

Premium positioning underpins growth

20th July 2022

Strong 25% sales growth, a further 24% advance in membership numbers and important progress at the Masterton Bond facility were key features of a trading update released by The Artisanal Spirits Company (ASC) today. Furthermore, the company reiterated its ambition to double sales revenue between FY2020 and FY2024. With a focus on the ultra-premium category, a fast-growing global membership base and embedded value in its maturing whisky stocks - £430m at retail - we continue to argue that a fair value for the shares is 150p.

Following the 25% advance in first half sales we maintain our 18% full year FY2022 revenue growth forecast. The pace of FY2022 H1 expansion gives us raised confidence in this expectation being met. Furthermore, a more than 50% sales gain in China confirms the benefit of ASC owned SMWS being both a premium products business and one with access to worldwide markets. Our full year profit forecasts are unchanged at this stage, but ASC's overall positive momentum suggests the risk is on the upside.

Membership growth of the Scotch Malt Whisky Society recorded a 24% increase from 28,700 to 35,500. The company's ability to sell its premium products into an established customer base is a key factor behind ASC's renewed confidence that it will double revenue from £15m to £30 between FY2020 and FY2024, a period in which we expect gross margins to increase from 59% to 65%. European membership rose strongly benefiting from a new EU route to market in 2021.

ASC's ability to maintain both near-term and longer-term sales and profits expectations reflects a number of important qualities which are inherent to the business. ASC boasts a proven ability to grow its membership base and satiate its members' passion for ultra-premium single cask malt whiskies. Moreover, ASC has almost complete stock coverage to meet expected demand growth through to the end of FY2028 with substantial stock for the following years too, which has positive implications for profitability and certainty of supply.

Internal developments remain on track. The company announced in today's statement that its Masterton Bond facility is progressing on time and on budget, ahead of it becoming fully operational in the second half of FY2022 and margin enhancing in FY2023.

Valuation summary

The Artisanal Spirits Company's clear and resilient route to growth, which is discussed in more detail in this report, is not reflected in the company's share price. Putting those strengths to one side though, investors should recognise that the company's maturing stock of Scotch whisky has an estimated value of £430m. **This is more than 10 times the entire market cap of the company.** The current share price shows no recognition of the intrinsic value that underpins it.

In addition to this, there are strong arguments for the shares to trade higher on revenue growth considerations. We reiterate our 150p per share fair value at which price the shares would trade on 5.5x EV/sales in FY2022 and 4.1x sales in FY2024, based on our estimates.

Company Data

EPIC	ART
Price (last close)	54p
52 weeks Hi/Lo	118p/52p
Market cap	£37m
ED Fair Value/share	150p

Share Price, p



Source: ADVFN

Description

The Scotch Malt Whisky Society (SMWS) is focused on providing premium single cask spirits. With an average whisky cask yielding around 250 bottles each time, each release is by its very nature a limited edition with exclusive characteristics.

ASC's objective is to bring together spirits from some of the world's best spirits producers, add value by managing the maturation process and provide exclusive access to a vast and unique range of outstanding single cask Scotch malt whisky and other spirits to The Scotch Malt Whisky Society's global membership.

Key financials

Yr to 31 Dec	2020A	2021A	2022E	2023E	2024E	2025E
Revenue (£m)	15.0	18.2	21.6	24.8	28.6	32.7
Revenue growth	2.6%	21.4%	18.3%	15.1%	15.3%	14.2%
EV/sales (x)	3.4	2.8	2.4	2.0	1.8	1.6

Source: ED estimates, company historic data

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Premium positioning underpins growth

Strong first half growth in both membership numbers and sales revenue leaves The Artisanal Spirits Company (ASC), through its ownership of the Scotch Malt Whisky Society (SMWS), well positioned to match both our own and market expectations for the full current year. We leave our revenue and profit forecasts for FY2022 unchanged.

ASC is a resilient business whose membership numbers and sales revenue continue to grow. Profitability and intrinsic value are supported by the ownership of a substantial quantity of maturing whisky stock. We reiterate our fair value of 150p for the shares which implies substantial upside on a re-rating but would still leave the company only trading in line with our selected peer groups, when arguably a premium is deserved.

