EDISON

Electra Private Equity

Realisation strategy at the final stage

Investment trusts
Special situations – private equity

On 2 November and 2 December 2021, Electra Private Equity (ELTA) reiterated its corporate strategy for moving its listing from the Main Market of the London Stock Exchange to AIM, and provided updates on current trading for its remaining corporate investment, Hotter Shoes. With respect to trading, there was ongoing strength in Hotter's revenue growth. Management's medium-term guidance for Hotter suggests a revenue CAGR of 12% and EBIT CAGR of c 86% in FY22–25e. This guidance excludes incremental revenue from potential new brand partnerships as Unbound seeks to leverage its core target demographic, which management believes could double profits again in the medium term. Applying the median EV/sales multiple of UK online consumer peers to Hotter's FY22 and FY23 guidance suggests an equity value of £22–33m, an average of £27.5m, versus its last reported (30 September 2021) adjusted net asset value (NAV) of £33.5m, before any incremental revenue and profit from the new brand partnerships. Unbound's equity value will likely be enhanced when it is listed on AIM by the transfer of residual cash from Electra. Our estimated NAV for ELTA is £36.1m compared to the current market cap of £24.8m.

NAV estimate for ELTA post Hostmore disposal

Item	Edison average estimate (£m)	Reported by ELTA* (£m)
Hotter equity value	27.5	33.5
Management shares	(2.8)	(3.2)
Assets being realised	1.3	1.3
Assets being retained	2.2	2.2
Cash	8.2	8.2
Other non-core assets and liabilities	(0.3)	(0.3)
Other adjustments (Edison estimates)		
Net asset value (NAV)	**36.1**	**41.7**

Source: Edison Investment Research at 2 December 2021. Note: *Risk-adjusted valuation by ELTA at end September 2021. For details, see Exhibit 2.

Key points

- Subject to shareholder approval, ELTA will cease to be an investment trust, be renamed as Unbound Group and relist on AIM.
- Management's strategy is to continue growing Hotter Shoes as a digitally led, direct-to-consumer (DTC) footwear brand in the UK, United States and Europe aimed at its core demographic, people aged 55+, which has a favourable growth and wealth profile. Management's guidance suggests FY22–25e revenue and EBIT CAGRs of c 12% and 86% respectively.
- The company plans to leverage its growing customer database (4.6 million customers) by offering a range of new and complementary products through a curated 'Unbound' digital marketplace to its core demographic. Management's aspiration is for non-Hotter products to represent c 50% of Unbound's profit by FY26, suggesting a doubling of profit in addition to its stated medium-term guidance, if the strategy is successful.
- The end-September 2021 unrisked ELTA NAV of £325.5m included Hostmore, which was subsequently demerged on 1 November 2021.

2 December 2021

Price	**65p**
Market cap	**£24.8m**
NAV*	**£325.5m**
NAV* per share	835.2p
Discount to NAV	N/A

*Including income. As at 30 September 2021 (prior to Hostmore demerger).

Yield		N/A
Ordinary shares in issue		38.2m
Code		ELTA
Primary exchange		LSE
AIC sector		Private Equity
52-week high/low*	670.0p	65.6p
NAV** high/low	835.2p	353.4p

*A-shares. **Including income.

Gearing

Cash (pro forma at 30 September 2021)	£8.2m

Fund objective

Electra Private Equity's (ELTA) investment objective has been to follow a realisation strategy to crystallise value for shareholders by balancing the timing of returning cash to shareholders with maximisation of value. Following the demerger of Hostmore in November 2021, Hotter Shoes is ELTA's only corporate investment. It is expected to relist on AIM as Unbound Group.

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Strategy, outlook and business update

Nearing completion of realisation strategy with Unbound

ELTA is nearing the completion of its realisation strategy, having demerged Hostmore in November and on the way to its final exit of the remaining Hotter Shoes investment, which will be renamed Unbound and which it plans to list on AIM in early 2022.

On 2 December, ELTA published its end-September NAV. The reported NAV of £205.0m as at 30 September 2021 (525.9p per share) and pro forma NAV of £325.5m (835.2p per share, see Exhibit 1) have increased by c 1.5x (2.4x) from £135.1m on 30 September 2020, respectively (see our initiation note). Although Hostmore was demerged on 1 November, it still formed part of ELTA's 30 September 2021 NAV.

Management has presented two end-September 2021 valuation scenarios for ELTA, including both Unbound and Hostmore. Exhibit 1 reflects valuations by ELTA, excluding any transaction execution risk. In Exhibit 2, ELTA has applied transaction execution risk as well as a discount to reflect the risk of not completing the extension of its banking facilities, although the board is confident that this will be completed ahead of the planned listing.

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

Investment	Sector	Projected % of UK revenue for 2021	Year of investment	Purchase price (£m)	Pro forma ELTA equity valuation* (£m)	Pro forma Hostmore* (£m)	Pro forma Unbound* (£m)
TGI Fridays (Hostmore)	Consumer discretionary	100	2015	99	278.2	278.2	
Hotter Shoes (Unbound)	Consumer discretionary	90	2014	85	59.4		59.4
Management shares					(25.3)	(20.2)	(5.1)
Assets being realised**					4.0		4
Assets being retained***					2.2		
Cash					8.2		8.2
Other non-core assets & liabilities					(1.2)		(1.2)
Pro forma NAV					**325.5**	**258.0**	**67.5**
Pro forma NAV per share, p					**835.2**		
% of ELTA's NAV					100%	79%	21%

Source: Electra Private Equity as at 30 September 2021, Edison Investment Research at 2 December 2021. Note: *Company projections of equity valuations as at 30 September 2021 with values adjusted to exclude transaction risk and marketability discount. **Assets expected to be realised prior to transition to Unbound. ***An illiquid property investment expected to be retained with annual income of approximately £0.3m. ***Includes accrual for operating costs prior to transition to Unbound.

Exhibit 2: Reported NAV reconciliation with two key investments* – TGI Fridays and Hotter Shoes

Investment	Sector	Reported ELTA equity valuation* (£m)	Hostmore* (£m)	Unbound* (£m)
TGI Fridays (Hostmore)	Consumer discretionary	176	176	
Hotter Shoes (Unbound)	Consumer discretionary	33.5		33.5
Management shares		(15.9)	(12.7)	(3.2)
Assets being realised**		1.3		1.3
Assets being retained***		2.2		2.2
Cash		8.2		8.2
Other non-core assets & liabilities		(0.3)		(0.3)
NAV		**205**	**163.3**	**41.7**
NAV per share, p		**525.9**	**418.9**	**107.0**
% of ELTA's NAV		100%	80%	20%

Source: Electra Private Equity as at 30 September 2021, Edison Investment Research at 2 December 2021. Note: *Company reported equity valuations as at 30 September 2021 with values adjusted to include transaction risk and marketability discount relative to values in Exhibit 1, above. **Assets expected to be realised prior to transition to Unbound. ***An illiquid property investment expected to be retained with annual income of approximately £0.3m. ***Includes accrual for operating costs prior to transition to Unbound.

We note that the equity value of Unbound (Hotter Shoes) was presented by ELTA, as at end September 2021, at £33.5m on a risked basis and £59.4m unrisked. After the adjustments shown in the notes to Exhibits 1 and 2 above, this results in a risked NAV value for Unbound of £41.7m and an unrisked NAV value of £67.5m.

