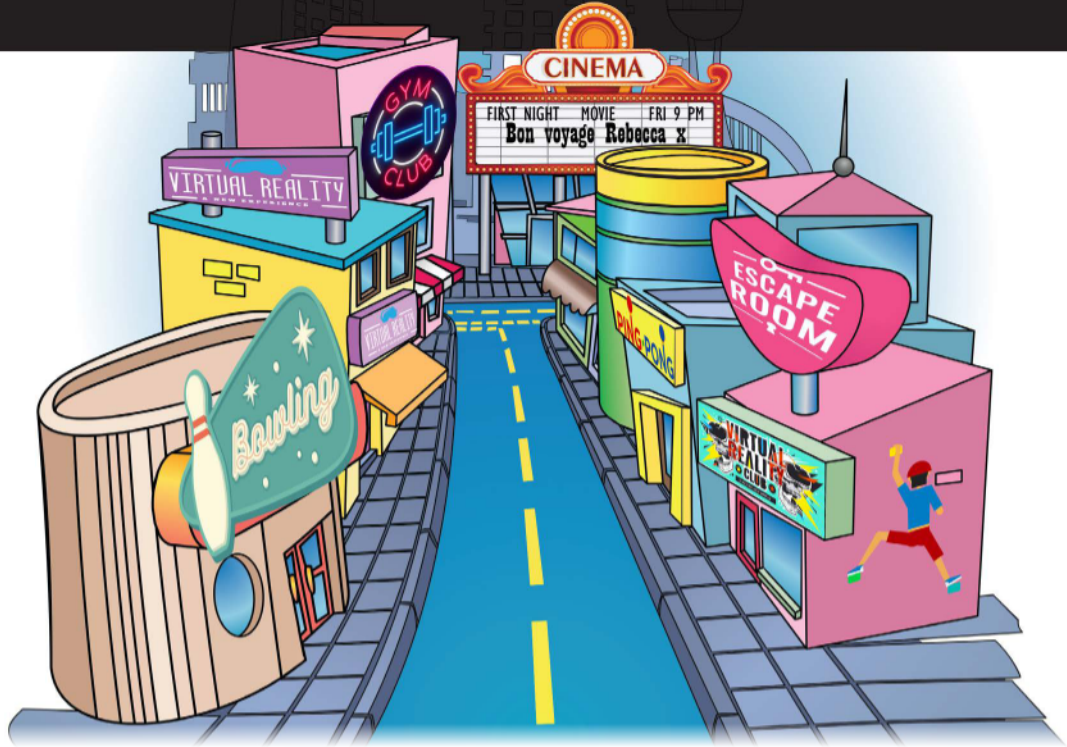


LEISURE SECTOR TO THE RESCUE



HOW EXPERIENCES AND ATTRACTIONS ARE HELPING TO SAVE RETAILERS

The leisure sector is arguably the unsung saviour of the high street and other retail destinations. Companies offering attractions and experiences such as gyms and bowling are helping to fill vacant shops and bring back the energy which attracts consumers.

They are acting as very important tenants for shopping malls and similar retail destinations, helping to drive footfall which effectively brings new life to the retail properties and also puts other shops in a better position to trade well.

It is no wonder that many retail landlords are helping to foot the bill for revamped or new leisure fit-outs, as these companies are becoming the lifeblood of the surrounding premises.

Investors should look very hard at the UK-quoted leisure space as we believe many of the companies are being undervalued in terms of their importance and ultimately their ability to drive future earnings.

HIGH STREET WOES

The struggles of the high street have been well documented. Inflation, slow wage growth and Brexit uncertainties have created a problematic backdrop for the retail sector and indeed other consumer-facing businesses such as restaurant companies.

Profit warnings from **Debenhams (DEB)** and **Dixons Carphone (DC.)** as well as widespread closures by restaurant chains, including Carluccio's and Byron, are clearly concerning.

According to an independent Grimsey Review, 100,000 shops could be left empty within a decade if the crisis continues.

Retail property investor **Stewart & Wight (STE)** suffered a 12.1% drop in the value of its estate over the past year, saying it has little prospect of re-letting at current rental levels when leases expire on shops in its portfolio.

Real estate group **Hammerson (HMSO)** last month said it would sell £1.1bn of retail properties

and confirmed plans longer term to exit the retail park sector completely, saying its future only lay in premium retail outlets and flagship retail destinations.

