

Caffè Nero Group Holdings Ltd

Report and Financial Statements

31 May 2018



Company Information

Registered No. 05936386

Directors

G W Ford

B J Price

Secretary

B J Price

Auditor

Ernst & Young LLP
1 More London Place
London SE1 2AF

Banker

Santander UK Plc
17 Ulster Terrace
London NW1 4PJ

Solicitor

Linklaters
1 Silk Street
London EC2Y 8HQ

Registered Office

9-15 Neal Street
London
WC2H 9PW
United Kingdom

Strategic Report

The directors present their Strategic report and Directors' report and financial statements for Caffè Nero Group Holdings Ltd ('the company') and its subsidiaries (collectively referred to as 'the group') for the year ended 31 May 2018.

Principal activities

Caffè Nero Group Holdings Ltd is the holding company of Rome Bidco Limited, which owns Italian Coffee Holdings Ltd and Caffè Nero Investments Limited, both UK based entities. Italian Coffee Holdings Ltd acts as the holding company for three brands trading in the UK and Ireland as Caffè Nero, Harris & Hoole and Aroma, as well as a high-quality coffee roasting facility. Caffè Nero Investments Limited is the holding company for the three brands' operations outside the UK and Ireland, including Caffè Nero stores in the USA, Poland and Turkey. It also manages franchises in the UAE, Cyprus, Croatia and Oman.

Caffè Nero is a brand of high quality Italian style coffee houses operating in nine countries, which serve a range of premium hand-crafted espresso-based coffee drinks and offers, in addition to its core range, an array of pastries, baked goods, freshly made panini, sandwiches, salads and pastas, as well as cakes and biscotti. In line with the brand's expansion strategy, 38 new stores were opened in the UK during the financial year as well as 33 additional international stores, bringing the total number of Caffè Nero stores worldwide to 845 which includes transport hubs where it trades as Nero Express.

Harris & Hoole is a group of speciality artisan coffee houses operating in supermarkets, high streets and airports in the UK. The business was acquired during the previous financial year (2016), where it added 36 stores to the group. It has since opened two new sites, one this financial year, taking the total number of stores in the UK to 38. Harris & Hoole was profitable during the year and the directors believe it has strong potential alongside Caffè Nero.

Aroma is a brand of premium quality coffee for sale to third parties. The company continues to build the foundation of this brand and is currently mobilising its entry into the market.

The directors believe that there are strong growth prospects in all the markets in which the group operates for high quality branded coffee and intend to continue the growth of the Caffè Nero, Harris & Hoole and Aroma brands.

Ethics and sustainability

Caffè Nero has been and continues to be a major job creator. It employs nearly 5,000 people in the United Kingdom and approximately 7,200 people worldwide (6,000 employed within the group). Over the last year, the business has created more than 300 new jobs in the UK and Ireland and approximately 700 jobs worldwide.

The company also spent considerable time, energy and money upgrading the skill sets of its employees. In the last year, Caffè Nero trained over 4,000 employees in the UK, including technical job skills, leadership and team skills as well as behavioural development training. The company also trained 79 apprentices in the period, launched a mental health first aider programme and mental health workshops have been rolled out regionally in the UK.

All funds generated by the business are reinvested to create further jobs, pay employees and drive growth, and a dividend has not been paid to shareholders in the year (or in its 21-year history). Each year the business contributes considerable funds to the UK government. Caffè Nero contributed £68 million of tax in the UK this year, which equates to 22% of UK sales and £100k per UK store.

The company also donates money to good causes and global humanitarian projects. In the year under review, the company donated £243k to such good causes and global humanitarian projects including to Medecins Sans Frontieres (Doctors Without Borders) to build a hospital for Syrian refugees who cannot access medical care. It also funded the charity 'Room to Read' to rebuild schools in Nepal following an earthquake and gave money to UK Spinal Research to improve the lives of those who suffer spinal cord tragedies.

Strategic Report (continued)

Ethics and sustainability (continued)

In addition, Caffè Nero supports farmers and communities where it sources its green beans, including financial support for farmers through the payment structure the company uses to buy the beans. Caffè Nero funds a clean water project for five schools in the La Esmeralda region of Nicaragua, as well as providing the money to double the size and increase the teaching staff of the main primary school in the community. In Ethiopia, money raised through the sale of filter coffee is funding bee keeping kits and the training to use them for coffee farmers when it is not harvest season. Caffè Nero also works closely with Rainforest Alliance to certify our beans and to support coffee farmers working in a sustainable and environmentally friendly way.

In the UK, the Caffè Nero Foundation donated nearly £90,000 to good causes this year, including £40,000 through the 'Make a Difference' campaign, which sees the Foundation match funds raised by employees for local or community causes. Caffè Nero also raised nearly £33,000 during UK Coffee Week by donating 20p from every flat white sold that week to charity.

Further, Caffè Nero is also committed to an extensive Corporate Social Responsibility program. In the UK, the business recycles left over coffee grinds and participates in First Mile, a project that recycles paper cups in the City of London and is adding cup recycling collection points to the majority of its stores. In the year, Caffè Nero introduced "keep cups" for customers who wish to refill their own coffee cups rather than use paper cups and in the UK replaced plastic straws with paper straws in order to minimise one-time plastic usage. Key performance indicators

The board has assessed that the following KPIs are the most effective measures of progress towards achieving the group's strategies and as such towards fulfilling the group's objectives:

Expansion

A key part of the group's strategy is to increase in scale. A key measure of this is the number of stores opened in a year. 38 Caffè Nero stores were opened in the UK and Ireland as well as 33 additional international stores in the year, bringing the total number of Caffè Nero stores worldwide to 845.

The acquisition of Harris & Hoole in June 2016 added 36 stores to the group with an additional new site opened in the prior year, and a further site opening this year, taking the total to 38 stores.

The group therefore had 883 stores operating worldwide at the year end. We expect to open approximately 80 stores next year worldwide across all our brands.

Like for like sales

The group seeks to increase profitability by increasing the sales of units open for more than one year. The group targets an annual range of 3-5% growth in worldwide like for like sales. Last year, performance of stores open for more than one year was 2.3% like for like sales growth for the group as a whole, slightly below target. Against the ongoing uncertainty of Brexit and the general challenges faced by the retail industry, the directors consider that in the context of the overall market, this is a fair result.

Store profit (gross profit)

The success of the group in its store opening programmes and like for like sales growth is ultimately displayed by means of increasing store profit in absolute terms. Last year the group's store profit increased by £3.7m to £75.2m (2017 – £71.5m), a 5% increase. Costs have however increased, this is primarily due to an increase in national living wage, apprenticeship levy and rates.

Strategic Report (continued)

Business review

The group's performance is summarised below:

	2018 £000	2017 £000
Revenue	334,402	313,137
Store profit	75,239	71,497
Operating profit	13,576	17,699
Loss before tax	(25,528)	(25,508)
Caffè Nero worldwide new store openings	71	63
Harris & Hoole new store openings	1	1
Total worldwide stores at the year end	883	822

As at 31 May 2018 the group had a total of 883 stores in 9 countries. 72 stores were opened during the year with 11 sites handed back to landlords.

UK and Ireland – Caffè Nero had 666 stores operating in over 250 towns and cities at the year end. It opened 38 stores in the year and handed 9 stores back to landlords resulting in a net increase of 29 stores or 4.4% of the estate in these two countries.

The acquisition of Harris & Hoole in June 2016 added 36 stores to the group with an additional new site opened in the prior year, and a further site opening this year, taking the total to 38 stores.

Turkey – The group opened 4 stores in Turkey. Caffè Nero Turkey had a total of 56 stores at the year end. Continued progress is expected, as Caffè Nero is scheduled to roll out new stores in Turkey in the coming year.

Poland – Green Caffè Nero, the brand as it is known in Poland, opened 13 sites during the year and closed 1 store, bringing the total to 63. Green Caffè Nero achieved a positive performance at EBITDA level and the directors are very encouraged by its performance.

USA – The group opened 9 sites in Massachusetts in the USA in the year, bringing its total in the USA to 22. The directors are satisfied with the performance of these new sites and further openings are expected in FY19.

Other territories – The group has a number of franchises operating in the United Arab Emirates, Croatia, Cyprus and now also in Oman, where 3 sites were opened in the year. The revenues from these franchise agreements are included in these financial statements. At the year-end, 21 Caffè Nero stores were open in the United Arab Emirates, 2 in Croatia, 12 in Cyprus (3 new stores) and 3 in Oman.

Diversity and Inclusiveness

Caffè Nero strives for an inclusive and open culture. We believe in hiring diverse and talented individuals who share our values of fairness, decency, warmth, kindness and the pursuit of excellence. We are fully committed to equality and believe that all individuals, regardless of gender, can build a successful career with Caffè Nero. All employees are remunerated according to their job role and salaries are determined by benchmarking roles against similar positions at comparable organisations.

Principle risks and uncertainties

The directors continually identify, evaluate and manage material risks and uncertainties faced by the group, which could adversely affect the group's business, operating results and financial condition. The directors consider the principal risks and uncertainties facing the business to comprise the following:

Strategic Report (continued)

Principle risks and uncertainties (continued)

Group specific risks

- Damage to the brand image due to failures in environmental health in the stores or contamination of products;
- Increases in prices of key raw ingredients;
- Increases in other key costs such as wages and rents;
- Decreased customer demand for Caffè Nero group products; and
- Breakdowns in internal controls through fraud or error.

The group continually monitors exposure to these risks and has developed policies and appointed qualified personnel to mitigate exposure to these risks.

Broader sector or macroeconomic risks

- The loss of key personnel or the failure to manage succession planning;
- Adverse economic conditions in the UK markets;
- Increased competition in the markets in which Caffè Nero brands operate;
- A rise in interest rates which will affect the amount of interest payable on the group's loans; and
- The outcome of Brexit negotiations especially as they affect availability of personnel, principally in London.

Financial risk management objectives and policies

The group uses various financial instruments including cash, trade debtors, bank overdrafts, bank and group loans and trade creditors that arise directly from its operations. The existence of these financial instruments exposes the group to a number of financial risks, which are described in more detail below.

The main risks arising from the group's financial instruments are interest rate risk, credit risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below. These policies have remained unchanged from previous years.

