

DISTIL BEVERAGES

13 June 2022

DIS.L

1.4p

Market Cap: £9.6m

SHARE PRICE (p)



12m high/low 2.7p/1.2p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£1.6m (at 31/03/22)
Enterprise value	£8m
Index/market	AIM
Next news	Q1 update - July '22
Shares in Issue (m)	684.4
Executive Chairman	Don Goulding
Finance Director	Shaun Claydon

COMPANY DESCRIPTION

Distil develops and markets internationally drinks brands, including RedLeg Spiced Rum and Blackwoods Vintage Gins.

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DISTIL IS A RESEARCH CLIENT OF PROGRESSIVE

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FY22 results reflect challenging comparatives

Distil's FY22 results reflect the exceptional performance delivered in FY21, when sales rose 48% following the distortions caused by the unprecedented response to Covid, lockdowns and retailer fears of supply chain disruption. FY22 has consequently seen declines in both turnover and profitability.

- FY22 results – some unwinding of FY21's strong financial performance.** Sales and gross profit both fell by 19% against FY21 but were up by 20% and 13%, respectively, against FY20. Gross margin came in around 20bps lower at 55.4%. With reported total operating costs broadly flat, albeit including some £66k of one-off transaction costs associated with the Ardgowan investment, the lower gross profit saw FY21's £254k operating profit swing to an operating loss of £132k. Finance income of £37k, driven by interest receivable from the loan to Ardgowan, improved the loss before tax to £95k, compared with profit before tax of £243k in FY21. Excluding the Ardgowan one-off costs and £34k of pre-paid marketing costs for the first RedLeg Spiced Rum TV commercial, Distil would have reported a small profit before tax of £5k.
- Commercial progress** manifested itself in the launch of RedLeg Tropical Rum in the UK and Australia, the launch of the new Blackwoods 2021 vintage, and the development of the Blackwoods distillery at Ardgowan. New Eastern Europe export markets were opened and the TRØVE Botanical Vodka trademark was listed in the USA.
- Volume performance – declines against FY21, but ahead of pre-Covid FY20 performance.** Reflecting the FY22 performance outlined above, sales volumes mirrored the declines seen in sales values. Compared with FY21, sales volumes (in litres) were down by 12%, having risen by 30% in that year. Against the pre-Covid FY20 year, volumes were up by some 13%. In terms of brands, the major revenue contributor, RedLeg Spiced Rum, saw revenues decrease 19%, with Blackwoods Gin revenues down 20%.
- Forecasts – against a backdrop of price inflation and a disposable income squeeze.** While trade channels remain open and are trading relatively freely, the consumer environment is far from stable, given the squeeze on disposable incomes from inflationary pressures across many fronts. These pressures also impact commercial enterprises, even ahead of likely wage demands to maintain real incomes and offset inflation. Against such a challenging backdrop, Distil is not giving forecast guidance at this stage.

FYE MAR (£M)	2018	2019	2020	2021	2022
Revenue	2.01	2.40	2.44	3.62	2.94
Adj EBITDA	0.16	0.17	0.25	0.27	(0.12)
Fully Adj PBT	0.16	0.16	0.18	0.24	(0.09)
Fully Adj EPS (p)	0.03	0.03	0.05	0.07	0.03
EV/Sales (x)	4.0x	3.3x	3.3x	2.2x	2.7x
EV/EBITDA (x)	49.1x	47.5x	32.6x	29.8x	-68.7x
PER (x)	44.4x	43.7x	27.2x	20.5x	54.5x

Source: Company Information and Progressive Equity Research estimates.

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Past, present, and future challenges

The past two years have thrown up considerable challenges for businesses and consumers alike, instigated by the Covid pandemic and the seismic shocks it imposed on accepted ways of living and doing business. The present challenges include both the aftershocks of the pandemic and the magnifying effect of the Ukraine conflict, which has exacerbated the supply chain and inflationary impacts felt as the world emerged tentatively from the pandemic. These impacts look set to continue into the medium term, which will throw up fresh challenges for consumers and businesses alike.

