

Successfully following a clear route to growth

14th September 2022

The Artisanal Spirits Company (ASC) continues to deliver on its strategy to take advantage of the sizable and fast growing global premium whisky market. Interim results released today reconfirmed robust growth in both revenue and membership in the first half of FY2022, and trading so far in the second half also appears strong. As a result, we maintain our confidence in close to 20% sales growth this financial year and reiterate our 150p fair value for the shares.

Sales revenue and membership numbers, already released in a trading update on 20th July 2022, recorded impressive 25% and 24% growth rates respectively in the first half of FY2022. Sales revenue was £9.9m in the six months with membership numbers reaching 35,500. Gross profits advanced strongly from £5.1m to £6.2m despite gross margins narrowing to 63% from 65% a year earlier, in part due to the timing of high margin US shipments. However, gross margins were ahead of their FY2021 level and in line with expectations for the whole of FY2022.

Membership numbers grew in all of ASC's seven operating regions with the strongest increases being recorded in the UK (+31%), Europe (+33%) and Australia (+28%). China, Japan, and the US all advanced by 15% - with overseas membership still comprising half the group total. Aggregate lifetime membership value increased sharply by 118% from the same period in FY2021 and is now calculated to be £62m. Member retention now stands at 80%. **Since half year end, membership increased further to 36,000 as growth in China resumed.**

Elsewhere, progress remains positive. The company's nascent J.G. Thomson branded blended Scotch malt whisky business made its first export sale to La Maison du Whisky in France. Encouragingly, as highlighted in the trading update, the Masterton Bond facility is on budget and on track to be operational in the second half of this year.

The notional retail value of ASC's cask inventory, which we believe should be a focus in relation to the market capitalisation of the group, increased from £430m at end-December 2021 to £455m at this year's interim stage. The retail value of this inventory should grow further as the company's whisky stocks mature. Moreover, the ongoing purchase of whisky by ASC at earlier stages of the maturation process augurs positively for future gross margins.

Given a healthy supply situation and good stock availability across all markets, we remain confident in our FY2022 full year financial forecasts, which we leave unchanged – a view consistent with today's release. The company remains fully capable of financing its expansion plans. Indeed, a further £2.6m was invested in maturing whisky stock in H1.

ASC's stock-market valuation represents a discount on EV/sales ratio to both its publicly listed distilled spirits and luxury goods peer groups, which we regard as the most relevant comparators. In addition, the notional value of the company's whisky stock at retail is **more than 8 times** current market capitalisation. **We reiterate our 150p per share fair value which on our estimates implies 5.5x EV/sales in FY2022 and 4.1x sales in FY2024.**

Company Data

EPIC	ART
Price (last close)	70p
52 weeks Hi/Lo	118p/52p
Market cap	£49m
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)	4.2	3.4	2.9	2.5	2.2	1.9

Source: ED estimates, company historic data

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Today's interim results statement is consistent with the overall growth backed investment case for The Artisanal Spirits Company. Through ownership of the Scotch Malt Whisky Society, the company is well placed to benefit from the powerful global trend to drink '**less but better**' alcoholic beverages.

We reiterate our view – initially outlined in our 16th September 2021 report "[Unique heritage and global opportunity](#)" - that ASC's growth will 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 strategic targets include **developing membership, enhancing the e-commerce channel, further improving margins through increased value creation** and the **establishment of 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 is uniquely placed both to embrace Scotch whisky heritage and ensure integrity of its product offering while adopting modern business techniques** - ensuring that it operates its e-commerce platform at best practice.

Interim results

Key figures

Headline sales revenue and membership numbers were included in ASC's 20th July 2022 trading update and commented on in a report entitled "[Premium positioning underpins growth.](#)" Incremental data in today's release include numbers for sales revenue and membership by region.

Figure 1 - FY2022H1 results highlights

6m to 30 June, £m	2021 H1	2022 H1	Change
Revenue	7.9	9.9	25%
Gross profit	5.1	6.2	21%
Gross margin	65%	63%	(2 ppt)
EBITDAE (1)	0.2	-0.3	n/a
Pre-tax loss	-0.9	-1.1	17%
After tax loss	-1.1	-1.4	27%
Net debt	-1.9	-8.2	n/a
Cask inventory	19.6	22.8	16%
Cask inventory notional retail value (2)	375	455	21%
Aggregate membership lifetime value (3)	28	62	118%

Source: Company data

Notes: (1) EBITDAE is a non IFRS measure and is defined as earnings before interest tax, depreciation, amortisation and exceptional costs. (2) Notional retail value is a non IFRS measure and is calculated as total litres of spirit in casks, converted to bottle equivalent (based on 70cl) multiplied by average net revenue per bottle in the period. (3) Aggregate Life Time Value is a non IFRS measure and is calculated as number of members at the period end date, multiplied by the average member life time value for the preceding 12 month period.

