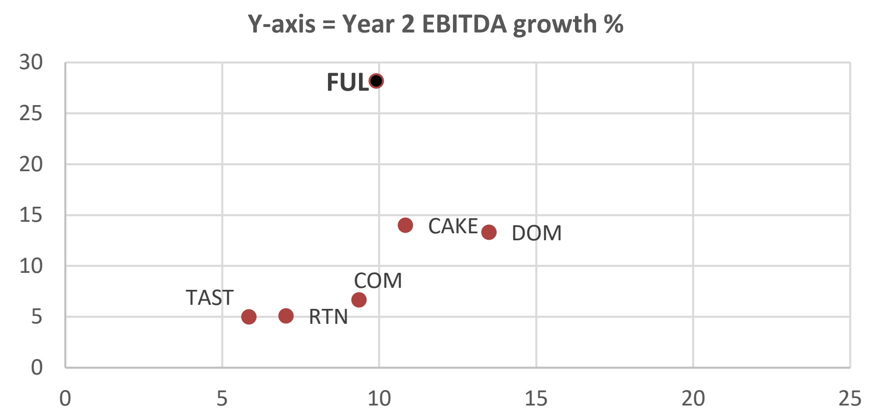
Whilst Fulham Shore's share price rating is at the upper end on year 2 PE (FY19E), it is mid range EV/EBITDA year 2. However, both of these measures would appear good value given the strong EPS growth (this is EPS stated before pre-opening costs, brand amortisation and share based payment costs). Fulham Shore's EPS growth is at the top end – the chart above is arranged in declining order on this metric.

Regression analysis fits quite well…

….. apart from Fulham Shore which appears to offer superior growth in EBITDA (year 2 i.e. FY19E) for a mid-range rating

….. Domino has a very strong track record and decent growth, justifying a high EV/EBITDA

Year 2 EV/EBITDA vs. Year 2 EBITDA growth



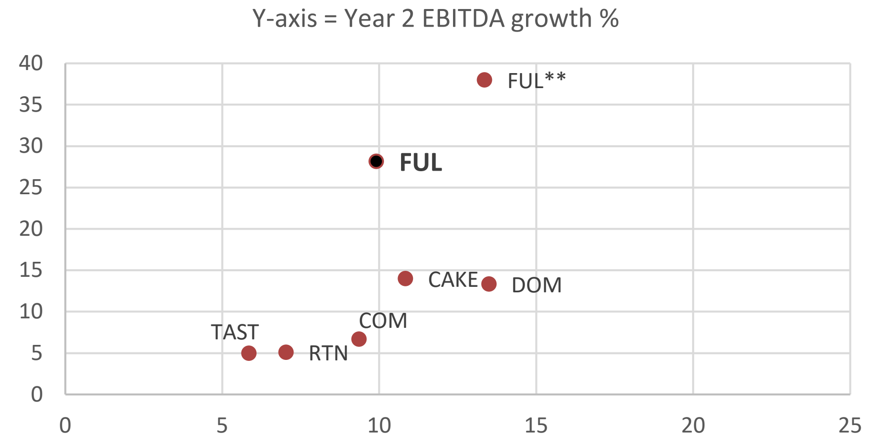
Source: Hardman & Co Research

Investors wishing to take a doubly conservative view, will consider it worth looking at the Fulham Shore rating if all the pre-opening and share based costs are taken off the EBITDA. We chart this overleaf (by showing both a FUL and a FUL** data point. FUL** is post the cost of share based and pre-opening). This reduces the EBITDA measure by 26%. Note that in these scatter diagrams all companies' pre-opening and share based costs (where split out) are excluded. On this more conservative basis, *Fulham Shore (FUL) appears to offer superior growth in EBITDA (year 2 i.e. FY19E) for a mid-range rating*

*FUL** which uses EBITDA post all costs still appears just as cheap (by regression) as its higher rating is also on higher growth*

Fulham Shore's year 2 rating does look more expensive, at 13.3x EV/EBITDA post those costs, as opposed to 9.9x. Set against this is the estimate that this EBITDA measure (post all costs) grows faster than our headline EBITDA figure. Note that 'year 2' refers to FY19E (to March) for Fulham Shore whereas the other stocks' metrics are based on years ending between September (CAKE) and December (all others) 2018. The following chart is identical to the previous but we also add to it the 'post cost' EV/EBITDA rating.

