

DISTIL BEVERAGES

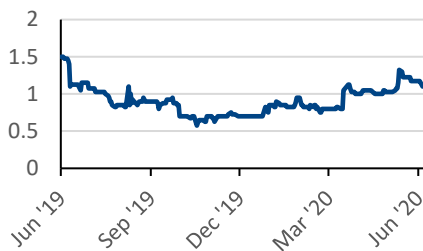
30 June 2020

DIS.L

1.1p

Market Cap: £5.5m

SHARE PRICE (p)



12m high/low 1.5p/0.6p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£0.9m (at 31/03/20)
Enterprise value	£4.7m
Index/market	AIM
Next news	Q1 update, Jul '20
Shares in Issue (m)	502.0
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.

www.distil.uk.com

DISTIL IS A RESEARCH CLIENT OF PROGRESSIVE

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A solid trading performance...

... in uncertain times

Distil delivered a solid trading performance in FY20, despite uncertainties caused by the impact of external events in the form of Brexit initially and COVID-19 more recently. With its disciplined cost approach, Distil saw a 15% increase in operating profit from a 2% rise in revenue. Range extensions have underpinned the continuing success of its leading RedLeg Spiced Rum brand and Distil has continued to lay the groundwork for the further development and future expansion of its brand portfolio.

- FY20 prelims:** Distil's FY20 outturn was in line with the revised guidance issued in February. Revenue and gross profit advanced by 2% and 1% respectively. Combined with a small decline in overall costs, operating profit increased by 15% over the prior year to £184K. Year-end net cash fell back £210K to £858K, primarily due to an increase in receivables in March, driven by the strong increase in retail consumer demand. Net assets rose 8% to £3.43m. The implementation of IFRS 16 with regard to accounting for operating leases accounts for the greater increase in EBITDA, relative to those for operating profit and PBT. A tax credit of £76K helped boost a 60% increase in EPS to 0.051p.
- Brand performance:** Total volumes were broadly flat across the year. RedLeg Spiced Rum continues to lead the way with a volume increase of 24% and a revenue increase of 26%, aided by contributions from the new Caramelised Pineapple variant and the launch of the ready-to-drink (RTD) RedLeg Spiced Rum and Franklins 1886 Cola product. Distil's gin and vodka brands registered volume declines, with the traditional dry London gin segment still overcrowded. New markets were opened internationally and Distil has secured the Mardi Gras trademark in Europe and the USA with an eye to future new product development (NPD).
- Outlook and forecasts:** Distil operates across both the on- and off-trade channels with well-positioned brands at affordable prices and can therefore respond to fluctuations in market demand across these channels. There still remains too much uncertainty around COVID-19 and its economic impact to forecast with a high degree of confidence or accuracy for the year ahead. Distil is therefore not giving market guidance at this stage, but will look to do so as soon as it is more assured on consumers' freedom of movement and the re-opening of trade channels.

FYE MAR (£M)	2018	2019	2020
Revenue	2.01	2.40	2.44
Adj EBITDA	0.16	0.17	0.25
Fully Adj PBT	0.16	0.16	0.18
Fully Adj EPS (p)	0.03	0.03	0.05
EV/Sales (x)	2.3x	1.9x	1.9x
EV/EBITDA (x)	28.5x	27.6x	19.0x
PER (x)	34.9x	34.3x	21.4x

Source: Company Information and Progressive Equity Research estimates

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Please refer to important disclosures at the end of the document.

Living through uncertain times

In light of the ongoing external disruptions and challenges to most businesses from the Brexit and COVID-19 factors, neither of which has fully played out yet, we believe it is appropriate to view Distil's FY20 performance primarily as one of consolidation. This includes an increased emphasis on cost containment and cash management, though these have always been major priorities for the company. Delivering a 15% increase in operating profit despite the advent of the coronavirus and its initial impacts on consumer behaviour and wider market confidence is no mean feat in our view.

Revenue growth in FY20 was more muted than in recent years, but nonetheless it nudged forward, notwithstanding an overprovided gin market and a listing reduction for Blackwoods Gin at a key UK grocery retailer. This top line growth was not achieved at the expense of gross profit margin, which was a mere 30bps lower than in FY19. Distil, as a supplier to both the on- and off-trade channels, was adept and able to balance its resources and supplies accordingly, as demand increased in the off-trade (retail) channel while the on-trade (hospitality sector) was to all intents and purposes closed for business.

