The Artisanal Spirits Company

Delivering robust profitable growth

29th March 2023

19% revenue growth, a 12% increase in membership numbers and a £1.0m favourable swing in adjusted EBITDA were key features of today's FY2022 results statement. With the Masterton Bond facility fully operational and group trading having started well in the current year, ASC appears well placed to deliver medium term sustainable profitable growth. As a membership organization which boasts substantial invested facilities and valuable whisky stocks, we reiterate our 150p fair value for the shares.

Today's results reported not only a swing to £0.4m profitability at the adjusted EBITDA level but also expectations that the company will meet its IPO commitment to pre-tax profitability in 2024. In terms of sales revenue, today's release confirmed the growth rates reported in the 24 January 2023 trading update, **to deliver a performance slightly ahead of market expectations**. Profitability was helped by an increase in gross margins to 63.6% from 61.5% in FY2021. The long-standing target to double sales revenue between 2020 and 2024 remains in place.

Membership numbers grew both domestically and internationally in FY2022 with Europe (+29%), Australia (+24%) and Japan (+21%) posting the strongest gains. Growth in the two largest membership countries was also double digit – the UK and US showed 10% and 16% increases respectively. Positive updates regarding agreements in Malaysia and South Korea are consistent with an ability to recruit in new countries.

Elsewhere, ASC confirmed that the Masterton Bond facility near Glasgow is now fully operational and delivering supply chain benefits. The company's venues delivered record performances in January and February 2023, and brand development outside the Scotch Malt Whisky Society – notably J G Thomson – is showing early signs of progress. Perhaps not surprisingly, the company's CEO reports in his statement that the new financial year has begun well.

The SMWS product offering is "ultra-premium" and above. In our view, as an effectively luxury item, the company's flagship whisky offering should be less susceptible to economic fluctuations than more mainstream categories of distilled spirits. As a result, ASC should be in a position to deliver sustainable growth on the demand side. With a notional retail value of £493m for its stock-in-cask whisky at end-FY2022, the supply side looks strong too. The company has enough whisky stock to satisfy demand through to 2028 and beyond, together with robust headroom on finance.

Assessment of fair value at 150p per share

We base our 150p fair value/share, which implies a 4.9x FY2023 EV/sales ratio, largely on a relative valuation when compared with leading listed distilled spirits companies and luxury goods providers. ASC is simultaneously exposed to both these categories given its emphasis on ultra-premium-and-above Scotch malt whiskies. Furthermore, **the £493m updated notional retail value of the company's maturing whisky stocks (mentioned above) is currently over 7 times today's market capitalisation**.

Key financials

Year to 31 Dec	2020A	2021A	2022A	2023E	2024E	2025E
Revenue (£m)	15.0	18.2	21.8	24.8	28.6	32.7
Revenue growth (%)	2.6	20.2	19.4	15.1	15.3	14.2
EV/sales (x)	5.4	4.5	3.7	3.3	2.8	2.5

Source: ED estimates, company historic data

Company Data

EPIC	ART
Price (last close p)	94
52 weeks Hi/Lo (p)	102 / 52
Market cap (£m)	65
ED Fair Value/share (p)	150

Share Price, p

Source: LSE

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 37,000 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

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Delivering robust profitable growth

Today's FY2022 full year results release confirmed the 19% sales growth (i.e. approximately 20%) and 12% expansion in membership numbers which we commented on in our 24th January 2023 report Sales and membership growth drives momentum at the time of ASC's FY2022 Trading Update.

Aside from giving greater geographical detail for these two important growth drivers, today's results include an all-important £1.0m positive swing in adjusted EBITDA to a £0.4m profit as well as a reiteration of the company's commitment to deliver pre-tax profitability in FY2024.

In terms of current trading, ASC's recently promoted company CEO Andrew Dane's statement reports that "the new financial year has begun well" – a view which is endorsed by a number of positive developments.

This report looks first at the key figures in today's results before analysing the membership numbers in more detail, commenting on key operational results and re-establishing the importance of SMWS's ultra-premium (or luxury) positioning as a driver of resilient sales revenue growth.

FY2022 results highlights

Financial highlights

We summarise the FY2022 results released today in Figure 1. Revenue was slightly ahead of our most recent £21.6m forecast as earmarked at the time of the FY2022 trading update. **All three profit measures released today moved in a positive direction**, with an improved gross margin of the order of 200 bps and £1.0m and £0.6m favourable swings in EBITDA and pre-tax profits respectively.