Year 2 EV/EBITDA vs. Year 2 EBITDA growth



Source: Hardman & Co Research

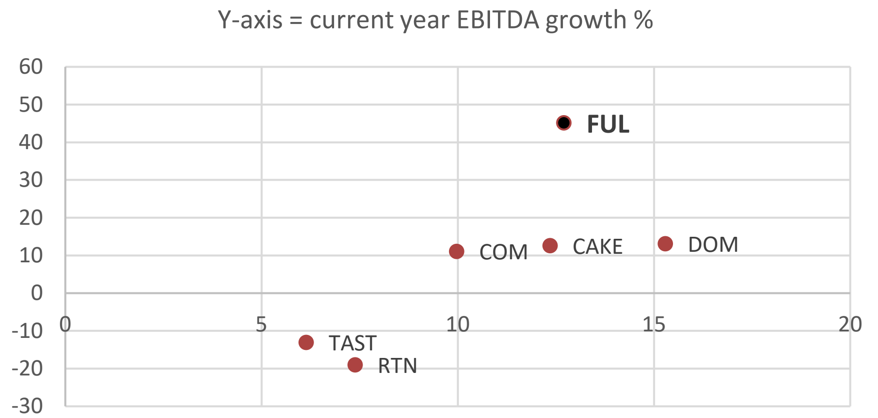
Investors should note that Fulham Shore is at a strong growth phase regarding openings and, medium-longer term, the growth rate will likely reduce. The growth should continue for many years so looking two years out is in itself rather short term.

Even shorter term (current year estimates), Fulham Shore remains attractively priced, we consider.

CAKE: Patisserie Holdings
COMP: Comptoir Group
DOM: Domino's Pizza
RTN: Restaurant Group
TAST: Tasty Holdings

At a rapid growth phase, Fulham Shore (FUL) should stand at a significant EV/ EBITDA premium. Its rating of 12.7x FY18E appears anomalously good value

Current year EV/EBITDA vs. Current year EBITDA growth



Source: Hardman & Co Research

Finally, we remind investors that Fulham Shore's track record stands out positively. The table below summarises ratings but highlights the EPS revisions vs a year ago for the current year. Note this refers to FY18E (to March) for Fulham Shore whereas the other stocks' metrics are based on years ending between September (CAKE) and December (all others) 2017.

We do not include Richoux Group (RIC), the owner and operator of 18 restaurants (Richoux, Dean's Diner, Villagio, and Friendly Phil's) – as its turnover is small at £13.3m last year. We note that recent figures reported £0.2m adjusted EBITDA, down 99% on the prior year. Certain of its restaurants have been rebranded and/or closed, which has led to the significant impairment charge and onerous lease provision.

Data below drives the charts above, prior page.

UK restaurant comparables

Company	Comptoir Group	Domino's Pizza Group	Fulham Shore	Patisserie Holdings	Restaurant Group	Tasty
Ticker symbol	COM	DOM	FUL	CAKE	RTN	TAST
Year end	December	December	March	September	December	December
Current Price p	32	316	21	322	346	58
Shares (diluted) m	96	497	593	100	201	60
Market Cap £m	31	1571	125	322	695	35
EV £m	30	1605	131	309	724	37
Historic PE x	11.0	24.5	33.0	23.7	10.2	12.6
Current PE x	9.1	20.9	24.5	20.5	15.6	15.7
Year 2 PE x	8.0	18.8	19.4	17.8	14.7	14.9
Historic EV/EBITDA x	11.1	17.3	18.4	13.9	6.0	5.3
Current EV/EBITDA x	10.0	15.3	12.7	12.3	7.4	6.1
Year 2 EV/EBITDA x	9.4	13.5	9.9	10.8	7.0	5.8
Mkt cap / current sales %	120	376	201	280	104	81
Price to book	3.1	14.7	3.4	4.1	3.3	1.2

