

HOTEL CHOCOLAT



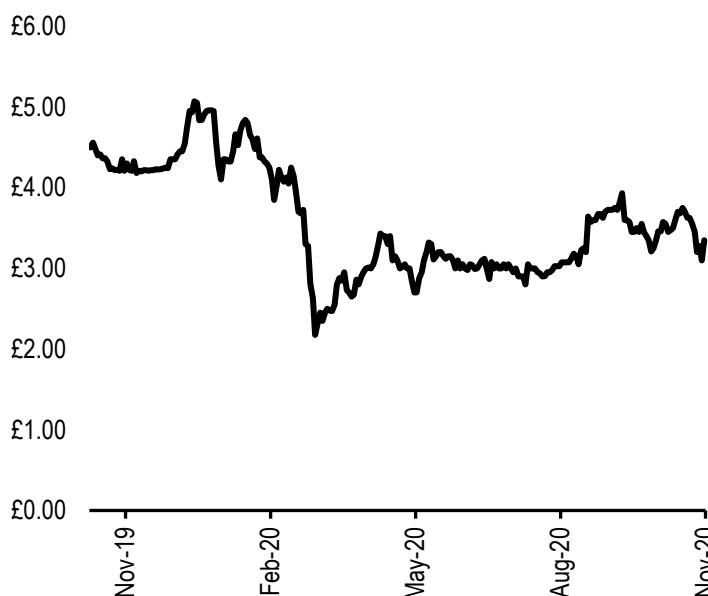
HOTEL CHOCOLAT SOLID BUY: MAKING CHOCOLATE FASHIONABLE AND SUSTAINABLE

Company Overview: *HOTEL Chocolat.*

| | |
|---------------|----------------|
| Company Name: | Hotel Chocolat |
| Exchange: | LSE |
| Ticker: | HOTC.L |
| Country: | United Kingdom |
| Industry: | Food Retail |

Company Data:

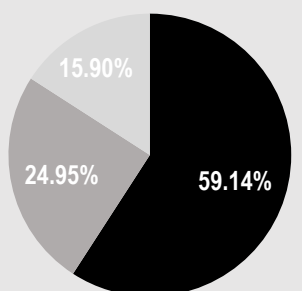
| | |
|-------------------|------------|
| Price Rating: | Solid Buy |
| Price Target: | £3.88 |
| Current Price: | £3.45 |
| Price Date: | 05/11/20 |
| 52 Week Average: | £3.62 |
| Market Cap: | \$433 (mn) |
| Enterprise Value: | \$452 (mn) |



Company Overview

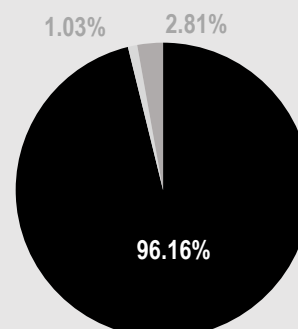
- Opening its first store in 2004, Hotel Chocolat has rose to become the UK's leading premium chocolate retailer.
- Hotel differentiates itself from its competitors by offering a fully vertically integrated supply chain – the company not only designs its own chocolates but operates its own cocoa bean farm in St. Lucia.
- While the company operates 140 retail stores globally, it has been gradually shifting to a multi-distribution strategy through an increased digital and B2B presence.
- Predominantly operating within the UK, Hotel has recently expanded its operations internationally in US and Japanese markets through opening 12 stores since 2018.

Figure 1: Sales Channel Mix



■ Physical ■ Digital ■ B2B

Figure 2: Geographic Mix



■ United Kingdom ■ Europe ■ Rest of World

Reasons to Invest in Hotel Chocolat

Hotel Chocolat offers a unique opportunity to invest in a company before it experiences major growth overseas. With current international sales accounting for only 2.81% of total revenue, there are growing tailwinds in the company's recent expansion into the US and Japan which represents a 9x larger total addressable market. We believe the market is currently not pricing in this new growth potential due to pessimism surrounding Covid-19. Hotel has quickly recovered from Covid with +14% Q1 revenue growth bolstered by a strong digital presence with Q1 growth of +150%. We rate Hotel a Solid Buy with a Price Target of £3.88.