Importantly, **these profitability uplifts all occurred ahead of the Masterton Bond Facility becoming fully operational, which adds significant credibility to the company's target of being profitable at the pre-tax level in FY2024**.

Figure 1 - FY2022 results release - financial highlights

All figures in £m	FY2021	FY2022	Change
Revenue	18.2	21.8	20%
Gross margin	61.5%	63.6%	2.1 ppt
Gross profit	11.2	13.8	23%
EBITDA (adjusted)	-0.6	0.4	+1.0m
Pre-tax profit/loss	-2.7	-2.1	+0.6m
Stock-in-cask numbers (casks)	15,300	16,500	+1,200
Stock-in-cask value (notional retail)	430	493	15%

Source: Company data

On the sales revenue side, the company maintains its target to double sales between 2020 and 2024 – i.e. from £15m to £30m, a target that is broadly consistent with our own forecast of £28.6m. Today's delivery of a result slightly ahead of market expectations gives us renewed confidence in the company's forward-looking targets being met. Increased debt headroom of £21.5m with RBS means the group is also well financed for future expansion.

Operational highlights

Operational highlights included confirmation of a 12% increase in SMWS membership, as well as an 11% increase in annual contribution per member, **while member retention – a key component of the embedded value of the business – was 77%, unchanged at an all-time high**. Consistent with strong retention, estimated lifetime value per member increased from £1,445 to £1,457. These figures are summarised in Figure 2.

Outside the membership statistics, the key development was **completion of the Masterton Bond facility, which is now fully operational** and discussed in more detail later in this report. There are clear advantages to being in charge of the bottling process and complexity reductions associated with fulfilling customer orders. Longer term the company expects to manage the bulk of its bottling in-house.

Figure 2 - Operational highlights

	FY2021	FY2022	Change (%)
SMWS membership growth	33,327	37,416	12%
Annual revenue/average member	619	651	5%
Annual contribution/average member	332	339	2%
Retention	77%	77%	
Lifetime value per member	£1,445	£1,457	1%

Source: Company data

Current trading

So far in FY2023 – i.e. with around one quarter complete – revenue is described as having been broadly flat versus an unusually strong Q1 in FY2022. However, the phasing of growth is in line with expectations and **there are no concerns regarding growth expectations for the full year being met**. Regionally, the UK and EU remain strong with some negative impact in China due to Covid.

UK venues delivered new records in the first two months of the year while membership numbers as a whole increased by 10% year on year.

Membership central to SMWS business growth and quality

Membership numbers – widespread growth

As highlighted earlier, **membership numbers grew both domestically and internationally in FY2022**, with Europe advancing by 29%, Australia +24% and Japan +21% posting the strongest gains**.** Growth in the two largest membership countries was also double digit, with 10% and 16% increases in the UK and US respectively. Moreover, positive news flow items from Malaysia and South Korea are consistent with an ability to recruit in new countries. Only China was in negative territory for membership numbers.

Membership expansion remains central to the growth case for ASC and its core SMWS franchise. Importantly, it is a membership model rather than a subscription one with clear positive implications for loyalty and engagement with the end-customer.

Members receive important updates via the company's membership magazine – *Unfiltered* – as well as invitations to events at the society's venues. Such activities help to cement the relationship with the society, as well as encouraging ongoing purchases of the ultra-premium whiskies on offer. Members log onto the Scotch Malt Whisky Society website (www.smws.com) with a personalised log in. We include a summary of global membership by geographical area in Figure 3 and show the latest *Unfiltered* in Figure 4.

Figure 3 - SMWS global membership by geographical area

	FY2021	FY2022	Change
UK	16,443	18,029	+10%
US	5,207	6,058	+16%
China	1,732	1,659	-4%
Europe*	3,348	4,327	+29%
Australia	1,337	1,659	+24%
Japan	1,496	1,809	+21%
Rest of World	3,761	3,875	+3%
Total members	**33,324**	**37,416**	**+12%**

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

Source: Company data

Figure 4 – Unfiltered magazine – March 2023 front cover

Source: www.smws.com

Revenue growth in all geographical areas in FY2022

As figure 5 shows, **all geographic areas experienced increased sales revenue in FY2022 despite a reduction in membership numbers in China**. UK venues showed the most pronounced growth and are fully back in fashion after their forced closure due to Covid disrupted their activities. As mentioned above, the venues enjoyed record sales in January and February 2023. Member rooms and events and tastings enjoyed 85% revenue growth to £2.0m and 77% growth to £0.8m respectively.

