LIBERUM

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BUY

Target Price 130.0p
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The Artisanal Spirits Company*

Assessing the key investment and valuation dynamics

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Since our initiation many discussions with investors have surrounded how best to value Artisanal. In this note we detail our approach but importantly support this view with the key characteristics that highlights its key attractions. We see positive profit and cashflow inflection points on the horizon which should drive the valuation significantly higher. If investors are looking for an asset-backed, long-term structural growth story with low market share, high margins, and a proven track record, look no further.

Key points

There is enough inventory to deliver revenues out to FY28 and this allows for profits and cash to grow rapidly. With multiple self-help drivers and a clear path to double digit margins, the majority of the +130% EBITDA CAGR FY23-25 is in its hands.

Value drivers

Artisanal Spirits avoids the low margin, high capex characteristics seen in resellers/ distillers. Instead, it benefits from all the value enhancing upstream work and by primarily selling through a D2C model, this ensures very strong GM%.

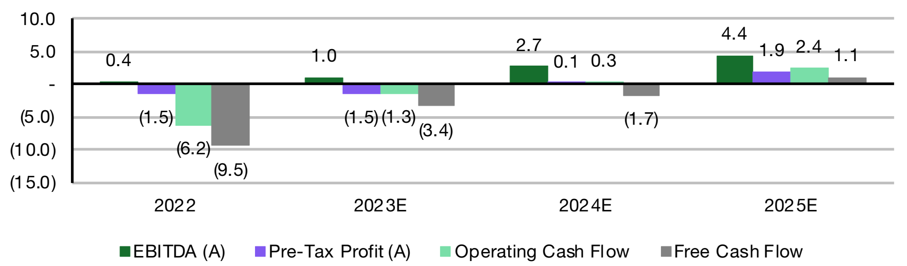
What market misses

There are three catalysts on the horizon and each one of these should command a re-rating**.** Operating FCF positive in FY24, PBT positive in FY24 and FCF positive and double-digit EBITDA margins by FY25.

Is there value?

We value Artisanal Spirits shares at a 130p target price, a simple average of 142p derived using DCF and 118p derived using our ROCE/WACC methodologies. We sense check this against the peer group and apply a discount for smaller scale.

Inflection points on the horizon

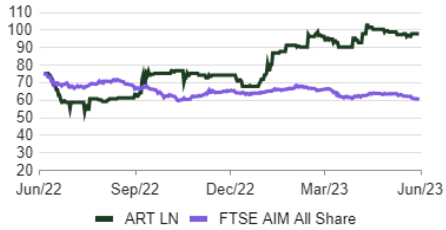


Source: Liberum

Next events

1H23 Trading Update	July 2023
1H23 results	September 2023

Stock performance



Summary financials & valuation (£m)

Calendar year

EV (CY)	22A	23E	24E	25E
Market Cap	67.3	67.3	67.3	67.3
Net Debt/(Cash)	18.3	21.8	23.2	22.0
EV	85.6	89.1	90.5	89.3

Valuation (CY)	22A	23E	24E	25E
P/E (x)	(34.5)	(29.2)	(72.0)	113.8
Div Yield (%)	0.0	0.0	0.0	0.0
EV/Sales (x)	3.9	3.5	3.0	2.5
EV/EBITDA (x)	228.3	85.7	34.0	20.2
EV/EBIT (x)	(96.8)	(196.9)	85.1	31.4
FCFe Yield (%)	(18.8)	(5.1)	(2.5)	1.6
Price / book (x)	3.2	3.6	3.7	3.6

Financial year (December year end)

Financials (FY)	22A	23E	24E	25E
Sales	21.8	25.5	30.2	35.1
EBITDA	0.4	1.0	2.7	4.4
EBIT	(0.9)	(0.5)	1.1	2.8
EBIT Margin (%)	(4.1)	(1.8)	3.5	8.1
Net Interest	(0.6)	(1.0)	(1.0)	(1.0)
PBT	(1.5)	(1.5)	0.1	1.9
FD EPS (p)	(2.8)	(3.3)	(1.4)	0.9
DPS (p)	0.0	0.0	0.0	0.0
Net Debt/(Cash)*	18.3	21.8	23.2	22.0
Net Debt*/EBITDA (x)	48.9	21.0	8.7	5.0
Net Debt*/MktCap (x)	0.3	0.3	0.3	0.3

Source: Liberum, Bloomberg
*All numbers are on a post IFRS 16 basis unless stated. * Including leases. ** Excluding leases*

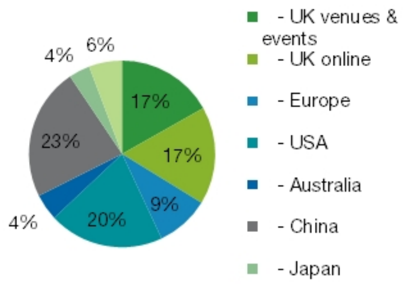
Company dashboard

Artisanal Spirits is the holding company of the Scottish Malt Whiskey Society (SMWS) and the owner of JG Thompson brand. SWMS is the leading curator and provider of premium single cask Scotch malt whisky and other spirits for sale primarily online to a global membership. These members pay for access to these exclusive spirits. SWMS has over 36,000 members in more than 30 markets worldwide. Artisanal Spirits acquired the J.G. Thomson & Co. brand in 2017 with the vision of reviving its renowned blended whisky heritage. In addition to diversifying the company's operations into the fast-growing blended malt whisky segment, there exists an opportunity to expand into rum and gin, further expanding the group's addressable market.

- Unique model and limited-edition offer/range makes for a compelling model
- High retention rates and consistent track of double-digit growth
- Benefits of the inventory model and D2C model, support high gross margins
- Strategic growth drivers or margins plus operating leverage led to material gains in profitability from now
- Having passed peak investment, cash flow now builds with self-funding near as an inflection point
- The group's revenues and margins are relatively secured through the long-term inventory planning model

- As a membership model the group is reliant on members retaining their membership on an annual basis
- Global economic conditions worsen impacting consumer spending
- Proves harder to secure adequate amounts and quality of inventory in the future
- Deposit return scheme and higher tax and duty charges coming into force in 2023/24
- As the group scales, the group will need to increase complexity with new offers, range, and subscription models

Geographic split of revenues



EBIT split by division

Sales by Division				
Sales (£m)	**2022A**	**2023E**	**2024E**	**2025E**
UK	7.4	8.5	9.6	10.9
- UK venues & events	3.7	4.2	4.8	5.4
- UK online	3.7	4.3	4.8	5.5
International	14.4	17.0	20.6	24.2
- Europe	2.0	2.6	3.2	3.8
- USA	4.4	5.2	6.2	7.1
- Australia	1.0	1.2	1.6	1.8
- China	5.0	5.7	7.0	8.6
- Japan	0.8	1.0	1.1	1.3
- Rest of world	1.3	1.4	1.5	1.6
Total	21.8	25.5	30.2	35.1

Key sensitivities

Key Sensitivities for FY'23		
Driver	**Change**	**Impact on Group EBITDA**
Membership growth	5.00%	30.00%
Gross margin	1.00%	30.00%

Key risks to our thesis

External risks: Tariffs placed on Scotch whisky by US or China, changes in regulatory environment such as rolling out Deposit Return Scheme (DRS) to the whole of UK – though this now seems unlikely with severe push back by Westminster, annual cost increases for alcohol duty, the group is exposed to geo-political risks as seen by the impact in China on their COVID policies.

Internal risks: Key man risk with regards to the Spirits Director, some territories, albeit small are under the control of franchise partners thereby there is a reliance on the quality of franchise partners.

How the target price is generated

We use a blended average between a DCF (142p) and ROCE/WACC analysis (118) and by looking at large cap spirit companies and applying a discount to account for lack of scale as a sense check we get a TP of 130p. We do not use a small-mid cap peer group due to there being no comparable comps. Being a whisky business with an appreciating asset, no weather dependency and with no exposure to low margin or high capex production means one cannot compare to the likes of Chapel Down or Gusbourne. The structure of the model also means a comp to Naked and Virgin Wines would be inappropriate whereas there are several similar features to Remy Cointreau in particular.

Contents

Investment summary

The Artisanal Spirits investment case is about considerable market share opportunity in the premium segment of the scotch whisky market. With 0.3% share of a c.$6bn TAM, and all the markets in which it operates exhibiting long-term structural tailwinds, offers decades of future growth opportunity. This together with favourable customer demographics underpins the consistency that Artisanal Spirits has been able to grow its member base by double digits. The case is not just for double-digit revenue CAGR, but avoiding the low margin and high capex activity of resellers and producers means these revenues drop through at high margins. It also has a proven track record delivering on all its IPO promises.

Why now is the time to look at Artisanal Spirits

We look at why Artisanal makes for such a compelling investment. There are clear catalysts on the horizon, one in each of FY23 through to FY25 and each one of these should command a re-rating.

1. Operating FCF positive in FY24,
2. PBT positive in FY24 and
3. FCF positive in FY25 – by which time EBITDA margins should be c.13% well on their way to the 20% they should mature at.

Why are we so confident these can be delivered – the key drivers come down to margin improvement with continued top-line growth of c.17% p.a. The key point is that these are mainly down to self-help and strategic investments that have been made.

- **Margin drop-through from here-on is rapid** - For every additional pound of revenue in FY23, should convert at an 18% EBITDA margin in FY23 with this drop-through rising to 34% and 36% respectively in FY24 & FY25 respectively.
- **What are these self-help measures delivering higher margins – (1)** purchasing of younger stock (new make spirit) – drives higher GM%, **(2)** ex-sherry cask finishing – drives pricing and **(3)** in-housing of bottling and warehousing activities – drives down costs. However, as the top-line expands and the group delivers on its global expansion, there is also an incremental benefit as these customers achieve much higher ARPM and higher frequency when compared to the core UK business.

