

# The Artisanal Spirits Company



## Well positioned for strong sales growth in FY2022

20th January 2022

**Strong growth in second half membership headcount and an overall increase in average spend per member prompted The Artisanal Spirits Company (ASC) – owner of the Scotch Malt Whisky Society (SMWS) – to beat both our and market revenue expectations in FY2021. Global sales advanced by around 20%. Membership numbers increased by 15% in the second half of the year, an important lead indicator of growth. ASC appears well invested for further sales expansion both in FY2022 and beyond. In our view, valuation continues to look attractive.**

**ASC announced around 20% sales growth in a Full Year 2021 trading update released today.** Sales growth was similar both in the UK and internationally, which tends to confirm the efficacy of the company's global approach to business development as well as the strength of its online offering.

**Strong membership growth is important - not just as a driver for current growth, but also for future sales.** While UK and International member numbers increased by 20% and 15% respectively in FY2021 as a whole, it should be noted that the bulk of this growth occurred in the second half of the fiscal year to end-December. As a result, the company may be expected to continue to record robust sales revenue growth into the first half of the current fiscal year. Implied revenue per member growth was 3% in the year as a whole, with the underlying number stronger due to a late surge in the year. Between end-June and end-December 2021 members increased from 28,700 to above 33,000.

**Furthermore, ASC is laying down significant foundations which not only supports future growth, but also augur well for margin expansion.** The company continues to invest in both maturing whisky and wooden casks to meet expectations of future demand growth. Importantly, as the company increasingly purchases younger whisky stock, future profit margins should improve.

**Elsewhere, the company highlights some important areas of progress in FY2021.** It has signed a 10-year lease on a new supply chain facility, launched J G Thomson to diversify its distilled spirits offering with the launch of complementary new brands, and restructured its joint-venture agreements in both China and Japan so as to capture more of the value creation in these markets. Senior leadership has also been bolstered by new strategic hires.

### On track to achieve objectives – yet shares well below our 150p fair value

**The core ASC investment case is its ability to grow membership numbers both domestically and internationally while benefiting from the observable trend within alcoholic drinks of customers “drinking less but better.”**

Today's trading statement tends to confirm that the company is on track to achieve these objectives. However, the current stock market valuation remains, in our view, materially shy of what we consider fair value based on comparable distilled spirits and luxury valuations. **We reiterate our fair value of 150p per share, which would imply a 5.5x EV/sales ratio.**

#### Company Data

EPIC	ART
Price (last close)	94p
52 weeks Hi/Lo	122p/80p
Market cap	£65m
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.

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 The Scotch Malt Whisky Society's global membership.

#### Key financials

Yr to 31 Dec	2019A	2020A	2021E	2022E	2023E	2024E	2025E
Revenue (£m)	14.6	15.0	18.1	21.6	24.8	28.6	32.7
Revenue growth (%)	20.6%	2.6%	20.2%	19.4%	15.1%	15.3%	14.2%
EV/sales (x)	5.5	5.3	4.4	3.7	3.2	2.8	2.5

Source: ED estimates, company historic data

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## Well positioned for strong sales growth in FY2022

The Artisanal Spirits Company's FY2021 trading statement, released today, focuses on the key drivers of revenue growth and membership numbers - both of which were ahead of expectations. In particular, the growth in membership towards the end of FY2021 sets the company up to deliver a fast pace of sales expansion again in FY2022.

Furthermore, the company's investment in both younger spirit stocks and cask wood should reinforce its ability to meet ongoing demand growth, with the former an important driver for future margin expansion. We leave our FY2022 revenue forecasts unchanged at this stage, although they should be easier to match after a strong FY2021 and make only minimal adjustments to EBITDA projections for both FY2021 and FY2022.

### Trading statement highlights

Key figures from the trading statement are highlighted in Figure 1. The 20% advance in global sales was ahead of the 17% forecast which we published in our 16<sup>th</sup> September 2021 initiation report, entitled "[The Artisanal Spirits Company - Unique heritage and global opportunity](#)".

UK venue & events sales enjoyed a continued recovery in the second half of FY2021 after a phased re-opening in the second quarter of the year. Second half sales alone were higher than in the whole of FY2020, which arguably supports the case for the company's multi-channel business model.