It should be noted that the profit data in Figure 1 make no adjustments for costs associated with American Whiskey and Masterton Bond. Using our own methodology, which also strips out share based payments, the company would have been closer to break-even in the first half at adjusted EBITDA level.

Revenue growth was largely driven by the growth in overall membership numbers in FY2022H1. As Figure 2 illustrates, all regions reported increased membership numbers and all regions reported increased revenue apart from the US, where ASC recognises revenue on a shipment basis.

The timing of shipments can be more concentrated than depletions and thus more prone to distortion. The company states that it remains **on track to deliver a doubling of revenue between FY2020 and FY2024**.

UK revenues, where online sales fell by 6% to £1.6m, benefited from a full resumption of the company's venues and events business. Venues and events revenues nearly tripled to £1.7m in FY2022H1 from £0.6m in the same period last year.

Gross margins at 63% in FY2022 H1 were close to their 65% level in the same six months of FY2021. In the year as a whole, we still expect an increase relative to FY2021 – i.e. from 62% to 63%. ASC itself states that the lower FY2022 H1 gross margin in part reflected the above-mentioned timing of high margin US shipments. Gross margin remained ahead of the full year FY2021 result and in line with consensus estimates for FY2022.

Today's release reconfirms the group's expectations that it will deliver meaningful profits in the medium term and is committed to minimizing the time taken to meeting this objective. In the first half of FY2022 there was a £0.5m swing from profit to loss at EBITDAE level while losses at pre-tax and net income level both widened, by £0.2m and £0.3m respectively. However, it should be noted that reported pre-tax and net income numbers included the impact of £0.2m of American Whiskey and Masterton Bond costs, which may be considered to have been exceptional.

Figure 2 - ASC revenue by region FY2022 H1

6m to end June, £m	FY2021H1	FY2022H1	Change
UK	2.3	3.3	45%
US	2.5	1.9	-24%
China	1.5	2.3	61%
Europe	0.5	0.9	88%
Australia	0.4	0.4	13%
Japan	0.3	0.4	32%
ROW	0.5	0.6	15%
Total	7.9	9.9	25%

Source: Company

The balance sheet remains in good shape as evidenced by net debt, despite an increase in H1, being equivalent to only around one third of the company's balance sheet inventory value. Moreover, working capital increased by less than sales. As measured by inventory + debtors – creditors, working capital increased by £1.8m from £22.7m at the half-way stage in FY2021 to £24.5m while sales increased by £2.0m.

The notional cask inventory value at retail increase is significant and something we focus on in the "Financials & valuation" section of this report. This notional value increased from £430m at end-FY2021 to £455m at the end of the half-year. At end FY2021 H1 the value was reported to be £375m. While the cask inventory figure refers to notional value at retail, two points should be mentioned.

First, as an online direct to consumer distributor of its ultra-premium and above whiskies **the company captures the distribution margin in full**.

Second, the company sells its distilled spirits into countries which have an overall bias towards specific tax regimes such as in the UK which accounts for close around half of group sales. Specific tax regimes mean

that the higher the selling price, the smaller the portion of the per bottle selling price which is captured in duty and additional taxes (e.g. VAT). ASC's focus on ultra-premium whiskies means that the bulk of the notional retail value of its stock will be **converted into net sales revenue** going forward. ASC reported average sales revenue of £95 per bottle for SMWS in today's interim results statement.

