The Artisanal Spirits Company

Beverages

19 May 2021

The spirit to grow

The Artisanal Spirits Company (ASC) is the owner of The Scotch Malt Whisky Society, which curates unique ultra-premium single cask Scotch malt whiskies and other spirits, with a focus on distinct flavour profiles. Sales are made exclusively to its global subscription-paying members and are mostly made direct to consumer (D2C), namely its own online websites and venues, with remaining sales via partner bars around the world. ASC has a loyal customer base and a significant inventory of maturing whiskies. Future growth opportunities include continued growth of its membership and geographic and virtual presence, as well as moves into adjacent product markets such as blended whiskies, with the potential to improve profitability.

Unique, limited edition luxury

The structural tailwinds of increasing global wealth and aspiration are expected to continue to drive growth for ultra-premium spirits at a higher rate than lower-priced spirits. ASC taps into this demand by creating a constant stream of limited edition products that have individual characters, using its own skills in the maturation process. The products are marketed exclusively to a growing and loyal global membership, by proactively building 'anticipation' ahead of the regular new launches. With an average lifetime customer value of £932 versus low customer acquisition costs (eg £65 in the UK), management's focus is to grow the membership base, revenue and profitability while investing in maturing inventory, which is currently equivalent to 26x the volume sold in FY20.

Focus on profitable revenue growth

Management's strategy to grow revenue and EBITDA has four key pillars: developing the membership base and geographic expansion; enhancing the e-commerce channels; improving margins by buying younger spirits, increasing the proportion of higher-value spirits and optimising the supply chain; and developing new and complementary brands and platforms.

Historical financials

Year end	Revenue (£m)	Adjusted EBITDA (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
12/18	12.1	0.0	N/A	0.0	N/A	N/A
12/19	14.6	0.3	N/A	0.0	N/A	N/A
12/20	15.0	1.3	N/A	0.0	N/A	N/A

Source: Company data

Price N/A

Market cap N/A

Share details

Code	ART
Listing	AIM
Shares in issue	N/A
Net debt as at 31 March 2021 (excluding IFRS 16 liabilities)	£14.6m

Business description

The Artisanal Spirits Company (ASC) is the owner of The Scotch Malt Whisky Society, the leading curator and provider of ultra-premium single cask Scotch malt whisky for sale, primarily online to a discerning global membership. It has a presence in over 30 international markets including the United States and China.

Bull

- The ultra-premium spirits markets are in structural growth due to increasing global wealth and aspiration.
- Established presence in key markets with loyal customer base but still low national and global market share.
- High return on low customer acquisition investment.

Bear

- The alcoholic beverages industry is highly competitive with many leading international brands that have more significant scale.
- Despite rapid growth in the number of members and revenue, ASC generates operating losses at the group level; however, this is mainly a function of investment in growing its global membership.
- ASC is vulnerable to changes in regulation, duties and tariffs that may affect customer demand and ASC's profitability.

Analysts

Russell Pointon +44 (0)20 3077 5700

Sara Welford +44 (0)20 3077 5700

consumer@edisongroup.com

Edison profile page

Company description: Curating ultra-premium spirits

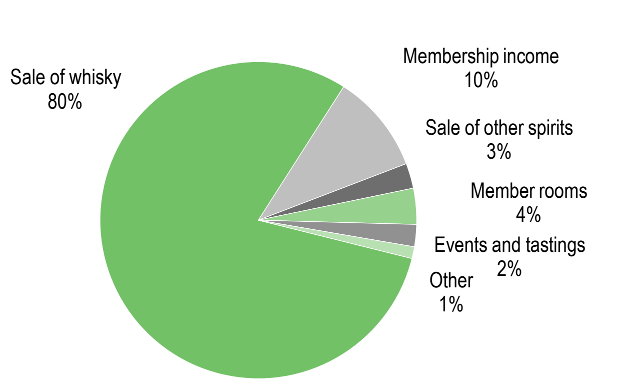
ASC is the holding company of the group and the principal subsidiary operates The Scotch Malt Whisky Society (SMWS). SMWS is a leading curator and retailer of ultra-premium and above (more than £35 per 70cl standard bottle per The International Wines and Spirits Record definition – see Exhibit 9) single cask Scotch malt whisky and other spirits including Armagnac, Bourbon, Cognac, gin, rum, Indian whisky and Japanese whisky. Each cask is unique, with a limited one-time-only supply. SMWS's average selling price per bottle during FY20 was £76 (excluding VAT).

Single cask Scotch malt whisky means a premium class of whisky in which each bottle comes from the contents of a single individual cask rather than the more common process for bottled single malt Scotch whiskies of blending together the contents of various casks from the same distillery to provide uniformity of colour and taste. Scotch whisky is matured in oak casks (barrels) for a minimum of three years and one day, and is often matured for much longer. During maturation, the Scotch interacts with the wood of the cask and oxygen that permeates from outside. The age of the wood and the previous contents of the cask (eg sherry) play an important part in the maturation process and influence the final finish or flavour of the whisky. The maturing can also be influenced by external temperatures. Once bottled, the whisky does not continue to age.

Sales are made primarily online to members who pay a subscription to gain exclusive access to the company's unique products. In addition to its online presence, the company operates four venues in the UK where members and potential new customers are able to sample and buy the whiskies, other spirits and food. Outside of the UK, there is a network of over 100 partner bars in over 20 countries, in which the products are sold. In total, SMWS has a presence in over 30 international markets including the United States and China.

