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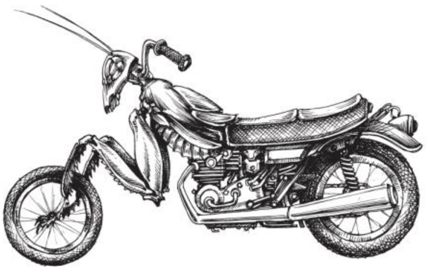


"A Royal Kegstand"
Majestic Wine plc

Those of you who have been following us know that we are not fans of stationary retail (Hi Gerry!). But there is more in this bottle than meets the eye. Majestic is best known for its just over 200 wine store outlets across the UK (we will call this part of the business "MR"). The best comp is German "Jacques' Weindepot". MR is the leading specialist wine retailer in the UK. The outlets look more like wine warehouses in non-prime locations than high-street stores. The typical customer drives to an MR outlet every three months or so and loads the back of her SUV to be well-stocked with wine for a while.
Luckily there is more to the business than this. Majestic consists of two completely different divisions.[1] Besides the retail division Majestic has „Naked Wines" („NW"). NW was acquired in 2015 for c. GBP70m. A key asset which entered the firm with that acquisition was NW founder and CEO, Rowan Gormley, who subsequently became CEO of the entire Majestic Group. NW runs an innovative direct-to-consumer wine club which is revolutionizing the classic supply chain of the global wine industry with its various intermediaries and indirect order processes. It connects consumers directly with vintners. The takeover of NW was a picture-perfect example of: "if you can't beat them - join them."

Majestic Retail

MR is active in the highly competitive wine retailing sector. The business model is under pressure from a variety of competitors. MR sells at affordable to upper middle price points. On average, customers of MR are not high-end wine experts but people who appreciate good wine and are willing to pay a reasonable price for it. Competition thus includes increasingly aggressive supermarkets and even discount retailers. If you, like we do, regularly shop at ALDI, you will have noticed that the wine aisle has been through upgrade cycles for quite a few years now and you can get much more than the good old "headache in a box". Discounters themselves are in heavy competition and are always looking for opportunities to give their outlets a more upscale experience. While the customer groups are not perfectly congruent, there is some overlap. Moreover, digitization does not spare the wine industry. The number of online wine stores has been increasing. Especially for consumers who buy wine by the case, home delivery is an attractive value proposition. While this all sounds terrible, we believe that we are still early in the cycle of creative destruction. MR is flat on revenue and according to management should generate roughly GBP20m of EBITDA in 2019.

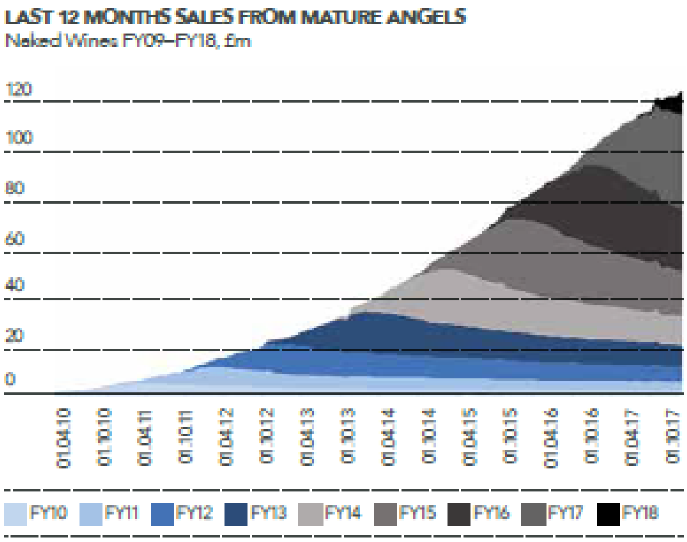
Naked Wines
NW was founded in 2008 by Rowan Gormley. Rowan is a serial entrepreneur and previously built Virgin Wines and Virgin Money. Today, NW is available in the USA, UK and Australia, while long-term the US will be the most important market due to volume and an attractive price point.

[1] There are in fact two further divisions which we will neglect in the spirit of staying concise. One of them is called „Commercial", which is wine wholesale. The other is a wine wholesale and advisory business that works with corporate customers, events and catering firms. („Lay & Wheeler"). Both divisions exhibit flat revenues, are profitable and thus support themselves.

On the website www.nakedwines.com customers can register as Angels. As an Angel you will be funding at least GBP20 monthly into your account and can use that credit to buy wines from mostly tiny vineyards across the world. The benefit of being an Angel is that you will be getting major discounts on the wines of the roundabout 120 vineyards that are on the NW platform. Some of the vineyards produce a very limited number of bottles. This model creates benefits both for consumers and producers. One of the key challenges that small vineyards face is a lack of sales visibility. A trip to one of the world's most important wine trade fairs in Duesseldorf ("ProWein") makes the problem tangible. Talk to the owner of a tiny vineyard in Uruguay and you will learn about how the guy boards a flight to Germany once a year and approaches random passer-by importers at his stand. The fair happens every year in March. The wine that is tasted at that fair has been made from grapes that were harvested many months, perhaps years ago. The vineyard thus needs to plan its capex and working capital far in advance. For us finance people this is nauseating. NW is part of the cure as its platform connects customers with producers at a much earlier stage in the production cycle. NW collects funds and orders, and is able to provide more visibility to vintners. Furthermore, winemakers receive direct customer feedback through the social networking part of the platform and are thus closer than ever to their end-markets.
The advantages for customers are obvious. By skipping the many intermediate sales-men, consumers get access to unknown, niche wines. The ability to directly interact with winemakers equips customers with the input to modestly brag and tell a story about the wine when drinking with friends. NW is thus both economically as well as psychologically elegant.

