

Hotel Chocolat Group PLC

HOTC.L. Sector: Consumer Services/Food Products

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Investment update 19/11/2019

- Since purchase, the investment has increased by 61.28%.
- The company has significant success during the festival holidays, with the share price increasing during Halloween, Christmas and Easter.
- When applying Bollinger bands to the graph, the bands have recently been expanding, suggesting the stock is becoming more volatile. However, with Christmas rapidly approaching, the share price still has potential to grow. After the Christmas period, we should consider selling 30% and holding 70% with close observation on the stocks progress.
- Hotel Chocolat have expanded to 14 new stores in the UK, attracting more customers (approximately 0.9 million) to their VIP membership scheme.
- Sold 21 shares (30%) at 435p, 51 shares remaining.

Business model

Hotel Chocolat Group plc is a chocolate company. The Company is engaged in manufacturing and retailing of chocolate in the United Kingdom and overseas. The Company operates in three areas: the United Kingdom, Europe and Rest of World. The Company offers chocolates under the brand, Hotel Chocolat. The Company sells its chocolate direct to customers through subscription, online and its approximately 83 stores. The Company's product ranges include self-purchase, gift and occasion, rare and vintage, and other. Its product types include boxed chocolates, luxury boxed chocolates slabs and batons, enrobed fruit and nuts, chocolate hampers, ribbon bags, wine and spirits, hot chocolate and cocoa cuisine. Its chocolate types include dark, milk, white, bean to bar, boozy, caramel, cocoa gin, coffee, fruity, marzipan, mint, nut, patisserie, praline and truffles. The Company owns a cocoa plantation in Saint Lucia called the Rabot Estate.

RECOMMENDATION

HOLD

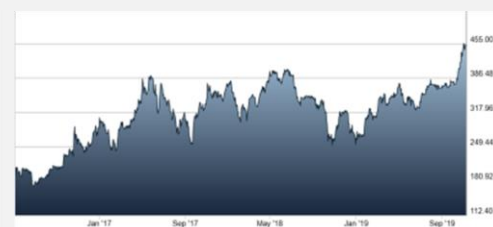
Current Price

421.50

Our Valuation Range

325.00 – 500.00

Hotel Chocolat Group plc has continued growth in share price, reaching its all-time high in over 5 years.



MARKET DATA

Date	24/03/2019	06/11/2019
Revenue	116.33m	132.48m
Net Income	9.98m	10.93m
Incorporated	1987	
52 Week Range	251.56 – 415.00	325.00 – 500.00
Average Volume	82,810	88,062
Shares Outstanding	112.84m	115.7m
Free float	37.49m	38.82m
P/E	39.92	46.62
EPS	8.8 GBP	9.5 GBP
Cash Flow	0.1305	0.14
Price/Cashflow	23.12	31.64
Book value	0.351	0.44
Tangible Book Value	0.351	0.41
Net Profit Margin	8.58%	8.25%
Operating Margin	11.37%	10.8%
Return on Capital Employed	29.49	29.50
Dividend Yield	0.54%	0.40%
Return on assets	16.79%	13.31%
Return on equity	28.20%	24.58%
Return on Investment	24.80%	22.92%

Investment rationale

Our HOLD recommendation is derived from a valuation analysis which employs two valuation methods and assumptions as follows:

- Analysis of the financial statements shows Hotel Chocolat have a strengthening balance sheet and income statement, with consistent increases in assets and net income. Although they have reduced their cashflow into investing activities, its clear Hotel Chocolat are expanding safely, therefore this stock is an excellent long-term investment. The reason for a HOLD decision is due to the reduction in returns, on both assets and equity, as well as this, the quick ratio is below 1 and volatility is growing. With a rise in the P/E ratio, it possibly suggests the stock is becoming overvalued, the average P/E for the sector (with similar market cap companies) is 14.33 which is much less than Hotel Chocolat's P/E ratio. Its these reasons why we should be cautious and hold, as the stock could potentially plateau and lose its momentum. However, with Christmas soon approaching, its historically shown to be a peak time for the share prices, with the only deviation being Christmas 2018 due to a new innovative product. Therefore, it is worth holding the stock until a further decision is made after Christmas.
- Ratio analysis shows a small decrease in returns on assets and equity, the current ratio is safely above 1 whilst the quick ratio is not. However, their low debt to equity ratio shows they are financially stable.
- The low dividend yields suggest that the company is more stable and low risk, hence the shares should be a long-term investment.