Interest rate risk

The group borrows in pound Sterling at floating rates of interest. Excess cash is placed on short term deposit for up to a week with Santander at variable money market rates. The group's policy is to keep approximately 66% of its borrowings at fixed interest rates. This is achieved by entering into interest rate swaps which are designated to hedge underlying debt obligations. The group classifies interest rate swaps as derivative financial instruments and measures them at fair value. These instruments do not qualify for hedge accounting.

Credit risk

The group monitors its exposure to credit risk through detailed checks on customers and regular review of outstanding receivables. The company mitigates its exposure by only lending to undertakings from the same group of which it is a member.

Strategic Report (continued)

Financial risk management objectives and policies (continued)

Liquidity risk

The group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans, other loans and facilities. The group regularly reviews its exposure and ensures funds are available as required.

Investment Impairment risk

The directors understanding of the risks associated with the investments held by the entity relate to the potential impairment of those investments. To identify any risk of impairment in a timely manner, the company reviews the financial performance of its investments on a regular basis. To date, all investments have had a strong year and are not exhibiting indicators of impairment. This is expected to continue for the foreseeable future.

Capital Management

Capital comprises shareholders' equity and financing from third party loans and the company's parent undertakings. The primary objective of the company's capital management policy is to ensure that the company has adequate capital to support the business. The company monitors the cost of the various sources of capital on an ongoing basis and manages cost through planning future alternative sources of capital. No changes in these factors were made during the year. The company has no externally imposed capital restrictions.

During the year, a £145.0m senior facility (of which £134.0m was drawn at year end) was put in place with reduced interest rates, which expires in September 2022. The rates associated with the £182.5m mezzanine facility were also improved, and the maturity date was extended to September 2023. Full details of the facilities can be found in notes 18 and 19 of these accounts.



Ben Price

Director

12/10/2018

Directors' Report

The directors present their report and financial statements for the year ended 31 May 2018.

Results and dividends

The group generated a loss before taxation of £25.5m (2017 – loss of £25.6m). No dividend is proposed (2017 – £nil).

Future Developments

The directors aim to maintain the management policies which have resulted in the group's substantial growth in recent years. They consider that the next year will show a further significant growth in sales from continuing operations and from the addition of new stores across its nine territories.

Financial Instruments

At year end the group had net liabilities of £320.3m (2017 – £295.2m). It is the group's policy to hedge approximately 66% of its exposure to interest rate risk on the floating rate third party debt. Further details of the group's financial objectives and exposure to risk are set out in note 19.

Going concern

The directors have produced cash flow forecasts, which indicate that the group can continue as a going concern and that the banking covenants are all met for the foreseeable future.

The group is in a net liability position of £320.3m due to external and intercompany debt. The group's immediate parent undertaking, Rome PIK Holdco Limited, has confirmed that it will not seek repayment of £252.2m owed by the group until such time as the group is able to meet these liabilities. The majority of the remainder of the group's third party loans (£326.2m) are not due within twelve months of the date of authorising these financial statements for issue, and will only start becoming due in September 2022.

Having made due and careful enquiry, the directors consider that there are no material uncertainties that may cast doubt over the group's ability to continue as a going concern.

Subsequent events

On 24 September 2018, Caffè Nero Ventures Limited acquired 11 stores in Sweden, with a view to converting these stores to the Caffè Nero brand over the course of the year.

Directors of the company

The directors at the date of approving this report and those that served during the year are set out on page 1. During the year, the directors' interests in the share capital of The Nero Company, the largest parent company of the group of which Caffè Nero Group Holdings Ltd is a member, were as follows:

	<i>At 31 May 2018</i>	<i>At 31 May 2017</i>
	<i>£20 each</i>	<i>£20 each</i>
G W Ford (1)	17,378	17,378
B J Price (2)	310	310

Directors' Report (continued)

Directors of the company (continued)

(1) G W Ford's interest in ordinary shares is registered as follows:

G W Ford	15,455
Paladin Partners 1	1,923

(2) B J Price's interest in ordinary shares is registered as follows:

Paladin Partners 1	310
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Additionally, B J Price has 495 shares in Rome Intermediate Holdings Sarl (the immediate parent of which is The Nero Company) held on his behalf through an Employee Benefit Trust. G W Ford also holds 157 shares directly in Rome Intermediate Holdings Sarl.

Creditor payment policy and practice

It is the group's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the group and its suppliers, provided that all trading terms and conditions have been complied with. Average creditor days at the year-end were 39 days (2017 – 37 days).

Employees

The UK Group strives for an inclusive and open culture. We believe in hiring diverse and talented individuals who share our values of fairness, decency, warmth, kindness and the pursuit of excellence. We are fully committed to equality and believe that all individuals, regardless of gender, can build a successful career with Caffè Nero. All employees are remunerated according to their job role and salaries are determined by benchmarking roles against similar positions at comparable organisations.

In the year, the group is pleased to have created over 700 jobs worldwide, of which 319 new jobs were in the UK and Ireland (2017 – 397).

The group provides employees with information concerning trading, development and other appropriate matters through formal and informal briefings. Employees are consulted on a regular basis to ensure their views are taken into account in making decisions likely to affect their interests.

The group gives full and fair consideration to the employment of disabled people, including the continuation in employment of employees who have become disabled. All employees are given equal opportunities for training and promotion, having regard to their particular aptitudes and abilities.

The group has a very extensive training program, benefiting circa 6,000 people worldwide during the year, including training 79 apprentices as a result of the apprenticeship levy. It believes in developing its people and provides courses in coffee making and business management to provide employees with the skills necessary to pursue a career both inside and outside the group. During the year, the Group paid £1.4m of bonuses across all its stores.

Donations

The UK group contributes to The Nero Foundation which distributes money to charities in the UK and overseas. Local charities are selected by store teams and funds raised are matched by The Nero Foundation. In the year, the company has donated £243k to good causes and global humanitarian projects. The Allegra Foundation, Malvern Special Families, Room to Read, Spinal Research, Steps Charity, St. Mungos and Rowcroft Hospice were supported in this way.

Directors' Report (continued)

Taxation

The group has made the following UK tax payments to UK government entities in the year:

	2018	2017
	£000	£000
VAT	32,648	30,011
Employment taxes	18,040	16,141
Business rates	17,293	14,962
Total tax paid	67,981	61,114
Tax paid per store	100	96

The group has paid a total tax bill of £68.0m in the UK this year. This is made up of VAT, employment taxes (including PAYE & apprenticeship levy) and business rate taxes, representing 22% of total UK sales for the group or £100k per store (2017 – £96k per store). The group generated a loss before taxation of £25.5m, this was primarily because the group's finance charges were significant. Therefore, no entity within the group was due to pay UK corporation tax for the year. Interest due to third party banks is charged at an arm's length basis and in isolation is greater than the group's operating profit, resulting in a loss before tax. The group has not included any of the interest payable to ultimate shareholder companies, only third party banks, in its corporation tax computations. The group's UK tax computations do not contain any overseas profits or losses, just UK results.

Tax Policy

In an environment of increased tax transparency, the UK group aims to demonstrate responsible tax management, including paying all UK taxes our business is eligible to pay, which has been determined through our regular dialogue with HMRC. Our approach to tax is in line with our ethical approach, which is to think responsibly about our business and everything we do. Our Board of Directors are accountable for how we approach our tax affairs and our Group Finance Director, who sits on the board, is responsible for ensuring that the approach set by the Board is implemented within our business. We are committed to paying the correct amount of tax and at the correct time, in accordance with the tax laws in which we operate.

Further, detailed information regarding our approach to tax in the UK is located on our website at: <https://Caffènero.com/company/uk-tax-policy/>. This detail forms part of our Directors' report.

Directors

The directors who served the company during the year were as follows:

G W Ford
B J Price

Directors' Report (continued)

Statement of disclosure of information to the auditor


The directors who were members of the Board at the time of approving the Directors' report are set out on page 1. Having made enquiries of fellow directors and the group auditor, each of these directors confirms that:

- a) to the best of each director's knowledge and belief, there is no relevant audit information of which the group auditors are unaware; and
- b) each director has taken all the steps a director might reasonably be expected to have taken to be aware of the relevant audit information and to establish that the group auditors are aware of that information.

Reappointment of auditor

In accordance with section 487 of the Companies Act 2006, the company has elected to dispense with the obligation under section 485 of the Companies Act 2006 to appoint auditors annually. Ernst & Young LLP are deemed to continue in office until further notice.

On behalf of the Board



Ben Price
Director

12/10/2018

Directors' Responsibilities Statement

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

Under Company Law the directors must not approve the financial statements unless they are satisfied that they present fairly the financial position, financial performance and cash flows of the group and company for that period. In preparing those financial statements the directors are required to:

- select suitable accounting policies in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the group's and company's financial position and financial performance;
- state that the company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements; and
- make judgements and estimates that are reasonable and prudent

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group's and company's transactions and disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report

to the members of Caffè Nero Group Holdings Ltd

Opinion

We have audited the financial statements of Caffè Nero Group Holdings Limited (the parent 'company') and its subsidiaries (the 'group') for the year ended 31 May 2018 which comprise the Group Statement of Comprehensive Income, the Group and Company Statements of Financial Positions, the Group and Company Statements of Cash Flows, the Group and Company Statements of Changes in Shareholder's Equity and the related notes 1 to 26, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

In our opinion:

- the financial statements give a true and fair view of the group's and of the parent company's affairs as at 31 May 2018 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the group and parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Independent auditor's report (continued)

to the members of Caffè Nero Group Holdings Ltd

Other Information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' Report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Independent auditor's report (continued)

to the members of Caffè Nero Group Holdings Ltd

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 11, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Zishan Nurmohamed (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

Date

15/10/2018

Group Statement of Comprehensive Income

for the year ended 31 May 2018

		2018	2017
	Notes	£000	£000
Revenue	2	334,402	313,137
Cost of sales		(259,163)	(241,640)
Gross profit		75,239	71,497
Administrative expenses		(61,663)	(53,798)
Operating profit	3	13,576	17,699
Finance income	6	2	7
Finance costs and similar charges	7	(39,745)	(43,670)
Share of post-tax profit of joint ventures	12	639	456
Loss before taxation		(25,528)	(25,508)
Income tax expense	8	(117)	(108)
Loss for the year		(25,645)	(25,616)
Other comprehensive (loss)/income		(175)	26
Total comprehensive loss for the year		(25,820)	(25,590)

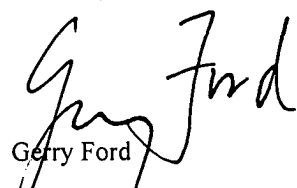
All amounts relate to continuing activities.