Source: Fulham Shore accounts; Hardman & Co Research estimates

EPS revisions and EBITDA – UK restaurants

Ticker:	COM	DOM	FUL	CAKE	RTN	TAST
Current EPS revision yoy %	-12.5	4.9	0.0	4.0	-39.8	-32.7
Prior year EBITDA before pre-opening costs	2.5	79.9	5.2	18.8	128.0	5.7
Historic EBITDA before pre-opening costs	2.7	92.8	7.1	22.2	121.0	6.9
Current EBITDA before pre-opening costs	3.2	105.0	10.3	25.0	98.0	6.0
Year 2 EBITDA before pre-opening costs	3.7	119.0	13.2	28.5	103.0	6.3

Source: Company accounts; Hardman & Co and market consensus estimates

Note: for consistency, EBITDA is stated before pre-opening costs

UK Private Equity transactions

The medium term corporate opportunity

There is evident and repeat appetite for similar brands from private equity. Note the private equity transactions tend to be for brands more mature (albeit cash generative) than Fulham Shore – hence are less highly financially rated.

UK restaurant chain assets have proven attractive. A number have changed hands, particularly since early 2013. In many cases, typical valuations have been 10-15x EBITDA historic. This is a benchmark, not a business driver. We do not see any logic for Fulham Shore to be anything other than fully focused on its expansion

Fulham Shore is younger but well established: that is what generates a valuation premium

Fulham Shore – no immediate read across but may be of relevance later…

…..forms a relatively tight pricing benchmark for brands at that more mature stage

programme. Fulham Shore is far away from the stage of the brands (as opposed to individual restaurants) becoming mature.

The scope of this report does not include detailed analysis of UK restaurant related PE transactions. However, a number of key themes may be identified. The key one for Fulham Shore is that this cohort would be keen acquirors to grow the brands further.

- The sector has been subject to a number of such transactions in the last three years, all of which having been of successful growth companies. Partly as a function of a former strong economic background, there are no 'turn-arounds' here. We do also infer that this sector is not one where a popular 'play' is turnaround from rescuing struggling brands.

- The brands acquired were not fledgling but were still pregnant with growth. The younger but established brands appear to attract the higher EBITDA multiples.

- The acquisition targets were all substantially profitable.

The read-across to Fulham Shore is that it operates in an industry where there is significant attention paid by substantial investors to successful brands. They do not seem to be targeting developing brands at the size Fulham Shore is interested (i.e., around £10m revenue). Fulham Shore would appear, strategically, to be fulfilling an attractive role, namely developing earlier stage restaurant brands carefully but rapidly and achieving good EBITDA and pretax profit returns (both before and after opening costs).

Selected Private Equity transaction data in UK restaurant sector

Brand name	Multiple of EBITDA	Per outlet £m	Date	Notes
GBK	n.a	1.6.	2016	*[1]*
Cote	12.0	n.a.	2015	
Las Iguanas	14.0	2.1	2015	*[2]*
Yo! Sushi	10.0	1.6	2014	*[3]*
Strada	n.a	0.9	2014	
Prezzo	10.0	1.5	2014	*[4]*
Byron	14.5	2.9.	2013	

Note [1] *£120m consideration. Former owners Clapham House (2010)*
Note [2] *EBITDA estd. Bought on 17.3x PBT*
Note [3] *Not completed - marketed at this level*
Note [4] *EBITDA estd. Bought on 9.2x PAT*

Source: Hardman & Co Research

Noteworthy is that the Fulham Shore team was successfully involved at an early stage in the GBK development as owners via a former vehicle (stockmarket quoted Clapham House).