Sales growth

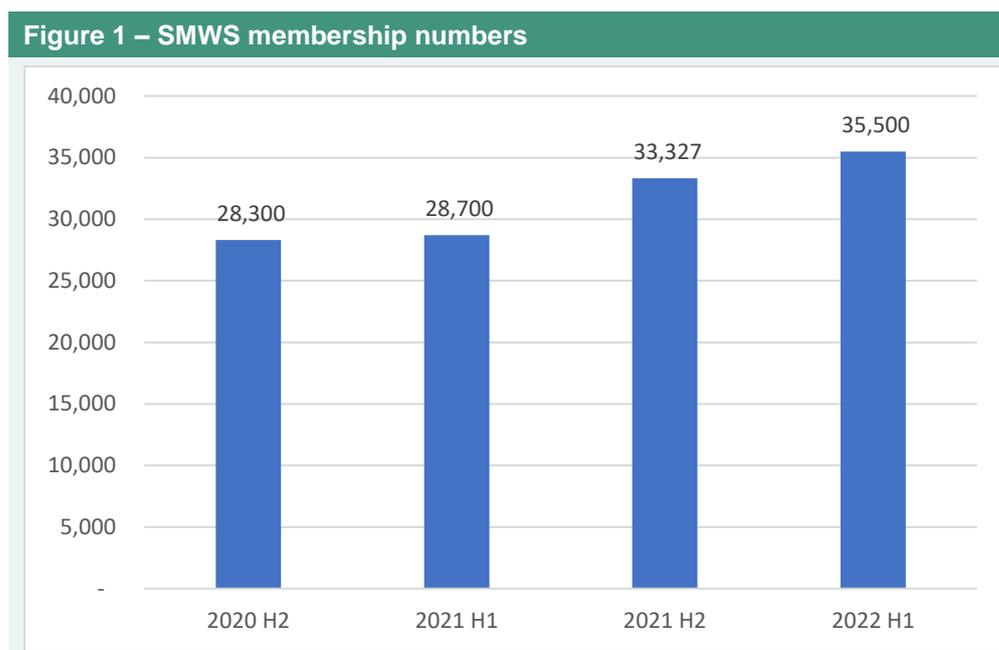
Sales growth of 25% included what the company describes as a “stand-out” performance in China, where revenue increased by more than 50%. The pace of growth in China is worth noting in our view given it was set against the challenging background of the country’s “zero tolerance” approach to COVID-19 and associated lockdowns in FY2022 Q2.

In the UK, revenue expansion benefited from being compared with a relatively soft period in the first half of FY2021 when the company was forced to close its venues due to the pandemic. However, underlying growth appears robust.

Membership growth

Membership and its growth remain vital to both the resilient nature and long-term expansion of ASC’s flagship SMWS operation. As a membership organization, it can communicate directly with its customer base and sustain customers’ passion for ultra-premium malt whiskies. This not only generates loyalty but also enables the company to promote its prestigious and unique products at relatively low marginal cost.

Recent half-yearly movements in membership numbers are summarised in Figure 1.

