

# Marlborough Wine Estates

**Food & beverages**
**05 September 2018**

## FY19 KOMs and FY18 preliminary results

Marlborough Wine Estates Group (MWE) is developing its brands and seeking to expand into international markets. The international wine market is strong and New Zealand (NZ) product has a reputation for quality. In the face of slowdown in the Chinese market, MWE continues to explore US, Japanese, Australian, UK and other markets. In this context, early inroads into the US and Japan are encouraging. In new KOMs, MWE is raising its targets for international and domestic wine sales.

## FY18 preliminary results

MWE reported a reduced loss after tax of NZ\$1.7m for FY18, against NZ\$4.4m in FY17. As adjusted, the net loss was NZ\$0.3m against NZ\$0.7m in FY17. Sales of NZ\$4.0m grew 4%, although that masked a 49% decrease in bottled wine sales largely compensated for by increases in bulk wine and bulk grape sales. As restated, gross margin was up 140bp year-on-year at 38.7%, and operating costs were down 4% driven by a reduction in wages and salaries. Net debt (including finance leases) decreased marginally from NZ\$5.7m to NZ\$5.6m year-on-year.

## Sales and market developments

MWE has made good progress in developing products, launching a Pinot Noir and Pinot Gris. With investment in irrigation complete, it is developing new blocks and planting new varieties. US market development is continuing to grow with bulk shipments of 10 containers of the 2017 vintage. Prospects for growth in exports to Japan are bright after a significant wine award, while MWE also shipped first orders to significant markets in the UK and Australia and to Taiwan and Finland.

## New key operating milestones

MWE has set new FY19 key operating milestones (KOMs) with a slight increase in gross harvest to 1,800 tonnes, but an 8% fall in bulk grape sales to 1,200 tonnes, as it strategically allocates more grapes to its own production. Correspondingly, it targets a 15% increase in its international bottled wine sales to NZ\$1.5m, and a 79% increase in NZ bottled wine sales to NZ\$610,000.

## Valuation: Sales multiple reflects market ambition

MWE trades on a 19.0x FY18 EV/revenue multiple. This is substantially higher than the 2.5x average FY18e EV/revenue peer multiple, although its peers are larger and more established entities, whereas MWE is aiming to generate higher sales and profits from increased production and new target markets.

### Historical performance

Year end	Revenue (NZ\$000s)	NPAT (NZ\$000s)	EPS (c)	DPS (c)	P/E (x)	Yield (%)
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
06/18	3,985	(316)	(0.1)	0.0	N/A	N/A

Source: MWE. Note: \*March to June 2015; FY15 NPAT includes fair value adjustment of +NZ\$1.1m. \*\* FY16 NPAT excludes capital raising costs. FY17 and FY18 are normalised.

**Price** **NZ\$0.24**  
**Market cap** **NZ\$70m**

### Share price performance



### Share details

Code	MWE
Listing	NXT
Shares in issue	290.9m

### Business description

Marlborough Wine Estates Group 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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## Preliminary results: Increased profitability

MWE reported a net loss after tax of NZ\$1.7m for FY18 (FY17 loss of NZ\$4.4m). Excluding one-off items and other smaller adjustments, the adjusted net loss was NZ\$0.3m against NZ\$0.7m in FY17. Exhibit 1 sets out the company's FY18 results.

**Exhibit 1: FY18 versus FY17**

NZ\$m	FY17	FY18
Sales	3.8	4.0
Cost of sales	(2.4)	(2.4)
Gross profit	1.4	1.5
Gross profit margin	37.3%	38.7%
Statutory EBITDA	(3.5)	(1.0)
Adjusted EBITDA	0.5	0.5
Adjusted EBIT	(0.4)	(0.1)
NPBT adjusted	(0.8)	(0.4)
NPAT adjusted	(0.7)	(0.3)
EPS adjusted (NZ\$c)	(0.2)	(0.1)

Source: Marlborough Wine Estates

## Performance against KOMs

MWE's full-year results were in line with revised guidance at April 2018, overachieving in all milestones except gross harvest (which underperformed by 0.3%).