Compared to the brands in the table above, Fulham Shore, is a younger but established brand with a large scope to grow: that is what generates a valuation premium, over and above the ratings listed above.

Risks and mitigation

Restaurant spending certainly is taking a growing proportion of the consumer's spending. The Office for National Statistics shows UK households spending £45.10 a week on restaurants and hotels in 2016 up 4% on 2015. Cardlytics Spending Index, (based on the spending behaviour and shopping habits of more than 10 million bank customers), found spending at (non fast-food) restaurants saw an 11.9% increase.

Potential trade-down value menu

Whilst strong positive momentum in sector spending continues, supply is rising and consumer spending as a whole is under pressure. One key point is that Fulham Shore is in a good position to benefit from its positioning. Eating out is a discretionary market and restaurant occupancy is crucial. Currently at peak times, the table utilisation is high (c. three sittings per day). Were utilisation at 'shoulder' times to tail off, this would erode returns. With its attractive menu pricing, there is every reason to expect any slowdown to see some benefit of rising patronage from former customers of competitors at more expensive chains.

Reputational risk is high in this industry. Fulham Shore must, above all, avoid over-reach in both quantum and speed of expansion.

Restaurants currently reach maturity within a number of months of opening at Franca Manca and c. two years for the larger The Real Greek restaurants; this could deteriorate.

Still London biased

Fulham Shore is still exposed to London-specific demand.

The ability to identify and secure available and suitable sites on an economic basis is important. There are occasions in the industry when costs (and time) are incurred to secure sites, which then do not complete. The move to expand the provincial footprint may exacerbate these and other costs prospecting for new real estate.

The take-out menu is being trialled and there is an operational risk regarding resourcing to maintain in-restaurant service levels.

We do not quantify currency or commodity price risk. We understand there is some modest exposure to Euro zone ingredients.

Rising costs, but mitigated by already paying London living wage and business rate exposure less than many competitors

General costs are rising. We estimate near half of ongoing operating costs (all these figures exclude central, fit out, lease-premiums and pre-opening costs) are labour-related, next largest ingredients, then rental costs. Business rates (at an estimated slightly over 5% total costs) are rising notably, but by less than many businesses: by circa 15% to the new revaluation (undertaken every five to seven years) effective over a two-year period). It is notable that the Fulham Shore sites are carefully chosen to be busy but neither 'trophy' nor overly spacious. Therefore, both lease costs and business rates may well prove less onerous than for much of the competition.

Labour costs are not rising significantly (they had not been minimised, in order to motivate staff). Fulham Shore pays above National Living Wage and all tips are kept by staff. Initial moves to Living wage do not cause pressure to budgets, however there is no certainty costs will not rise further. Full exit from EU may cause risks to choice regarding recruitment indeed this is a feature across the UK now.

EBITDA margins are well into the upper end of the range within the comparables we assess. Servings turnover is strong. This, clearly is good, but resources (costs) are being devoted to the central functions in order to facilitate growth.

The group is estimated to generate £6.8m cash this year (FY18E), pre the expansion capex. Nonetheless, growth ambition is integral to the strategy so the group has recently increased its facilities. Looking at strong EBITDA performance we see little impediment here however.