The impact of rising inflation and falling real incomes is starting to be felt, and spending and lifestyle patterns will have to adjust to cope. Typically, big ticket items such as electricals and furniture are the first to be hit, followed – usually reluctantly – by travel and other discretionary items. Historically, sales of spirits have risen in times of recession and lower travel spending, being seen as a more affordable treat to compensate for the wider tightening of belts and purse strings. Spirits could be described as a type of ‘defensive spending’.

This factor could be helpful for Distil, albeit within the context of an inflationary environment impacting the shape and size of consumers’ grocery basket. Difficult decisions are being undertaken across a wide spectrum. In turn, the major grocery retailers will be looking to use their scale to minimise price increases, in terms of both goods purchased from suppliers and goods sold to customers. Smaller suppliers will find it more difficult to advance their net selling prices in such an environment, although it should prove easier for those with superior differentiated products.

FY22 results

The following table summarises the FY22 results. Alongside these, we have included not only those for FY21 but also those for FY20. This is to facilitate comparison with and analysis of financial performance and underlying trends. FY21 was an exceptional year, delivering exceptional results on the back of the unparalleled sales surge in response to various impacts of the pandemic, most specifically the consumer lockdown and fears of supply chain disruption in both domestic and export markets. Distil highlights these unusual trading patterns, especially in the Q2 (June-September) period of FY21. As an aide-memoire, in FY21, turnover rose by 128% in H1 and by 7% in H2. In contrast, the financial performance in FY20, being the most recent pre-pandemic year, represents more typical trading patterns. Comparison of FY22 with FY20 therefore provides a better picture of and insight into underlying trends.

This reporting approach has been adopted by many companies in the presentation of their results as they emerge from the environment of the initial stringent impacts of the pandemic. As outlined above, the effects of the pandemic continue to manifest themselves in global supply chain pressures, more recently further compounded by the war in Ukraine, which has resulted in significant global inflationary pressures, impacting businesses and consumers alike.

It should also be noted that we have included a £59k (£34k in FY21, £0k in FY20) non-cash share-based payment charge within the FY22 ‘Other administrative costs’ line. It should be noted that our reported adjusted figures include these charges. FY22 also includes £66k of one-off transaction charges arising from the Ardgowan investment. Adjusting for these items, Distil has calculated that EBITDA amounted to £9k in FY22, £303k in FY21 and £195k in FY20.

Distil – FY22 profit and loss summary, compared with FY21 and FY20

(£'000 unless otherwise stated)	FY20	FY21	FY22	FY22 over FY21		FY22 over FY20	
				Change	% change	Change	% change
Turnover	2,441	3,616	2,942	-674	-19%	501	20%
Gross profit	1,446	2,010	1,629	-381	-19%	183	13%
<i>Gross margin (%)</i>	59.2%	55.6%	55.4%				
Advertising and promotion costs	-665	-1,071	-890	181	17%	-225	-34%
Contribution	781	939	739	-200	-21%	-42	-5%
<i>Contribution margin (%)</i>	32.0%	26.0%	25.1%				
Other administrative costs	-535	-670	-856	-186	-28%	-321	-60%
Depreciation and amortisation	-62	-15	-15	0	0%	47	76%
Total operating costs	-1,262	-1,756	-1,761	-5	0%	-499	-40%
Operating profit	184	254	-132	-386	-152%	-316	-172%
Finance charge	-2	-11	37	48		39	
Pre-exceptional profit before tax	182	243	-95	-338	-139%	-277	-152%
Exceptional charge	0	0	0	0	n.c.	0	n.c.
Reported profit before tax	182	243	-95	-338	-139%	-277	-152%
Reported profit after tax	258	343	174	-169	-49%	-84	-33%

Source: Distil, Progressive Equity Research

Turnover fell back 19% on a year-on-year (YOY) basis against the exceptional performance delivered in FY21. This decline was unsurprisingly weighted to H1, where turnover was down 23%, followed by a 13% decline in H2. This translates, however, into a 20% increase on the pre-pandemic FY20 performance, indicating solid growth on an underlying basis across the two-year period.

