

Marlborough Wine Estates

Full year preliminary results and new KOMs

Marlborough Wine Estates Group (MWE), which was formed in March 2015, is targeting the development of premium New Zealand white wine brands in China and internationally. MWE came within 10% of all its key operating milestones (KOMs) for the year. However, it is now seeking to revise its KOM for international bottled wine sales revenue to include revenue from all international wine sales. It has set out its remaining FY18 KOMs, targeting growth in all three measures.

FY17 preliminary results

MWE reported a net loss of NZ\$4.4m for FY17. However, that was after including one-off items totalling NZ\$3.9m relating to impairment of its distribution agreement and inventory. Excluding these and some smaller items, the adjusted net loss after tax was NZ\$0.7m against NZ\$0.5m in FY16. Sales of NZ\$3.8m were 49% lower than FY16 sales of NZ\$7.4m, largely as a result of the reduction in bulk wine sales year-on-year.

New key operating milestones

MWE has revised its view of the appropriateness of one of its four KOMs, namely international bottled wine sales, which it considers no longer meets NXT's standard for inclusion. There has been a softening in demand for premium wine in its key export market of China. At the same time, there has been increase in international demand for MWE's bulk wine product. As a result the board believes the KOM for international bottled wine sales revenue should be restated to include revenue from all international wine sales. MWE is now engaging with NZX in order to formally restate this KOM.

On the remaining three measures, MWE has set new FY18 KOMs with a 10% increase in the gross harvest to 1,600 tonnes, 8% growth in bulk grape sales to 1,200 tonnes, and a 25% increase in NZ bottled wine sales to NZ\$233,750.

Valuation: Remains above peers

MWE trades on a 24.5x FY17 EV/revenue multiple. This is substantially higher than the 2.4x average FY17 EV/revenue multiple on which peers are currently trading, although it is true that MWE is at an earlier stage in its life cycle, and is expecting substantial increases in its sales and profits.

Historical results

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	(481)	(0.2)	0.0	N/A	N/A
06/17	3,822	(717)	(0.2)	0.0	N/A	N/A

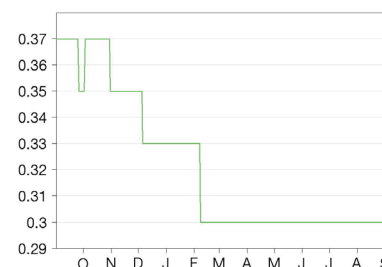
Source: Marlborough Wine Estates. Note: *Pro forma for 12 months; revenue includes sales revenue and other revenue. **Actual from 18 March 2015 to 30 June 2015. ***FY15 NPAT includes positive fair value adjustment of NZ\$1.054m, according to management, and FY16 NPAT excludes one-off capital raising costs. FY16 and FY17 results are normalised.

Food & beverages

5 September 2017

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

Share price performance



Share details

Code MWE
 Listing NXT
 Shares in issue 290.9m

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 the quality of the product.
- Increased competition in Chinese markets.
- Greater demand for MWE's products may depend on conversion of Asian markets from red wines to premium white wines.

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Marlborough Wine Estates coverage is provided through the NXT Research Scheme

Preliminary results: Reduction in adjusted net loss

Marlborough Wine Estates (MWE) reported a net loss after tax of NZ\$4.4m for FY17. However, that was after including one-off items totalling NZ\$3.9m, discussed below. Excluding these items and other smaller adjustments, the adjusted net loss was NZ\$0.7m against NZ\$0.5m in FY16. Exhibit 1 sets out the company's FY17 results.

