DISTIL

BEVERAGES

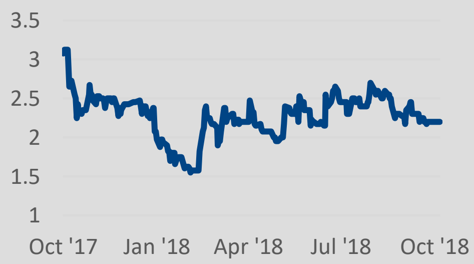
25 October 2018

DIS.L

2.2p

Market Cap: £11m

SHARE PRICE (p)



12m high/low	3.125p/2p

Source: LSE Data

KEY INFORMATION

Enterprise value	£10m
Index/market	AIM
Next news	Trading update - Jan '19
Gearing	N/A
Interest cover	N/A

DISTIL IS A RESEARCH CLIENT OF PROGRESSIVE

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Positive P&L dynamics …..

…..drive £101K interim profit

On the back of strong revenue growth of 42%, Distil has delivered interim profits at operating and pre-tax level of £101K, compared with last year's loss of £21K. This represents an operating profit margin of just under 9%, with the company's perennial cost control complemented by a welcome increase in gross margin driving this 11% swing at the operating margin level. The contribution margin increased by 240bps, despite the continued investment in brand marketing and promotion, which rose by 57% year-on-year. Net cash stood at £957K at the end of the period. We leave estimates unchanged ahead of the key Christmas period.

- **Interim profit delivered:** This was the most successful H1 trading period for the company since its name change to Distil and its shift to a total focus on development of its own brands. RedLeg Spiced Rum and Blackwoods gin remain the core brands and growth drivers of both revenue (+42%) and volume (+31%) growth. Gross margin expansion has further magnified the impact of operational leverage, with total operating costs increasing by some 27%. Within these, other operating cost growth was contained at just under 10%, despite some investment in staff resources to support Distil's growth.
- **New international listings:** Distil has also achieved new listings in international markets - namely in France and Canada. We would expect further announcements over the course of time as Distil looks to build and consolidate positions within these new markets.
- **New product formats:** The development of new gift packaging for RedLeg and Blackwoods and miniature bottles will underpin on-shelf differentiation in a highly competitive market, encourages gifting purchases and introduce these core brands to new consumers.
- **Forecasts unchanged:** Notwithstanding the very strong performance delivered in the first half, the full-year outturn will depend on trading in the current quarter (Q3 fiscal), which is driven by Christmas and New Year sales. In addition, the very late Easter in 2019 means there will be little benefit in the current fiscal year. We are therefore leaving our forecasts unchanged at this stage until the shape of peak trading is revealed in the post-Christmas trading update.

FYE MAR (£M)	2017	2018	2019E	2020E	2021E
Revenue	1.64	2.01	2.50	3.00	3.51
Adj EBITDA	0.01	0.16	0.17	0.41	0.60
Fully Adj PBT	0.01	0.16	0.16	0.40	0.59
Fully Adj EPS (p)	0.00	0.03	0.03	0.08	0.12
EV/Sales (x)	6.1	4.9	4.0	3.3	2.8
EV/EBITDA (x)	730.0	61.0	59.4	24.3	16.6
PER (x)	1,138.3	69.8	68.7	27.5	18.6

Source: Company Information and Progressive Equity Research estimates

High spirits on excellent H1 results…..

….delivering profit margin of almost 9%

Distil has delivered a very strong set of results for its first half. This was achieved from a 42% increase in revenue, supported by gross margin expansion of almost 500bps, which more than offset the increase in ongoing investment in advertising and promotion to support growth of Distil's core brands. Other costs were managed tightly to deliver a falling ratio relative to sales. The overall result of this combination saw last year's interim operating loss of £21K, transformed into a profit of £101K – or a year-on-year increase of £122K. This represented an 11% swing factor in the operating (and PBT) margin to 8.7%.

This represents a very heartening start to the year, given challenging trading conditions and general market uncertainty against a backdrop that includes the still imponderable shape of Brexit. Indeed, the only weak spot of performance was the decline in licensed sales of Blavod in Eastern Europe. As over the past two years, the main brand drivers remain RedLeg Spiced Rum and Blackwoods Gin.

