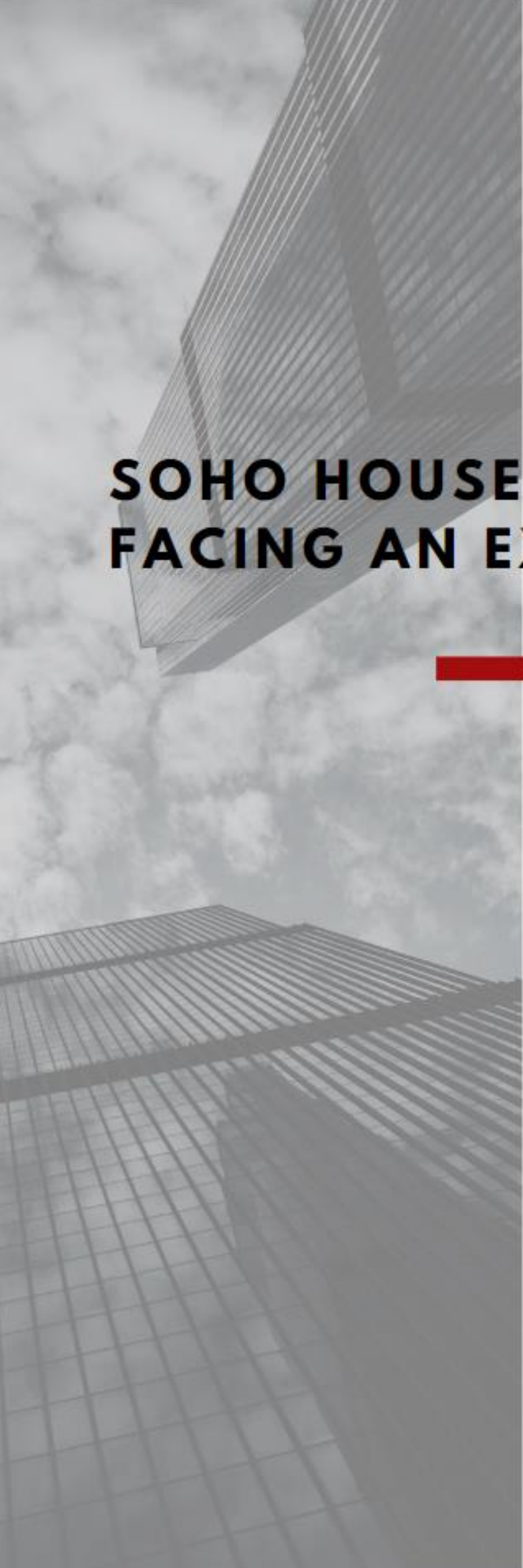

SOHO HOUSE & CO: A COMPANY FACING AN EXISTENTIAL CRISIS

NYSE:SHCO

GLASSHOUSE RESEARCH

SOHO HOUSE & CO, INC.

NYSE: SHCO

SUMMARY

Initiation of Soho House & Co with a target price of $0.

Soho House, a company with a broken business model and terrible accounting, faces material headwinds regarding its future viability as a public company.

SHCO's persistent lack of profits and rising debt levels puts the company in a precarious situation where they will need to continue to dump shares on investors as time goes on.

REPORT DATE
02/07/24

SHARE PRICE
$6.18

AVG DAILY VOLUME
157,375

MARKET CAP
$1.21 BILLION

SHORT INTEREST (% OF FLOAT)
5.80%

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SH CO

We believe Soho House & Co (SHCO) is a zero. Released in a public offering in 2021 under its previous name, Membership Collective Group, we believe this company, which was never profitable in its 28-year history, went public to dump on retail investors, all while its debt surged to insurmountable levels. Eerily similar to WeWork's public offering, we believe SHCO will eventually meet the same fate as the now defunct co-working space.

Our bearish take on Soho House begins with a critical examination of the company's purportedly broken business model, raising concerns about its path to profitability and the sustainability of its growth strategy. Despite its once esteemed position in the luxury hospitality sector, this analysis aims to shed light on multifaceted issues, including the need to expand into less affluent cities for revenue growth, the persistent lack of profitability, overcrowding, a perceived decline in service quality, rising debt levels, our suspicions surrounding the company's accounting practices and critical comments made by both the SEC and its auditors regarding the company's financials.

Broken Business Model and Expansion into Less Affluent Cities:

Soho House's ambitious growth strategy, including plans to expand into less affluent cities, is working against the company as it loses its exclusive appeal. The pursuit of revenue growth through expansion in less economically prosperous locations poses a fundamental challenge to the brand's upscale identity. Our analysis will explore how venturing into less affluent cities may strain the delicate balance between brand exclusivity and market accessibility.

Persistent non-profitability in Soho House's financial history remains a significant concern. Despite its premium positioning and continuous expansion efforts, the company has struggled to demonstrate sustained profitability. The absence of GAAP profits raises questions about the effectiveness of the company's cost structure, pricing strategy and overall financial management.

If this company could not successfully produce a profit in cities like London, New York, and Miami, how does it expect to earn one in less affluent ones such as Portland and Sao Paulo?

Overcrowding Concerns and A Decline in Service Quality:

Th rapid expansion of Soho House's membership base and global footprint raises worries about the potential dilution of the exclusive experience. Several member interviews shed light on how overcrowding decreases member satisfaction, potentially eroding the unique ambiance that was once a hallmark of Soho House.

Members also raised concerns about a decline in service quality at Soho House properties. Reports suggest that rapid member expansion may be stretching the company's operational capabilities thin, leading to longer wait times, reduced personalized attention and an overall diminishing standard of service. As a result, the company recently halted new memberships at some of its prime locations.

Questionable Accounting Practices:

Soho House went public in 2021, listed as an "emerging growth company" under the JOBS Act. As such, the company was able to produce lenient financials in certain areas. We believe the relaxed focus surrounding SHCO's accounting led to many of the grievances listed in our report, centered around the following tenets:

- A pull forward of millions of dollars of revenue through their new membership credits program introduced in 2022.

- Near 50% YOY rises in both inventories and receivables are extremely high for a company whose revenue has only increased by 13% during the same timeframe.

- Recent spikes in prepayments and 100-year useful lives on its buildings suggest delayed expense recognition that we believe artificially aided earnings metrics.

- A lack of an opinion on internal controls by its auditor and one of the worst correspondence letters we have read from the SEC suggest dismal accounting practices.

Rising Debt Levels:

The financing required for Soho House's aggressive expansion strategy has led to substantial debt accumulation, raising questions about the company's ability to service and manage its debt obligations effectively.

Broken Business Model Turns to Public Investors for Money

A deep dive into Soho House's metrics (SHCO) paints a sobering picture of a company seemingly hurtling toward financial ruin. The looming specter of eventual bankruptcy casts a shadow as we uncover the intricacies of Soho House's business model. While the allure of exclusivity and luxury has been the cornerstone of its success, we posit that there are inherent limitations to how much revenue the company can continue to extract from its existing members or per house.

In the public market, where a "grow or die" mantra echoes relentlessly, Soho House finds itself ensnared in the paradoxical demand for rapid expansion. Going public in 2021 was, in part, a strategic move to tap into the financial resources of public investors, a lifeline to fuel its aggressive growth aspirations and to aid in debt service. However, this strategy teeters on a precarious edge. The necessity to impress public investors by adding new members and houses is inadvertently taking a toll on the very brand and service quality that defines Soho House's essence.

When the company IPO'd in 2021, it had grand endeavors of opening eight to 10 new houses yearly, with a target of 85 houses by the end of 2027.[1] SHCO also targeted average revenues of $20 million to $30 million per house according to the firm's S-1 filing. However, this rapid growth appears to have stalled.