Exhibit 1: FY17 versus FY16

NZ\$m	FY16	FY17
Sales	7.4	3.8
Cost of sales	6.7	3.3
Gross profit	0.7	0.5
Gross profit margin	10.0%	13.9%
Statutory EBITDA	0.5	(3.5)
Adjusted EBITDA	0.9	0.5
EBIT adjusted	(0.1)	(0.4)
NPBT adjusted	(0.4)	(0.8)
NPAT adjusted	(0.5)	(0.7)
EPS adjusted (NZc)	(0.2)	(0.2)

Source: Marlborough Wine Estates

Performance against KOMs

MWE came within 10% of all its existing KOMs:

Exhibit 2: Performance against key operating milestones

	KOM FY17	Actual FY17	±
Gross harvest (tonnes)	1,544	1,450	-6.1%
Bulk grape sales (tonnes)	1,144	1,112	-2.8%
International bottled wine sales revenue (NZ\$)	1,300,000	1,347,665	3.7%
New Zealand bottled wine sales revenue (NZ\$)	205,940	187,215	-9.1%

Source: MWE

Operating results

Sales of NZ\$3.8m were 49% lower than FY16 sales of NZ\$7.4m, largely as a result of the reduction in bulk wine sales year-on-year.

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	2.0	0.0	-0.6%
Bulk wine sales	3.6	0.3	-3.3	-92.1%
Bottled wine sales	1.8	1.5	-0.2	-12.5%
Other sales	0.0	0.0	-0.1	
Total sales	7.4	3.8	-3.6	-48.5%

Source: MWE, Edison Investment Research

Gross margin of 13.9% for FY17 was higher than the 10.0% gross profit margin achieved in FY16. The FY16 margin had been affected by a material sale of inventory at cost, which had less impact on the FY17 margin. As a result, gross margin was close to the 14.1% for the three-month period (March to June) reported in FY15.

Operating expenses in the business were NZ\$1.45m compared with NZ\$1.4m after excluding capital raising costs, with salaries and wages accounting for 45% of operating expenses (FY16: 35%).

One-off items

There were two material one-off items in the year:

Impairment loss

During the year MWE announced reduced expectations for its Chinese distributor GEL and reset its target under the distribution agreement from of NZ\$3m to NZ\$1.3m. The distribution rights were acquired in March 2015 for NZ\$5.15m and are estimated to have a 10-year useful life. As a result of the reduced sales in the year and future sales forecast, management has concluded that it is appropriate to make an impairment of NZ\$2.6m attributable to the distribution rights.

Inventory write down

Included in the inventory balance as at June 2017 is NZ\$1.2m of bottled wine, which is yet to receive certification from Ministry of Primary Industries (MPI). At June 2017, management performed an impairment test on this bottled wine, and made the decision to provide against the value of the inventory.

Commentary on trading

The harvest season

MWE reports that its gross harvest tonnage was within 10% of its annual target, despite enduring two major storms during the harvest season. As a result of action by its vineyard staff, the company only suffered a minor loss of grapes and was still able to harvest some high-quality grapes.

Vineyard development

Irrigation was one of the main opportunities at the time of the IPO in 2015. The company completed the construction of the Donaldson block dam in early 2017. The dam is now functional and greatly improves the irrigation of the McKee and Donaldson blocks. The company has now shifted its investment and capital expenditure focus to new vineyard development and planting. It is developing and planting 5ha of non-Sauvignon Blanc varieties in 2018 and more in 2019-20. It is also replenishing its existing blocks where vines have died.

Sales strategy and product portfolio

Over the past year, MWE has focused on improving its product portfolio and optimising its sales strategy. The company has released new Syrah, Rose, and Merlot Cabernet Sauvignon wines, which have proved to be popular. As well as the long-term development of brands and premium wines, MWE sees the opportunity in lower tiers of the wine markets, and has released lower priced products to target some of the more competitive international markets.

International market development

China continues to be the company's largest export market. The Chinese market, however, has slowed down due to general economic factors and competition from other countries. As a result, exports to China did not grow as hoped. MWE will continue to work with the Chinese distributor to take advantage of its large sales network and capitalise on new opportunities. However, the company has also worked well with its US distributor to develop the US market and has secured initial orders. This market is very competitive but the Marlborough Sauvignon Blanc is very well received and still has significant potential. The company has started to work with a major US bulk wine importer in the past year, resulting in NZ\$288,000 of revenue. The importer has now signed new deals for the coming year for substantially higher volumes of bulk wine. MWE has also shipped its first order to Japan, and further opportunities exist in other geographies.

