

## Investing in ultra-premium Scotch's global growth

18th July 2023

Today's Artisanal Spirits Company (ASC)'s FY2023 H1 trading update reported just over £10m in sales revenue compared with £9.9m a year earlier and included 7% growth in the second quarter. Importantly, there was a 9% increase in membership numbers. In addition, the statement reconfirmed the benefits of the company's ultra-premium distilled spirits positioning, its focus on Scotch whisky, and the advantage of not only being international but also in control of its supply chain and distribution system. We leave our forecasts unchanged and maintain our opinion that fair value for the shares – almost a pure play on ultra-premium Scotch - is 150p.

While the ASC's H1 sales growth was beneath our full year expectation of 14%, it should be noted that the company was lapping particularly strong growth in the same period a year earlier when sales advanced by 25%. The company itself remains confident that full year market expectations for sales and adjusted EBITDA will be met. We leave our own forecasts unchanged at £24.7m and £1.3m respectively for these two measures.

Membership remains central to the ASC investment case and the 9% H1 advance to above 38,700 members should, in our opinion, be seen as positive. Furthermore, the wide geographical spread of membership continues to ensure a steady performance with softer than expected trading in UK online and China being offset by strength in UK venues and continental Europe. We highlight the addition of 300 new members in South Korea and plans to establish a subsidiary in Taiwan.

Diverse global distilled spirits and Guinness beer giant Diageo PLC (DGE LN) hosted an investor presentation in Edinburgh on 1<sup>st</sup> June 2023 entitled "Delivering sustainable long-term growth – our vibrant Scotch portfolio." Diageo's central investment messages focused on premium Scotch as a growth driver and its value creating qualities relative to other distilled spirits categories. But Diageo is by no means a play on ultra-premium Scotch - The Artisanal Spirits Company is!

### Assessment of fair value at 150p per share

We base our 150p fair value/share, which implies a 4.8x FY2023 EV/sales ratio, on a relative valuation comparison with other international distilled spirits companies and luxury providers. Despite being far smaller by sales revenue and market cap size than the average for these groups, the ASC effectively represents a pure play not only on Scotch whisky but also on ultra-premium Scotch - both of which arguably merit a narrower gap between its own EV/sales value and those of its peers.

Key financials						
Year to 31 Dec	2020A	2021A	2022A	2023E	2024E	2025E
Revenue (£m)	15.0	18.2	21.8	24.7	28.7	32.9
Revenue growth (%)	2.6	20.2	19.4	13.6	15.9	14.7
EV/sales (x)	4.8	3.9	3.3	2.9	2.5	2.2

Source: ED estimates, company historic data

### Company Data

EPIC	ART
Price (last close p)	81
52 weeks Hi/Lo (p)	105 / 52
Market cap (£m)	56
ED Fair Value/share (p)	150

### Share Price, p



Source: ADVFN

### Description

Based in Edinburgh, ASC owns The Scotch Malt Whisky Society (SMWS) which was established in 1983 and currently has a growing worldwide membership of over 38,000 paying members. 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. The Group'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 SMWS's global membership.

### Chris Wickham (Analyst)

0207 065 2690  
[chris@equitydevelopment.co.uk](mailto:chris@equitydevelopment.co.uk)

### Hannah Crowe

0207 065 2692  
[hannah@equitydevelopment.co.uk](mailto:hannah@equitydevelopment.co.uk)

## Investing in ultra-premium Scotch’s global growth

**The Artisanal Spirits Company (ASC)’s FY2023 H1 trading update in our opinion reconfirms the company’s status as a growth company.** Moreover, as discussed in previous reports, the ASC’s ability to grow membership numbers both domestically and internationally enhances sales revenue growth as well as providing a natural hedge against any intermittent sluggishness in individual markets.