It's a bleak situation but importantly there are some bright spots as the consumer hasn't given up spending completely. The Confederation of British Industry's latest retail sales gauge showed stores enjoyed robust sales growth in July, slowing less than expected.

Some retailers with physical stores like **Joules (JOUL:AIM)** and **JD Sports Fashion (JD.)** are continuing to churn out good numbers, and many leisure companies are reporting decent earnings as they continue to grab a share of consumers' wallets.

PROPERTY OPPORTUNITIES FOR LEISURE COMPANIES

The closure of numerous retail outlets provides an opportunity for leisure companies to pick up property cheaply, either buying freehold or taking out lower than average leases.

Some leisure activities won't be able to fit straight into an existing building, but others can. Gyms are a great example of a business that could quickly set up inside an old shop or even a pub.

As more people adopt healthier diets and try and keep fit, there has been a surge in budget gym chains in the UK both on and off the high street to tap into these trends.

Gym Group's (GYM) chief executive John Treharne says his business has been able to take advantage of an increasing amount of retail space but stresses the location still has to be good.

When looking for new sites, Gym Group's management considers if it is close to the local community, has high visibility and whether it boasts lots of physical space for plenty of activities.



In some cases, new gyms are opened near retailers or in leisure centres where people can refresh themselves after a hard workout as Gym Group does not offer food and beverages.

An example of Gym Group working with retailers is the Redhill branch, which is located above a **Sainsbury's (SBRY)** store and offers free parking.

Treharne says the gyms do not depend on other retailers to bring in footfall and believes it is more of a collaborative effort to benefit local businesses.

LEISURE COMPANIES HAVE THE 'PULL FACTOR'

Cinemas tend to need larger buildings than most shops but they can open in old churches or large retail outlets, although most chain operators would probably prefer new-build sites.

Often cinemas are built as part of redevelopment projects. For example, various shops and cafes will be transformed at Piries Place in Horsham to make room for a new retail and leisure complex. **Everyman Media (EMAN:AIM)** is building a new cinema in a former Waitrose unit and **Whitbread (WHB)** is turning a café and a former Pets Corner shop into a Premier Inn hotel.

Cineworld (CINE) says some of the cost of refurbishing many of its existing cinemas is being met by landlords, illustrating how a leisure business is seen to be such an important 'pull factor' for retail landlords. Cineworld also benefits as it says customers tend to spend more in a refurbished site.

Landlords are also helping to spruce up some of **Hollywood Bowl's (BOWL)** outlets, with some paying out up to £2m for a full fit-out to gain further value from their investment.

In some cases, landlords can provide lease incentives instead of funding refurbishments and fit-outs, which boosts profits and cash flow.

Broker Liberum analyst Joe Brent argues return on capital employed (ROCE) for Hollywood Bowl is



strong even without landlord contributions.

The analyst says if landlord contributions for scheduled projects were 50% of new site capital expenditure, Hollywood Bowl's ROCE would grow to 20.6%. Without any contributions, returns would only be 112 basis points lower.

Cinemas' fortunes move up and down depending on the quality of the film slate in certain periods although there is generally a strong level of demand throughout the year.

Hollywood Bowl's chief financial officer Laurence Keen argues that bowling has an edge over cinemas as demand isn't dependent on particular events like a blockbuster film. People like to bowl at any time of the year.

Keen says bowling offers good value, decent food and arcades to keep people entertained after the pins are down. It can also be seen as a part of a broader day trip, whereby people meet their friends to go shopping, have a drink, go bowling and perhaps go for a meal at the end of the evening.

We note that more than a quarter of Hollywood Bowl's sales come from arcades which is perhaps an area more susceptible to a drop in trading should consumers experience harsher economic conditions.

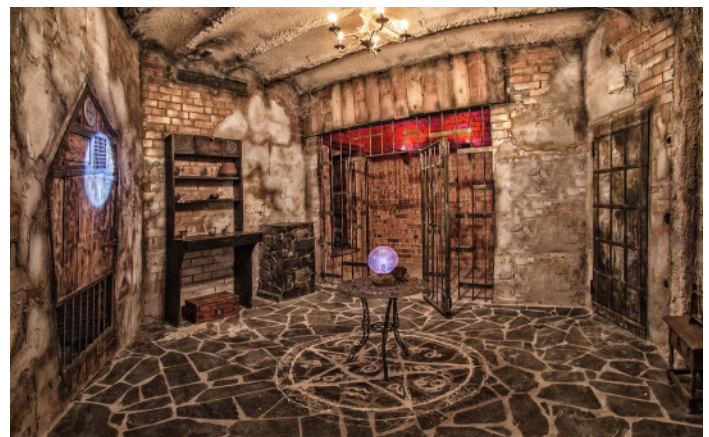
EXPERIENCES RATHER THAN PRODUCTS

Many consumers are currently valuing experiences over buying material items which plays to the leisure sector's strengths.

