

CAFFE NERO GROUP PLC

Placing of 18 million Ordinary Shares of 0.5p each at a price of 50p per share and Full Listing on the London Stock Exchange

KEY POINTS

- Caffè Nero, a leading Italian-style coffee bar operator, is floating on the London Stock Exchange following a Placing of shares by Collins Stewart
- The flotation has raised £9.0 million in new money to fund further expansion of the Group and puts a market capitalisation on Caffè Nero of £33.7 million
- Caffè Nero currently was founded in 1997. It is the UK's fourth largest branded coffee bar operator with a current total of 58 units across the UK and new units being opened at the rate of 3-4 per month
- The Group has established wide brand recognition and in the leading industry report (Allegra) has been named by consumers as best branded coffee bar operator in the UK
- Proceeds from the Placing will be used to accelerate the rate of opening with a initial target of 100 sites trading by May 2002

Gerry Ford, Chairman & Chief Executive, comments:

“Over the past four years, we have established a distinctive Italian brand that has proven the potential of the Caffè Nero format. With rapid growth in the UK branded coffee bar market, now is the time to capitalise on our success to date and use the proceeds of our flotation to accelerate our expansion plans.”

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Caffè Nero Group plc

**Placing of 18 million Ordinary Shares raising £9.0 million
Placing price of 50p per share values the Group at £33.7 million
Admission to the Official List**

Introduction

Caffè Nero is a leading operator of Italian-style coffee bars in the rapidly expanding UK gourmet coffee sector.

The Group was founded in 1997 when five sites were acquired by a syndicate of investors led by Paladin Associates Ltd, a venture capital company headed by Gerry Ford. The name Caffè Nero was retained from the original five sites but an entirely new brand was created centring around an authentic European coffee house concept and serving gourmet quality coffee and deli food products.

The brand has achieved widespread recognition. It has been named by consumers as the best of all the coffee bar brands in the UK in the Allegra report (source: Allegra I), the most comprehensive study of the UK coffee market to date, and is "overwhelmingly considered to be the industry experts preferred coffee concept" (source: Allegra II). Other acclaim of the Caffè Nero brand includes "best espresso this side of Milan" (Tatler), and "the traditional Italian cafe" (Egon Ronay) as well as being rated the best coffee house in London (The Observer).

There are currently 58 Caffè Neros and with its strongly differentiated brand, the Company is well positioned to take advantage of the UK's rapid gourmet coffee market expansion.

The market opportunity

In 1997, the UK had the lowest consumption of coffee in Europe with 2.4Kg of raw coffee consumed per capita per annum, in comparison to Germany (6.7Kg), Holland (9.0Kg) and Sweden (11.5Kg) (source: Allegra II). The market for gourmet coffee in the UK is now growing rapidly. The number of cups of espresso based coffee served in branded chains is expected to rise from 3.9 million cups in 2000 to 7.2 million cups by December 2003, a compound growth rate of 23 per cent. per annum (source: Allegra II). Many consumers have made a fundamental shift away from tea and instant coffee toward gourmet coffee, which is now seen as an affordable luxury. Along with these changes in taste, coffee bars have come to be seen as an attractive alternative to pubs and bars as places for meeting and socialising.

In August 1999, there were 577 branded coffee focussed bars from an estimated total coffee shop market of 6,028. This number of branded coffee focussed bars is expected to grow to 1,737 units by December 2003, representing a threefold increase in the market size. (source: Allegra II). The coffee market is therefore increasingly becoming a brand led business with branded coffee bars currently accounting for 13 per cent. of the total market (December 2000) and forecasted to grow to 20 per cent. of the total market by December 2003 (source: Allegra II).

There are a small number of branded coffee bar operators taking advantage of the growth in the sector and increasing their market share within it. Caffè Nero is one of these leading brands. Indeed it is one of two brands which has gained the most market share in the branded sector over the last twelve months (source: Allegra II). The Directors believe the reasons for such growth can be attributed to Caffè Nero being well differentiated as a European Styled (as opposed to American) coffee house. In short, the Directors believe the Caffè Nero brand is well positioned and sufficiently differentiated from competitors to take advantage of this significant market opportunity.