Current trading and outlook

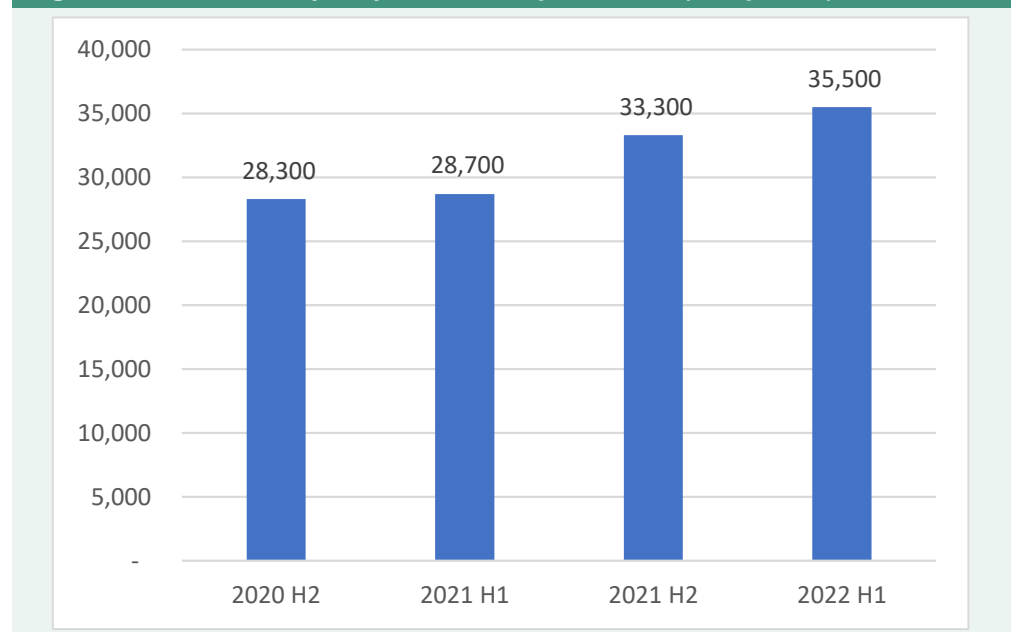
FY2022 H2 is reported to have enjoyed a strong start with further progress reported in July and August relative to the company achieving its financial objectives in the year as a whole.

Specific items include an advance in global SMWS membership to 36,000, which included a return to growth in China during FY2022 Q3 and an increase in US shipments in the same period. The volume of US shipments in these three months is expected to exceed the £1.6m achieved in the whole of FY2021 H2.

Further ahead, the group highlights both its healthy supply chain and good stock availability across all markets.

As a result, ASC appears well placed structurally, as well as financially, to meet any upcoming increases in demand for its premium offering.

Figure 3 – Recent half yearly membership numbers (end period)



Source: Company data

Membership growth

Expansion in Scotch Malt Whisky Society (SMWS) membership numbers remains an important component of the investment case for the Artisanal Spirits Company.

That membership numbers grew in all of ASC's seven operating regions confirms the group's efficacy in keeping this growth driver on track. Moreover, it shows that ASC is capable of acting locally as well as globally.

The strongest increases were recorded in the UK (+31%), Europe (+33%) and Australia (+28%). China, Japan and the US all advanced by 15% with overseas membership as a whole remaining at half the group total.

Recent half yearly growth in membership numbers is illustrated in Figure 3 above, with FY2022H1 membership growth by region shown next in Figure 4:

Figure 4 - Global membership growth in 2022 H1			
'000s of members	Jun-21	Jun-22	Change
UK	13.4	17.7	31%
US	4.8	5.5	15%
China	1.4	1.6	15%
Europe*	2.9	3.9	33%
Australia	1.2	1.5	28%
Japan	1.4	1.6	15%
ROW	3.6	3.8	7%
Total members	28.7	35.6	24%

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

Source: Company

Aggregate lifetime membership value, a measure which combines membership numbers with trailing average spend per member, increased sharply by 118% from the same period in FY2021 and is now calculated to be £62m. This value is supported by membership retention which increased to 80% in FY2022 H1.

FY2022 H1 – a half of progress across the group

Our 20 July 2022 FY2022 H1 trading update report highlighted that the first six months of FY2022 was a period of significant groupwide progress. Today's statement reiterates the importance of three important developments:

Masterton bond facility

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

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

Ex-sherry cask programme

ASC's ex-sherry cask programme is set to deliver around 35% of whisky with a sherry cask influence by FY2024, compared with around 15% in FY2018, which has positive implications for margins.

ASC states that it typically achieves of the order of a 10% price uplift per bottle (reflecting the strong member demand for whisky with this profile) and thus earns more than a 200% payback on first use of the cask. Furthermore, ex-sherry casks characteristically benefit from around a 20-year useful lifetime cycle.