On the gross margin front, Distil performed resolutely, broadly holding this flat, with a small decline of just 20bps on a YOY basis vs FY21. This follows the 360bps decline to 55.6% seen in FY21 (from 59.2% in FY20), primarily reflecting incremental production and logistics costs arising from the impacts of Covid. Consequently, the gross margin erosion compared with FY20 amounts to some 380bps. Distil is working hard to at least maintain gross margin going forward, with a combination of working practice and cost efficiencies, combined with some price increases. Management has, however, advised that it does not expect gross margin percentage to return to pre-Covid levels in the short term, given ongoing cost pressures throughout the supply chain.

Advertising and promotion investment in Distil's brands has continued apace relative to turnover. In FY21, these costs increased by just over 60% to £1,071k, outstripping the top-line growth of 48%. In FY22, these costs fell back by 17%; that is a lower decline relative to the top-line fall of 19%. Advertising and promotion costs therefore rose as a percentage of sales to 30.3% from 29.6% in FY21. The monetary investment costs in FY22 were some £225k (34%) higher than in FY20.

Distil – summary of sales and contribution evolution FY17 to FY22

(£'000 unless otherwise stated)	FY17	FY18	FY19	FY20	FY21	FY22	Change	% change	5-yr CAGR
Turnover	1,642	2,014	2,401	2,441	3,616	2,942	-674	-19%	12.4%
Gross profit	950	1,172	1,429	1,446	2,010	1,629	-381	-19%	11.4%
Gross margin (%)	57.9%	58.2%	59.5%	59.2%	55.6%	55.4%			
Advertising and promotion costs	384	465	688	665	1,071	890	-181	-17%	18.3%
Advertising as % of sales	23.4%	23.1%	28.7%	27.2%	29.6%	30.3%			
Contribution	566	707	741	781	939	739	-200	-21%	5.5%
Contribution margin (%)	34.5%	35.1%	30.9%	32.0%	26.0%	25.1%			

Source: Distil, Progressive Equity Research

The combined impact of reduced gross margin and increased marketing as a percentage of sales resulted in a 90bps decrease in the contribution margin (gross profit minus marketing costs) to 25.1% for FY22. The monetary contribution was £200k or 21% lower than that achieved in FY21. However, compared with FY20, the reduction in gross margin and higher advertising and promotion costs translate into a more modest decline of £42k, or a 5% decline.

The impact of operational deleverage is further magnified at the reported operating profit line due to a 28% increase to £856k in other administrative costs excluding depreciation and amortisation. This total includes the share-based payment and Ardgowan transaction costs referenced previously. Excluding these costs, 'Other administrative costs' amounted to £746k, a 17% increase on FY21's £636k (also deducting the £34k share-based payment of that year). FY22 therefore delivered a reported operating loss of £132k, compared with the prior year's £254k operating profit. This equates to an operating margin of (4.5%), compared with the 7.0% margin achieved in FY21 and the 7.5% margin of FY20.

Finance income of £37k, driven by interest receivable from the loan to Ardgowan, improved the loss before tax to £95k, compared with profit before tax of £243k in FY21. Excluding the Ardgowan one-off costs and £34k of pre-paid marketing costs for the first RedLeg Spiced Rum regional TV commercial, Distil would have reported a small profit before tax of £5k. A tax credit of £269k, compared with a £100k credit in FY21 and £76k in FY20, results in reported profit after tax of £174k, around half of that achieved in FY21 and a third lower than that achieved in FY20. Diluted earnings per share came in at 0.02p, down from 0.07p in FY21.

As previously reported, the FY22 year-end cash balance improved by £500k to £1.562m. Operating cash flows saw an outflow of around £150k, compared with last year's inflow, with the improved cash position reflecting the net benefit in the year of the equity raise and convertible loan notes extended to Ardgowan. Reflecting the Ardgowan transactions, net assets have increased to £7.5m from £3.8m.