Given uncertainties relating to the eventual nature of Brexit, Distil has undertaken measures to protect itself from potential adverse impacts, for example by sourcing glass for its UK production from within the UK, while glass for its Blavod Black Vodka production in Germany is sourced within Europe. Currency risk is also mitigated with all invoicing in sterling.

As, or possibly more, importantly, Distil has continued to invest in its brand portfolio and for the future. Investment in existing brands has been maintained at over 27% of revenue, well above the range of 22% - 24% invested between FY15 and FY18. Range extensions have been developed, most notably pertaining to the key RedLeg Spiced Rum brand, with a new variant (Caramelised Pineapple) and a new format (ready to drink rum with cola) looking to attract new, as well as existing customers, and extend market reach and brand awareness.

Distil continues to push ahead with new product development, as well as new packaging and formats. The Mardi Gras trademark has been secured in both Europe and the USA, with a view to a new product line. Given the ongoing disruption to consumer movement and international travel, and the potential risk of imposition of re-application of tougher lockdown measures as second waves of COVID-19 emerge, we view a new brand launch as more likely over the medium-term than in the near-term. It is also pleasing to note that several new international markets were opened for the group's products in FY20, spanning three different continents.

The company has managed its resources well and is well-positioned to deliver future growth. Offering quality product at affordable price points, Distil's brand portfolio should be better protected than many other weaker brands and therefore better able to weather the likely choppy waters ahead, as the global economy tries to chart a recovery course from the initial ravages of COVID-19. This does not of course mean that Distil will be immune to the ongoing impacts within a more uncertain future compared with more stable conditions. Much remains unclear at this stage regarding the longer-term impacts on how people work, travel and socialise in the future. This uncertainty will impact on the commercial performance of businesses across most products and services and is prudently reflected in no formal company guidance at this stage for FY21E (and beyond) and our withdrawal of forecasts in April.

FY20 prelims

The following table summarises the FY20 results, alongside the FY19 figures. It should be noted that the FY20 figures include the first-time adoption of IFRS 16 with regard to operating leases, while the FY19 results are presented under the previous accounting standard. Under IFRS16, companies recognise right of use assets (ROUA) and lease liabilities (on balance sheet) for most operating leases, with lease payments in the profit and loss account replaced by a depreciation charge on the ROUA and an interest charge on the outstanding liability. This has the impact of boosting EBITDA, with a lesser impact at both operating and pre-tax profit levels.

Distil – FY20 profit and loss account summary

(£'000 unless otherwise stated)	FY19	FY20	Change	% change
Turnover	2,401	2,441	40	2%
Gross profit	1429	1446	17	1%
<i>Gross margin (%)</i>	<i>60%</i>	<i>59%</i>		
Advertising and promotion	-688	-665	23	3%
Contribution	741	781	40	5%
<i>Contribution margin (%)</i>	<i>31%</i>	<i>32%</i>		
Other administrative costs	-572	-535	37	6%
Depreciation and amortisation	-9	-62	-53	-589%
Total operating costs	-1269	-1262	7	1%
Operating profit	160	184	24	15%
Finance charge	0	-2	-2	n.c.
Pre-exceptional loss before tax	160	182	22	14%
Exceptional charge	0	0	0	n.c.
Reported loss before tax	160	182	22	14%

Source: Distil, Progressive Equity Research

Turnover increased by 2% over the previous year, which had been boosted by an export stock build by distributors to counter potential shortages in the event of a possible hard Brexit in March 2019. Gross margin was broadly flat over the year, declining by just 30bps to 59.2% from 59.5%. The gross margin decline of 40bps in H1 reversed in H2, where a 50bps increase was achieved. Advertising and promotion costs were managed carefully, coming in just over 3% lower than in FY19, declining as a percentage of turnover to 27.2% (from 28.7% in FY19). The net impact of gross margin and advertising cost movements was a 110bps improvement in the contribution margin to 32.0%, with contribution rising 5% to £781K.

Other administrative costs, including the higher depreciation charge arising from the implementation of IFRS16, rose by 3%, with total operating costs falling by 1%. This shows the company's ongoing cost discipline, despite some increases in areas relating to accounting and AIM fees, along with some recruitment costs incurred to underpin marketing and New Product Development activities.