NW has only been around for just over a decade; its underlying profitability is hidden behind growth investments booked as operating expenses. This profile is common among online business models like Zalando, Takeaway.com or Hellofresh. Here, revenue growth is fueled by aggressive discounting. If you live in New York, you will regularly be bombarded with Hellofresh vouchers in your mailbox… During a conversation with Rowan Gormley you will quickly notice that he is not a fan of this shotgun approach. His market penetration approach is marked by a series of small A-B tests. He told us that on average he will be running 15-20 experiments with small investment amounts. Approaches that don't work are killed ruthlessly and those that do will be backed with more resources. This reminds us a bit of Jeff Bezos.

This style of gradual incremental marketing spending leads to growth rates of 10-15% - modestly lower than the online comps previously mentioned.[2] NW does, however, nail down the most valuable customers (with high Customer Lifetime Value "CLV") and has lower churn rates of newly acquired customers. That way, every year NW acquires new cohorts of customers with repeat sales. The following chart illustrates this:



[2] 2019 H1: 14% revenue growth at NW. By country: UK 6.9%, USA 19.3%, Australia 18.6%

In 2018, NW invested GBP14m into new customer acquisition. In 2019, this will increase to GBP20m, which temporarily depresses earnings but generates sustainable value going forward. So far, Majestic has produced the following unadjusted financial results:[3]

FYE in GBPm	Mar 15	Mar 16	Mar 17	Mar 18
Revenue				
Majestic Retail	231,4	244,0	262,2	263,8
Naked Wines	-	102,5	144,3	156,1
Commercial	42,2	45,6	46,6	43,4
Lay & Wheeler	11,8	10,7	14,7	14,5
Unallocated	(0,9)	-	-	-
Inter-Segment Revenue	-	(0,7)	(2,4)	(1,6)
Total Revenues	**284,5**	**402,1**	**465,4**	**476,1**
EBIT				
Majestic Retail	19,1	14,0	13,3	13,3
Naked Wines	-	1,0	1,4	8,7
Commercial	3,7	3,8	2,5	2,4
Lay & Wheeler	0,0	0,2	1,0	0,9
Unallocated	(1,2)	(2,3)	(4,2)	(7,2)
Total EBIT	**21,7**	**16,6**	**14,1**	**18,2**

How value is created

We can't really tell whether Majestic was smart or lucky but with the acquisition of NW. Nonetheless they acquired a digital powerhouse and dynamic management team which appreciates the dangers of traditional retailing. Rowan holds just over 6% of the company's equity, draws a sub-standard salary and regularly rejects a salary increase that the supervisory board wants to "burden" him with.

On March 25th, 2019[4] Majestic announced "strategic considerations" for MR. The board will choose between freeing up capital from the MR division or keeping it and trying to convert as many customers as possible from MR to NW, as long as MR is generating cash flow. In a conversation with Rowan, he told us that this is an unemotional decision based on NPV (especially the sale price of MR) – he is not attached to the MR outlets. If Majestic thinks they can generate more shareholder value by converting customers, then they will keep MR.

What is all this worth?

Majestic as a group is valued with an enterprise value of c. 210GBP and a market cap of GBP190m.

Management told us MR could generate about GBP20m in 2019. Looking at the M&A landscape one might put a 5-6x EBITDA multiple on the business. There is still a decent cohort of PE houses willing to take on retail businesses at that multiple. In a conservative case you could value MR at GBP80-90m. SkyNews[5]

[3] Source: S&P CapitalIQ
[4] https://otp.investis.com/clients/uk/majestic_wine/rns/regulatory-story.aspx?cid=1391&newsid=1242384
[5] https://news.sky.com/story/former-comet-owner-wants-to-toast-100m-majestic-wines-deal-11724788

recently reported that two private equity firms, OpCapita and Fortress, are interested. First rumors point to a valuation of around GBP100m.

The tricky question is valuing NW. The company was acquired in 2015 (in a much lower valuation environment) for GBP70m. Sales have more than doubled since then (at acquisition GBP80m sales) which gives us a first datapoint. In 2019, consensus estimates suggest that NW could generate GBP180m in sales and yield GBP10m EBIT. According to Majestic that includes GBP20m of growth investments. If you give their statement only 50% credit, an adjusted EBIT for NW would be GBP20m. The business thus has the potential to generate a 11% EBIT margin and is growing at 10-15% p.a. Hawesko, the owner of German Jacques' Weindepot trades on 15x 2019e EBIT. Hawesko EBIT margin is only 6% and growth rates are around 5% p.a. Though we believe NW is far more future-oriented, it does give us a further data point.

Our conservative valuation approach for the group includes the following safety margins:

- Only GBP80m valuation for MR
- We apply the same sales multiple for the valuation of NW as manifested in the 2015 takeover and ignore the fact that the business has reached critical mass with positive operating leverage
- We ignore the two other divisions „Commercial" and „Lay & Wheeler" for which one would still get paid in a trade sale (maybe GBP10-15m)

This gives us a share price of roughly GBP 3.00 versus the share price today: around GBP 2.63

Removing the safety margins gives us a share price of GBP 7.50

Why is Majestic trading so cheaply? The name of the group and its retail legacy scares off many potential investors. Furthermore, the true underlying profitability of the business is not easy to read and disguises the intrinsic value of the group. Also, the growth rates at NW are not as impressive as other e-commerce businesses. Finally, Majestic shares have also been hit with an undifferentiated broad sell-off of British small caps post-BREXIT referendum. All this contributed to the decline in the shares from their high of GBP 4.70 to their low of GBP 2.20.

Looks like we need to let this one breath a bit. Upon closer inspection, the catalysts have long legs and the bouquet hints at a robust value creation.

Cheers!

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