

Country Food & Dining

EIS Farm Shop Chain Enters New Round Of Fund-Raising

29 September 2008

Share Price: 100p**12m High:**100p**12m Low:** 100p**Market Cap:** £5m before current issue, up to £15m following issue**Shares in Issue:** up to 15.3m fully diluted following issue**NAV/Share:** n.a. (full year accounts not yet available)**Gearing:** Nil**Interest Cover:** N/A**EPIC Code:** N/A**Sector:** Retailing**Market:** Unlisted**Promoter:**

Smith & Williamson

Contact: Christian Elmes 020 7131 4502**Website:** www.cobbsfarmshop.co.uk
www.springleazefarmshop.com

Description: Country Food & Dining is an EIS qualifying chain of farm shops, incorporating food retailing, cafes/restaurants and a limited amount of farm production/pick-your-own production. Its two units have each been trading for over five years under different ownership, and Country Food & Dining has been in operation for a year.

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Country Food & Dining, the unquoted farm shop chain, has launched a further round of fundraising in order to expand its chain of units from two to, depending upon investor appetite, hopefully four or more.

Key points for potential new investors are:

- The first unit has traded well in the year that it has been under Country Food & Dining ownership. Sales have increased, it is profitable before allowance is made for central overheads, and site expansion/development work is having a favourable impact (although it is running a little behind schedule).
- The second site appears to be a sound purchase, and has a lot of potential. Its floor area is being poorly utilised at present, and with a relatively modest planning approval could be made much more productive. There is also the medium term possibility, subject to planning, of selling off surplus land for development when the property market improves.
- There is as yet no national chain of farm shops, integrating food sales and café/restaurants. Country Food & Dining intends to be the first.
- David Bruce, the man behind the Slug & Lettuce and Firkin pub chains and until midsummer the Chief Executive of the AIM quoted Capital Pub Company, is Non-Executive Chairman. He is a man with a strong track record, and a good investor following.
- This industry is holding up very well in the face of the economic recession.
- The business is based on freehold property, so has strong defensive characteristics.
- EIS tax reliefs are available on new investment.

We like this company, and we are pleased with the progress it has made. IFAs and other financial advisers will find a lot to interest them in this latest issue.

Background

Country Food & Dining is an Enterprise Investment Scheme fund that was launched by promoters Smith & Williamson in January of 2008. The business was formed by David Bruce, its Non-Executive Chairman, and Gordon Leatherdale, the Chief Executive. Bruce made a great deal of money for investors with his Capital Pub Company (now quoted on AIM) and was also responsible for creating the Slug & Lettuce and Firkin pub chains.

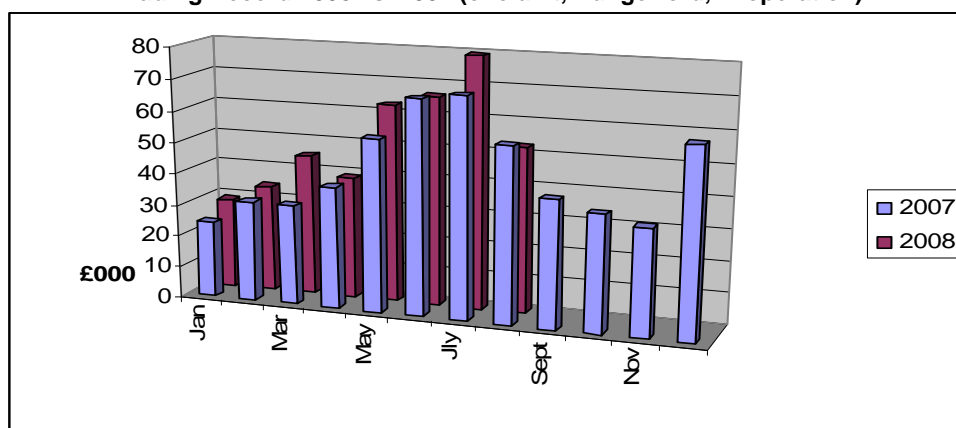
The company's aim is to build a chain of farm shops incorporating retail food sales and cafes/restaurants. In some instances food will be grown on site, and there will be a commonality of produce – items grown on the farmland will be sold in the shops, and will form the basis for dishes served in the cafes/restaurants. Customers who eat in the cafes/restaurants might then visit the shop to purchase items to take home, or visit pick-your-own space in the farm as a result.