And all this is provided with a strong asset backing - The case for investment is also about the quality and value of its inventory. Not only is the inventory an appreciating asset (which is very rare to see) but provides an inflation hedge and relative gross margin protection. From a valuation perspective, inventory (at book value) represents c.45% of the current market cap.

The key skill set at the group is to buy high quality spirit and add value through the maturation process. Simply, the younger the spirt and the longer it matures, the more value accrues to shareholders. It has been doing this for over 20 years and through several rounds of funding has expanded its asset base to over 16,500 casks of whisky in its reserves. This is important because:

- **There is enough inventory to support revenues all the way out to FY'28 and 75% out to 2033**, thus offering great protection for gross margins and solidifies the investment case. Crucially, this means the intensive investment phase has now peaked and as the group moves towards a stock replacement cycle, should allow for rapid EBITDA growth from hereon and positive PBT in 2024
- **The book value as at FY22 of total inventory is £28m**; made up £23m of cask spirit value, £3.1m of bottled stock and c.£2m other. The actual cask wood value is around £3m.
- **The current book value of the inventory equates to 45% of the current market cap and bank liquidation value of the spirit is £35m (55% market cap)**.

A unique model - Putting this all together, means Artisanal Spirits benefits from the appreciation in value of the inventory and because c.80% of its sales are through its D2C model, it achieves high gross margins. The model has been set up in such a way that it avoids the negatives in the reseller and the manufacturer models.

Delivering very strong KPI's - The high retention and engagement rates combined with the high gross margins mean that member lifetime values are over £1,400; some c.7x the £65 CAC.

Self-funding in-sight – multiple inflection points

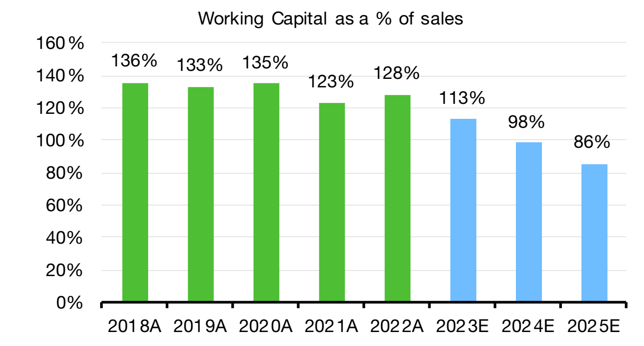
Artisanal Spirits has invested heavily since 2015 to build out its inventory base. It now has enough whisky stock to satisfy demand into the next decade, hedging inflationary costs and providing security for gross margins.

Of the spirit purchases being made from now on, the age profile is getting younger - This brings two key benefits: **(1)** the group will get more bang for its buck, in terms of volume acquired, which will over time see the cost of spirit per bottle fall by c.60%; and **(2)** the maturation of the spirit in ex-sherry casks allows for at least £10/bottle of higher pricing. These two catalysts alongside organic growth and benefits from the supply chain investment, allow for EBITDA to expand and FCF to build.

Multiple inflection points in sight – Having accelerated its whisky investment since 2015, the group now moves into replacement cycle thereby requiring less working capital:

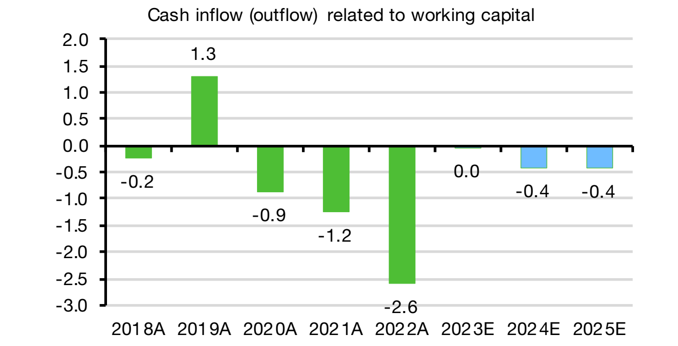
- **FY23** – Gross margins rise 140bps to 65%, expansion of EBITDA margins to 4.1% from 1.7% in FY22.
- **FY24** – Gross margins rise a further 100bps, EBITDA margins more than double to 8.8%, and the group becomes PBT positive and funds all its working capital, and tax from internally generated cash.
- **FY25** - The group becomes fully self-funding being FCF positive.

Figure 1: Working capital as a % of sales



Source: Company data, Liberum

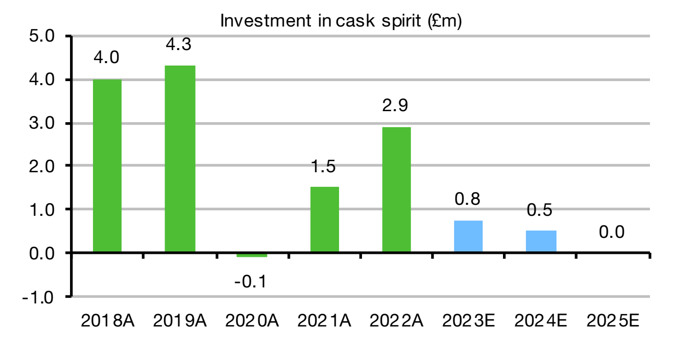
Figure 2: Cash flow related to working capital (excluding investment in cask spirits for future growth)



Source: Company data, Liberum

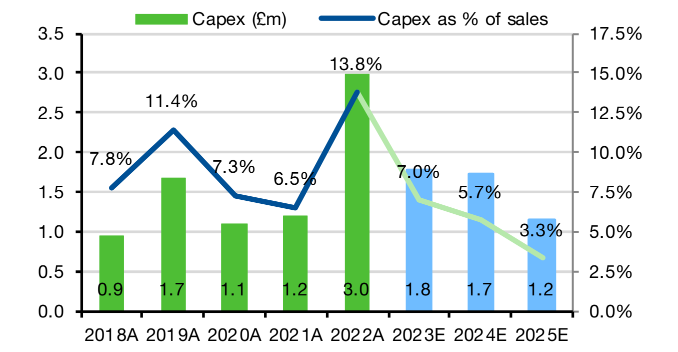
- Limited further investment in spirit inventory over the forecast period (Fig 3).
- The group has also passed peak capex having spent a significant amount on the in-house supply chain facility and IT spend last year.
- The greatest portion of capex spend will now be on cask wood for the next few years.

Figure 3: Investment in cask spirits



Source: Company data, Liberum

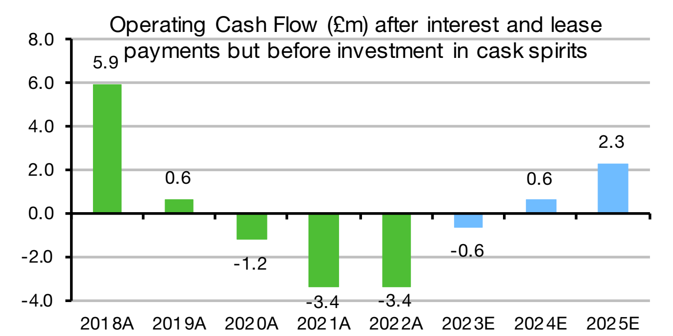
Figure 4: Capital expenditure



Source: Company data, Liberum

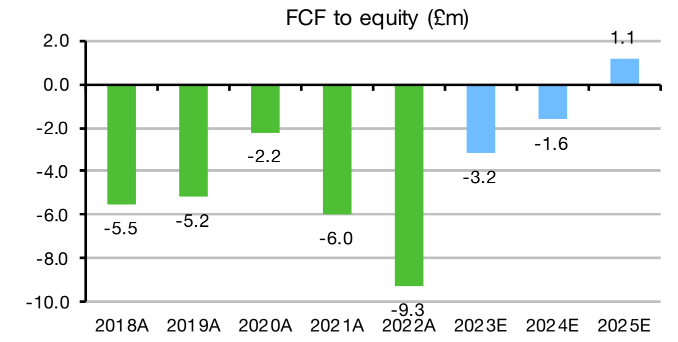
And all this means, working capital becomes self-funded from internally generated cash in FY24 (Fig 5), and the group becomes fully self-funding in FY25 (Fig 6).

Figure 5: Operating cash flow after interest and lease payments



Source: Company data, Liberum

Figure 6: Free cash flow to equity



Source: Company data, Liberum

And why are we confident this can be delivered

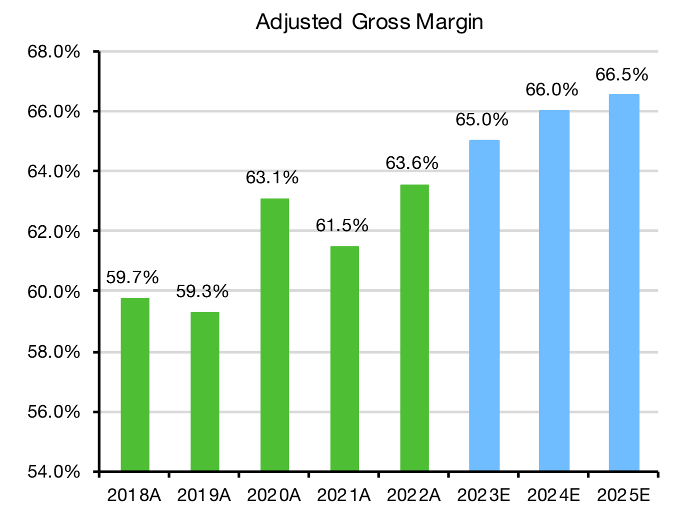
Fundamentally, 60% of a spirit's flavour comes from the maturation process and this is where Artisanal Spirits expertise lies. It does this through a combination of:

- Selecting best-in class single malt liquid (increasingly newer fill).
- Storing most products in Artisanal Spirits owned casks.
- Using the group's expertise to enhance the maturation process for most spirits; and
- Not undertaking any blending with other spirits or the use of chill filtering.

