

Marlborough Wine Estates

Half year preliminary results

Marlborough Wine Estates Group (MWE) is targeting development of premium New Zealand (NZ) wine brands in China and, increasingly, internationally. The global market is strong and the popularity of quality NZ wine is growing. MWE continues to work to expand market share in China and is exploring US, Japanese, Australian, UK and Canadian markets. In this context, early inroads into the US and Japan are encouraging.

HY18 preliminary results: Improved bottom line

MWE reduced its net loss to NZ\$0.7m (HY17: NZ\$1.0m). Revenues, flat in total, were 54% composed of bulk wines (HY17: 100% bottled). While these were sales to the US, one of MWE's targeted new markets, they diluted gross margin to 13.3% (HY17: 22.4%). However, management actions on operating costs, as well as lower amortisation of intangible assets, more than compensated for the lower margin.

Strong harvest prospects, promising developments

Due to excellent weather in the region, prospects for the 2018 vintage are strong both in terms of quality and crop yield. MWE forecasts a 10% increase in gross harvest and it also has supply agreements in place for Bulk Grapes. The strategy is to progressively allocate more production to higher margin Bottled Wines.

MWE is progressing its strategy on increasing market presence, building new distribution networks for overseas markets and improving vineyard capacity and efficiency. In H1, bottled wines were shipped to the US and Japan. It is also exploring potential in Europe, Australia and Canada. With regularised water supply in the McKee and Donaldson blocks, the way is clear for future production there.

First half and key operating milestones (KOMs)

Although KOMs for gross harvest and bulk grape sales are not applicable in H1 (as the harvest is in H2), international wine sales of NZ\$0.8m are promising against an annual target of NZ\$2m, given the progress in growing international markets. MWE has also achieved over half its NZ\$233,750 annual target for NZ bottled wine sales.

Valuation: Little comparability

For larger established peers, the average peer EV/revenue multiple of 2.6x for FY18 is substantially lower than the 19.2x FY17 EV/revenue multiple on which MWE is currently trading. However, MWE is at an earlier stage in its life cycle and is currently in the process of repositioning its market focus.

Consensus estimates (historics if no consensus)

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

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Price **NZ\$0.25**
Market cap **NZ\$73m**

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 (NZ). It sells bottled and bulk wine to NZ and international markets, as well as bulk grapes to wine producers in NZ.

Bull

- Potential for developing international markets building on the Marlborough region's 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 and regulatory barriers in Chinese markets.
- Development of international markets is still at an early stage.

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Preliminary H118 results: Improved bottom line

In its half year to December 2017, MWE improved its net financial result year-on-year. NPAT was a loss of NZ\$0.7m compared with NZ\$1.0m for the six months to December 2016:

Exhibit 1: H118 versus H117

NZ\$m	H117	H118
Sales	0.9	0.9
Cost of sales	(0.7)	(0.8)
Gross profit	0.2	0.1
Gross profit margin	22.4%	13.3%
Statutory EBITDA	(0.6)	(0.5)
Adjusted EBITDA	(0.6)	(0.5)
EBIT	(1.1)	(0.8)
Net profit before tax, adjusted	(1.2)	(0.9)
Net profit after tax, adjusted	(1.0)	(0.7)
EPS adjusted (NZ\$)	(0.004)	(0.002)

Source: Marlborough Wine Estates

Revenues in the period, while similar in total to the prior year period, were composed very differently. Whereas in H117 they all consisted of bottled wine sales, in H118 bulk wine sales accounted for 54% of revenue, with bottled wines only making up 46%. While the bulk wine sales represent shipments of product to the US, one of the company's targeted new markets, bulk wine sales are less profitable, which resulted in the reduction in the company's gross margin percentage.

There were no bulk grape sales in the period in either year, as the bulk grape product is seasonal and is only sold after the harvest has taken place in April and May each year.

During the period management took action on improving efficiency and the allocation of human and capital resources. As a result, operating expenses were reduced to \$0.64m, down from \$0.89m in the prior year period. This meant that, despite the lower gross profit, EBITDA improved from a loss of NZ\$0.6m in H117 to a loss of NZ\$0.5m.