We produced an earlier research note in January 2008. This outlined the business background and the trading environment for the industry generally; we found these to be favourable, with long established growth patterns, and trends towards local food purchasing and healthy eating moving strongly in Country Food & Dining's favour. This research note is still almost entirely valid, the only serious exceptions being that Country Food & Dining is likely to move towards 50% gearing on sites as it develops, rather than staying debt free, and that regionally it is likely to concentrate upon units within two hours' drive of the Hungerford Head Office. Copies of this report are still available and will be provided upon request.

Although Country Food & Dining is relatively new and therefore has a limited trading record, its two trading units were purchased as ongoing businesses with a long track record of serving their local communities. This is not a typical start-up business. There are, as yet, no chains of farm shop businesses, and Country Food & Dining intends to become the first, and the largest.

The trading record during the twelve months has been positive, especially as it has been achieved in an environment where most pub and restaurant chains have been trading heavily in negative territory compared to the previous year. Country Food & Dining is showing a like-for-like 8.4% turnover gain in 2008 on the same period of 2007.

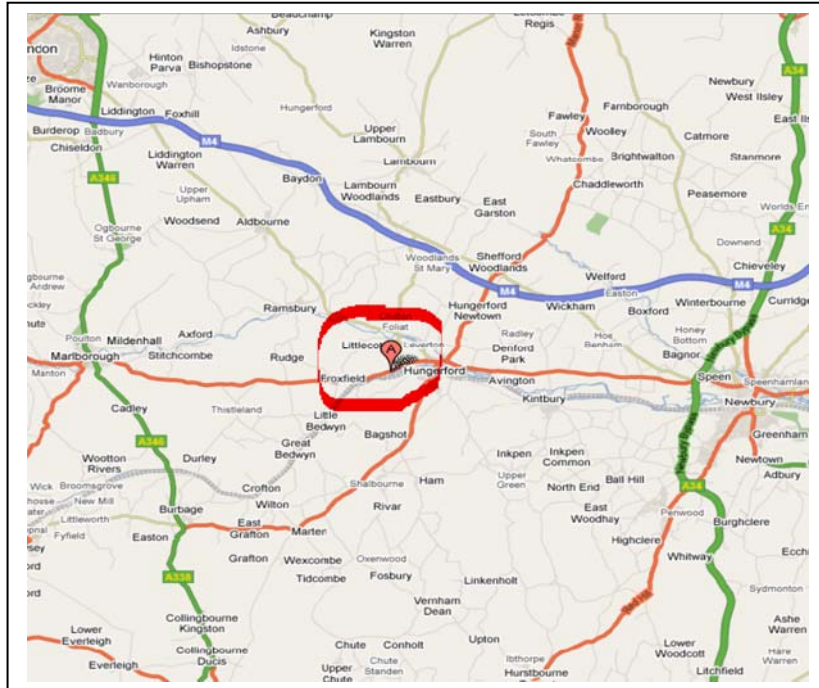
Trading Record 2008 vs. 2007 (one unit, Hungerford, in operation)



The Issue

The first two rounds of funding for Country Food & Dining provided £5.1m of capital, most of which has now been invested. The promoters are Smith & Williamson. The current EIS issue is to raise between £2m and £10m. The issue will close on 15 December 2008 unless extended.

The Hungerford Site



Map c. Google

A considerable number of changes have been made to the Hungerford site since our last visit. Almost all of them were foreshadowed in our previous research note, and all the changes are for the better.