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

We note that well documented COVID-19-related market uncertainties in relation to the hospitality and retail sectors have led to share price declines for both Hostmore and ELTA since September 2021.

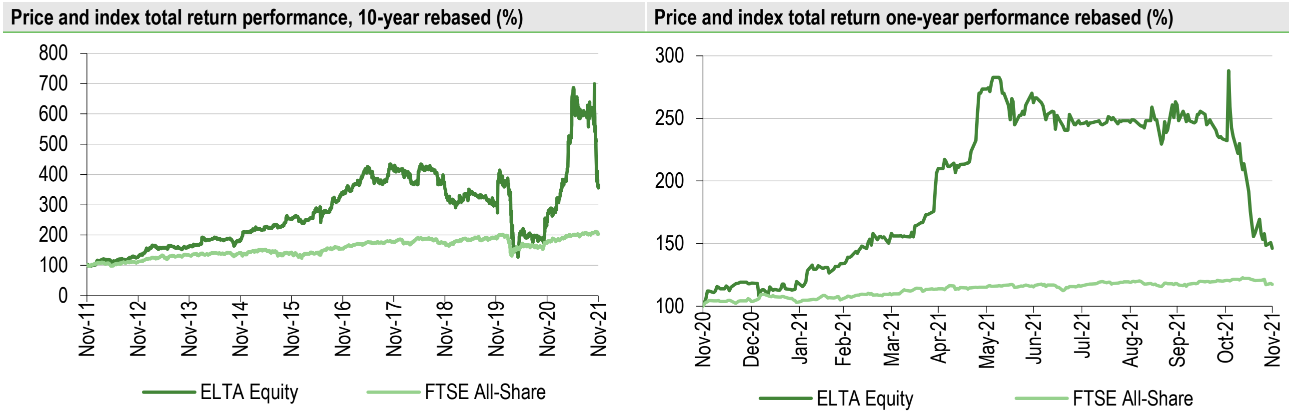
In its 2 December presentation, ELTA's management outlined its strategy for Unbound, which we discuss further in this note.

Performance

ELTA's share price performance (Exhibit 3) reflects the dual influences of market conditions and the group's value realisation programme. Performance in 2020 suffered as the market discounted the hospitality industry and restaurant shares in Q1 after the pandemic hit and lockdown was imposed in the UK. Optimism about a post-pandemic recovery, combined with the anticipation of Electra's demerging and Hostmore listing on AIM, propelled the shares ahead in 2021, prior to new late-2021 concerns about COVID-19, which are again disproportionately hitting the consumer discretionary sector. The 1 November Hostmore demerger is also evident in Exhibit 3. The next catalyst for change will be the planned early 2022 renaming and listing on AIM as Unbound, comprising the remaining investment asset, Hotter Shoes.

We note that ELTA's share price return has been superior to UK equities over the past 10 years and, despite November's setback, its share price has still outperformed the major UK All Companies index over the past 12 months (to 30 November 2021).

Exhibit 3: Investment company performance to 30 November 2021



Source: Refinitiv, Edison Investment Research

Unbound Group: A platform for growth

Following the demerger of Hostmore, which began trading on the Main Market of the London Stock Exchange on 2 November 2021, Hotter Shoes is ELTA's only corporate investment. Subject to shareholder approval, ELTA will cease to be an investment trust, be renamed as Unbound Group and relist on AIM.

Hotter specialises in the design and manufacture of comfort footwear and is renowned for its product quality, customer service and innovation, epitomised by its pioneering use of comfort technology.

The company's vision is to 'help people move better, feel better and do more of what they love'. Therefore, management's strategy is to continue growing Hotter Shoes as a digitally led, DTC comfort footwear brand in the UK, United States and Europe. In addition, it seeks incremental growth by working with partners to sell new and complementary products and brands through a curated 'Unbound' digital marketplace to its core demographic, people aged over 55. The target demographic is the wealthiest, has the highest level of disposable income, and is expected to be the fastest growing of any age group as the population ages (source: Office for National Statistics), leading to strong growth potential in Hotter's addressable market.

Management's financial guidance for the Unbound group from the capital markets day in September 2021 points to a CAGR for Hotter's revenue of c 12% and EBIT of 86% from FY22–25. These exclude any incremental revenue from the new partnerships sought. Management aspires for non-Hotter products to represent 50% of Unbound's profit by FY26, suggesting a doubling of estimates from current guidance if the strategy proves successful.

Hotter's development

Established in 1959 by the Houlgrave family and still based in Skelmersdale, Lancashire, Hotter Shoes is Britain's largest shoe manufacturer. In January 2014, ELTA invested £84m in the management buyout of Hotter from the company's founder and Gresham LLP. A further £1m was paid in July 2017 for a 1% interest taking the total investment to £85m. At the time of acquisition, Hotter had more than doubled its revenue in the prior four years driven by the favourable demographic changes of its core target customer, as well as international growth opportunities in the United States and South Africa. The strategy was to continue building the business via: more store openings in the UK; further growth in international markets; growing online sales; and developing and extending the product range to broaden its target market.

From 2016–18, a combination of internal operational challenges, a loss of focus on the brand's core demographic (ie lack of product vision and brand development), difficult trading conditions in key markets, greater discounting and increased costs, such as rent, took their toll on Hotter's profitability. Prior to the arrival of the new (current) management team from 2019, revenue was in decline across all distribution channels and coupled with a high level of fixed costs, Hotter was loss making but profitable at the EBITDA level, and operational cash flow was negative.

In 2019, the present CEO, Ian Watson was appointed and there followed changes across the majority of the senior management team, all with sector-specific and implementation/turnaround skills. From a retail-focused single brand footwear business serving mainly women aged over 55 years, the strategy was, and remains, to focus more on DTC serving both men and women with an own brand product offering. This required the company to regain its focus on the core demographic, better differentiate its product, develop the DTC digital channel and reduce the seasonality of the business.

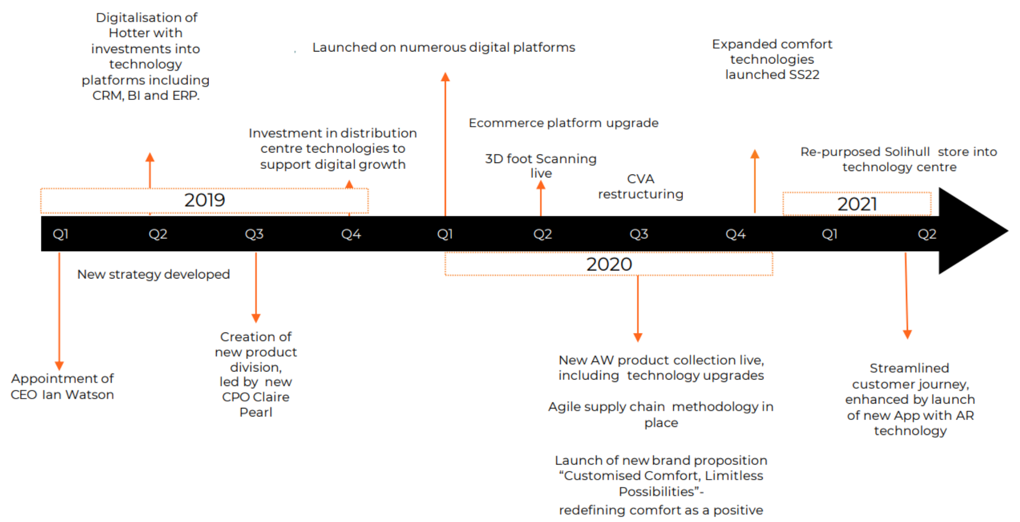
With respect to regaining focus on the core demographic and improving product differentiation, the company hired a new chief product officer (from Hobbs and prior to that Phase 8 and the White Company) and returned to its traditional focus on 'comfort' and 'fit'. It invested in technology such as 3D foot scanning and further expanded its range of 'comfort' technologies.