Our valuation range is 325.00 – 500.00 with a current price of 421.50. Since Hotel Chocolat reached an all-time high of 456.00, the stock's volatility was becoming a concern, with spreading Bollinger bands and a peak in the relative strength index, it was signalling to sell. And with a rise in volatility and uncertainty if the stock may plateau, a decision to sell 30% of shares was made to secure profits and perhaps even enhance future incoming cash flows.

The remaining 51 shares (70%) is to be held over the Christmas period, which historically has shown to be a peak season for Hotel Chocolat.

Investment risks

- There is currently an inherent market risk due to recent political events which may reduce household income and therefore reduce spending on luxury food goods which is the main source of income for HTCL.L
- There are also supply chain risks being created by Brexit as coco is sourced from farms overseas and therefore may be held at borders if the appropriate deals are not made.
- This firm is also competing in an already saturated market with companies such as Thornton's, Cadbury and nestle which already hold substantial market shares.
- A bullish rise has caused an increase in the standard deviation and volatility, although this does not mean the stock will decline, it may blur future predictions on where the stock may go. We should be wary of declines after the festival holidays as historical data shows Hotel Chocolat are most successful during these periods and experience declines in between.

- A beta of 1.51 should be considered as the stock follows the FTSE100, for example when there was a sharp decline in the FTSE100 from January 2018 to February 2018 and from June 2018 to October 2018, Hotel Chocolat declined at a similar, if not greater rate.
- The price of Cocoa beans should be carefully watched as its down by 36% since its last peak in December, although a decrease in supply of Cocoa may increase the price, as demonstrated when there was a shortfall in Ghana, the second world's largest producer, due to disease-related issues.
- There is increased awareness in Healthcare and diet, with a rising concern that people should be cutting down on products such as the ones Hotel Chocolat sell. Hence any major news in regard to the consumption of chocolate products should be considered.

INCOME STATEMENT

	Notes	52 weeks ended 30 June 2019 £	52 weeks ended 1 July 2018 £
Revenue	4	132,479,543	116,331,566
Cost of Sales		(45,139,983)	(36,740,859)
		87,339,560	79,590,707
Administrative expenses	5	(73,028,333)	(66,360,796)
		14,311,227	13,229,911
Finance income	10	68,967	22,113
Finance expenses	10	(294,966)	(578,760)
Share of joint venture (loss)/profit	11	(33,969)	35,501
Profit before tax		14,051,259	12,708,765
Tax expense	12	(3,122,486)	(2,729,123)
Profit for the period		10,928,773	9,979,642
Other comprehensive income/(loss):			
Derivative financial instruments	17	71,931	(106,001)
Deferred tax charge on derivative financial instruments	16	16,667	20,561
Currency translation differences arising from consolidation		372,795	(168,661)
Total other comprehensive income/(loss) for the period		461,393	(254,101)
Total comprehensive income for the period		11,390,166	9,725,541
Earnings per share – Basic	13	9.7p	8.8p
Earnings per share – Diluted	13	9.5p	8.8p

STATEMENT OF FINANCIAL POSITION

	Notes	As at 30 June 2019 £	As at 1 July 2018 £
ASSETS			
Non-current assets			
Intangible assets	14	2,911,586	2,788,152
Property, plant and equipment	15	40,115,095	36,408,775
Deferred tax asset	16	622,649	623,961
Derivative financial assets	17	–	68,721
Prepayments	19	18,000	1,643
Loan to Hotel Chocolat KK	20	2,488,041	–
Investment in JV	11	8,731	35,501
		46,164,102	39,926,753
Current assets			
Derivative financial assets	17	81,299	14,925
Inventories	18	12,810,049	12,555,517
Trade and other receivables	19	9,359,766	7,486,894
Cash and cash equivalents	22	5,778,205	235,936
		28,029,319	20,293,272
Total assets		74,193,421	60,220,025
LIABILITIES			
Current liabilities			
Trade and other payables	23	19,527,743	15,545,845
Corporation tax payable		1,607,069	1,328,673
Derivative financial liabilities	17	1,671	54,691
Borrowings	24	16,811	201,732
		21,153,294	17,130,941
Non-current liabilities			
Other payables and accruals	23	2,757,158	2,581,044
Derivative financial liabilities	17	9,106	–
Borrowings	24	–	16,811
Provisions	25	943,627	879,808
		3,709,891	3,477,663
Total liabilities		24,863,185	20,608,604
NET ASSETS		49,330,236	39,611,421
EQUITY			
Share capital	26	112,838	112,838
Share premium	27	11,750,056	11,749,487
Retained earnings	27	33,358,932	24,348,409
Translation reserve	27	1,253,355	880,560
Merger reserve	27	223,251	223,251
Capital redemption reserve	27	6,301	6,301
Other reserves	27	2,625,503	2,290,575
Total equity attributable to shareholders		49,330,236	39,611,421

