The Artisanal Spirits Company

Serving up a strong growth outlook in 2022

29 March 2022

Full year FY2021 results for The Artisanal's Spirits Company (ASC) delivered both sales revenue growth and member numbers ahead of market expectations. Moreover, a sharp rise in membership towards the end of FY2021 gave the company the "*best possible start*" to the current year and raises our confidence in the group's ability to deliver another year of around 20% higher net sales revenue. On that basis, ASC's ratings still appear at an attractive level, and we reiterate our 150p fair value for the shares.

Artisanal Spirits already released a trading statement for FY2021 on 20th January 2022, which showed a 20% advance in global sales and a 15% increase in second half membership. As we stated in an accompanying report entitled "Well positioned for strong sales growth in FY2022", ART should continue to grow membership and benefit from the observable alcoholic drinks trend of "*drinking less but better*." And that looks to be the FY2022 story.

Aside from a 21% increase in sales revenue, which was ahead of market expectations, other positive features of today's release included a 27% advance in gross profit, as gross margins increased from 58.6% to 61.5%, plus a reduction in net debt from £13.7m to £5.2m. The company was lossmaking at the EBITDA level to the sum of £0.6m, compared with a £0.6m profit in FY2020. However, given the scale of gross margins and the manageability of the cost base overall, there is no structural impediment to the business returning to a profit in the near term.

Membership growth for the Scotch Malt Whisky Society (SMWS) is a vital driver of the group's business. The company reported 18% membership growth in FY2021 with an important 15% second half increase, which included strong growth in China. Given that many members only joined towards the end of the last financial year, the scope for incremental purchases of the company's malt whiskies is sizable. Hence, we have confidence in our expectation of near 20% growth in FY2022.

Other parts of the business made progress and are on track to assist growth in both sales and profits. The company took control of important joint ventures in the second half of last year and the J G Thomson brand is showing early signs of adding incrementally to group sales revenue.

Despite a strong set of 2021 numbers, we leave our FY2022 forecasts unchanged at this stage. However, it should be noted that confidence in these numbers being achieved is bolstered significantly by the achievement of better sales figures than expected and a surge in membership towards the end of FY2021 (+18% in Q4). Importantly, such momentum should in our view be associated with the market being willing to pay a higher multiple of sales revenue for the business. We highlight this point in our relative valuation analysis later in the report.

We leave our expectations for sales revenue, gross profits, and EBITDA unchanged. And we continue to argue that fair value for the business is 150p per share – i.e. considerably more than the most recent close. At 150p the FY2022 EV/sales ratio would still be only 5.5x, remaining well beneath that of the Artisanal Spirits Company's two identifiable peer groups: distilled spirits and luxury goods.

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%	20.2%	19.4%	15.1%	15.3%	14.2%
EV/sales (x)	4.4	3.6	3.0	2.6	2.3	2.0

Source: ED estimates, company historic data

Company Data

EPIC	ART
Price (last close)	75p
52 weeks Hi/Lo	118p/75p
Market cap	£52m
ED Fair Value/share	150p

Share Price since IPO, p

Source: ADVFN

Description

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.

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Investment case

Today's FY2021 preliminary results statement is consistent with the overall long term investment case for The Artisanal Spirits Company. Through ownership of the Scotch Malt Whisky Society, the company is well placed to benefit from the important alcoholic beverage trend of drinking "less but better."

We reiterate our view that ASC's growth should continue to be fuelled by three important metrics: **growth in membership numbers**, **increases in average spend per member** and **the potential to expand gross margins significantly.**

ASC's four stated growth drivers remain in place**.** They are to grow and develop membership, enhance the e-commerce channel, further improve margins through increased value creation and to establish new and complementary brands.

These four drivers are important not only because they reflect clear growth ambitions, but also because they are consistent with the "DNA" of the company. ASC can embrace Scotch whisky heritage and ensure integrity of its product offering while adopting modern business techniques to ensure that it operates its e-commerce platform at best practice.

Serving up a strong growth outlook in 2022

Aside from ASC's better than expected sales revenue results and an in-line EBITDA outcome, this report highlights three important business factors – membership growth and increased lifetime value per member, the potential for ongoing margin expansion and growth opportunities outside core single cask Scotch malt whisky. But first we look at the results:

Preliminary FY2021 results

Key features of today's FY2021 preliminary results announcement are shown in Figure 1.

The 21% increase in sales revenue beat our own 20% forecast. Gross margins benefited from the removal of US tariffs on Scotch whisky and have probably not peaked as the company is well placed to shift its offering in favour of malt whisky stock which it has owned from a younger age.