1. Growing Tailwinds in US & Japan Markets:

- Hotel's entry into the US and Japan have grown ROW revenues by a 5-year growth rate of 44% – this represents substantial outperformance of UK and European markets and we forecast sustained international growth going forward.
- Since 2018, Hotel have successfully opened 4 stores in the US and 8 stores in Japan with further plans to double supply chain capacity by 2024 and a strategic partnership with the Hut Group to penetrate US markets.
- Japan and US rank as 1st and 3rd respectively in spend per capita on confectionary goods as well as representing a combined total addressable market of £175 billion vs £20 billion in the UK.

Figure 3: Revenue Growth by Region 2018-2025

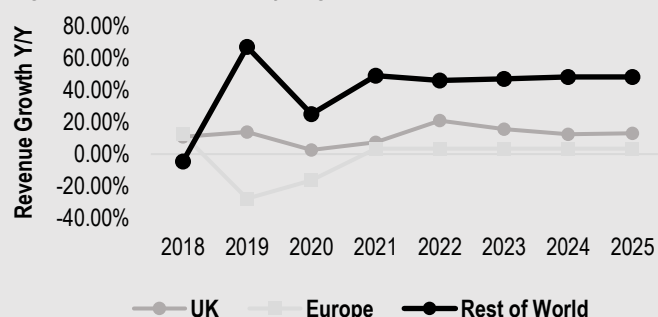
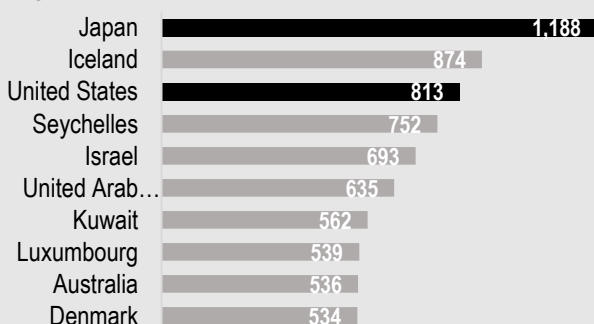


Figure 4: Spend per Capita (\$)



2. Quality and Growth Indicators Support Investment Thesis:

- Hotel's 2018-2020 revenue growth rate of 8.24% doesn't reflect future growth potential, which we forecast to be 17.14%.
- US and Japan expansion has resulted in strong revenue growth of 44.38% bolstered by 2021 Q1 sales growth of +14%.
- Digital revenue has also been growing at a CAGR of 17.83% supported by 2021 Q1 sales growth of +150% and Hotel's loyalty 'VIP' scheme growing by +50% in 2020 to reach 1.3 million customers.
- Quality indicators add further tailwinds with Hotel boasting a strong balance sheet as well as best-in-class gross margins.

Figure 5: Hotel Chocolat Revenue Growth Forecast

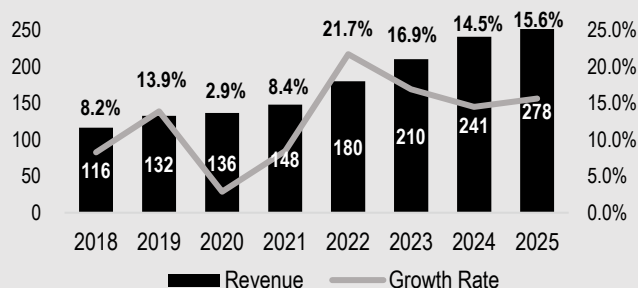


Figure 6: Hotel Chocolat Quality Metrics

| Hotel Chocolate Quality Metrics | |
|---------------------------------|--------|
| Return on Equity | 16.23% |
| Free Cash Flow Coverage | 6.06x |
| Current Ratio Growth | 13.67% |
| Gross Margin | 60.92% |
| CEO Ownership | 59.40% |

Hotel Chocolat Valuation Methodology

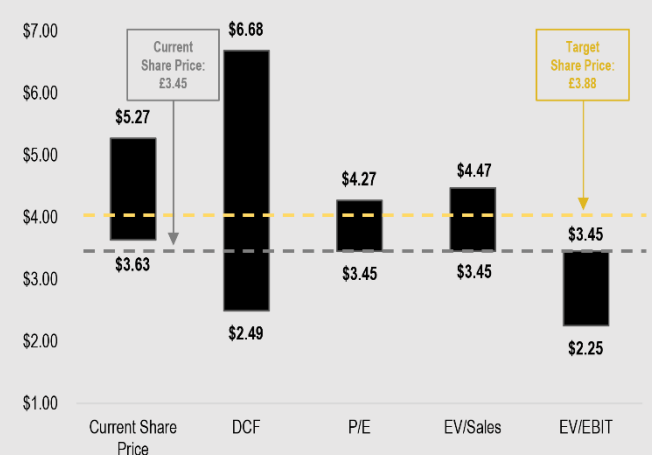
We made usage of a discount cash flow (DCF) and comparable company analysis to reach a price target of £3.88 per share for Hotel Chocolat.