Development

Since January the building footprint has been increased from 5,500 sq. ft. to 7,500 sq. ft. The space is currently split:

Retailing	56%
Catering	33%
Storage	11%

Not included in this total is a mezzanine floor which houses the Country Food & Dining offices, some site administrative facilities and some miscellaneous storage.

The additions to space have been achieved with little lost trading time. The buildings have been shut on several afternoons, but as yet there has been no extended shut-down. The building was closed at end-September in order to allow further layout changes to both the shop and the café.

The Shop

Only minor changes were made to the layout of the shop during the Spring and Summer of 2008. More serious alterations are planned for this Autumn; these changes are being made later than we expected, and to this extent the alterations at Hungerford are running behind schedule. We do not view this slippage from the original plans as serious.

Changes to be implemented during Autumn 2008 include:

- Widening of the aisles. During redevelopment the aisles have been slightly narrowed, but these will be opened up considerably once the new area of retail space is operational.

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- Introduction of a specialist butchery counter. This has been sub-let to a local independent butcher. It will replace a small butchery chiller area, which has high quality meat but which has much unrealised potential. The butcher joins the fishmonger, which has been on site since Spring.
- Introduction of a further specialist, a baker. This is also being contracted out. The nature of the contracts for all three outside specialists (butcher, baker, fishmonger) is a combination of a fixed rent plus a percentage of turnover. The fishmonger has been on site since September.
- Introduction of freezer areas in the storage section to support the butcher and fishmonger.
- The introduction for a trial period of a housewares retail section (cookery equipment etc). This is also to be contracted out.

We also expect to see, after the closure for the refit, a greater linkage between the produce being grown on the farm, the food for sale in the shop, and the meals and snacks available in the restaurant.

Recent trading suggest that average spend per customer in the shop has risen from c. £9.00 at the time of acquisition to £13.50. We are not relying upon average spend remaining this high, but this certainly shows what is possible if the company 's management produce this consistently.

The Restaurant

The old café has been upgraded to a restaurant and has been increased from 28 covers to 60 indoor covers at present. This is four fewer than we had expected, because the internal layout of the café has been changed slightly from the plan originally drawn up in January. A further 60 covers have been made available outside; there was no outside dining area previously.

A new menu was introduced in mid-August, giving a wider variety of snacks and meals, and this has increased the average spend per customer from £3.50 to, on initial figures, in the region of £7.50, according to management. This has been accomplished without any fall-off in customer numbers, and is an encouraging development.

The Farm

The farm has been the most disappointing area of development to date, and has probably lost money in the current year. This is partly due to poor weather and partly to a number of years during previous ownership when the farm was probably not high on the management's list of priorities. Excessive rain cost £5,000 - £10,000 from the strawberry crop, and also resulted in the corn on the cob crop being poor. On the other hand, pumpkins are cropping better than in 2007, and asparagus has turned out to be very suited to the soil and very profitable. Additional asparagus and a large number of Christmas trees have been planted and both will yield their first crop in the 2009 season.

Expenditure on the farm has been higher than expected at c. £60,000; part of this has been to install a deer proof fence, which has eliminated the problem of deer eating the crops (this was a serious issue in 2007) and improves the possibility of reaching a contract with another market gardener to manage the land.

We expect Country Food & Dining to hire an outside farming consultant to improve the p & l account of this part of the business. Another possibility might be to lease out farm operations.

Children's Area

When Country Food & Dining purchased the Hungerford site it had no provision for children. During the spring, c. £10,000 was spent on installing a children's play area, which is sited next to the outdoor area of the restaurant. This has proved popular, and may be indirectly responsible for some of the additional spend in the restaurant. Management plans expansion of this play area ready for next summer. Some animals such as rabbits and goats will probably be introduced, and the range of push-along toys vastly increased. A mini race

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miles from Frome. These three towns have a combined population of another 65,000. In all, Country Food & Dining's management estimates that a population of at least 177,000 lives within a 16 minute drive of the unit. The visibility and accessibility of the unit is certainly first rate.