Membership numbers rose sharply towards the end of the year, which is more important for FY2022 and the market's comfort factor with projections than the FY2021 favourable outcome. Notably, not only did growth come towards the end of the year but the annualised 32% increase in the second half of FY2021 (based on an increase from 28,700 to >33,000) implies that even if membership growth now stalls there should be significant sales in FY2022 so long as spend per member does not meaningfully dip.

In FY2021, average spend per member rose by 3%. However, this growth rate was constrained by the relatively late increase in the membership numbers. Importantly, both the UK and International recorded strong membership gains in the second six months of the year.

Figure 1: Trading statement highlights			
	2020	2021	% Change
Global sales (£m)	15	18	20%
Global members ('000s)	28.3	>33	>17%

Source: Company data

### Investing for growth

Today's trading update supports the case for strong underlying demand growth at ASC and the potential, given the late surge in membership numbers in FY2021, for FY2022 to be another strong year. However, it is important to note that the company is also investing to be able to meet potentially much higher levels of demand for its products.

In the 16<sup>th</sup> September 2021 initiation report mentioned above, we highlighted the importance of ASC's significant investment in spirit stock and cask wood. Spirit stock is important because Scotch malt whisky is an aged, or matured, product. The company needs to secure an abundant supply of malt whisky to meet future demand. As the company continues to use a higher portion of younger whisky stock for maturation, underlying profitability of its aged malt whiskies should increase.

Each cask sold by ASC's The Scotch Malt Whisky Society is unique. While the maturing Scotch whisky is sourced from specifically selected distilleries, the Society itself takes direct control of the maturation process, which underscores the importance of the SMWS owning a sufficiently large number of casks in which to mature the whisky.

SMWS ensures that its casks of malt whiskies differ from each other and meet specific flavour requirements by adjusting the types of cask wood – e.g. sherry or bourbon - which is used during maturation.

We note ASC's stated ambition to double sales by 2024 and that it continues to invest sufficiently in spirit stock and wood to meet this objective.

## Key progress points

Today's trading statement highlights a number of important developments, aside from spirit stock and wood, since the company was admitted to a listing on AIM in June 2021. We comment on each in turn:

- ASC has signed a 10-year lease on a new supply chain facility which not only should ensure greater control over its supply chain but should also assist with margin expansion.
- The company launched J G Thomson which is a differentiated distilled spirits offering from SMWS that includes small batch blended malt whiskies, grain whiskies, rum and gin. In our view an important benefit from J G Thomson is the brand's ability to expand ASC's addressable market while remaining within a core competence – i.e. premium distilled spirits.
- ASC restructured its joint venture agreements in China and Japan and increased its stake in both territories' operations. As a result, more of the value created in these markets should accrue to ASC shareholders. China was highlighted in today's statement as an important area of membership growth.

## Investment case remains strong

Today's trading 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."

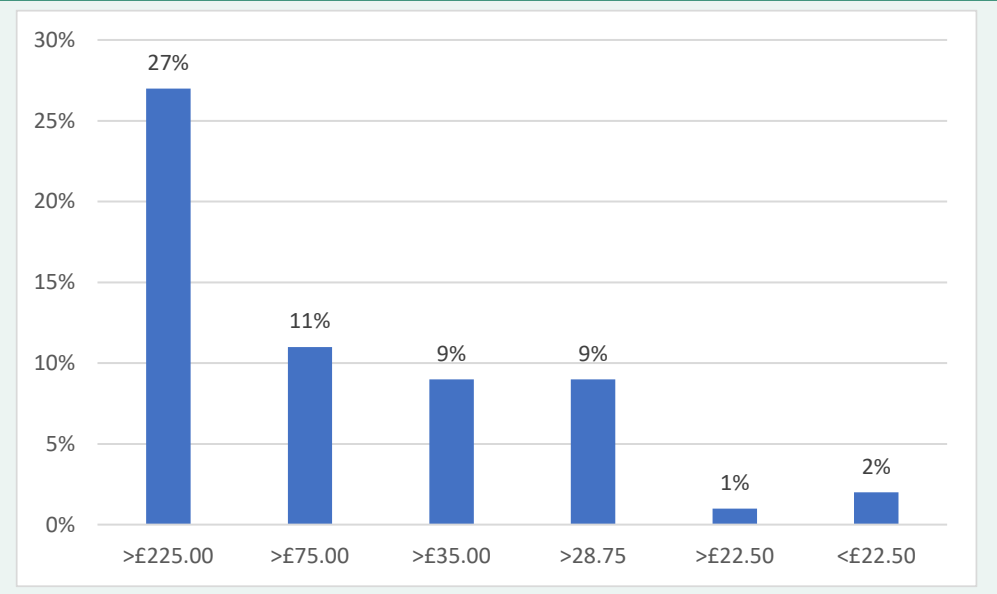
We reiterate our view that ASC's growth should continue to be fuelled by three important metrics: growth in membership numbers, increases in average spend per member and the potential to expand gross margins significantly.