Operating profit therefore rose by 15% to £184K. After the IFRS16 nominal finance charge, pre-tax profit increased by just under 14% to £182K. Following a £76K tax credit, profit for the year rose by 61% to £258K.

Total volumes were broadly flat across the year, with H2 significantly ahead of H1, where volumes decreased by 20%. RedLeg Spiced Rum continues to lead the way with a volume increase of 24% and a revenue increase of 26%, aided by contributions from the new Caramelised Pineapple variant and the launch of the ready-to-drink (RTD) RedLeg Spiced Rum and Franklins 1886 Cola product. RedLeg Spiced Rum is the crown jewel of Distil's portfolio. Its success is highlighted by independent market research from IWSR, the drinks market analysis company. This showed that RedLeg Spiced Rum achieved the highest cumulative annual growth rate in the UK between 2013 and 2019 of any rum brand since its launch, on both volume and value terms. RedLeg has also increased its international presence further, with launches of the original Spiced Rum variant in the Netherlands and Canada during the course of the year.

Driven primarily by a range reduction at one UK retailer, Blackwoods Gin saw a revenue decline of 57% (though LFL sales growth was positive in other retailer stockists). The launch of Blackwoods 2020 Vintage Dry Gin has been delayed due to complications arising from the COVID-19 situation. However, new export markets opened in the course of the year for Blackwoods Vintage Dry Gin, including Africa and the Middle East. Blackwoods Vodka and Blavod Black Vodka experienced revenue declines of 5% and 18% respectively, while the premium Diva Vodka saw sales rise significantly, though all three are from a small base figure within the context of the brand portfolio. Given the restrictions on international travel in operation since the emergence of COVID-19, it is unsurprising that demand for Blavod Black Vodka weakened in Q4, dependent as it primarily is on Duty Free and Travel Retail outlets.

The following table shows the company's sales, gross profit and contribution performance since FY15. The change columns relate to the comparison of FY20 to FY19. While the growth achieved in FY20 was modest in comparison to previous years, reflecting the challenging backdrop, the compound annual growth rate (CAGR) achieved over this period remains impressive, with turnover, gross profit and contribution delivering CAGR rates of between 25% - 30%. At both the operating and pre-tax profit levels, there has been an improvement of around £470K across this period.

Distil – summary of sales and contribution evolution FY15 – FY20

(£'000 unless otherwise stated)	FY15	FY16	FY17	FY18	FY19	FY20	Change	% change	5-yr CAGR
Turnover	666	1,169	1,642	2,014	2,401	2,441	40	2%	29.7%
Gross profit	406	681	950	1,172	1,429	1,446	17	1%	28.9%
Gross margin (%)	61.0%	58.3%	57.9%	58.2%	59.5%	59.2%			
Advertising and promotion	-148	-280	-384	-465	-688	-665	23	3%	35.1%
Contribution	258	401	566	707	741	781	40	5%	24.8%
Contribution margin (%)	38.7%	34.3%	34.5%	35.1%	30.9%	32.0%			

Source: Distil, Progressive Equity Research

In terms of cash flow movements, Distil reported an operating cash outflow of £99K in the period, compared with an £85K inflow in FY19. There was a small increase in inventories, driven by securing more bottles and packaging as a precaution against possible disruption of supply in light of the UK lockdown and the UK's departure from the EU. However, the key driver was an outflow of £366K for trade debtors, which more than offset the £28K inflow from trade creditors. The increase in debtors arose primarily from a surge in retail consumer demand in the final month of the year, March, ahead of the lockdown. All these receivables have since been paid. This increase in receivables was the prime reason behind year-end net cash falling back £210K to £858K, though still a healthy position in the current market environment. On the balance sheet front, net assets rose 8% to £3.43m.

Outlook and forecasts

The relaxation of lockdown restrictions in the UK relating to the on-trade from early July should lead to some re-balancing of trade channels over time. The off-trade channel, and online especially, has clearly benefited and seen volume increases from staying open for business while the on-trade has effectively been shuttered down from late March. Distil operates across both the on- and off-trade channels with well-positioned brands at affordable prices and can therefore respond to fluctuations in market demand across these channels.

There still remains too much uncertainty around COVID-19 and its impact on both consumer behaviour and the wider economy to enable forecasting with any great degree of confidence or accuracy for the year(s) ahead. Distil is therefore not giving market guidance at this stage, but will look to do so as soon as it is more assured on consumers' freedom of movement (and willingness to do so) and the re-opening of trade channels.

