

# Marlborough Wine Estates

**Food and beverages**
**5 May 2017**

## KOM target reset at lower level

Marlborough Wine Estates Group (MWE), which was formed in March 2015 to acquire vineyard assets comprising the Otuwhero Estate from Min (James) Jia, is targeting the development of premium New Zealand white wine brands in China. MWE notified the market in April 2017 that it expected to fall short of its key operating milestone (KOM) target for international bottled wine sales revenue by more than 10% for the year to June 2017. It is now resetting the target at NZ\$1.3m, down from NZ\$3.2m.

## Background to reset of KOM

MWE announced in April 2017 that it was unlikely its Chinese distributor, Great Esprit (GEL), would be able to meet its annual commitment to purchase bottled wine for FY17. Consequently, the company had to inform the market that its KOM target of NZ\$3.2m for international bottled wine sales revenue would be missed by more than 10%. The KOM is now being reset at NZ\$1.3m.

The company gives more background on the issues faced by Great Esprit. The distributor is experiencing a slowdown in Chinese consumer spending, which adversely affects spend on premium New Zealand wines. Probably related to this, the Chinese New Year shopping period has been slower than expected, resulting in lower wine sales by the distributor and a back-up in orders. Talks are continuing with GEL about the shortfall.

## New US customer may provide revenue support

New Zealand bottled wine sales revenue has grown strongly this year and the company confirms its KOM of NZ\$205,940. Local demand is helping MWE expand this market. Two new products have been launched into this market. MWE has also started selling bulk wine to a large US-based importer and distributor. Year to date sales to Q3 were \$288,000. Such sales may help to provide some support to revenue for the year at a time when the KOM relating to international bottled wine sales has been downgraded.

## Valuation: Remains above peers

MWE trades on a 12.3x FY16 EV/revenue multiple. This is substantially higher than the 2.2x average FY16 EV/revenue multiple on which peers are currently trading, although it is true that MWE is at an earlier stage in its life cycle.

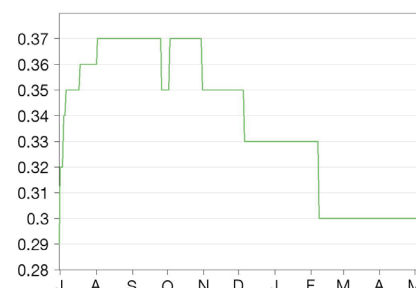
### Historical performance

Year end	Revenue (NZ\$000)	NPAT*** (NZ\$000)	EPS (c)	DPS (c)	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	(494)	(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.

**Price** **NZ\$0.30**  
**Market cap** **NZ\$88m**

### Share price performance



### Share details

Code MWE  
 Listing NXT  
 Shares in issue 293.3m

### 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. It sells bottled wine to China, NZ and other markets, as well as bulk wine and grapes to wine producers in NZ.

### Bull

- Marlborough white wines, particularly sauvignon blanc, have a 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 quality of the product.
- The majority of distribution in Asia is being made by related parties, albeit that the related party is purchasing bottled wine at a premium of 30% to the average NZ export price for white wine.
- Greater demand for MWE's products may depend on conversion of Asian markets from red wines to premium white wines.

### Analysts

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**Marlborough Wine Estates coverage is provided through the NXT Research Scheme**

## Third quarter update

### Exhibit 1: Key operating milestones and quarterly performance

	Q117	Q217	Q317	Ytd FY17	KOM FY17
Gross harvest (tonnes)	-	-	-	-	1,544
Bulk grape sales (tonnes)	-	-	-	-	1,144
International bottled wine sales revenue (NZ\$)	170,169	651,910	-	822,079	1,300,000
New Zealand bottled wine sales revenue (NZ\$)	41,104	48,093	36,017	125,214	205,940

Source: MWE

### Gross harvest

We do not expect to see any data here until the last quarter of the financial year (April to June) since that is when the annual grape harvest is completed.

### Bulk grape sales

Actual sales and delivery of bulk grapes are made after the grapes are harvested, so this is normally also in the period of April to June. Therefore, the nil bulk grape sales revenue in the third quarter is in line with expectations.

