

Marlborough Wine Estates

Food & beverages
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Q3 update and reset of full-year targets

Marlborough Wine Estates Group (MWE) is targeting development of premium New Zealand (NZ) wine brands in China and, increasingly, internationally. The global market is strong and the popularity of quality NZ wine is growing. In the face of slowdown in the Chinese market, MWE continues to explore US, Japanese, Australian, UK and Canadian markets. In this context, early inroads into the US and Japan are encouraging.

Q3 trading update

MWE has reported its Q3 trading results. Favourable climatic and growing conditions have meant that, unusually this year, part of the harvest took place in Q3, and the company has reported 785 tonnes against zero in Q317. Similarly, 587 tonnes of bulk grapes were sold in Q3 (Q317: zero), although management says that the larger part of such sales is still expected to fall into Q4. International wine sales revenue for Q3 at NZ\$297k was at a similar level to that of Q2. With its current focus on international markets outside China, MWE has enjoyed some early success with exports to the US and Japan. Bottled wine revenue has continued at broadly similar levels in all three quarters, totalling NZ\$224k after nine months.

Review and reset of KOM targets

Following a review, MWE has revisited three of its four key operating milestone (KOM) targets for FY18. The gross harvest KOM has been raised 12% to 1,790 tonnes, attributable to improved irrigation, the maturity of the vines and favourable weather conditions. The KOM for international wine sales revenue is being reduced by 35%, to NZ\$1,300k, due to both slower than expected growth in the Chinese market and slower development in other international markets. We note the materiality of the NZ\$700k reduction. The NZ bottled wine sales revenue KOM is being increased by 35% to NZ\$315k, with improved product variety and portfolio, and the success of a greater focus on marketing and business development.

Valuation: Limited relevance in peer comparison

We review MWE's market valuation against two peers, which trade on an average FY18e EV/revenue of 2.6x, substantially lower than MWE's 19.2x (FY17). We caution that the comparison is of limited relevance. The listed peers are larger and well established, while MWE is at an earlier stage in its life cycle and is also repositioning its market focus, which detracts from the relevance of the comparison.

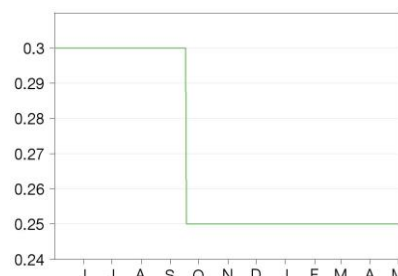
Historical performance

Year end	Revenue (NZ\$000s)	NPAT*** (NZ\$000s)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
06/15 PF*	2,788	170	0.1	0.0	N/A	N/A
06/15**	1,840	590	0.2	0.0	N/A	N/A
06/16	7,424	(481)	(0.2)	0.0	N/A	N/A
06/17	3,822	(717)	(0.2)	0.0	N/A	N/A

Source: Marlborough Wine Estates. Note: *Pro forma for 12 months; revenue includes sales revenue and other revenue. **Actual from 18 March 2015 to 30 June 2015. ***FY15 NPAT includes positive fair value adjustment of NZ\$1.054m, according to management, and FY16 NPAT excludes one-off capital raising costs. FY16 and FY17 results are normalised.

Price **NZ\$0.25**
Market cap **NZ\$73m**

Share price graph



Share details

Code	MWE
Listing	NXT
Shares in issue	290.9m

Business description

Marlborough Wine Estates Group (MWE) owns and operates six vineyard blocks located in the Awatere Valley in the Marlborough wine district of the South Island of New Zealand (NZ). It sells bottled and bulk wine to NZ and international markets, as well as bulk grapes to wine producers in NZ.

Bull

- Potential for developing international markets building on the Marlborough region's global reputation for quality.
- Option to improve earnings by converting more of the grape harvest into bottled wine for local and export sales.
- Improvements in vineyard management, particularly in securing water supply, could improve grape yields.

Bear

- Maintenance of premium pricing is dependent on the quality of the product.
- Increased competition and regulatory barriers in Chinese markets.
- Development of international markets is still at an early stage.

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Marlborough Wine Estates coverage is provided through the NXT Research Scheme

Q318 update and reset of KOM targets

In April 2018 MWE completed an initial review of trading to date and advised the market that the performance against three of its KOMs for FY18 would be likely to vary by more than 10%. The company said then that it expected its KOMs for gross harvest and New Zealand bottled wine sales revenue to be exceeded by more than 10% and its international wine sales revenue KOM to be underachieved by more than 10%. Management said it would update the market further with its Q3 business update.