Management appears to have lowered its opening guidance during each conference call since 2022. On the Q3 2022 earnings call, management lowered its goals to five to seven new houses per year. In more recent calls, it does not disclose new house targets at all. Furthermore, SHCO has shuttered new membership in many of its key cities as the company deals with overcrowding.[2]

The recent actions (or lack thereof) by the company underscore this struggle, revealing the cracks in its once-pristine facade. As the brand extends its reach into less affluent cities, the question of how much revenue per house it can realistically generate becomes increasingly pertinent. The fear, we opine, is that Soho House's quest for growth may lead it to an inevitable ceiling in revenue per house, jeopardizing the delicate equilibrium that has been fundamental to its allure. The challenging road ahead raises critical questions about the sustainability of Soho House's growth-centric approach and the potential ramifications it may inflict on the company's financial health and overall standing in the luxury hospitality arena.

[1] Stated in Q2 2021 earnings call.

[2]

Membership Numbers Hit a Ceiling:

Rapid expansion into new territories and cities, coupled with an ambitious growth strategy, have resulted in a new challenge – the potential saturation of available square footage. Let's break down the numbers and explore how the company's expansion endeavors could jeopardize the very essence that made Soho House a sought-after destination.

Soho House's membership key performance indicators (KPIs) as of Q3 2023:

- 42 total Soho Houses
- 184,542 Soho House Members
- 70,710 Other Members[3]
- 255,363 Total Members
- 9,100 Members of Cities without Houses

Breaking this down by Soho House member (total members) per house, this puts the company at 4,393 Soho members (6,077 total members[4]) per house. Historical data from 2019 reveals there is a limit to members in a space, with a cap of approximately 4,600 members per house (see Chart 1, Page 7). This figure doesn't include the recent influx of Other Members that were which have access to the houses (Soho Friends, Soho Works, and Soho Members w/o Cities). According to the Soho bylaws, members are allowed to bring up to three guests during each visit, further exacerbating the overcrowding issue.

The largest YOY influx of new members came in 2022, with 39,168 new Soho House Members, 31,826 Other Members and 2,148 Cities without Houses Members for a total of 73,142 new total members.

Since then, new YOY memberships have decelerated to 32,524 new Soho House Members, 11,524 Other Members and 2,700 Cities w/o Houses Members in the TTM period (46,766 new total members in Q3 2023).

In a November 2023 letter to members, Founder Nick Jones stated the following about the influx of new members:

> I've been talking to our members and the teams in all our houses, which I've really valued. We continue to be very focused on improving service, as well as making sure our houses don't feel too busy.[5]

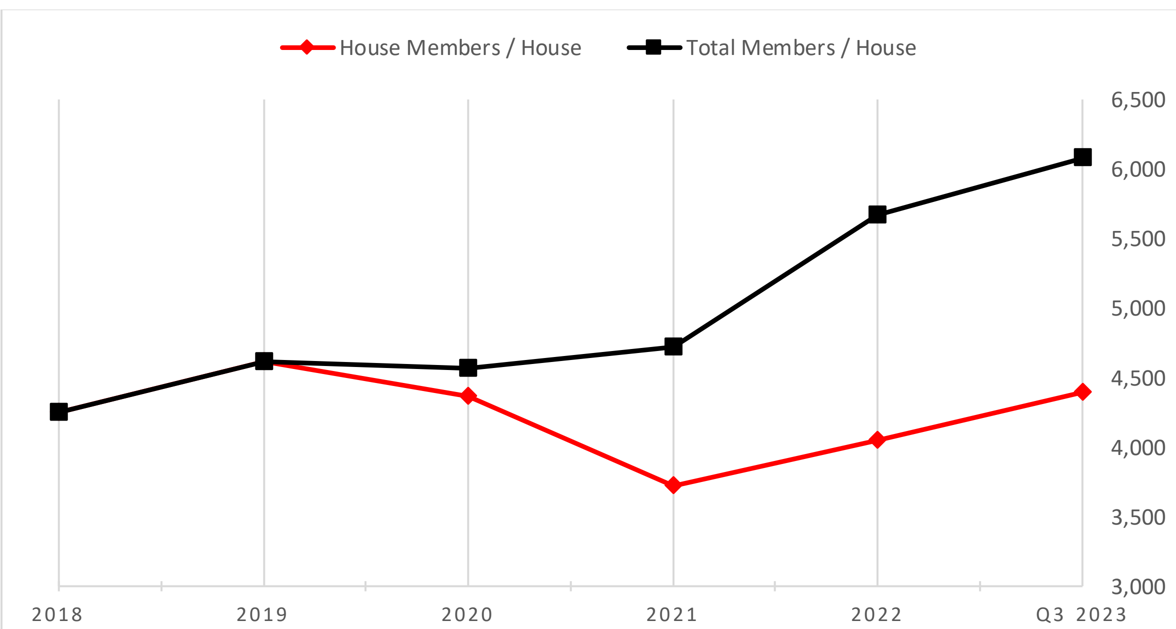
[3] Other Members include Soho Friends, Soho Works and Soho Home+.
[4] Total members include Soho House Members + Other Members
[5]

Jones' sentiment corroborates our suspicions of overcrowding.

In-house revenues also appear to have hit a ceiling of $3,000 per house member (see Chart 2, Page 8). In the latest TTM period, this metric fell to $2,756 per Soho House Member. Soho House appears to have tried to make up for this Food & Beverage maximum by increasing its membership cost. In the most recent TTM, membership revenue reached an all-time high of $1,979 per Soho House member, up from $1,916 and $1,601 at the end of 2022 and 2021, respectively.

In terms of revenue per house, there appears to be a cap of $20 million per house in both membership and in-house revenue. This is on the lower end of management's projected $20 million to $30 million of revenue per house detailed in its IPO filings. Specifically, Total revenue per house (which includes membership and in-house revenue) came in at $20.0 million in the latest TTM. However, this figure is not much higher than the reported numbers in 2019 and 2018 (see Chart 3, Page 8). This leads us to believe there is a hard limit on how much SHCO can charge its members before they reduce spending in other areas like in-house charges.

Chart 1: Annual Membership per House Metrics[6]



[6] COVID impacted 2020 and 2021 data.

Chart 2: Annual Revenue per Member Metrics[7]

