

Fever-Tree Drinks

Value Investing Analysis

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www.hpvalueinvesting.com

About the Company

Fever-Tree Drinks is a UK based producer of premium mixers (non-alcoholic beverages).

The company was founded in 2003 in the UK, and was listed on the London Stock Exchange in 2014.

In 2019 they sold over 441 million bottles, and 127 million cans, in over 75 countries worldwide.

An example of Fever-Tree's products



Source: *Fever-Tree 2018 annual report*

The company is known for its high quality products, and its strong brand name. They are the global market leader in the premium mixer category, with an estimated 40% market share in its home region - the UK.

According to the [Drinks International annual brands report 2020](#) (page 46) Fever-Tree dominates the premium mixer category, with nearly half of the participating bars saying it is the number one tonic brand in sales.

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Industry Dynamics

The premium mixer category is a relatively small one, but has high potential for future growth.

As a result of their success, the Fever-Tree's revenue has increased tremendously over the last few years, and they have delivered impressive financials, including high operating margins and high returns on equity.

Key Financials

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Revenue	£59m	£102m	£170m	£237m	£261m
Operating margin	29.1%	33.6%	33.1%	31.7%	27.7%
Return on equity (ROE)	22.5%	35.6%	41.6%	39.4%	28.6%
Book value per share	£0.56	£0.77	£1.12	£1.58	£1.93
Debt/total assets	7.1%	5.2%	3.5%	2.7%	0.0%
Cash & ST investments/total assets	20.7%	27.9%	33.2%	39.8%	49.3%

Source: Morningstar.com, Fever-Tree annual reports

However, there have been some worries recently that the UK market is maturing, and that the growing popularity of the gin & tonic drink is slowing down (a trend that Fever-Tree has been riding).

As a result, the share price has decreased considerably over the last 18 months:

Five Year Share Price



Source: [Googlefinance.com](https://www.google.com/finance)

We believe the risk of a maturing UK market is somewhat overblown; consumer confidence has been weak (-1% decline in Fever-Tree's UK revenue in 2019), but we believe that should be temporary.

Moreover, if the growth in the gin & tonic trend is slowing down, Fever-Tree is in a good place as they have established a solid position in the gin category, which is now worth £2.5bn, and is firmly established as the second biggest spirits category in the UK.

The company will still be able to earn high returns on equity and generate strong free cash flows, even if growth is slowing.

And to mitigate the risk, we have included slower growth scenarios in our valuation models.

On a positive note, the growth in all the other geographies was very strong in 2019:

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Revenue by Region			
	Revenue FY2019	Revenue FY2018	% change
	£m	£m	
United Kingdom	132.7	134.1	-1.1%
United States of America	47.6	35.8	+33.0%
Europe	64.4	55.5	+16.0%
Rest of the World	15.8	12.0	+31.7%
Total	260.5	237.4	+9.7%

Source: Fever-Tree preliminary results 2019

And Fever-Tree is also focusing on other categories, such as whisky, rum, vodka and tequila. These spirits are seeing good growth at the premium end, and Fever-Tree's mixers and sodas are placed to take advantage of these trends.

The Management Team

The company is still led by its two founders - Charles Rolls (who is retiring this year, after 17 years with the company), and Tim Warrillow (CEO).

They are the second and third largest shareholders, suggesting their interests are aligned with those of the other shareholders.

They have proven themselves to be very capable managers, not only building a very successful business, but also pioneering the premium mixer category - taking it mainstream.

The Financials

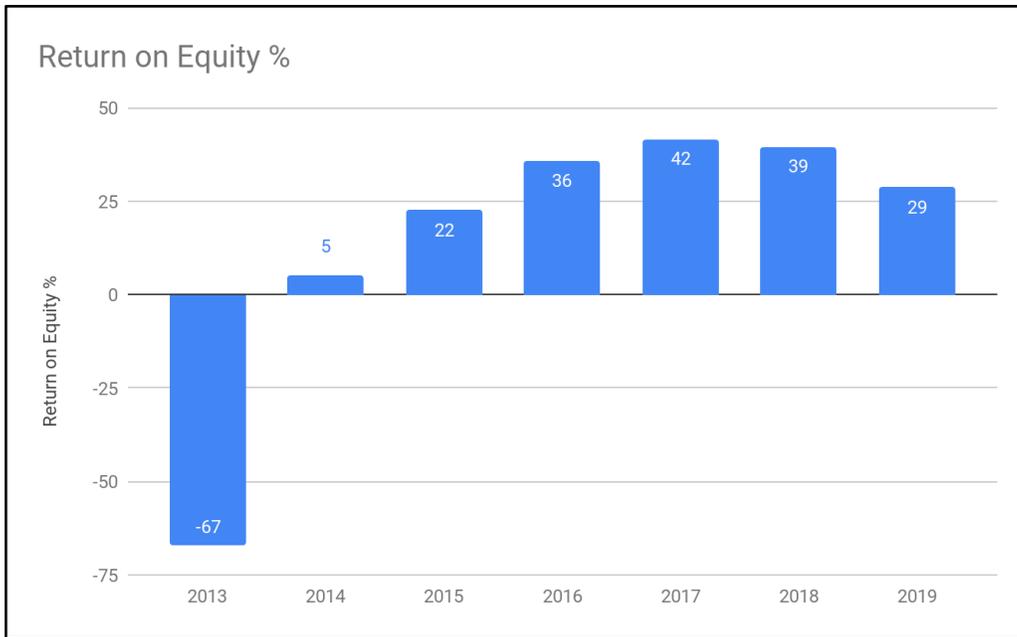
Fever-Tree's financials are excellent; their margins and return on equity are high, and the business requires little capital expenditures to run, which translates into strong cash generation.