Moreover, scale benefits should boost operating profit measures going forward.

Figure 1 - FY2021 results highlights

Dec y/e, £m	FY2020	FY2021	Change
Revenue	15.0	18.2	21%
Gross profit	8.8	11.2	27%
Gross margin	59%	61%	2ppt
EBITDAE	0.6	-0.6	nm
Net debt	13.7	5.2	nm

Source: Company data

Sales revenue benefited from a continued recovery in UK venue and events sales following a phased post-lockdown reopening in the middle of the year. ASC's statement emphasises that UK venue sales in the second half of FY2021 exceeded those for the whole of the previous year, a year also affected negatively by Covid19 pandemic measures. Venues represent around 25% of the company's business.

Other noteworthy features of the year included significant investment in matured spirit stock and cask wood, the signing of a 10-year lease on a new supply chain facility, the launch of the new heritage brand J G Thomson, which includes other spirits categories such as blended whisky, and increased equity interests in the joint venture entities in China and Japan.

Membership growth in FY2021 augurs positively for FY2022

Membership growth was strong with advances of 18% overall in FY2021 and a 15% gain in the second half of the year as the end-June number grew from 28,700 to 33,000 at end-December. UK membership grew by 20% and other markets averaged 15% in the year as exceptionally strong growth in China was offset by lower levels of growth in continental Europe where the company experienced some Brexit related challenges in the first half of the year.

In the final quarter, **membership rose by 18%.** Since year-end there was a further 3% increase to 34,200.

The company's ability to grow membership on a global, even if not worldwide basis, was an important feature of our 16th September 2021 report Unique heritage and global opportunity, which initiated Equity Development's coverage of The Artisanal Spirits Company. In that report we not only highlighted the benefits of membership from a sales perspective but also the scope for the lifetime member value to grow: encouragingly in FY2021 lifetime member value increased to **£1,445 from £932** a year earlier.

However, it should be noted that the Lifetime Value calculation can be subject to year-on-year fluctuations due to changes in estimated churn rates. The company itself places greater emphasis on absolute values of revenue per member and membership growth, where the position is clearly positive.

Lifetime membership value is measured by the company taking the total number of members and analysing their contribution to profit per member. This figure is then multiplied by the membership retention rate – or churn – to generate a lifetime number of years, which in turn computes the lifetime value in sterling. A 55% advance, as experienced in FY2021, is clearly positive.

Global membership growth of the Scotch Malt Whisky Society is summarised by key country in Figure 2.

Clearly China, where there is an observable enthusiasm for higher priced products, was a stand-out with a 57% increase in member numbers. Moreover, double digit gains were recorded in all other regions aside from continental Europe.

Figure 2 - SMWS global membership

All figures in '000s of persons	FY2020	FY2021	Change
UK	13.7	16.4	20%
US	4.4	5.2	18%
China	1.1	1.7	57%
Europe*	3.3	3.3	3%
Australia	1.1	1.3	18%
Japan	1.4	1.5	14%
Rest of World	3.3	3.8	15%
Total members	**28.3**	**33.3**	**18%**

Source: Company data
Note: * Europe represents direct sales markets within continental Europe, but excludes franchise markets in Denmark and Switzerland which are shown within Rest of World

However, continental Europe should accelerate in FY2022 as any shipping delays associated with Brexit continue to shorten. Initially such delays were observed to be measurable in months - but have since shrunk to weeks and now days. It is also worth noting that ahead of Brexit, European membership numbers advanced by a rapid 60% in FY2019 and by a further 18% in FY2020. With a sizable and developed economy - US$15.3 trillion GDP in the EU alone in 2020 *(Source: worldbank.org)* - **continental Europe continues to be seen as a major opportunity.**

An important step forward in the continental European business is the establishment of a warehouse in the region. This should not only enable the company to mitigate any Brexit-related challenges in the sizable region but also to reduce delivery times to EU based members – i.e. execute an improvement in service levels.

The pace of membership growth lends credibility to the view that overall membership numbers may hit the ASC's medium term 40,000 target ahead of schedule. Currently, the company is gaining new members at a rate of around 500 per month or 6,000 annualised. As a result, that landmark could well be reached in FY2023 with positive implications for revenue growth.

Importantly at a time when some regions have been subjected to economic sanctions and business disruption due to geo-political tensions, the Scotch Malt Whisky Society has a broad geographical spread of membership numbers. No single market outside the UK represents more than 15% of the company's overall membership.

Furthermore, in the unlikely event of any cyber attacks on the business, it is worth noting that the SMWS does not operate from a single platform. As a result, the potential risk of any trading disruption due to negative external forces should be seen as limited.

