

DISTIL PLC

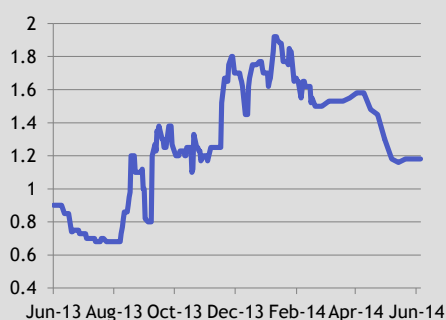
BEVERAGES

DIS.L

1.18p

Market Cap: £4.3m

SHARE PRICE (p)



12m high/low

1.92p/0.68p

Source: LSE Data

KEY INFORMATION

Enterprise value	£4.5m
Index/market	FTSE/AIM
Next news	FY14 AGM, 3 July 2014
Gearing	n.a.
Interest cover	n.a.

 DISTIL IS A RESEARCH CLIENT OF
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A year of transition

Preliminary results

Distil (previously known as Blavod Wine and Spirits PLC) has announced an improved result in its preliminary results for what has been a year of transition for the company. The pre-exceptional pre-tax loss improved by 11% to £392K from a loss of £439K last year. On an underlying basis, excluding the £58K of redundancy costs incurred, there was a 24% year-on-year improvement at the pre-exceptional pre-tax loss level. Distil is moving from a mixed (third party agency and its owned) brand model to one focusing solely on the development of its owned brands. This has included a move to using third party distributors rather than its own direct sales force, which will reduce operating costs, offsetting the loss of contribution from the lower margin agency distribution business. FY15E will see further evolution of the owned brand model, as Distil focuses on achieving its initial objective of a planned break even position.

- FY14 results:** The shape of the FY14 results reflect the transition of Distil's operating model to focus on the higher quality earnings potential of a purely owned brand model. Turnover fell 36% as revenue from the distribution of third party brands almost halved as they were phased out from the business. Despite this, the reduction in operating and financing costs associated with the owned brand model resulted in an improvement in the reported pre-exceptional pre-tax loss. Distil ended the year with £344K of net cash, following its private placing in October 2013.
- Investing for the future:** The past year has seen the re-launch of a number of brands with more to follow in FY15, specifically Diva Vodka and Jago's cream liqueur. Distil has also been working on the launch of another new brand. These investment activities, which should yield benefits from FY15E onwards, amounted to £112K for the year, of which £22K related to product reconfiguration and tooling costs.
- Outlook:** The shape of our forecasts reflects our expectation of higher revenues from product re-launches, new product launches over time and extended distribution in all key markets. The appointment of a US distributor will be an important factor in underpinning sales growth and complementing UK growth of owned brands.

FYE MARCH	2012	2013	2014	2015E	2016E
Revenue	4.6	3.8	2.4	1.8	2.2
Adjusted EBITDA	-0.4	-0.3	-0.4	0.1	0.2
Adjusted PBT	-0.5	-0.4	-0.4	0.1	0.2
Adjusted EPS (p)	-0.5	-0.2	-0.1	0.0	0.1
EV/Sales	1.0x	1.2x	1.9x	2.5x	2.0x
EV/ Adj. EBITDA	n.a.	n.a.	n.a.	73.2x	21.1x
P/E	n.a.	n.a.	n.a.	56.7x	18.8x

Source: Company Information and Progressive Equity Research estimates

Moving into a new era....

....through transformation of the business model

Introduction

The April 2014 name change of the group to Distil is a better reflection of the group's core competencies and its business model for the longer-term, namely the designing and marketing of a growing portfolio of its own brands. The FY14 results continue to reflect this transition which impacts both at turnover and operating cost level. As agency distribution of third party brands is phased out, and distribution of its own brands is outsourced to third party specialist distributors, both reported turnover and operating costs will decrease. With FY14 representing only a part year effect of this evolution, FY15 will also see a further decline in both turnover and operating costs, as the business model re-focuses to the core value-added activities of brand creation and development.

Overview of FY14

The following table summarises the key developments that took place in FY14, which clearly reflect the changes within the overall business model, as well as other highlights and notable events.

Company developments in FY14

April '13	RedLeg wins Double Gold award at San Francisco World Spirits Competition
May '13	Completed acquisition of Blackwood's brands Appointment of Hi-Spirits as UK & Ireland distributor for company's owned brands
June '13	Cessation of distribution for third party whisky brand, Bruichladdich
September '13	Re-launch of Blackwoods Vintage Dry Gin and Blackwoods Limited Edition 60% ABV
October '13	Share placing announced with gross proceeds of £571,300 Served notice on invoice discounting facility (completed in April '14)
November '13	FY14 interim results announced RedLeg Rum Shack started promotional tour in major UK cities
January '14	Appointment of The Water Company as exclusive distributor for all Spanish territories
February '14	Announced cessation of distribution of Mickey Finn brand
March '14	Re-launch of Blackwoods Vodka

Source: Distil; Progressive Equity Research

The share placing in October 2013 has given the group additional cash resources to manage the business model transformation, with the group finishing the financial year with net cash resources of £344K, following additional investments of £112K on portfolio developments, including the early stages of a new brand.