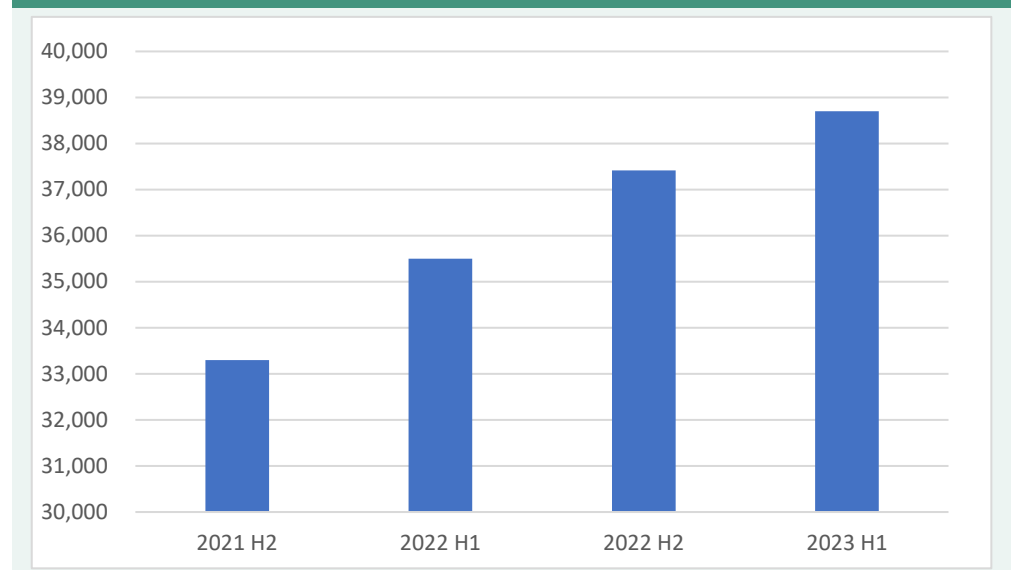
This report looks first at the operating performance highlights, progress against strategic objectives and the key outlook statements. In addition, we draw a positive read-across from the recent investor presentation by the world’s largest distilled spirits company Diageo PLC (DGE LN) about that company’s own expectations for Scotch whisky – notably in the premium and ultra-premium segments of the market.

### Performance highlights

ASC’s overall sales revenue increased to just over £10m from £9.9m a year earlier FY2023 H1 while Scotch Malt Whisky Society membership numbers advanced by 9% to over 38,700. Importantly, these H1 sales data lapped an unusually strong period in FY2022 when sales had advanced by 25%. In Q2 alone sales increased by 7%. As Figure 1 illustrates, **memberships maintained their consistent positive momentum in recent half-year periods.**

FY2023 H1 sales benefited from strong performances in European and UK venues, which offset softer than expected performances from UK online and China. Hence our comment regarding the benefits of a “natural hedge” arising from geographically diverse membership appears pertinent.

**Figure 1 – End half-year number of SMWS members**



Source: Company data

ASC also announced that, in line with its strategy, the company further optimised its cask spirit holdings to take advantage of opportunities to acquire old and rare spirits. Such activities – including the use of swaps and brokerage - are capable of realising value from existing stocks.

## Strategic objectives

**Strategically, ASC remains on track to deliver further sales and profit growth.** The company completed the final development stage of its Masterton Bond facility, which was e-fulfilment. All bottling and despatch activities are now completed on-site which augurs positively for margin expansion.

Meanwhile, the company continues to strengthen its senior management team with the promotion of Billy McCarter to the newly created position of CFO and Chris Leggatt (former CEO of Douglas Laing & Co) as the new Business Development Director.

Elsewhere, the company confirmed the success of its new South Korean launch where 300 new members were added on its initial launch in April 2023 and the signing of new franchise agreements in Malaysia and Singapore where the relationship with Maison du Whisky was expanded. A new subsidiary in Taiwan – the world's third largest market for ultra-premium Scotch whisky - is due to be added in FY2023 Q3.

## Confidence in matching full year expectations

ASC expects to meet full year consensus forecasts for sales revenue and EBITDA. As a result, we maintain our FY2023 sales estimate at £24.7m and adjusted EBITDA at £1.3m which after rounding is in line with the company's assessment of current consensus expectations – i.e., £25.2m and £1.1m, again respectively.

Factors which contribute to this confidence include the current trading performance and momentum of UK venues, Continental Europe, China and expectations of a stronger H2 in UK online and the US.

Elsewhere, the company highlights further re-balancing of cask spirit holdings including development of member cask sales as a new revenue driver and additional benefit of membership.

## Diageo presentation reads across positively for ASC's SMWS

The world's largest distilled spirits and Scotch whisky company Diageo PLC (DGE LN) made a presentation to investors on 1<sup>st</sup> June 2023, details of which can be found on this hyperlink - [Diageo 2023 Scotch investor presentation](#). Diageo used their seminar – hosted by new CEO Debra Crew – to showcase the investor benefits arising from taking a leading position in **ultra-premium Scotch whisky**.

Diageo highlighted that Scotch is a large market and one which is growing ahead of total beverage alcohol (TBA) in size. They noted that Scotch is “premiumising” and that there is scope to recruit consumers into the category as well as driving new Scotch whisky consumption occasions.