Group Statement of Financial Position

at 31 May 2018

	Notes	2018 £000	2017 £000
Non-current assets			
Property, plant and equipment	10	92,631	82,137
Intangible assets	11	184,546	187,753
Investment in joint ventures	12	6,653	6,014
Lease premiums	13	344	456
Trade and other receivables	14	165	1,512
		<u>284,339</u>	<u>277,872</u>
Current assets			
Trade and other receivables	14	19,810	28,194
Inventories	15	4,204	5,135
Lease premiums	13	168	186
Cash and cash equivalents		<u>11,596</u>	<u>14,583</u>
		<u>35,778</u>	<u>48,098</u>
Total assets		<u>320,117</u>	<u>325,970</u>
Current liabilities			
Derivative financial instruments		(372)	(1,433)
Trade and other payables	16	(60,932)	(69,450)
Other financial liabilities	18	<u>(253,193)</u>	<u>(237,641)</u>
		<u>(314,497)</u>	<u>(308,524)</u>
Non-current liabilities			
Other financial liabilities	18	(325,243)	(312,249)
Provisions	17	<u>(650)</u>	<u>(374)</u>
		<u>(325,893)</u>	<u>(312,623)</u>
Total liabilities		<u>(640,390)</u>	<u>(621,147)</u>
Net liabilities		<u>(320,273)</u>	<u>(295,177)</u>
Capital and reserves			
Called up share capital	20	–	–
Share premium account		2,024	2,024
Foreign exchange translation reserve		1,238	514
Retained earnings		<u>(323,535)</u>	<u>(297,715)</u>
Total equity		<u>(320,273)</u>	<u>(295,177)</u>

The financial statements were approved by the Board of Directors on 12 October 2018 and signed on its behalf by:


 Gerry Ford
 Director
 12/10/2018


 Ben Price
 Director
 12/10/2018

Company Statement of Financial Position

at 31 May 2018

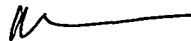
	Notes	2018 £000	2017 £000
Non-current assets			
Investments	12	2,024	2,024
Current assets			
Trade and other receivables	14	173,935	156,883
Cash and cash equivalents		2	2
		<u>173,937</u>	<u>156,885</u>
Total assets		<u>175,961</u>	<u>158,909</u>
Current liabilities			
Trade and other payables	16	(515)	(515)
Other financial liabilities	18	(252,193)	(235,141)
		<u>(252,708)</u>	<u>(235,656)</u>
Total liabilities		<u>(252,708)</u>	<u>(235,656)</u>
Net Liabilities		<u>(76,747)</u>	<u>(76,747)</u>
Capital and reserves			
Called up share capital	20	—	—
Share premium account		2,024	2,024
Retained earnings		<u>(78,771)</u>	<u>(78,771)</u>
Total equity		<u>(76,747)</u>	<u>(76,747)</u>

The financial statements were approved by the Board of Directors on 12 October 2018 and signed on its behalf by:



Gerry Ford
Director

Date: 12/10/2018



Ben Price
Director

Date: 12/10/2018

Group Statement of Cash Flows

for the year ended 31 May 2018

	2018 £000	2017 £000
Operating activities		
Loss before taxation	(25,528)	(25,508)
<i>Adjustments to reconcile loss for the year to net cash flow from operating activities:</i>		
Finance expense	39,745	44,144
Finance income	(2)	(7)
Unrealised gain on foreign exchange	(724)	208
Movement in fair value of options	(1,819)	(889)
Depreciation of property, plant and equipment, amortisation of intangible assets and amortisation of lease premiums	26,045	24,318
Impairment of property, plant and equipment	950	235
Fair value of currency contract	(174)	98
Share of profit of joint venture	(639)	(456)
	37,854	42,143
(Increase)/decrease in inventories	931	(794)
(Increase)/decrease in other receivables	8,384	(5,547)
Increase/(decrease) in trade and other payables	(8,690)	7,299
Increase/(decrease) in provisions	276	(47)
Net cash from operating activities	38,755	43,054
Investing activities		
Payments to acquire intangible fixed assets	(827)	(829)
Investment in subsidiary (net of cash acquired)	–	(5,496)
Investment in joint ventures	–	(2,485)
Payments to acquire property, plant and equipment	(35,568)	(27,793)
Interest received	2	7
Net cash used in investing activities	(36,393)	(36,596)
Financing activities		
New third party long-term loans	10,404	12,032
Interest paid	(15,013)	(16,538)
Loan issue costs and other bank fees paid	(228)	(288)
Loan advanced to parent	(512)	(538)
Net cash used in financing activities	(5,349)	(5,332)
Net decrease in cash and cash equivalents	(2,987)	1,126
Cash and cash equivalents at 1 June	14,583	13,457
Cash and cash equivalents at 31 May	11,596	14,583

Company Statement of Cash Flows

for the year ended 31 May 2018

	2018 £000	2017 £000
Operating activities		
Profit before taxation	–	–
Financing costs	17,052	15,899
Interest receivable	(17,052)	(15,899)
Net cash flow from operating activities	–	–
Net movement in cash and cash equivalents		
Cash and cash equivalents at 1 June	2	2
Cash and cash equivalents at 31 May	2	2

Group Statement of Changes in Shareholders' Equity

for the year ended 31 May 2018

	<i>Called up share capital £000</i>	<i>Share premium account £000</i>	<i>Foreign exchange translation reserve £000</i>	<i>Retained earnings £000</i>	<i>Total £000</i>
At 1 June 2016	–	2,024	(25)	(272,125)	(270,126)
Total comprehensive Loss for the year	–	–	–	(25,590)	(25,590)
Retranslation movement	–	–	539	–	539
At 1 June 2017	–	2,024	514	(297,715)	(295,177)
Total comprehensive Loss for the year	–	–	–	(25,820)	(25,820)
Retranslation movement	–	–	724	–	724
At 31 May 2018	–	2,024	1,238	(323,535)	(320,273)

Company Statement of Changes in Shareholders' Equity

for the year ended 31 May 2018

	<i>Called up share capital £000</i>	<i>Share premium account £000</i>	<i>Retained earnings £000</i>	<i>Total £000</i>
At 1 June 2016	–	2,024	(78,771)	(76,747)
Total comprehensive income for the year	–	–	–	–
At 1 June 2017	–	2,024	(78,771)	(76,747)
Total comprehensive income for the year	–	–	–	–
At 31 May 2018	–	2,024	(78,771)	(76,747)

Notes to the financial statements

at 31 May 2018

1. Accounting policies

Authorisation of financial statements and statement of compliance with IFRSs

The group and company financial statements were authorised for issue by the Board of Directors on 12 October 2018. Caffè Nero Group Holdings Ltd is a private limited company incorporated and domiciled in England and Wales.

The group and company financial statements have been prepared in accordance with International Financial Reporting Standards adopted by the European Union, in accordance with the provisions of the Companies Act 2006.

Going concern

The directors have produced cash flow forecasts, which indicate that the group can continue as a going concern and that the banking covenants are all met for the foreseeable future.

The group is in a net liability position of £319.9m due to external and intercompany debt. The group's immediate parent undertaking, Rome PIK Holdco Limited, has confirmed that it will not seek repayment of £252.2m owed by the group until such time as the group is able to meet these liabilities. The majority of the remainder of the group's third party loans (£326.2m) are not due within twelve months of the date of authorising these financial statements for issue, and will only start becoming due in September 2022.

Having made due and careful enquiry, the directors consider that there are no material uncertainties that may cast doubt over the group's ability to continue as a going concern.

Basis of preparation

The group and company financial statements are presented in Pounds Sterling which is the functional and presentational currency of the Group and Company and all amounts are rounded to the nearest thousand pounds (£000) except as otherwise indicated.

The company has taken advantage of the exemption provided under section 408 of the Companies Act 2006 not to publish its individual statement of comprehensive income and related notes.

New standards and interpretations not applied

The following standards and interpretations, which have been issued by the IASB, become effective after the current year end and have not been early adopted by the group:

<i>International Accounting Standards (IAS/IFRS/IFRIC)</i>	<i>Effective date</i>
IFRS 9 Financial Instruments: Classification and measurement	01 January 2018
IFRS 15 Revenue from Contracts with Customers	01 January 2018
IFRS 16 Leases	01 January 2019

The effective dates stated here are those given in the original IASB standards. As the company prepares its financial statements in accordance with IFRS adopted by the European Union, the application of new standards will be subject to the standards having been endorsed for use in the EU via the EU Endorsement mechanism. In the majority of cases this will result in an effective date consistent with that given in the original standard or interpretation but the need for endorsement restricts the company's discretion to early adopt standards.

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

New standards and interpretations not applied (continued)

The directors do not anticipate that the adoption of the standards will have a material impact on the group's financial statements in the period of initial application, other than IFRS 16 Leases, which is currently being assessed.

Key sources of estimation uncertainty and accounting judgement

The preparation of financial statements requires management to make estimates and assumptions that affect the balances reported for assets and liabilities at the balance sheet date and the amounts reported for revenues and expenses during the year. The nature of estimation means that actual outcomes could differ from those estimates.

The key sources of estimating uncertainty that have a significant risk of causing material adjustment to the carrying amount of assets and liabilities within the next financial year are the measurement and impairment of goodwill (note 11) and property, plant and equipment (note 10) ('fixed assets'). The group identifies whether fixed assets are impaired on an annual basis, and this requires an estimation of the value in use of the group of cash generating units to which the fixed assets are allocated. This involves estimation of future cash flows and choosing a suitable discount rate.

Other key sources of estimation uncertainty include the impairment of group receivables (note 14), the estimation of useful lives of actual assets, outstanding coffee due under loyalty cards (note 17) and the replacement cost of raw materials (note 15). The accounting policies for these areas are set out in this note.

The group estimates the fair value of points awarded under the customer loyalty programme by applying statistical techniques. Inputs to the models include making assumptions about expected redemption rates and the average length of time taken to obtain the nine points required for redemption. As points issued under the programme do not expire, such estimates are subject to significant uncertainty. At 31 May 2018, the estimated liability for unredeemed points was approximately £853.6k (2017 – £981.8k).