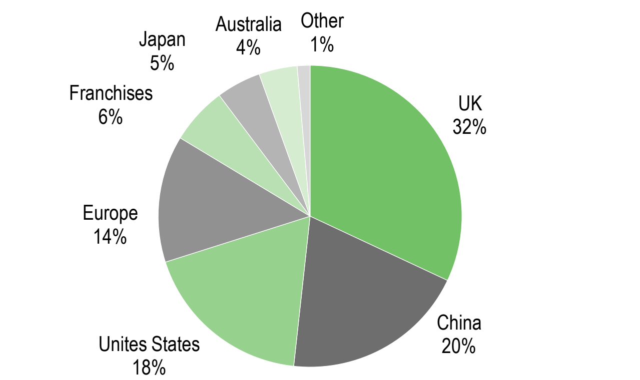
In FY20, 90% of ASC's revenue was derived from the sale of whisky (80%) and from membership subscriptions (10%). Geographically, its most important sources of revenue are the UK (32%), China (20%) and the Unites States (18%).

Exhibit 1: ASC's FY20 revenue by product



Source: Company data

Exhibit 2: ASC's FY20 revenue by geography



Source: Company data

ASC's development

SMWS was formed in 1983 by Philip Hills to buy single cask Scotch malt whiskies, bottle them straight from the cask and then sell them to friends who in turn became the first subscribing members of SMWS. After a fund-raise from members in 1996, SMWS was subsequently owned by The Glenmorangie Company in 2004, which was subsequently acquired in the same year by LVMH. ASC, funded by HotHouse Syndicate, a group of high net worth individuals, acquired SMWS in 2015. In 2018 there was a further equity raise of £4m from Inverleith, a private equity investor in consumer-facing businesses. The owners have invested heavily: quadrupling the investment in stock-in-cask from FY15–FY20; and investing in both the digital and e-commerce platforms. These have led to a growth in its paying membership (+8% CAGR to approximately 28,300 members) between FY18–FY20, and its international presence. ASC's revenue almost doubled from £7.6m in FY16 to £14.6m in FY19, a CAGR of 24%. In FY20, revenue grew at a slower 3% to £15m, due to the adverse effects of COVID-19 on venues.

Business model

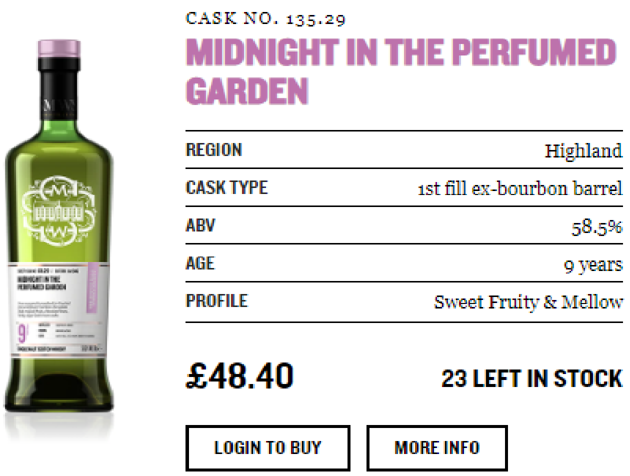
Production: Self-curated from bought-in spirit

SMWS purchases casks of spirits from over 100 distilleries to meet its requirements and then actively manages the maturation process to develop a Scotch whisky that has one of its 12 different flavour profiles from 'young and spritely' to 'spicy and dry' to 'heavily peated'. The flavour of the whisky is the focus of the offer rather than a brand, as offered by the large, quoted spirits companies. As c 60% of a spirit's final flavour comes from the maturation process, the skill of SMWS's Spirits Director and the tasting panel that selects the whiskies to be sold at a particular time, is very important. With respect to the maturation process, there are three key personnel from a technical perspective, two of whom have been with the company for over 10 years, and one is a more recent recruit. The tasting panel that selects the individual whiskies to be sold is typically made up of three or four people, from a pool of 20 experts, who each have different strengths and weaknesses in tasting, ie identifying the different flavour profiles. The other non-Scotch products are also mainly sourced in cask from distillers and may or may not be matured further by SMWS.

SMWS does not own a distillery but selects the best-in-class spirit from both large producers and new entrants with which it has long-term relationships. This means SMWS's business model is capital light relative to a typical distiller. As 40% of the final flavour comes from the acquired spirit, good relationships with the best distilleries are essential. The supply base is not concentrated: no single distillery make represents more than 3% of SMWS's current stock and the top 10 distillery makes represent 24%. SMWS currently has forward purchase agreements for the supply of new make spirit equivalent of 190,000 bottles per annum until 2022, which represents c 120% of the volume sold in FY20, at a stated price with annual escalators. The current ageing inventory is equivalent to 4.3m bottles, 26x the volume sold in FY20.