**In our view ASC is already a clear beneficiary from these trends and opportunities and thus it should be no surprise that the much larger company by market capitalisation should be investing in Scotch for long term sustainable growth.**

Ironically, the Scotch whisky investment message read across is arguably more pertinent for ASC than for Diageo. ASC through SMWS is pretty much solely **focused on the procurement, maturation and consumer delivery of ultra-premium Scotch whisky**, which contrasts with Scotch whisky being only 27% of Diageo's sales revenue. Furthermore, within Scotch whisky Diageo continues to carry a significant portion of standard – i.e. non-premium – brands.

## Financials and Valuation

### Relative valuation

We reiterate our long-held fair value of 150p per share for ASC. This is based on an EV / 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 2 and 3 respectively.

Were ASC to achieve our fair value of 150p, the **EV/sales ratio for FY2023 would be 4.8x** at most, which would still be beneath the average for either group despite ASC's Scotch malt whisky focus, ultra-premium price positioning, lack of supply chain threats and a membership headcount driven revenue model. Furthermore, this membership continues to grow in size.

As we highlight from the reads across from Diageo's recent investor presentation, **ASC is virtually a pure investment play on ultra-premium Scotch whisky** which is arguably the distilled spirits industry's most attractive category. Ultra-premium Scotch malt whisky boasts the important luxury goods industry qualities of relatively low price elasticity of demand and commercial resilience in the face of economic fluctuations.

**Figure 2 - Relative valuation - distilled spirits**

All figures in local currency units	Share price (local)	Shares (m)	Mkt cap (m)	Net debt (m)	EV	Sales 2023	EV/sales (x)
<b>Artisanal Spirits Company (ART)</b>	<b>81</b>	<b>69.7</b>	<b>56</b>	<b>16</b>	<b>73</b>	<b>25</b>	<b>2.9</b>
Brown Forman (BF.B)	66.93	479.2	32,076	2,158	34,234	4,519	7.6
Campari (CPR)	12.72	1,120.6	14,247	1,460	15,707	2,997	5.2
Diageo (DGE)	3,365	2,248.5	75,541	14,967	90,508	17,264	5.2
Remy Cointreau (RCO)*	140.75	50.4	6,960	585	7,545	1,479	5.1
<b>Average</b>							<b>5.2</b>

Share prices are as at 17 July 2023 UK close for European listed companies and 1700BST for Brown Forman

Source: MarketScreener, ADVFN and Equity Development estimates

**Figure 3 - Relative valuation - luxury goods**

All figures in local currency units	Share price (local)	Shares (m)	Mkt cap (m)	Net debt (m)	EV	Sales 2023	EV/sales (x)
<b>Artisanal Spirits Company (ART)</b>	<b>81</b>	<b>69.7</b>	<b>56</b>	<b>16</b>	<b>73</b>	<b>25</b>	<b>2.9</b>
Hermes (RMS)	1,912	104.5	199,899	-10,815	189,084	13,571	13.9
LVMH (MC)	859	501.1	430,425	21,462	451,887	88,083	5.1
<b>Average</b>							<b>7.3</b>

Share prices are as at 17 July 2023 UK close

Source: MarketScreener, ADVFN and Equity Development estimates

## Financial forecasts

At this stage we make no changes to our FY2023 financial forecasts which are thus the same as those published in our 29<sup>th</sup> March 2023 report [Delivering robust profitable growth](#) **We continue to expect sales growth to be firmly double digit during our forecasting period with the business becoming increasingly profitable.**

Our income statement, balance sheet and free cash flow projections are summarised in Figures 4, 5 and 6 respectively.

### Figure 4 - Income statement

All figures in £'000s	2020A	2021A	2022A	2023F	2024F	2025F
<b>Revenue</b>	<b>15,026</b>	<b>18,237</b>	<b>21,781</b>	<b>24,747</b>	<b>28,672</b>	<b>32,896</b>
increase in revenue	2.6%	21.4%	19.4%	13.6%	15.9%	14.7%
Gross profit	8,804	11,211	13,845	15,851	18,653	21,565
Gross margin (%)	58.6%	61.5%	62.6%	64.1%	65.1%	65.6%
Selling & distribution expenses	-2,979	-4,046	-5,503	-5,526	-6,402	-7,345
Administrative expenses (exc D&A)	-6,055	-8,848	-8,616	-9,027	-9,298	-9,577
<b>EBITDA - adjusted</b>	<b>572</b>	<b>-626</b>	<b>395</b>	<b>1,299</b>	<b>2,953</b>	<b>4,643</b>
Exceptional items	-392	-897	-631			
Depreciation	-600	-575	-1,000	-914	-1,053	-1,208
Amortisation of intangible assets	-283	-271	-259	-259	-259	-259
EBIT - reported	-1,113	-2,529	-1,533	126	1,641	3,176
Other income	410	160				
Other costs (share options)			-200	-200	-200	-200
Finance costs	-499	-348	-577	-507	-541	-515
<b>Pre-tax profits - reported</b>	<b>-1,202</b>	<b>-2,717</b>	<b>-2,072</b>	<b>-381</b>	<b>1,100</b>	<b>2,661</b>
Taxation	-418	-631	359	-300	-220	-532
Net earnings	-1,648	-3,743	-1,981	-861	700	1,970
<b>Basic EPS (pence) - reported</b>	<b>-3.0</b>	<b>-5.9</b>	<b>-2.8</b>	<b>-1.2</b>	<b>1.0</b>	<b>2.8</b>