The Caffè Nero brand

The Caffè Nero brand has been ranked the best espresso bar brand in the UK (source: Allegra I). In creating the Caffè Nero brand, careful attention has been given to establishing and sustaining a distinctive brand identity which is capable of achieving both profitability and nationwide recognition and presence (Caffè Nero won the top brand award for Corporate Brand Identity in 1999 from the Design Business Association). The Caffè Nero brand is based on four main strengths:

- premium espresso based coffees;
- high quality and varied Italian based food menu that changes throughout the day;
- continental style atmosphere and gathering point rather than a fast food experience; and
- high level of personal service and attention.

The Company also has two additional strengths:

- site selection judgement; and
- experienced management.

Coffee

The Company places great emphasis on supplying a high quality range of espresso based coffees. Caffè Nero uses a unique Italian blend which contrasts with the generally milkier and weaker coffees served by American styled coffee bars. Caffè Nero's blend of coffee is roasted to precise specifications and is exclusive to the Company. Its coffee has won widespread praise suggesting that Caffè Nero is a leading operator in the premium coffee market including "the perfect cappuccino" (Sunday Mirror), "winner of the best latte competition" (Observer) and "the best espresso this side of Milan" (Tatler).

Food

Caffè Nero provides a high quality food offering which is based around typical Italian foods such as gourmet sandwiches, pastas and cakes. The aim of the food offering is to progress through the day with the customers. In the mornings, customers are offered muffins together with a wide range of pastries. For lunch there are sandwiches, salads and pastas and throughout the afternoon there are cakes and biscotti. The majority of the food is made exclusively for Caffè Nero to its own specification. Food sales account for approximately thirty five per cent. of the Group's turnover.

Atmosphere

Caffè Nero aims to create a relaxed continental atmosphere providing a place to meet rather than a fast food experience. The Company's success in achieving this has been shown by it being voted best of the branded coffee bar groups for atmosphere in the Allegra I survey.

Caffè Nero designs and operates its cafes to fit with local customers. The decor and furnishings draw on contemporary Italian styled themes and the emphasis has been on achieving strong branding without absolute uniformity or blandness. In high "foot-flow" office locations, the decor is dominated by high stools and tiled floors to reflect customers' desire for a quick takeaway or a short stay. In residential areas, sofas and armchairs, newspapers and books are provided to create a gathering point. Other locations have power points and desks for students to use. Opening times are also adapted to meet customer demand, for example the cafe in Frith Street in London's Soho area remains open until 4am at weekends.

This attention to detail creates a welcoming and attractive environment which becomes a gathering point for local residents, shoppers and workers in the vicinity. This drives an average spend per head of 250p to 300p which is higher than the average spend for this market.

Service

The Company aims to provide an efficient and friendly service. To build on its relaxed atmosphere, customers are served by one barista throughout the transaction rather than passed around several points of contact. Staff are encouraged to talk to customers and to learn the orders of regular customers.

This service is backed by an extensive training programme which involves an intensive period of coffee and customer service training at the Company's training centre followed by one week of on site training. Managers must undergo a seven week training programme before they are allowed to take over a unit.

Sites and site selection

The Company intends to use all of the net proceeds of the Placing to accelerate its opening programme. Caffè Nero units are typically located in high-traffic, high visibility locations to achieve a high level of "foot-flow". The Directors do not believe site procurement to be a restriction on growth as many sites are being made available as part of the restructuring of the high street, with several chains selling large numbers of shops. Sites are chosen on a number of factors, particularly visibility, size, ambience, competition, rent and premium. The Company envisages such expansion will follow a clustering strategy in order to benefit from the efficiencies in distribution and field management. Size requirements vary with location; in the City of London the minimum requirement is approximately 600 sq. ft. but in residential or shopping locations sites are likely to be between approximately 800 and 1,500 sq. ft. Sites which have character and high ceilings, particularly corner sites, add to the continental meeting point atmosphere which is a key differentiation from competitors.