FY14 – financial results

The following table summarises the outturn of FY14, which was in line with our expectations at key turnover and profit lines. A fuller summary of results and our forecast expectations can be found later in this note.

FY14 actual versus estimate

£m unless stated	FY14A		
	Estimate	Actual	Difference (%)
Revenue	2.4	2.4	0%
Adj EBITDA	-0.4	-0.4	n.a.
Reported PBT	-0.4	-0.4	n.a.
Fully adj PBT	-0.4	-0.4	n.a.
Reported EPS (p)	-0.1	-0.1	n.a.
Fully adj EPS (p)	-0.1	-0.1	n.a.

Source: Company information, Progressive Equity Research estimates

As noted above, the key driver of the shape of FY14's results have been the phased withdrawal from the distribution of third party brands on an agency basis, along with some changes to accompany the future sole focus on the development of own brands. Most notably this has seen Distil enter distribution arrangements both in the UK (with Hi-Spirits) and for Spanish territories (with The Water Company).

Agency brands saw turnover decline by 46% to £1.7m (£3.1m), with contribution declining by 56% to £205K (£471K). Management states that agency brand sales will be minimal in FY15E, with the transfer out of these now nearly completed. Overall group turnover declined 36% to £2.4m (£3.8m). Overall group contribution fell 51% to £340K (£700K), as Distil increased its marketing investment in owned brands by some £106K over the year. This had an adverse impact on the contribution of its owned brand business, which reduced by 41% to £135K (£229K), with the margin reducing to 19% from 34%. This investment will yield future benefits, as FY15E will see further benefit from re-launches that took place in FY14, but have yet to anniversary and from upcoming re-launches (Diva Vodka and Jago's). It should also be noted that some of this investment was on a new brand currently under development.

Management continues with its efforts to appoint a US distributor for its brands. Arrangements with the previous incumbent finished in 2013, and the current absence of a US distributor has had an adverse impact on sales of the Blavod Black Vodka brand in FY14 in the US. However, volume increases in other brands compensated for this shortfall, notably the successful re-launches of Blackwoods Gin and Vodka, and further increases in volumes for the award winning RedLeg Spiced Rum brand.

Owned brand performance

With an eye on the future core of the business, we look to analyse further the performance of owned brands in FY14. The key metrics are shown in the table below at the aggregate level.

The highest growth levels were attained by Blackwoods Gin, up 36% in the year, with RedLeg Spiced Rum leading the way with a 37% increase, within an overall flat volume performance. Turnover was up 7% year-on-year, reflecting selective price increases across the portfolio. Gross margin decreased around 160bps to 46.3%, reflecting the move to operating via a sales distributor, with the associated benefit moving from gross margin to a reduction in overheads. As previously flagged, the increased tooling costs referred to above shaved some 3% from the gross margin in the short term, so the underlying gross margin movement was positive.

Owned brand performance (£'000 unless stated)

	FY13	FY14	% change
Revenue	681	730	7.2%
Gross profit	326	338	3.7%
Gross margin (%)	47.9%	46.3%	
A&P costs	-97	-203	109.3%
A&P (%)	14.2%	27.8%	
Contribution	229	135	-41.0%
Contribution margin (%)	33.6%	18.5%	

Source: Distil; Progressive Equity research analysis

Advertising and promotional costs on owned brands increased over the year, more than doubling, with £90K of this related to investment in brand redesign and liquid development in preparation for re-launches.

While further progress was made with sales of Blavod in Germany and other European markets through the production and distribution arrangement with Waldemar Behn GmbH & Co, exports fell as a proportion of owned brand sales in FY14. This reflects changes in other distributor arrangements and most significantly the lack of a US distributor at present.

Estimates

Distil's FY14 results were in line with our expectations. As we note earlier in this document, the following financial years will reflect the contribution solely from Owned brands as the Third Party business ends as planned.

Although this focus on Owned brands reduces revenue, it also reduces costs and we expect an improved performance at the Adjusted PBT and Adjusted EPS levels which is already reflected in our existing estimates. Those estimates assume that management is successful in appointing a US distributor for its brands during FY15 and that the investment made in FY14 and the upcoming re-launches of Diva Vodka and Jago's cream liqueur will yield benefits during the current financial year.

Consequently, we leave our existing numbers for FY15 and FY16 all but unchanged. The table below shows the very minor alterations to our two forecast years which stem from updating the numbers after the publication of the FY14 results.