Financial Analysis

Revenue account						
March Year end £m	**2015 [1]**	**2015 [2]**	**2016**	**2017E**	**2018E**	**2019E**
Turnover	**8.30**	**11.07**	**29.30**	**40.00**	**62.00**	**79.50**
Gross profit	3.82	5.09	13.28	18.00	27.00	34.50
Margins %	*46.02*	*46.02*	*45.32*	*45.00*	*43.55*	*43.40*
EBITDA pre central costs	2.16	2.88	6.43	8.80	12.40	15.65
Margins %	*26.02*	*26.02*	*24.23*	*22.00*	*20.00*	*19.70*
PLC costs and franchisee	-0.86	-1.15	-1.20	-1.70	-2.10	-2.45
EBITDA BEFORE pre-opening costs etc [3]	1.30	1.73	5.23	7.10	10.30	13.20
Margins %	*15.66*	*15.66*	*17.85*	*17.75*	*16.61*	*16.60*
Share based payments	-0.20	-0.27	-0.64	-0.75	-1.00	-1.00
Pre opening costs	-0.20	-0.27	-0.91	-1.90	-2.20	-2.40
EBITDA	**0.90**	**1.20**	**3.68**	**4.45**	**7.10**	**9.80**
Depreciation & amortisation	-0.71	-0.95	-2.77	-3.60	-5.10	-6.30
Above includes amortization of Franco Manca brand	0.00	0.00	-0.82	-0.82	-0.82	-0.82
EBIT after pre-opening costs, share based	0.39	0.52	1.73	1.67	2.82	4.32
EBIT (post costs) margins %	*4.70*	*4.70*	*5.90*	*4.17*	*4.55*	*5.43*
EBITA (pre amortisation, pre-open, share based)	0.79	1.05	3.28	4.32	6.02	7.72
EBITA (pre costs) margins %	*9.52*	*9.52*	*11.19*	*10.80*	*9.70*	*9.70*
Interest	-0.02	-0.03	-0.08	-0.20	-0.35	-0.40
Pretax before pre-opening costs, brand amort, share based	**0.77**	**1.03**	**3.20**	**4.12**	**5.67**	**7.32**
Pretax post pre-opening costs, share based [4]	0.37	0.49	1.65	1.47	2.47	3.92
Pretax post pre-opening costs, share based, brand amort [5]	0.37	0.49	0.83	0.65	1.65	3.10
'Exceptional' costs [6]	-0.37	-0.49	-0.40	0.00	0.00	0.00
Pretax Reported	**0.00**	**0.00**	**0.43**	**0.65**	**1.65**	**3.10**
Tax	-0.12	-0.16	-0.35	-0.34	-0.59	-0.90
Tax rate %	*32.43*	*32.43*	*21.20*	*23.40*	*24.05*	*23.00*
Ave. Shares in issue (dil)	304.70	304.70	584.36	592.90	592.90	592.90
EPS (p) before pre-opening costs, brand amort, share based	**0.21**	**0.28**	**0.49**	**0.64**	**0.86**	**1.08**
EPS (Adj., post pre-opening, share based costs, dil.) (p)	0.08	0.11	0.22	0.19	0.32	0.51
EPS post pre-opening but PRE brand amort., share based (p)	0.16	0.21	0.36	0.38	0.56	0.76
EPS Reported (p) [4]	-0.04	-0.04	0.01	0.05	0.18	0.37
DPS (p)	0.00	0.00	0.00	0.00	0.00	0.00

[1] Nine months to 29th March

[2] NOT statutory and simply the reported 9 month figures extrapolated to 12 months i.e. 133.3% of the reported 2015 figures

[3] BEFORE all impairments and specifically, FM Brand Amortisation; all pre-opening costs; share based payments; acquisition costs

[4] Post opening costs, share based payments but pre impairments and acquisition costs