And there are clear plans to improve gross margins:

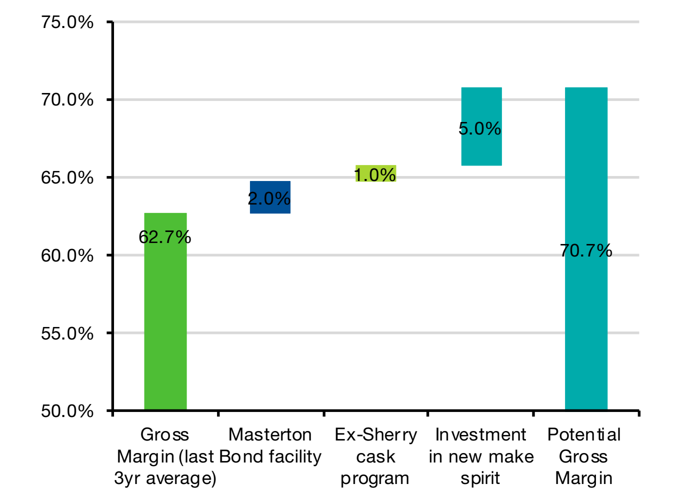
- **Purchasing of younger stock (new make spirit)** – by purchasing younger spirits, the cost of the spirit in a bottle of finished product will fall from c.£6/bottle to <£2. We should start to see this flowing into GM% from FY25/26 onwards as the spirit needs time to mature. This could add up to 5ppts of GM% over time.
- **Ex-sherry cask finishing** – Around 25% of the group's casks are now of this make, aiming to mature around 1/3rd of all whisky in an ex-sherry cask by FY25. This allows for a pricing premium of 10% / bottle. This could add up to 1-2ppts of GM% over time.
- **In-housing of bottling and warehousing activities** – This facility allows for the group to do its own bottling, storage, warehousing and have offices within the Masterton Bond facility. The facility opened in Q4'22 but started ramping up in Q1'23. From then we should start to see a potential two percentage points incremental GM% improvements starting to flow through.

Figure 7: Gross margin progression



Source: Company data, Liberum

Figure 8: Potential for c. 70% gross margin



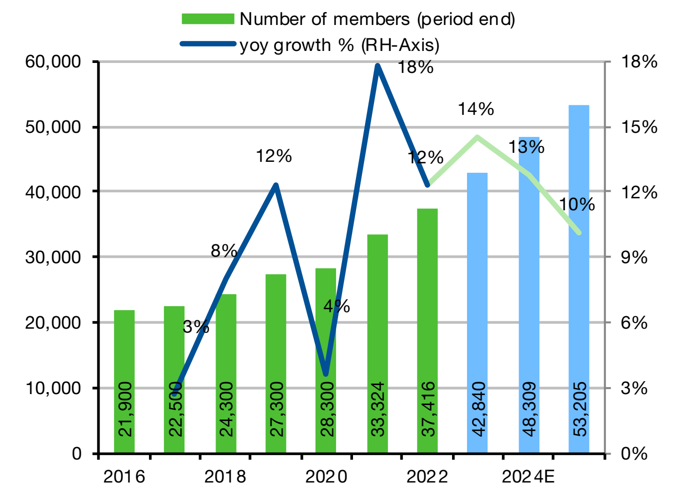
Source: Company data

International growth inherently drives LTV and profits

At the heart of SMWS' unique market positioning is its membership model. This is a key driver of the group's financial performance and has expanded by a CAGR of 11% since 2017.

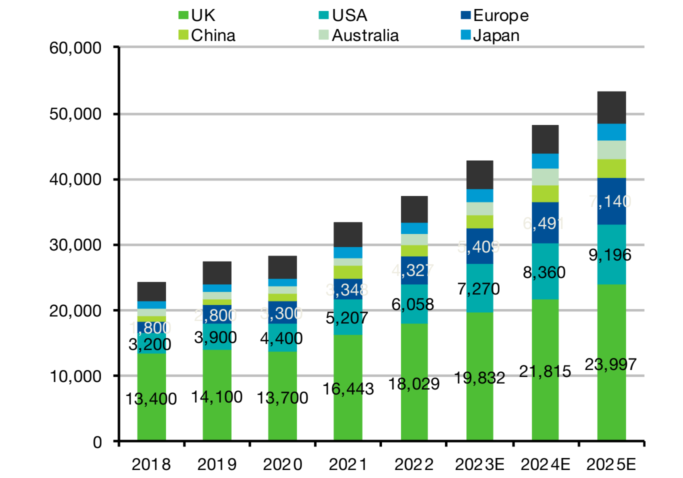
- There are now over 37,000 members across the globe, achieving revenue retention rates of 77%.

Figure 9: Strong and consistent membership growth



Source: Liberum

Figure 10: Membership base by territory

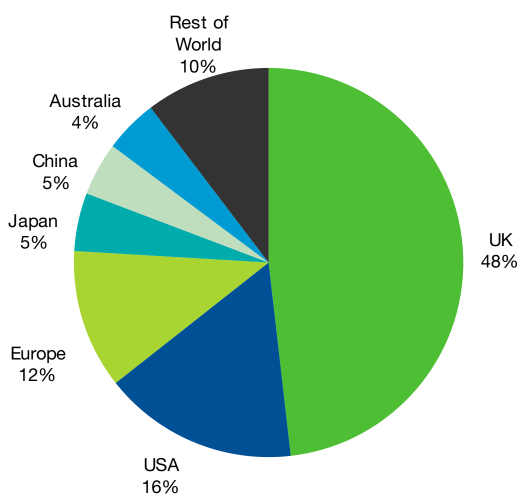


Source: Liberum

Despite a c.50/50 mix of members between UK and international, the group's revenue mix is 34/66 in favour of international markets.

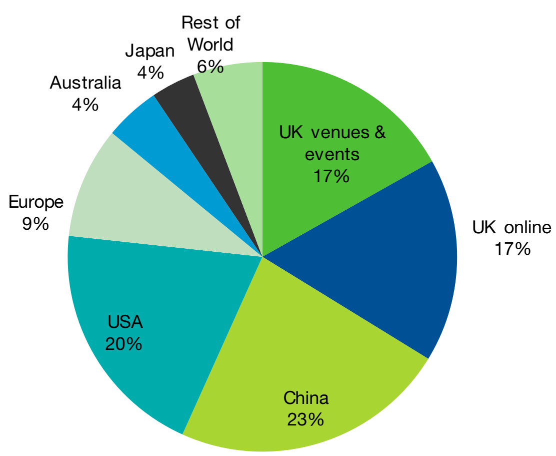
- Interestingly, the value and spend of members in international markets are significantly higher than a core UK member highlighting the global appeal of the model. Artisanal Spirits has seen good growth in revenue per average member over the years, driven by (a) regional mix as membership in higher average revenue geographies like USA (£783 in 2022) and China (£2,944) has grown ahead of the overall group (£559) and (£390) in the UK.
- A member on average buys >5 bottles p.a., with the frequency much higher in China and above average in USA; (b) higher average selling price per bottle, which has grown from £76 in 2020 to £99 in 2022 as the group has increased the quality of its offering with more aged whisky and more ex-sherry cask matured whisky.

Figure 11: Membership base by geography



Source: Liberum, company data

Figure 12: Revenue mix by geography

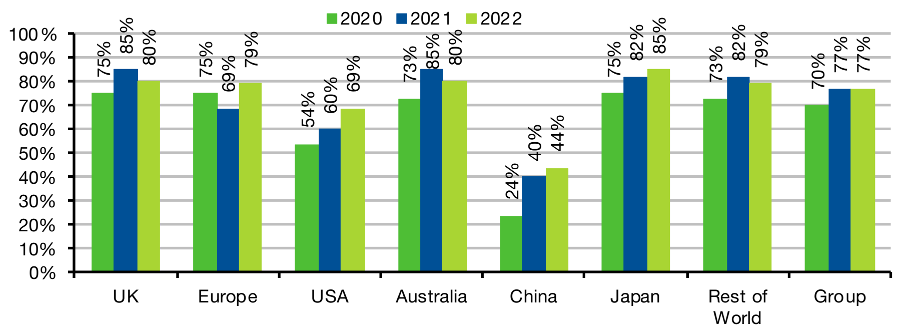


Source: Liberum, company data

New international markets are capital light - The group's strategy to grow in international whisky markets is relatively capital light opting for franchised agreements to start with which may, depending on success, lead to JV's or buying the market outright. This ensures capital investment is kept to a minimum as scale is built until it is economically viable for the company to deploy its own financial resources to bolster the opportunity.

Loyalty drives high retention rates of 77% - Membership loyalty not only provides a strong platform from which to recruit new members and develop brand awareness, but also generates a predictable recurring revenue stream in the form of annual membership fees which account for 7% of the revenue mix.

Figure 13: Customer retention rates in more mature markets average 80%



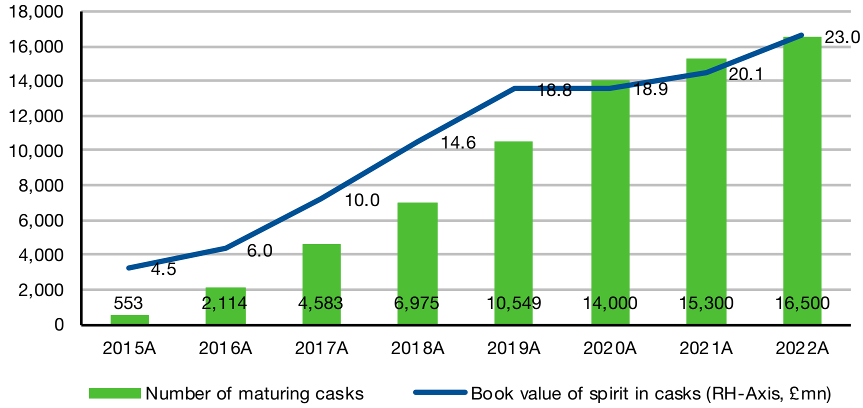
Source: Liberum

And despite being high growth and delivering on margin expansion, there is a strong asset underpin.