The site covers 7.9 acres, of which 4.4 acres is surplus to current requirements, and not used for anything, although it is currently not zoned for development. The site area breaks down as follows:

Springleaze Farm Shop	Site Area
Farm shop, industrial buildings and car park	1.2 acres
Children's animal area/play area	2.3 acres
Field with main road frontage used for overspill car parking	4.4 acres
TOTAL SITE AREA	7.9 acres

The seller has clearly done well from the site, having developed it from disused farm buildings and obtained planning permission. His planning approvals were not won without a fight, however, and contained several restrictions. These severely limited the area of space that could be used as a café, and also prevented half the site being used for retail or catering purposes at all. Consequently, much of the square footage is currently being used as a commercial kitchen and store. Based on experiences at Cobbs Farm Shop & Kitchen, management believes there is a strong possibility of altering the planning conditions on the site.

Approximately 20% of the building footprint is currently let out for industrial use. This has its advantages, because it produces a rent of approximately £40,000 a year, giving a rental yield of 4.5% on CFD's total purchase price. For the short term at least, this arrangement will not be changed – there is no point in changing it until or unless the planning constraints are eased.

The Café

The Café at Bath is the most under-utilised part of the premises. It consists of only 16 covers inside, plus a further eight covers outside. This is too small to be economic, and we expect Country Food & Dining to develop this area of the trading space.

Part of the problem at the café is availability of kitchens. At present Bath has limited kitchen facilities for the café, but does have a 750 sq.ft. separate kitchen area dedicated to in house manufacture both for Springleaze Farm Shop and Cobbs Farm Shop & Kitchen at Hungerford, a key part of the overall multi site business plan. The kitchen has recently won a contract to supply a number of National Trust properties.

Unused Land

Management at present does not intend to use this land for farming. It feels the capacity at Hungerford is quite sufficient to provide the unit with all the own-grown fruit and vegetables it requires for the immediate future. The land is not zoned for development. It would be quite possible to apply for rezoning of this land and then for planning permission, but management is attempting to get quite enough changes through the planning system at the moment.

Management has set in hand the initial process of applying for a grant to assist in any future redevelopment works.

Management Changes

One of the two Executive Directors present at the time of the public launch of Country food & Dining 1, Jonathan Shearme, has left the company. He held no shares in the company.

He has been replaced by Tom Newey, who was appointed Operations Director in June 2008. He had been appointed General Manager of the Hungerford unit (at the time the only unit in the business) in January 2008. His background is in marketing, after which for a short period of time he ran a farm shop in Cornwall. Newey has bought shares in the business and will be actively involved in the roll-out of the concept as more farm shop units are purchased.

Two further managerial appointments are planned.

The first is a Finance Director. As Country Food & Dining is currently turning over £1.2m p.a. from its two units, and this figure will grow even if no new units are added, proper control of the financial functions has become important. The Finance Director appointment will probably be on a part time basis initially; the position will be made full time as the number of units grows to justify it.

The second planned appointment is for a manager for the Hungerford site.

Country Food & Dining retains the same non-executive Chairman and two non-executive directors.

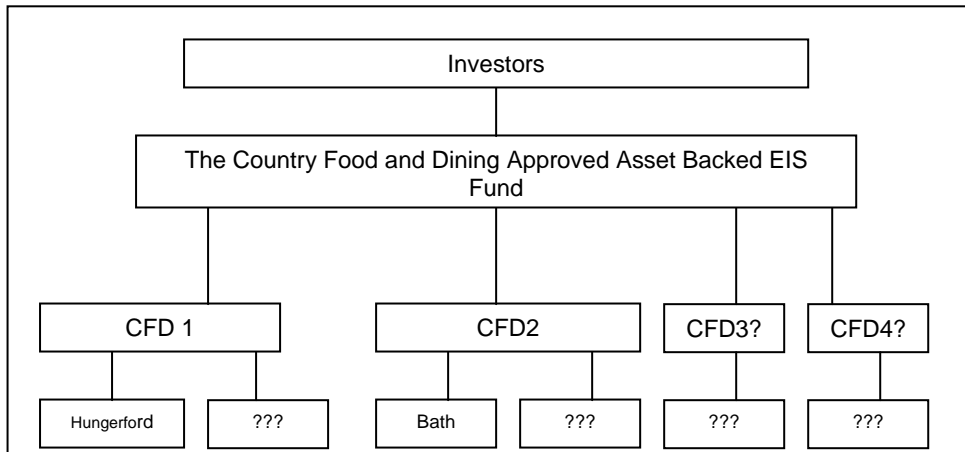
The Non-Executive Chairman is David Bruce, He was the the co-founder, and until June 2008 the Chief Executive, of the AIM quoted Capital Pub Company plc. He was also responsible for the successful development of the Slug & Lettuce and Firkin pub chains.

