

## Stores reopened and a positive outlook

15<sup>th</sup> June 2020

**Cake Box's preliminary FY2020 results, released today, reconfirmed strong sales growth in FY2020 with scope for an expanded distribution footprint to deliver further sales revenue expansion in FY2021. While the Covid19 lockdown clearly disrupted franchisees' in-store sales, Cake Box appears well placed to spring back both quickly and with a positive growth trajectory.**

**Cake Box's sales revenue increased by 10.8% to £18.7m in FY2020 as the company increased its number of franchised stores by 20 to 133 outlets.** Adjusted pre-tax profits dipped slightly to £3.8m from £4.0m a year earlier while adjusted EPS was 1.3% lower at 7.8p. The company believes that it is prudent not to declare a final dividend at this stage.

The final month of Cake Box's FY2020 trading year, which ended 31<sup>st</sup> March, was negatively affected by the Covid19 pandemic which forced the company to close all franchised stores on 23<sup>rd</sup> March 2020 in accordance with official guidelines. **Ahead of closure, like for like sales in the year to 8<sup>th</sup> March 2020 increased by 5.1%,** as already reported in the company's 14<sup>th</sup> April 2020 trading update. Cake Box has made use of the UK government's Job Retention Scheme to furlough workers and franchisees have been able to take business rent holidays.

**Current trading news looks positive. Cake Box was in a position to start re-opening its franchised stores, commencing 18<sup>th</sup> May.** By the end of the month 98% of its stores were open with the added benefit that 75% of these were trading at a level of at least 90% of pre-Covid19 levels. The overall closure period – i.e. time lost to the pandemic – was around 6 weeks. While comprehensive in scope, the company's safety measures were implemented for an immaterial cost. Importantly, its stores were open in advance of the end of Ramadan celebrations.

**The Cake Box investment case remains fully intact.** The company offers affordable, delicious and uniquely egg-free cakes in convenient locations via a capital light business model. Despite the brisk growth of its franchised estate, there is still substantial headroom for more outlets with some heavily populated UK regions still relatively underserved – notably the North West and North East.

Furthermore, the company's strong cash position should enable it to exploit any M&A opportunities that arise in the aftermath of Covid-19.

We include a relative valuation for Cake Box later in this report. Based on the company's FY2020 figures the company trades on a trailing EV/sales ratio of 3x.

**We are surprised that this rating is only in line with what we deem to be its franchised food retailer peer group, given the brisk underlying sales growth at Cake Box, plus a robust balance sheet and the benefits of operating with a capital light business model.**

### Company Data

EPIC	CBOX
Price	163p
52 weeks Hi/Lo	184p / 90p
Market cap	£65m

### Share Price, p



Source: ADVFN

### Description

Cake Box Holdings is a franchise retailer and manufacturer of egg-free cakes with a growing store base across the UK.

The company specialises in making high quality, affordable, bespoke and personalised fresh cream cakes for immediate purchase and for advanced orders, both on-premise and online.

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## Stores reopened and a positive outlook

Cake Box appears well positioned to be one of the first retail based companies to resume trading on normal terms. Having released FY2020 figures which tend to confirm the company's growth capability, the bulk of the franchised estate is now trading on a "new normal" basis.

Furthermore, its ability to offer affordable treats and the existence of significant under-served geographic regions imply plenty of scope to grow. This report looks at the FY2020 results in more detail, how the company reacted to Covid19 and its resumption of trading; before commenting on valuation and showing up to date historic financials.

## FY2020 Preliminary results

Cake Box reported brisk 10.7% sales revenue growth in FY2020, which was driven by a combination of like-for-like growth and new franchised store openings. Underlying growth in the year to 8<sup>th</sup> March – i.e. excluding the final three weeks of trading – was 5.1%. For the full financial year, like-for-like growth was a slower 2.0% due to the first impact of Covid19 related closures. Gross margins expanded from 45.7% to 46.7% in FY2020 to help generate a 13.5% overall gross profit increase. The key numbers are summarised in Figure 1.

A £1.6m increase in operating costs prompted adjusted EBITDA to be 3.0% lower than in the same period last year with adjusted pre-tax profits also down by 5.0%. However, adjusted EPS benefited from a lower tax rate and dropped by a smaller 1.3%. Taxation fell from 20.3% to 16.9% as a portion of adjusted pre-tax profits.