Within the core ASC asset of the SMWS, membership growth is driven not only by the company's effective marketing, but also by an observable desire for distilled spirits drinkers to substitute volume consumption with higher quality – i.e. '**premiumisation**'. Members are central to the business and their growth in numbers in FY2021 clearly underpins expectations for FY2022 as discussed earlier in this report.

Furthermore, despite the age and tradition of Scotch whisky, ASC is a modern business with a heavy online focus. The company's members receive their communication updates, including the SMWS monthly magazine, virtually and order via the company's website.

Finally, it is worth noting that SMWS markets whiskies which are in the highest level of premium product within a premium category. The superior growth performance of product in this category is illustrated in Figure 2:

**Figure 2: Scotch whisky sales growth by price point (CAGR) 2010 to 2019**



Source: IWSR

## Financials and Valuation

### Relative valuation

We continue to argue for 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 3 and 4. 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.

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 3: 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)		2022	(x)
Artisanal Spirits Company (ART)	94	69.6	65.1	15.3	80.3	21.6	3.7
Brown Forman (BF.B)	67.18	478.7	32,159	1,428	33,587	3715	9.0
Campari (CPR)	11.38	1125.3	12,801	792	13,593	2331	5.8
Diageo (DGE)	3710	2322	86,135	12,427	98,562	14151	7.0
Remy Cointreau (RCO)	191.7	50	9,560	384	9,944	1280	7.7
Average							6.7

*Share prices are as at 19th January 2022 UK close and 1700GMT for Brown Forman*

Source: MarketScreener, ADVFN and Equity Development estimates

**Figure 4: 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)		2022	(x)
Artisanal Spirits Company (ART)	94	69.6	65.1	15.3	80.3	21.6	3.7
Hermes (RMS)	1369	104.6	143,205	-7,172	136,033	10,116	13.4
LVMH (MC)	698	503.8	351,491	6,610	358,101	69,740	5.1
Average							7.4

*Share prices are as at 19th January 2022 UK close*

Source: ADVFN, MarketScreener and Equity Development estimates

## Financial forecasts

Today's trading statement focused on sales revenue and membership growth numbers only, both of which were ahead of our, and market, expectations. Aside from factoring in higher revenue in FY2021 we leave both last year's and FY2022's numbers broadly unchanged. We expect FY2021 net debt to end the year lower than originally estimated at £5m, due to the deferred timing of investments in cask goods and property, plant & equipment but to rise to £15m in FY2022.

The longer-term central 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 5, 6 and 7.

<b>Figure 5: Income statement</b>							
All figures in £'000s	2019	2020	2021	2022	2023	2024	2025
	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast
<b>Revenue</b>	<b>14,645</b>	<b>15,026</b>	<b>18,056</b>	<b>21,566</b>	<b>24,827</b>	<b>28,622</b>	<b>32,678</b>
increase in revenue	20.6%	2.6%	20.2%	19.4%	15.1%	15.3%	14.2%
Gross profit	8,533	8,804	11,141	13,491	15,903	18,620	21,422
Gross margin (%)	58.3%	58.6%	61.7%	62.6%	64.1%	65.1%	65.6%
Selling & distribution expenses	-3,178	-2,979	-3,890	-4,800	-5,526	-6,370	-7,273
Administrative expenses	-5,240	-5,663	-7,900	-8,436	-9,027	-9,297	-9,576
<b>EBITDA - adjusted</b>	<b>115</b>	<b>162</b>	<b>-649</b>	<b>255</b>	<b>1,351</b>	<b>2,952</b>	<b>4,573</b>
Depreciation	-460	-600	-721	-861	-991	-1,143	-1,305
Amortisation of intangible assets	-227	-283	-283	-283	-283	-283	-283
EBIT - adjusted	-572	-721	-1,653	-890	76	1,526	2,985
Exceptional items		-392					
Other income		410					
Other costs (share options)			-200	-200			
Finance costs	-439	-499	-350	-380	-596	-608	-556
<b>Pre-tax profits - adjusted</b>	<b>-1,011</b>	<b>-810</b>	<b>-2,203</b>	<b>-1,469</b>	<b>-719</b>	<b>718</b>	<b>2,229</b>
Taxation	-330	-418		-300	-300	-144	-446
After tax profits - adjusted	-1,341	-1,228	-2,603	-1,769	-1,019	575	1,783
Basic EPS (pence)	-11.6	-9.3	-3.8	-2.6	-1.6	0.7	2.5