UK and Export sales

Distil provides a geographical split of both sales and gross profit for the UK and Export markets, which we summarise below. No analysis is provided below the gross profit level, given the difficulty in attributing costs between these markets, with all trade undertaken and assets held in just one location, namely the UK. As for the financial performance above, we compare the FY22 performance firstly with FY21, and secondly with FY20

Distil – UK and Export sales and gross margin performance; FY22 compared with FY21 and FY20

	FY21			FY22			Growth/change (%)		
	UK	Export	Total	UK	Export	Total	UK	Export	Total
Sales	3,221	395	3,616	2,612	330	2,942	-19%	-16%	-19%
Gross profit	1,810	200	2,010	1,424	205	1,629	-21%	2%	-19%
Gross margin (%)	56.2%	50.6%	55.6%	54.5%	62.1%	55.4%	-1.7%	11.5%	-0.2%
Sales mix (%)	89.1%	10.9%	100.0%	88.8%	11.2%	100.0%	-0.3%	0.3%	n.a.
	FY20			FY22			Growth/change (%)		
	UK	Export	Total	UK	Export	Total	UK	Export	Total
Sales	2,227	214	2,441	2,612	330	2,942	17%	54%	21%
Gross profit	1,310	136	1,446	1,424	205	1,629	9%	51%	13%
Gross margin (%)	58.8%	63.6%	59.2%	54.5%	62.1%	55.4%	-4.3%	-1.4%	-3.9%
Sales mix (%)	91.2%	8.8%	100.0%	88.8%	11.2%	100.0%	-2.4%	2.4%	n.a.

Source: Distil, Progressive Equity Research

The results broadly follow the overall group figures, with export sales performing slightly better from a significantly lower base and in relation to the larger and more established UK market. The FY22 export margin increase reflects not only a combination of market and product mix but also an increase in Blavod licence sales via Duty Free, with revenue dropping straight through to margin.

Growth drivers and commercial progress

Distil focuses on four key growth drivers, which are:

- Brand activation and marketing at the point of sale
- Innovation in liquid and packaging innovation
- Route to consumer
- Access to new production and design

Commercial progress made by Distil over FY22 reflects all of the above aspects. We show examples of these below, reflecting the growth drivers in order:

- Distil developed its first TV commercial for RedLeg Spiced Rum in FY22, which subsequently was aired on a regional basis in April 2022, namely the first month of its FY23 year. Marketing activity in FY22 has been designed to support a strategy of price premiumisation, while remaining accessible and affordable. The latter will be of key importance given the likely consumer market backdrop in FY23.
- New packaging and gifting formats were developed, primarily for the RedLeg brand. These included the January 2022 launch of a one-litre bottle format, targeting more value-conscious online shoppers. In August 2021, a miniature gift pack was designed in conjunction with a national gifting specialist company, with national listings secured in a number of grocery and High Street retailers. The new 2021 vintage of Blackwoods Gin was complemented by a brand refresh to highlight its Scottish provenance.
- RedLeg Tropical Rum was introduced and secured a major listing in Australia. The TRØVE range secured a listing for all three flavour variants with a premium UK department store retailer.

- Production of Blackwoods Gin and Blackwoods Vodka has been moved to and consolidated in Scotland, ahead of the planned opening of the new Blackwoods Distillery at the Ardgowan site. This is slated to commence production in late summer 2022.

Forecasts

While trade channels remain open and are trading relatively freely, the consumer environment is far from stable, given the squeeze on disposable incomes from inflationary pressures across many fronts. Energy costs were rising steadily ahead of the Ukraine conflict but have been further exacerbated since. These pressures also have an impact on commercial enterprises, even ahead of likely wage demands to maintain employees' real incomes and offset inflation. Against such a challenging and volatile backdrop, and with retailers aggressively seeking to hold prices for – and minimise price increases to – consumers, Distil is not giving forecast guidance at this stage.

Financial Summary: Distil

Year end: March (£m unless shown)

