

Black Sheep Brewery PLC

Review of 2019 AGM

Dear Fellow Shareholder.

The Meeting

Thursday 19th September. We arrived in Masham on a truly glorious, sunny, early Autumnal day, with the town looking its prettiest best.

This year, the Black Sheep Brewery (“Company”) AGM had returned to its former home at the Town Hall, and such was the queue to be carefully vetted as a shareholder, have one’s hand ink-stamped, and enter the upstairs hall, that the meeting didn’t start till 2.15 p.m.

The hall was packed with the faithful and thirsty, and without any accurate way of measuring, I would hazard there were at least two hundred (200) shareholders in attendance.

The Presentations

Our chairman, Andy Slee (“Andy”), kicked off, followed by a stressed-out looking Rob Theakston (“Rob”). Sadly, both their presentations were amateurish.

Andy once again misleadingly referred to Black Sheep’s second year of “profitability”, avoided giving much information unless directly asked, showed a now two year old chart purporting to demonstrate Black Sheep products popularity (in which case, why aren’t we selling more beer?), moaned about UK Beer Duty (isn’t it funny how non-performers always find someone/thing else to blame?) and asked us to lobby for its reduction, unconvincingly brushed aside the mess they’ve made of the York Brewery, or rather “non-brewery” acquisition, and again reiterated how much there is still left to do. Too right.

He said they would like to invest more heavily in marketing if only they had the available funds, suggesting that he and the Board still don’t get it, that the current level of leverage is irresponsible, unsustainable and leaves Management literally trying to manage our business with one if not two hands tied behind their backs.

Rob then read out his address in leaden fashion, with neither flair, nor conviction. Lots of earnest, now annually repeated words, about the focus on Yorkshire because it has a population the size of Norway or Denmark, seriously!., and that exports last year increased by 22% and to 20 countries, which sounded good till you realise that increase was from the previous year’s export revenues base of circa £300,000, so the actual increase in export sales was just £66,000! Just who do they think they’re kidding?

Both Andy and Rob spoke of much work still to be done, and their hope for the future, but gave no sense at all that they have any confidence in the future for the UK brewing industry or indeed in their own or Black Sheep's ability to deliver.

We were left with the distinct impression that they'll be asking for yet more time for the Board's "journey" in two years' time. How long oh Lord, how long?

The stand-out presenter was Jo Theakston ("Jo"), who now freed of the onerous responsibility for sales, and in charge of innovation, spoke with fluency and conviction, even if the message was not so much about beer, but the new Black Sheep gin, I kid you not!, and one or more low and/or zero alcohol products under development, but still a year away from being available to market.

Simon Adams, the new CFO, a new and seemingly sane voice, presented some interesting, detailed numbers, but since they were not available in printed form to take away and study, it's difficult to comment on them.

In all cases, the accompanying slides were dark, indistinct and amateurishly produced, which for a business focussed on professionally exploiting brands was just sad.

The non-executive board

After the AGM, while I was introducing myself to Simon Adams, I offered my hand to Paul Nolan, but he was extremely rude to me. A chippy and embarrassing little man, he is an appalling ambassador for Black Sheep, and we should all do our best to vote him off the Board as soon as possible.

Charlene Lyons on the other hand, who I chatted to back at the Brewery afterwards, was charm itself, and spoke intelligently and with conviction about her increasing workload at Masham. She is an impressive and valuable addition to the Black Sheep team.

A new product - Gin

As a part of Management's headlong rush to obscure their failure by trying to reinvent our Company (retail, third-party packaging, gin, etc.) instead of focussing on professionally developing and exploiting our excellent beer brands, Jo announced Black Sheep's new gin offering, so help us. At a recommended retail price (RRP) of £39.95 a bottle, you can just imagine Black Sheep's sales team being killed in the rush!

I tasted the product after the AGM and to be fair it tasted good, though it was worrying that an expensive juniper based gin needed extra juniper berries to be added in my glass.

However, there was no information on who's distilling for Black Sheep, or any sense of projected volumes, and we all know that craft gin in the UK is a sensationally competitive market, with over 200 brands now available.

The key messages

The four key messages I took from the AGM covered (a) the Board's loss of faith in the UK brewing industry, (b) projected future profitability, (c) new share issuance, and (d) the new packaging plant.

Future profitability

Against the Board and Executive Management's generally gloomy outlook for either the UK beer industry, or the prospect of generating meaningful profits from brewing, Andy promised, without any supporting evidence (i.e. no rainfall of projected sources), that Black Sheep will generate EBITDA of £1.75 million in next year's financial period to end March 2021, and pay an ordinary dividend. Wow!