### International bottled wine sales revenue

The company reports that there were no international bottled wine sales in the quarter. MWE announced in April 2017 that it was unlikely its Chinese distributor GEL would be able to meet its NZ\$3m minimum annual commitment to purchase bottled wine for FY17. Consequently, the company had to inform the market that its KOM target of NZ\$3.2m for international bottled wine sales revenue would be missed by more than 10%.

MWE is now resetting its KOM for international bottled wine sales revenue at NZ\$1.3m.

The company gives more background on the issues faced by GEL. The distributor is dealing with more challenging trading conditions in China, which is MWE's main export market. In particular:

- there is a general slowdown of the Chinese economy and consumer spending, which adversely affects the spend on premium New Zealand wines; and
- the Chinese New Year shopping period has been slower than expected, resulting in the distributor selling less wine than expected. This is having a knock-on effect and delaying further orders.

Talks are continuing with GEL about the shortfall. As we mentioned in our [initiation](#) in June 2016, Great Esprit is considered to be a related party, as it is owned by an associate of MWE's executive chairman, Min (James) Jia.

### New Zealand bottled wine sales revenue

MWE reports that New Zealand bottled wine sales revenue has been growing strongly this year and in line with expectations. MWE remains confident that the New Zealand bottled wine sales revenue will continue to grow and that the annual KOM target will be met.

### New developments – products

The company has launched two products in the third quarter, including a Hawke's Bay Merlot Rosé and Hawke's Bay Organic Syrah. Management indicates that these were created due to strong market demand and will further broaden the company's product range and variety.

## New developments – markets

MWE has started selling bulk wine to a large US-based importer and distributor. Year to date sales as at the end of the third quarter were \$288,000. This is of particular interest as such sales may help to provide some support to revenue for the year at a time when the KOM relating to international bottled wine sales has been downgraded.

## No change on other matters

On two issues that were present at IPO there has been no change:

### MPI update

The dispute between the Ministry for Primary Industries (MPI) and MWE's former wine processor remains unresolved. As a result, \$1.2m of MWE's bottled wine stock still cannot be released for sale. MWE considers that it has a strong basis for claiming damages from its former processor, based on its legal advice.

### OIO update

MWE continues to work with the Overseas Investment Office (OIO) regarding a retrospective consent application that would effectively cure technical breaches of the Overseas Investment Act 2005 that occurred as part of MWE's internal restructuring to prepare for listing on the NXT Market. The timing for a final decision from the OIO remains uncertain, although there is no indication from the OIO that in the case consent were declined, it would seek any materially adverse remedies.

## Valuation

To provide a valuation reference for MWE we have looked at how the market is pricing comparable companies. There are two listed peers in the NZ/Australian market. Both companies are well established, are substantially larger than MWE and are therefore of limited relevance. They are trading on an average FY16 EV/revenue multiple of 2.2x, substantially lower than the 12.3x FY16 EV/revenue multiple on which MWE is currently trading, although MWE is at an earlier stage in its life cycle.

**Exhibit 2: Comparable company analysis**

Company	Currency	Market cap (m)	2016e P/E (x)	2017e P/E (x)	2018e P/E (x)	2016e EV/ EBIT (x)	2017e EV/ EBIT (x)	2018e EV/ EBIT (x)	2016e EV/ Revenue (x)	2017e EV/ Revenue (x)	2018e EV/ Revenue (x)
Australian Vintage	A\$	113	24.2	12.8	8.4	17.6	12.2	9.2	2.3	4.6	5.8
Delegat Group	NZ\$	627	17.2	15.4	13.5	14.3	13.1	11.7	2.0	2.1	2.4
<b>Average</b>			<b>20.7</b>	<b>14.1</b>	<b>13.5</b>	<b>16.0</b>	<b>12.7</b>	<b>11.7</b>	<b>2.2</b>	<b>3.4</b>	<b>2.4</b>

Source: Bloomberg. Note: Prices at 3 May 2017. Both companies have a 30 June year end.

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