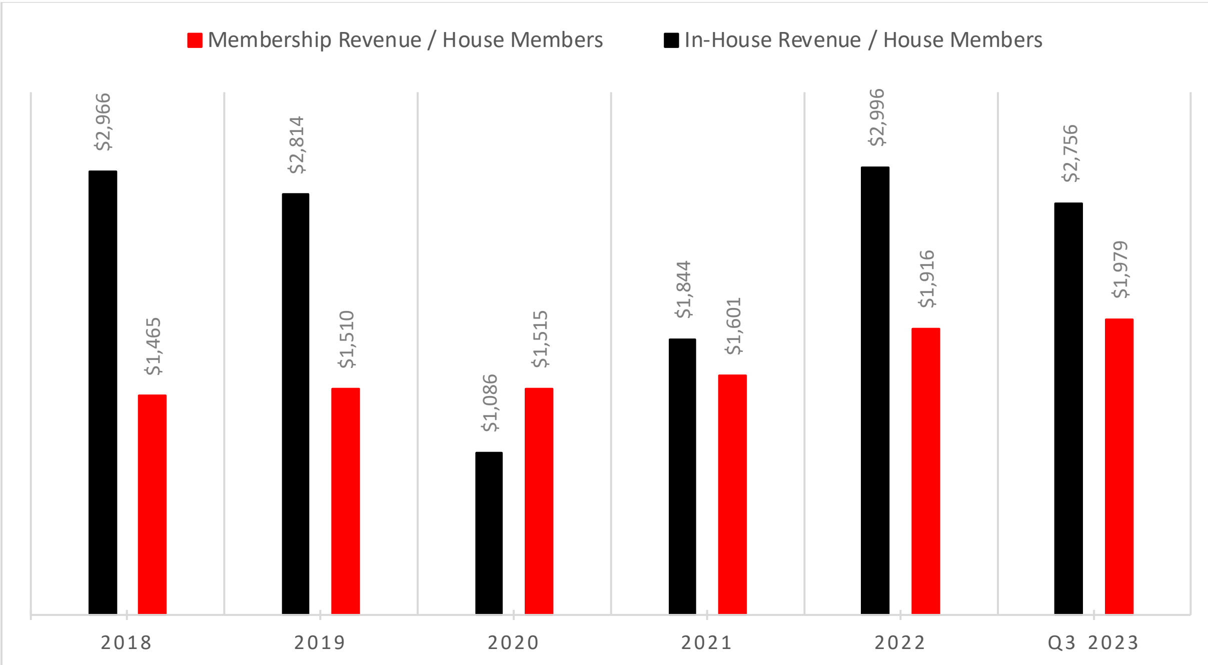
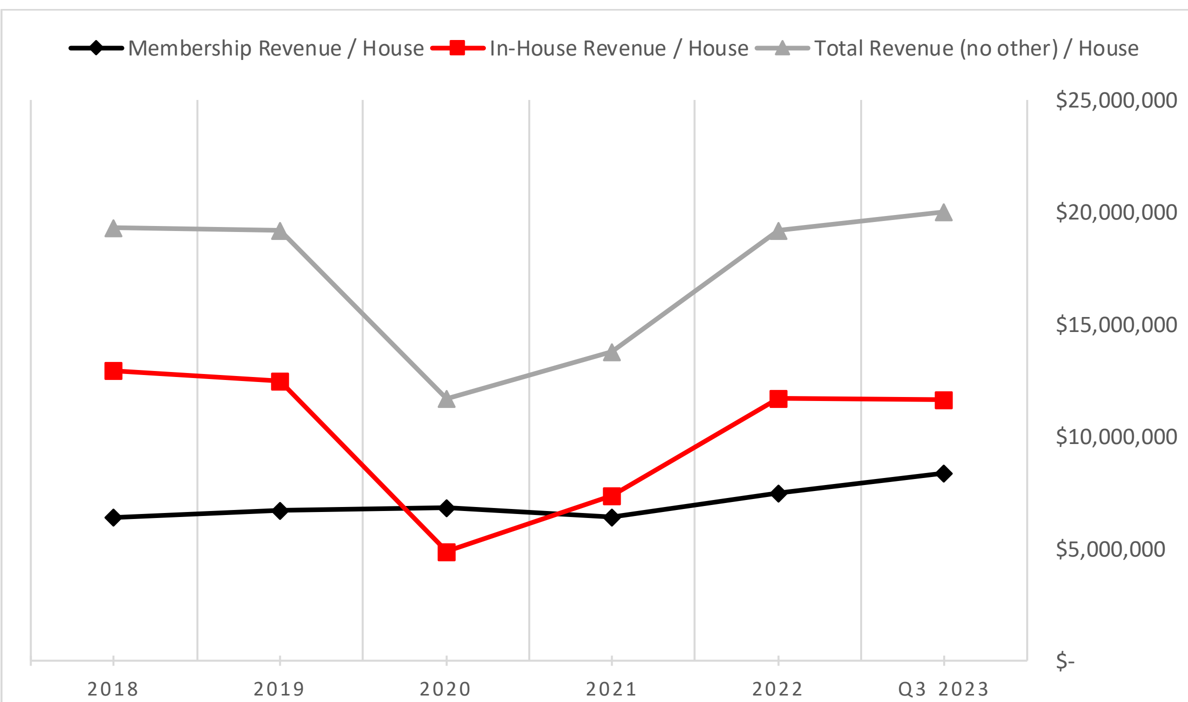


Chart 3: Annual Revenue per House Metrics[8]



[7] COVID impacted 2020 and 2021 data.
[8] COVID impacted 2020 and 2021 data.

Retention Rates Take a Turn for the Worse:

With the influx of new members and increase in membership price, it appears that cancellation rates have increased over the past year. On previous conference calls, management has been quick to disclose its strong retention figures near 95% in 2021 and 2022. For example, in SHCO's earnings presentations, the company disclosed retention rates on its "Key Highlights" slide up until Q3 2022.

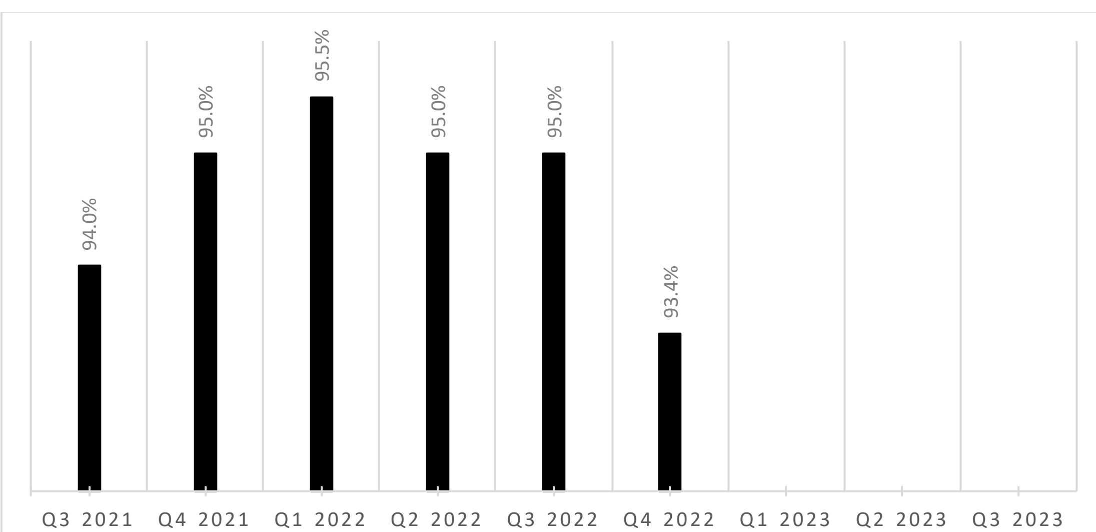
Although the retention rate was removed from the slide deck and not discussed on the call, the company's Q4 2022 Press Release stated, "Soho House member retention was 93.4% in 2022 versus the five-year average of 94%." This drop off in retention rates coincides with the massive influx of new members discussed in the prior section. Even more concerning, since this disclosure of reduced retention rates in Q4 2022, SHCO has removed numerical references of retention rates in all earnings calls, releases, and presentations.

However, Chief Financial Officer, Thomas Allen, discussed prior retention numbers on the latest call, but evaded any recent numerical figures:

> So in 2021, we had 95% retention or is the highest level that we've been at in the prior seven years. In 2022, it dropped a bit to 93.4%. '21, we benefited from – members were just coming back post COVID. So they were less likely to leave.

The lack of given retention rate after being a staple of the company's presentations since its IPO is troublesome to say the least.

Chart 4: Soho House TTM Retention Data Metrics



Demographics and Location Working Against SHCO:

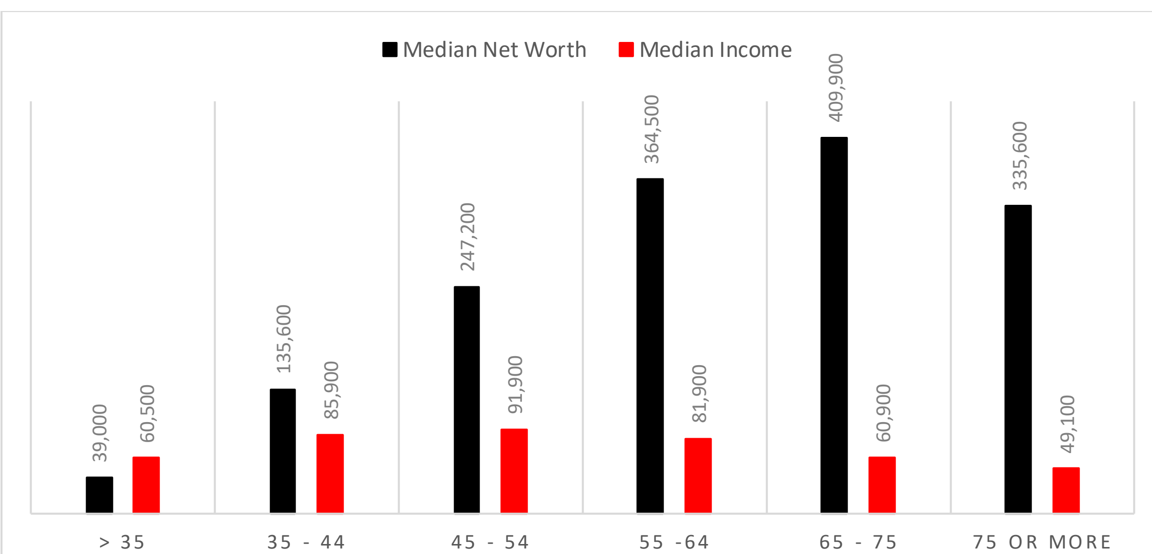
So, what's the problem? Can't Soho House just expand to other cities for growth rather than focus on its current houses? Herein lies another issue with SHCO's business model.