Sources: Company historic data and Equity Development estimates

**Figure 5 - Balance sheet**

All figures in £'000s	2020A	2021A	2022A	2023F
<b>Assets</b>				
<b>Non-current assets</b>				
Investment property	391	391	405	405
Property, plant & equipment	5,785	8,377	10,362	10,859
Intangible assets	2,599	2,420	2,249	1,990
<b>Total non-current assets</b>	<b>8,775</b>	<b>11,188</b>	<b>13,016</b>	<b>13,254</b>
<b>Current assets</b>				
Cask goods & bottled stock	21,651	23,719	28,129	29,129
Trade & other receivables	1,956	2,968	3,888	4,087
Forward currency contracts	83			
Cash & cash equivalents	2,176	2,012	2,331	2,331
<b>Total current assets</b>	<b>25,866</b>	<b>28,699</b>	<b>34,348</b>	<b>35,547</b>
<b>Total assets</b>	<b>34,641</b>	<b>39,887</b>	<b>47,364</b>	<b>48,801</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	3,157	3,949	3,703	3,814
Forward currency contracts				
Current tax liabilities	332	277	405	405
Financial liabilities	14,963			
Lease debt	139	259	360	360
Convertible loan notes				
<b>Total current liabilities</b>	<b>18,591</b>	<b>4,908</b>	<b>4,824</b>	<b>4,935</b>
<b>Non-current liabilities</b>				
Financial liabilities	901	6,796	16,984	18,077
Lease liability	1,428	3,332	2,959	2,959
Deferred tax liabilities	324			
Provisions	404			
<b>Total non-current liabilities</b>	<b>3,057</b>	<b>11,098</b>	<b>20,523</b>	<b>21,536</b>
Called up share capital	135	174	174	174
Share premium account	99	14,938	14,997	14,997
Translation reserve	-15			
Retained earnings	12,544	8,505	6,685	5,824
Hedging reserve	67			
Other reserves				1,107
Shareholders' funds	12,830	23,577	21,788	22,102
Minority interest	163	304	228	228
<b>Total liabilities</b>	<b>34,641</b>	<b>39,887</b>	<b>47,364</b>	<b>48,801</b>

Sources: Company historic data and Equity Development estimates

**Figure 6 - Cash flow statement**

All figures in £'000s	2020A	2021A	2022A	2023F
Profit (loss) for year after tax	-1,620	-3,348	-1,713	-681
<b>Cash flow from operations</b>	<b>-215</b>	<b>-4,013</b>	<b>-5,625</b>	<b>211</b>
Income taxes paid	-327		-75	-300
Interest paid	-477			
<b>Net cash flow from operating activities</b>	<b>-1,019</b>	<b>-4,666</b>	<b>-6,194</b>	<b>-596</b>
Cash flow from investing activities				
Purchase of intangible assets	-437	-92		
Purchase of property, plant & equipment	-660	-1,101	-2,911	-497
Proceeds received on sale of fixed assets	1			
Interest receivable	19			
Net cash used in investing activities	-1,077	-1,188	-3,385	-497
<b>Free cash flow before dividends etc</b>	<b>-2,096</b>	<b>-5,854</b>	<b>-9,579</b>	<b>-1,093</b>

Sources: Company historic data and Equity Development estimates



## Contacts

### Andy Edmond

Direct: 020 7065 2691

Tel: 020 7065 2690

[andy@equitydevelopment.co.uk](mailto:andy@equitydevelopment.co.uk)

### Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

[hannah@equitydevelopment.co.uk](mailto:hannah@equitydevelopment.co.uk)

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Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London EC2M 7EB

Contact: [info@equitydevelopment.co.uk](mailto:info@equitydevelopment.co.uk) | 020 7065 2690