Overall, the membership position is a strong one and we reiterate that the second half and fourth quarter gains should enhance confidence in another year of around 20% sales growth in FY2022. In particular, a sizable number of new members are unlikely to have developed what might be described as a full year purchasing habit.

Margin outlook remains positive

The gross margin increase **from 58.6% to 61.5%** in FY2021 was largely attributable to the removal of US tariffs on Scotch whisky. However, there are plenty of underlying developments which should enhance margins going forward.

ASC can enhance future gross margins by purchasing younger casks of maturing whisky stock. As the company grows it will be able to purchase casks for a lower price - with the direct result that gross margins will expand. Based on the calculations which appeared in our 16th September 2021 initiation report mentioned above, an increase from around 60% to closer to 70% is feasible within the current decade. This process remains ongoing.

Supply chain management should be margin enhancing at the EBITDA and pre-tax levels. As highlighted in the FY2021 results statement, the company signed a 10-year lease on a new 37,000 square feet supply chain facility which should become fully operational in the second half of FY2022. The company also expects increased use of sherry casks in the maturation process to be earnings enhancing.

As the business grows there should be significant economies of scale resulting from higher volume densities within the existing infrastructure.

A feature of premium distilled spirits is that customers tend to drink better rather than more. As a result, sales revenue should grow faster than volumes with additional positive implications for margins.

The International Wine & Spirits Research data which appear in Figure 3 tend to support this view of premium product growth. The table illustrates that the fastest growing price point in distilled spirits is the ‘prestige plus’ segment where bottles are sold for amounts in excess of £225.

An important point to remember regarding Scotch malt whisky is that a single bottle does not have to be consumed in “one go,” which is in stark contrast to super premium wines. Moreover, the bottles have very long shelf lives.

Figure 5 - Global Scotch Whisky market by price band

Segment	£/70cl bottle	Market size 2019 (US$bn)	CAGR (2010 to 2019)
Prestige-Plus	225.00+	0.7	27%
Prestige	75.00 to 224.99	1.1	11%
Ultra-Premium	35.00 to 74.99	3.8	9%
Ultra-Premium and above		**5.5**	**10%**
Super-Premium	28.75 to 34.99	3.2	9%
Premium	22.50 to 28.74	5.0	1%
Standard and below	**Up to 22.49**	**12.9**	**2%**
Total		**26.7**	**4%**

Source: IWSR

Momentum in the business

The re-opening of the SMWS’s venues in a post pandemic environment, the development of the J G Thomson business, reformulation of the group’s joint-ventures and sustained investment in the online offering all tend to confirm positive momentum in the ASC business overall. We look at each in turn.

Venues

SMWS’s venues are important outlets for both engaging with the society’s individual members and the ability for them to taste different products within the overall offering. The four venues, which include locations in Edinburgh, Glasgow, and London, provide a social experience around whisky education and are an important contributor to membership retention and lifetime value in the company’s domestic market.

Due to the impact of the Covid19 pandemic and forced closures, venues in FY2021 were equivalent to 17% of the overall business compared with pre-virus levels of closer to 25%. FY2022 will effectively lap around 6 months of venue closure. There should thus be a useful fillip to this year’s growth number from the re-openings.

J G Thomson

J G Thomson appears to be on track with a soft brand launch having taken place in November 2021. This year will see a more active launch as the brand enters new distribution channels and geographies. J G Thomson & Co is the group’s only Scotch whisky offering which carries its own brand name and the primary product will be blended Scotch malt whisky, which is itself a fast-growing market. Moreover, even blended malt whiskies tend towards the higher price points.

The subsidiary’s spirits will be marketed to consumers using both a Direct to Consumer (D2C) distribution model, as well as traditional channels such as specialist retail outlets.

While a diversification away from the traditional membership model of SMWS, J G Thomson embraces the overall culture of ASC – i.e. an ability to market heritage products steeped in history using modern e-commerce led methods of distribution.

Joint ventures

ASC increased the equity interest in its China and Japan joint ventures towards the end of FY2021. The company increased its Chinese holding by an additional 10% for an overall £0.5m of which £0.1m was the end-year cash balance. There was no material cost incurred in Japan.

The larger proportionate holdings are operationally important as they add scope to incentivise the in-market management with more equity. A higher level of local equity ownership should facilitate upskilling within those countries' business activities.

Online offering

Continuous improvements in the online offering remain an important focus for ASC overall. While Scotch Malt Whisky is a heritage product, the overall business model remains that of an e-commerce provider with an associated need to operate at best practice on a real time basis and optimise the use of the company's Big Commerce website platform and Netsuite for ERP.