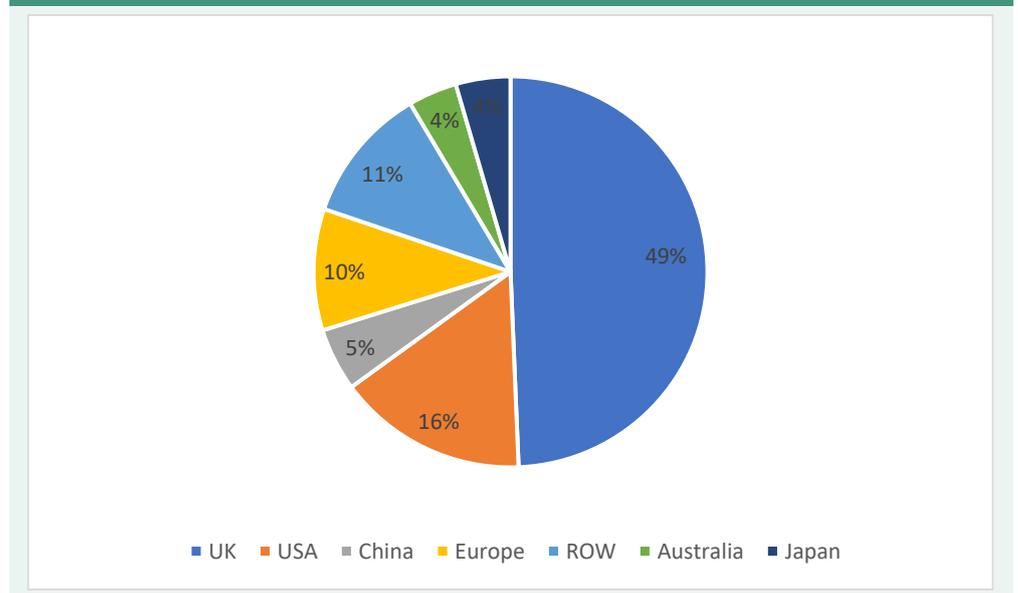


Source: Company

In addition to overall growth in member headcount we emphasise the **global nature of the SMWS's membership distribution** which is in turn reflected in the international nature of the company's revenue base. Lack of reliance on a single market for sales revenue should enhance resilience going forward. We summarise membership numbers by region and sales by region in Figures 2 and 3 respectively.

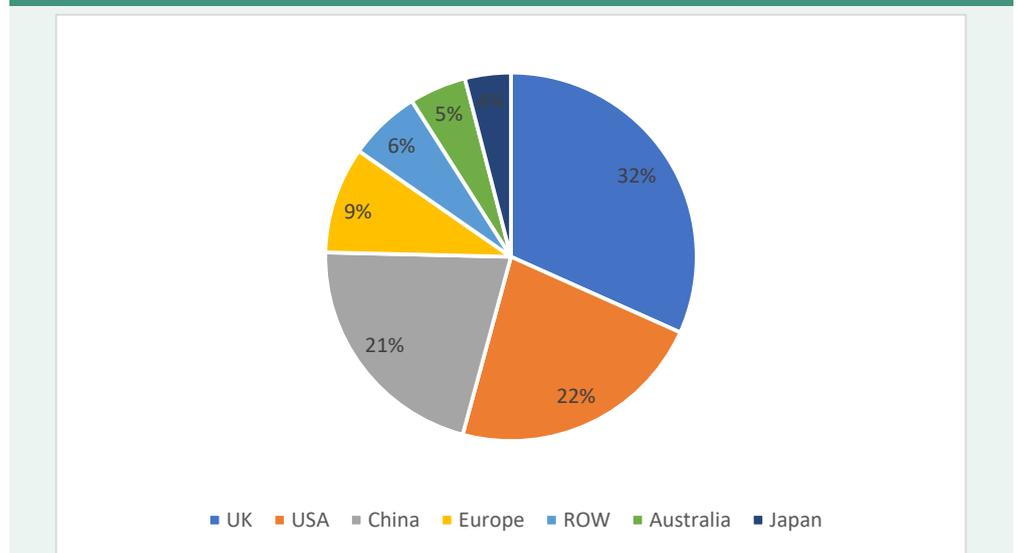
An interesting feature of the two pie charts is that the implied spend per member in the UK is lower than that for international members with 49% of the membership accounting for only 32% of sales revenue in FY2021. As a result, continued international growth for SMWS should lead to higher levels of average spend per member. For example, when combined the US and China comprised 21% of membership in FY2021 but generated 43% of sales revenue. The company also announced an exceptionally successful recruitment campaign in Australia and European membership grew strongly, helped by the launch of a new EU route to market towards the end of FY2021.

Figure 2 – SMWS membership at end FY2021– regional breakdown



Source: Company

Figure 3 – ASC FY2021 sales revenue breakdown by region



Source: Company

Ambition to double sales between 2020 and 2024 on track

A strong pace of membership growth and continued emphasis on international recruitment puts ASC in a good position to match the company's ambition to double sales revenue between FY2020 and FY2024 – i.e. raise sales from £15m to £30m. The company reiterated its confidence in delivering against this objective in today's trading update.