Langton Capital analyst Mark Brumby says many people are looking for kooky activities to do instead of heading to the shops. Unusual social activities include axe-throwing bar Whistle Punks, crazy golf courses from Swingers, social darts bar Flight Club, ping pong club Bounce and even shuffle boarding.

Leisure analyst Mark Brumby from Langton Capital acknowledges these experiences are more popular, yet he is worried about how these firms will scale up and avoid becoming temporary fads should the market becomes more saturated.

Relevant to this point on UK-listed leisure

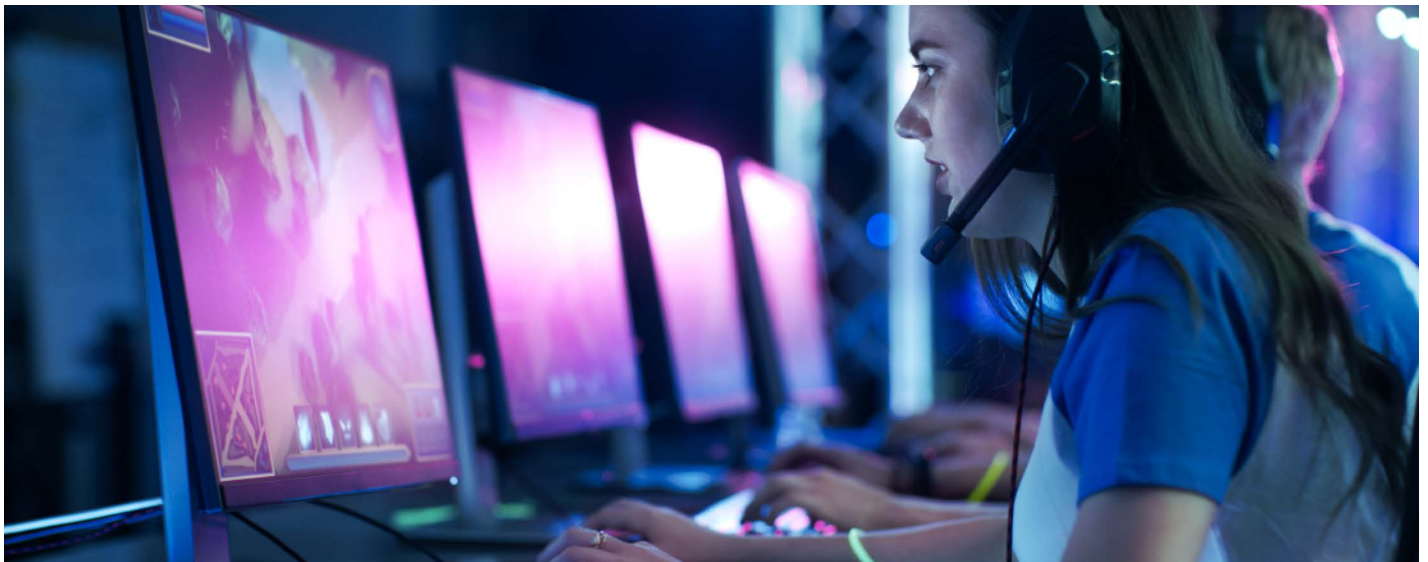


companies is **Escape Hunt (ESC:AIM)**, which provides escape rooms where a group of people are encouraged to work together for their freedom by finding clues and solving puzzles.

The business is certainly 'trendy' at the moment and it recently struck a deal to build Doctor Who-themed escape rooms in the UK. However, it remains loss making and issued a veiled profit warning last month.

You can have a great idea, but the business won't be a good investment proposition unless it can achieve decent scale and operate with a handsome profit margin. We have major concerns that Escape Hunt won't be able to meet this threshold, particularly as the market is already well supplied.

Escape rooms usually involve a variety of scenarios such as people in room trying to evade a (pretend) kidnapper or murderer, or saving the



world from destruction.