In addition, amortisation costs were lower following the write-down of intangible assets in the year ended June 2017, resulting in an adjusted loss after tax of NZ\$0.7m versus NZ\$1.0m in the corresponding period.

Promising medium-term developments

MWE is continuing its strategy of increasing market presence, building new distribution networks to expand into overseas markets, improving vineyard production capacity and operating efficiency.

- The company reports progress in the US and Japanese markets with two shipments of bottled wine sent to each of these markets during the period. MWE is also working closely with various contacts to explore new distribution networks and sales channels in Europe, Australia and Canada. The US was also a destination for bulk wine as noted above.
- Following the completion of the Donaldson Dam construction in FY17, the company's McKee and Donaldson blocks are now receiving a steady water supply, which should be reflected in future production. Preparation has started for five hectares of Pinot Noir planting in the Donaldson block. International demand is growing and further planting is planned for the next two to three years.
- During the first half, MWE launched a new product, Marlborough Pinot Gris, under the O:TU Classic range. The range also includes a Marlborough Sauvignon Blanc, a Merlot Rosé and a Merlot Cabernet Sauvignon. Management regards the Classic range as a key driver of growth in the New Zealand and international markets, and intends to continue to strengthen its product range and look for new growth opportunities.

First-half results and key operating milestones

Against its key operating milestones (KOMs), MWE has had a promising start.

Exhibit 2: Progress against key operating milestones

	H118 actual	FY18 target
Gross harvest (tonnes)	0	1,600
Bulk grape sales (tonnes)	0	1,200
International Wine Sales Revenue (NZ\$000)	755	2,000
NZ bottled wine sales (NZ\$000)	158	234

Source: MWE

Although the KOMs relating to the gross harvest and bulk grape sales are not applicable in the first half (since the harvest is in the second), fair progress has been achieved both on international wine sales and NZ bottled wine sales. International wine sales are promising, considering that management has good hopes of growing new international markets. Meanwhile, the company has achieved over half its annual target for NZ bottled wines.

Strong prospects for the harvest and wine market

The prospects for the 2018 vintage are good. Due to the excellent weather in the Marlborough region during the growing season, the 2018 harvest is likely to be earlier than previous years and there is reason to expect high quality grapes combined with higher crop yield.

MWE is forecasting a gross harvest of 1,600 tonnes, an increase of 150 tonnes over the previous year. Grape supply agreements are in place to supply bulk grapes from some of the company's blocks, including a bulk grape swap deal with a reputable winery in New Zealand which enables MWE to secure premium quality red grapes.

MWE's core strategy is to continue expanding sales of bottled wines and as a result the intention is to progressively allocate more of its grape production to bottled wine processing, where it will attract the best margins.

The global wine market has been strong for the past few years and the appreciation and popularity of quality New Zealand wine is growing. MWE continues to work to expand its market share in China and intends to invest into the US, Japan, Australia, UK and Canada. In this context, the company's early inroads into the US and Japanese markets are encouraging.

Valuation: Limited comparability

As a valuation reference for MWE we review market valuations for 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.

Exhibit 3: Peer group valuation

Company	Currency	Market cap (m)	2018e P/E (x)	2019e P/E (x)	2018e EV/EBIT (x)	2019e EV/EBIT (x)	2018e EV/Revenue (x)	2019e EV/Revenue (x)
Australian Vintage	A\$	164	22.7	13.7	15.7	11.1	1.0	1.0
Delegat Group	NZ\$	819	19.3	16.9	15.2	13.5	4.1	3.7
Average			21.0	15.3	15.5	12.3	2.6	2.4

Source: Bloomberg. Note: Prices at 28 February 2018. Both companies have a 30 June year end

However, they are trading on an average FY18 EV/revenue multiple of 2.6x, substantially lower than the 19.2x FY17 EV/revenue multiple on which MWE is currently trading, although MWE is at an earlier stage in its life cycle, and in addition is in the process of repositioning its market focus.

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