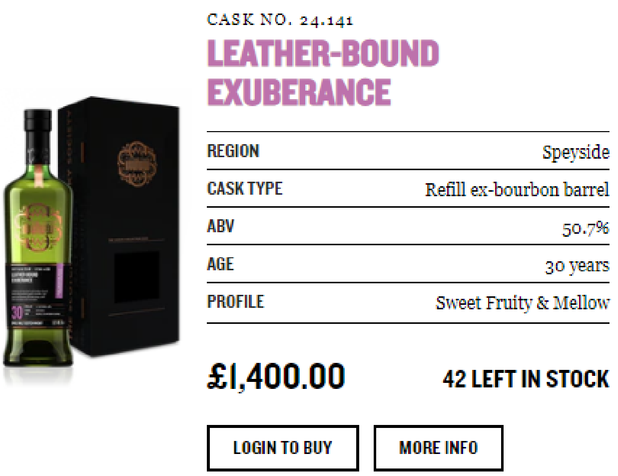
Each cask has exclusive characteristics and typically yields c 250 70cl bottles. Once bottled they are labelled to create a limited edition Scotch with a unique cask number identifier and 'brand'. The initial distiller is not named on the bottle, but each distiller has a unique identifier code and the source region of the spirit is identified. To highlight the quality of the products, in the last three years SMWS has received almost 200 awards from seven leading industry bodies. At the date of writing, 13 May 2021, SMWS.com was offering 48 whisky 'products' including multi-buy offers as well as single bottles. The lowest and highest priced single bottles on offer were as shown below.

Exhibit 3: Lowest priced whisky



Source: SMWS 13 May 2021

Exhibit 4: Highest priced whisky



Source: SMWS 13 May 2021

In other categories there were four Armagnacs (ranging in price from £63–139/bottle), one gin product (Gelataria Splatter at £44/bottle), one rum (Havana, Madagascar and Tahiti at £275/bottle) and no Bourbon or Cognac.

Marketing: Exclusive and mostly online

Most of SMWS's sales are made D2C ie online and from four venues in the UK, with the remaining sales to over 100 partner bars in 20 countries, which are important in recruiting new members and for existing members to sample and/or buy the products.

SMWS operates more than 20 websites in the different geographies with the spirits priced in local currency. Online represented 86% of SMWS's revenue in FY20, a significant increase from 57% in FY17. When sales from UK venues are included, D2C revenue represented 96% of SMWS's revenue.

Each month SMWS releases dozens of new whiskies for exclusive sale to its membership base. In the UK members pay an annual fee of £65, which primarily provides the right to access the sale of whiskies when released. Management estimates that for sales in the UK and Europe, c 75% of the product launched in the monthly release (Outturn) is sold within one hour of the launch, reflecting the proactive marketing to build interest ahead of the release.

Other membership benefits include access to the company's venues, events and the Unfiltered monthly magazine. In addition to purchasing online and at the company's venues and tasting events, customers can order by mail and telephone. In other countries (see below) the membership relationship varies.

In China, SMWS provides its products through three online third-party channels: WeChat, Tmall and JD.com, as well as through the 17 partner bars.

In the United States the three-tier regulatory system prevents ownership by the same party in more than one of the three stages (ie production/importation, wholesale distribution and retail) of the route to market, therefore SMWS sells to an appointed US import agent, who then sells D2C via a US retailer, Rye Brook.

Infrastructure and fulfilment: Outsourced

ASC's infrastructure and fulfilment are mainly outsourced to third-party providers. Bottling is carried out by a third party, Angus Dundee Distillers in Coatbridge and at two other sites. Over half of ASC's stock is stored at a single bonded warehouse facility in the UK provided by John G Russell (Transport), and the remainder is stored in a number of other third-party bonded warehouses. Distribution is fulfilled by national delivery companies but in the United States it relies on one company as its sole US import agent.

To address the impact of Brexit on EU logistics, management established a number of third-party regional distribution centres in mainland Europe to fulfil member orders.

Membership

ASC's global membership base has increased at a CAGR of c 8% since 2018 to reach 28,300 members at the end of December 2020 as it has sought to internationalise its business. Please note there may be rounding differences in the exhibits below.

Until 2015 overseas memberships were mostly run by franchisees, but the majority (excluding Canada, Denmark, Switzerland and Taiwan) are now managed by ASC. The Chinese and Japanese activities are joint ventures.

Exhibit 5: ASC's global membership at year-end				
000's	FY18	FY19	FY20	CAGR FY18–FY20
UK	13.4	14.1	13.7	1%
Europe	1.8	2.8	3.3	35%
Australia	1.2	1.2	1.1	(4%)
China	0.7	0.9	1.1	25%
Japan	1.1	1.2	1.4	13%
South East Asia	0.1	0.2	0.2	41%
United States	3.2	3.9	4.4	17%
Franchises	2.9	3.0	3.1	3%
Total	**24.3**	**27.3**	**28.3**	**8%**

Source: Company data

All countries/regions have delivered annual growth in the number of members from FY18–FY20 except the UK and Australia which declined in FY20. Management accredits the UK decline (3%) to the COVID-19 related closures of its venues as they typically act as an important source of new membership recruitment. The closures are likely to represent a drag in H121. The decline in Australia was due to a 'scrub' of membership numbers following the transition from a franchise to in-house operation, and the business has subsequently performed well with respect to new customer recruitment.

The international membership base has grown (FY18–FY20 16% CAGR) at a faster rate than in the UK, and therefore international's importance to the group has increased, representing c 52% of total membership in FY20. As can be seen in Exhibit 6, international's geographic share of revenue has increased as average revenue per member has grown in these markets. Overseas markets also generate a greater contribution (gross revenue less commissions) per member, and the lifetime value of that customer is higher despite more variable retention rates and length of time as a customer. Note that the UK figures for FY20 were affected by venue closures due to COVID-19.