They have no debt, and a £128m cash position.

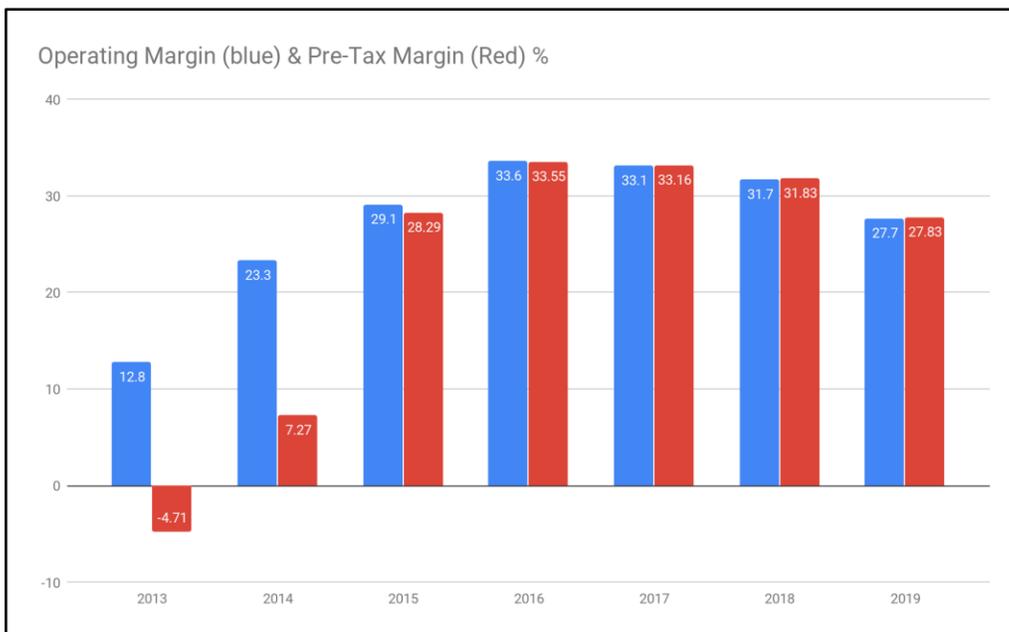
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Source: Morningstar.com

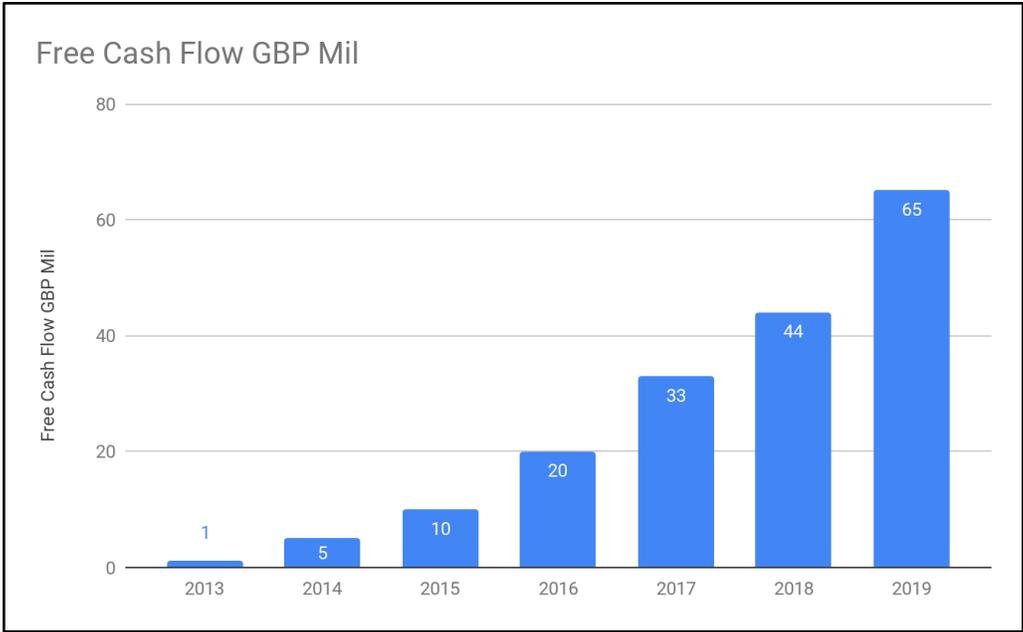


Source: Morningstar.com

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Conclusion

In March 2020 we carried out several discounted cash flow analyses of the company, using different free cash flow numbers, and growth projections, and concluded that the share price of £9.00 at the time, was undervalued.

We believe the company will generate strong and growing cash flows in the future, continuing to deliver value to shareholders.

Consequently, we allocated 3% of our model portfolio (and a sizable amount of our real portfolio) to Fever-Tree at £9.00.