The investment case is also about the quality and value of its inventory. Both the selection of cask spirit from distilleries and the maturation process are carried out under the supervision of the Group's Spirits Director who has been with the business for 20 years. The task here is to ensure that the final outturn represents the finest quality spirits and flavour profiles, which are carefully managed to balance the 12 taste profiles the group maintains.

- The group has over 16,500 casks of whisky in its reserves. **There is enough inventory to support revenues all the way out to FY'28, thus offering great protection for gross margins.**
- **The book value as at FY22 of total inventory is £28m**; made up £23m of cask spirit value, £3.1m of bottled stock and c.£2m other. The actual cask wood value is around £3m.
- **The current book value of the inventory equates to 45% of the current market cap.**
- **Bank liquidation value of the spirit only is £35m (55% market cap)** and is calculated using the external valuation used by RBS for the purposes of banking facility i.e. this is the current liquidation value.
- **The indictive retail value of £493m** is calculated as total litres of spirt in casks (5m), converted to bottles (based on 70cl) multiplied by the average revenue per bottle (£99 for FY22).
- The inventory itself is an appreciating asset which serves as a compelling inflation hedge.

Figure 14: Number of casks over time and book value of cask spirit (excl. bottled stock and other)



Source: Liberum

And are we going to see a risk removed

On 26 May, the UK government finally announced it would allow a "temporary exclusion" under the Internal Markets Act for Scotland to go ahead with the launch of DRS – **but only if the scheme dropped plans for the inclusion of glass**.

However, as the industry awaits Holyrood's next move, the BSDA, which has previously been urging the UK government to support Scotland's DRS launch, withdrew its support. **The only sensible move now was for DRS across the UK to be put back until at least October 2025, it said**.

"BSDA members have long supported the introduction of an industry-led, interoperable DRS run on a not-for-profit basis to help support a circular economy, reducing litter and increasing recycling," said BSDA director general Gavin Partington.

"Our members have made significant investments of money, resource and time since 2019 to prepare for the launch of DRS Scotland.

"However, given the level of political uncertainty currently surrounding DRS Scotland, surely the only viable option now is for all stakeholders to commit to launching DRS across the UK on the same timeframe, October 2025."

Last week, Rishi Sunak urged the Scottish government to go back to the drawing board with its plans, claiming they would lead to reduced choice and increased prices.

But a day later, the government announced it was granting a temporary exclusion with major conditions. These included the exclusion of glass, which is included in the Scotland plans but not those south of the border.

The valuation debate.

Artisanal ranks very well against peers

We have drawn up a relevant peer group to compare Artisanal Spirits against. This constitutes large scale spirit companies, the listed wine retailers, wine producers and a premium mixer company.

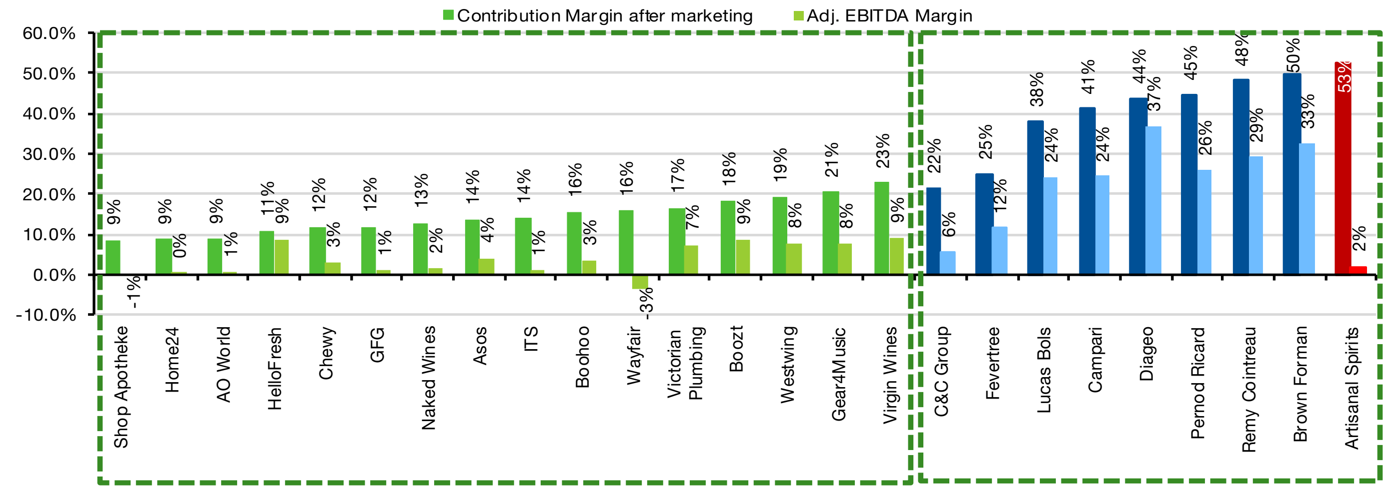
We acknowledge that there are challenges with these as comps and these include:

- **Large scale spirit companies** – The scale of these businesses and geographical and distribution stretch, their market share dominance make it challenging to compare to Artisanal Spirits considering it is much earlier in its journey.
  - That said, Remy Cointreau, has the most similarities when it comes to the inventory models and margin structure.
- **Wine producers** – These have significant weather-related risks, low margin yet high capex demands being a producer (and landowner) and do not have an appreciating asset when it comes to its inventory, and
- **Wine resellers** – these models are comparable in that they are both D2C models, but they operate at the mass end of the market (not the ultra-premium and above), and do not have an inventory appreciating asset.

We note the significant advantage the combination of a strong premium brand in a profitable and growing category and operating via the D2C channel brings to the investment story brings.

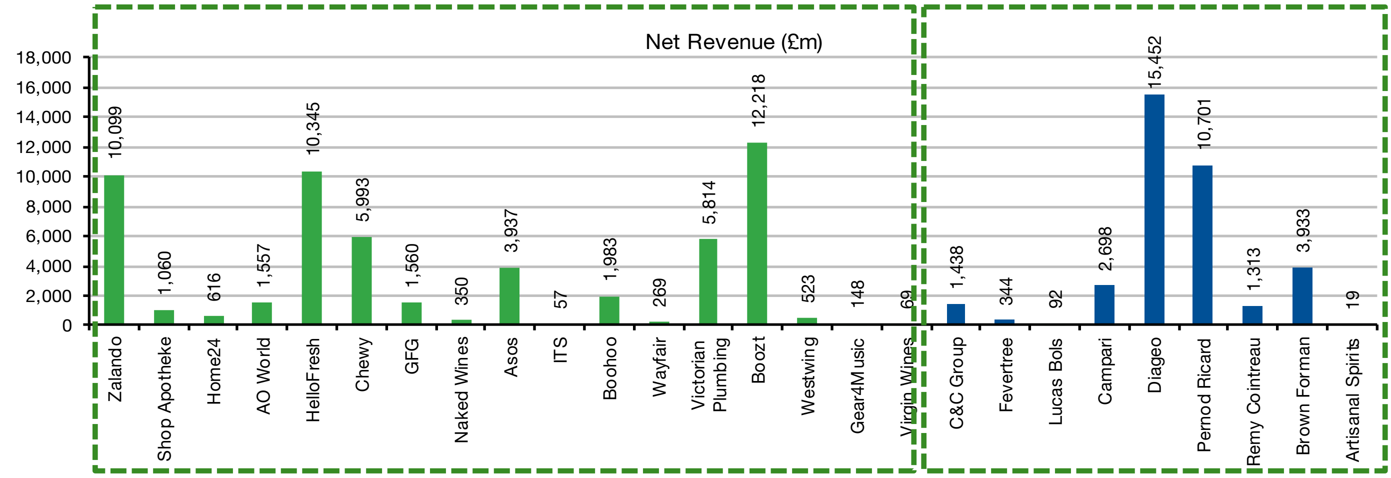
1. **The high contribution margin sets it apart** from all other pure-play online retailers (the green columns below). Despite its scale, it achieves the highest contribution margins amongst the spirits players (blue columns below).
   a. This suggests the group can reach profitability even at a smaller scale, and this is shown in our forecasts.

Figure 15: Contribution margin after marketing and adjusted EBITDA margin of pure-play online retailers and alcoholic beverage and mixers companies



Source: Company data, Liberum

Figure 16: Net revenue of pure-play online retailers and alcoholic beverage and mixers companies



Source: Company data, Liberum

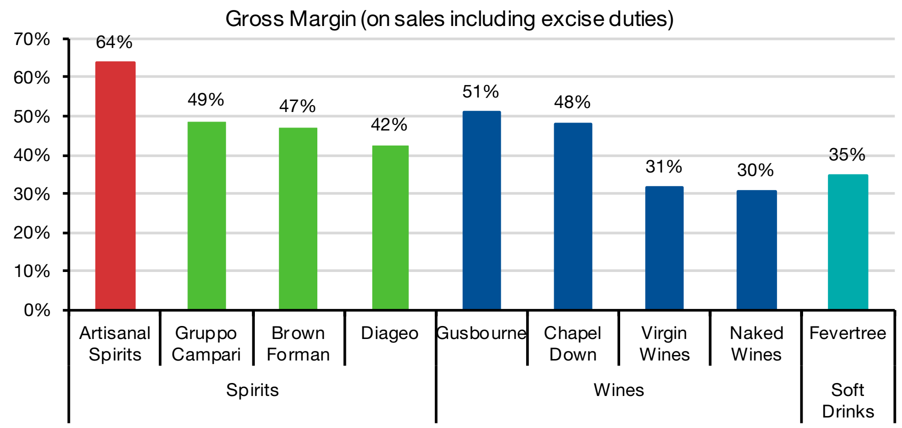
2. The D2C model and focus on the ultra-premium and above segment provides it with significantly higher margins than other listed spirits players.
3. The appreciating nature of its biggest asset, maturing inventory, and a much lower dependence than wine on weather for the quality and the yield of the output sets it apart of other UK SMID cap listed players in the alcoholic beverage market like Naked Wines, Chapel Down. Gusbourne.