Caffè Nero is a growing brand within the speciality coffee bar market. The Company opened 28 units in 2000 and is currently growing at a rate of 3 to 4 units per month. The Directors believe that there continues to be considerable demand to be satisfied in the market and therefore intends to continue a rapid roll-out programme. Caffè Nero's main focus will be out of London where the branded market segment is growing by a compounded 38 per cent. per annum, double the rate of London, and this segment is expected to reach 1,332 units by 2002 (source: Allegra II). To date, Caffè Nero has opened 53 coffee bars and has signed leases on a further 5 sites (of which 4 are under construction) giving it a total of 58 units in 21 cities throughout the UK.

Directors, senior management and employees

The Board

Dr Gerry Ford, Chairman and Chief Executive (aged 42)

Dr Ford is the driving force behind Caffè Nero and first developed the European coffee house concept in 1996. His concept was applied to the original five Caffè Nero units, which began trading in May 1997 and the brand has been subsequently rolled-out throughout the UK. Dr Ford oversees the general management, strategy, growth and branding. Dr Ford has a BA from Stanford, a MBA from INSEAD and a PhD from Oxford. He began his career at Hewlett-Packard, then spent 3 years with the international venture capital firm APAX Partners where he helped develop a series of small businesses. Subsequently he headed several small and medium sized companies in the food and consumer goods sector. In 1991 he co-founded Paladin Associates, a venture capital group which both invests in and manages food, consumer brands and media businesses.

Christian Reeve, Managing Director (aged 39)

Mr Reeve oversees the day to day operations. Mr Reeve has an economics degree from Cardiff and an MSc in Marketing Management. He has extensive experience having spent the past 16 years working within the branded retail leisure sector. Past appointments included 5 years at JD Wetherspoon plc, where he worked both as director of human resources and director of retail. More recently, Mr Reeve has been responsible for all branded retailing at Wolverhampton and Dudley plc as director of retail concepts and managing director of Pitcher & Piano. Mr Reeve joined the Company in September 2000.

Ben Price, Finance Director (aged 33)

Mr Price oversees all financial aspects of the Company as well as site acquisitions. Mr Price has a physics degree from Oxford and qualified as an accountant with Ernst & Young, where he worked for 5 years in the audit practice. Since then he has had 7 years of senior finance management experience in the retail sector. For 3 years he was at Dixons plc, where he became one of the senior finance managers reporting directly to the group finance director. He then served as the finance controller of a furniture retailer before joining Caffè Nero in June 1997 as part of Dr Ford's original management team.

John Barnes, Non-executive Director (aged 51)

Mr Barnes has over 30 years management experience in consumer orientated business with particular emphasis on the establishment, marketing and retailing of brand names. He was a brand manager with Procter & Gamble lid and later became director of marketing and franchise services for Pepsico Europe. In the early 1980s he was appointed as managing director of Kentucky Fried Chicken Ltd and thereafter became managing director of the UK rental and retail division of Thorn EMI plc. Mr Barnes was the founder chairman and chief executive of a start up company which acquired the one Harry Ramsden's restaurant in Guiseley, Yorkshire in 1988. He led the company through 10 years of brand expansion in the UK and internationally before floating it on the London Stock Exchange in 1989. The company was then acquired by

Granada Compass in November 1999. Mr Barnes' other non-executive directorships include Yates Group plc, Arena leisure plc and Galaxy Radio 105 FM. Mr Barnes joined the Board in January 2001 and is a member of both the audit and remuneration committees.

David King, Non-executive Director (aged 50)

Mr King is currently the chairman and chief executive of Interior Services Group plc "Interior" the occupancy specialist firm he founded, as Stanhope Interior, in 1989. In 1995, when Stanhope Properties was acquired by British land Plc, Mr King led a management buyout of Stanhope Interior. In January 1998 the company bought Exterior Construction Management limited, to enable them to meet the demand from owner occupiers to provide an integrated solution for their combined construction and fit-out requirements. Interior expanded its customer base, turnover and the value of work performed year on year and was subsequently floated on the Alternative Investment Market in June 1998 on the basis of its strategy to develop through acquisitions into an occupancy support services business. Following the formation in 1999 of its facilities management business, Eurica Limited, Interior now employs over 500 fee earning staff and reported turnover of £252 million for the year ended 30 June 2000. Mr King joined the Board in February 2001 and is a member of both the audit and remuneration committees.

