

Marlborough Wine Estates

Food and beverages
2 March 2017

Reduced loss in first half

Marlborough Wine Estates (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 wine brands in China. The company has reported an improved first-half result, with the statutory net loss for H117 at NZ\$1.0m against NZ\$1.3m in H116. The company recently confirmed its FY17 key operating milestones, although trading will be second-half weighted.

H117 results

MWE has released its interim results for FY17, reporting reduced net loss of NZ\$1.0m against NPAT of NZ\$1.3m for H116. Revenue was NZ\$0.9m against NZ\$2.8m in H116. However, the H116 included NZ\$2.7m of bulk wine sales whereas there were none in H117 as MWE is focusing on developing its bottled wine business. Bottled wine sales have grown strongly to reach NZ\$0.9m against NZ\$0.1m for H116. There were no bulk grape sales in the first half of either year as such sales result from the harvest that takes place in the second half.

Gross profit for the first half was NZ\$0.2m, against a loss of NZ\$32,000 in H116. The company reported an operating cash outflow of NZ\$0.5m and net debt rose by NZ\$1.3m from NZ\$4.6m at June 2016 to NZ\$5.9m at December 2016.

Outlook positive

There have been a number of positive developments in the first half. Normal growing conditions mean the harvest should be in line with expectations. A bulk grape swap deal with a New Zealand winery should help MWE broaden its product portfolio. Construction of the Donaldson Block dam is complete. The dam will greatly improve the irrigation of the McKee and Donaldson blocks over the medium term. MWE has continued to broaden its product range with the launch of a Hawke's Bay blended red wine.

However, there is no resolution on two issues flagged at IPO: the Ministry for Primary Industries dispute, which means NZ\$1.2m of stock cannot be released, and the process to cure technical breaches of the Overseas Investment Act 2005.

Valuation: Priced above peers

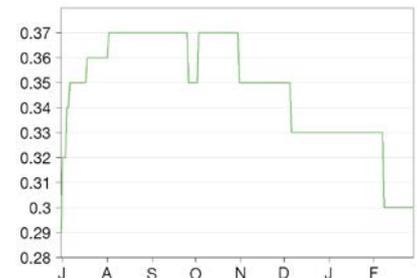
MWE trades on an 11.5x FY16 EV/revenue multiple, which is considerably higher than its two listed peers in the NZ/Australian market, which trade at an average FY16 EV/revenue multiple of 2.3x.

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. ***NPAT includes positive fair value adjustment of NZ\$1.054m, according to management, and FY16 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 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.
- Majority distribution in Asia 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

First-half results and key operating milestones

MWE reported a net loss of NZ\$1.0m for H117, a 24% improvement on the H116 net loss of NZ\$1.3m. This was despite sales being only around one-third of those in H116 at NZ\$0.9m against NZ\$2.8m.

The gross profit margin of 22% for FY16 was above the negative 1% gross profit margin achieved in H116. The improvement reflects expectations following the sell-off of old inventory.

Operating expenses in the business were NZ\$0.9m, with salaries and wages accounting for around one-third of operating expenses, consistent with H116. Exhibit 1 sets out the company's reported results.

Exhibit 1: H117 versus H116			
NZ\$m	H117	H116	
Sales	0.9	2.8	
Cost of sales	0.7	2.8	
Gross profit	0.2	0.0	
Gross profit margin	22.4%	(1.1%)	
EBITDA	(0.6)	(0.7)	
EBIT	(0.8)	(0.9)	
NPBT adjusted	(1.2)	(1.3)	
NPAT adjusted	(1.0)	(1.3)	
EPS adjusted (c)	(0.3)	(0.4)	

Source: Marlborough Wine Estates

Positive developments

The company highlights a number of positive developments:

- Growing conditions so far in FY17 have been reasonably normal and the harvest in the second half should be in line with expectations. The fruit is developing naturally and in accordance with its seasonal growth.
- MWE has agreed a bulk grape swap deal with a reputable winery in New Zealand, which will enable MWE to secure a quality red wine source and broaden its product portfolio.
- Construction of the Donaldson Block dam was completed in January and is now awaiting local authority sign off. The dam will greatly improve the irrigation of the McKee and Donaldson blocks. Planting is expected to begin in late 2017 and the harvest is expected to start in five years' time.
- MWE has continued to broaden its product range with the launch of a Hawke's Bay blended red wine, which has been popular in both the domestic market and Asia, where there is strong demand for red wine.