Gross margins

Despite having the lowest scale amongst the peer group, Artisanal Spirits enjoys the highest gross margin.

Alcoholic beverage companies report revenues in two different ways: (i) Gross sales which includes the excise duties which are part of the bottles' selling price, and (ii) Net sales which excludes the excise duties to show only the underlying revenues of the business. While reporting sales on a gross or net basis does not have any impact on other reported financials, it does make margin and ratio analysis comparison difficult across companies. In this section, we try to clearly identify in the charts whether the margin and ratios are calculated on gross or net sales to ensure fair comparisons.

Figure 17: Gross margin on gross sales (i.e. including excise duties)



Source: Company data, Liberum.

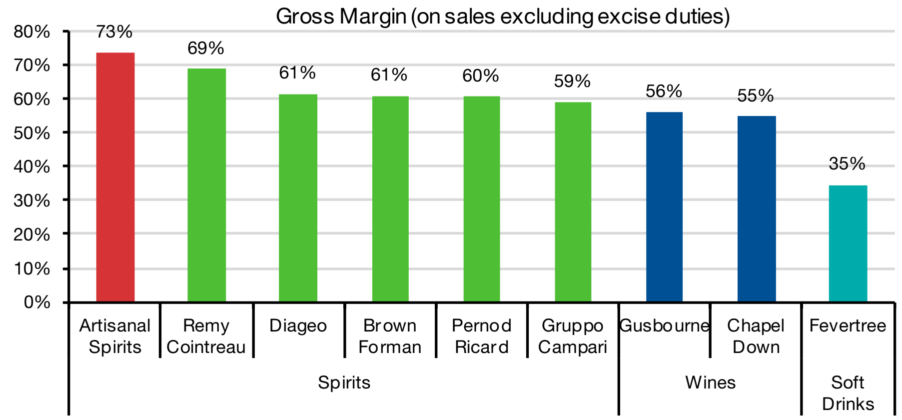
Note: All data based on last reported financial year. For Naked Wines, we take out an element of variable fulfilment costs (estimated) from gross margin to report a margin comparable to all other companies in the analysis.

- **The peers that we think are not applicable** - Fevertree, Naked Wines and Virgin Wines have a gross margin more than half of Artisanal Spirits. Fevertree has a low GM% as it outsources all its production and Naked and Virgin Wines, while being very different models, are resellers of third-party product hence the lower GM%. Gusbourne and Chapel Down enjoy higher GM% than Naked and Virgin due to their vertical integration and sits comparably to Gruppo Campari, Brown Forman and Diageo. However, the weather-related risks, the significant capex outlay in owning vineyards, and not having an inventory asset that appreciates (despite having to wait for many years for the vineyard to become productive) suggests a high degree of risk in these models.

- The large-scale spirit companies, Gruppo Campari, Brown Forman and Diageo are more comparable but even these have their challenges. Diageo and Campari have a large proportion of revenues that come from spirits that do not need to age, are more weighted towards mass market and premium brands. Brown Forman is a whisky business but largely American Whiskey where ageing requirements are much less and the pricing dynamics relative to Remy and Artisanal are lower.
- Artisanal Spirits and Remy Cointreau sit within the ultra-premium and above category, and both have by far most of their revenues coming from aged stock. This suggests to us that none of the companies in (Fig 17 & 18) enjoy the pricing power those in the ultra-premium and above have.

We must show a separate list for GM% that excludes excise duties because Remy Cointreau and Pernod Ricard disclose their GM% on this basis. This none the less shows us an interesting dynamic because Remy Cointreau is a premium+ model. It mainly sells Cognac which has a long maturation process something akin to Artisanal. So, both enjoy an inventory appreciating asset and premium and above pricing, delivering superior margins. Aside from Remy's scale – the models are the most comparable.

Figure 18: Gross margin on net sales (i.e. excluding excise duties)



Source: Company data, Liberum.

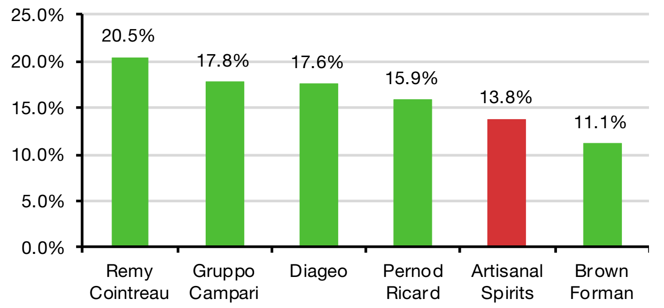
Note: All data based on last reported financial year. Artisanal Spirits does not report a net sales number excluding excise duties. We have estimates net sales for Artisanal Spirits.

Key point - Huge leverage opportunity to start flowing through for Artisanal Spirits

The scale of the large spirit companies allows for great flexibility down the P&L and makes marketing/brand investment very affordable. However, when the SG&A as a % of sales is as low as their models are (Fig 20), then one can also afford to boost brand investment which no doubt acts as a significant economic moat and drives revenues.

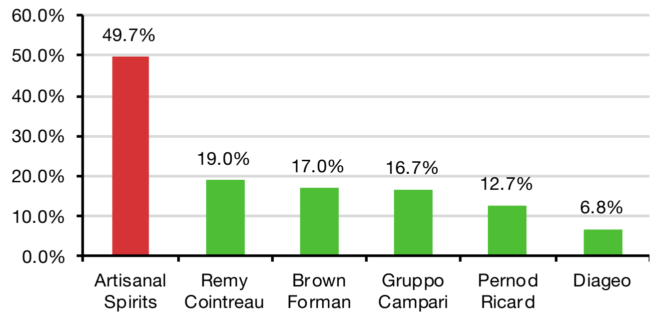
- Key take-away is that Artisanal Spirits has significant leverage opportunity due to its fully loaded cost base. This should drive a material margin opportunity in the future where the scale of this is shown in (Fig 21).

Figure 19: Marketing spend as a % of net sales (excluding excise duties)



Source: Company data, Liberum.

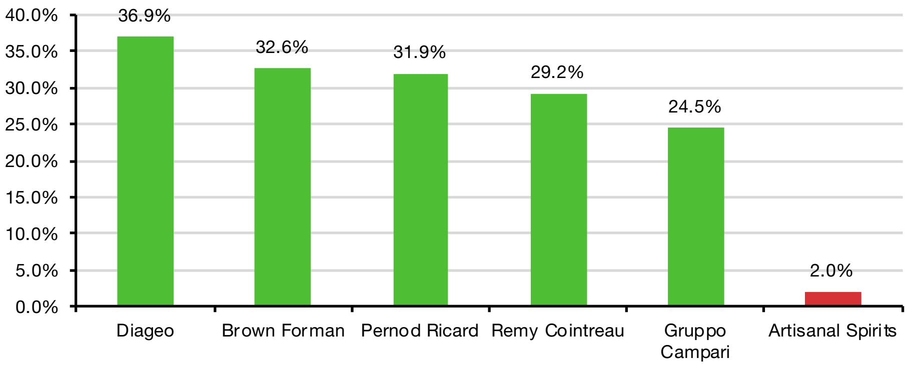
Figure 20: Staff and other overheads as a % of net sales (excluding excise duties)



Source: Company data, Liberum.

Large scale spirit companies generate significant profits and margins. This provides some insight as to the potential for Artisanal Spirits. Our forecasts suggest 12.6% EBITDA margin is achievable by FY25E and 20% by FY'28E. And even by 2028 SG&E will only be 27.5% of net sales highlighting that there remains much more leverage to be had to close the gap to the relevant large cap spirits companies.

Figure 21: Adjusted EBITDA margin



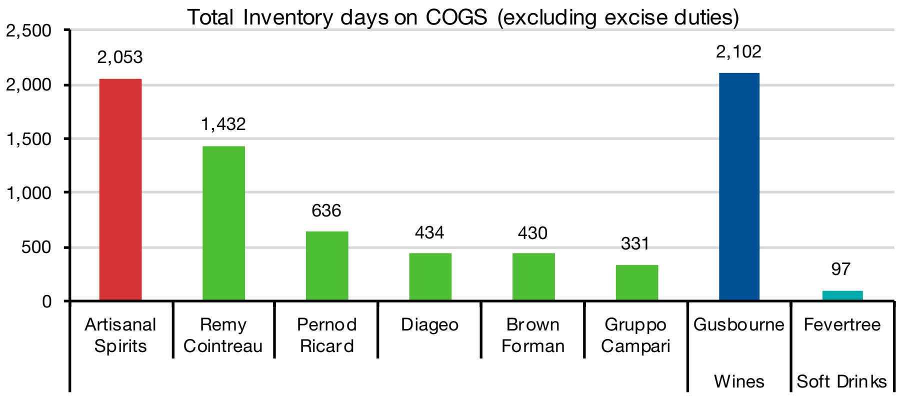
Source: Company data, Liberum.

Efficiency measures

The inventory profile for Artisanal Spirits and Remy reflects that their models require a lot of ageing of their stock. The average age profile for Artisanal is ageing for 7-12 years. The lower ageing requirements amongst the large spirit players and the different spirit categories they play in highlights their faster stock turn.