The company has existing houses in many of the most affluent cities globally. Disposable income for the 20 to 35 age group is already hard to come by. As SHCO expands to less affluent cities like Portland and Sao Paulo, it should expect less revenue per house.

In the U.S., it is no secret that those under 35 don't possess much wealth. But a quick glance at the Federal Reserve's 2023 Survey of Consumer Finances paints a bleaker picture than one might expect. The median net worth of an individual who belongs to the 35-and-under age group (SCHO's target market) is just $39,000; older age groups have median numbers well into the six figures (see Chart 5, below). Therefore, we predict a major roadblock to SHCO's expansion plans (and we're not even taking into account the increased membership rates).

Income by age is another factor working against SHCO's business model. The under-35 age group has one of the lowest metrics reported at a mere $60,500 median income per year. It's clear that Soho House's ambitious expansion plans and elevated membership rates pose a significant hurdle for a target market with the least disposable income. By comparison, private country clubs target the highest net worth demographic and purposefully try not to scale.

Chart 5: United States Wealth & Income Distribution by Age[9]



[9] https://www.federalreserve.gov/publications/files/scf23.pdf

Venturing into less economically viable cities could also undermine the company's financial health.

SHCO collects its highest membership fees in London, New York, Chicago, and Los Angeles, representing four of the top 10 wealthiest cities in the world.[10] Although it has never been profitable throughout its 28-year history. We believe that moving into less wealthy cities will only make things worse.

In Q4 2023, the company plans to open new houses in Mexico City, Sao Paulo, and Portland. However, none of the cities even break the top 100 of wealthiest cities worldwide. We predict SHCO will be unable to maintain its $20 million to $30 million revenue target in these less affluent cities.

<u>**Service is Deteriorating at Soho Houses:**</u>

In interviews conducted by GlassHouse, many former members reported they left Soho House due to declining service and overcrowding.

> It was always too crowded, more than we were led to believe — it didn't feel exclusive at all. For all their talk about being so selective, it never felt that way. My friend who is still a member says it's even worse now.
>
> \- Former Soho House Member

This is just one of many comments of parroting the same outlook. In a November 2023 letter to members, former CEO Nick Jones corroborated the sentiment by halting new memberships in its flagship cities.[11]

> When I went there, it didn't have the right feel anymore. It has always been a creative, friendly place with a relaxed feel. If there are too many corporate types around, then that atmosphere doesn't occur.

Herein lies the problem with SHCO's business model – its main customers do not have disposable income like "corporate types" do. If the company lets in too many members, then the brand hurts, service declines and retention rates eventually drop. If it expands into more cities, the pool of wealthy 20 to 35-year-olds decreases. Seems like a broken business model to us.

[10] https://www.henleyglobal.com/publications/wealthiest-cities
[11] https://ca.finance.yahoo.com/news/soho-house-shuts-members-following-195526132.html

We Believe SHCO Will Seldom Report GAAP Profitable Metrics:

Based on the company's S-1 filing, SHCO has never been profitable in its 28-year history. The firm loves to tout its increasing "Adjusted EBITDA" metric that has been improving over the last three years. The Adjusted EBITDA excludes massive amounts of depreciation/amortization and interest expenses, but also adds back items such as stock-based compensation, operational reorganization, and other costs. We take issue with many of these exclusions as we believe they are normal operating expenses of the business.

- While depreciation is a normalized exclusion for EBITDA, we believe this only makes sense with a property/land heavy company where its assets are skewed to its buildings. This is not the case with SHCO.

- One of its largest assets, "Fixtures and Fittings," reports $336.8 million in gross value at the end of 2022. These have an estimated useful life of 2 to 5 years. For a company that thrives on the latest decor and furnishings, using a mid-point of 3.5 years, we estimate an estimated depreciation expense of $89.2 million per annum.[12]

- As a public company, SHCO also pays approximately $75 million in debt service yearly. We will delve into SHCO's debt levels in a later section, but believe this true expense should not be disregarded.

- While normalized to most adjusted EBITDA calculations, stock-based compensation is often excluded. However, we implore analysts to factor these dilutive expenses into earnings as they account for a substantial amount of adjusted EBITDA since going public. For instance, SHCO reported $25.1 million in SBC versus $60.7million in adjusted EBTIDA in 2022 (over 41%!).

- Perplexing our analysts, SHCO provides two different calculations of adjusted EBITDA (one in its earnings presentation and one in its 10-Q filing) without disclosing why.

[12] Using straight-line depreciation with no salvage value.

Q3 2023 Earnings Presentation

	For the 13 Weeks Ended October 1, 2023	October 2, 2022
	Actuals (Unaudited, dollar amounts in thousands)	
Net income (loss)	$ (41,450)	$ (91,373)
Depreciation and amortization	24,516	26,971
Interest expense, net	18,799	18,453
Income tax benefit	4,208	3,013
EBITDA	6,073	(42,936)
(Gain)/Loss on sale of property and other, net	(7)	12
Share of income of equity method investments	(1,953)	(686)
Foreign exchange (gain) loss, net[2]	30,698	53,910
Share of equity method investments adjusted EBITDA	2,557	1,978
Share-based compensation expense[2]	4,683	3,980
Membership credits expense[3]	—	4,046
Out of period operating lease liability adjustment[4]	—	(44)
Adjusted EBITDA	$ 42,051	$ 20,260

Q3 2023 10-Q Filing

(in thousands)	For the 13 Weeks Ended October 1, 2023	October 2, 2022
Net income (loss)	$ (41,450)	$ (91,373)
Depreciation and amortization	24,516	26,971
Interest expense, net	18,799	18,453
Income tax expense (benefit)	4,208	3,013
EBITDA	**6,073**	**(42,936)**
Loss (gain) on sale of property and other, net	(7)	12
Share of income of profit method investments	(1,953)	(686)
Foreign exchange (gain) loss, net	30,698	53,910
Pre-opening expenses [1]	5,093	2,555
Non-cash rent [2]	1,317	4,654
Deferred registration fees, net	(465)	(489)
Share of equity method investments adjusted EBITDA	2,557	1,978
Share-based compensation expense [3]	4,683	3,980
Other expenses, net [3][4]	783	4,693
Adjusted EBITDA	**$ 48,779**	**$ 27,671**

This clusterfuck of data reveals that SHCO's own accountants cannot prepare their made-up earnings number correctly. Notwithstanding the inconsistent numbers, we still take issue with SHCO's liberal use of pre-opening expenses and non-cash rent that are excluded from adjusted EBITDA.

SHCO opened up the floodgates to new members, yet still could not produce GAAP income on an annual basis. We believe many of these excluded expenditures are true operating expenses that will never allow the company to be sustainably profitable.

Accounting Red Flags Suggest Cosmetic Earnings

Soho House went public in 2021, qualifying as an emerging growth company under the JOBS Act. This qualification allows for relaxed reporting and accounting standards from the SEC while the nascent company gets up to speed on financial requirements. However, it can also lead to suspect financials and weak accounting staff.