Figure 5 - ASC revenue by geographical area FY2022

All figures in £m	FY2021	FY2022	Change
UK - venues	2.3	3.7	60%
UK - online	3.5	3.7	5%
US - shipments	4.1	4.4	6%
China	3.9	5.0	29%
Europe *	1.7	2.0	18%
Australia	0.9	1.0	11%
Japan	0.7	0.8	10%
Rest of World	1.2	1.3	9%
Total	18.2	21.8	19%

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

Source: Company data

Key performance indicators

ASC derives its key performance indicators from the above sets of data. The company uses these to measure annual revenue per average member, average contribution per average member as well as lifetime value per member based on an expected retention rate. The position is summarised in Figure 6. (Note that this uses £'000s for revenue).

Figure 6 - Group KPIs by geographical area

	Revenue (£'000s)	Year-end members	Average members	Revenue/ ave mem	Contrib/ ave mem	Retention	Expected years	LTV per member
UK	6,782	18,029	17,382	£390	£215	80%	5.1	£1,095
United States	4,353	6,058	5,560	£783	£438	69%	3.2	£1,415
China	5,002	1,659	1,670	£2,994	£2,125	44%	1.8	£3,768
Europe	2,014	4,327	3,799	£530	£110	79%	4.9	£534
Rest of World	1,256	3,875	3,836	£828	£371	79%	8.0	£1,539
Australia	1,001	1,659	1,523	£657	£327	80%	5.0	£1,668
Japan	800	1,809	1,651	£485	£362	85%	6.9	£2,487
Total	**21,209**	**37,416**	**35,421**	**£599**	**£339**	**77%**	**4.3**	**£1,457**
Change vs prior year	**16%**	**12%**	**20%**	**-3%**	**2%**		**-2%**	**1%**

Source: Company data

The central message from the KPIs in our opinion is resilient, sustainable growth. The company's member retention rate is unchanged at a strong 77%, while the contribution per member was in positive territory despite a fall in spend per member. As the year progresses, there is scope for members who joined towards the end of the previous year to place orders and raise their spend. The current growth rate and outlook for that growth rate are not only firmly positive but also built on strong foundations – i.e. membership.

Notes to Figure 6 – Group KPIs by geographical area

We draw attention to the following notes to Figure 6 in relation to the calculations. First, contribution is a non-IFRS measure, and is defined by Management as Gross Profit less commission paid on sales (primarily in relation to the US). Second, Expected Years is also non-IFRS measure, and is defined as one divided by one minus retention 1/(1-r%). Third, Lifetime Value (LTV) is a further non-IFRS measure, and is defined as Annual Contribution per member, multiplied by expected years. Finally, revenue excludes J G Thomson and cask sales of £0.7m as they do not relate to the membership proposition.

Operating highlights

Masterton Bond

Located near Glasgow, the Masterton Bond facility's status as fully operational was the key operational development of FY2022 and the first quarter of FY2023. The company began the initial production phase at Masterton Bond's multipurpose supply chain operation in the final quarter of FY2022.

Around 20,000 bottles were produced prior to the FY2022 year end. Since then production increased to around.70,000 bottles and the facility will provide production, cask storage, fulfilment and distribution of the group's whisky and other spirit products further ahead.

In addition, the facility should facilitate the maturation process as around 3,000 casks are expected to be stored at Masterton. ASC's SWMS constantly monitors which casks it is using to mature whisky stocks. Immediate access to these casks and the potential to switch whisky from one type of cask to another easily – e.g. from sherry to bourbon – enhances the operating efficiency of the organization.

ASC states that that **the company is already beginning to benefit from the improved operating margins (anticipated to be around 200 bps per year) from Masterton**. Some idea of the premises' state-of-the-art nature can be gleamed from the photographs in Figure 7.

Figure 7 – Masterton Bond facility images

Sources: DRAM Scotland and Whisky Magazine

J G Thomson

Development and progress with J G Thomson was covered briefly in ASC's January 2023 trading update. The brand represents an eclectic group of superior quality spirit and complementary brands under the heritage moniker of "J.G. Thomson." It is available both to SMWS members and through selected independent retail channels.

The first full year of J G Thomson generated around £0.2m of additional revenue to the Group, with most of that arising in H2 through initial exports to La Maison du Whisky in France, as well as cross sales to SMWS members.

Malaysia and South Korea

In terms of expanded geographic coverage, ASC announced in the final quarter of FY2022 that it had signed a new franchise agreement with F J Korea (FJK) in South Korea, Asia's fourth largest economy and the world's fifth largest market for Ultra-Premium Scotch whisky.