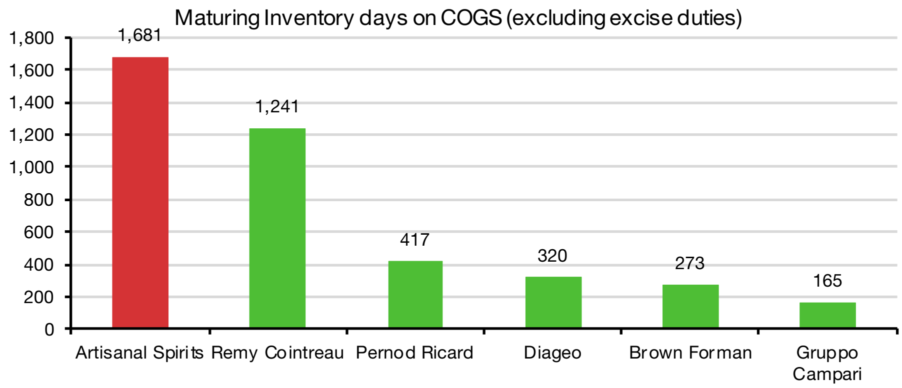
What the two charts below also show is that Artisanal is not far off from a similar profile to Remy and it only requires scale to get there.

Figure 22: Total Inventory days on COGS (excluding excise duties)



Source: Company data, Liberum.

Figure 23: Maturing Inventory days on COGS (excluding excise duties)

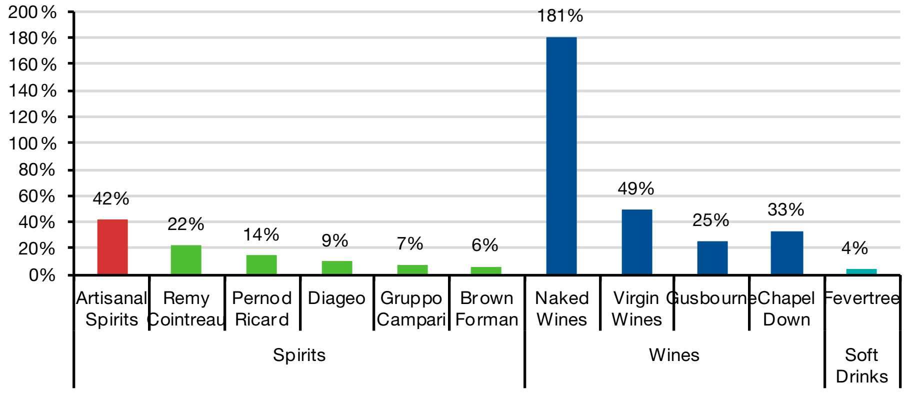


Source: Company data, Liberum.

Valuation relative to inventory

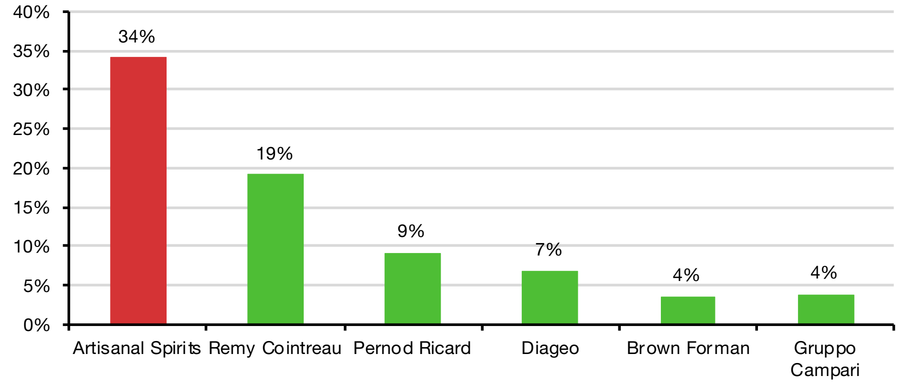
As discussed in this note, Artisanal has all the inventory to meet its revenue requirements out to 2028 and 75% out to 2033. It has planned its growth profile and mapped this to inventory purchases accordingly reflecting the time to age its inventory. Scale takes time and Remy and Pernod reflect a more normalised level that Artisanal can achieve in the long term.

Figure 24: Total inventory as a percentage of market cap



Source: Company data, Liberum.

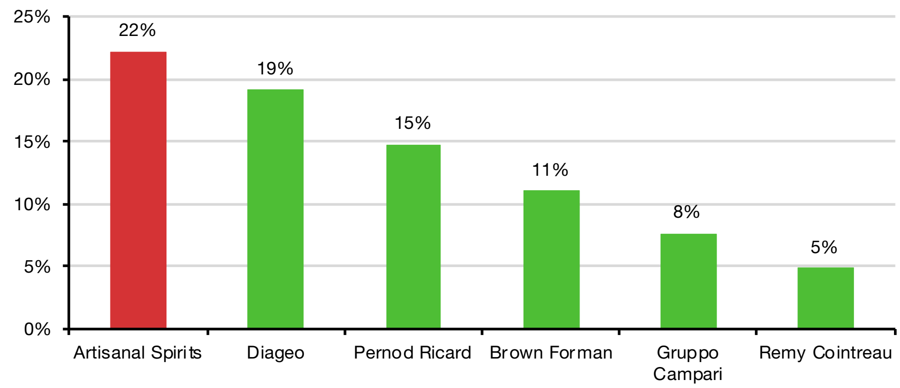
Figure 25: Maturing inventory as a percentage of market cap



Source: Company data, Liberum.

Debt is commonplace in the spirits sector - (Fig 26) shows that consumer staples businesses tend to operate with debt. Recall the EBITDA margins (Fig 21) range between 37% and 25% across the large spirit companies indicating their highly cash generative nature. Artisanal has a relatively high debt balance vs. the peers but it is a matter of time until the group becomes FCF positive, and this starts to fall. But it is common for spirit companies to finance their businesses with reasonable levels of financial leverage.

Figure 26: Net debt as a percentage of market cap



Source: Company data, Liberum.

We value Artisanal Spirits' shares at 130p

We use an average of DCF and ROCE/WACC valuation methodologies to value Artisanal Spirits as the group is still loss making but has a clearly identifiable path to FCF generation in 2025E, and scope to achieve significant levels of free cash flow in the long-term. We value Artisanal Spirits shares at a 130p target price, a simple average of 142p derived using DCF and 118p derived using our ROCE/WACC methodologies. We sense check this against the peer group and apply a discount for smaller scale.

DCF implies a £106m equity valuation.

We use a three-stage DCF model, which gives us a 142p target price. We use three years of explicit forecast and a 5-year middle period where we assume the company grows at a 13% CAGR and achieves a 15% EBIT margin.

For our terminal value calculation, we forecast a 20% terminal EBIT margin, a 3% capex rate as a % of sales, an 8.0% WACC (8.9% cost of equity and 4.5% cost of debt) and 3% terminal growth rate to calculate our DFC valuation.

Figure 27: Artisanal Spirits DCF Valuation

Derived EV of operations	121.3
Pension (deficit)	-
Prepayments	-
Minorities	(0.2)
Provisions	-
Adjusted EV	121.1
Net cash / (debt)	(15.0)
Implied Market Cap	**106**
NOSH (m)	74.7
Target price (p)	**142**

	Explicit forecasts			Middle Period (First cashflow)	Terminal Period (First cashflow)
	2023	**2024**	**2025**	**2026**	**2031**
Turnover	25.5	30.2	35.1	39.6	66.6
Underlying EBIT	(0.5)	1.1	2.8	5.9	13.3
- EBIT margin (%)	*-1.8%*	*3.5%*	*8.1%*	*15.0%*	*20.0%*
Add back depreciation & amortisation	1.5	1.6	1.6	1.8	2.7
EBITDA	1.0	2.7	4.4	7.7	16.0
Less: Share based payments					
Taxation (EBIT * tax rate)	(0.2)	(7.3)	(1.3)	(1.5)	(3.3)
Less increase/add decrease in Working Capital	(0.3)	(0.4)	(0.5)	(0.2)	(0.1)
Less: Net investment in cask spirit	(0.8)	(0.5)	-	-	-
Less: Capex	(1.8)	(1.7)	(1.2)	(1.3)	(1.9)
Less: Cash outflow related to lease liabilities	(0.4)	(0.3)	(0.3)	(0.3)	(0.4)
Free Cashflow for the Firm (FCFF)	(2.3)	(7.7)	1.3	4.5	10.3
Discount rate (WACC) (%)	**8.0**				
Annual discount factor	0.93	0.93	0.93	n/a	n/a
Cumulative factor for period	0.93	0.86	0.79	5.07	20.06
Discount factor to start of first forecast period				0.79	0.54
Total discount factor	0.93	0.86	0.79	4.03	10.81
Discounted value	**(2.2)**	**(6.6)**	**1.0**	**18.0**	**111.0**
Derived EV	**121.3**				

WACC Calculation	
Cost of equity (%)	
Risk free rate (%)	**4.0**
Beta	**0.8**
Equity risk premium (%)	**6.5**
CAPM unleveraged discount rate	**8.9**
Cost of debt (%)	
Average spread over risk-free rate (%)	**2.0**
Pre-tax cost of debt (%)	**6.0**
Average corporate tax rate for company (%)	**25.0**
Post-tax cost of debt (%)	**4.5**
Estimated target gearing (net debt/EV) (%)	**20.0**
WACC (%)	**8.0**

Number of years of explicit estimates	**3.0**
Middle period duration (yrs)	**5.0**
No. of years to start of terminal period	**8.0**
First forecast period	**2023**

$$PV(\text{Growing Annuity}) = \frac{C}{r-g}\left[1 - \frac{(1+g)^T}{(1+r)^T}\right].$$