According to the SEC, emerging growth companies are permitted:

- to include less extensive narrative disclosure than required of other reporting companies, particularly in the description of executive compensation

- to provide audited financial statements for two fiscal years, in contrast to other reporting companies, which must provide audited financial statements for three fiscal years

- not to provide an auditor attestation of internal control over financial reporting under Sarbanes-Oxley Act Section 404(b)

- to defer complying with certain changes in accounting standards and

- to use test-the-waters communications with qualified institutional buyers and institutional accredited investors

As a result, we were not surprised to find many accounting red flags throughout Soho House's financials. We believe that much of the earnings gains made since going public have been fabricated with accounting gimmicks such as pull forwards of revenue and delayed expense recognition.

Changes in Initiation/Registration Fees in 2022 Pull Forward 20 Years Worth of Amortized Revenue:

- Our first accounting red flag centers around Soho's revision to new member registration fees. We calculate that this one-time fee usually takes up approximately 22% to 41% (although most are closer to 41%) of the overall annual membership cost.

- According to SHCO's 2022 10-K filing:

> House Membership Revenues are comprised primarily of annual membership fees *and one-time legacy registration fees from Soho House members which are amortized over 20 years. The one-time registration fee is no longer applicable to new members admitted from April 4, 2022*, see House Introduction Credits above.

- Before 2022, Soho House recognized its registration fees over a 20-year period. However, with the introduction of "House Introduction Credits," the company would be able to recognize the full registration fee as In-House Revenues in the year incurred.

> ***HOUSE INTRODUCTION CREDITS***
> . New members admitted from April 4, 2022 have been required to purchase House Introduction Credits as part of their membership, per the House rules. House Introduction Credits are credits of an equivalent value to cash within Houses and are redeemable to purchase food and beverage items, and bedroom stays, at the Houses. House Introduction Credits expire after the first three months from the date of issuance, where legally permitted in the regions we operate, if not utilized or if the Company terminates a member's House membership. House Introduction Credits are recognized upon issuance as deferred revenue on our consolidated balance sheets. Revenue from House Introduction Credits are recognized as In-House revenues when redeemed by members, and as breakage revenue within Membership revenues upon expiration or in the period that we are able to reliably estimate expected breakage to the extent that they are unredeemed, are recognized. House Introduction Credits expire three months from the date of issue.

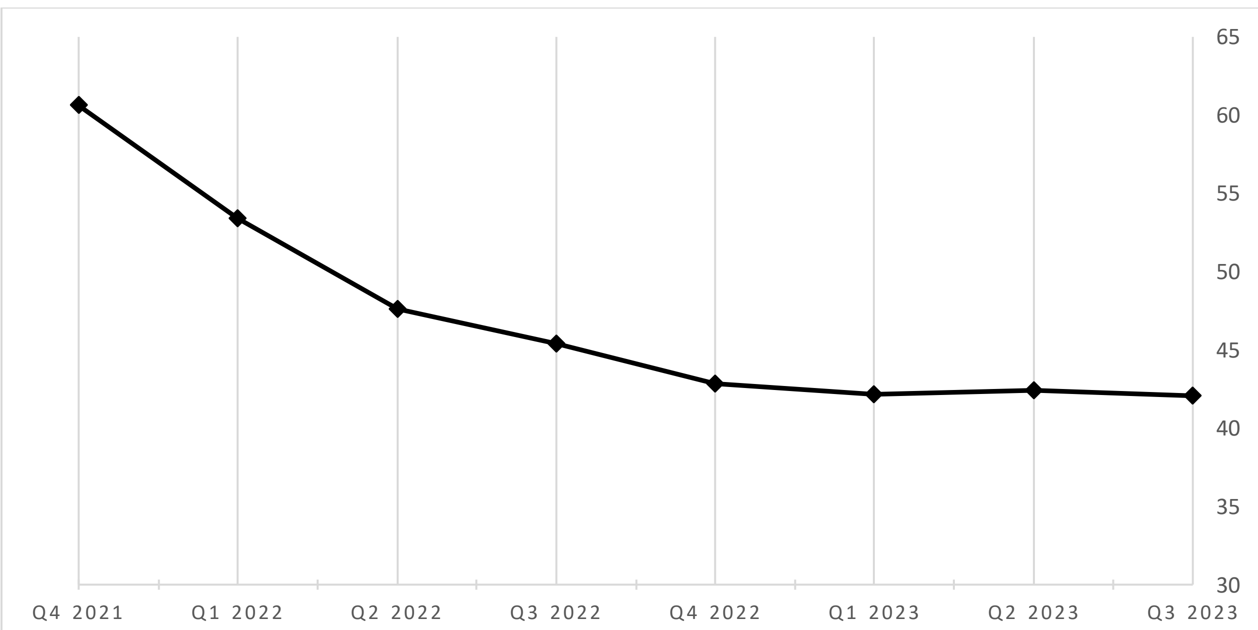
- With the change highlighted above, the company now could recognize revenue of its initiation fee in the first year under the guise of "House Introduction Credits." Soho did not mention the revision on conference calls or in press release headers. With the material amount of revenue pulled forward, we think SHCO should have discussed the change instead of burying it in the footnotes.

- The change aesthetically enhances Soho's revenue and earnings numbers post Q1 2022, as the company could now recognize the revenue up front. While this may initially look good on a revenue basis, the company will lose out in the long term on future amortized revenue, not to mention the In-House Revenues lost due to these credits.

- Based on our estimates, we believe that $39.1 million worth of In-house revenue was pulled forward due to this accounting change in 2022. Or on a percentage basis, 11.5% of revenue for the three periods enacted in 2022.[13]

- This is also apparent in the persistent outpacing of sales relative to deferred revenue since the change to place in Q1 2022. To illustrate this, we use "days of deferred revenue" or DDR[14] to show the supposed impact of this change. TTM DDR has fallen from a recent high of 61 days reported in Q4 2021 down to a recent low of 42 days in the latest period. We opine that a substantial portion of this decline is due to revision to Soho's registration fee accounting.

Chart 6. Days of Deferred Revenue Trend (TTM)



[13] This is calculated by taking new members from Q2 2022 to Q4 2022 (54,903 members), multiplying by estimated initiation fee (40% of membership), and then multiplying by 95% (19 of 20 years).
[14] Three-month days of deferred revenue (3M DDR) = Average deferred revenue QOQ / 3M Sales * 91.25.

Inventories Balance Skyrockets Outpacing Sales in Four Consecutive Periods

- In the most recent period, inventories increased 48.9% YOY to a value of $55.8 million. Quarterly revenue did not keep up with this pace, only increasing by 13.1% YOY. Focusing on the last year, inventories outpaced sales in the last four periods by an average of 482 bps (see Table 1, Page 18).

- Three-month days sales of inventory (DSI)[15] reflected this same trend, growing 45.4% YOY to 51 days, a high for Soho since COVID-19. Twelve-month DSI also increased by 35.7% to 47 days. In its 2022 10-K filing, SHCO stated the following in a footnote:

> **Inventories**
>
> Inventories are valued at the lower of cost or net realizable value and cost is determined using a weighted-average cost method. Inventories consist of raw materials, service stock and supplies (primarily food and beverage), and finished goods which are externally sourced. Raw materials and service stock and supplies totaled $19 million and $8 million as of January 1, 2023 and January 2, 2022, respectively. Finished goods totaled $39 million and $22 million as of January 1, 2023 and January 2, 2022, respectively. The Company records a reserve for obsolete or unusable inventory, where applicable. The reserve was less than $1 million and zero as of January 1, 2023 and January 2, 2022, respectively.

- "So we have been in a very high inflationary period over the past 2 years, in particular in the U.K. I think the U.K. was running double digit for most of last year," management said during the Q3 2023 earnings call, leading us to believe the increase is primarily due to food inflation.

- We are puzzled by the recent rise of food and beverage inventory at Soho House with what appears to be very little corresponding reserves for obsolescence (only $1 million). And although most of the rise is reportedly due to inflation, we do not believe this fully explains the recent inventory rise due to the firm's use of weighted-average cost method (as opposed to first-in, first-out [FIFO], which would explain the rise).