Domestic sales

In FY17, the company has achieved a 25% increase in domestic bottled wine sales compared to the previous financial year. This growth was mainly driven by an improved sales strategy and sales network, as well as new products that have proven to be popular in domestic markets.

Key operating milestones for FY18

The key operating milestones (KOMs) are required under the NXT listing rules to be reported on a quarterly basis. This requirement is to allow investors and potential investors to track the performance of the company and to gain some insights into 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 NZ bottled wine sales (NZ\$).

Proposed revision of KOM for international bottled wine sales

MWE has revised its view of the appropriateness of one of its four KOMs, namely international bottled wine sales, which it considers no longer meets NXT's standard for inclusion. The relevant standard is that KOMs should address the most significant factors by which the performance of MWE's business should be assessed and monitored, and should therefore result in understandable reporting for investors.

MWE reported in July 2017 a softening in demand for premium wine in its key export market of China. At the same time however, there has been an increase in international demand for MWE's bulk wine product. As a result the board believes the KOM for international bottled wine sales revenue should be restated to include revenue from all international wine sales. MWE is now engaging with NZX in order to formally restate this KOM, and informed the market on 30 August 2017 that it expected to update the market within the next 10 business days.

There is no change to MWE's other three KOMs, gross harvest, bulk grape sales and New Zealand bottled wine sales revenue.

New KOMs for FY18

Exhibit 4: FY18 KOMs

	FY16 actual	FY17 actual	±	FY18 target	±
Gross harvest (tonnes)	1,653	1,450	-12.3%	1,600	10.3%
Bulk grape sales (tonnes)	1,187	1,112	-6.3%	1,200	7.9%
NZ bottled wine sales (NZ\$)	150,400	187,215	24.5%	233,750	24.9%

Source: MWE

- The **gross harvest**, or grape production from the vineyards, measure shows the vineyard's grape supply capacity, which in the opinion of the board is sustainable for at least 15 years. Grape production is expected to increase as the vines mature and the board's longer-term forecasts are for a gross annual harvest of 2,000 tonnes (a 5% annual growth rate). The KOM forecasts are for grapes produced from the existing vineyards and do not factor in future vineyard development where the time to full production could take five years. For FY18, with increased irrigation and provided weather conditions remain favourable, MWE is forecasting a 150 tonne increase in gross harvest from FY17 levels, which is a 10% increase.
- **Bulk grape sales** have been expressed in tonnes because of the difficulty in forecasting the price, which can vary materially depending on supply/demand factors. The bulk grape sales measurement shows the bulk grape allocation of the total harvest, with the remaining harvest being processed for bottled wine and bulk wine sales. MWE's key strategy is to significantly increase exports of bulk and bottled wine, supported by grape supply agreements that have been signed to supply bulk grapes from certain vineyard blocks. MWE is expecting to see an

8% increase in bulk grape sales for FY18, continuing over time by more allocation of grapes to bulk and bottled wine processing.

- **NZ bottled wine sales** revenue grew strongly, by 24%, in the last financial year and MWE is budgeting on 25% growth in sales for FY18. MWE's new products will help capture additional market share in an increasingly competitive domestic market.

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 FY17 EV/revenue multiple of 2.4x, substantially lower than the 24.5x FY17 EV/revenue multiple on which MWE is currently trading, although MWE is at an earlier stage in its life cycle.

Exhibit 5: Peer group valuation

Company	Currency	Market cap (m)	2017 P/E (x)	2018e P/E (x)	2019e P/E (x)	2017 EV/ EBIT (x)	2018e EV/ EBIT (x)	2019e EV/ EBIT (x)	2017 EV/ revenue (x)	2018e EV/ revenue (x)	2019e EV/ revenue (x)
Australian Vintage	A\$	116	21.0	12.4	8.1	20.6	12.0	9.0	0.9	0.8	0.8
Delegat Group	NZ\$	688	17.0	16.9	14.8	14.6	14.0	12.6	3.9	3.7	3.4
Average			19.0	14.7	11.5	17.6	13.0	10.8	2.4	2.3	2.1

Source: Bloomberg. Note: Prices at 31 August 2017. Both companies have a 30 June year end.

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