CASH FLOW

	Notes	52 weeks ended 30 June 2019 £	52 weeks ended 1 July 2018 £
Profit before tax for the period		14,051,259	12,708,765
Adjusted by:			
Depreciation of property, plant and equipment	15	4,939,982	4,247,550
Impairment loss on fixtures and equipment	15	–	284,681
Amortisation of intangible assets	14	512,862	509,892
Net interest expense	10	225,999	556,647
Share-based payments	9	246,262	726,585
Share of Joint Venture Loss	11	33,969	–
(Profit)/loss on disposal of property, plant and equipment and intangible assets	5	44,100	(88,253)
Operating cash flows before movements in working capital		20,054,433	18,945,867
Increase in inventories		(259,442)	(2,931,781)
Increase in trade and other receivables		(1,890,866)	(1,460,333)
Increase in trade and other payables and provisions		4,076,600	277,219
Cash inflow generated from operations		21,980,725	14,830,972
Interest received		40,935	22,113
Income tax paid		(2,820,395)	(2,466,051)
Interest paid on:			
– finance leases and hire purchase loans		–	(1,192)
– bank loans and overdraft		(110,282)	(28,802)
– derivative financial liabilities		(180,083)	(147,747)
Cash flows from operating activities		18,910,900	12,209,293
Purchase of property, plant and equipment		(8,295,817)	(10,645,621)
Proceeds from disposal of property, plant and equipment		9,500	340,737
Purchase of intangible assets		(580,795)	(949,229)
Loan to joint venture		(2,460,009)	–
Acquisition of joint venture		(7,200)	–
Cash flows used in investing activities		(11,334,321)	(11,254,113)
Dividends paid		(1,918,250)	(2,482,432)
Buy back of Chocolate bonds		–	(6,505,500)
Sale of shares		570	–
Capital element of hire purchase and finance leases repaid		(201,732)	(237,195)
Cash flows (used in)/from financing activities		(2,119,412)	(9,225,127)
Net change in cash and cash equivalents		5,457,167	(8,269,946)
Cash and cash equivalents at beginning of period	22	235,936	8,470,178
Foreign currency movements		85,102	35,704
Cash and cash equivalents at end of period	22	5,778,205	235,936

SUPPLEMENTARY CALCULATIONS

$$P_0 = \frac{D_1}{(r - g)}$$

Given that the dividends are growing at a constant rate, 0.1p per year. We can assume the dividend paid next year will be 1.9p, since the most recently paid is 1.8p.

Calculating that the required rate of return is 11.42% and growth at 5.8% constant growth.

Price of the stock = $1.9 / (11.42\% - 5.8\%) = 338p$. Showing Hotel Chocolat is overvalued.

LINCOLN STUDENT MANAGED INVESTMENT FUND (LSMIF)

Founded in 2018, the Lincoln Student Managed Investment Fund (LSMIF) is exactly what it says on the tin, a fund which will analyse, determine upon, and purchase shares to create a portfolio. The only difference is we are students. No simulations, just our knowledge and ability vs the real market. The best test of our teachings and learnings.

The fund is set up with a structure similar to any other professionally run fund management company with students running every aspect of the fund, from CEO to analyst. It is designed to give any student involved the best experience of the financial world possible before getting a job.

The fund will be handed down to new students each year as those partake in this fund finish their studying. The fund aims to grow in the future, with more positions available to give the most number of students the chance to partake.

The ultimate goal of the fund is to raise the profile of each student involved to allow for them to get the best experience possible. We, however, set the following objectives to make the fund grow on sustainable basis:

- To generate long-term returns from investments using our stylized investment strategies.
- To raise funds through crowdfunding and donors to help increase the capital base.
- To increase the number of students involved in the fund with expanded capital base.
- To link the fund's activities with the related programmes and modules' assessments
- To get more outside sponsors who want to work directly with the fund as well, to further simulate the professional environment.

Contact details

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