[5] Above minus Brand Amortisation Franco Manca

[6] Acquisition related, principally

Source: Fulham Shore accounts; Hardman & Co Research estimates

Cash flow

March Year end £m	2014 [1]	2015 [2]	2016	2017E	2018E	2019E
Operating cash flow	1.57	1.10	4.33	5.20	8.10	10.80
WIP	0.20	-0.04	-0.06	4.25	-0.50	-0.20
Cash interest	-0.05	-0.02	-0.08	-0.15	-0.35	-0.40
Tax	-0.20	0.04	-0.55	-0.35	-0.34	-0.59
Capex	-0.58	-1.18	-7.09	-12.00	-11.25	-11.25
Other	0.00	0.00	0.00	0.00	0.00	0.00
Net cash flow	**0.94**	**-0.10**	**-3.45**	**-3.05**	**-4.34**	**-1.64**
Dividends	0.00	0.00	0.00	0.00	0.00	0.00
Equity	0.00	0.12	4.65	0.00	0.00	0.00
Acquisition (incl. cash)	0.00	2.61	-7.50	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00	0.00	0.00
Net cash change	**0.94**	**2.63**	**-6.30**	**-3.05**	**-4.34**	**-1.64**
Net cash	**0.39**	**3.02**	**-3.28**	**-6.33**	**-10.67**	**-12.32**
Free cashflow	**0.99**	**-0.08**	**-3.37**	**-2.90**	**-3.99**	**-1.24**
Free cashflow per share (p)	0.33	-0.03	-0.58	-0.49	-0.67	-0.21

[1] 12 months to 29 June 2014

[2] 9 months to 29 March 2015 (ie day prior to acquisition)

Source: Fulham Shore accounts; Hardman & Co Research estimates

Balance sheet

March Year end £m	2014 [1]	2015 [2]	2016	2017E	2018E	2019E
Intangible assets	0.12	3.29	28.10	27.20	26.30	25.40
Property, plant, equipment	3.80	4.90	16.70	26.00	33.05	38.90
Other non current assets	0.28	0.52	1.90	0.50	0.50	0.50
Total non-current assets	4.20	8.71	46.70	53.70	59.85	64.80
Trade receivables, inventories	0.87	1.43	2.10	2.00	2.00	2.00
Total Current assets (incl cash)	2.49	5.32	2.40	4.00	4.00	4.00
Current liabilities (ex debt)	(2.24)	(3.23)	(6.80)	(10.25)	(10.25)	(10.25)
Current liabilities (incl debt)	(2.59)	(3.58)	(7.40)	(12.25)	(12.25)	(12.25)
Net current assets	(0.10)	1.74	(5.00)	(8.25)	(8.25)	(8.25)
Long term liabilities (ex debt)	(0.20)	(0.47)	(2.00)	(2.00)	(2.00)	(2.00)
Long term liabilities (incl debt)	(1.07)	(0.98)	(5.00)	(8.33)	(12.67)	(14.32)
Net assets	3.03	9.47	36.70	37.12	38.93	42.23

Source: Fulham Shore accounts; Hardman & Co Research estimates

Appendix:

Franco Manca opening dates

Franco Manca			
Location	Date open	Location	Date open
Brixton	2008	Stoke Newington	2016
Chiswick	2010	Wimbledon Bdway	2016
Stratford	2011	Guildford	2016
Battersea	2012	Brighton	2016
Balham	2013	Muswell Hill	2016
Tottenham Court Road	2013	Bromley	2016
Broadway Market	2014	Kilburn	2016
Southfields	2014	Tooting	2016
South Kensington	2014	Kentish Town	2016
East Dulwich	2014	Victoria	2017
Belsize Park	2015	Westfield London	2016
Broadgate	2015	Westbourne Grove	2016
Ealing	2015	Southampton	2016
Bermondsey	2015	Putney	2017
Soho	2015	Russell Square	2017
Covent Gdn	2015	Canary Wharf	2017
Earls Court	2015	Brighton Marina	2017

Source: Fulham Shore

The Real Greek opening dates

The Real Greek	
Location	Date open
Bankside	2004
Marylebone	2005
Covent Garden	2006
Westfield, Shepherd's Bush	2008
Spitalfields	2008
Westfield, Stratford	2011
Windsor	2014
Soho	2015
St Martins Lane	2015
Muswell Hill	2016
Southampton	2016
Boxpark Croydon Greek on The Street	2016

Source: Fulham Shore

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