Cake Box will not pay a final dividend in FY2020. The company states that it appreciates importance of dividends to its shareholders and will resume payments when appropriate. We note that the interim dividend was markedly higher in FY2020 at 1.6p compared with 1.2p in FY2019.

**Figure 1 – Cake Box FY2020 Results highlights**

All figures in £m	FY2019	FY2020	Increase
Y/E 31 <sup>st</sup> March			
Sales revenue	16.9	18.7	10.8%
Gross profit	7.7	8.8	13.5%
EBITDA	4.4	4.3	-3.0%
Pre-tax profit - adjusted	4.0	3.8	-5.0%
Cash at bank	3.1	3.7	£0.6
EPS - adjusted (pence)	7.9	7.8	-1.3%
Dividend - final	2.4	0.0	n/a

Source: Company data

## Covid-19

The impact of Covid-19 related lockdown had a significant trading impact on Cake Box towards the end of its FY2020 fiscal year. In particular, the company was forced to close all its franchised outlets on 23<sup>rd</sup> March. These remained shut for all of April and for most of May. There were some offsets from reduced revenue in the form of the company's participation in the government's Job Retention Scheme in relation to head office, warehousing and bakeries. Moreover, the company took action to save motoring costs (insurance and licensing) by gaining Statutory Off-Road Notices for its delivery vehicles.

In addition, Cake Box's franchisees benefited from their overall relatively low rent levels and the ability in many cases to be able to take business rent holidays. During lockdown the company was able to offer a limited click & collect service. On 11<sup>th</sup> May the decision was made to re-open the trading estate subject to the implementation of important safety measures.

Key measures implemented included operating with smaller teams in-store, placing 2 metre social distancing markers outside franchised outlets, the provision of face shields and masks for retail employees and the erection of safety screens above selling counters to minimize interaction between customers and staff. In addition, the company brought in even more vigorous personal and property hygiene regimes.

Interestingly, these equipment-based measures were achieved at what should be considered a relatively insignificant amount of cost. The company was able to source 3,000 face masks from China and to supply all other relevant PPE hardware to its franchisees for an overall cost of around £10,000.

## Unlocked at speed

**So far, the end-customer and franchisee response to Cake Box's re-opening decision has been brisk and positive.** As highlighted in an 11<sup>th</sup> May statement, the company initially allowed 79 franchised stores to re-open with a plan for the franchised estate to be fully open in June. Given that 98% of franchised stores were open by end-May, this plan is clearly on-track.

Furthermore, the trading experience of the stores has been firmly positive. The company currently estimates that **around 75% of its franchised outlets are operating at a minimum of 90% of their pre Covid-19 levels**, which tends to confirm the underlying integrity of the Cake Box brand as well as both the attractiveness of the concept – i.e. affordable but indulgent egg-free cakes – and product quality.

Furthermore, the timing of Cake Box's decision to re-open stores meant that the company was able to **capture the benefit of post-Ramadan celebrations**. In 2020 the lunar month of Ramadan, which requires dawn to dusk fasting for Islamic religious reasons, ran from 23<sup>rd</sup> April to 23<sup>rd</sup> May. End Ramadan Eid al-Fitr celebrations tend to be substantial and significantly food based.

According to ONS census data, the UK's Muslim population, which comprises the country's second largest religion, is estimated to be 2.5 million, or around 4.5% of the population.

## Growth case largely intact

Despite the interruption from Covid-19, the investment case for Cake Box remains fundamentally intact in our view. In particular, not only was the response to the company's planned store re-openings executed well at both corporate and franchisee level but also the customer uptake appears to have been rapid. The company's ability to produce fresh cream, indulgent egg-free cakes at affordable prices gives it a clear advantage. Moreover, their egg-free expertise is a clear barrier to entry.

Fundamental to the Cake Box growth case is its headroom to open more franchised outlets. In FY2020 the number increased by 20 to 133. The company generates revenue by selling sponge, toppings and decorations to its franchisees.

Currently, the geographic pattern of Cake Box's outlets argues against any suggestion that the company may have reached a saturation point for the number of outlets. As Figure 2 shows, there are some **clear areas of under-representation** in terms of the franchised outlet estate. Two more stores have been opened so far in the current financial year.