Competition

The Company operates in a highly fragmented market and hence has many competitors. There are numerous coffee shop operators throughout the United Kingdom, the majority of which are independent enterprises. However, branded coffee bar operators are rapidly increasing their market share at the expense of independent operators. A small number of companies have significant market presence in the branded coffee market. Caffè Nero is one of the fastest growing brands having increased its market share from 3 per cent. in August 1999 to 5.4 per cent. in December 2000 (source: Allegra II).

The barriers to entry in the speciality coffee shop market are high. Small operators suffer from a lack of capital to acquire premium sites and to establish the required operations infrastructure for a roll-out programme. As brand recognition is becoming an increasingly important factor in customer choice, the small independent operators are being put at an even greater disadvantage.

Strategy

The Company intends to continue to build on its position as one of the leading coffee bar brands in the UK by expanding the number of Caffè Nero outlets both in London and throughout the UK. Caffè Nero intends to develop its concept in most large cities, regional towns and university centres in the UK and already operates in 21 such cities.

Fundamental to the Company's expansion program is the continued promotion of the Caffè Nero brand as the leading Italian styled coffee bar with a relaxed continental atmosphere and a high quality product and service offering.

Financial information

The trading record of the Company, which is extracted without adjustment from the Accountants' Report set out in Part II, is summarised below. Investors should read the document as a whole and not rely solely on the key or summarised information in this section.

	Years ended 31May			Six
	Period			months to
	ended			30
	31 May			November
	1998	1999	2000	2000
	£'000	£'000	£'000	£'000
Number of units	5	13	30	41
Turnover	2,101	2,870	6,747	6,754
Gross Profit (Store contribution)	561	601	1,146	1,088
EBITDA	243	(90)	(219)	11
Operating Loss	(209)	(629)	(990)	(598)
Loss on ordinary activities before taxation	(488)	(963)	(1,371)	(868)

The Group commenced trading on 27 May 1997 and the above trading record illustrates the impact of the Company's expansion from 5 units for the period ended 31 May 1998 to 41 units for the six months to 30 November 2000. Turnover grew at an average compound rate of 80 per cent. over the three financial years shown and became profitable at the EBITDA level for the six months to 30 November 2000.

Current trading

The Company's turnover and gross profits are growing significantly as new units are opened. For the six months to 30 November 2000, turnover increased to £6,754,000, which is greater than the turnover achieved for the twelve months to 31 May 2000 (£6,747,000). Like for like store sales were 12 per cent. higher overall, and 18 per cent. higher for those stores opened after May 1997. Gross profit for the six months to 30 November 2000 also rose to £1,088,000, reflecting a similar level to that achieved for the twelve months ended 31 May 2000 (£1,146,000).

While Caffè Nero is profitable at the EBITDA level in the six months to 30 November 2000, the costs of opening new stores, the depreciation charge thereon, and the infrastructure requirements to allow the Company to grow, mean that the Company is not currently generating profit at the operating level. The Directors believe that the results for the six months to 30 November 2000 reflect the increasing popularity of the Caffè Nero brand and justify the Company's roll-out programme. With the implementation of the Company's intended roll-out programme and the results achieved by the Company's established outlets, the Directors remain confident of the underlying profitability of the Caffè Nero brand and its growth potential in the market.

Reasons for the flotation and use of proceeds

The Directors consider that the Admission of the Company's shares to the London Stock Exchange will be an important step in its development and will enhance its standing within the market place. The funds raised will enable the Company to take advantage of its strong brand position within the rapidly growing gourmet coffee sector by allowing the Company to expand further.

In particular, the Company intends to apply the net proceeds of the Placing of £7.55 million to acquire and develop new sites.

Future prospects

The Directors believe that Caffè Nero's brand and product offering will be well placed to take advantage of the anticipated rapid growth in the UK gourmet coffee market and look forward to the future and the roll out of the brand with confidence.

Details of the Placing

18 million New Ordinary Shares are being made available at the Placing Price to institutional and other investors. The New Ordinary Shares will raise approximately £7.55 million net and will represent 26.7% per cent. of the enlarged issued share capital following the Placing.

The Placing has been fully underwritten by Collins Stewart and is conditional upon Admission becoming effective by not later than 23 March 2001 (or such later date as Collins Stewart may agree not being later than 31 March 2001) and the Placing Agreement becoming unconditional in all respects.