Basis of consolidation

The consolidated financial statements comprise the financial statement of the group and its subsidiaries at 31 May 2018. Control is achieved when the group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the group controls an investee if and only if the group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee)
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

When the group has less than a majority of the voting or similar rights of an investee, the group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual agreement with the other vote holders of the investee
- Rights arising from other contractual agreements
- The group's voting rights and potential voting rights

The group re-assesses whether or not it controls an investee, if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the group obtains control over the subsidiary and ceases when the group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Basis of consolidation (continued)

included in the statement of comprehensive income from the date the group gains control until the date the Group ceases to control the subsidiary.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the group are eliminated in full on consolidation.

Interests in joint ventures

The group has contractual arrangements with other parties, which represent joint ventures. These take the form of an agreement to share control over another entity. Where the joint venture is established through an interest in a company, partnership or other entity (a jointly controlled entity), the group recognises its interest in the entity's assets and liabilities using the equity method of accounting. Under the equity method, the interest in the joint venture is carried in the balance sheet at cost plus post-acquisition changes in the group's share of its net assets, less distributions received and any impairment in value of individual investments. The group statement of comprehensive income reflects the share of the joint ventures controlled entity's results after tax. Any goodwill arising on the acquisition of a jointly controlled entity, representing the excess of the cost of the investment compared to the group's share of the net fair value of the entity's identifiable assets, liabilities and contingent liabilities, is included in the carrying amount of the jointly controlled entity and is not amortised. To the extent that the net fair value of the entity's identifiable assets, liabilities and contingent liabilities is greater than the cost of the investment, a gain is recognised and added to the group's share of the entity's profit or loss in the period in which the investment is acquired.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognised at their fair value at the acquisition date.

Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition. If after reassessment, the group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the statement of comprehensive income. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortised but reviewed for impairment annually or more frequently if events or changes in circumstances indicate the carrying value may be impaired. Further details are set out in note 11.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the group of stores at which goodwill is monitored internally.

Intangible assets

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses. Intangible assets acquired separately from a business are carried initially at cost. Expenditure on internally developed intangible assets is taken to the statement of comprehensive income in the year in which it is incurred. Following initial recognition, the historic cost model is applied, with intangible assets being carried at cost less accumulated amortisation and accumulated impairment losses. Intangible assets with a finite life are amortised on a straight-line basis over their expected useful lives, as follows:

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Intangible assets (continued)

Software	–	3 years
Brand	–	10-20 years
Trademarks	–	Indefinite useful life
Lease premium	–	Over the lease term

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable in making the asset capable of operating as intended.

Depreciation

Depreciation is provided on property, plant and equipment at rates calculated to write off the cost, less estimated residual value based on prices prevailing at the balance sheet date of each asset evenly over its expected useful life, as follows:

Leasehold improvements	–	over the lease term
Furniture, fittings and equipment	–	over 3 to 5 years

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable immediately and are written down to their recoverable amount. The asset's residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each financial year end.

An item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset is included in the statement of comprehensive income in the period of derecognition.

Impairment

The group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the statement of comprehensive income in those expense categories consistent with the function of the impaired asset. An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such a reversal is recognised in the statement of comprehensive income. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Impairment (continued)

Any impairment recognised in relation to goodwill cannot be reversed.

Investments in subsidiaries

Investments are stated at cost less provision for impairment. The carrying value is reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Cash and cash equivalents

Cash and cash equivalents comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less. For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Interest bearing loans and overdrafts

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs, when the group becomes party to the related contracts. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance income and finance expense.

Borrowing costs

Borrowing costs are recognised as an expense when incurred.

Inventories

Inventories are stated at the lower of cost and net realisable value. Inventories comprise food, coffee beans and packaging goods for resale. The group applies a first in first out basis of inventory valuation.

Provisions

Provisions are recognised when the group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Financial assets

Financial assets are recognised when the group becomes party to the contracts that give rise to them and are classified as financial assets at fair value through profit or loss; loans and receivables; held to maturity investments; or as available for sale financial assets, as appropriate. The group determines the classification of its financial assets at initial recognition and re-evaluates this designation at each financial year end. When financial assets are recognised initially, they are measured at fair value, being the transaction price, plus in the case of financial assets not at fair value through the profit or loss, directly attributable transaction costs.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available-for-sale. Such assets are carried at amortised cost using the effective interest method if the time value of money is significant. Gains and losses are recognised in the statement of comprehensive income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading and other assets designated as such on inception are included in this category. Financial assets are classified as held for trading if they are acquired for sale in the short term. Assets are carried in the balance sheet at fair value with gains or losses recognised in the statement

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Financial assets at fair value through profit or loss (continued)

of comprehensive income. This category includes derivative financial instruments entered into by the group that are not designated as hedging instruments in hedge relationships.

Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Impairment of financial assets

The group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

Financial liabilities

When a financial asset or financial liability is initially recognised, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:

- financial liabilities at fair value through profit or loss; and
- financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or are accounted for using the continuing involvement approach.

Financial liabilities at fair value through profit or loss includes financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments.

Capital instruments

Ordinary shares are classified as equity instruments. Other instruments are classified as liabilities if they contain an obligation to transfer economic benefits and if not they are included in equity.

Derecognition of financial assets and liabilities

A financial asset or liability is generally derecognised when the contract that gives rise to it is settled, sold or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in the statement of comprehensive income.

Leases

Leases taken by the group are assessed individually as to whether they are finance leases or operating leases.

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Leases (continued)

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease rental payments, other than contingent rentals, are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term. The benefit of lease incentives is spread over the term of the lease.

Contingent rentals, which are determined by revenue of individual stores, are charged when incurred. Where a minimum guarantee exists, a charge is made to the statement of comprehensive income, based on planned performance, to the extent that the individual store is expected to exceed minimum guarantee levels, or at the minimum guarantee level if there is a projected shortfall in performance.

Where lease premiums are paid, these are depreciated over the lease terms, which range between 6 and 20 years.

Income taxes

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions:

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and
- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

The carrying amount of deferred tax assets is reviewed at each balance sheet date. Deferred tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities, the deferred taxes relate to the same taxation authority and that authority permits the group to make a single net payment.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be reliably measured. The revenue shown in the profit and loss account represents amounts earned during the year, exclusive of value added tax. The following specific recognition criteria must also be met before revenue is recognised:

Sale of goods

Revenue is recognised when the goods have passed to the buyer, usually on despatch / at the point of sale.

The group operates a loyalty programme which entitles customers to a point for each cup of coffee purchased from its stores. Nine loyalty points can then be redeemed for a free coffee. Consideration

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Revenue recognition (continued)

received is allocated between the cup of coffee sold and the point issued, with the consideration allocated to the points equal to their fair value. The fair value of the points issued is deferred and recognised as revenue when the points are redeemed.

Development fee income

Fees received by the group in relation to a third party or joint venture obtaining a licence to operate the Caffè Nero brand in a specific overseas territory are recognised as revenue in the period to which the licence relates.

Royalty fee income

Fees received by the group in relation to royalties payable under the terms of operating agreements between the group and third parties or joint ventures operating the Caffè Nero brand overseas are recognised as revenue in line with overseas sales in the period the sales are made. Franchise revenue is received in the form of royalties.

Opening fee income

Fees received by the group in relation to stores opened by third parties or joint ventures operating the Caffè Nero brand overseas are recognised as revenue at the opening date, which reflects the point that the group is entitled to the fee.

Interest income

Revenue is recognised as interest accrues applying the effective interest method.

Rental income

Rental income is recognised as other income in accordance with the group's right to receive payment under the terms of the lease agreement.

Revenue recognition

Marketing income

Marketing income is earned through third party promotions in store and is recognised as other income at the time the promotion takes place.

Operating segments

For management purposes, the group is organised into one business unit and has one reportable operating segment which covers the sale of coffee and food items at all its stores in the United Kingdom.

Senior management monitors the operating results of its business unit for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss and is measured consistently with operating profit or loss in the consolidated financial statements.

Derivative financial instruments

The group uses derivative financial instruments such as interest rate swaps to hedge its exposure to risks associated with interest rate fluctuations. As part of its investment in joint ventures, the group also entered into call and put options in respect of its right to future ownership of shares.

Derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The fair value of interest rate swap contracts is determined by reference to market values for similar instruments. The fair values of the call and put options are calculated by reference to recognised option pricing models.

Notes to the financial statements

at 31 May 2018

1. Accounting policies (continued)

Derivative financial instruments (continued)

Any gains or losses arising from changes in fair values on derivatives that do not qualify for hedge accounting are taken directly to the statement of comprehensive income.

Foreign currency translation

The company's financial statements are presented in sterling, which is also the company's functional currency. Transactions in foreign currencies are initially recorded in the entity's functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

2. Revenue

Revenue is analysed as follows:

	2018 £000	2017 £000
Coffee shop sales and associated income	333,073	312,040
Royalty fee income, opening fees and other charges	1,329	1,097
	<u>334,402</u>	<u>313,137</u>
Finance income (note 6)	2	7
Total revenue	<u>334,404</u>	<u>313,144</u>

Revenue is derived from the following geographic areas:

	2018 £000	2017 £000
UK and Ireland	302,536	286,638
Turkey	18,107	18,088
USA	11,591	6,758
Poland	618	378
Oman	32	–
Croatia	60	33
Gulf States	779	757
Cyprus	679	485
	<u>334,402</u>	<u>313,137</u>

Notes to the financial statements

at 31 May 2018

3. Operating Profit

Operating profit is stated after charging/(crediting):

	2018 £000	2017 £000
Auditor's remuneration – audit of group financial statements	90	90
– audit of financial statements of subsidiaries	84	84
– tax compliance and advisory	66	66
Costs relating directly to opening new sites	686	645
Depreciation of property, plant and equipment	21,881	20,132
Impairment of property, plant and equipment	950	235
Movement in fair value of share options	1,819	889
Amortisation of intangible assets	4,035	3,776
Amortisation of lease premiums	130	411
Operating lease rentals – land and buildings	59,497	58,078
Other operating income – rental income	(164)	(162)
Other operating income – marketing income	(2,855)	(2,115)

Operating lease rentals are split between minimum lease payments of £54.8 million (2017 – £54.6million) and contingent rents of £4.7 million (2017 – £3.5million).

4. Directors remuneration

No remuneration was paid or is payable to the directors in their capacity as directors of the company (2017 – £nil). The directors are also directors of a fellow group undertaking, Nero Holdings Limited, who paid the directors remuneration and pension contributions of £0.8m (2017 – £1.0m) in respect of services to the group of which the company is a member.