In order to focus on DTC, the store portfolio was significantly rationalised, ultimately leading to a Company Voluntary Arrangement (CVA) in July 2020. The CVA led to the closure of 58 unprofitable/low profitability stores, leaving 17 stores and six concessions in garden centres. In addition the company increased its investment in IT systems and infrastructure to enhance its digital capabilities and the customer experience. The technology and systems investment focused on customer relationship management (CRM), business information, enterprise resource planning (ERP), and upgrading the e-commerce platform.

The seasonality of the business has been improved by a move away from two to four key seasons to 10 monthly (excluding December and January) new product 'drops' with continuous product refreshment, which should produce an improved gross margin through lower terminal stock and therefore not be required to be discounted.

The timeline of the Hotter's transformation to a digitally led business is highlighted below.

Exhibit 4: Transformation timeline to a digitally led business



Source: Unbound capital markets day, 15 September 2021

We will discuss Hotter's financials in more detail later, but as a result of the transformation to date, in fiscal H122, revenue is growing strongly from most channels, fixed costs have been halved leading to all channels being profitable at the EBITDA level according to management, and the company is generating positive operating cash flow.

Unbound's investment case

Hotter specialises in the design and manufacture of stylish comfort footwear with a target market of people aged over 55 years. It manufactures over 1m pairs of shoes per annum making it the UK's largest shoe manufacturer. It is renowned for its product quality, customer service and innovation, including a number of proprietary or specialist 'Comfort Tech' options, all of which are supportive of Hotter's premium price proposition:

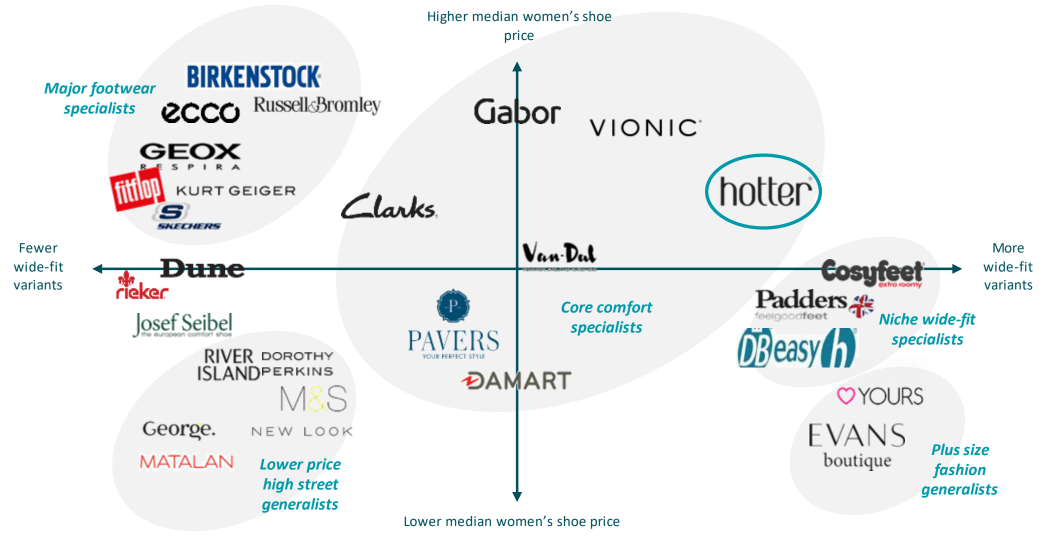
- Freesole is a technology that uses a polyurethane compound to help with support and comfort to return 35% of the energy invested in each step back into the next.
- Cushion+ is a proprietary technology that creates ultralightweight and supremely soft shoes by using OrthoLite insole and Infinergy technology, the latter inspired by performance sports shoes with superior energy return.
- Stability+ is a proprietary balance bar made from thermoplastic polyurethane that sits mid-foot to give more lateral support. The shoes also include adjustability points on every shoe, which enables tailoring to fit the shape of the foot.
- Precision Fit: with the belief that there is no such thing as the average foot, Hotter offers four different shoe widths (slim, standard, wide and extra wide), plus UK whole and half sizes, a total of 40 different size and width combinations.

The Freesole, Cushion+, and Stability+ product ranges were launched in October 2020 as the company's new operating model was implemented and their representation in the range has increased significantly.

In order to ensure customers get the best fitting footwear, and to differentiate its retail experience, Hotter has invested in 'Footprint' across its store estate including the garden centre concessions. Footprint is a 3D foot scanning technology that provides exact foot measurements enabling the customisation of product recommendations. Hotter also benefits from the collection of customer data including email addresses (for future marketing opportunities) and specific knowledge of the customer's fitting requirements. Hotter also has other technologies in store that enable staff to present the available comfort tech options in an interactive way, helping to better inform the customer's buying decision.

At the time of writing, Hotter's website includes non-discounted ranges of 76 styles of footwear (boots, shoes and slippers) for women, and 18 styles for men, with a number of colour options available for each style. The comfort technology options in each product are easy to identify on the website. For women, the price ranges were slippers (£49–75), shoes (£34–109) and boots (£89–149), and for men were slippers (£59–75), shoes (£99–139) and boots (£105–129). In addition, there were 49 styles in the 'Outlet' section of the website discounted to prices of £25–75. Its price architecture and positioning of women's footwear versus its competitors is as follows:

Exhibit 5: Brand positioning



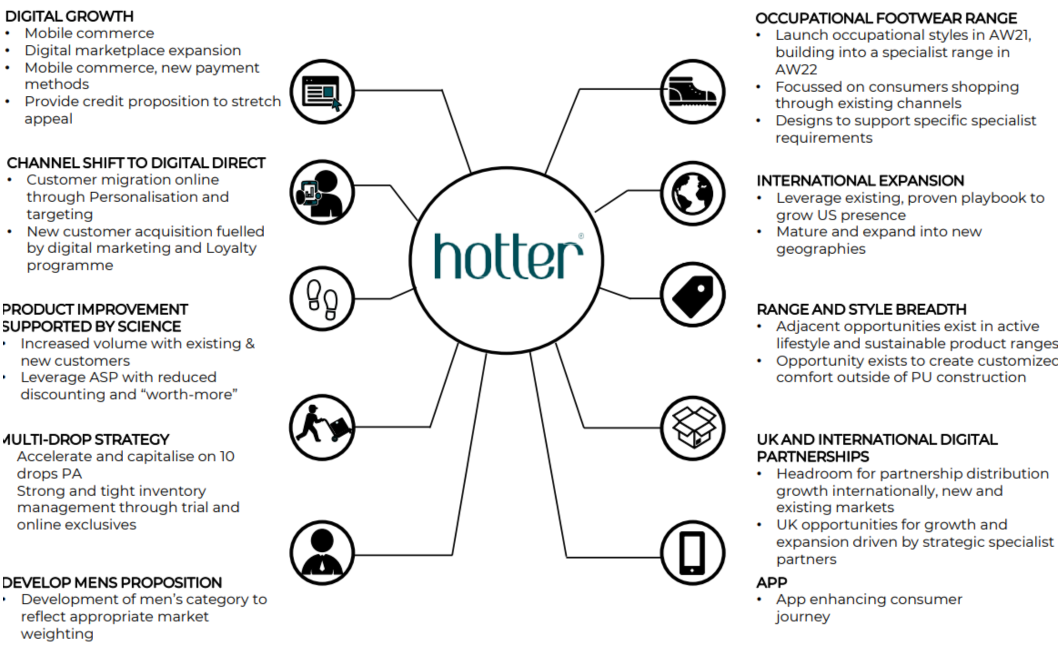
Source: Hotter Shoes

The growth strategy

Hotter's target market has historically been women aged over 55 with specific fit and comfort needs in footwear, and the company now offers a smaller selection of footwear to men.

The many growth initiatives that Hotter is pursuing are summarised below.

Exhibit 6: Hotter growth plan



Source: Unbound capital markets day, 15 September 2021

While this has a favourable growth outlook (see below) and will continue to be an important target with further range extensions expected, the company aims to broaden the proposition significantly by working with partners and other brands to sell a range of products in other categories, notably active lifestyle, wellbeing and health, that should appeal to the entire 55+ demographic. The business model for the partnerships is expected to be commission based on revenues and the medium-term ambition is non-Hotter products will represent 25% of profit in three years (2024) and 50% in five years (2026).

Initially, the company is focusing on developing brand partnerships in footwear, apparel and wellness with the expectation that new revenues will be generated in the second quarter of CY22. At around the same time, it will seek to develop new brand partnerships in adjacent markets/categories, with no stated timetable for the expected generation of the new revenue streams. Thereafter, management expects to begin developing own branded products in the same categories, which should be supportive for gross margins on a relative basis.

The over-arching criteria for new partners and brands is they must: be relevant to the company's core demographic; be aspirational or desirable, enhance Unbound's brand; have expertise or specialism in the category; and have strong environmental and sustainability credentials.

Structural growth drivers

Hotter's growth outlook is supported by favourable structural drivers that management expects will continue to drive increasing penetration of online revenues from its core demographic in its categories of focus, summarised as follows:

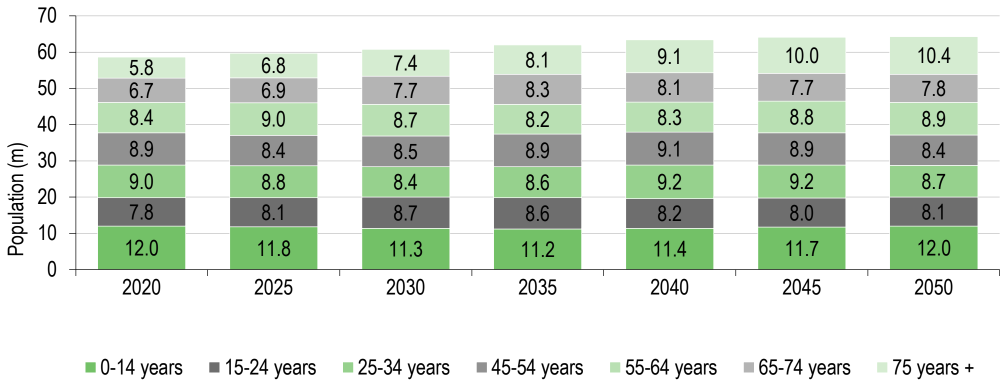
- Ageing population: the over 55 years demographic is expected to grow in absolute terms (see Exhibit 7), which will increase Hotter's total addressable market, and the demographic is expected to grow at a greater rate than other age groups.
- Wealthiest age demographic with most disposable income: management estimates the core demographic accounts for c 57% of total household wealth, and also has the greatest disposable income.
- Increasing online penetration and digital literacy: this an ongoing trend for all demographics given greater accessibility of lower-cost technology and communications. Retail sales data

supports the popular conception the COVID-19 pandemic has accelerated the transition to online.

- Increasing focus on health and wellbeing: management believes the older demographic is becoming increasingly more active and at the same time is seeking more comfort-orientated products.
- Core demographic materially underserved online and offline: management believes its core demographic is less of a focus for mainly online businesses as they are more focused on younger demographics. In addition, the long-term decline in the number of retail outlets that traditionally focused on the older demographic, for example department stores, provides less choice for Hotter's core demographic on the traditional high street, accelerating their move online.

The chart below shows how Hotter's core target demographic, aged over 55 years, is expected to demonstrate the most significant growth in population of any age group in the coming years.

Exhibit 7: UK population forecasts



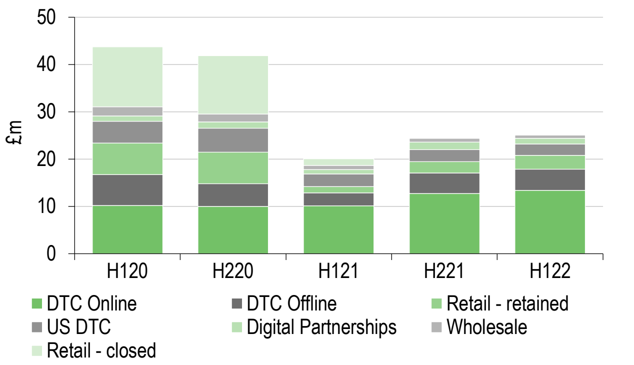
Source: Office for National Statistics, 2018

From a UK population of 67.2 million in 2020, 20.9 million or 31% of the population were aged 55 years or over. The Office for National Statistics forecasts that by 2050 the number of people aged over 55 years will be 27.2 million or 37% of the total population of 73.6 million people. Over this period, the total population is expected to grow by c 10%, but those aged over 55 years will grow by a more significant c 30%. Within the 55+ age range, the greatest growth will be among those aged over 75 years (79% growth from 5.8 million in 2020 to 10.4 million in 2050), followed by 65–74 years (c 16% growth from 6.7 million to 7.8 million) and 55–64 years (c 7% growth from 8.4 million to 8.9 million).

Distribution channels

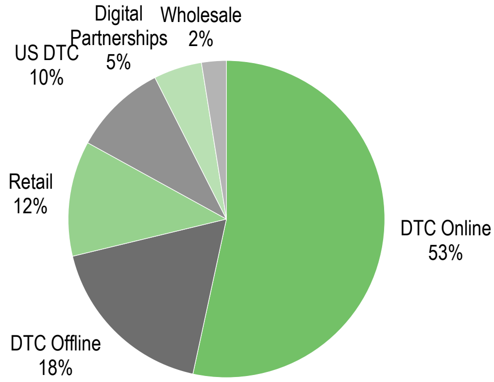
Hotter's sales are primarily through its own DTC channels with a full proposition across digital and mobile, and it also has a physical retail exposure, albeit much reduced following the CVA. From a geographic perspective, the majority of Hotter's sales are in the UK, 10% of sales are in the United States, and there is some minor unspecified revenue outside the UK and United States. The following chart shows the development of Hotter's revenue split since the arrival of the new management team, including the effects of the retail stores closed during the CVA.