At the same time the company formed a new partnership agreement with Drinks Alliance in Malaysia, providing a new route to market in Malaysia (the 12th largest market within the global Ultra-Premium Scotch malt whisky sector) and further strengthening the Group's geographic footprint in South-East Asia.

Luxury and resilience to economic setbacks

ASC's SMWS operates in the ultra-premium segment of Scotch Whisky, which in our view gives the company added resilience at a time when there are some visible economic headwinds – notably consumer price inflation and rising interest rates as well as uncertainty associated with the ongoing military conflict in Ukraine.

This focus on ultra-premium distilled spirits formed a major component of our investment case for the company in our 16th September 2021 initiation report on The Artisanal Spirits Company which was entitled Unique heritage and global opportunity. In particular, we highlighted the faster observable growth of higher price-point whiskies within the category and the ongoing potential for trading up.

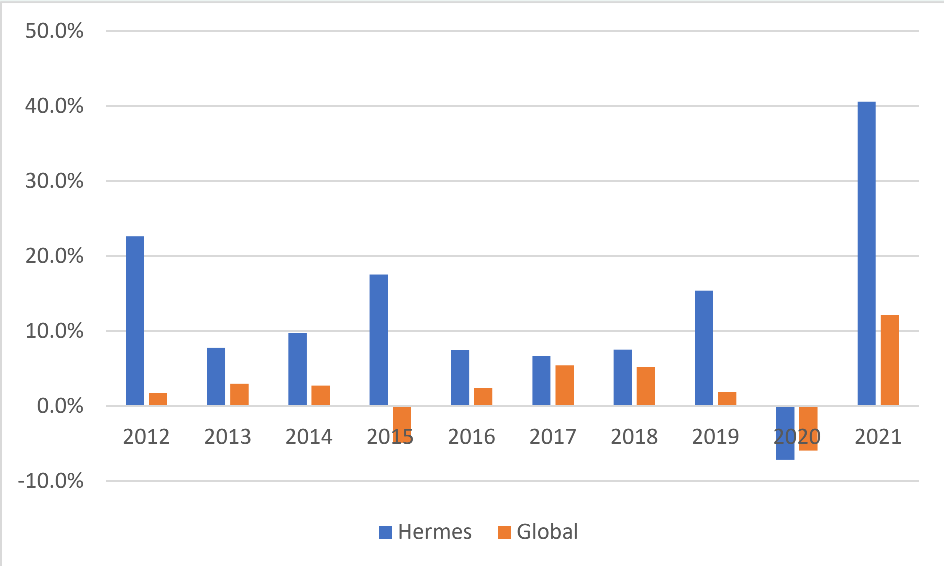
Moreover, given that ASC, through SMWS, demonstrates many characteristics of the luxury goods industry – e.g. uniquely crafted products and ultra-premium price positioning – we continue to include luxury goods companies Hermes SA and LVMH in our relative valuation. LVMH itself is active in the premium drinks sector – notably in Champagne, Cognac and some ultra-premium still wines.

Despite its relatively rarefied nature and exclusivity, luxury is a growth industry. In the past decade, sales revenue of the key publicly listed luxury goods providers – Hermes, LVMH and Richemont – consistently outperformed global consumers expenditure, based on OECD data. Given ASC's ultra-premium, arguably luxury status, we include these companies in our relative valuation.

It is also worth noting these companies' resilience and consistent ability to grow sales revenue. Indeed, using the example of French listed luxury goods company Hermes SA, we note that its only negative year for sales growth was in 2020 when, as a retailer as well as manufacturer, it was clearly negatively affected by COVID lockdowns and major disruption to travel and duty-free business.

In Figure 8 we compare sales growth for luxury goods provider Hermes SA with the OECD's estimates for global consumers expenditure. During the period shown, Hermes grew sales revenue at a 12.2% compound annual rate, which was significantly faster than the 2.2% reported for global consumption. LVMH and Richemont also comfortably outperformed global consumer spending in the period. These companies posted 10.5% and 8.0% CAGRs respectively.

Figure 8 – Hermes and global consumer spending annual growth rates (%)



Sources: finance.hermes.com and Statista

Financials and Valuation

Relative valuation

We retain 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 9 and 10 respectively.

In our view, ASC boasts many positive qualities relative to its distilled spirits peers which should support the valuation. The company is predominantly a direct-to-consumer based business which sells its products online into a growing membership base. Its focus is on the ultra-premium and above distilled spirits categories which are arguably less economically sensitive than products at other price points. As a result, it seems appropriate to include luxury goods companies in our relative valuation comparisons.