Given that 83% of ASC's sales were online in FY2021 and the business grew by revenue by 21%, it is clear to us that a focus on, and investment in, the online platform is working well.

Financials and Valuation

Relative valuation

We continue to hold a fair value of 150p per share for ASC based on Enterprise Value to Sales relative to what we deem to be the company's two salient peer groups, both of which comprise publicly listed companies. These are **distilled spirits** and **luxury goods**, for which relative valuations appear in Figures 4 and 5.

Luxury goods is particularly pertinent because they capture the high price points and exclusivity of the company's products. What is clear is that ASC trades at a large EV/sales valuation discount to both kinds of companies.

Moreover, there is a tangible valuation benefit which arises from the strength of the FY2021 numbers and the strong start to membership growth in FY2022, as well as the late surge in membership towards the end of the previous year. These unchanged forecasts will become easier to match or even beat than might previously been supposed. As a result, investors should be willing to pay a higher multiple of sales for a share in the business.

Were ASC to achieve a 150p share price, our fair value, the EV/sales ratio would be 5.5x which would still be comfortably beneath the average for either group.

Figure 4: Relative valuation - distilled spirits

All figures in local currency units	Share price (local)	Shares (m)	Mkt cap (m)	Net debt (m)	EV	Sales 2022	EV/sales (x)
Artisanal Spirits Company (ART)	**75**	**69.6**	**52**	**13**	**66**	**22**	**3.0**
Brown Forman (BF.B)	66.25	479.0	31,732	1,478	33,210	3,766	8.8
Campari (CPR)	10.38	1124.2	11,670	743	12,413	2,354	5.3
Diageo (DGE)	3822	2306.4	88,151	12,998	101,149	14,520	7.0
Remy Cointreau (RCO)	181.00	50.7	9,181	398	9,579	1,293	7.4
Average							**6.3**

Share prices are at 28th March 2022 UK close and 1700GMT for Brown Forman

Source: MarketScreener, ADVFN and Equity Development estimates

Figure 5: Relative valuation - luxury goods

All figures in local currency units	Share price (local)	Shares (m)	Mkt cap (m)	Net debt (m)	EV	Sales 2022	EV/sales (x)
Artisanal Spirits Company (ART)	**75**	**69.6**	**52**	**13**	**66**	**22**	**3.0**
Hermes (RMS)	1239	104.6	129,602	-7,756	121,846	10,103	12.1
LVMH (MC)	636	503.5	320,078	4,375	324,453	72,632	4.5
Average							**6.5**

Share prices are at 28th March 2022 UK close

Source: ADVFN, MarketScreener and Equity Development estimates

Financial forecasts

Despite a better outcome than expected on sales revenue and gross profit, we are leaving our FY2022 sales (+18%) and gross margin (62.6%) forecasts unchanged. What is important to note is that confidence in the company's ability to match or beat these numbers is enhanced – as we state in our relative valuation comments – by the FY2021 results and the strong start to membership growth in FY2022.

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

Dec y/e, £'000s	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
	Actual	Actual	F/cast	F/cast	F/cast	F/cast
Revenue	**15,026**	**18,237**	**21,566**	**24,827**	**28,622**	**32,678**
increase in revenue	2.6%	21.4%	18.3%	15.1%	15.3%	14.2%
Gross profit	8,804	11,211	13,491	15,903	18,620	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**	**2,952**	**4,573**
Depreciation	-600	-671	-793	-913	-1,053	-1,202
Amortisation of intangible assets	-283	-271	-271	-271	-271	-271
EBIT - reported	-1,113	-2,529	-810	166	1,628	3,099
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**	**-562**	**866**	**2,361**
Taxation	-418		-300	-300	-173	-472
After tax profits - reported	-1,620	-3,348	-1,653	-862	693	1,889
Basic EPS (pence) - reported	**-3.0**	**-5.9**	**-2.5**	**-1.5**	**0.7**	**2.5**

Sources: Company historic data and Equity Development estimates

Figure 7- Balance sheet

Dec y/e, £'000s	2020A	2021A	2022F
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	22,655
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

Dec y/e, £'000s	**2020**	**2021**	**2022**
	Actual	Actual	Forecast
Profit (loss) for year after tax	**-1,580**	**-3,438**	**-1,653**
Cash flow from operations	**816**	**11,315**	**-3,072**
Income taxes paid	-327		-300
Interest paid	-477		
Net cash flow from operating activities	12	10,608	-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	**-1,065**	**9,420**	**-8,251**

Sources: Company historic data and Equity Development estimates

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