Exhibit 8: Revenue progression



Source: Unbound capital markets day, 15 September 2021

Exhibit 9: Revenue split H122



Source: Unbound capital markets day, 15 September 2021

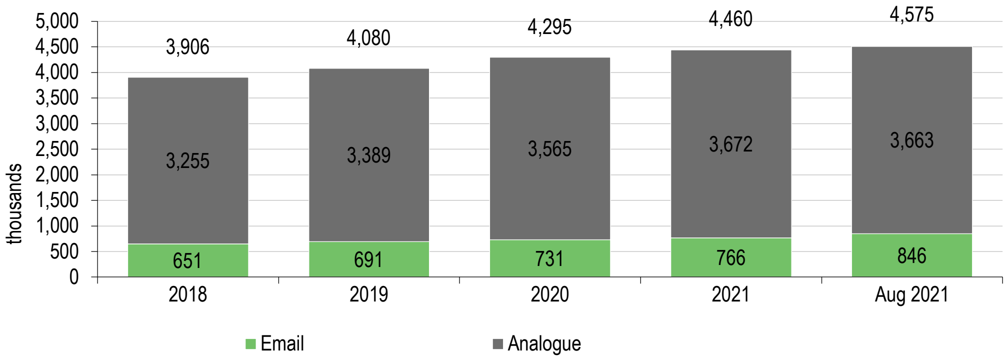
Management's focus on developing DTC and the other changes to the customer proposition have led to DTC's importance to the group increasing over this time. Hotter's UK DTC (online and offline) revenue has increased from 54% (£16.7m) of Hotter's H120 continuing revenue (£31m) to 71% (£17.8m) of the total (£25m) in H122. The online versus offline classification simply refers to how the customer's order is received: online is a 'pure' digital sale via the company's website, app or in response to its email campaigns, while offline refers to sales received via the company's call centre.

The increasing importance of DTC and the move to more monthly supply drops should be supportive for gross margin given the ability to flex pricing quicker and require lower stock commitment that should help to reduce markdown risk.

The growth of DTC revenue has been by driven by steady growth in Hotter's customer database to 4.6m at the end of August 2021, improved marketing to and conversion of those customers to a sale, and the general company-wide benefits from the return to Hotter's 'roots' and subsequent new product development. Management estimates c 29% of the total UK 55+ female population is registered in its customer database.

Below we show how the numbers of both 'email' and 'analogue' customers have increased since 2018. The growth has been fuelled by the company's cultural shift to focus on digital; enhanced data capture including when customers are in store; and the relaunch of the company's app in February 2021. Management believes the improved functionality of the new app, including an augmented reality 'try on' functionality, has been significant in helping to grow downloads of the app, reaching 70k downloads by August 2021 from 24k on relaunch in February. In turn, these new customers are proving to be more productive, with a conversion rate to revenue that is twice that of new customers from other sources. Management will continue to invest in the functionality of the app, including plans to offer foot sizing.

Exhibit 10: Number of database customers



Source: Unbound capital markets day, 15 September 2021

'Email' customers are, by definition, those for whom Hotter has their email contact details and are relatively easy to market to. 'Analogue' customers are those for whom it has names, addresses and telephone numbers etc. To date, there are no stated key performance indicators (eg average order value, returning customers) beyond the quoted numbers of the customers. We cannot attest to the 'quality' of the analogue customer database, specifically how up to date customers details are given likely changes since initially collecting the detail due to changes of address and deaths etc. However, it is encouraging the number of analogue customers increased at a CAGR of c 4% from 2018–21, and the number of email customers has grown at a greater rate, a CAGR of 6% from 2018–21, and an apparent acceleration in the seven months to August 2021, reaching 846k customers. By the end of October 2021, the number of email customers had accelerated quickly to reach over one million. The growth is testimony to the company's enhanced marketing/CRM capabilities against a backdrop of Hotter having fewer physical stores over this period.

As already highlighted, since the arrival of Ian Watson as CEO in 2019, the store base has been rationalised so that Hotter currently has a presence in 18 key standalone town/city locations including Aberdeen, Cambridge, Cardiff, Exeter, Norwich and York as well as six garden centres, which gives nationwide coverage. During the CVA in July 2020, Hotter closed 58 locations and was left with 17 profitable standalone stores. The stores or 'technology centres' are important for new customer recruitment and also the offer of the important Footprint 3D technology, which scans customers' feet. It has recently opened a pop-up store in Manchester's Trafford Centre, and management intends to open more pop-up stores in areas of high footfall on an opportunistic basis to increase brand awareness, introduce the Footprint technology to more customers and grow its database of customers. In FY20, the closed stores generated £25m revenue, or c 29% of Hotter's total reported revenue of £85.5m.

Digital Partnerships refer to the offer of selected ranges via other retailers such as Amazon (UK, EU and US), Debenhams (relaunched July 2021), John Lewis (October 2021), Next, Very and Zalando (October). These help to increase the company's distribution, and further limit the need for its own store infrastructure.

Wholesale revenues represent sales to independent retailers, therefore the growth outlook for this revenue is dependent on the health of the high street and the attractiveness of the independent retailer to Hotter.

Infrastructure and sourcing

Based in one location in Skelmersdale, Lancashire, Hotter is a vertically integrated manufacturer and retailer. It manufactures c 80% of its products in the UK, and the remaining 20% is sourced as completed products from China, India, Portugal and Vietnam. In addition to the direct sourcing of completed products from overseas, Hotter also sources other inputs and work-in-progress from overseas markets. Therefore, in aggregate c 90% of inputs are sourced outside the UK.

We believe the existing infrastructure can support a significant of level of growth given prior to the recent investment in technology and closure of a good proportion of the retail estate. The infrastructure previously supported a revenue base of over £100m in 2017 versus FY21's £44.5m.

In the 2 November 2021 trading update, management pointed to a reduction in the supply chain disruption due to COVID-19 related lockdowns in India and Vietnam that it had experienced in August and September. Naturally, Hotter is also experiencing higher incoming freight costs, notably air freight, and therefore management is looking to re-introduce sea freight as a more cost effective and environmentally friendly option. Notwithstanding this increased cost pressure, management indicated that costs are in line with those expected for its medium-term guidance.

Management of Unbound

Neil Johnson – non-executive chairman: Neil became executive chairman of ELTA in March 2018 after joining as a non-executive chairman and director in May 2016. Currently he is also a chairman of QinetiQ Group and senor independent director of the Business Growth Fund.

Ian Watson – chief executive officer: Ian was appointed as CEO of Hotter Shoes in March 2019 and has been responsible for the development of the strategy. Prior to joining Hotter, he was CEO of Start-Rite Shoes, European MD at Britax Childcare and a senior vice president at Newell Brands.

Daniel Lampard – chief finance officer: Dan joined Hotter as CFO in August 2021. His prior roles include CFO of D2C Glanbia Performance Nutrition, FD at AO World Group, and Manchester Airport Group.