Asset manager Gresham House owns a 5% stake in Escape Hunt as fund manager Graham Bird is confident the company can take advantage of an interesting niche and lack of knowledge around the activity.

Escape Hunt believes only 10% to 15% of people in the UK have heard of escape rooms based on a survey, up from 5% at the time of the company's stock market debut in April 2017.

Bird argues there is no established brand or network for escape rooms, offering an Escape Hunt an opportunity to build a high quality brand as it changes from a franchisee model to an owner-operator one. Locations in high streets with strong footfall, a high concentration of students and tourists would suit the business.

VIRTUAL REALITY'S NEW EXPERIENCE

We're more enthused by virtual reality being used as the backbone for leisure experiences.

Immotion (IMMO:AIM) recently joined the UK stock market and is trying to build a business that supplies VR pods and associated content to leisure operators and shopping centres.

A partner builds the equipment in China and Immotion creates the content which includes sitting in machines that let you feel as if you are actually riding a rollercoaster or going down a very long slide, among many other ideas.

Immotion has a deal with **Merlin Entertainments (MERL)** to provide multi-sensory VR experience pods to two Legoland centres in the UK and US, letting six year-olds race across mountains, rivers and hot lava.

Executive chairman Martin Higginson says

Immotion is talking to retail landlords **Intu (INTU)** and Hammerson about installing VR pods into various shopping centres as they are excited about using them to help boost footfall.

Merlin itself is looking at using different types of buildings to increase its range of attractions. Most of its outlets require large outdoor premises like theme parks or indoor locations such as aquariums. However, it does have some propositions that can be fitted into smaller buildings such as its Shrek's Adventure experience which is situated in London's County Hall.

One of its most intriguing new experiences this year is Merlin's Bear Grylls Adventure where thrill seekers can test their limits by undertaking tough mental and physical challenges. The first site will be located as part of the Birmingham NEC exhibition complex.

People can choose from indoor climbing and skydiving, tackling heights with high ropes or even go exploring underwater.

For hard core adventurers, they can choose the 'Basecamp' experience where they have to escape a room by solving puzzles, hit targets with precision, survive a challenging maze and tackle an assault course.

Numis analyst Tim Barratt says the growth opportunity from new brands is compelling with the Bear Grylls experience potentially hitting a margin conversion of 40% compared to 34% for the Midway division which includes Madame Tussauds and the Sea Life aquariums.

In a bid to capitalise on the success of *Peppa Pig* and appeal to families, Merlin is also planning indoor attractions that allow visitors to experience the world of popular kids franchise.

SPORTS DIRECT'S SPACE CONUNDRUM

The issue of space leaves us puzzled as to how **Sports Direct (SPD)** plans to roll out eSports arenas in some of its stores.

The retailer announced a partnership with **Game Digital (GMD)** to host live matches between players battling it out in various competitive video games.

We're perplexed as to how Sports Direct will make any decent money from this venture, plus question whether the benefits of e-sports is worth giving up store space previously used to sell clothes and sporting equipment.

ESports as a concept is very popular as many people – particularly youngsters – enjoy watching other people play games. Sports Direct may argue that it will increase footfall into its stores and

players or viewers may pick up a few items while visiting its premises.

Game Digital is involved in the venture via its **BELONG** brand, effectively its eSports offshoot. Sports Direct paid £3.2m for 50% of the intellectual property of Belong and will be entitled to half its profits – in exchange for a £55m loan to Game Digital.

According to YouGov, eSports generated £565m in global sales last year and an audience of 385m. By 2020, forecasts by the data analytics firm suggest eSports will deliver over £1bn in sales and nearly double its audience to 600m.

Liberum analyst Adam Tomlinson is supportive of the deal as he believes it will boost Game Digital's transformation from a retailer exposed to the gaming console cycle into eSports.