In light of the lockdown and the unknown economic consequences, we formally withdrew our FY21E and FY22E forecasts following the Q4 and year-end trading update in April, awaiting a return to some greater semblance of normality.

Financial Summary: Distil

Year end: March (£m unless shown)

	2018	2019	2020
PROFIT & LOSS			
Revenue	2.01	2.40	2.44
Adj EBITDA	0.16	0.17	0.25
Adj EBIT	0.16	0.16	0.18
Reported PBT	0.16	0.16	0.18
Fully Adj PBT	0.16	0.16	0.18
NOPAT	0.16	0.16	0.26
Reported EPS (p)	0.03	0.03	0.05
Fully Adj EPS (p)	0.03	0.03	0.05
Dividend per share (p)	0.00	0.00	0.00
CASH FLOW & BALANCE SHEET			
Operating cash flow	0.17	0.09	(0.10)
Free Cash flow	0.13	0.04	(0.14)
FCF per share (p)	0.03	0.01	(0.03)
Acquisitions	(0.02)	(0.01)	(0.02)
Disposals	0.00	0.00	0.00
Shares issued	0.01	0.00	0.00
Net cash flow	0.12	0.04	(0.21)
Overdrafts / borrowings	0.00	0.00	0.00
Cash & equivalents	1.03	1.07	0.86
Net (Debt)/Cash	1.03	1.07	0.86
NAV AND RETURNS			
Net asset value	3.01	3.17	3.43
NAV/share (p)	0.60	0.64	0.68
Net Tangible Asset Value	1.46	1.62	1.86
NTAV/share (p)	0.29	0.32	0.37
Average equity	2.91	3.09	3.30
Post-tax ROE (%)	5.4%	5.2%	7.8%
METRICS			
Revenue growth	22.6%	19.2%	1.7%
Adj EBITDA growth	1097.6%	3.4%	45.6%
Adj EBIT growth	1531.8%	1.6%	15.0%
Adj PBT growth	1531.8%	1.6%	13.7%
Adj EPS growth	1531.8%	1.6%	60.4%
Dividend growth	N/A	N/A	N/A
Adj EBIT margins	7.8%	6.7%	7.5%
VALUATION			
EV/Sales (x)	2.3	1.9	1.9
EV/EBITDA (x)	28.5	27.6	19.0
EV/NOPAT (x)	29.6	29.1	17.9
PER (x)	34.9	34.3	21.4
Dividend yield	N/A	N/A	N/A
FCF yield	2.4%	0.8%	(2.5%)

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

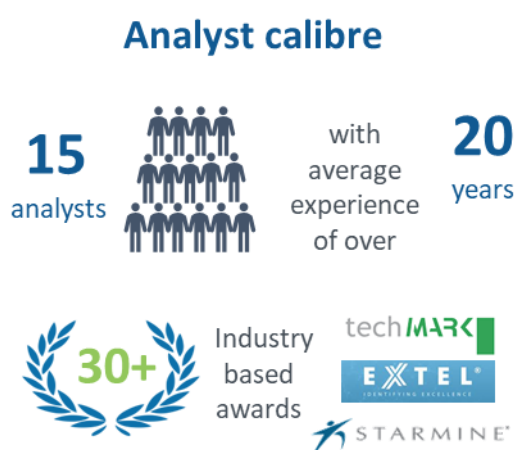
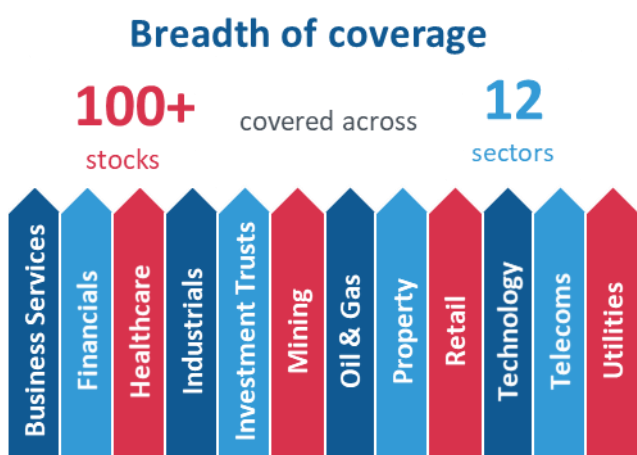
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