Sources: Company historic data and Equity Development estimates

**Figure 6: Balance sheet**

All figures in £'000s	2019	2020	2021	2022
	Actual	Actual	Forecast	Forecast
<b>Non-current assets</b>				
Investment property	391	391	391	391
Property, plant & equipment	5,700	5,785	6,491	13,692
Intangible assets	2,613	2,599	2,555	2,272
<b>Total non-current assets</b>	<b>8,704</b>	<b>8,775</b>	<b>9,437</b>	<b>16,355</b>
<b>Current assets</b>				
Cask goods	18,824	18,707	20,457	23,457
Other inventories	2,129	2,944	3,538	4,225
Trade & other receivables	2,547	1,956	2,655	2,905
Forward currency contracts	32	83		
Cash & cash equivalents	1,536	2,176	2,176	2,176
Total current assets	25,068	25,866	28,825	32,764
<b>Total assets</b>	<b>33,772</b>	<b>34,641</b>	<b>38,262</b>	<b>49,118</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	3,622	3,157	3,252	3,349
Forward currency contracts				
Current tax liabilities	428	332	418	418
Borrowings	12,940	14,963		
Lease debt	146	139	144	144
Convertible loan notes				
<b>Total current liabilities</b>	<b>17,136</b>	<b>18,591</b>	<b>3,947</b>	<b>4,044</b>
<b>Non-current liabilities</b>				
Borrowings	833	901	7,018	17,309
Lease liability	1,546	1,428	1,354	1,354
Deferred tax liabilities	241	324		
Provisions	264	404		
<b>Total non-current liabilities</b>	<b>2,884</b>	<b>3,057</b>	<b>9,072</b>	<b>19,463</b>
<b>Total</b>	<b>20,020</b>	<b>21,648</b>	<b>13,019</b>	<b>23,507</b>
Called up share capital	131	135	174	174
Share premium account	15,980	99	14,938	14,938
Translation reserve	-48	-15		
Retained earnings	-2,687	12,544	9,033	7,263
Hedging reserve	27	67		
Other reserves			989	3,073
<b>Shareholders' funds</b>	<b>13,403</b>	<b>12,830</b>	<b>25,081</b>	<b>25,448</b>
Minority interest	349	163	163	163
<b>Total liabilities</b>	<b>33,772</b>	<b>34,641</b>	<b>38,262</b>	<b>49,118</b>

Sources: Company historic data and Equity Development estimates

**Figure 7: Cash flow statement**

All figures in £'000s	2018	2019	2020	2021
	Actual	Actual	Actual	Forecast
Profit for year after tax	-1,367	-1,341	-1,620	-3,511
<b>Cash flow from operations</b>	<b>-4,680</b>	<b>-2,777</b>	<b>-215</b>	<b>-4,705</b>
Income taxes paid	-99	-169	-327	
Interest paid	-266	-439	-477	
<b>Net cash flow from operating activities</b>	<b>-5,045</b>	<b>-3,385</b>	<b>-1,019</b>	<b>-5,455</b>
Cash flow from investing activities				
Purchase of intangible assets	-215	-167	-437	44
Purchase of property, plant & equipment	-733	-1,507	-660	-706
Purchase of investment property	-230	-161		
Proceeds received on sale of fixed assets		13	1	
Interest receivable			19	
Grant income			391	
Net cash used in investing activities	-1,178	-1,822	-686	-662
<b>Free cash flow before dividends etc</b>	<b>-6,223</b>	<b>-5,207</b>	<b>-1,705</b>	<b>-6,117</b>

Sources: Company historic data and Equity Development estimates





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