**Exhibit 2: Performance against KOMs**

	KOM FY18	Actual FY18	±
Gross harvest (tonnes)	1,790	1,784	(0.3%)
Bulk grape sales (tonnes)	1,200	1,306	8.8%
International bottled wine sales revenue (NZ\$)	1,300,000	1,372,974	5.6%
New Zealand bottled wine sales revenue (NZ\$)	315,000	339,313	7.7%

Source: Marlborough Wine Estates. Note: Gross harvest, international bottled wine sales revenue and NZ bottled wine sales revenue KOMs were adjusted at Q318.

## Operating results

FY17 results have been reclassified in respect of changes in fair value of biological assets and agricultural produce, depreciation on vines and vineyards, and excise duties. These have been reclassified to cost of sales to reflect that they are integral to the production of grapes and bottled wines for sale. There is no net effect on profit.

FY18 sales of NZ\$4.0m showed overall growth of 4% against FY17's NZ\$3.8m. Within that there was a 49% decrease in bottled wine sales, which was compensated by a 243% increase in bulk wine sales and an 11% increase in bulk grape sales.

**Exhibit 3: Sales analysis**

	June 2016	June 2017	Year-on year	Year-on year
	(NZ\$m)	(NZ\$m)	(NZ\$m)	(%)
Bulk grape sales	2.0	2.2	0.2	10.7
Bulk wine sales	0.3	1.0	0.7	242.7
Bottled wine sales	1.5	0.8	-0.8	-48.9
Other sales	0.0	0.0	0.0	
Total sales	3.8	4.0	0.2	4.3

Source: Marlborough Wine Estates, Edison Investment Research

Under the new classification, FY18 gross margin was 140bp higher at 38.7% than FY17's restated 37.3% (FY17 old classification gross margin 13.9%).

Operating expenses in the business were NZ\$1.35m, a 4.1% reduction on FY17's NZ\$1.41m, driven by a reduction in salaries and wages from 47% to 35% of total operating expenses.

## **Adjusting items**

In stating underlying profit, we have adjusted two material items: impairment loss and inventory write down.

### **Impairment loss**

In FY17 MWE announced reduced expectations for its Chinese distributor and as a result made an impairment of NZ\$2.6m against the distribution rights, which had been acquired in 2015 for NZ\$5.2m. As a result, they were reduced to a carrying value of NZ\$1.4m. Due to continued challenging trading conditions in China, management has now concluded that, after amortisation charged through the P/L of NZ\$0.2m, the remaining NZ\$1.2m valuation of the distribution rights should be impaired.

### **Inventory write down**

Due to the challenging trading conditions overseas, especially in China, MWE's bottled wine sales were slower than expected, meaning the realisable value of some of its aged wine stock was likely to be reduced. Based on an annual impairment test, a provision of NZ\$0.2m has been made at June 2018. This is, however, much lower than the NZ\$1.2m provision made at June 2017, which related to bottled wine that had not received certification from Ministry of Primary Industries.

Including some smaller items, the total adjustment was NZ\$1.5m.

## **Commentary on trading**

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Favourable conditions coupled with investment in irrigation and new equipment contributed to 23% increase in gross harvest for the 2018 vintage of 1,784t (2017: 1450t). The harvest season started earlier than usual and almost half of the grapes were harvested in Q3 with the remaining in the final quarter. Additionally, yields have been materially improved by continuous investment, which also bodes well for the year ahead.

## **Product development**

MWE has made good progress on competitive product development. In FY18 it launched its first batch of Pinot Noir and Pinot Gris, following product releases of Syrah, Rose and Merlot Cabernet Sauvignon in FY17. In FY19 the company aims to launch a new Chardonnay and sparkling wine product. In addition, management aims to broaden the appeal of its products outside of the premium brands for which it is best known. It is marketing through both local and international trade shows and events, and is stepping up media coverage via editorials, articles and promotional material.

## **Vineyard investment**

Having completed all its planned investment in irrigation, MWE is now shifting the focus of development to new blocks and planting of new varietals. The company reports a start in planting five hectares of Pinot Noir, with further planting of Pinot Noir and Pinot Gris planned over the next two to three years. Pinot Noir in particular is gaining good traction in international markets.