Financials

At the capital markets day (CMD) on 15 September 2021, management provided more detailed summary financial information than has been available for Hotter while under ELTA's ownership. In addition, some medium-term guidance for revenue growth, profitability and elements of cash flow and the balance sheet were provided.

The H122 results (to July 2021) and subsequent trading update to (October 2021) show that Hotter's reshaping as a largely DTC business is paying off with impressive results. Hotter's year-end has historically been January but will move to December in 2022, therefore the next set of results will be released as Unbound for the year-ended January 2022. The financials in Exhibit 11 below are presented to a January year-end.

Income statement

In the six months to July 2021 (H122), Hotter's continuing revenue (excluding revenue from closed retail sites) increased by c 34% to £25m and gross profit increased by c 52% to £15.4m with a notable increase in the gross margin of 10.9 percentage points to 61.6% from 50.7% in H121. Absolute year-on-year reductions in fixed costs and reductions in variable costs (relative to revenue) led to a significant increase in Hotter's profitability: operating income improved from a loss of £4.8m to a profit of £1.6m, and EBITDA (pre IFRS 16) moved from a loss of £3.7m to a profit of £2.5m.

In the trading update of 2 November 2021, management reported revenue for the last 12 months (to end October 2021) of £50.4m with continued growth in DTC and recovery in retail. In addition, gross margins and costs during the period were consistent with those envisaged in the medium-term guidance provided at the CMD on 15 September 2021. As previously highlighted the revenue growth was driven by strong growth in the number of DTC customers and profitability has been managed despite supply disruption and freight costs. In the trading update on 2 December 2021, management quantified third-quarter sales of £12.7m, year-on-year growth of 9.2%, with a gross margin improvement to 65.8% from 56.2% in the comparative period. In addition, trading n the key Black Friday period grew by over 10% compared to the same period last year.

At the CMD presentation in September 2021, Unbound's management provided medium-term guidance for how they anticipate the company's financials will evolve. Although there is no stated timeframe for the 'medium term', the fact some constituents (see below) specify FY23, we assume the medium term refers to FY24 onwards. The guidance includes no upside from future partner relationships; therefore it is likely to prove conservative.

The guidance for the P&L is summarised as follows:

- UK DTC: online mid-teen percentage annual growth, and offline mid-single-digit percentage annual growth.
- UK Retail: recovers to FY20 levels by end of FY23 and then stable. Therefore the consideration here is the rate of recovery to FY23.
- US DTC: is undergoing strategic review and therefore in the short-term revenue will be maintained at current levels.
- Hotter Digital Partnerships: double-digital percentage annual growth.
- Wholesale: maintained at current levels.
- Gross margin: approximately two percentage points above pre-COVID-19 levels from FY23 as disruption diminishes and the positive impact of differentiated product drives margin.
- EBIT margin pre IFRS 16: to reach mid-teen percent over the medium term.

We believe the broad underlying assumptions for management's guidance are improved marketing to increase brand awareness, which will continue to drive growth in the number of customers, as well as product improvements and range extensions.

For illustrative purposes only, the table below shows the development of revenue, gross profit and EBIT based on management guidance provided at the CMD on 15 September 2021, albeit management is likely to have a slightly more cautious outlook for Retail given the emergence of the 'Omicron' strain of COVID.

Exhibit 11: Summary income statement

£m	H120	H220	FY20	H121	H221	FY21	H122	H222e	FY22e	FY23e	FY24e	FY25e
Revenue	43.7	41.8	85.5	20.0	24.5	44.5	25.0	27.1	52.1	60.3	65.8	72.1
Growth y-o-y				(54%)	(42%)	(48%)	25%	11%	17%	16%	9%	10%
DTC - Online	10.2	10.0	20.2	10.1	12.7	22.8	13.4	14.0	27.4	30.6	35.2	40.5
Growth y-o-y				(1%)	27%	13%	32%	10%	20%	12%	15%	15%
DTC - Offline	6.5	4.8	11.3	2.8	4.3	7.1	4.5	3.7	8.1	8.4	8.8	9.2
Growth y-o-y				(58%)	(10%)	(38%)	62%	(15%)	15%	3%	5%	5%
DTC - total	16.7	14.8	31.5	12.8	17.0	29.9	17.8	17.7	35.5	39.0	44.0	49.7
Growth y-o-y				(23%)	15%	(5%)	39%	4%	19%	10%	13%	13%
Retail - continuing	6.6	6.7	13.3	1.3	2.4	3.7	2.9	4.5	7.4	11.9	11.9	11.9
Growth y-o-y				(80%)	(64%)	(72%)	122%	88%	100%	60%	0%	0%
US DTC	4.7	5.1	9.7	2.7	2.6	5.3	2.4	2.6	5.0	5.0	5.0	5.0
Growth y-o-y				(43%)	(49%)	(46%)	(11%)	1%	(5%)	0%	0%	0%
Digital Partnerships	1.1	1.3	2.4	1.0	1.6	2.6	1.2	1.7	2.9	3.2	3.7	4.3
Growth y-o-y				(12%)	19%	5%	28%	7%	15%	10%	15%	15%
Wholesale and other	1.9	1.6	3.5	0.8	0.8	1.6	0.6	0.6	1.2	1.2	1.2	1.2
Growth y-o-y				(56%)	(51%)	(54%)	(24%)	(26%)	(25%)	0%	0%	0%
Total revenue - continuing	**31.0**	**29.5**	**60.5**	**18.6**	**24.4**	**43.0**	**25.0**	**27.1**	**52.1**	**60.3**	**65.8**	**72.1**
Growth y-o-y				(40%)	(17%)	(29%)	34%	11%	21%	16%	9%	10%
Retail - closed	12.7	12.3	25.0	1.4	0.1	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Gross profit	**27.0**	**26.4**	**53.5**	**10.1**	**13.1**	**23.2**	**15.4**	**16.6**	**32.0**	**38.6**	**42.5**	**46.9**
Gross margin	61.8%	63.2%	62.5%	50.7%	53.4%	52.2%	61.6%	61.4%	61.5%	64.0%	64.5%	65.0%
EBIT (post IFRS 16)	**1.3**	**0.9**	**2.1**	**(4.8)**	**(0.6)**	**(5.5)**	**1.6**	**(0.0)**	**1.6**	**3.0**	**6.6**	**10.1**
Margin	2.9%	2.1%	2.5%	(24.2%)	(2.5%)	(12.3%)	6.3%	(0.1%)	3.0%	5.0%	10.0%	14.0%

Source: Unbound, Edison Investment Research

The guidance provided would lead to continuing revenue growth of c 21% in FY22 (to £52.1m) and 16% in FY23 (to £60.3m), and growth of 9–10% (to £65.8m and £72.1m) in FY24 and FY25, respectively. For FY22–25, this would represent a CAGR of c 12%. The estimate of a gross margin of 64% in FY23 and 64.5% in FY24 compares with management's guidance of approximately two percentage points above pre-COVID-19 levels (62.5%) from FY23. The guidance for a mid-teen percentage EBIT margin is pre-IFRS 16, and we believe IFRS 16 leads to incremental depreciation of £1.4m pa. Our post-IFRS 16 margin assumptions of 10.0% in FY24 and 14.0% in FY25 correspond to pre-IFRS 16 margins of 12.1% and 15.9% respectively. The increase in EBIT from £1.6m in FY22 to £10.1m in FY25 would represent a CAGR of c 86%.