Stock supply reinforces confidence in the growth outlook

ASC's ownership of an abundant supply of maturing whisky stock should ensure that the company is capable of meeting the growth in demand for its products. The company is both hedged against inflation and insulated from any risks associated with supply chain disruption.

Currently, ASC has almost complete stock coverage to meet expected demand growth through to the end of FY2028, with substantial stock for the following years too.

New operational developments

The salient operational development in the first half of FY2022 was confirmation that the Masterton Bond facility is progressing on time and on budget. The facility is expected to be fully functional in the second half of this year. In addition, Masterton is expected to deliver financial benefits – i.e. higher margins - as early as FY2023.

The company's statement confirmed that all of its cask racking has been installed and that work is underway on internal firewalls with a similar status for electrical and mechanical equipment.

Brexit

Being a global business selling UK sourced product, ASC is significantly mitigated from Brexit related pressures. However, the company had 10% of its members in continental Europe last year and generated 9% of sales in the region. As a result, the comment in today's statement that not only was European growth strong but also that "Brexit-related issues" are "now addressed" should be welcomed.

Financials and valuation

Relative valuation

We continue to argue for a fair value of 150p per share for ASC based on an Enterprise Value to Sales ratio relative to the company's two peer groups, both of which comprise publicly listed companies. These are **distilled spirits** and **luxury goods** with valuations as shown in Figures 4 and 5.

Aside from growing membership numbers and their likely impact on sales revenue growth, a key component of ASC's intrinsic value is the amount of maturing whisky stock, which the company owns outright. According to the company's 2021 Annual Report, the group had over 15,000 casks of maturing stock on 31st December 2021 which was equivalent to around 4.7m standard 70cl bottles and based on last year's average revenue per bottle had a retail value of the order of £430m which, as Figures 4 and 5 show, is **more than 10 times the market capitalisation of the company**.

When making relative comparisons investors should note the critical "resilience factors" which we outline earlier in this report. ASC's ability to counter macro headwinds better than some of its distilled spirits and luxury goods peers should be reflected in its relative valuation.

Were ASC to achieve a 150p share price, our fair value, the EV/sales ratio for FY2022 would be 5.5x which would still be beneath the average for either group despite ASC's ultra-premium price positioning, lack of supply chain threats and a membership headcount driven revenue model. Moreover, the company reiterated its ambition to double revenues between FY2020 and FY2024 in today's statement.

Figure 4: Relative valuation - distilled spirits

	Share price	Shares	Mkt cap	Net debt	EV	Sales	EV/sales
All figures in local currency units	(local)	(m)	(m)	(m)	(m)	2022	(x)
Artisanal Spirits Company (ART)	54	69.6	37	13	51	22	2.4
Brown Forman (BF.B) *	71.13	479.1	34,078	1,119	35,197	4,112	8.6
Campari (CPR)	10.20	1,130.4	11,530	759	12,289	2,475	5.0
Diageo (DGE)	3,682	2,279.5	83,919	13,021	96,940	14,787	6.6
Remy Cointreau (RCO) *	178.80	50.7	9,072	291	9,363	1,552	6.0
Average							5.7

*Share prices are at 19th July 2022 UK close and 1700GMT for Brown Forman. * FY2023 forecasts*

Source: MarketScreener, ADVFN and Equity Development estimates

Figure 5: Relative valuation - luxury goods

	Share price	Shares	Mkt cap	Net debt	EV	Sales	EV/sales
All figures in local currency units	(local)	(m)	(m)	(m)	(m)	2022	(x)
Artisanal Spirits Company (ART)	54	69.6	37	13	51	22	2.4
Hermes (RMS)	1174	104.6	122,800	-7,690	115,110	10,571	10.9
LVMH (MC)	628	503.5	316,251	3,991	320,242	74,737	4.3
Average							5.8

Share prices are at 19th July 2022 UK close

Source: ADVFN, MarketScreener and Equity Development estimates

Financial forecasts

Aside from an increased assumption for membership numbers in FY2022 we are leaving our forward-looking sales (+18%) and gross margin (62.6%) forecasts unchanged. **It is important to note is that our confidence in the company's ability to match or beat these numbers is enhanced** – as we state in our relative valuation comments – by today's trading update.

Our FY2024 sales forecast at £29m is broadly consistent with the company's ambition to double sales revenue between FY2020 and FY2024.