We are also heartened by other news, which should contribute to future growth. These include new listings in France and Canada, together with some new product developments. The latter comprise miniature bottle formats, together with new gift packaging for the core brands. While the miniature bottle formats will be launched ahead of the Christmas period, and should be beneficial this year, the impact will be far greater next year, given than grocery multiple operators have typically finished planning their Christmas ranges and promotions by the end of June. Details of the new premium gift packaging for RedLeg and Blackwoods Gin will be available on the company's websites from early November. Another part of the promotional Christmas PR push will see the publication of new cocktail recipes to encourage product testing and consumption.

On the Brexit front, Distil has done as much as possible to in effect ring-fence two supply chains within two individual markets. For Blavod, all supply and sourcing is effectively self-contained within Germany. Similarly, for RedLeg and Blackwoods, supply and sourcing is self-contained within the UK. Thus no borders need to be crossed, at least until the (export) sales part of the process. While not eliminating all risks, this set-up certainly goes a long way to mitigating risk in our view.

Interim results analysis

The following table summarises the P&L performance compared with the same period last year. Please note that an improvement in (ie reduction of) operating cost lines is shown as a positive percentage change, and conversely, an increase in operating cost lines is shown as a negative percentage change. These reflect the direction of the absolute monetary change shown in the preceding column.

We have commented on some aspects of the P&L dynamics on the front page of the note. We believe it is worth highlighting some of these further, in particular the impressive escalation of operational gearing as one moves down the P&L. The sales growth has been driven primarily by the success of the core brands, combined with the increase in listings achieved over the past 18 months, including within longstanding clients.

FY19 interim results – Profit and loss account

(£'000 unless stated)	H1 FY18	H1 FY19	Change	% change
Turnover	818	1,164	346	42%
Gross profit	459	710	251	55%
Gross margin (%)	56.1%	61.0%	4.9%	
Advertising and promotion	-199	-312	-113	-57%
Other administrative costs	-267	-293	-26	-10%
Depreciation and amortisation	-3	-4	-1	-33%
Other costs	-11	0	11	100%
Total operating costs	-480	-609	-129	-27%
Operating profit/(loss)	-21	101	122	581%
Finance charge	0	0	0	n.c.
Pre-exceptional loss before tax	-21	101	122	581%
Exceptional charge	0	0	0	n.c.
Reported loss before tax	-21	101	122	581%
Operating costs to sales ratio	-58.7%	-52.3%	6.4%	
Operating margin (%)	-2.6%	8.7%	11.2%	

Source: Distil, Progressive Equity Research

Our FY 19 forecast is predicated on a broadly flat margin. The H1 performance delivered an impressive 490bps improvement to 61%, which represents a record level for Distil. Contributory factors to this include greater economies of scale for RedLeg as sales momentum continues, along with a focus across the whole brand portfolio of managing its own supply side and cost of sales. An example of this would be just-in-time (JIT) management, which sees bottles being delivered the day before scheduled production of spirits to eliminate unnecessary storage costs. Other JIT measures reduce waste in other parts of the supply chain and production. While there could be some potential downside risk to gross margin, were promotional pressures to intensify within the grocery sector, management believes the benefits from scale economies and JIT measures should continue to accrue, pointing to gross margins being maintained around the level achieved in H1. By the same token, we believe there is very limited scope, if indeed any at all, for further gross margin improvement from the current level.

The sole drag on the operational leverage delivered in H1 came from the ongoing investment in brand marketing and promotion. Here investment costs rose by some 57% to £312K. Public relations spend on brands has been increased, along with further upgrading of digital marketing efforts, including some done out of house. Maintaining a high degree of topicality within digital marketing and social media is critical to delivering relevance to consumers in these communication channels.

As can be seen from the following table, which looks at the contribution and margin after advertising and promotional costs, monetary contribution increased by 53% - ahead of the rate of revenue increase - to £398K, driven by the benefit of the widening gross margin. Thus, despite the advertising to sales ratio moving by 250bps from 24.3% to 26.8%, the contribution margin increased by an almost similar amount (+240bps) to 34.2%.