In addition, a key component of ASC's intrinsic value is the amount of maturing whisky stock which the company owns outright. As stated earlier, the notional retail value of this stock is estimated to be £455m which, as Figures 9 and 10 show, is more than **7 times** the current market capitalisation of the company.

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 ultra-premium price positioning, lack of supply chain threats and a membership headcount driven revenue model.

Figure 9 - 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)
Artisanal Spirits Company (ART)	**94**	**69.7**	**65**	**16**	**81**	**25**	**3.3**
Brown Forman (BF.B)*	63.42	479.2	30,393	2,256	32,649	4,157	7.9
Campari (CPR)	11.03	1,120.9	12,363	1,499	13,862	2,941	4.7
Diageo (DGE)*	3,547	2,254.4	79,954	14,803	94,757	17,435	5.4
Remy Cointreau (RCO)*	162.8	50.4	8,213	413	8,626	1,561	5.5
Average							**5.4**

Share prices are as at 28 March 2023 UK close for European listed companies and 1730BST for Brown Forman * FY2023

Source: MarketScreener, ADVFN and Equity Development estimates

Figure 10 - 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)
Artisanal Spirits Company (ART)	**94**	**69.7**	**65**	**16**	**81**	**25**	**3.3**
Hermes (RMS)	1,799	104.5	188,008	-10,862	177,146	11,462	13.5
LVMH (MC)	814	501.1	407,977	20,901	428,878	78,797	5.0
Average							**7.3**

Share prices are as at 28 March 2023 UK close

Source: MarketScreener, ADVFN and Equity Development estimates

Financial forecasts

As highlighted previously, despite our increased comfort in ASC matching (indeed, slightly beating) our expectation for FY2022, we make no major changes to our forecasts at this stage. **We expect sales growth to be firmly double digit during our forecasting period with the business becoming increasingly profitable**.

The central income statement message from FY2022 was that adjusted EBITDA swung from a £0.6m loss to a £0.4m profit. Note that our forecasts show reported numbers that include £0.6m of negative exceptional items.

ASC is committed to delivering positive pre-tax profits in FY2024 and doubling sales in that year relative to FY2020. Both are reflected in our own forecasts with expectations of £1m pre-tax profit in FY2024 and £29m sales revenue – i.e. close to double the £15m achieved in FY2020.

Our income statement, balance sheet and free cash flow projections are summarised in Figures 11, 12 and 13 respectively.

Figure 11 - Income statement

All figures in £'000s	2020A	2021A	2022A	2023F	2024F	2025F
Revenue	**15,026**	**18,237**	**21,781**	**24,747**	**28,672**	**32,896**
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
EBITDA - adjusted	**572**	**-626**	**395**	**1,299**	**2,953**	**4,643**
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
Pre-tax profits - reported	**-1,202**	**-2,717**	**-2,072**	**-381**	**1,100**	**2,661**
Taxation	-418	-631	359	-300	-220	-532
Net earnings	-1,648	-3,743	-1,981	-861	700	1,970
Basic EPS (pence) - reported	**-3.0**	**-5.9**	**-2.8**	**-1.2**	**1.0**	**2.8**

Sources: Company historic data and Equity Development estimates

Figure 12 - Balance sheet

All figures in £'000s	2020A	2021A	2022A	2023F
Assets				
Non-current assets				
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
Total non-current assets	**8,775**	**11,188**	**13,016**	**13,254**
Current assets				
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
Total current assets	**25,866**	**28,699**	**34,348**	**35,547**
Total assets	**34,641**	**39,887**	**47,364**	**48,801**
Liabilities				
Current liabilities				
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				
Total current liabilities	**18,591**	**4,908**	**4,824**	**4,935**
Non-current liabilities				
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			
Total non-current liabilities	**3,057**	**11,098**	**20,523**	**21,536**
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
Total liabilities	34,641	39,887	47,364	48,801

Sources: Company historic data and Equity Development estimates

Figure 13 - Cash flow statement

All figures in £'000s	2020A	2021A	2022A	2023F
Profit (loss) for year after tax	-1,620	-3,348	-1,713	-681
Cash flow from operations	**-215**	**-4,013**	**-5,625**	**211**
Income taxes paid	-327		-75	-300
Interest paid	-477			
Net cash flow from operating activities	**-1,019**	**-4,666**	**-6,194**	**-596**
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
Free cash flow before dividends etc	**-2,096**	**-5,854**	**-9,579**	**-1,093**

Sources: Company historic data and Equity Development estimates

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