Since last year's EBITDA was circa £906,000, he is effectively promising our Company will increase annualised EBITDA by a cool 93% over the next eighteen months.

Really? With no prospect of much additional EBITDA coming from either brewing or the existing, newly acquired retail estate, Andy must be basing his forecast either on savings and additional third-party packaging income to be generated by the new packaging plant, which by his own admission won't be operational till half way through the next financial year, or perhaps from a mentioned but yet to be acquired new chain of pubs? He didn't say, and while *I will be delighted to be proved wrong, his promise sounded like it was in "I'll eat my hat" territory!*

Dividends

And as Andy has promised to pay shareholders a dividend for the year ended March 2021, I assume that he or our new CFO have cleared that with the Company's lenders, who may rather prefer to see our over-indebtedness reduced instead.

Frankly, at what will, even if achieved, still be a very early stage in the Company's recovery trajectory, planning to pay away cash as dividends in late 2021, when those moneys should be being reinvested in the business, will be bonkers, nothing more than a naked bribe to shareholders, and a reflection of *our current Board's complete misapprehension of how to build a sustainable business for the long-term.*

Share issuance

The Board have finally, and successfully, but notably *without prior reference to us the shareholders* (and passing a resolution a year ago doesn't count as consulting shareholders), placed 315,000 new Black Sheep Ordinary shares, increasing the total number of Ordinary shares currently in issue by 14.88% to 2,432,172.

The new shares were placed at £2 each, a pleasing premium to the then prevailing indicative offer price on the Asset Match web-site of £1.40 per share, raising a gross figure for the Company of £630,000 before costs. As I envisage the cost of raising these funds is unlikely to have been less than 5% or £31,500, probably more, Black Sheep should be better off to the tune of a little less than £600,000 net.

The two subscribing shareholders

Of the 315,000 new Black Sheep shares subscribed for last week, 177,500 were purchased by Mark Horrocks, an experienced professional investor and founder of Intrinsic Capital, a regulated wealth management firm, who now owns 7.3% of Black Sheep's enlarged issued equity capital.

The balance of 137,500 shares were purchased by CAMRA (The Campaign for Real Ale), a long-standing and supportive shareholder in Black Sheep, who now own a total of 331,887 Ordinary shares or 13.65% of Black Sheep's enlarged issued equity capital.

Further share issuance

The Board received approval at last week's AGM to issue a further 705,000 new shares, and undertook to first offer them to shareholders, but only pro-rata to their existing interests in the Company.

Since many existing shareholders will probably not avail themselves of this opportunity, I suspect the Board, or rather Mark Brady of SPARK Advisory Partners, are looking for a friendly new shareholder who will buy the bulk of the new shares and promise to invest for the long-term and support the existing Executive Management team.

The extraordinary length of time (nearly a year) it's taken to find Mr. Horrocks and persuade him and CAMRA to invest in Black Sheep, is indicative of the difficulties of finding support for the in situ Board and Management team.

It is also not clear whether Black Sheep will be required to go to the expense of issuing a prospectus in order to be able to offer shares to existing shareholders, many if not most of whom will be categorised by the FCA as unsophisticated investors.

Pricing the rights issue shares

Because there is only a very illiquid, and therefore notional and unrepresentative share price provided by Asset Match in Black Sheep's shares, it is difficult to forecast at what price the forthcoming rights issue will be priced.

However, I suspect the Board will find itself between a rock and a hard place, as if the offer price is less than £2 per share, CAMRA and Mr. Horrocks will not be happy campers, while if the offer price is above £2 per share, many shareholders, including me, will likely be upset they were not given the opportunity to invest at the same time and price as CAMRA and Mr. Horrocks the week before last!

Proceeds of the forthcoming Rights Issue

If I'm right and the further 705,000 new shares are offered at £2 per share, the Company will probably raise a further about £1.32 million after expenses.

Added to the probably short £600,000 just raised, Black Sheep will then have issued 1,020,000 new shares (in my letter of 1st September this year I forecast the Board might issue "between 975,000 and say 1.4 million new shares"), increasing the issued equity capital by 32.5% (not the maximum of 30% promised by Andy), and have raised a total of circa £1.9 million of new moneys for the Company, and increased the number of Ordinary shares in issue to 3,137,172.