1/(r-g)	-20.1
(1+g)^T	1.8
(1+r)^T	1.5
Annuity Factor	5.1
Growing perpetuity formula	
1/(r-g)	-20.1
r	8.0%
g	3.0%
Perpetuity factor	20.1

Middle period assumptions	
Growth rate (%)	**+13.0**
Operating margin (%)	**15.0**
Capex/D&A ratio (x)	**0.7**
Working capital/ turnover ratio (%)	**5.0**
Tax rate (%)	**25.0**

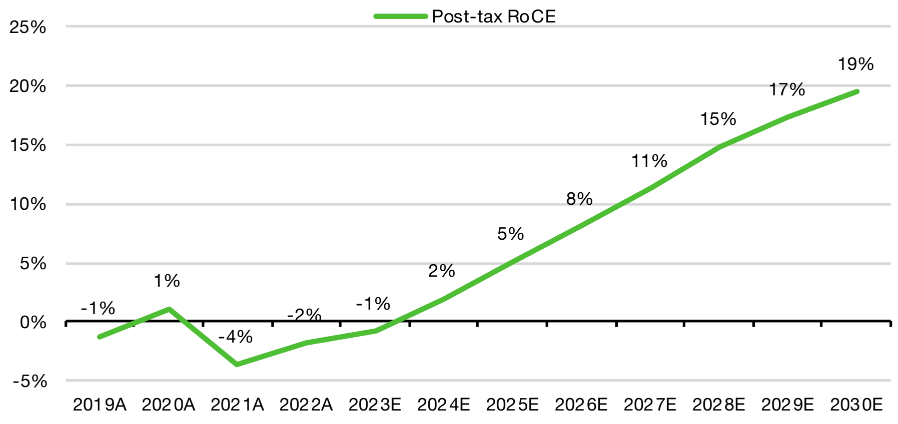
Terminal period assumptions	
Growth rate (%)	**+3.0**
Operating margin (%)	**20.0**
Capex/depreciation ratio (x)	**0.7**
Working capital/ turnover ratio (%)	**5.0**
Tax rate (%)	**25.0**

Source: Liberum

ROCE/WACC implies a £88m equity valuation

This is based on the theory that EV/CE should equal ROCE/WACC adjusted for growth. We use our FY'23-33E forecasts to arrive at an average ROCE and capital employed to derive a fair value for the company. We apply a WACC of 8% and a terminal growth rate of 3%, which gives us an 118p target price.

Figure 28: Post tax ROCE



Source: Liberum

We forecast Artisanal Spirits will start generating positive RoCE in 2024E post-tax ROCE will continue to expand at c. 3 percentage points p.a. after that driven by higher profits and better asset efficiency as the investment cycle in casks is now winding down.

Figure 29: Artisanal spirits ROCE vs. WACC analysis

EV = (ROCE-g/WACC-g) X Capital Employed	
Av. post-tax ROCE (FY23E-33E)	14.3%
WACC	8.0%
Av. Capital Employed (FY23E-33E) (£m)	45.5
Long-term growth rate	3.0%
Fair Value of Enterprise (£m)	**103**
Net cash/(debt) (FY22, £m)	(15)
Implied Equity Value	**88**
Shares Outstanding (Fully Diluted) (m)	74.7
Implied share price	**118**

Source: Liberum estimates

Comparison with peer group

We think international global spirits companies form the best peer group for Artisanal Spirits. While Artisanal is not a distiller, it achieves better gross margin than global spirits companies as it controls the maturing process which is the most-value added part of scotch whisky production. Given its smaller scale and lack of profitability, we think Artisanal Spirits should trade at a 20-25% discount to global spirits peers on an EV/Sales basis. At the current share price, Artisanal Spirits trades at a 40% discount to global spirits peers, which reduces to 20% at our target price.

For reference, we also provide the SMID-cap alcoholic beverages and mixers peer group which has a much lower margin profile and riskier business model than Artisanal, and we believe Artisanal should trade at a significant premium to these companies.

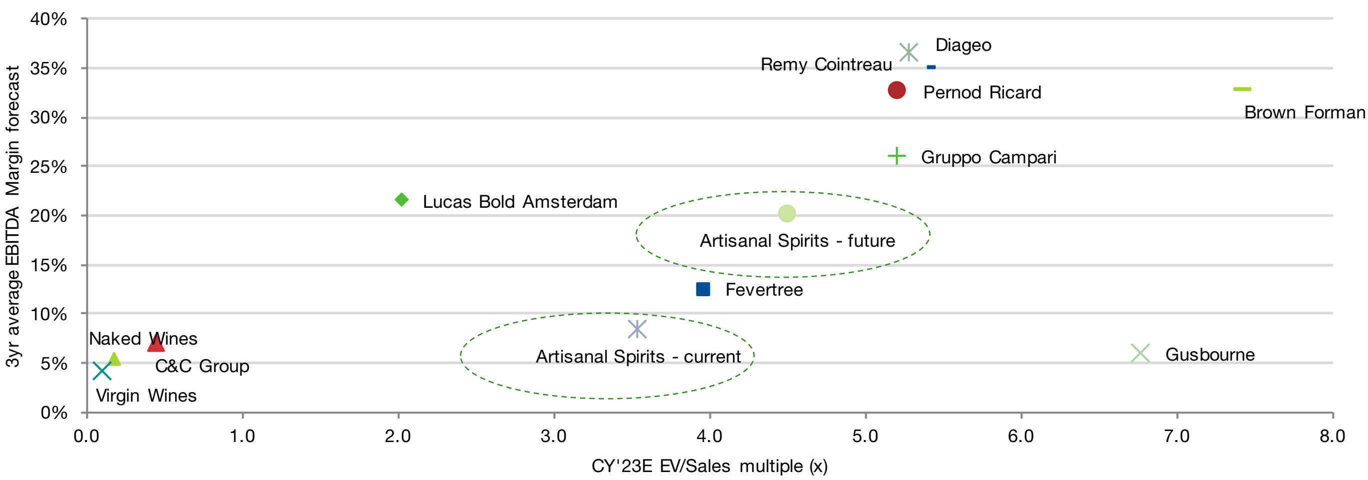
Figure 30: Artisanal Spirits relative valuation vs. peer group

	Market Cap	EV/Sales (x)		EV/EBITDA (x)		P/E (x)		Dividend Yield %		Sales growth		EBITDA growth	
Companies	**(£m)**	**CY23**	**CY24**	**CY23**	**CY24**	**CY23**	**CY24**	**CY23**	**CY24**	**CY'19-22A CAGR**	**CY'22-25E CAGR**	**CY'19-22A CAGR**	**CY'22-25E CAGR**
Diageo	76,515	5.3	5.0	15.2	13.6	19.7	17.8	2.5	2.7	9%	5%	8%	7%
Pernod Ricard	45,592	5.2	4.9	16.2	14.9	21.6	19.8	2.6	2.8	8%	4%	13%	5%
Gruppo Campari	12,191	5.2	4.8	20.6	18.5	31.4	27.6	0.6	0.6	14%	8%	11%	12%
Remy Cointreau	6,338	5.4	4.8	15.4	14.1	28.6	22.5	1.7	1.8	12%	5%	22%	9%
Brown Forman	23,959	7.4	7.0	23.6	20.8	32.6	28.0	1.4	1.5	7%	6%	0%	11%
Kweichow Moutai	232,751	13.5	11.7	19.3	16.6	27.9	23.8	1.9	2.2	14%	15%	16%	16%
Wuliangye Yibin	70,862	6.2	5.5	12.8	11.1	20.1	17.5	2.6	3.0	14%	13%	16%	15%
Global large cap spirit median		**5.4**	**5.0**	**16.2**	**14.9**	**27.9**	**22.5**	**1.9**	**2.2**	**12%**	**6%**	**13%**	**11%**
C&C Group	562	0.4	0.4	7.2	5.5	15.3	11.3	279.7	4.4	3%	7%	-7%	8%
Chapel Down	47	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gusbourne	43	6.8	5.4	n.a.	43.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Lucas Bold Amsterdam	130	2.0	2.0	10.0	8.5	22.5	9.8	4.3	5.1	5%	n.a.	-8%	15%
Fevertree	1,640	4.0	3.6	40.7	27.2	72.2	45.8	1.2	1.2	10%	12%	-20%	22%
Naked Wines	79	0.2	0.2	3.5	na	12.4	9.1	0.0	0.0	7%	0%	46%	11%
Virgin Wines	18	0.1	0.1	3.2	2.1	35.2	12.7	n.a.	n.a.	n.a.	2%	n.a.	-1%
European SMID cap beverages median		**2.0**	**2.0**	**8.6**	**17.1**	**22.5**	**11.3**	**2.8**	**2.8**	**6%**	**7%**	**-8%**	**13%**
ASC at current price	68	3.5	3.0	86.4	34.3	n.a.	n.a.	n.a.	n.a.	14%	17%	10%	128%
- premium(discount) to large cap spirit		**-35%**	**-40%**	**434%**	**131%**	**n.a.**	**n.a.**	**n.a.**	**n.a.**				
ASC at target price	91	4.4	3.8	108.2	42.8	n.a.	n.a.	n.a.	n.a.	14%	17%	10%	128%
- premium(discount) to large cap spirit		**-18%**	**-25%**	**569%**	**188%**	**n.a.**	**n.a.**	**n.a.**	**n.a.**				

Source: Bloomberg, Liberum

We observe a mostly linear relationship between EV/Sales multiple and EBITDA margins for listed alcoholic beverage companies. As Artisanal's EBITDA margin improves, we expect the company to command a higher EV/Sales multiple.