Exhibit 6: Membership financials				
	FY18	FY19	FY20	CAGR FY18–FY20
UK:				
Members (000's)	13.4	14.1	13.7	3%
Revenue per member (£)	412	420	344	(9%)
Contribution per member (£)	217	217	170	(11%)
International:				
Members (000's)	10.9	13.2	14.6	16%
Revenue per member (£)	609	673	712	8%
Contribution per member (£)	332	354	377	7%

Source: Company data

In FY20, the average international member generated revenue of £712, more than double the UK's average of £344. This flows through to respective contributions per member of £377 and £170, with international more than 2.2x that of the UK. Using the quoted average price per bottle of £76 for FY20 implies an average of 4.5 purchases per UK member and 10.6 purchases per international member, or some variation thereof.

Exhibit 7 provides more granular data on key performance indicators (KPIs) for ASC's most important countries in FY20.

Exhibit 7: Membership metrics in FY20					
	Members (000's)	Contribution/ member (£)	Retention (%)	Lifetime (years)	Lifetime value (£)
UK	13.7	168	75%	4.1	682
United States	4.4	231	54%	2.2	500
Japan	1.4	323	75%	4.0	1,309
Australia	1.1	313	73%	3.8	1,180
Europe	3.3	210	75%	4.0	833
Franchises	3.1	190	81%	5.4	1,081
South East Asia	0.2	416	58%	2.4	994
China	1.1	2,114	24%	1.3	2,777
Total/average	**28.3**	**276**	**70%**	**3.4**	**932**

Source: Company data

On average, each member contributed £276 to ASC in 2020 and had an estimated lifetime value of £932, though we note that there is a wide range for the individual metrics by geography. The contribution of a UK member was £168 versus the group average of £276, albeit that was skewed by the COVID-19 closures of venues. All international markets, except those operated by franchisees, generated a greater contribution per member than the group average, with a significant contribution per member from China. The counter to this high contribution is a relatively low retention rate of 24% in China, a comparatively new market where the company is developing brand awareness, versus the group average of 70%.

Strategy

With a focus on KPIs that cover four key areas: membership, profit, growth and stock, management's aim to grow ASC's revenue and profitability has four key drivers:

- **Grow the global membership:** directing investment into new and high growth markets via rollout of the online platform as well as increasing the number of venues; and to increase retention by enhancing the membership proposition.
- **Enhance e-commerce channels:** includes rolling out the online proposition to new territories; enhancing customer relationship management (CRM) to improve marketing, and developing more virtual events.
- **Further improve margins through increased value creation:** management believes there are a number of key opportunities for margin expansion: buying greater quantities of younger (ie less expensive) spirit from the distillers; more maturation in sherry casks to produce more products in high growth markets that would realise higher prices; and general supply chain optimisation.
- **Launch new and complementary brands:** management believes the launch of two new brands, J.G. Thomson & Co (JGT) in mid-2021 and The American Whiskey Society (AWS) in H222, which have differentiated product lines, will extend ASC's addressable market. JGT is Scotland's oldest wine merchant and a leading independent whisky blender. ASC acquired the legal rights to JGT to enable 1) ASC to diversify into the blended malt whisky market and 2) JGT to extend its offering to other spirits and its distribution into other retail channels as well as via ASC's e-commerce platform. A membership will not be required to access JGT's products. The AWS is a development project to establish a similar platform and membership society to the SMWS that serves the American whiskey market, which has around 2,000 domestic craft distilleries. The latter may present some minor cannibalisation risk as well as execution risk, but the size of the market (the ultra-premium and over market is valued at $1bn pa) and growth rate (recent historic growth rate of 20%+) are believed to significantly outweigh these risks.

Recent news flow and upcoming catalysts

In Q121, ASC's total revenue grew by 20% y-o-y to £3.4m, driven by strong international growth of 39% to £2.5m, partially offset by a 10% decline in UK revenue to £1.0m. Strength in the UK's online business, which grew by 56% to £0.8m, was not enough to offset the COVID-19 related decline of two-thirds to £0.2m for UK venues and events. The Q121 performance would have been better in the absence of fulfilment delays on sales to the EU following Brexit on 31 December 2020, which led to just one-third of orders that were placed being booked as revenue during the period.

With easier comparatives for a good part of the remainder of FY21 due to COVID-19 related restrictions during 2020, notably for the UK venues and events, and the temporary suspension of US tariffs on Scotch whisky (announced in March 2021) which is expected to provide a short-term (at least) boost to US demand, management is optimistic about ASC's prospects for FY21.

ASC's net debt at the end of March 2021 was £14.6m excluding IFRS 16 liabilities, a slight increase versus the December 2020 net debt of £13.7m.

Market overview

Management estimates its global addressable market was worth $4.2bn in 2019. The global addressable market is defined as Scotch whiskies (including primary malt, blended and grain Scotch) in price brands that are ultra-premium (see Exhibit 9) and above, and excludes sales made through duty-free channels. ASC does not currently offer blended Scotch whiskies but will on the launch of JGT in mid-2021.