- If we estimate the firm's normalized inventory balance based on last year's 12M DSI figures, we calculate an inventory balance of only $40.4 million. Thus, we believe that EBITDA could have benefitted from this aesthetic gain by approximately $15.4 million in the last year.[16]

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[15] Three-month days sales of inventory (3M DSI) = Average inventory QOQ / 3M COGS * 91.25.

[16] Using SHCO's 12M DSI value of 34 days in Q3 2022, we reversed engineered an estimated inventory balance of only $40.4 million. Twelve-month COGS of $427.9 million x 34 days / 365.

Table 1: Soho House Inventory Metrics
($ in millions)

Period Ended:	Q3 2023	Q2 2023	Q1 2023	Q4 2022	Q3 2022
Inventory	$55.8	$65.8	$57.4	$57.8	$37.4
Inventory-to-3M sales	18.5%	22.8%	22.5%	21.4%	14.1%
Inventory-to-12M sales	5.0%	6.1%	5.5%	6.0%	4.2%
3M DSI (days)	51	49	49	46	35
12M DSI (days)	47	45	41	39	34
YOY					
Inventory	48.9%	53.4%	64.7%	94.8%	40.7%
Inventory-to-3M sales (bps)	446	518	434	530	-74
Inventory-to-12M sales (bps)	77	73	42	65	-172
3M DSI	45.4%	38.3%	25.7%	44.7%	-14.5%
12M DSI	35.7%	22.0%	4.3%	-15.7%	-26.6%

Why Are Receivables Rising So Fast?

- Soho House discloses three different types of receivables growing at an alarming rate over the past year. Contract receivables ($64.6 million as of Q3 2023), contract assets ($4.8 million) and other receivables ($67.3 million). These accounts combined (total receivables) shot up by 48.8% YOY to $136.7 million in the latest period. Again, this increase dwarfed the 13.1% YOY increase of revenue during the same time period.

- Three-month (twelve-month) days' Sales Outstanding, AKA DSO,[17] has increased by 36.3% (32.7%) YOY to 39 days (37 days). While the absolute number of 39 days is not necessarily high for a normal company, for a retail-facing company such as Soho House, it is a blatant cause for concern.

- Total receivables have now outpaced sales in five consecutive periods, which begs the question of who owes this money to Soho House? While there are absolutely no disclosures related to the very material "other receivables," a footnote from the 2022 10-K filing states:

[17] Three-month days sales outstanding (3M DSO) = Average receivables QOQ / 3M Sales * 91.25.

> Accounts receivable include amounts due from customers in connection with the Company's in-house building service whereby the Company extends credit, generally without requiring collateral, based on its evaluation of the customer's financial condition. Accounts receivable also include amounts due from customers, guests and members relating to services rendered. Any allowance for doubtful accounts includes management's estimate of the amounts expected to be uncollectible on specific accounts receivable, taking into account the creditworthiness of the counterparty, the aging of the outstanding balance, and historical recoverability patterns. Allowance for doubtful accounts was $4 million as of January 1, 2023 and $3 million as of January 2, 2022.

- In other words, the company is lending credit to supposedly high-net-worth individuals. Members should pay for membership fees and food and beverage, primary revenues, via credit cards. Why does Soho House have receivables at all?

- According to the excerpt below, two Soho House customers owed the company approximately $3.1 million and $1.9 million, respectively, at the end of FY2021. These are highly egregious debts for a company of this scale.

> While the Company has a concentration of credit risk in relation to certain customers, this risk is mitigated by payments on account and credit checks on customers. Typically, accounts receivable have terms ranging from 0-60 days and do not bear interest. As of January 1, 2023, there were no customers which individually accounted for more than 10% of trade receivables; there were no customers which individually accounted for more than 10% of revenue during the fiscal year then ended. As of January 2, 2022, there were two customers which individually accounted for more than 10% of trade receivables (16% and 10%); there were no customers which individually accounted for more than 10% of revenue during the fiscal year then ended.

- In the latest fiscal year, an allowance for doubtful accounts of only $4 million is too low based on the recent spike in AR balance. Due to a lack of transparency around this balance, we are not unsure whether the recent AR surge is due to premature revenue recognition or collection concerns. Either way, we view this as a material red flag that will hamper the business.

- Estimating the firm's normalized AR balance based on last year's 12M DSO figures, we calculate an AR balance of only $86.4 million.[18] Thus, we believe that EBTIDA could have benefitted from this aesthetic gain by $50.4 million over the TTM.

[18] Using SHCO's 12M DSO value of 28 days in Q3 2022, we reversed engineered an estimated AR balance of only $86.4 million. Twelve-month revenues of $1,115.5 million 28 days / 365.

Table 2: Soho House Total Receivables Metrics
($ in millions)

Period Ended:	Q3 2023	Q2 2023	Q1 2023	Q4 2022	Q3 2022
Total Receivables	$136.7	$117.8	$120.1	$105.9	$92.3
AR-to-3M sales	45.4%	40.8%	47.0%	39.2%	34.7%
AR-to-12M sales	12.3%	10.9%	11.6%	10.9%	10.4%
3M DSO (days)	39	38	40	33	28
12M DSO (days)	37	34	33	29	28
YOY					
Total Receivables	48.2%	61.8%	70.2%	110.5%	61.4%
AR-to-3M sales (bps)	1075	1092	1030	1190	284
AR-to-12M sales (bps)	185	180	122	192	-236
3M DSO	36.3%	40.0%	40.7%	25.8%	7.8%
12M DSO	32.7%	26.8%	11.7%	-6.0%	-27.0%

Prepayments and Accrued Income Suggest Delayed Expense Recognition

According to SHCO's Note 7 footnote (Q3 2023 10-Q), the company infuriatingly classifies many of its receivables (Contract assets, other receivables, etc.) within its "Prepaid Expenses and Other Current Assets" line item.

The table below presents the components of prepaid expenses and other current assets.

(in thousands)	As of October 1, 2023	As of January 1, 2023
Amounts owed by equity method investees	$ 1,431	$ 1,492
Prepayments and accrued income	43,434	27,416
Contract assets	4,839	9,344
Other receivables	67,294	52,849
Total prepaid expenses and other current assets	**$ 116,998**	**$ 91,101**

- Focusing in on Prepayments and accrued income (discussed contract assets and other receivables above), we observe that this account significantly increased by 105.4% YOY to $43.4 million in the latest period, dwarfing 3M revenue's growth of only 13.1% YOY.

- When prepaids rise to this extent, we get suspicious about delayed expense recognition. When this account spikes well above revenues pace, it suggests that management could be capitalizing expenses à la WorldCom. The "accrued income" tag is also peculiar, as it suggests the account is related to yet another risky receivable balance stuffed down in the prepaids account. For simplicity, we will analyze this as a prepaid expense account.

- Relative to 3M sales, prepayments grew by 648 bps YOY to 14.4% of sales at the end of Q3 2023. Longer-term trends reported similar figures, with prepayments rising 151 bps to 3.9% of sales.

- Normalizing prepayments based on the 12M OpEx metric as of Q3 2022, it is entirely possible that SHCO delayed approximately $19.2 million in expenses over the TTM, causing an aesthetic gain to EBTIDA of the same amount.[19] An account no one looks at might be responsible for millions in artificial gains, and that could make the difference of making or missing estimates in a period.