The non-executive directors are Kris Gumbrell and Martin Sherwood. Gumbrell is Chief Executive of Capital Pub Company 2 (to be renamed Convivial London Pubs PLC) and was previously the COO of Close Imperial Pub Company and Operations Director of Greene King. Sherwood is Head of Tax Efficient Solutions at Smith & Williamson.

Marketing

A great deal remains to be done in terms of marketing. However both sites have dedicated websites. These are www.cobbsfarmshop.co.uk and www.springleazefarmshop.com . Neither of them is yet listed on www.farmshops.org, or www.farmshopping.net. The Hungerford unit trialed a leaflet drop in the Spring and management judged this to be very successful. Another is planned for the Autumn, after the closure for the refit and ahead of Christmas, which will be even more of a key trading period than it was in 2007.

Structure Of The Group



The diagram above explains the structure of the investment vehicle. The master organisation is 'The Country Food and Dining Approved Asset Backed EIS Fund'. The fund will then pass the investment down to the individual operating companies.

The individual operating companies, represented by CFD1, CFD2, etc in the diagram, each own one or more farm shops. CFD1 owns Hungerford and will probably be allocated additional capital by the Fund with which to buy a second unit. CFD2 owns Bath, and will probably also operate a second unit. CFD3 and CFD4 have not yet been formed, but when investor money is received will be created and will buy one unit each, possibly more. There is no reason why more farm owning companies cannot be formed. We could see CFD5, CFD6 and so on being created in due course.

From the legal point of view, this rather complex structure is not a single entity, it is a grouping of independent companies with common directors, common shareholders and identical memoranda and articles of association.

The reason for this structure is tax based. Under the Inland Revenue's current Enterprise Investment Scheme legislation, the amount of investment permissible in a new single company is limited to £2m each year.

The policy of the Chief Executive is to avoid gearing for the time being, and neither CFD1 nor CFD2 has any debt. However, each company will be authorised to take on some corporate debt, up to approximately 50%, in due course.

Key points in this structure are:

- Each investor in the fund will be the beneficial owner of a specific number of shares in each investee company.
- Each investor's money will be managed on a portfolio basis.
- Smith & Williamson will have total discretion as to how investor money is divided up between operating companies.
- As CFD1 and CFD2 are to receive additional funds for a second property purchase, new investors will get a 'free ride' on the work already done in improving the Hungerford and Bath premises.

The Exit

We stated in our previous research note that an exit was likely in between three and five years. Since then, Smith & Williamson has pushed out and tightened the timetable slightly; the wording in the current prospectus is 'between three and a half and five years', from the time that the fund closes. The most likely exit is a trade sale, although an AIM float is also possible.

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As management improves the profits of the businesses, their value to a buyer will rise. In addition we envisage Country Food & Dining could, and should, gain from the following:

- Enhancement of underlying asset value by the increase in footprint of the buildings on each site.
- Other planning gains, such as possibly freeing surplus land for development or sale.
- A 'lotting premium' as is seen with pub and restaurant chains on sale, where the sum of a group of units is greater than their individual value.