## **International market development**

While China remains a key market, premium wine has not developed there as fast as expected. MWE aims to explore new channels and partners in China for its entry-level products. The company also continues to build a stronger presence in the US market, which is number one in terms of revenue of NZ wine exported, and where it has made early shipments. In addition, MWE is hoping

for an increase in US bulk shipments from 10 containers of 2017 vintage to 12 containers of the 2018 vintage.

Prospects for growth in exports to Japan are bright after a significant wine award, while MWE has also shipped first orders to the UK, Australia, Taiwan and Finland. The company is focusing on growing its presence in the significant markets of the UK and Australia.

## FY19 KOMs

The KOMs are required under the NXT listing rules to be reported on a quarterly basis. This requirement allows current and potential investors to track the key growth and profit drivers of the business. Since listing, MWE has had four KOMs: gross harvest (tonnes), bulk grape sales (tonnes), international bottled wine sales (NZ\$) and New Zealand bottled wine sales (NZ\$).

## Revision of KOM definition

In September 2017, MWE changed one of its four KOMs, international bottled wine sales revenue, to include revenue from all international wine sales. There was no change to its three other KOMs: gross harvest, bulk grape sales and NZ bottled wine sales.

MWE's key focus for FY19 is to grow international market penetration, offsetting the historical softening of demand in China through adjusting the exporting mix towards the UK, US and Australian markets.

## New KOMs for FY19

Exhibit 4: FY19 KOMs				
		FY18 actual	FY19 KOMs	±
Gross harvest (tonnes)		1,784	1,800	0.9%
Bulk grape sales (tonnes)		1,306	1,200	(8.1)%
International wine sales revenue (NZ\$)		1,372,974	1,500,000	9.3%
New Zealand bottled wine sales revenue (NZ\$)		339,313	610,000	79.8%

Source: Marlborough Wine Estates, Edison Investment Research

Details of the KOMs are as follows:

- The **gross harvest**, or total vineyard grape production, measure shows the company's grape supply capacity, which the board believes is sustainable for the next 15 years. MWE's longer-term forecast of 2,000 tonnes reflects the immaturity of existing vines as harvest yields and the vineyard maturity proportionately. MWE has mitigated major irrigation-related issues through heavy investment but favourable FY18 conditions create tough comparatives and minimise forecasted year-on-year growth. The company expects a small lift in volumes for FY19 to 1,800 tonnes, up 1% from the FY18 actual.
- **Bulk grape sales** shows the bulk grape allocation of the total harvest, with the rest processed for bulk and bottled wine sales. Despite agreements to supply bulk grapes from various vineyard blocks, MWE forecasts a decrease of 8% to 1,200 tonnes. The reduction reflects the adjustment in the company's international sales strategy, changing mix to favour own production.
- Following the revision to MWE's key operating milestones at the start of FY18, **international wine sales** measures the revenue generated from all international activities (previously exclusively bottled revenue). MWE is focusing on diversification into new markets as well as other channels in China, to offset the softening of demand in the Chinese market, supporting its higher FY19 target of NZ\$1.5m (FY18 NZ\$1.3m).

- **NZ bottled wine sales** revenue grew strongly, by c 70%, in the last financial year and MWE is budgeting for 80% growth in sales for FY19. MWE's new products will help capture additional market share in an increasingly competitive domestic market.

## Valuation

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 three listed peers in the NZ/Australian market, which are all well established and substantially larger than MWE.

The peers trade on an average FY18e EV/revenue multiple of 2.5x, substantially lower than the 19.0x FY18 EV/revenue multiple on which MWE is trading. However, MWE is at an earlier stage in its life cycle, and is also aiming to generate higher sales and profits from increased production and new target markets. These differences in profile detract from the relevance of the comparison.

### Exhibit 5: Peer group valuation

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\$	156	15.1	12.7	11.8	10.4	0.8	0.8
Delegat	NZ\$	1,094	21.8	19.2	16.6	14.9	4.6	4.3
Foley Family Wines	NZ\$	78	0.0	0.0	0.0	0.0	0.0	0.0
<b>Average</b>			<b>18.5</b>	<b>16.0</b>	<b>14.2</b>	<b>12.6</b>	<b>2.7</b>	<b>2.5</b>

Source: Bloomberg, Edison Investment Research. Note: Prices at 31 August 2018. All companies have a 30 June year end.

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