MWE has now updated on Q318 trading and, as advised, has revised the three KOM targets:

Exhibit 1: Actual results and revised KOM

	Q1 actual	Q2 actual	Q3 actual	Q1-3 actual	FY18 target (old)	FY18 target (new)
Gross harvest (tonnes)	0	0	785	785	1,600	1,790
Bulk grape sales (tonnes)	0	0	587	587	1,200	1,200
International wine sales revenue (NZ\$000)	467	288	297	1,052	2,000	1,300
NZ bottled wine sales (NZ\$000)	71	87	66	224	234	315

Source: MWE

Q318 trading

We review the Q3 trading result and KOM revisions by category:

Gross harvest

Because of the seasonality of the crop, the wine harvest tonnage is usually all reported in the final quarter of the financial year ending June. What is unusual about the current year is that, due to favourable climatic and growing conditions, the harvest for the 2018 vintage started slightly earlier than usual, with some of the grapes harvested before the end of March, and therefore being reported within Q3. The remainder have been harvested during April. Although the Q3 amount does not itself tell us anything about the total amount expected to be harvested, favourable production factors have prompted a 12% upward revision of the KOM target to 1,790 tonnes.

Management cites three specific factors that have pushed production up:

- Improvements to water irrigation with the completion of Donaldson Block Dam in early 2017.
- MWE's vines are becoming more productive as they mature.
- Weather conditions for the 2018 vintage and harvest season were favourable.

On the basis of the revised target, the Q3 tonnage represents 44% of the total.

Bulk grape sales

Delivery and sales to customers of bulk grapes are dependent on the timing of the grape harvest, discussed above. Similarly to the grape harvest, this is normally in Q4. As with the grape harvest, sales of bulk grapes this year began in Q3, although management says that the larger part of such sales is still expected to fall into Q4.

The KOM target of 1,200 tonnes has not been revised, which means that management does not expect the full-year result to vary by more than 10% from that figure. However, with the Q3 tonnage at 49% of the target, the Q4 tonnage would not need to be much higher for the KOM to be overachieved.

International wine sales revenue

MWE has focused on international markets outside China this year and, as we noted in [March](#), has enjoyed some early success with exports to the US and Japan. MWE also expects to start exporting to the UK, Australia and Canada in the coming months. Management also expects a

revised agreement for increased quantities of bulk wine to be shipped to its US importer for the 2018 vintage, but there are no details yet.

With Q3 revenue at a similar level to that of Q2, the total to date is just over 50% of the existing KOM target for the year. MWE is now reducing that target by NZ\$700k, or 35%, to NZ\$1,300k. The reduction can be attributed to two specific reasons:

1. the wine market in China has not grown as much as MWE projected, with red wine still dominating the market; and
2. MWE is focusing on other international markets which are proving slower to develop than expected. These markets include the US, Japan, UK, Canada and Australia. Early results are nonetheless promising, with exports to the US and Japan growing year-on-year. The first exports to Australia and Canada are likely to occur in the next few months, but the majority of such sales are likely to be later than June 2018.

The timing of these export sales is likely to result in an increase in inventory at end June 2018.

New Zealand bottled wine sales revenue

Bottled wine revenue has continued at broadly similar levels in all three quarters, totalling NZ\$224k after nine months. Sales in the Auckland region have grown steadily, and the company has now started to expand its sales network beyond Auckland. Products launched this year have proved popular and a new Pinot Noir product launch should further boost sales in the New Zealand market.

The year to date revenue is 95% of the existing target for the year, and management is increasing that target by NZ\$81k or 35%, to NZ\$315k. The increase relates to two factors:

1. Improved product variety and portfolio. MWE now offers a large range of highly rated white and red wines. The offer has been taken up by major New Zealand grocery and supermarket chains.
2. The success of a greater focus on marketing and business development. MWE is working closely with retail outlets, prospective clients and marketing experts to improve its brand awareness and reputation.

The new KOM target implies that management expects to achieve Q4 revenue of NZ\$91k, which is somewhat greater than the NZ\$75k average of Q1-3.

Valuation: Relevance is limited

We review MWE's market valuation against those of comparable companies, although we would caution that such a comparison is of limited relevance. There are only two listed peers in the NZ/Australian market, both of which are well established and substantially larger than MWE.

Company	Currency	Market cap (m)	2018e P/E (x)	2019e P/E (x)	2018e EV/EBIT (x)	2019e EV/EBIT (x)	2018e EV/Revenue (x)	2019e EV/Revenue (x)
Australian Vintage	A\$	167	23.1	14.0	15.9	11.3	1.0	1.0
Delegat Group	NZ\$	844	19.9	17.4	15.7	14.0	4.2	3.9
Average			21.5	15.7	15.8	12.7	2.6	2.5

Source: Bloomberg. Note: Prices at 30 April 2018. Both companies have a 30 June year-end.

The two peers trade on an average FY18e EV/revenue multiple of 2.6x, substantially lower than the 19.2x FY17 EV/revenue multiple on which MWE is currently trading. However, MWE is at an earlier stage in its life cycle, and in addition is in the process of repositioning its market focus, which detracts from the relevance of the comparison.

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