Exhibit 8: Global addressable market

Market	Global addressable market ($m) 2019	Global addressable market growth 2010–19	SMWS whisky sales ($m) 2020	SMWS market share
United States	1,502	323%	3.1	0.2%
Taiwan	424	116%	0.3	0.1%
China	412	120%	3.8	0.9%
United Kingdom	327	157%	3.7	1.1%
Germany	156	239%	0.9	0.6%
Japan	147	158%	0.9	0.6%
Australia	140	354%	0.7	0.5%
France	113	81%	0.2	0.2%
Top eight markets	3,222	203%	13.5	0.4%
Other current markets	604	206%	2.0	0.3%
Top current markets	3,826	204%	15.4	0.4%
Markets within reach	397	190%	0.0	0.0%
Total addressable market	**4,222**	**202%**	**15.4**	**0.4%**

Source: Management analysis of The International Wines and Spirits Record (IWSR) data

In the individual markets, ASC's market shares are low and globally its market share is c 0.4%.

The recognised price bands for the spirits industry and their respective sizes and historic growth rates are as follows:

Exhibit 9: Global Scotch whisky market 2019

Price band	£ per 70cl bottle	Market size ($bn)	CAGR 2010–19
Prestige-plus	Over 225.00	0.7	27%
Prestige	75.00–224.99	1.1	11%
Ultra-premium	35.00–74.99	3.8	9%
Super-premium	28.75–34.99	3.2	9%
Premium	22.50–28.74	5.0	1%
Standard (and below)	Up to 22.49	12.9	2%
Total		26.7	4%

Source: IWSR

At $5.5bn in 2019, the ultra-premium and above price bands (ie more than £35 per 70cl bottle) represented c 21% of the global Scotch market having demonstrated a nine-year CAGR of 10% since 2010, which was greater than the average annual growth rate for the total Scotch market of 4% over the same period. IWSR (Source: ASC company data) forecasts that the ultra-premium market will represent 13% of the total market by 2024 (ie its growth rate will continue to exceed that of the total market). All of SMWS's sales are in the ultra-premium and above price points, of which 96.9% of ASC's spirit sales are single cask Scotch malt whisky. Management is confident that ASC's future growth rate will exceed market growth given its focus on innovation and new flavours and entering new geographies while taking market share in existing countries.

The structural growth drivers for the spirits markets include increasing global wealth, which enables a larger customer base to be able to afford higher-priced products; aspiration amongst the population, which leads to more people seeking products with more heritage, prestige and authenticity (ie 'branded' products at higher price points); innovation by the spirits makers; and global distribution including the rapid growth of e-commerce due to higher internet and mobile penetration along with the consumer's desire for more convenience.

ASC's primary competitors for share of wallet are the other distillers including Diageo and Pernod Ricard, which are significantly different in scale and have broader product mixes in different price bands.

With respect to online distribution, competitors include whisky membership clubs and cask specialists, online whisky or spirits retailers, or general online retailers. Management believes that its key competitive advantages versus these various competitors include technical expertise in maturation, the wide distiller supplier network, scale and global reach of its established membership.

Management and shareholders

Management team

The directors and management of the company have strong experience in managing consumer brands. The main members of the management team are:

- Chair, Mark Hunter. Mark became a director and chair of ASC in March 2021. Until September 2019, Mark was the president and CEO of MolsonCoors Brewing Company. He is a non-executive director of TreeHouse Foods, a US-listed, leading manufacturer and distributor of private label packaged foods and beverages. Mark has 35 years of marketing, sales and business unit leadership experience in North America, Europe and internationally.
- Managing director, David Ridley. David has been the managing director since March 2017. He has 21 years' experience in international wines and spirits across brand development, commercial and distribution management. More recent roles in Moet Hennessy included three years as managing director of MH Vietnam and five years as business development director for Asia Pacific, Africa, Middle East and the Americas and global travel retail for Glenmorangie/Ardbeg single malt Scotch whisky. He is a Liveryman of the Worshipful Company of Distillers.
- Finance director, Andrew Dane. Andrew has been the finance director since August 2020. He has eight years with KPMG transaction services, including time in London and Edinburgh and two years in Toronto and was involved in transactions covering multiple sectors, business sizes and geographies. From 2014 to 2020 he was finance director with Argent Energy, the high growth UK biodiesel producer.
- Spirits director, Kai Ivalo. Kai joined SMWS in 2005 and has had roles in marketing, strategy and planning, spirits stock planning, procurement, maturation, cask selection and production management (bottling). He is Keeper of the Quaich and a Liveryman of the Worshipful Company of Distillers.

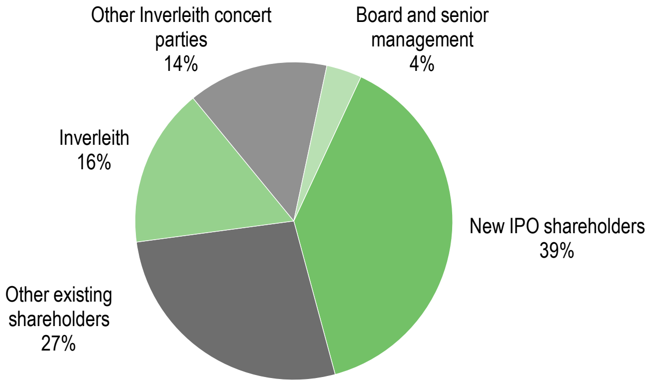
Shareholders and free float

Management hopes to raise gross proceeds of c £31.5m, of which roughly one-half is primary (ie new money). The primary proceeds and existing cash and debt facilities of c £4m will likely be used to fund investment:

- £8–10m: stock of whisky and other spirits and cask wood including the sherry cask maturation programme;
- £6–8m: membership recruitment, retention and engagement; new and existing venues; and brand and digital development; and
- £2m: supply chain optimisation to improve operating efficiency.