It is not possible to identify the proportion of these remunerations that relate to services to this company.

Amounts paid on a group basis are summarised below:

	2018 £000	2017 £000
Basic salary	761	989
Fees and bonuses	2	–
Pension	20	20
Benefits	7	29
	<u>790</u>	<u>1,038</u>
	2018 £000	2017 £000
In respect of the highest paid director:		
Aggregate remunerations in respect of qualifying services	<u>466</u>	<u>473</u>

Notes to the financial statements

at 31 May 2018

5. Staff costs

	2018 £000	2017 £000
Wages and salaries	92,120	80,323
Social security costs	6,388	5,736
Other pension costs	18	18
	<u>98,526</u>	<u>86,077</u>

The average monthly number of employees, including executive directors during the year was as follows:

	No.	No.
Operational	5,040	4,516
Administration	963	869
	<u>6,003</u>	<u>5,385</u>

6. Finance income

	2018 £000	2017 £000
Bank interest receivable	<u>2</u>	<u>7</u>

7. Finance costs and similar charges

	2018 £000	2017 £000
Senior debt interest	5,429	7,069
Mezzanine debt interest	9,569	9,142
Mezzanine debt interest (rolled up)	7,135	8,271
Amortisation of loan issue costs	2,782	2,571
Bank fees	228	258
Movement in fair value of interest rate swap	(1,061)	(415)
Interest on loan from parent (rolled up)	17,052	15,899
Other interest payable	430	652
Change in fair value of put and call options	(1,819)	(889)
	<u>39,745</u>	<u>43,670</u>

Notes to the financial statements

at 31 May 2018

8. Income tax

The group paid a total tax bill of £68.0m in the UK in the year. Primarily because the group's finance charges were significant, no income tax was payable for the year (2017 – £nil). The taxes paid were made up of VAT, employment taxes (including PAYE & apprenticeship levy) and business rate taxes, representing 22% of total UK sales for the group or £100k per store (2017 – £96k per store). The group generated a loss before taxation of £25.5m. Finance charges contributing to this loss were interest due to third party banks charged at an arm's length basis and in isolation this was greater than the group's operating profit, resulting in a loss before tax. The group has included only third party banks (not any of the interest payable to ultimate shareholder companies) in its corporation tax computations. The group's UK tax computations do not contain any overseas profits or losses, just UK results.

The tax assessed for the year differs from the average rate of corporation tax in the UK of 19.00% (2017 – 19.83%). The differences are explained below:

	2018 £000	2017 £000
Loss before tax	(25,528)	(25,508)
Loss before tax at 19.00% (2017 – 19.83%) (average rate for the year)	(4,851)	(5,058)
<i>Effects of:</i>		
Expenses not deductible for tax purposes	2,533	862
Income not taxable	(368)	(268)
Foreign tax	117	108
Group relief	3,279	3,892
Amounts not recognised	(535)	–
Movement in deferred tax asset recognised	–	572
Tax charge for the period	175	–

(a) Deferred tax

Deferred tax recognised in the financial statements and the amounts not recognised are as follows:

	Recognised*	Not recognised	Recognised	Not recognised
	2018 £000	2018 £000	2017 £000	2017 £000
Decelerated capital allowances	4,675	6,905	5,130	6,710
Deductable temporary differences	(4,675)	397	(5,130)	430
Tax losses	–	5,055	–	5,980
Deferred tax asset	–	12,357	–	13,120

*Deferred tax assets of £4.675m and deferred tax liabilities of £4.675m are offset and therefore not recognised on the Balance Sheet in accordance with IAS12 section 74.

Deferred tax assets are recognised once it is considered more likely than not that they will be recoverable against future taxable trading profits arising in the group.

Notes to the financial statements

at 31 May 2018

8. Income tax (continued)

The Finance (No.2) Act reduced the UK corporation tax rate from 1 April 2017 to 19% and by a further 1% to 18% from 1 April 2020. A further reduction in the corporation tax rate to 17% from 1 April 2020 was then substantively enacted in Finance Act 2016.

Entities within the group have claimed UK group relief in the year to mitigate their UK corporation tax liabilities.

9. Results attributable to members of parent undertaking

The post-tax profit attributable to the parent undertaking for the year was £nil (2017 – £nil).

10. Property, plant and equipment

Group

	<i>Leasehold improvements</i>	<i>Furniture, fittings and equipment</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>
Cost:			
At 1 June 2017	144,825	85,765	230,590
Additions	14,215	21,353	35,568
Disposals	(2,166)	(117)	(2,283)
Transfers	38	(38)	–
Effect of translation to presentational currency	10	16	26
At 31 May 2018	156,922	106,979	263,901
Depreciation and impairment:			
At 1 June 2017	81,863	66,589	148,452
Provided during the year	11,692	10,189	21,881
Impairment	950	–	950
Disposals	(1)	(18)	(19)
Effect of translation to presentational currency		6	6
At 31 May 2018	94,504	76,766	171,270
Net book value:			
At 31 May 2018	62,418	30,213	92,631
At 1 June 2017	62,961	19,176	82,137

Assets written down to nil net book value but with a gross cost of £27.9m (2017 – £13.6m) are still in use by the group at 31 May 2018.

The impairment charge relates to unrecoverable elements of assets relating to cash generating units. Two stores were impaired during the year as a result of poor trading performance, these have been written down to a net book value of nil since the directors do not consider that these stores will be profitable in the next year.

Notes to the financial statements

at 31 May 2018

10. Property, plant and equipment (continued)

The recoverable amounts of these stores are calculated from value in use calculations based on cash flow projections approved by senior management. The post-tax discount rate applied to cash flow projections is 9.0% (2017 – 9.3%). The growth rate applied is store specific and dependent upon the age of the store.

Impairment assumptions are covered in note 11.

11. Intangible assets

Group

	<i>Software</i> <i>£000</i>	<i>Brand</i> <i>£000</i>	<i>Trademark</i> <i>£000</i>	<i>Goodwill on</i> <i>acquisition</i> <i>£000</i>	<i>Total</i> <i>£000</i>
Cost:					
At 1 June 2017	4,028	61,668	366	175,398	241,460
Additions	827	–	–	–	827
At 31 May 2018	4,855	61,668	366	175,398	242,287
Amortisation and impairment:					
At 1 June 2017	2,407	31,000	–	20,300	53,707
Charge for the year	867	3,167	–	–	4,034
At 31 May 2018	3,274	34,167	–	20,300	57,741
Net book value:					
At 31 May 2018	1,581	27,501	366	155,098	184,546
At 1 June 2017	1,621	30,668	366	155,098	187,753

Goodwill arose as follows:

1. On acquisition of Italian Coffee Holdings Ltd on 1 February 2007, the brand value also arose on the same acquisition and is being amortised over 20 years.
2. In 2015, the company acquired a 50% shareholding in Caffè Nero Gida Urunleri AS, taking the group's total shareholding to 100%. Goodwill on acquisition of £14.1m was recognised.
3. During the prior year the company acquired a 100% shareholding in Harris and Hoole Limited. Goodwill on acquisition of £2.5m and a brand value of £1.7m were recognised. The brand value was based on a 10 year forecast, hence is being amortised over 10 years.

The remainder of goodwill arose on the acquisition of the UK Caffè Nero stores in 2007.

Impairment testing of goodwill

The group tests for impairment annually or more frequently if there are indications that goodwill may be impaired.

UK (Italian Coffee Holdings Ltd and Harris and Hoole Limited)

The recoverable amount has been determined based on a value in use calculation. The value in use has been determined using a discounted cash flow model. The model incorporates projected cash flow forecasts over a period of 5 years and incorporates a terminal value based on expected long-term growth. The cash flows have been discounted to a present value using an appropriate discount rate. As a result of

Notes to the financial statements

at 31 May 2018

11. Intangible assets (continued)

this analysis no impairment has been recorded in the current year. The model uses the following key assumptions:

Discount rate

A post-tax discount rate of 9.0% has been used (2017 – 9.3%). The discount rate has been derived from the group's weighted average cost of capital, adjusted to reflect a market assessment of the risks specific to the cash generating assets.

EBITDA growth

The discounted cash flow model was driven by EBITDA, representing the operating cash flows of the business. The EBITDA growth assumption used was 2.5% (2017 – 2.5%). The growth rate is consistent with historic performance and expected future market conditions. The forecast EBITDA is based on existing stores and excludes projected earnings from future store openings. Forecast capital expenditure on new stores has been excluded from the cash flow projections.

A terminal growth rate of 2.5% (2017 – 2.5%) has been used to calculate expected cash flows of Italian Coffee Holdings Ltd after 5 years. This assumption is consistent with the long-term growth projections for the industry.

Sensitivity to changes in assumptions

With regard to the assessment of value-in-use, management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of the unit to materially exceed its recoverable amount.

International (Caffè Nero Gıda Ürünleri AS)

The recoverable amount has been determined based on a value in use calculation. The value in use has been determined using a discounted cash flow model. The model incorporates projected cash flow forecasts over a period of 5 years and incorporates a terminal value based on expected long-term growth. The cash flows have been discounted to a present value using an appropriate discount rate. As a result of this analysis no impairment has been recorded in the current year. The model uses the following key assumptions:

Discount rate

A post-tax discount rate of 10.5% has been used. The discount rate has been derived from the group's weighted average cost of capital, adjusted to reflect a greater risk premium relating to Turkey.

EBITDA growth

The discounted cash flow model was driven by EBITDA, representing the operating cash flows of the business. The growth rate reflects current growth rates and inflation. The forecast EBITDA is based on existing stores and excludes projected earnings from future store openings. Forecast capital expenditure on new stores has been excluded from the cash flow projections.

A terminal growth rate of 8% has been used to calculate expected cash flows of Caffè Nero Gıda Ürünleri AS after 5 years. This assumption reflects current growth rates and inflation.

Sensitivity to changes in assumptions

With regard to the assessment of value-in-use, no reasonably possible change in any of the above key assumptions would cause the carrying value of the unit to materially exceed its recoverable amount.

Notes to the financial statements

at 31 May 2018

12. Non-current asset investments

	<i>Investment in joint ventures</i>	
	<i>2018</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>
<i>Group</i>		
Cost:		
At 1 June	6,014	3,073
Investments during the year	–	2,485
Share of profit for the year	639	456
At 31 May	<u>6,653</u>	<u>6,014</u>
		<i>Investment in subsidiary undertakings</i>
		<i>£000</i>
<i>Company</i>		
Cost at 31 May 2017 and 31 May 2018		<u>2,024</u>

In the opinion of the directors, the aggregate value of the investment in subsidiary undertakings is not less than the amount at which it is stated in the balance sheet.