Hotter is unlikely to pay corporation tax for a couple of years at it has a tax asset of accumulated losses carried forward of £8m.

Cash flow

Exhibit 12: Cash flow

£m (Year-end January)	H121	H221	H122
EBIT before exceptionals – IFRS 16	(4.841)	(0.623)	1.589
IFRS 16 non-cash adjustments	(0.414)	0.604	(0.186)
EBIT before exceptionals - FRS	(5.255)	(0.018)	1.403
Depreciation	1.545	0.866	1.114
Working capital	2.992	0.911	0.599
Tax	0.685	0.000	0.055
Operating cash flow	(0.033)	1.759	3.171
Capex	(1.892)	(0.331)	(0.468)
Financing	(0.575)	0.412	(2.536)
Exceptionals	(0.838)	(2.772)	(1.063)
Net cash flow	(3.338)	(0.931)	(0.896)

Source: Unbound capital markets day, 15 September 2021

The improvement in Hotter's profitability along with lower working capital intensity (improved stock management and improved payment terms secured with suppliers in H1) and lower cash tax payments have translated to a significant improvement in Hotter's cash flow. In H121 there was a modest operating cash outflow of £33k and in H122 the company generated operating cash of £3.2m, equivalent to 126% of reported EBITDA of £2.5m.

The exceptional cash costs relate to restructuring, advisors and COVID-19 related factory closures not covered by government support.

For the medium term, management guides for operating cash generation to be in line with EBITDA, with no significant further change in its working capital intensity. It expects annual capex of £2.5m from FY22, which should be higher than depreciation, hence the company's fixed asset base is expected to increase.

Management does not envisage paying a dividend in the near term.

Balance sheet

The reduction of the store portfolio is reflected in the significant reduction in IFRS 16 assets and liabilities from FY20 to H122.

Exhibit 13: Balance sheet

£m (year-end January)	FY20	FY21	H122
Property, plant and equipment	7.484	7.347	6.717
Right-of-use assets	19.865	4.978	4.437
Inventory	11.169	5.972	4.583
Debtors	3.774	2.158	2.092
Creditors	(10.848)	(10.112)	(9.220)
Cash	8.590	4.321	3.425
Lease liabilities (excluding head office)	(20.421)	(5.361)	(4.881)
Other long-term assets/liabilities	(0.839)	0.688	0.687
Net asset before financing	18.774	9.991	7.840

Source: Unbound capital markets day, 15 September 2021

At the end of July 2021, Hotter's total net debt was £22m (core financial net debt £13.7m and lease liabilities £8.3m including head office leases). Management targets a net debt to EBITDA level of below 2x in the short term and a move to a net cash position in the medium term, in the absence of future strategic spend.

Valuation

Since being acquired for £85m in 2014 and 2017, Hotter's net book value valuation suffered a cumulative write down in ELTA's financial statements to £5.8m in the year-ended September 2020, before being revalued at £19.2m at the end of March 2021 and £33.5m at the end of September 2021.

Hotter has few directly comparable peers due to its scale, business mix, geographic exposure and the nature of its vertically integrated business model. We also highlight Hotter's restructuring and the differing levels of disruption from COVID-19 related lockdowns and subsequent re-openings on it and the other companies may make near-term comparison of growth rates and profitability more challenging.

In Exhibit 14 we show consensus estimates and resulting valuation multiples for a number of peers in different categories: footwear manufacturers/retailers; UK online companies across a broad range of product categories; and small-cap retailers including other AIM-listed retailers (there is some overlap with the online group of companies) in different product categories with a market value below or around £100m.

Exhibit 14: Peer valuations

Company	Year-end	Share price (local)	Market value (local m)	EV (local m)	Sales growth FY1 (%)	Sales growth FY2 (%)	EBIT margin FY1 (%)	EBIT margin FY2 (%)	EV/Sales CY22 (x)	EV/Sales CY23 (x)	EV/EBIT CY22 (x)	EV/EBIT CY23 (x)
Dr Martens	Mar	404.4	4,044	4,297	17.1	16.5	23.5	24.1	4.2	3.7	17.6	15.0
Geox	Dec	1.03	268	625	14.3	11.4	(5.4)	1.3	0.9	0.9	68.4	26.4
Skechers USA	Dec	46.0	7,169	6,453	34.5	10.8	9.7	10.4	0.9	0.8	9.1	7.7
Average - footwear					**21.9**	**12.9**	**9.3**	**12.0**	**2.0**	**1.8**	**31.7**	**16.4**
Median - footwear					**17.1**	**11.4**	**9.7**	**10.4**	**0.9**	**0.9**	**17.6**	**15.0**
AO World	Mar	105	503	605	7.4	14.0	0.9	1.7	0.3	0.3	20.2	17.9
Artisanal Spirits Company	Dec	100	70	73	16.5	23.0	(6.0)	(4.1)	3.4	2.9	N/A	960.0
ASOS	Aug	2,389	2,388	2,517	14.2	15.5	3.4	3.9	0.5	0.5	14.8	11.8
boohoo group	Feb	172	2,174	2,130	22.6	24.2	6.4	6.9	0.8	0.7	12.1	9.8
Gear4music Holdings	Mar	680	143	166	(4.1)	13.5	4.3	5.1	1.0	0.9	20.3	15.9
in Style Group	Mar	111	58	47	27.6	27.2	3.9	4.7	0.7	0.5	14.9	10.4
Made.Com Group	Dec	138	538	374	64.9	25.0	(1.3)	(1.0)	0.7	0.6	N/A	33.6
Moonpig Group	Apr	329	1,126	1,241	(24.2)	10.4	17.7	18.6	4.2	3.6	22.7	19.5
musicMagpie	Nov	163	175	171	(3.1)	6.0	(1.3)	6.6	1.1	N/A	16.2	N/A
N Brown Group	Feb	39	182	454	1.1	5.0	7.3	7.5	0.6	0.6	7.9	N/A
Naked Wines	Mar	654	480	426	5.5	15.1	(0.6)	0.1	1.1	0.9	N/A	187.0
Sosandar	Mar	34	75	71	100.6	57.8	N/A	N/A	2.0	1.5	N/A	N/A
Studio Retail Group	Mar	168	146	430	(5.2)	8.4	8.2	9.0	0.7	0.7	8.4	6.3
Virgin Wines UK	Jun	183	102	89	2.8	13.8	8.8	9.5	1.1	1.0	12.1	10.3
Average - UK online					**16.2**	**18.5**	**4.0**	**5.3**	**1.3**	**1.1**	**15.0**	**116.6**
Median - UK online					**6.4**	**14.6**	**3.9**	**5.1**	**0.9**	**0.7**	**14.8**	**15.9**
Angling Direct	Jan	59	46	37	7.3	13.1	N/A	N/A	0.5	N/A	N/A	N/A
Mothercare	Mar	19	107	121	(6.3)	(2.9)	12.1	19.2	1.5	1.6	8.9	6.9
QUIZ	Mar	18	22	24	154.9	(15.8)	(3.4)	1.0	0.3	0.3	N/A	15.7
SCS Group	Jul	222	84	113	20.0	2.0	5.0	4.2	0.3	0.3	6.4	7.0
Shoe Zone	Sep	99	49	101	0.0	27.2	8.2	5.2	0.6	0.8	12.4	9.2
Works co uk	Apr	52	33	167	20.7	7.6	3.0	2.8	0.7	0.6	25.8	23.1
Average - UK small cap retail					**32.8**	**5.2**	**5.0**	**6.5**	**0.7**	**0.7**	**13.4**	**12.4**
Median - UK small cap retail					**13.6**	**4.8**	**5.0**	**4.2**	**0.5**	**0.6**	**10.6**	**9.2**