Following the IPO, the shareholding structure is expected to be as follows:

Exhibit 10: Post-IPO shareholders



Source: Company data

Inverleith is a private equity business that focuses on investments in consumer-facing businesses. 'Other Inverleith concert parties' includes certain members of the HotHouse Syndicate, a group of high net worth individuals. Prior to the IPO, the respective shareholdings were 29.5% and 42.5%. The lock-up shareholders, shareholders holding more than 3% pre IPO, have committed to not dispose of any shares for a period of 12 months following the IPO. The typical sell-down is expected to be c 20% and there are no shareholder exits.

Financials

ASC has generated strong revenue growth as it has grown the membership base, increased geographic coverage and enhanced new revenue streams outside membership and whisky sales. It has reported consistent operating losses primarily due to investment in growing the membership base as well as some one-off costs including exceptional costs and tariff increases, mainly in FY19 and FY20. Excluding the one-off costs, ASC was profitable at the adjusted EBITDA level in both FY19 and FY20.

Income statement

Revenue grew at a CAGR of c 11% between from FY18–FY20, including growth of c 21% in FY19 and c 3% in FY20 due to the effects of COVID-19, predominantly in the UK. Between FY18 and FY20 the membership base has grown from 24,300 to 28,300, a CAGR of 8%, implying growth in average revenue per member. ASC's reported revenue is net of VAT but includes excise duty, which may distort comparability with numbers for other distillers that report revenue gross and net of excise duties.

Exhibit 11: Summary income statement

Year end 31 December (£m)	FY18	FY19	FY20
Revenue	**12.148**	**14.645**	**15.026**
Cost of goods sold (COGS)	(4.891)	(6.112)	(6.222)
US tariff increases	0.000	(0.149)	(0.658)
Adjusted gross profit	**7.257**	**8.682**	**9.462**
Adjusted gross margin (%)	**59.7%**	**59.3%**	**63.0%**
Reported gross profit	7.257	8.533	8.804
Reported gross margin (%)	59.7%	58.3%	58.6%
Selling and distribution expenses	(2.594)	(3.178)	(2.979)
% of sales	(21.4%)	(21.7%)	(19.8%)
Administrative expenses	(5.196)	(5.927)	(6.938)
% of sales	(42.8%)	(40.5%)	(46.2%)
Other income			0.410
Adjusted EBITDA	**(0.019)**	**0.284**	**1.298**
Margin (%)	**(0.2%)**	**1.9%**	**8.6%**
Reported EBITDA	(0.019)	0.115	0.572
Margin (%)	(0.2%)	0.8%	3.8%
Operating profit before exceptionals	(0.483)	(0.572)	(0.311)
Exceptionals	(0.050)	0.000	(0.392)
Reported operating profit	(0.533)	(0.572)	(0.703)
Finance costs	(0.268)	(0.439)	(0.499)
Reported PBT	(0.801)	(1.011)	(1.202)
Tax	(0.102)	(0.330)	(0.418)
Reported PAT	(0.903)	(1.341)	(1.620)
Minorities	(0.137)	(0.236)	(0.068)
Attributable profit	(1.040)	(1.577)	(1.688)

Source: Company data

Management estimates that it currently holds in stock (see cash flow and balance sheet section below) a mix of spirits to fulfil 95% of all future bottlings that would build to revenue of £40m in 2026, cumulative growth of 166% from FY20's revenue of £15.0m, a CAGR of c 18% pa.

Exhibit 12: Sources of revenue

£m	FY18	FY19	FY20
Sale of whisky	7.947	10.219	12.047
Membership income	1.157	1.273	1.523
Sale of other spirits	0.344	0.284	0.384
Member rooms	1.245	1.704	0.552
Events and tastings	1.193	0.769	0.340
Other	0.262	0.396	0.180
Total	**12.148**	**14.645**	**15.026**

Source: Company data

In FY20, whisky represented 80% of group revenue, and its importance to the group has increased, partially exaggerated by the effects of COVID-19 on certain revenue streams in FY20.

ASC's adjusted gross margin, namely before US tariff increases, has grown from 59.7% in FY18 to 63.0% in FY20. The reported gross margin has been broadly stable, ranging between 58.3% in FY19 to 59.7% in FY18. The gross margin is mainly influenced by sales mix (higher valued products have a higher gross margin) and the geographic location of its customers. In October 2019, the United States imposed a 25% tariff on the import of single malt Scotch whisky into the country, which the Scotch Whisky Association estimates has led to cumulative lost exports for the whole industry of £500m. In March 2021 the temporary suspension (for four months) of the tariffs was announced, during which time the United States and the UK would seek to reach a long-term settlement. The tariffs, which were absorbed by ASC mainly as increased COGS, negatively affected ASC's gross profit by £0.1m in FY19 and a further £0.7m in FY20.