J.G. Thomson

Elsewhere within the group, J.G. Thomson – a proprietary branded distilled spirits offering – made significant progress in the first half of FY202. Success with J.G. Thomson puts ASC in a position both

directly to own and manage a premium distilled spirits brand as well as to satiate growing demand for premium blended Scotch whiskies. Such product range expansion is consistent with longer term aspirations to develop a franchise in whiskies other than Scotch - notably North American whiskies

In addition, the J. G. Thomson proposition is not based on membership. As a result, the brand should enable ASC to address a broader range of the Scotch whisky and other premium distilled spirits markets as well as leveraging the company's e-commerce and specialist premium distribution skills for its whiskies.

J.G. Thomson achieved its inaugural export sales to France through Masters of Malt and La Maison du Whisky and is reported to have built traction and some encouraging sales momentum.

Financials and valuation

Relative valuation

We retain our long-held fair value of 150p per share for ASC. This is 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 5 and 6 respectively.

In our view, ASC boasts many positive qualities relative to its distilled spirits peers which should support 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 was estimated to be £455m which, as Figures 4 and 5 show, is more than **8 times** the current market capitalisation of the company.

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.

Figure 5 - 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)	70	69.6	49	14	63	22	2.9
Brown Forman (BF.B) *	72.24	479.1	34,612	893	35,505	4,059	8.7
Campari (CPR)	9.52	1,124.7	10,707	819	11,526	2,592	4.4
Diageo (DGE) *	3,809	2,277.5	86,751	14,563	101,314	16,996	6.0
Remy Cointreau (RCO) *	180.80	51.1	9,245	326	9,571	1,585	6.2
Average							5.6

*Share prices are at 13 September 2022 UK close and 1700GMT for Brown Forman. * FY2023 forecasts*

Source: MarketScreener, ADVFN and Equity Development estimates

Figure 6 - 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)	70	69.6	49	14	63	22	2.9
Hermes (RMS)	1,299	104.5	135,740	-7,934	127,806	10,845	11.8
LVMH (MC)	651	502.1	326,801	5,164	331,965	76,669	4.3
Average							6.3

Share prices are at 13 September 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 interim results statement.

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 benefit 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.

Pre-operational losses at the American whiskey venture and Masterton are shown in the income statement as exceptional items and amount to £0.2m. We assume that these costs, which have no impact on EBITDAE, will be closer to £0.6m in FY2022 as a whole.

We include income statement, balance sheet and cash flow projections in Figures 7, 8 and 9.

Figure 7 - Income statement

All figures in £'000s	2020A	2021A	2022F	2023F	2024F	2025F
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)	-6,055	-8,848	-8,436	-9,027	-9,297	-9,576
EBITDA - adjusted	572	-626	255	1,351	2,951	4,573
Depreciation	-600	-575	-793	-914	-1,053	-1,202
Amortisation of intangible assets	-283	-271	-271	-271	-271	-271
EBIT - adjusted	-311	-1,472	-809	166	1,627	3,100
Exceptional items	-392	-897	-600			
EBIT – reported	-703	-2,369	-1,409	166	1,627	3,100
Finance costs	-499	-348	-354	-551	-586	-563
Pre-tax profits - adjusted	-1,202	-2,717	-1,763	-385	1,041	2,537
Taxation	-418	-631	-300	-300	-168	-467
After tax profits - reported	-1,620	-3,348	-2,063	-884	673	1,869
Basic EPS (pence) - reported	-3.0	-5.9	-3.4	-1.5	0.7	2.5

Note – after tax profit includes adjustments for non-controlling interests

Source: Company historic data and Equity Development estimates

Figure 8 - Balance sheet

All figures in £'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	26,519
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	31,744
Total assets	34,641	39,887	47,197
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	15,458
Lease liability	1,428	3,332	3,332
Deferred tax liabilities	324		
Provisions	404		
Total non-current liabilities	3,057	11,098	19,853
Total liabilities	21,648	16,006	24,848
Called up share capital	135	174	174
Share premium account	99	14,938	14,938
Translation reserve	-15		
Retained earnings	12,544	8,505	6,242
Hedging reserve	67		
Other reserves			691
Shareholders' funds	12,830	23,577	22,045
Minority interest	163	304	304
Total	34,641	39,887	47,197

Sources: Company historic data and Equity Development estimates

Figure 9 - Cash flow statement

All figures in £'000s	2020A	2021A	2022F
Cash flow from operations	-607	-4,855	-3,472
Income taxes paid	-327		-300
Interest paid	-477		
Net cash flow from operating activities	-1,411	-5,562	-4,126
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	-2,488	-6,750	-8,662

Sources: Company historic data and Equity Development estimates



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