- We believe Hotel Chocolat's future revenue growth potential is not reflected in the current share price and thus we have forecasted a future growth rate of 17.14% with a DCF derived valuation of £4.20.
- While a true comparable peer list was limited, we felt that comparing Hotel to the main players in the chocolate and confectionary industry was the most reliable method – this includes Nestle, the Hershey Company and Mondelez International.
- While Hotel was trading at a 26% premium to its peers in terms of EV/EBIT, Hotel traded at a 12% discount in P/E and a 14% discount in EV/Sales.

Figure 7: Hotel Chocolat Discounted Cash Flow Model

| HOTEL CHOCOLAT DISCOUNTED CASH FLOW | | | | | | |
|--|------------|------------|------------|----------------------------|------------|------------|
| Fiscal Year | 2020A | 2021A | 2022A | 2023A | 2024A | 2025A |
| Fiscal Calendar Date | 30/06/2020 | 30/06/2021 | 30/06/2022 | 30/06/2023 | 30/06/2024 | 30/06/2025 |
| EBIT | 14,206 | 12,223 | 21,203 | 26,952 | 34,611 | 41,196 |
| % Growth | - | (13.98%) | 73.46% | 27.11% | 28.42% | 19.03% |
| Tax Expense on EBIT | 2,021 | 1,739 | 3,017 | 3,835 | 4,925 | 5,862 |
| NOPAT | 12,185 | 10,484 | 18,186 | 23,117 | 29,686 | 35,334 |
| % Growth | - | (13.98%) | 73.46% | 27.11% | 28.42% | 19.03% |
| Plus: D&A | 17,332 | 15,103 | 14,651 | 14,880 | 15,620 | 16,821 |
| % Growth | - | (12.88%) | (2.99%) | 0.02 | 0.05 | 7.89% |
| Less: Acquisitions of PP&E | 12,740 | 12,199 | 14,306 | 17,908 | 19,835 | 22,927 |
| % Growth | - | (4.25%) | 17.28% | 25.17% | 10.77% | 15.58% |
| Less: Net Change in Working Capital | 4,915 | (7,544) | 795 | (904) | (92) | (483) |
| Unlevered Free Cash Flow | 11,862 | 20,932 | 17,736 | 20,993 | 25,563 | 29,712 |
| % Growth | - | (76.46%) | (15.27%) | 18.38% | 21.77% | 16.23% |
| Discount Factor | | 0.94 | 0.88 | 0.82 | 0.77 | 0.72 |
| Present Value of UCFC | | 19,598 | 15,547 | 17,229 | 19,643 | 21,376 |
| Present Value of Stage 1 Unlevered Free Cash Flows | | 93,393 | | Terminal Value Calculation | | |
| Present Value of Terminal Value | | 453,578 | | TV Growth Rate | 2.00% | |
| Enterprise Value | | 546,971 | | 2024 UCFC | 29,712 | |
| Less: Debt | | 47,307 | | Terminal Value | 630,451 | |
| Plus: Cash | | 28,053 | | Present Value of TV | 453,578 | |
| Equity Value | | 527,717 | | | | |
| Diluted Shares Outstanding | | 125,500 | | | | |
| Equity Value Per Share | | 4.20 | | | | |
| Current Share Price | | 3.45 | | | | |
| Upside/Downside | | 21.88% | | | | |

Figure 8: Hotel Chocolat Valuation Football Field Chart



Future Catalysts:

- **Jan 2021 Interim Results:** focus on EPS growth, improving gross margins and US/Japan revenue growth rates.
- **Further Announcements in Supply Chain Capacity:** focus on announcements regarding new distribution centre capacity and Hut Group partnership for market penetration in the US.
- **Insider Buying:** with CEOs owning 59.4% majority in the company, look for further insider buying as a strong buy signal.

Investment Risks:

- **Prolonged Winter Lockdown:** with the UK's second major lockdown in enforcement for 4 weeks starting from November 2020, any extension into the holiday season could pose a major risk for Christmas and January sales.
- **International Expansion Could Lower Operating Margin:** Increased overheads could put a short-term downward pressure on distribution and admin related expenses.

Disclosure:

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