ASC's COGS includes a charge for inventories of £3.7m in FY18, £4.2m in FY19 and £4.7m in FY20, which have equated to c 69–76% of total COGS over this period and therefore represented 31.5% of sales in FY20. This implies a product gross margin for FY18–FY20 of 69.6%, 71.3% and 68.5% respectively, including the recent negative effects of the US tariffs.

ASC's gross margin compares favourably to the larger quoted beverage companies, albeit they have a more diverse product mix at wider price points (including less than ultra-premium), methods of distribution (on-trade/off-trade versus D2C), infrastructure, scale and geographic presence. In the year ended June 2020, Diageo's gross profit of £7,098m on gross sales (sales including excise duties) of £17,697m equated to a gross margin of 40.1%. From this, Diageo spent £1,841m (10.4% of gross sales) on 'marketing', and reported a clean operating profit of £3,494m (19.7% of gross sales). Diageo's costs included a charge for raw materials and consumables of £2,842m, equivalent to 16% of gross sales.

ASC has consistently reported an operating loss mainly due to its high investment in future growth, which has been accentuated by the decision to absorb the US tariff increases in FY19 and FY20, and exceptional costs for enterprise resource planning (ERP) and reviewing fund-raising options in FY20. Selling and distribution expenses reduced relative to revenue in FY20 due to geographic mix and lower promotions for events due to COVID-19 closures. Excluding the one-off costs (tariffs and exceptionals), adjusted EBITDA was positive in FY19 and FY20.

Other income in FY20 included primarily government grants, and financial support from governments due to COVID-19.

As the key strategy is to invest in order to grow the number of global members, management does not intend to distribute a dividend in the near term.

Cash flow and balance sheet

ASC has generated positive cash flow from operations (ie prior to tax and interest payments) and after including the costs of purchasing replacement inventory in each of the last three financial years. When the additional investment in growing inventory, and cash tax and interest payments are deducted, cash flow from operating activities and free cash flow have been negative for FY18–FY20. However, relative to revenue, the trends in free cash consumption have improved. The negative free cash flow has been more than funded by new debt of c £6m pa in both FY18 and FY19, and c £1m of new equity (rights issue to existing shareholders) in FY20, leading to an improvement in the year end cash position from FY18 to FY20.

Exhibit 13: Summary cash flow

£m	FY18	FY19	FY20
Operating activities	**(4.581)**	**(3.385)**	**(1.019)**
- Profit after tax	(0.903)	(1.341)	(1.620)
- Depreciation and amortisation	0.495	0.753	0.966
- Working capital	(4.232)	(2.986)	(0.762)
o/w Inventories	(4.466)	(4.138)	(0.698)
- Cash from operations	(4.216)	(2.777)	(0.215)
- Taxes paid	(0.099)	(0.169)	(0.327)
- Interest paid	(0.266)	(0.439)	(0.477)
Investing activities	**(1.178)**	**(1.822)**	**(1.077)**
- Investment in fixed and intangible assets	(0.948)	(1.674)	(1.097)
Free cash flow	(5.529)	(5.059)	(2.116)
Financing activities	**5.875**	**5.734**	**2.703**
- Asset backed lending draw down	1.751	5.369	1.980
- Net loans	4.124	0.626	0.111
- Dividends	0.000	(0.124)	(0.254)
- Share issue	0.000	0.000	0.991
Change in cash	**0.116**	**0.527**	**0.607**
Cash at start	**0.933**	**1.060**	**1.536**
Cash at end	**1.060**	**1.536**	**2.176**
Net debt at end (excl IFRS 16 liabilities)	10.758	12.237	13.688
Net debt at end (incl IFRS 16 liabilities)	10.758	13.929	15.255
Relative to revenue:			
Operating cash flow	(38%)	(23%)	(7%)
Investing cash flow	(10%)	(12%)	(7%)
Free cash flow	(46%)	(35%)	(14%)

Source: Company data

Typically, investment in cask stock is relatively high for distillers as they continue to lay down inventory for the multi-year maturation process, but the annual increase in value is not realised until sold as inventory on the balance sheet is valued at the lower of cost and net realisable value. In FY18 and FY19 the investment in growing inventory represented an additional cash investment of £4.1–4.2m pa, but a more modest £0.7m in FY20 while investment was paused due to COVID-19.

Movements in trade debtors and trade creditors at year end can be volatile due to the phasing of the purchase of spirits and shipments. From a non-current asset perspective, the investment in fixed and intangible assets has been typically c 7–8% of revenue due to the investment in casks, and was higher at c 11% of revenue in FY19 due to the refurbishment and opening of the Glasgow venue in March 2020.