**Figure 2 – Cake Box retail estate**

	Cake Box outlets	% of estate	Population (millions)	% of population	Cake Box outlets/ million population
London within M25 (Greater London)	50	37.6%	8.9	13.4%	5.6
South East	27	20.3%	9.3	14.0%	2.9
West Midlands	20	15.0%	5.9	8.9%	3.4
East Midlands	14	10.5%	4.8	7.2%	2.9
Yorkshire	9	6.8%	5.5	8.3%	1.6
North West	8	6.0%	7.3	11.0%	1.1
Scotland	1	0.8%	5.4	8.2%	0.2
North East	3	2.3%	2.7	4.0%	1.1
South West	0	0.0%	5.6	8.4%	0.0
East	0	0.0%	6.2	9.3%	0.0
Northern Ireland	0	0.0%	1.9	2.8%	0.0
Wales	1	0.8%	3.1	4.7%	0.3
<b>Total</b>	<b>133</b>	<b>100.0%</b>	<b>66.6</b>	<b>100.0%</b>	<b>2.0</b>

Source: Company data

In addition to new stores, there is scope to expand retail selling space through the addition of **more kiosks**. These typically function in shopping centres are annexed to local franchises. The company added 12 new kiosks in FY2020. Furthermore, the opening of a new warehouse in Bradford in the period tends to confirm the company's commitment to expanding outside its core South-East and Midlands footprint.

Aside from geography, there remains scope to expand the offering. For instance, their 'Red Velvet' and premium fresh cream 'Salted Caramel' cakes counted as a salient successes within a range of new product launches in FY2020.

Moreover, the company looks to expand its distribution and marketing reach with the use of both online and digital marketing. Franchisee online sales in FY2020 increased by 25% to £5.5m in FY2020. The company has also announced agreements with both Uber Eats and Just Eat for home delivered cakes.

## Financials & Valuation

Cake Box has no plans to put new financial guidance into the market ahead of July 2020. We update our tables only to include actual numbers from the FY2020 accounts. However, our expectation is that **underlying growth will be positive**. Moreover, we take comfort in these uncertain times from the company's **strong financial position**.

## Relative valuation

Based on a trailing sales number we include a relative EV/sales valuation for Cake Box in Figure 3. While the company trades in line with peer group on a rounded basis – i.e. 3x – it should be noted that the Cake Box number is a reported number compared with the consensus forecast data for its peer group who, due to later year-ends, are yet to report FY2020.

**However, where we see positive differentiation is the company's brisk underlying sales growth, its cash positive balance sheet and the benefits for both free cash flow and returns on capital of operating with a capital light business model.**

**Figure 3 Cake Box - Relative Valuation**

Company	Share price (p)	Shares o/s (m)	Market Cap (£m)	Debt (£m)	EV (£m)	Sales 2020 (£m)	EV/sales 2020 x
<b>Cake Box</b>	<b>163</b>	<b>40.0</b>	<b>65</b>	<b>-2</b>	<b>63</b>	<b>19</b>	<b>3.4</b>
Domino's Pizza	338	462.2	1562	211	1773	531	3.3
Greggs	1651	101.2	1717	47	1751	726	2.4
Hotel Chocolat	310	112.8	353	3	359	129	2.7
Average							3.0

*Note: share prices refer to 12<sup>th</sup> June 2020 close.*

*Hotel Chocolat reports on a June year-end basis while both Domino's Pizza and Greggs are on calendar years – i.e. end-December.*

*Source: ADVFN, MarketScreener and Equity Development estimates*

## Forecasts

In keeping with the company's decision to suspend guidance on future financial years until at least July 2020, we include no financial forecasts in this report. However, we have updated our income statement, balance sheet and free cash flow tables to include actual data. These are shown in Figures 4 to 6.