Contribution and margin performance – H1 FY19 vs prior year

(£'000 unless otherwise stated)	H1 FY18	H1 FY19	Change	% change
Turnover	818	1,164	346	42%
Gross profit	459	710	251	55%
Gross margin (%)	56.1%	61.0%		
Advertising and promotion	-199	-312	-113	-57%
Contribution	260	398	138	53%
Contribution margin (%)	31.8%	34.2%	2.4%	
Advertising to sales ratio (%)	-24.3%	-26.8%	-2.5%	

Source: Distil, Progressive Equity Research

As previously mentioned, other administrative costs were tightly managed, increasing by just under 10% to £293K. There was a small increase in the depreciation charge, and the operating profit line benefitted from the absence of a share based payment charge within our Other Costs line. Last year, this amounted to £11K in H1 and £22K for the full year.

Forecasts unchanged awaiting January trading update

Given the importance to the full-year outturn of trading across this current quarter (Q3 fiscal), covering the key Christmas and New Year period, we are leaving our forecasts unchanged, until we have confirmation of trading performance in the January update. Another reason for a smaller degree of caution is the very late timing of Easter in 2019, with Easter Sunday falling on 21 April. This will subdue reported revenues in the latter part of the current fiscal year, ending March 2019.

Financial Summary: Distil

Year end: March (£m unless shown)

PROFIT & LOSS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue	1.64	2.01	2.50	3.00	3.51
Adj EBITDA	0.01	0.16	0.17	0.41	0.60
Adj EBIT	0.01	0.16	0.16	0.40	0.59
Reported PBT	0.01	0.16	0.16	0.40	0.59
Fully Adj PBT	0.01	0.16	0.16	0.40	0.59
NOPAT	0.01	0.16	0.16	0.40	0.59
Reported EPS (p)	0.00	0.03	0.03	0.08	0.12
Fully Adj EPS (p)	0.00	0.03	0.03	0.08	0.12
Dividend per share (p)	0.00	0.00	0.00	0.00	0.00
CASH FLOW & BALANCE SHEET	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Operating cash flow	0.00	0.17	0.14	0.31	0.52
Free Cash flow	-0.07	0.13	0.12	0.31	0.52
FCF per share (p)	-0.01	0.03	0.02	0.06	0.10
Acquisitions	-0.01	-0.02	0.00	0.00	0.00
Disposals	0.00	0.00	0.00	0.00	0.00
Shares issued	0.01	0.01	0.00	0.00	0.00
Net cash flow	-0.07	0.12	0.12	0.31	0.52
Overdrafts / borrowings	0.00	0.00	0.00	0.00	0.00
Cash & equivalents	0.91	1.03	1.15	1.46	1.98
Net (Debt)/Cash	0.91	1.03	1.15	1.46	1.98
NAV AND RETURNS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Net asset value	2.8	3.0	3.2	3.6	4.2
NAV/share (p)	0.6	0.6	0.6	0.7	0.8
Net Tangible Asset Value	1.3	1.5	1.6	2.0	2.6
NTAV/share (p)	0.3	0.3	0.3	0.4	0.5
Average equity	2.8	2.9	3.1	3.4	3.9
Post-tax ROE (%)	0.3%	5.4%	5.2%	11.9%	15.2%
METRICS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue growth	40.4%	22.6%	24.2%	20.0%	17.0%
Adj EBITDA growth	(114.6%)	1,097.6%	2.7%	144.3%	46.2%
Adj EBIT growth	(110.0%)	1,531.8%	1.5%	150.2%	47.4%
Adj PBT growth	(109.9%)	1,531.8%	1.5%	150.3%	47.3%
Adj EPS growth	(108.7%)	1,531.8%	1.5%	150.3%	47.3%
Dividend growth	N/A	N/A	N/A	N/A	N/A
Adj EBIT margins	0.6%	7.8%	6.4%	13.3%	16.8%
VALUATION	**2017**	**2018**	**2019E**	**2020E**	**2021E**
EV/Sales (x)	6.1	4.9	4.0	3.3	2.8
EV/EBITDA (x)	730.0	61.0	59.4	24.3	16.6
EV/NOPAT (x)	1,032.6	63.3	62.3	24.9	16.9
PER (x)	1,138.3	69.8	68.7	27.5	18.6
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	(0.6%)	1.2%	1.1%	2.8%	4.7%

Source: Company information and Progressive Equity Research estimates

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