Exhibit 14: Summary balance sheet

Year end 31 December (£m)	FY18	FY19	FY20
Non-current assets	**5.799**	**8.704**	**8.775**
- Property, plant and equipment	2.896	5.700	5.785
- Intangibles	2.673	2.613	2.599
Current assets	**19.726**	**25.068**	**25.866**
- Inventories	16.815	20.953	21.651
- Receivables	1.851	2.547	1.956
- Cash	1.060	1.536	2.176
Current liabilities	**(13.710)**	**(17.136)**	**(18.591)**
- Payables	(1.893)	(3.622)	(3.157)
- Financial liabilities	(7.490)	(12.940)	(14.963)
Non-current liabilities	**(0.703)**	**(2.884)**	**(3.057)**
- Financial liabilities	(0.288)	(0.833)	(0.901)
Net assets	**11.112**	**13.752**	**12.993**
Minorities	0.237	0.349	0.163
Shareholders' equity	**10.875**	**13.403**	**12.944**

Source: Company data

ASC has a well-capitalised balance sheet with the primary asset being its inventory, which includes the maturing cask whisky and bottled stock of £21.7m at the end of FY20, equivalent to c 63% of total assets of £34.6m. The inventory includes spirit in cask of £18.7m and the balance of £2.9m is bottled stock and dry goods such as bottles, labels and corks. The stock position is equivalent to over 14,000 casks of whisky, which represents c 4.3m standard 70cl bottles or approximately 26x the volume sold during FY20. Management estimates that this stock provides the potential to produce over 14,000 new products lines and that using the average SMWS selling price per bottle of £76 in FY20, the implied retail value of the current spirit stock is c £330m.

Within non-current assets, property, plant and equipment of £5.8m includes £1.9m of casks, from which a portion of the annual depreciation charge is typically capitalised as a cost of stock, while the remainder is charged to the income statement. The main intangible assets include goodwill of £1.3m and trademarks of £0.7m. Trade debtor days have been relative stable at 42–49 days for the last three financial years.

Total financial liabilities of £15.9m (£15.0m current and £0.9m long term) at the end of FY20 included an asset-based lending facility of £14.8m, which was repaid in full in January 2021 from a new three-year £18.5m revolving credit facility (RCF). The asset-based lending facility was secured by a bond and floating charge over ASC's assets, but now the RCF is secured over the inventory. Total financial liabilities have increased as the business has grown, funding the investment in cask inventory. The increase in total financial liabilities has led to a growing net debt position (excluding IFRS 16 liabilities) from £10.8m at the end of FY18 to £13.7m at the end of FY20. IFRS 16 lease liabilities were £1.6m at the end of FY20.

Valuation

ASC does not have any directly comparable quoted peers that have control over the maturation process, 'branding' of their products, and distribute the majority of their products globally D2C online. The most valid comparators are the quoted spirits beverage companies given the control and provenance of their products, albeit their scale, product mix and infrastructure are very different to ASC. The online retailers that distribute the products of others are not useful comparators given the lack of control over the production of the final products offered.

ASC reports an operating loss at the reported level, and the different disclosure with respect to revenue (some peers report gross of excise duties and others net of excise duties) make EV/sales multiples not directly comparable. EV/gross profit should be comparable with that of peers.

Exhibit 15: Peer valuations

Company	Year end	Share price (local)	Currency	Market cap (local m)	EV (local m)	Sales growth (%)		EBIT margin (%)		EV/sales (x)	EV/gross profit (x)	EV/EBIT (x)
						FY1	FY0	FY1	FY0	FY0	FY0	FY0
Diageo PLC	30/06/2021	3,304	£	77,320	91,299	6	(9)	32.0	29.7	7.8	12.9	26.1
Pernod Ricard SA	30/06/2021	174	€	45,441	53,782	2	(8)	28.1	26.8	6.4	10.6	23.8
Davide Campari Milano NV	31/12/2021	10	€	11,741	12,745	8	(4)	22.1	18.2	7.2	12.4	39.6
Remy Cointreau SA	31/03/2021	165	€	8,337	8,741	(0)	(9)	24.6	20.9	8.5	N/A	40.8
Distil PLC	31/03/2021	3	£	14	13	N/A	N/A	N/A	7.5	5.3	9.0	70.6
Average						**4**	**(7)**	**26.7**	**20.6**	**7.0**	**11.2**	**40.2**

Source: Refinitiv, company data. Note: Priced 14 May 2021.

In its last financial year, ASC reported revenue growth versus declines reported by the peers, and in the prior year reported greater growth than the peers, although the different year ends may affect comparability. We highlight that in Q121, ASC reported revenue growth of 20% y-o-y to £3.4m, versus c 3% growth in FY20.

Sensitivities

Below we highlight what we believe are the key sensitivities for ASC:

- Demand for its products may be affected by changes in consumer tastes between beverage categories and versus other branded spirits. The maturation process takes a significant period of time, during which consumer preferences may change.
- The alcoholic beverages industry is highly competitive, and ASC has many competitors that have more scale and financial strength.
- ASC is vulnerable to changes in regulation, excise duties and tariffs that may influence consumer demand for its products and/or the company's profitability.
- ASC is responsible for the curation of its products and brands, the IP of which may not be adequately protected in other countries.
- Brexit may present risks to ASC's ability to trade freely and its ability to move goods without delay.
- ASC is reliant on third-party distilleries as a source of supply of the spirits used in its maturation process.
- ASC is dependent on a small number of key individuals from a technical perspective, albeit they have been loyal employees and are well incentivised.
- Spirit production can be affected by the quality of grain production which is dependent on weather conditions.
- In certain geographies ASC is reliant on franchisees, joint ventures, importers and other partners that operate bars.
- ASC will continue to enter new geographies which will present new execution and foreign currency risks.
- ASC plans to launch two new brands (JGT and AWS) in adjacent markets, one of which is non-membership, unlike its core business.
- ASC is reliant on outsourced bottling, storage and distribution.
- Pandemics such as COVID-19 may affect ASC's ability to trade normally due to limitations on travel and social distancing.

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