	2018	2019	2020	2021	2022
PROFIT & LOSS					
Revenue	2.01	2.40	2.44	3.62	2.94
Adj EBITDA	0.16	0.17	0.25	0.27	(0.12)
Adj EBIT	0.16	0.16	0.18	0.25	(0.13)
Reported PBT	0.16	0.16	0.18	0.24	(0.09)
Fully Adj PBT	0.16	0.16	0.18	0.24	(0.09)
NOPAT	0.16	0.16	0.26	0.36	0.24
Reported EPS (p)	0.03	0.03	0.05	0.07	(0.01)
Fully Adj EPS (p)	0.03	0.03	0.05	0.07	0.03
Dividend per share (p)	0.00	0.00	0.00	0.00	0.00
CASH FLOW & BALANCE SHEET					
Operating cash flow	0.17	0.09	(0.10)	0.25	(0.15)
Free Cash flow	0.13	0.04	(0.14)	0.22	(0.17)
FCF per share (p)	0.03	0.01	(0.03)	0.04	(0.03)
Acquisitions	(0.02)	(0.01)	(0.02)	(0.02)	0.00
Disposals	0.00	0.00	0.00	0.00	0.00
Shares issued	0.01	0.00	0.00	0.00	3.49
Net cash flow	0.12	0.04	(0.21)	0.20	0.50
Overdrafts / borrowings	0.00	0.00	0.00	0.00	0.00
Cash & equivalents	1.03	1.07	0.86	1.06	1.56
Net (Debt)/Cash	1.03	1.07	0.86	1.06	1.56
NAV AND RETURNS					
Net asset value	3.01	3.17	3.43	3.81	7.55
NAV/share (p)	0.60	0.64	0.68	0.76	1.10
Net Tangible Asset Value	1.46	1.62	1.85	2.21	5.94
NTAV/share (p)	0.29	0.32	0.37	0.44	0.87
Average equity	2.91	3.09	3.30	3.62	5.68
Post-tax ROE (%)	5.4%	5.2%	7.8%	9.5%	(1.7%)
METRICS					
Revenue growth		19.2%	1.7%	48.1%	(18.6%)
Adj EBITDA growth		3.4%	45.6%	9.3%	(143.4%)
Adj EBIT growth		1.6%	15.0%	38.0%	(151.9%)
Adj PBT growth		1.6%	13.7%	33.5%	(139.0%)
Adj EPS growth		1.6%	60.4%	32.9%	(62.4%)
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		6.7%	7.5%	7.0%	(4.5%)
VALUATION					
EV/Sales (x)	4.0	3.3	3.3	2.2	2.7
EV/EBITDA (x)	49.1	47.5	32.6	29.8	-68.7
EV/NOPAT (x)	50.9	50.1	30.8	22.4	33.2
PER (x)	44.4	43.7	27.2	20.5	54.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	1.9%	0.6%	(1.9%)	3.2%	(2.0%)

Source: Company information and Progressive Equity Research estimates

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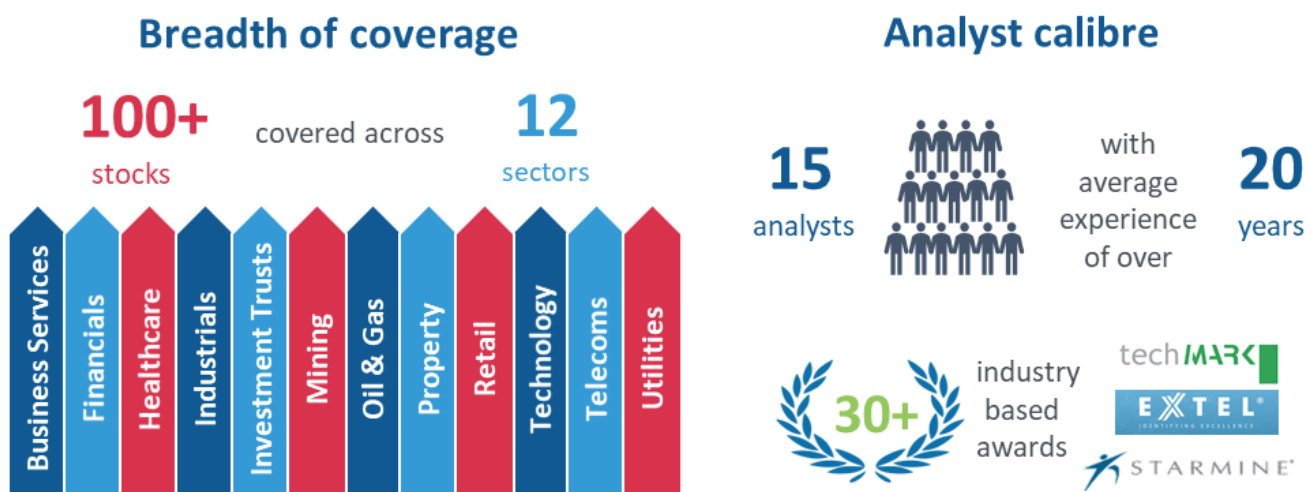
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