Table 3: Prepayments and Accrued Income Metrics
($ in millions)

Period Ended:	Q3 2023	Q2 2023	Q1 2023	Q4 2022	Q3 2022
Prepayments & Accrued Income	$43.4	$57.8	$35.5	$27.4	$21.1
Prepaids to 3M Sales	14.4%	20.0%	13.9%	10.1%	7.9%
Prepaids to 12M Sales	3.9%	5.3%	3.4%	2.8%	2.4%
Prepaids to 3M OpEx	24.0%	32.9%	22.3%	13.5%	11.9%
Prepaids to 12M OpEx	6.0%	8.1%	5.1%	4.0%	3.4%
YOY					
Prepayments & Accrued Income	105.4%	41.6%	-3.1%	5.3%	-16.1%
Prepaids to 3M Sales (bps)	648	326	-517	-397	-609
Prepaids to 12M Sales (bps)	151	25	-196	-182	-324
Prepaids to 3M OpEx (bps)	1,206	597	-274	-357	-483
Prepaids to 12M OpEx (bps)	267	129	-116	-78	-162

[19] Using SHCO's prepaid-to-12M OpEx value of 11.9% in Q3 2022, we reversed engineered an estimated prepaids balance of only $24.2 million.

Depreciation Schedules Appear Underreported and Not In-Line with Peers

When researching the firm's property and equipment footnotes (below), we found discrepancies with Soho's reported depreciation expense relative to our own estimated depreciation expense and the absurdity of Soho's use of a 100-year depreciation schedule for its buildings.

Property and Equipment

Property and equipment relate to buildings for owned Houses, leasehold improvements for leased Houses, fixtures and fittings and other office equipment. Property and equipment are recorded at cost, or if acquired in a business combination, at fair value as of the acquisition date, less accumulated depreciation. Costs of improvements that extend the economic life or improve service potential are capitalized. Capitalized costs are depreciated over the assets' estimated useful lives. Costs for normal repairs and maintenance are expensed as incurred. The carrying amounts of assets sold or retired and the related accumulated depreciation are eliminated in the year of disposal, with resulting gains or losses included in gain (loss) on sale of property and other, net in the consolidated statements of operations.

Depreciation is recorded using the straight-line method over the assets' estimated useful lives, which are generally as follows:

Buildings	50-100 years
Leasehold improvements	Lesser of useful life or remaining lease term
Fixtures and fittings	2-5 years
Office equipment and other	2-4 years
Finance lease property	Reasonably assured lease term

Depreciation expense is included in depreciation and amortization in the accompanying consolidated statements of operations.

9. Property and Equipment, Net

Property and equipment is comprised of the following:

(in thousands)	As of January 1, 2023	As of January 2, 2022
Land and buildings	$ 213,901	$ 216,540
Leasehold improvements	353,181	300,821
Fixtures and fittings	336,758	287,866
Office equipment and other	42,660	41,176
Construction in progress	20,394	81,208
Finance property lease	64,521	73,110
	1,031,415	**1,000,721**
Less: Accumulated depreciation	(384,414)	(315,760)
	$ 647,001	**$ 684,961**

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The Company recorded depreciation expense of $81 million, $69 million, and $56 million in the fiscal years ended January 1, 2023, January 2, 2022, and January 3, 2021, respectively, which is included in depreciation and amortization in the accompanying consolidated statements of operations.

- Fixtures and fittings make up the bulk of overall property and equipment (32.6% in FY2022). Using straight-line method to calculate depreciation with no salvage value and a reported 3.5-year useful life (an average of 2 to 5 years listed above), we calculate an expected depreciation expense of $89.2 million for the year [20] on just on fixtures and fittings for 2022.

- Factoring this into our overall total depreciation expense calculation, we come to a value of $130.2 million. However, the company only reported a *total* of $81 million in depreciation expense for all its assets, not just fixtures and fittings.

- What's going on here? Could they be depreciating all fixtures and fittings at five years? Calculated this way, total depreciation expense comes to $103.3 million, still $20 million above the reported number. However, switching to the five–year calculation would also deviate greatly from the peers listed below, with a 3.5-year average estimate for assets listed as "fittings or fixtures".

- Regarding our second point about 100-year useful life, we understand that buildings retain their value and don't fully follow GAAP historical cost minus depreciation. But 100 years is still an awfully long time, as evidenced by SHCO's competitors.

- These peers, all public companies, have much more conservative useful life expectancies:

    - Lifetime Fitness (44 years for building)
    - Hilton Worldwide (8 to 40 years for building and improvements)
    - Marriott International (40 years for buildings)
    - IHG Hotels (50 years for buildings)
    - Hyatt Hotels (10 to 50 years for buildings and improvements)
    - Choice Hotels International (24.4 years for buildings)

- This means the company is enjoying a building depreciation expense that is less than half that of its peers.

[20] Assuming straight-line depreciation with no salvage value, SHCO lists "fixtures and fittings" at gross value of $336.8 million as of 2022. Divided by mid-point 3.5 useful life to equate to $89.2 million in depreciation for 2022.

Table 4: Estimated Depreciation Expense Versus Reported Metrics[21]
($ in millions)

Period Ended:	Useful Life (Years)	2022	2021	2020	2019	2018
Land and buildings	75	$2.9	$2.9	$2.4	$1.8	$1.8
Leasehold improvements	15	$21.8	$19.4	$16.9	$12.5	$9.9
Fixtures and fittings	3.5	$89.2	$76.3	$60.8	$43.9	$36.8
Office equipment and other	3	$14.0	$12.7	$10.3	$7.7	$6.5
Construction in progress	-	-	-	-	-	-
Finance lease property	30	$2.3	$2.5	$4.0	$3.9	$2.4
Total Estimated Depreciation Exp		$130.2	$113.7	$94.3	$69.9	$57.3
Reported Depreciation Expense		$81.0	$69.0	$56.0	$47.0	$40.0
Difference		$49.2	$44.7	$38.3	$22.9	$17.3

Sustainable EBIDTA Versus Reported Adjusted EBITDA

We believe many of the recent EBITDA gains management has touted area farce. Thus, adjusted EBITDA numbers based on normalized inventory, receivables and prepayments figures.

Reported depreciation numbers also appear to be highly suspect and critical to EPS. However, we will not adjust the EBITDA calculation, as it excludes depreciation values.

- Detailed in previous sections, we report negative adjustments of $15.4 million, $50.4 million, and $ 19.2 million of inventory, AR and prepayments, respectively to TTM EBITDA.
- As a result, we estimate a sustainable EBITDA figure of only $33.9 million over the TTM, which deviates from management's reported TTM $118.8 million (see Table 5, Page 25).
- With debt rising to unsustainable levels (discussed in next section) and the company's desire to prove itself after its IPO, we believe SHCO may have been highly motivated to enhance its numbers.

[21] Our estimates assumes mid-point useful life range given by SHCO. Also, we assume leasehold improvements (15 years) and finance lease property (30 years) based on excerpts from filings.

Table 5: Estimated SHCO EBITDA Metrics Vs. Reported
($ in millions)

TTM Period Ended:	Q3 2023
Reported Adjusted EBITDA	$118.8
Sustainable EBITDA Adjustments	–$84.9
GlassHouse Estimated Sustainable EBITDA	$33.9
Difference from Reported (%)	–71.5%

SHCO's Altman Z-Score, a Harbinger for Bankruptcy

We believe Soho will succumb to its unsustainable debt levels. We find the Altman Z-score[22] to be one of the most reliable metrics to predict future debt calamity. It predicts the likelihood of bankruptcy for public companies as follows:

Safe Zone (>2.60) – Low Likelihood of Bankruptcy
Grey Zone (1.10 to 2.60) – Moderate Risk of Bankruptcy
Distress Zone (<1.10) – High Likelihood of Bankruptcy

To calculate this ratio, we use inputs of EBIT, sales, working capital, retained earnings, market cap, total assets and liabilities of our target company. For example, we calculate the now-defunct WeWork's Altman Z-score of 0.74 (distress zone) prior to its demise in November of last year.

We calculate SHCO's Altman Z-score at *negative* 0.05 as of Q3 2023. Over the last two fiscal years, it has been consistently below the 1.10 distress zone.

> "In more recent years, however, a Z-Score closer to 0 indicates a company may be in financial trouble. In a lecture given in 2019 titled, 50 Years of the Altman Score, Professor Altman himself noted that recent data has shown that 0 – not 1.8 – is the figure at which investors should worry about a company's financial strength."