On the other hand, there is no resolution on the dispute between the MPI and MWE's former wine processor. As a result, NZ\$1.2m of MWE's bottled wine stock still cannot be released for sale. This situation is unchanged since IPO in June 2016. Based on legal advice received, MWE considers it has a strong basis for claiming damages from its former processor.

In addition there is still no indication of timing for a decision by the retrospective consent by the Overseas Investment Office, required to cure the 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.

Key operating milestones

Under the NXT listing rules, the key operating milestones (KOMs) are required to be reported quarterly. This requirement is to allow investors and potential investors to track the performance of the company and gain some insights into the key growth and profit drivers of the business.

MWE has set four key metrics by which investors should be able to assess performance, which it confirmed in its Q2 update on 27 January 2017. Progress against to H117 the KOMs is as follows:

Exhibit 2: Actual against KOMs			
	FY16 actual	HY17 actual	FY17 KOM
Gross harvest (tonnes)	1,653	0	1,544
Bulk grape sales (tonnes)	1,187	0	1,144
International bottled wine sales (NZ\$)	1,604,500	822,079	3,200,000
NZ bottled wine sales (NZ\$)	150,400	89,197	205,940

Source: MWE

- Gross harvest**, or grape production from the vineyards (the harvest takes place in the second half). The FY17 forecast of 1,544 tonnes assumes normal growing conditions and is therefore 5% pa growth from the FY15 production baseline. FY16 was considered to be an exceptional year. In FY17 to date, the climatic and growing conditions have been normal and in line with expectations and the fruit is developing naturally and in accordance with its seasonal schedule.
- 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 tonnage of bulk grape sales is governed by how much of the harvest is put into bottled and bulk wines, and is therefore actualised in the second half. It is MWE's intention to increase bottled wine sales because they offer higher margins than grapes sold in bulk or grapes processed into bulk wine. An increase in the sale of bottled wines will mean a reduction in the amount of wine sold as bulk wine to other NZ wine producers.
- International bottled wine sales**, which management expects to double from NZ\$1.6m in FY16 to NZ\$3.2m in FY17, are underpinned by minimum purchase requirements that form part of the distribution arrangements with related party HK-based distributor Great Esprit. International bottled wine sales revenue is low against the full year target. The distributor tends to place large orders to minimise costs of freight and customs clearance. It is expected that a large proportion of sales will fall into the second half of the financial year. The Chinese New Year holiday also tends to increase wine demand. It is unlikely that the KOM target will not be met, particularly considering the distributor has contractually agreed to order a minimum of NZ\$3m of wine in the current financial year.
- NZ bottled wine sales:** New Zealand bottled wine revenue has been strong and in line with expectations. The total bottled wine sales in New Zealand for the first half of the year are slightly lower than 50% of the annual target and there has been strong growth of bottled wine sales in the second quarter. MWE is confident that the New Zealand bottled wine revenue will continue to grow and the annual KOM target will be met.

Peer comparison

There are two listed peers in the NZ/Australian market. Both companies are well established and substantially larger than MWE, so are of limited relevance. They are trading on an average FY16 EV/revenue multiple of 2.3x, substantially lower than the 11.5x FY16 EV/revenue multiple that MWE is currently trading on, given its earlier stage in its life cycle.

Exhibit 3: 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	15.2	26.1	16.8	14.3	18.0	14.1	1.0	0.8	0.8
Delegat Group	NZ\$	627	11.7	16.7	14.1	10.6	13.7	12.0	3.5	3.5	3.3
Average			13.5	21.4	15.5	12.5	15.9	13.1	2.3	2.2	2.0

Source: Bloomberg (Australian Vintage adjusted for one-off items). Note: Prices at 27 February 2017. Both companies have a 30 June year end.

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