The same incentive and penalty structures will apply as with the March 2008 fundraising. These are:

- The executive management team at the farm shops and also the fund promoters Smith & Williamson will be eligible for bonus payments if the scheme produces a return above a set hurdle rate.
- If investors choose to wind up the scheme without the backing of Smith & Williamson, heavy penalties will be payable. This is in order to protect the lotting premium, and benefit all shareholders.
- Bonuses for Smith & Williamson are geared to encourage an early wind-up of the fund.

The potential returns can be seen from the following illustration:

Country Food & Dining		3 yrs £	4 yrs £	5 yrs £
Initial Investment		10,000	10,000	10,000
Placing Fee	5.00%	500	500	500
Intermediaries' fees	2.50%	250	250	250
Property Agent Finder's Fee	2%	200	200	200
Net Sum Invested		9,050	9,050	9,050
Return Year 1	6%			
Value End of Year 1		9,593	9,593	9,593
Return Year 2	6%			
Value End of Year 2		10,169	10,169	10,169
Return Year 3	6%			
Value End of Year 3		10,779	10,779	10,779
Return Year 4	6%			
Value End of Year 4			11,425	11,425
Return Year 5	6%			
Value End of Year 5				12,111
Surplus				2,111
Hurdle Rate*		1,500	1,750	2,000
Excess for Bonus Calculations				111
Bonuses on Agreed Sale:				
To Management	20.00%			22
To Smith & Williamson	5.00%			6
Total Bonuses				28
Remaining for Individual Investors				12,083
EIS Relief	20%			2,000
Net Cost to Individuals				8,000
Gain Over Period				51.0%

* Hurdle rate is 15% after 3 years, 17.5% after four years, 20% after five years

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Our initial illustrative model assumed a 6% gross annual increase in value for the business for each of the five years and produced a total return for investors of 51%. The 'Gain Over Period' in the final line assumes investors have taken full advantage of the 20% EIS income tax relief. Those investors able to roll over capital gains taxes into this vehicle could, of course, obtain larger gains.

There are bonuses for management if operating profit exceeds 15% of turnover in any one year, and other incentives. We have treated these as part of the normal costs of running a business, because any organisation of this size will have to have some form of incentive scheme for its key directors and staff. We have not attempted to produce p & I forecasts, but have assumed that a combination of steadily growing turnover and profits, combined with modest site development and possibly some sales/development of surplus land, will lead to a positive total return that will increase the value of the company upon sale or flotation after five years.

Below we have produced a table of the likely returns, using an annual Total Return ranging from -4% to +12%. It is interesting to note that, because of a combination of sensible management charges by the promoter and the availability for this final tax year of personal tax relief at 20%, the scheme will not dip into loss unless the Total Return p.a. exceeds a negative 2%.

Country Food & Dining - Illustrative Returns	
Annual Growth Rate of the Underlying Business	5 Year Gain For Investors
-4%	-7.8%
-2%	2.3%
0%	13.1%
2%	24.9%
4%	37.6%
6%	51.0%
8%	62.2%
10%	74.1%
12%	87.0%

Conclusion

We are pleased with the progress that Country Food & Dining has made since our original research note in January 2008. The business model appears sound, is at the low end of the risk scale for schemes of this nature, and management and promotional charges are in our opinion not excessive. The latest round of fund-raising clearly deserves close examination by IFAs and other financial advisors.

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Management	Major Shareholders
<p>Non-Executive Chairman: David Bruce</p> <p>Chief Executive: Gordon Leatherdale</p> <p>Operations Director: Tom Newey</p>	
Key Dates	Key Milestones
<p>15 December 2008: Second round of EIS fundraising due to close unless extended.</p> <p>2012: First likely date for closure of scheme and return of capital to investors.</p> <p>2014: Final likely date for closure of scheme and return of capital to investors.</p>	<p>September 2007: Formation of Country Food & Dining and purchase of Hungerford site.</p> <p>April 2008: First round of EIS public fundraising completed.</p> <p>September 2008: Purchase of second property, at Bath, completed.</p>

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