**Figure 4 – Income Statement – Historic data**

Y/E 31 <sup>st</sup> March	2017A	2018A	2019A	2020A
All figures in £'000s				
<b>Revenue</b>	<b>8,664</b>	<b>12,739</b>	<b>16,909</b>	<b>18,742</b>
% increase in revenue	54.9%	47.0%	32.7%	10.8%
Cost of sales	-5,015	-7,263	-9,189	-9,979
Gross margin (%)	42.1%	43.0%	45.7%	46.8%
Total operating costs	-1,661	-2,095	-3,271	-4,963
EBIT - adjusted	1,987	3,381	4,005	3,800
EBIT margin (%)	22.9%	26.5%	23.7%	20.3%
EBITDA - adjusted	2,268	3,700	3,991	3,309
EBITDA margin - adjusted	26.2%	29.0%	23.6%	17.7%
Net financial income	-63	-46	-42	-36
Pre-tax profit adjusted	1,924	3,336	3,963	3,764
Taxation	-299	-568	-806	-635
Tax rate (%)	-15.5%	-17.0%	-20.3%	-16.9%
After tax income - adjusted	1,625	2,768	3,157	3,129
EPS - basic adjusted	4.1	7.0	7.9	7.80
DPS - total	1.6	1.6	3.6	1.6
Dividend pay-out ratio (%)	31.0%	23.0%	56.3%	20.5%

Source: Company data

**Figure 5 – Balance Sheet – Historic data**

Y/E 31 <sup>st</sup> March	2017A	2018A	2019A	2020A
All figures in £'000s				
<b>Assets</b>				
Property, plant & equipment	3,334	3,341	5,048	7,200
Investment property	322	343	-	-
Trade and other receivables	43	259	53	10
Total non-current assets	3,699	3,943	5,101	7,247
Inventories	555	709	910	1,396
Trade and other receivables	1,153	1,301	1,532	1,453
Cash and cash equivalents	476	2,506	3,082	3,676
Non-current assets held for sale			650	
Total current assets	2,184	4,516	6,174	6,526
<b>Total assets</b>	<b>5,883</b>	<b>8,458</b>	<b>11,275</b>	<b>13,773</b>
<b>Equity &amp; liabilities</b>				
Share capital	0	0	400	400
Revaluation reserve	438	455	455	1,589
Retained earnings	1,960	4,205	5,768	7,297
<b>Total equity</b>	<b>2,398</b>	<b>4,661</b>	<b>6,623</b>	<b>9,484</b>
Trade and other payables	1,091	1,493	1,532	1,493
Short term borrowings	197	186	212	168
Corporation tax liabilities	297	520	747	649
Total current liabilities	1,586	2,198	2,492	2,310
Borrowings	1,724	1,457	1,938	1,446
Deferred tax liability	175	141	222	532
Total non-current liabilities	1,898	1,599	2,160	1,979
<b>Total liabilities</b>	<b>3,485</b>	<b>3,797</b>	<b>4,652</b>	<b>4,288</b>
<b>Total equity &amp; liabilities</b>	<b>5,883</b>	<b>8,458</b>	<b>11,275</b>	<b>13,773</b>

Source: Company data

**Figure 6 – Free cash flow**

Y/E 31 <sup>st</sup> March	2017A	2018A	2019A	2020A
All figures in £'000s				
Pre-tax profit (reported)	1,924	3,336	3,365	3,764
Depreciation	281	319	431	492
Profit on disposal	0	-5	-3	-6
Increase in inventories	-30	-154	-201	-487
Increase in receivables	-785	-364	-25	122
Increase in payables	-671	402	39	-39
Net fair value gain	0	0	-444	0
Share based payment charge				198
Finance income	-0	-1	-7	-18
<b>Cash generated in operations</b>	<b>719</b>	<b>3,532</b>	<b>3,154</b>	<b>4,028</b>
Finance costs	63	47	49	54
Taxation paid	-180	-363	-497	-728
<b>Net cash from operating activities</b>	<b>602</b>	<b>3,216</b>	<b>2,705</b>	<b>3,354</b>
<b>Cash flows from investing activities</b>				
Sale of investment properties	0	190	140	650
Purchases of PP&E	-264	-531	-567	-1,266
Purchases of assets under construction	0	0	-1,571	0
Purchase of investment properties	-137	0	0	0
Interest received	0	1	7	18
<b>Net cash used in investing activities</b>	<b>-400</b>	<b>-340</b>	<b>-1,991</b>	<b>-570</b>
<b>Cash flows from financing activities</b>				
Interest paid	-63	-47	-49	-54
<b>Free cash flow before dividends/buybacks</b>	<b>139</b>	<b>2,830</b>	<b>665</b>	<b>2,730</b>
Dividends paid	-70	-522	-1,040	-1,600
<b>Free cash flow after dividends</b>	<b>69</b>	<b>2,308</b>	<b>-375</b>	<b>1,130</b>

Source: Company data





## Investor Access

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