

Broo Bounding Into China

BY JAMES DUNN - 24/03/2017



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It has been a strange quirk in recent times, that in a nation that loves a beer, the 12th largest beer market, the stock exchange has hosted only one brewing stock – the Fremantle-based Gage Roads Brewing (GRB). Despite a profitable niche brewing beers under contract for Pinnacle Liquor Group P/L – a subsidiary of the recently re-named Endeavour Drinks Group, formerly Woolworths Liquor Group – and more recently, focusing more on its own highly awarded craft brands, Gage Roads is valued at a minuscule \$33 million.

Last October, a new brewer arrived on the market, the Victorian niche brewer Broo Limited (BEE), maker of Broo Premium Lager and Australia Draught. Broo floated with ambitious plans to be a player in the largest beer market in the world, China.

Broo raised a total of \$10.5 million through the issue of 52.5 million shares at 20 cents. It was capitalised on listing at \$121.6 million.

Despite the brewer being a loss-maker, not owning a brewery and not having yet sold a single beer in China, Broo shares frothed onto the market, up 40% on day one and more than tripling in three days, to 61 cents.

Broo stressed in its prospectus that it was a speculative investment, but there seemed no explanation for the enthusiasm for the stock. The shares have since sobered up, easing back to 32 cents, but after the hangover, it could be worth taking another look at Broo, because it is starting to walk the walk it talked about China.

This week, Broo announced a major milestone, with its Chinese partner Jinxing Beer Group, commencing the production and distribution of Broo Premium Lager in China, on the back of a deal announced in November.

The privately owned Jinxing operates 20 breweries throughout China, with an annual production capacity of 2 million tonnes of beer (equivalent to about 200 million cases) a year, and employing 6,000 people. Broo Premium Lager is the only international label in Jinxing's offering and distribution network through Henan Liquor, which spans the nation. Jinxing's distribution network is one of China's largest and, together with its 260 retail outlets, provides Broo with a huge opportunity to capture a lucrative percentage of the Chinese market.

Broo has altered Broo Premium Lager slightly for the Chinese market, cutting the alcohol-by-volume (ABV) level from 4.6% in Australia to 4%, to match Chinese consumer preferences. The packaging has also been slightly altered, but still features the Kangaroo road sign that Broo founder Kent Grogan wanted to take to the world when he launched the beer in 2009.

The China deal follows two interesting announcements on the local front, in February. First, Broo reported that it had bought the Mildura Brewery, in Victoria's Murray River tourism region, from celebrity chef Stefano de Pieri and his family, for \$1 million. Established in 2004, the Mildura Brewery has a core range of six of its own beers, a solid range of contract brewing arrangements with other small 'craft' breweries, and a popular onsite pub.

Broo said the acquisition would give it a "commercial brewery facility to immediately commence its own beer production" – hitherto, Broo's beers have been made under contract in Sydney, by contract brewer Icon Brewing – as well as provide it with "the opportunity and capacity to expand distribution of its beer products nationally".

Later in February came a much bigger announcement on the brewing front, with Broo revealing that it had bought a \$2.2 million parcel of land in the western Victorian city of Ballarat, where it planned to build its own brewery, with a planned production capability up to 480 million bottles a year – which would make it one of Australia's largest breweries.

Broo's announcement bills the proposed \$95 million plant – to be built over the next two to three years – as the "world's greenest brewery," which will "showcase the world's most advanced environmental and manufacturing technologies." It says the brewery will include a visitor centre, museum, brewing experience tour and open space entertainment zones.

Broo says the new site will include a sustainable water source, solid waste being recycled into energy production, efficient and best-practice wastewater treatment and recycling technologies, and "green, renewable" electricity sources – Broo will install on-site solar, wind turbines and bio-gas to make all

the electricity used at the brewery 100 per cent renewable, greenhouse-gas-free and carbon-neutral.

You can take the gushing “greenness” of the proposed brewery as a sign of the times – a company is hardly going to announce that its major new facility will be a carbon dioxide-pumping monstrosity – but amid the Green hype, there are some concrete aspects to this announcement that will please Broo shareholders.

The first – and by far the most important – is that the plan envisages a serious brewing facility, that would at a stroke give Broo substantial capacity to produce its own beers and other beverage products, as well as the capacity to provide contracted brewing services for third party beer labels. Broo would be able to supply its national – and international – distribution requirements.

The second is that by using water efficiency measures, Broo is aiming to drastically reduce the current ratio of needing five litres of water to make one litre of beer, which the brewer says will save 300 million litres of water a year. Anything that lowers the costs of operation will please shareholders.

Broo has engaged German firm Krones, a global leader in brewery design and fabrication, to plan and pre-engineer the plant on the proposed Ballarat site. As well, it has given three globally recognised architectural firms commissions to put together a master plan and concept design of an integrated brewing complex, hospitality and tourism venue, in a world-class facility. After receiving these proposals, scheduled for the first half of the year, Broo will evaluate them and choose the winning firm to complete the design.

However, all that shareholders could read in the announcement of how the brewery might be paid for is that “the company will be exploring a range of funding opportunities for the development of the brewery.”

It’s a big plan, and how it will be funded is obviously critically important.

Broo is still a loss-maker. For the half-year ended December 2016, the company sold \$362,359 worth of packaged beer, up 48%, but it reported a loss of \$1.47 million, an improvement on the \$1.78 million in the December 2015 half. On a per-share basis, the loss improved from 1.71 cents to 0.25 cents.

Broo said in its prospectus that it was a speculative investment, and it still is. The company expects significant increase in cash flows to come from China: that is the company maker. It is very early days, but Broo has achieved a substantial deal with a highly credible local partner. Any investor buying now would be banking on cash flow from China starting to flow over the next couple of years, and progress on funding plans for the ambitious brewery. Broo might have raised the capital for its float from its own customer base, but the Ballarat brewery will need a lot more than that. Success in China will be critical in convincing potential funding sources, both debt and equity, to back Broo.

Broo founder Kent Grogan has achieved a lot since establishing his two brands, with the Jinxing deal being the high point so far. Now he has to parlay that deal into a credible cash flow that starts to show Broo shareholders a clear path to profitability; while at the same time advancing the Ballarat plans. (Grogan owns 68% of the stock, and non-executive director Geoff de Graaf owns 8%, but these shareholdings are locked up in escrow until October 2018.)

Broo is a highly speculative stock, but it has significant upside potential in the Chinese market, if consumers go for the Kangaroo-adorned beer.

The upside is massive. How big is the opportunity? Well, China consumes more beer than any other country, in the world and Jinxing produces more beer than the entire Australian market. Don't look for earnings forecasts or analysts' consensus price targets – there are none. In the meantime, crack one of the company's beers to salute an Australian business having a go, and so far, achieving what it said it would do.

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