We believe SHCO will not generate enough cash flow to cover debt payments in the upcoming year. While the company loves to tout its non-GAAP metric, famous investor Charlie Munger once said, "You can't pay bills with adjusted EBITDA."

We believe using free-cash-flow (FCF) is a better proxy for economic earnings in this case as SHCO is a long-term asset heavy company. It would be a massive mistake for investors to ignore material depreciation with a company like SHCO, which cycles through long-term assets quickly.

SHCO's adjusted EBITDA metric has improved annually to -$23.9 million, $60.7 million and $118.8 million as of 2021, 2022, and TTM Q3 2023, respectively. However, FCF has not followed this trend and is still generating losses with reported figures of -$218.3 million, -$59.0 million, and -$54.0 million during the

[22] https://www.

same timeframe. We believe that SHCO will continue to consume approximately $50 million in cash per annum.

SHCO management has kept this trainwreck by continuing to accumulate debt. The company's debt has increased in seven consecutive periods on a YOY basis to a current $770.5 million (not including leases). This number balloons to $2.23 billion when including leases, the highest value reported since going public in 2021.

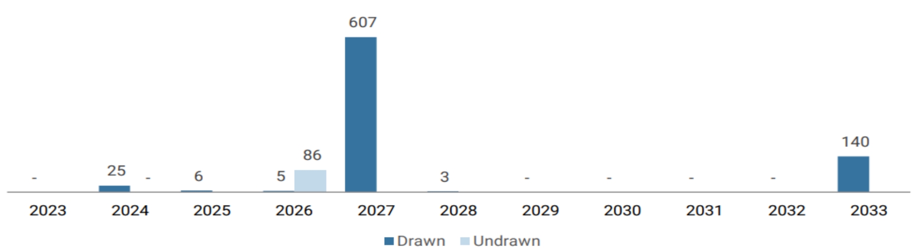
At the beginning of the year, SHCO reported $142.0 million in maturities in 2024, primarily due to its Soho Beach House Miami debt, which was refinanced until 2033 with an increased rate of 6.99%. Now, the company faces a mountain of debt maturities, with $607.0 million coming due in 2027.

Excerpt 1: Soho House Q3 2023 Earnings Presentation

Cash and Debt as of October 2, 2023

Total Cash and Cash Equivalents (including Restricted cash)	$163m
Total Debt	$770m
Net Debt*	$607m

Loan Expiry Profile $m's



According to the 2022 10-K, the large debt balance stems from a Notes Purchase Agreement of $441 million in senior secured notes sponsored by Goldman Sachs and another senior secured note with an outstanding balance of $571 million. Making matters worse, the notes have a payment-in-kind (PIK) option that allows SHCO to defer its interest costs at a much higher interest rate. It appears that SHCO has taken advantage of this by deferring $36.3 million in interest payments in 2022. As of Q3 2023, the company deferred $27.9 million in interest payments, and it doesn't look like they will stop this high-risk practice anytime soon.

How Will Soho Pay Off This Debt?

Management has predicted that it would be cash flow positive for years now but has failed time and time again. At the July 2022 Goldman Sachs Travel and Leisure Conference CEO Andrew Carnie said,

> "We'll have 85 Soho Houses within five years. All the houses will be following the maturation curve. So as they grow, they get much more profitable. Our margins will be north of 20% in five years. We're pretty confident on that... And that's why we're very confident on opening eight to 10 houses per year for the next five years."

At the same conference, prior CFO Humera Afzal, said,

> "Ultimately, all of that drives free cash flow. So being able to deliver free-cash-flow, pay down our debt, secure our balance sheet, make sure we have liquidity to grow, with the support of our asset-light model."

Since then, the company tempered its target openings and is not on track to reach its 85-house goal within five years. Furthermore, the company's debt has only grown since 2022.

On the Q2 2022 earnings call, then newly appointed CFO Thomas Allen gave his own debt prediction.

> "As you can see from our loan maturity profile, the vast majority of our debt currently runs out to 2027. We're currently looking at refinancing options for the debt coming due in 2024. Our priority remains to generate free cash flow in the short-to-medium term, and we expect to be cash flow positive in the fourth quarter this year."

This statement regarding SHCO's positive free-cash-flow in Q4 2022 did not come to fruition either. The company reported *negative* FCF of $34.1 million ($59.0 million) in the Q4 (2022) period. We opine that management will need to sell stock in order to pay off its 2027 maturities, causing a downward spiral.

SHCO's Financial Statements Cannot Be Relied Upon

As stated earlier, SHCO in 2021 went public as an emerging company under the JOBS Act. With relaxed reporting rules. We believe the relaxed reporting rules in this scenario led to insufficient accounting staff. Even worse, In the absence of competent staff to stop it, management may even be intentionally engineering its finances.

- Based on June 2021 letters from the SEC, it was concerned with SHCO's non-GAAP exclusions in its filings. Specifically, the SEC ordered the removal of pre-opening expenses and non-cash rent adjustments. As shown earlier, SHCO decided to remove these exclusions, but only for certain deliverables and not others. This oversight now reports two different adjusted EBITDA numbers for a +$1 billion market cap company.

- Non-cash rent was related to the correction of an error in SHCO's 2021 and 2020 fiscal years. The error, identified in 2022, relates to the correction of operating lease liabilities calculations, which resulted in the overstatement of its leases.

- BDO, a non-Big 4 firm, audited SHCO's financials. It did not share an opinion on Soho's internal controls, which appear to be lacking in our opinion.

- The SEC also voiced concerns regarding SHCO's continued material weaknesses on internal controls, which it said needed to remedied quickly. This was *three years ago*. The SEC's concerns were as follows:
    - Lack of sufficient number of personnel with an appropriate level of knowledge and experience in the application of GAAP, commensurate with our financial reporting requirements.
    - Policies and procedures to review, supervise and monitor accounting and reporting functions were either not designed and not in place, or not operating effectively.

Previously, as an emerging company, SHCO did not need to comply with Sarbanes-Oxley. But as of fiscal year 2023, we expect the company to file as a large accelerator company, which will be under much more scrutiny.

SHCO's presentations contain errors like the one below, where the sign for its units is incorrectly used. Cash is deducted in its net debt calculation; however, the signs are switched in the year before. It's not a huge mistake, but we would hope for a billion-dollar company to avoid even small errors.

Excerpt 2: Soho House Q3 2023 Earnings Presentation

	As of	
	October 1, 2023	October 2, 2022
Current portion of debt, net of debt issuance costs	$ 25,887	$ 897
Debt, net of current portion and debt issuance costs	607,609	559,169
Property mortgage loans, net of debt issuance costs	136,991	116,012
Current portion of related party loans		21,663
Total Debt	770,487	697,741
Cash and cash equivalents	(162,540)	227,896
Restricted cash	(500)	7,205
Net Debt	$ 607,447	$ 462,640

Broken Business Model + Accounting Red Flags + Poor Internal Controls Could Lead to Calamity at Soho House

The bull case regarding Soho House's stock price revolves around the following tenets that we believe the sell-side community has misunderstood:

- Analysts believe the company will expand successfully into new markets, increasing the top line without sacrificing margins.
- Analysts/investors believe the company can continue to grow its adjusted EBITDA based on recent strength.
- Currently analysts following SHCO have 8 – outperform (buy), 3 – market perform (hold) and a whopping 0 – underperform (sell) ratings.

Our analysis reveals that much of the recent sales growth was attributable to changing its revenue recognition policy on its new membership fees.

We believe much of the recent EBITDA gains have been a farce artificially enhanced by accounting gimmicks. We think the recent adjusted EBTIDA gains are unsustainable and should many of the non-GAAP exclusions taken were egregious. A more accurate form of cash earnings would be free-cash-flow, a continually negative metric for Soho House.

With SHCO's continued GAAP losses and mounting (and pushed off) debt balances, we believe the company will need to sell massive amounts of shares to pay off its impeding maturities in 2027, with material negative consequences on the company's stock price.

Accordingly, we are initiating coverage on Soho House and Co Inc. (SHCO) with a target price of $0.

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