FY15 and FY16 estimate changes

£m unless stated	FY15E			FY16E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	1.8	1.8	0%	2.2	2.2	0%
Adj EBITDA	0.1	0.1	-1%	0.2	0.2	0%
Reported PBT	0.1	0.1	1%	0.2	0.2	1%
Fully adj PBT	0.1	0.1	1%	0.2	0.2	1%
Reported EPS (p)	0.0	0.0	1%	0.1	0.1	1%
Fully adj EPS (p)	0.0	0.0	1%	0.1	0.1	1%

Source: Company information, Progressive Equity Research estimates

Financial Summary

Year ended March £m unless stated	FY-12A	FY-13A	FY-14A	FY-15E	FY-16E
Profit & Loss					
Revenue	4.6	3.8	2.4	1.8	2.2
Adj EBITDA	-0.4	-0.3	-0.4	0.1	0.2
Adj EBIT	-0.4	-0.3	-0.4	0.1	0.2
Reported PBT	-0.5	-0.7	-0.4	0.1	0.2
PBT before exceptionals and AAG	-0.5	-0.7	-0.4	0.1	0.2
Fully adj PBT	-0.5	-0.4	-0.4	0.1	0.2
NOPAT	-0.4	-0.3	-0.4	0.1	0.2
Reported EPS (p)	-0.6	-0.4	-0.1	0.0	0.1
EPS before exceptionals and AAG (p)	-0.6	-0.4	-0.1	0.0	0.1
Fully adj EPS (p)	-0.5	-0.2	-0.1	0.0	0.1
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Cash flow & Balance sheet					
Operating cash flow	0.3	-0.7	0.1	0.0	0.1
Free Cash flow £m	0.2	-0.8	0.1	0.0	0.1
FCF per share p	0.2	-0.4	0.0	0.0	0.0
Acquisitions	0.0	0.0	-0.1	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	1.1	0.6	0.0	0.0
Net cash flow	0.2	0.3	0.5	0.0	0.1
Overdrafts / borrowings	-1.0	-0.3	0.0	0.0	0.0
Cash & equivalents	0.1	0.1	0.3	0.4	0.5
Net (Debt)/Cash	-0.9	-0.2	0.3	0.4	0.5
NAV and returns					
Net asset value	1.0	1.8	2.0	2.0	2.3
NAV/share (p)	0.0	0.0	0.0	0.0	0.0
Net Tangible Asset Value	(0.4)	0.4	0.5	0.5	0.8
NTAV/share (p)	0.0	0.0	0.0	0.0	0.0
Average equity	0.5	1.4	1.9	2.0	2.1
Post-tax ROE (%)	-104.5%	-53.6%	-20.9%	3.8%	10.6%
Metrics					
	FY-12A	FY-13A	FY-14A	FY-15E	FY-16E
Adj EBIT growth		-22.1%	14.7%	-115.6%	263.8%
Adj PBT growth		-8.4%	-10.7%	-119.3%	201.1%
Adj EPS growth		-56.6%	-49.8%	-117.5%	201.1%
Adj EBIT margins	-9.0%	-8.5%	-15.3%	3.2%	9.4%
Valuation					
	FY-12A	FY-13A	FY-14A	FY-15E	FY-16E
EV/Sales	1.0	1.2	1.9	2.5	2.0
EV/EBITDA	(11.2)	(14.4)	(12.5)	73.2	21.1
EV/NOPAT	(10.9)	(14.0)	(12.2)	78.4	21.5
PER	n.a.	n.a.	n.a.	56.7	18.8
FCF yield	21.1%	-36.3%	1.7%	1.1%	1.9%

Source: Company information, Progressive Equity Research estimates

RISKS AND CHALLENGES

As with all businesses, Distil faces risks and challenges to its growth. It is Progressive Equity Research policy to include in any large note a table of risks and challenges, and management's responses to these. In the table below, we highlight what we believe to be the main risks and allow management the opportunity to describe whatever actions are being taken to minimise or mitigate the risk.

Risks and management response

Risks	Management response
Economic downturns can result in lower customer spending	Management can react to this through its pricing policy, with the development of differentiated products encouraging consumer spending and market share gains in a falling market
Brand portfolio falls out of consumer favour	Distil undertakes regular consumer research to stay abreast of taste and drinking trends
Current lack of a US distributor limits sales potential in a major market	Management is cognisant of this and is actively seeking an appropriate distributor appointment for its brands
Drinks marketplace is very competitive, exerting pressure on margins	Management has a policy of constant price monitoring in order to react and adjust pricing where necessary
Financial uncertainty given PBT loss and transition of business model	The focus on owned brand should deliver higher margins and better quality of earnings. Cash is being managed tightly, and investments undertaken in FY14, together with re-launches of Diva and Jago's, should see benefits delivered in FY15.

Source: Progressive Equity Research

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