The company holds all the equity share capital of Rome Bidco Limited, which is the parent company of Italian Coffee Holdings Ltd, which operates Italian style coffee houses. Italian Coffee Holdings Ltd holds all the equity share capital of Nero Holdings Limited, Harris and Hoole Limited, Caffè Nero Ireland Limited and Aroma Limited. Italian Coffee Holdings Ltd also holds all the equity share capital of Nero Coffee Roasting Limited, which roasts and packages coffee for the worldwide operations of the group. The results of these companies have been consolidated in these financial statements. All these companies are incorporated in England and Wales.

On 1 March 2007, Rome Bidco Limited acquired the entire share capital of Caffè Nero Investments Limited for £100. Caffè Nero Investments Limited is the holding company of Caffè Nero Ventures Limited, which is the management company of the group's overseas subsidiary Caffè Nero Gida Urunleri AS, joint venture Green Coffee Sp z.o.o, and franchises. The group holds 100% of the ordinary shares of Caffè Nero Gida Urunleri AS and 90.0% of Green Coffee Sp Z.o.o.

On 27 September 2012, the group acquired 58.46% of Green Coffee Sp Z.o.o. a company based in Warsaw, Poland and also acting as a coffee retailer. During the prior year, a further £2.5 million was invested bringing the group's stake to 90.0%. The company is accounting for this investment as a joint venture as unanimous shareholder votes are required for all key operating, Strategic and financial decisions and the definition of control has not been satisfied.

The group has a call option to acquire the remaining 10% of Green Coffee Sp Z.o.o. The holders of the remaining shares also have a put option to sell their remaining shares to the company.

The execution price of the above is dependent on company performance. The call and put options are accounted for at fair value through profit and loss, the call option is recognised as a financial asset (note 14) and the put option is recognised as a financial liability (note 16). On initial recognition, the options had a fair value of £290,280 and £494,200 respectively. The fair value of the options increased by £1.8m (2017 increase of £0.9m), which has been recognised in the statement of comprehensive income.

Notes to the financial statements

at 31 May 2018

12. Non-current asset investments (continued)

The share of the assets, liabilities, income and expenses of Green Coffee Sp. Z.o.o at 31 May 2018 are as follows:

	2018 £000	2017 £000
<i>Share of the joint venture's balance sheet:</i>		
Non-current assets	6,918	5,371
Current assets	1,435	1,309
Share of gross assets	8,353	6,680
Current liabilities	(2,674)	(1,742)
Non-current liabilities	(2,277)	(2,097)
Share of gross liabilities	(4,951)	(3,839)
Share of net assets	3,402	2,841

	2018 £000	2017 £000
<i>Share of the joint venture's results:</i>		
Revenue	17,361	12,248
Cost of sales	(10,715)	(7,805)
Administrative expenses	(5,717)	(3,735)
Finance costs	(129)	(126)
Profit before tax	800	582
Tax charge	(161)	(126)
Profit for the year	639	456

Details of group undertakings

All investments are held by subsidiary undertakings apart from a directly held investment in Rome Bidco Limited. Details of the investments in which the Group holds 20% or more of the nominal value of any class of share capital are as follows:

<i>Name of company</i>	<i>Proportion of voting rights and shares held</i>	<i>Nature of Business</i>
Rome Bidco Limited ⁽¹⁾	100%	Financing
Italian Coffee Holdings Ltd ⁽¹⁾	100%	Holding
Harris and Hoole Limited ⁽¹⁾	100%	Coffee retail
Nero Holdings Limited ⁽¹⁾	100%	Coffee retail
Aroma Limited ⁽¹⁾	100%	Coffee retail
Caffè Nero Ventures Limited ⁽¹⁾	100%	Holding
Caffè Nero Investments Limited ⁽¹⁾	100%	Holding
Nero Coffee Roasting Limited ⁽¹⁾	100%	Coffee Roasting
Caffè Nero Ireland Limited ⁽²⁾ (Incorporated in the Republic of Ireland)	100%	Coffee retail
Caffè Nero Americas Limited ⁽¹⁾	100%	Holding

Notes to the financial statements

at 31 May 2018

12. Non-current asset investments (continued)

(Incorporated in the United States)

Caffè Nero Gıda Urunleri AS ⁽⁴⁾ (Incorporated in Turkey)	100%	Coffee retail
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Joint ventures

Green Coffee Sp Z.o.o. ⁽⁵⁾ (Incorporated in Poland)	90.0%	Coffee retail
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Muffia Sp. z Z.o.o Sp.k (Incorporated in Poland)	30%	Food production
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All shareholdings are of ordinary equity shares.

⁽¹⁾ Registered address for subsidiaries is: 9-15 Neal Street, London, WC2H 9PW

⁽²⁾ Registered address for subsidiary is: 2nd Floor Beaux Lane House, Mercer Street Lower, and Dublin 2

⁽³⁾ Registered address for subsidiary is: 320 Congress St Fl 4, Boston, MA, 02210 United States

⁽⁴⁾ Registered address for subsidiary is: Büyükdere Cad. No: 103 Noramin İş Merkezi Maslak Şişli, İstanbul, Turkey

⁽⁵⁾ Registered address for subsidiary is: Al. Jana Pawła II 29, 00-867 Warszawa, NIP: 5262590815

⁽⁶⁾ Registered address for subsidiary is: Ul. Burakowska 11, 01-066 Warszawa, NIP 5272495260

13. Lease premiums

	<i>Lease premiums £000</i>
Cost:	
At 1 June 2017	5,459
Additions	–
At 31 May 2018	<u>5,459</u>
Amortisation:	
At 1 June 2017	4,817
Charge for the year	<u>130</u>
At 31 May 2018	<u>4,947</u>
Net book value:	
At 31 May 2018	<u>512</u>
At 1 June 2017	<u>642</u>
The net book value at 31 May 2018 is split as follows:	
Non-current assets	<u>344</u>
Current assets	<u>168</u>
The net book value at 31 May 2017 is split as follows:	
Non-current assets	<u>456</u>
Current assets	<u>186</u>

Lease premiums are depreciated over the lease term, which range from 6 to 20 years.

Notes to the financial statements

at 31 May 2018

14. Trade and other receivables

	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
	<i>2018</i>	<i>2018</i>	<i>2017</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
<i>Non-current:</i>				
Other debtors	165	–	103	–
Deposits and guarantees	–	–	71	–
	<u>165</u>	<u>–</u>	<u>174</u>	<u>–</u>
<i>Current:</i>				
Amounts due from related party	530	173,935	521	156,883
Amounts due from parent company	2,399	–	1,878	–
Tax and social security	–	–	1,338	–
Trade debtors	6,808	–	2,742	–
Prepayments	8,454	–	17,083	–
Corporation tax asset	–	–	5,874	–
Fair value of currency contract	174	–	–	–
Fair value of call option	1,445	–	96	–
	<u>19,810</u>	<u>173,935</u>	<u>29,532</u>	<u>156,883</u>

As at 31 May 2018 the ageing analysis of trade debtors due to third parties was as follows:

			<i>Past due not impaired</i>		
	<i>Neither past due nor impaired</i>		<i>< 30</i>	<i>30 – 60 days</i>	<i>> 60 days</i>
	<i>Total</i>		<i>< 30</i>	<i>30 – 60 days</i>	<i>> 60 days</i>
	<i>£000's</i>	<i>£000's</i>	<i>£000's</i>	<i>£000's</i>	<i>£000's</i>
2018	<u>6,808</u>	<u>5,433</u>	<u>953</u>	<u>16</u>	<u>406</u>
2017	<u>2,742</u>	<u>789</u>	<u>944</u>	<u>141</u>	<u>868</u>

15. Inventories

	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
	<i>2018</i>	<i>2018</i>	<i>2017</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Goods for resale	<u>4,204</u>	<u>–</u>	<u>5,135</u>	<u>–</u>

Notes to the financial statements

at 31 May 2018

16. Trade and other payables

	<i>Group</i>	<i>Company</i>	<i>Group</i>	<i>Company</i>
	<i>2018</i>	<i>2018</i>	<i>2017</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Trade payables	30,119	–	35,649	–
Amounts due to subsidiary undertaking	2	515	2	515
Foreign tax payable	66	–	108	–
Other creditors, including taxation and social security	11,469	–	9,508	–
Accruals and deferred income	19,178	–	23,494	–
Interest and fees accruals	84	–	107	–
Fair value of currency contracts	–	–	98	–
Fair value of put option	14	–	484	–
	<u>60,932</u>	<u>515</u>	<u>69,450</u>	<u>515</u>

17. Provisions

	<i>2018</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>
At 1 June 2017	374	109
Utilised in the year	–	(119)
Provided during the year	276	–
Acquired with subsidiary	–	384
At 31 May 2018	<u>650</u>	<u>374</u>

Provisions relate to onerous lease obligations where the group's lease commitments exceed anticipated future income. The provision is based on assumptions concerning income in future periods and the timing of cash flows is dependent on the remaining term of the leases, which is up to 15 years.

18. Other financial liabilities

Group

At 31 May 2018

	<i>Current</i>	<i>Non-current</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>
Interest bearing loans and borrowings:			
Term loan – Senior – £130m	–	127,984	127,984
Term loan – Revolver facility – £5m	1,000	–	1,000
Term loan – Capex facility – £10m	–	3,000	3,000
Mezzanine term loan – £182.5m	–	150,440	150,440
Rolled up interest – Mezzanine term loan	–	34,486	34,486
Loan from parent undertaking	98,450	–	98,450
Rolled up interest due to parent undertaking	153,743	–	153,743
Other bank loans	–	9,333	9,333
Total	<u>253,193</u>	<u>325,243</u>	<u>578,436</u>

Notes to the financial statements

at 31 May 2018

18. Other financial liabilities (continued)

Amounts disclosed above are net of issue costs.

At 31 May 2017

	Current £000	Non-current £000	Total £000
Interest bearing loans and borrowings:			
Term loan – Senior – £117m	–	114,189	114,189
Term loan – Revolver facility – £5m	2,500	–	2,500
Term loan – Capex facility – £13m	–	13,000	13,000
Mezzanine term loan – £153m	–	150,161	150,161
Rolled up interest – Mezzanine term loan	–	27,351	27,351
Loan from parent undertaking	98,450	–	98,450
Rolled up interest due to parent undertaking	136,691	–	136,691
Other bank loans	–	7,548	7,548
Total	237,641	312,249	549,890

Amounts disclosed above are net of issue costs.