Figure 31: Artisanal Spirits and peer group EV/Sales multiple vs. 3yr forecasted average EBITDA margin



Source: Bloomberg, Liberum

Financial model

Figure 32: Income statement (£m)

December year-end	**2022A**	**2023E**	**2024E**	**2025E**
Total sales	21.8	25.5	30.2	35.1
Sales growth (%)	n.a.	17.0	18.5	16.2
Gross margin (%)	63.6	65.0	66.0	66.5
Cost of sales	(7.9)	(8.9)	(10.3)	(11.8)
Gross profit	13.8	16.6	19.9	23.3
Operating expenses	(4.1)	(5.2)	(6.4)	(7.2)
Administrative expenses	(9.2)	(10.2)	(10.7)	(11.5)
Share based payments	(0.2)	(0.2)	(0.2)	(0.2)
Underlying EBITDA	**0.4**	**1.0**	**2.7**	**4.4**
Depreciation	(1.0)	(1.2)	(1.3)	(1.3)
Amortisation (not acquired)	(0.3)	(0.3)	(0.3)	(0.3)
Underlying EBIT (pre JVs)	(0.9)	(0.5)	1.1	2.8
EBIT (pre JVs) margin (%)	(4.1)	(1.8)	3.5	8.1
Revenue	0.0	0.0	0.0	0.0
PBT	0.0	0.0	0.0	0.0
Tax	0.0	0.0	0.0	0.0
JV post tax profit	0.0	0.0	0.0	0.0
JV contribution	0.0	0.0	0.0	0.0
Profit on disposal	0.0	0.0	0.0	0.0
Underlying EBIT	**(0.9)**	**(0.5)**	**1.1**	**2.8**
EBIT Margin (%)	**(4.1)**	**(1.8)**	**3.5**	**8.1**
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0
Exceptional / extraordinary costs	(0.6)	0.0	0.0	0.0
Reported EBIT	(1.5)	(0.5)	1.1	2.8
Non-operating exceptional costs	0.0	0.0	0.0	0.0
Interest income	0.0	0.0	0.0	0.0
Interest costs	(0.6)	(1.0)	(1.0)	(1.0)
Pension credit / (cost)	0.0	0.0	0.0	0.0
Net Interest	(0.6)	(1.0)	(1.0)	(1.0)
Underlying PBT	**(1.5)**	**(1.5)**	**0.1**	**1.9**
Reported PBT	(2.1)	(1.5)	0.1	1.9
Underlying tax rate (%)	(10.3)	(38.0)	688.7	44.5
Exceptional tax rate (%)	(10.3)	(38.0)	688.7	44.5
Reported tax rate (%)	(10.3)	(38.0)	688.7	44.5
Underlying tax	(0.2)	(0.6)	(0.7)	(0.8)
Exceptional tax	0.0	0.0	0.0	0.0
Reported tax	(0.2)	(0.6)	(0.7)	(0.8)
Underlying PAT	**(1.7)**	**(2.0)**	**(0.6)**	**1.0**
Discontinued operations (net)	0.0	0.0	0.0	0.0
Profit on disposal	0.0	0.0	0.0	0.0
Reported PAT	**(2.3)**	**(2.0)**	**(0.6)**	**1.0**
Preference dividends	0.0	0.0	0.0	0.0
Underlying net income	**(1.7)**	**(2.0)**	**(0.6)**	**1.0**
Reported net income	(2.3)	(2.0)	(0.6)	1.0
Weighted average number of shares (basic) (m)	69.7	69.7	69.7	69.7
Weighted average number of shares (diluted) (m)	74.7	74.7	74.7	74.7
Number of shares at period end (basic) (m)	0.0	0.0	0.0	0.0
Reported EPS (basic) (p)	(3.7)	(2.9)	(0.8)	0.9
Reported EPS (diluted) (p)	(3.7)	(3.3)	(1.4)	0.9
Underlying EPS (basic) (p)	(2.8)	(3.3)	(1.4)	0.9
Underlying EPS (basic) growth (%)	n.a.	18.3	(59.5)	(167.9)
Underlying EPS (diluted) (p)	**(2.8)**	**(3.3)**	**(1.4)**	**0.9**
Underlying EPS (diluted) growth (%)	**n.a.**	**18.3**	**(59.5)**	**(163.3)**
Pro-forma EPS (diluted) (p)	**(3.7)**	**(3.3)**	**(1.4)**	**0.9**
DPS (Ordinary) (p)	0.0	0.0	0.0	0.0
DPS (Special) (p)	0.0	0.0	0.0	0.0
DPS (Total) (p)	0.0	0.0	0.0	0.0

Source: Liberum

Figure 33: Cash flow statement (£m)

December year-end	**2022A**	**2023E**	**2024E**	**2025E**
Reported EBIT	(1.5)	(0.5)	1.1	2.8
Profit in associates	0.0	0.0	0.0	0.0
Depreciation	1.0	1.2	1.3	1.3
Amortisation	0.3	0.3	0.3	0.3
Loss / (profit) on sale of PPE	(0.0)	0.0	0.0	0.0
Share based payments	0.2	0.2	0.2	0.2
Increase/(Decrease) in provisions	0.2	0.0	0.0	0.0
Loss / (Gain) on business disposal	0.0	0.0	0.0	0.0
Other	(2.9)	(0.8)	(0.5)	0.0
Operating cash flows before movements in working capital	**(2.8)**	**0.5**	**2.4**	**4.7**
(Increase) / decrease in inventories	(1.4)	(0.1)	(0.2)	(0.3)
(Increase) / decrease in receivables	(0.9)	(0.7)	(0.8)	(0.9)
(Decrease) / increase in payables	(0.2)	0.4	0.6	0.7
(Increase) / decrease in working capital	(2.6)	(0.3)	(0.4)	(0.5)
Cash generated by operations	**(5.4)**	**0.2**	**1.9**	**4.2**
Tax paid	(0.1)	(0.6)	(0.7)	(0.8)
Net cash flow from operating activities	**(8.8)**	**(0.3)**	**1.3**	**3.4**
Purchase of PPE	(2.9)	(1.4)	(1.4)	(0.9)
Purchase of other intangibles	(0.1)	(0.4)	(0.4)	(0.3)
Disposals	0.0	0.0	0.0	0.0
Net capex	(3.0)	(1.8)	(1.7)	(1.2)
Dividends from associates	0.0	0.0	0.0	0.0
Movement in short term investments	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0
(Investments) / disposals of associates	0.0	0.0	0.0	0.0
Net cash flow from investing activities	**(3.4)**	**(1.8)**	**(1.7)**	**(1.2)**
Net interest received / (paid)	(0.6)	(1.0)	(1.0)	(1.0)
Equity dividends paid	(0.4)	0.0	0.0	0.0
Share issues / (repurchases)	0.1	0.0	0.0	0.0
Increase / (decrease) in borrowings	10.2	3.0	1.0	0.0
Net cash flow from financing activities	**9.3**	**2.0**	**0.0**	**(1.0)**
Increase in cash and cash equivalents	(3.4)	(0.4)	(0.7)	1.1
(Increase) / decrease in borrowings	0.0	0.0	0.0	0.0
Repayment of finance leases	(0.3)	(0.3)	(0.2)	(0.2)
Exchange / other	0.0	0.0	0.0	0.0
(Increase) / decrease in net debt	**9.6**	**3.5**	**1.4**	**(1.2)**
Net cash / (debt) (start)	(8.8)	(18.3)	(21.8)	(23.2)
Net cash / (debt) (end) including leases	**(18.3)**	**(21.8)**	**(23.2)**	**(22.0)**

Source: Liberum

Figure 34: Balance sheet (£m)

December year-end	**2022A**	**2023E**	**2024E**	**2025E**
Goodwill	1.3	1.3	1.3	1.3
Other intangible assets	0.9	1.0	1.1	1.0
PPE	10.4	10.6	10.6	10.3
Trade and other LT receivables	0.0	0.0	0.0	0.0
Deferred tax asset	0.0	0.0	0.0	0.0
Investments in JVs / Associates	0.0	0.0	0.0	0.0
Retirement benefit asset	0.0	0.0	0.0	0.0
Other non-current assets	0.4	0.4	0.4	0.4
Fixed assets	**13.0**	**13.3**	**13.4**	**13.0**
Inventories	28.1	28.9	29.7	29.9
Trade and other receivables	3.9	4.5	5.4	6.3
Cash & cash equivalents	2.3	1.9	1.2	2.3
Financial assets	0.0	0.0	0.0	0.0
Other current assets	0.0	0.0	0.0	0.0
Current assets	**34.3**	**35.4**	**36.3**	**38.5**
Total Assets	**47.4**	**48.7**	**49.7**	**51.6**
Trade payables	(3.7)	(4.2)	(4.8)	(5.5)
Borrowings	(0.4)	(0.4)	(0.4)	(0.4)
Tax liabilities	(0.4)	(0.4)	(0.4)	(0.4)
Provisions	0.0	0.0	0.0	0.0
Other current liabilities	(0.4)	(0.4)	(0.4)	(0.4)
Current liabilities	**(4.8)**	**(5.3)**	**(5.9)**	**(6.6)**
Total assets less current liabilities	**42.5**	**43.4**	**43.8**	**45.0**
Net current assets	**29.5**	**30.1**	**30.4**	**31.9**
Long-term borrowings and finance leases	(19.9)	(23.0)	(23.8)	(23.6)
Provisions	(0.6)	(0.6)	(0.6)	(0.6)
Other payables	(0.6)	(0.6)	(0.6)	(0.6)
Other non-current liabilities	0.0	0.0	0.0	0.0
Net Assets	**21.4**	**19.3**	**18.9**	**20.2**
Total equity	21.4	19.3	18.9	20.2
Minority interests	0.2	0.6	0.9	1.3
Shareholders' equity	**21.2**	**18.7**	**18.0**	**18.9**

Source: Liberum

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