Source: Refinitiv. Note: Priced 29 November 2021

The footwear companies have a greater global presence and have significantly higher market values than Hotter. On average, consensus estimates of revenue growth of c 22% in FY1 and c 13% in FY2 for the group are greater than the above projections for Hotter. With respect to profitability, the average EBIT margin of 9.3% in FY1 and 12.0% in FY2, albeit with a very wide range of expected margins for the individual companies, is also higher than implied by management's guidance for Hotter of 3.0% in FY1 and 5.0% in FY2. Therefore, we believe Hotter warrants a lower valuation multiple than the footwear companies.

The UK online companies have a wide range of market values due to differing geographic coverage, product mix and therefore size of their addressable markets. On average, consensus estimates revenue growth of c 16% in FY1 and 19% in FY2, with a very wide range of estimates for the individual companies. To adjust for the outliers, the median expected revenue growth rates of c 6% in FY1 and c 15% in FY2 are lower than those expected by Hotter's management above. In addition, the estimated EBIT margin for Hotter in FY2 of 5.0% is broadly in line with the median for the online peers of 5.1%. The wide range of estimated margins for the peers reflects a combination of competitive intensities and variable product margins. We therefore believe that Hotter's premium sales growth and in-line margin versus the median suggests its valuation should be at least in line with the median of these companies, prior to any size or liquidity discount. If management is able to achieve its medium-term mid-teens EBIT margin, we believe it would enhance the valuation.

The small-cap retailers also have a diverse range of product category exposures, have a greater exposure to physical store locations than Hotter and have been affected by the COVID-19 pandemic in very different ways, as evidenced by the wide range of expected consensus growth rates. Again adjusting for outliers, the consensus median revenue growth rates of c 14% in FY1 and c 5% in FY2 are below those expected by Hotter's management. The median EBIT margins for FY2 of 4.2% are affected by the expected differing levels of profitability for this varied group and are below management's expectations for Hotter's 5.0%. Therefore, we believe management's expectations for higher and more consistent revenue growth, and with a higher level of profitability, would warrant a higher Hotter valuation than the median for this group of peers, before any discount for liquidity.

The table below shows the implied valuations for Hotter if we attribute the median EV/sales and EV/EBIT multiples for each of the three peer groups to the year-end estimates above for Hotter to CY22 and CY23 on a pro rata basis.

Exhibit 15: Implied valuation for Hotter

	EV/ Sales CY22 (x)	EV/ Sales CY23 (x)	EV/ EBIT CY22 (x)	EV/ EBIT CY23 (x)	Hotter Sales CY22 (£m)	Hotter Sales CY23 (£m)	Hotter EBIT CY22 (£m)	Hotter EBIT CY23 (£m)	Hotter valuation using EV/ Sales CY22 (£m)	Hotter valuation using EV/ Sales CY23 (£m)	Hotter valuation using EV/ EBIT CY22 (£m)	Hotter valuation using EV/ EBIT CY23 (£m)
Footwear - median	0.9	0.9	17.6	15.0	59.6	65.4	1.0	2.7	56	57	18	40
UK online - median	0.9	0.7	14.8	15.9	59.6	65.4	1.0	2.7	55	44	15	43
Small cap retail - median	0.5	0.6	10.6	9.2	59.6	65.4	1.0	2.7	33	42	11	25

Source: Edison Investment Research, Refinitiv. Note: Prices as at 29 November 2021

In our view, Hotter's growth prospects and profitability appear to be attractive relative to UK online companies and the UK small-cap retailers. Therefore we believe Hotter should trade at least in line with the former and at a premium to the latter. If we attribute the median EV/sales multiples for the UK online companies for CY22 and CY23 of 0.9x and 0.7x to Hotter's calendarised (simple pro rata to December) estimates, it suggests an enterprise value of at least £44–55m and a market value of £22–33m, when we account for net debt including leases of £22m at 31 July 2021. We highlight that as ELTA relists as Unbound, the net debt position of Unbound will be c £8.5m lower than Hotter's £22m above as the net cash position of ELTA transfers across, which will have positive implications for the equity value of Unbound as a listed company versus that of Hotter within ELTA.

The valuation above does not reflect any potential value arising from an ongoing business interruption insurance claim relating to COVID-related lockdowns. A range of recovery outcomes from this claim is possible, from zero to in excess of £15m. Resolution is expected in late 2022 or early 2023.

Environmental, social and governance (ESG)

Management's progress and future strategy with respect to ESG initiatives is summarised as follows:

Exhibit 16: ESG strategy

Environmental	Social	Governance
SUSTAINABLE PACKAGING We have completed a review of all materials used in packaging with a view to reducing excess waste **SUSTAINABLE SHOE BOX** We will be changing our shoe box to a sustainable option for Spring/Summer 2022 rollout. We are targeting UK producers who will recycle our returns packaging **ROLL OUT SUSTAINABLE MATERIAL OPTIONS** We are working across our entire material supply chain to introduce sustainable alternatives, looking to introduce replacements from Spring/summer 2022 onwards **RECYCLED MATERIALS** The majority of our footbeds use premium Ortholite foam which contains 5% recycled rubber and is machine washable designed to be long-lasting **INTRODUCTION OF ORGANIC TEXTILES** We have introduced organic cotton canvas into our summer deck ranges	**OUR CUSTOMERS** Fundamental principle of allowing our consumers to do more of what they love **CHARITABLE PARTNERSHIPS** Long standing relationship with Marie Curie **DATA PROTECTION** Clear Privacy Policy in place, in accordance with GDPR, commitment to protect and safeguard consumer data **GLOBAL SOURCING PRINCIPLES** All of our suppliers must sign up to our supplier manual including our Global Sourcing Principles which are in line with the 9-point base code of the Ethical Trade Initiative **ESTABLISHED SUPPLY CHAIN MAPPING** Our Indian factories which supply the majority of our product have mapped and reported their supply chains to tier 3 level **WORLD CLASS STAFF TRAINING** As part of our commitment to best practice we engage in regular training all key staff members engaged with supply chain management, using the services of SGS, the world leading testing, inspection and certification company	**BOARD COMMITTEES** In addition to our Audit, Nomination and Remuneration Committees, we have established a monthly ESG Committee chaired by the CEO, to monitor, control and report on key actions **BEST IN CLASS TANNERY CONTROLS** We are members of the Leather Working Group (LWG) and all of our Indian suppliers are using tanneries which are gold rated approved by the LWG **IN COUNTRY CONTROLS** We have local based staff in India under the direction of an in country manager who visit all key factories on a weekly basis, conducting audits as required to ensure compliance with our Global Sourcing Principles

Source: Unbound capital markets day, 15 September 2021

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