Company

At 31 May 2018

	Current £000	Non-current £000	Total 2018 £000
Interest bearing loans and borrowings:			
Loan from parent undertaking	98,450	–	98,450
Rolled up interest due to parent undertaking	153,743	–	153,743
	252,193	–	252,193

At 31 May 2017

	Current £000	Non-current £000	Total 2017 £000
Interest bearing loans and borrowings:			
Loan from parent undertaking	98,450	–	98,450
Rolled up interest due to parent undertaking	136,691	–	136,391
	235,141	–	234,841

During the year the group refinanced its facilities, substantially reducing its cost of capital. Details of the new facilities are set out below.

The loans from the parent undertaking are repayable on demand. Interest is to be paid as agreed between the company and the parent company. Interest is currently agreed as payable semi-annually at 7.125%.

The group's immediate parent undertaking, Rome PIK Holdco Limited, has confirmed to the directors that it will not seek repayment of amounts owed until such time as the group is able to meet its liability. However, the loan is still classified as repayable on demand per the terms of the agreement.

Notes to the financial statements

at 31 May 2018

18. Other financial liabilities (continued)

Loan repayment dates

	£000	£000
	2018	2017
Senior (Interest charged at LIBOR* + 3.0% margin)		
30 September 2022	130,000	117,000
Mezzanine (Interest charged at LIBOR + 4.25% cash margin + 4.75% PIK margin**)		
30 September 2023	182,500	153,000
Revolving credit facility (Interest charged at LIBOR* + 3.0% margin)		
The facility expires on 30 September 2022	5,000	5,000
Capex facility (Interest charged at LIBOR* + 3.0% margin)		
30 September 2022	10,000	13,000

* where LIBOR means the British Bankers Association Interest Settlement Rate for Sterling.

**4.25% of the interest payable is settled by cash, 4.75% is rolled up into the carrying value of the loan.

The term loans were principally taken out to refinance the loans taken out to fund the acquisition of Italian Coffee Holdings Ltd) in 2007 (taking the business from listed on the London Stock Exchange into private ownership). During the year, the group refinanced its banking facilities to extend their maturity and reduce the overall cost of capital. A new £145m senior facility (of which £134.0m was drawn at year end) was put in place with reduced interest rates, which expires in September 2022. The rates associated with the £182.5m mezzanine facility were also improved, and the maturity date was extended to September 2023. The term loans are charged interest at the rates as set out in the table above.

In order to hedge exposure to interest rate risk, the group entered into an interest rate swap to fix the interest rate on £200.0 million of the term loans over a period of two years to February 2019. The group has further committed to a new interest rate swap agreement in the current year to fix the interest rate on £200.0 million which is due to commence in February 2019, for a period of 1 year to February 2020.

The loans are secured by a floating charge on the assets of the group. All loan repayments are to be made in the same currency in which the loan principal is denominated.

Finance costs in the prior year on the new facilities were £7.4m for Senior debt and £6.8m for Mezzanine debt. Additional finance costs associated with the re-financing of the loan in the prior year were £1.0m for Senior debt and £0.1m for Mezzanine debt. These finance costs are presented net of the underlying loan and are amortised over the duration of the facilities. Amortisation of £2.8m (2017 – £2.6m) was charged in the year.

Notes to the financial statements

at 31 May 2018

19. Financial instruments

The group and company's principal financial instruments comprise cash, interest bearing loans and amounts due to / from other group companies. Cash and cash equivalents are considered to be cash at bank, cash on short term money market deposits and cash at hand. The main purpose of the interest bearing loans is to raise finance for the group's operations and acquisitions. The group has various other financial instruments, such as trade payables, that arise directly from its operations. It is, and has been throughout the period under review, the group and company's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the group and company's use of financial instruments are interest rate risk, credit risk and liquidity risk. The Board reviews and agrees policies for managing exposure to each of these risks and these policies are summarised below.

Interest rate risk

The group borrows in Pound Sterling at floating rates of interest. Excess cash is placed on short term deposit for up to a week with Santander at variable money market rates. The group's policy is to keep approximately 66% of its borrowings at fixed interest rates. This is achieved by entering into interest rate swaps which are designated to hedge underlying debt obligations. The group classifies interest rate swaps as derivative financial instruments and measures them at fair value. These instruments do not qualify for hedge accounting.

Credit risk

The group monitors its exposure to credit risk through detailed checks on customers and regular review of outstanding receivables. The company mitigates its exposure by only lending to undertakings from the same group of which it is a member.

Investment Impairment risk

The directors understanding of the risks associated with the investments held by the entity relate to the potential impairment of those investments. To identify any risk of impairment in a timely manner, the company reviews the financial performance of its investments on a regular basis. To date, all investments have had a strong year and are not exhibiting indicators of impairment. This is expected to continue for the foreseeable future.

Liquidity risk

The group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans, other loans and facilities. The group regularly reviews its exposure and ensures funds are available as required.

The table below summarises the maturity profile of the group's financial liabilities at 31 May 2018 and 31 May 2017 based on contractual undiscounted payments.

Notes to the financial statements

at 31 May 2018

19. Financial instruments (continued)

As at 31 May 2018

Group

	<i>On Demand</i>	<i>Within 1 year</i>	<i>1-5 years</i>	<i>More than</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>5 years</i>	<i>£000</i>
				<i>£000</i>	
Trade and other payables	–	30,119	–	–	30,119
Mezzanine loan	–	–	–	182,500	182,500
Rolled up interest on mezzanine loan	–	–	–	66,948	66,948
Variable interest on mezzanine loan	–	9,018	–	43,808	52,826
Senior term loans	1,000	–	144,000	–	145,000
Variable interest on term loans	–	4,764	7,949	–	12,713
Loan from parent	98,450	–	–	–	98,450
 Rolled up interest on loan from parent	 153,743	 –	 –	 –	 153,743
Interest rate swap	372	–	–	–	372
Variable interest on swap facilities	–	1,029	770	–	1,799
Third party bank loans	–	–	–	–	–
	<u>253,565</u>	<u>44,930</u>	<u>152,719</u>	<u>293,256</u>	<u>744,470</u>

Company

	<i>On Demand</i>	<i>Within 1 year</i>	<i>1-5 years</i>	<i>More than</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>5 years</i>	<i>£000</i>
				<i>£000</i>	
Trade and other payables	–	515	–	–	515
Loan from parent	98,450	–	–	–	98,450
Rolled up interest on loan from parent	153,743	–	–	–	153,743
	<u>252,193</u>	<u>515</u>	<u>–</u>	<u>–</u>	<u>252,708</u>

Notes to the financial statements

at 31 May 2018

19. Financial instruments (continued)

As at 31 May 2017

Group

	On Demand £000	Within 1 year £000	1-5 years £000	More than 5 years £000	Total £000
Trade and other payables	–	35,649	–	–	35,649
Mezzanine loan	–	–	153,000	–	153,000
Rolled up interest on mezzanine loan	–	–	65,469	–	65,469
Variable interest on mezzanine loan	–	8,647	34,206	–	42,853
Senior term loans	2,500	–	130,000	–	132,500
Variable interest on senior loans	–	4,364	11,299	–	15,663
Loan from parent	98,450	–	–	–	98,450
Rolled up interest on loan from parent	136,691	–	–	–	136,691
Interest rate swap	–	–	1,433	–	1,433
Variable interest on swap facilities	–	871	651	–	1,522
Third party bank loans	–	–	7,548	–	7,548
	<u>237,641</u>	<u>49,531</u>	<u>403,606</u>	<u>–</u>	<u>690,778</u>

Company

	On Demand £000	Within 1 year £000	1-5 years £000	More than 5 years £000	Total £000
Trade and other payables	–	515	–	–	515
Loan from parent	98,450	–	–	–	98,450
Rolled up interest on loan from parent	136,691	–	–	–	136,691
	<u>235,141</u>	<u>515</u>	<u>–</u>	<u>–</u>	<u>235,656</u>

The table below sets-out the interest rate risk profile. Interest rates on variable rate loans have been based on LIBOR at the relevant balance sheet date. The PIK notes and Mezzanine loans accrue rolled-up interest, which is not payable until the maturity of the loan under the terms of the finance agreements. The Mezzanine loan also has a cash interest payable element. Future interest on the PIK and Mezzanine loans is charged on the unpaid interest element as well as the original capital amount. Interest will accrue on previously unpaid interest charges throughout the term of each agreement. Interest due on the senior loans is not rolled-up and is payable on a quarterly basis on contractual due dates. The contract maturity table assumes that interest will continue to be accrued until the termination date of each agreement.

Notes to the financial statements

at 31 May 2018

19. Financial instruments (continued)

Year ended 31 May 2018

<i>Company</i>	<i>On Demand</i>	<i>Within 1 year</i>	<i>1-5 years</i>	<i>More than</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>5 years</i>	<i>£000</i>
				<i>£000</i>	
Amounts due to subsidiary undertaking	–	515	–	–	515
Loan from Parent*	98,450	–	–	–	98,450
Rolled up Interest on Loan from Parent	153,743	–	–	–	153,743
	<u>252,193</u>	<u>515</u>	<u>–</u>	<u>–</u>	<u>252,708</u>

Year ended 31 May 2017

<i>Company</i>	<i>On Demand</i>	<i>Within 1 year</i>	<i>1-5 years</i>	<i>More than</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>5 years</i>	<i>£000</i>
				<i>£000</i>	
Amounts due to subsidiary undertaking	–	515	–	–	515
Loan from Parent*	98,450	–	–	–	98,450
Rolled up Interest on Loan from Parent	136,691	–	–	–	136,691
	<u>235,141</u>	<u>515</u>	<u>–</u>	<u>–</u>	<u>235,656</u>

* Carry fixed interest (in addition to interest rate swaps). All other loans carry interest at a floating rate.

Interest rate risk

Group

The floating rate financial liabilities bear interest at rates based on the percentages above LIBOR as set out in note 18.

Floating rate cash and deposits earn interest at rates linked to LIBOR.

Notes to the financial statements

at 31 May 2018

19. Financial instruments (continued)

The following table demonstrates the sensitivity, to a reasonably possible change in interest rates, with all other variables held constant, of the group's result before tax (through the impact on floating rate borrowings and financial assets).