The longer-term message from our financial forecasts is one of rapid sales growth combined with higher gross margins. The gross margin story is a direct function of the company's ability to source casks of maturing whisky stock more cheaply as the company reduces the average age of whisky stock purchased.

We include income statement, balance sheet and cash flow projections in Figures 6, 7 and 8.

Figure 6 - Income statement

All figures in £'000s	2020A	2021A	2022E	2023E	2024E	2025E
Revenue	15,026	18,237	21,566	24,828	28,620	32,679
increase in revenue	2.6%	21.4%	18.3%	15.1%	15.3%	14.2%
Gross profit	8,804	11,211	13,491	15,904	18,618	21,422
Gross margin (%)	58.6%	61.5%	62.6%	64.1%	65.1%	65.6%
Selling & distribution expenses	-2,979	-4,046	-4,800	-5,526	-6,370	-7,273
Administrative expenses (exc D&A)	-5,663	-8,752	-8,436	-9,027	-9,297	-9,576
EBITDA - adjusted	572	-626	255	1,351	2,951	4,573
Depreciation	-600	-671	-793	-914	-1,053	-1,202
Amortisation of intangible assets	-283	-271	-271	-271	-271	-271
EBIT - reported	-1,113	-2,529	-810	167	1,627	3,100
Exceptional items	-392					
Other income	410					
Other costs (share options)		-200	-200			
Finance costs	-499	-348	-343	-528	-562	-538
Pre-tax profits - reported	-1,202	-2,717	-1,353	-561	865	2,361
Taxation	-418		-300	-300	-173	-472
After tax profits - reported	-1,620	-3,348	-1,653	-861	692	1,889
Basic EPS (pence) - reported	-3.0	-5.9	-2.5	-1.5	0.7	2.5

Note: reported and adjusted are the same for all forecast years

Sources: Company historic data and Equity Development estimates

Figure 7 - Balance sheet

All figures in £'000s	2020A	2021A	2022E
Assets			
Non-current assets			
Investment property	391	391	391
Property, plant & equipment	5,785	8,377	12,913
Intangible assets	2,599	2,420	2,149
Total non-current assets	8,775	11,188	15,453
Current assets			
Cask goods & bottled stock	21,651	23,719	26,719
Trade & other receivables	1,956	2,968	3,213
Forward currency contracts	83		
Cash & cash equivalents	2,176	2,012	2,012
Total current assets	25,866	28,699	31,944
Total assets	34,641	39,887	47,397
Liabilities			
Current liabilities			
Trade and other payables	3,157	3,949	4,067
Forward currency contracts			
Current tax liabilities	332	277	277
Borrowings	14,963		
Lease debt	139	259	259
Convertible loan notes			
Total current liabilities	18,591	4,908	4,995
Non-current liabilities			
Borrowings	901	6,796	15,047
Lease liability	1,428	3,332	3,332
Deferred tax liabilities	324		
Provisions	404		
Total non-current liabilities	3,057	11,098	19,442
Total	21,648	16,006	24,437
Called up share capital	135	174	174
Share premium account	99	14,938	14,938
Translation reserve	-15		
Retained earnings	12,544	8,505	6,852
Hedging reserve	67		
Other reserves			691
Shareholders' funds	12,830	23,577	22,656
Minority interest	163	304	304
Total liabilities	34,641	39,887	47,397

Sources: Company historic data and Equity Development estimates

Figure 8 - Cash flow statement

All figures in £'000s	2020A	2021A	2022E
Profit (loss) for year after tax	-1,620	-3,348	-1,653
Cash flow from operations	-215	-3,958	-3,072
Income taxes paid	-327		-300
Interest paid	-477		
Net cash flow from operating activities	-1,019	-4,665	-3,715
Cash flow from investing activities			
Purchase of intangible assets	-437	-92	
Purchase of property, plant & equipment	-660	-1,101	-4,536
Proceeds received on sale of fixed assets	1		
Interest receivable	19		
Net cash used in investing activities	-1,077	-1,188	-4,536
Free cash flow before dividends etc	-2,096	-5,853	-8,251

Sources: Company historic data and Equity Development estimates



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