FOUR LEISURE STOCKS TO BUY

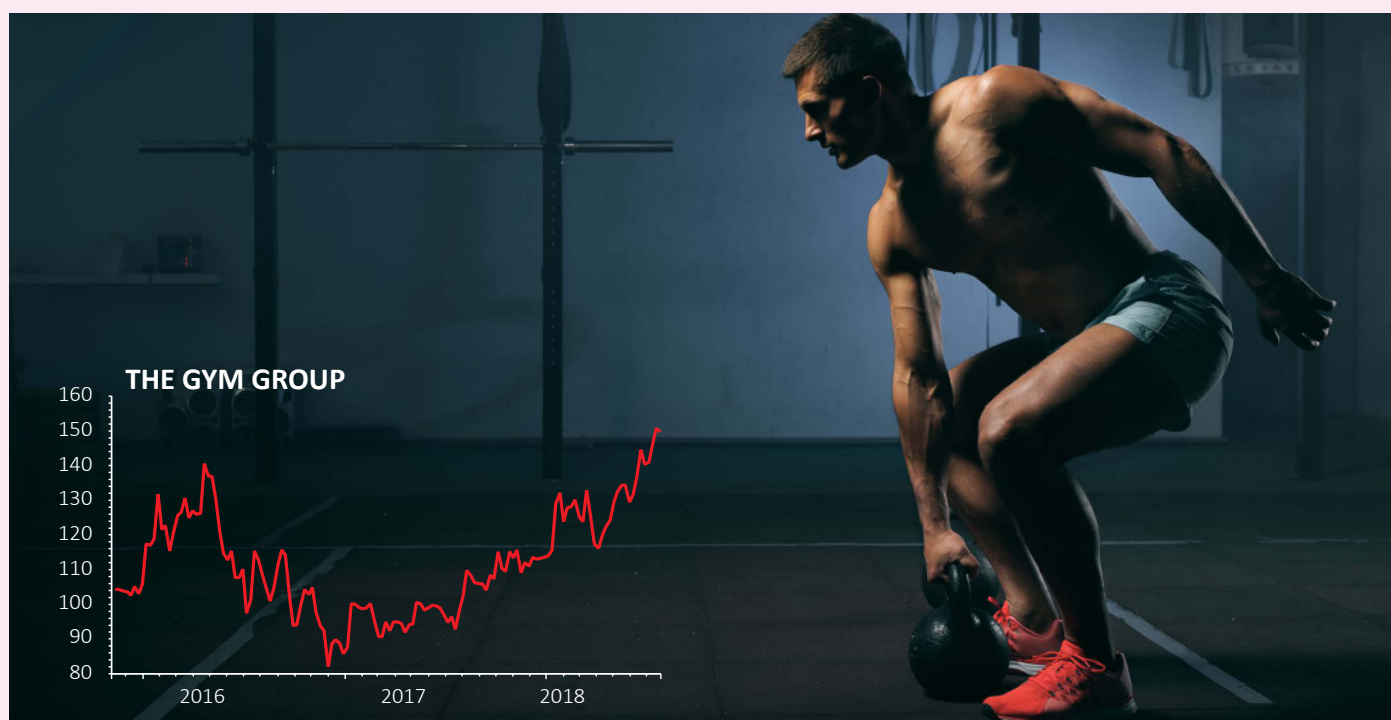
Our top leisure picks related to the attractions and experiences theme are Gym Group, Hollywood Bowl, Cineworld and Immotion.

GYM GROUP

THE BUSINESS IS forecast to make £15.5m adjusted pre-tax profit in 2018, rising to £23.1m in 2019 and £27.1m

in 2020, according to Liberum's estimates. While the gym sector is highly competitive, we believe Gym

Group has proven its ability to run a highly-successful business and continue to drive up earnings.



HOLLYWOOD BOWL

IT HAS SUCCESSFULLY tested different pricing models and found ways to drive up the volume of people bowling and the amount of money people spend in its sites, as

well as having more efficient operations.

It is a well-run business generating lots of cash that can be reinvested in its estate and returned to

shareholders via ordinary and special dividends. Liberum forecasts £24.6m pre-tax profit in 2018, rising to £25.7m in 2019 and £28.2m in 2020.



CINEWORLD

THE CINEMA OPERATOR has exposure to multiple geographic territories and has proven the benefits of reinvesting money back into its estate as

spruced-up cinemas led to higher spending per customer.

Its recent foray into the US market presents a new earnings growth driver,

led by refurbishment gains and greater buying power. The analyst consensus forecast is for £316m pre-tax profit in 2018, rising to £403m in 2019 and £437m in 2020.

IMMOTION

THIS IS A high-risk investment selection as the business is still very young and currently loss-making. We think it is in

the right place at the right time as leisure operators and companies on a broader scale are keen to embrace virtual

reality as it greatly improves the end-user experience. There are presently no earnings forecasts in the market. (LMJ/DC)