	<i>Increase / decrease in basis points</i>	<i>Effect on result before tax £000</i>
Floating rate loans		
2018	+100	-1,217
	-100	+1,217
2017	+100	-1,129
	-100	+1,129
Financial assets		
2018	+100	+98
	-100	-98
2017	+100	+146
	-100	-146

Fair values of financial assets and liabilities

The book values of financial assets and liabilities of the group are set out below. The directors consider that there were no material differences between the book values and fair values at each year end.

	<i>2018 £000</i>	<i>2017 £000</i>
Investments	6,653	6,014
Other receivables	9,902	12,527
Cash at bank and in hand	11,596	14,583
Trade and other payables	(30,205)	(35,756)
Loans from parent undertaking	(252,193)	(235,141)
Current portion of third party long term borrowings	(1,000)	(2,500)
Long term third party borrowings	(325,243)	(312,249)
Interest rate swap	(372)	(1,433)
Call option	1,445	96
Put option	(14)	(484)
Fair value of currency contracts	174	(98)

Notes to the financial statements

at 31 May 2018

19. Financial instruments (continued)

Interest rate swaps

The group's interest rate swaps have a duration of two years and payments of interest under the hedge arrangements are due on the same dates as those on which the interest payments on the underlying borrowings fall due for payment. Payments and receipts under these interest rate swaps are recognised in the statement of comprehensive income when they become due and the interest rate swap is accounted for at fair value through the profit and loss. During the prior year the group committed to a new interest rate swap arrangement, which commenced in February 2017, when the previous swaps expired.

The overall fair value of its interest rate swaps increased by £1,061,000 to a total liability of £372,000 (2017 – liability of £1,433,000).

The table below summarises the details of the current interest rate swaps:

	<i>Principal amount</i> £000	<i>Termination date</i>	<i>Interest rate</i> %
Swap 1 (Lloyds)	40,000	28 February 2019	0.78%
Swap 2 (Santander)	80,000	28 February 2019	0.80%
Swap 3 (Rabobank)	40,000	28 February 2019	0.80%
Swap 4 (HSBC)	40,000	28 February 2019	0.79%
Total	200,000		0.79%

The table below summarises the details of the new interest rate swap agreements:

	<i>Principal amount</i> £000	<i>Termination date</i>	<i>Interest rate</i> %
Swap 5 (updated HSBC swap agreement)	40,000	28 February 2020	1.079%
Swap 6 (updated Santander swap agreement)	80,000	28 February 2020	1.055%
Swap 7 (updated Lloyds swap agreement)	40,000	28 February 2020	1.058%
Swap 8 (updated Rabobank swap agreement)	40,000	28 February 2020	1.070%
Total	200,000		1.0634%

Put and call options

The group has granted a put option to the minority shareholder of Green Coffee Sp Z.o.o. by which it can sell its shares to the group at certain multiples of EBITDA. The liability has been fair valued using the Black Scholes model. The group also has a call option whereby it can acquire the minority shareholder's remaining shares. This is also based on multiples of EBITDA. The asset has been fair valued using the Black Scholes method.

Fair value hierarchy

In accordance with IFRS 7 Financial Instruments: Disclosures, financial instruments which are carried at fair value in the balance sheet are analysed as level 1, 2, or 3. The company classified interest rate and exchange rate swaps as level 2 financial instruments (2017 – level 2) as their fair value is determined based on techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly. The call and put options and fair value of the international CGU

Notes to the financial statements

at 31 May 2018

19. Financial instruments (continued)

Fair value hierarchy (continued)

are classified as level 3 (2017 – level 3) financial instruments as their valuations are based on non-observable inputs.

Credit risk

Group

Aside from other cash at bank there are no other significant exposures to credit risk within the group. The maximum credit risk exposure relating to financial assets is represented by the carrying value at the balance sheet date.

Company

The company limits its exposure to credit risk by only lending to fellow group companies who are considered low risk due to the strength of the enlarged group of which the company is a member. The maximum credit risk exposure is represented by the carrying value of the amount due from the parent undertaking.

Borrowing facilities

The group has various borrowing facilities available. The undrawn committed facilities available at each relevant period or year-end were as follows:

	2018 £000	2017 £000
Expiring one to five years	11,000	2,500
Expiring after more than five years	–	–

Capital management

Capital comprises shareholders' equity and financing from third party loans and the company's parent undertakings. The primary objective of the company's capital management policy is to ensure that the company has adequate capital to support the business. The company monitors the cost of the various sources of capital on an ongoing basis and manages cost through planning future alternative sources of capital. No changes in these factors were made during the year. The company has no externally imposed capital restrictions.

During the year, a £145.0m senior facility (of which £134.0m was drawn at year end) was put in place with reduced interest rates, which expires in September 2022. The rates associated with the £182.5m mezzanine facility were also improved, and the maturity date was extended to September 2023. Full details of the facilities can be found in notes 18 and 19 of these accounts.

Notes to the financial statements

at 31 May 2018

20. Authorised and issued share capital

<i>Authorised</i>	<i>£1 Ordinary shares</i>	
	<i>No.</i>	<i>£</i>
£1 ordinary shares (At 31 May 2018 and 31 May 2017)	100	100

<i>Allotted, called up and fully paid</i>	<i>£1 Ordinary shares</i>	
	<i>No.</i>	<i>£</i>
£1 ordinary shares (At 31 May 2018 and 31 May 2017)	51	51

The company has one class of share with equal voting rights.

21. Contingent liability

Group

At the year-end there were no contingent liabilities (2017 – £nil).

A subsidiary of the group, Rome Bidco Limited, has guaranteed a loan of \$8.5m to its Turkish subsidiary, Caffè Nero Gıda Urunleri AS. Rome Bidco Limited has also guaranteed a loan of \$4.0m (2017 – \$1.2m) to Caffè Nero Americas Inc., a subsidiary of the group.

Company

The company and certain subsidiaries have provided an unlimited cross guarantee in favour of the group's bankers covering the term loans of Rome Bidco Limited. At 31 May 2018, these guarantees totalled £326.2 million (2017 – £312.9 million).

22. Capital commitments

At 31 May 2018, capital commitments contracted but not provided for in the financial statements were £0.6 million (2017 – £0.6 million).

23. Other financial commitments

The group has a number of lease agreements that, pursuant to their economic substance, qualify as non-cancellable operating lease agreements. These primarily relate to rents payable on land and buildings. The terms of the leases vary significantly but can broadly be summarised as follows:

Lease terms

Shop leases are typically between 10 and 15 years with rent reviews every 5 years.

Determination of rent payments

Rent payments are based on the amount specified in the agreement. The agreements are not terminated automatically after expiry of the lease term and in the majority of cases, there will be an opportunity to negotiate lease extensions with the lessor.

Notes to the financial statements

at 31 May 2018

23. Other financial commitments (continued)

Restrictions

There are no restrictions imposed upon the group concerning dividends, additional debt or further leasing under any of the existing lease arrangements.

Future minimum rentals payable under non-cancellable operating leases are as follows:

<i>Group</i>	<i>Land and buildings</i>	
	<i>2018</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>
Due:		
In less than one year	50,598	48,271
After one year but not more than five years	135,521	116,810
After five years	51,958	51,149
	<u>238,077</u>	<u>216,230</u>

Subleases

The group subleases areas of leased properties and receives sublease payments from third parties. Group companies other than the parent have sublet space in certain properties. These typically are flats on short term tenancies, other commercial lettings on periods of less than 5 years and shops on leases of up to 10 years. The future minimum sublease payments expected to be received under non-cancellable sublease agreements at 31 May 2018 is £0.6 million (2017 – £0.6 million)

24. Related party transactions

The group considers key management personnel to only include the directors of the group.

Group

The amounts outstanding between the group and other related parties at the year-end were as follows:

	<i>2018</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>
Amounts owed to Rome PIK Holdco Limited	(252,193)	(235,141)
Amounts owed by Rome Intermediate Holdings Limited	1,458	1,027
Amounts owed by The Nero Company.	941	850
Amounts owed to Saratoga Limited	(180)	(144)
Amounts owed to Cheyson Partners Limited - services	(180)	(126)

Company

The amounts outstanding between the Company and other related parties at the year-end were as follows:

	<i>2018</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>
Amounts owed to Rome PIK Holdco Limited	(252,193)	(235,141)
Amounts owed by Rome Bidco Limited	173,935	156,883
Amounts owed to Italian Coffee Holdings Ltd	(515)	(515)

Notes to the financial statements

at 31 May 2018

24. Related party transactions (continued)

Cheyson Partners Limited manages Paladin Partners 1, a 36% shareholder of the group.

The following transactions took place between the group and related parties during the year (the first two transactions are applicable to the company):

- Interest of £17.1m has accrued during the year (2017 – £15.9m) on the group's loan from its immediate parent undertaking Rome PIK Holdco Limited. The amount due to Rome PIK Holdco Limited at the year-end was £252.2m (2017 – £235.1m).
- Rome Bidco Limited has paid monitoring fees to Saratoga Limited and Cheyson Partners Limited. At 31 May 2018, the amounts paid during the year were £36,000 and £18,000 respectively (2017 – £36,000 and £18,000 respectively).

Transactions with key management personnel (comprising the directors) are disclosed below:

	<i>Group</i>	<i>Group</i>	<i>Company</i>	<i>Company</i>
	<i>2018</i>	<i>2017</i>	<i>2018</i>	<i>2017</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Short-term employee benefits	770	1,017	–	–
Post-employment benefits	20	20	–	–
	<u>790</u>	<u>1,037</u>	<u>–</u>	<u>–</u>

25. Ultimate parent undertaking

At the year end, the ownership structure is as follows:

Immediate parent undertaking	Rome PIK Holdco Limited
Parent company of the smallest and largest group for which accounts are prepared	The Nero Company ⁽¹⁾
Majority shareholder of The Nero Company	G W Ford ⁽²⁾

(1) The Nero Company is a company incorporated in Luxembourg. Copies of these group accounts can be obtained from Avenue 46a JF Kennedy, Luxembourg, and L-1855.

(2) G W Ford is the ultimate controlling party of the company.

26. Subsequent events

On 24 September 2018, Caffè Nero Ventures Limited acquired 11 stores in Sweden, with a view to converting these stores to the Caffè Nero brand over the course of the year.