While £1.9 million sounds like a lot of money, for a heavily indebted and unprofitable company, starved of funds to invest in broader distribution, brand development, marketing, retail-estate growth, and debt reduction, it barely touches the surface and is not nearly sufficient, even more so when Andy and the Board are promising to pay away a dividend in 2021.

The new Packaging Plant

In December last year (2018) Andy promised "with work due to start early in 2019", that "by early 2020, we will have the capability to bottle, can, standard keg, mini-keg and one trip export keg for our burgeoning range as well as generating income from third parties."

But at the AGM, Andy reneged and was now promising the new packaging project will only be complete within 12 months, which would be by mid-September 2020, so halfway through next years' financial period!

In sum, this is not a man who is either careful with his promises or delivers when or what he says he will.

He has of course found the excuse that Management were distracted by the York non-Brewery acquisition and that they were waiting for grant moneys to be awarded.

Well the promised grant has been received, a measly £90,000, which was hardly a reason to delay for a year the development of a project stated to be worth hundreds of thousand pounds of annual savings.

I conjecture that the truth for the packaging plant delay is very different.

Last year, in relation to the packaging project, Andy referred to "a credit backed offer from RBS", being "a significant vote of confidence from a high street bank". This was confirmed in his flyleaf letter accompanying the latest, 2019, Report & Accounts, when Andy wrote that funding for the new packaging project had been secured with Royal Bank of Scotland plc.

However, at the AGM, it was suddenly Lombard, the asset finance company affiliated to NatWest, which is an RBS subsidiary, that appears to be lending the money.

In other words, RBS got cold feet because of our Company's overall indebtedness, lack of true profitability, non-availability of asset security, and Andy's failure to deliver on his promises, and clearly decided to link any advance of funding to receipt of funds from last week's equity issue.

Voting at last week's AGM

At the AGM, it was notable that though technically within their rights as per Section 61 of the Company's Articles of Association, where it states that "At any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands *unless* (*before* or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) a poll is demanded by the chairman of the meeting, etc.", it was very odd that for the first time ever after twenty seven years, no voting took place by show of hands.

The reason was evident: The Board were simply afraid of being embarrassed by too many votes against being seen in public at the AGM meeting.

This was evidenced after the poll votes had been counted, recorded and published, when Special Resolution No. 14, which was a disgrace (see below), was shown to have attracted the highest number of votes against ever recorded (11.21%) for any resolution put to a Black Sheep AGM.

Special Resolution No. 14

By Special Resolution No. 14, our Board received your approval to be able to buy-in up to 211,717 Ordinary shares. However, Special Resolution No. 14 did not state whether such shares, if bought-in, would be taken into (held in) Treasury (i.e. the shares would remain in issue and be owned by the Company), or be cancelled (which if effected would mean the assets of the Company would be owned by the smaller number of shares remaining in issue, which could, depending on the price paid to buy-in the shares, have a positive or negative effect on the per share net asset value of the remaining shares in issue). A pretty important omission.

Andy claimed this resolution was merely to grant the Board "flexibility", when it was almost certainly inserted to be used to increase Board control of the shareholder register.

The suggestion that the Board should even contemplate wasting our Company's cash buying-in shares, when Black Sheep is so irresponsibly over-leveraged and starved of funds for investment, whether into capex, packaging, retail or brand development and marketing is truly shocking, and I said so out loud at the AGM.

Conclusion

Finally, while on the train from Kings Cross to Northallerton on my way to Masham last week, I received, unprompted and out of the blue, a sad and alarming e-mail, reporting significant unhappiness amongst some Black Sheep staff about the way the Company is so evidently run for the protection and benefit of Rob and Jo.

That e-mail went on to say, that several members of staff wished to vote against Rob and Jo's reappointment as directors, and certain other resolutions, but were afraid to do so, because they believed their ballot papers had been marked or numbered in such a way, they could be identified and might lose their jobs! *That information received is a far more stunning indictment of what's wrong with our Company than almost anything I can say.*

So sadly, the conclusion we must draw is that Andy is not a man whose word can be relied on, and his appointment as chairman is primarily to ensure that Black Sheep remains a Theakston Family benefit business.

I fear, it is most probable that no real progress will be made till we've had a complete clear out of most of the current Board and Management.

I will continue to keep you posted on developments at Black Sheep and the conclusions to be drawn, so please continue to keep an eye on www.buildingabetterblacksheep.com, and of course, please keep drinking our Black Sheep Brewery's excellent beers. Thank you.

With best wishes from,

A handwritten signature in black ink, appearing to read 'David Nabarro', with a stylized flourish at the end.

David Nabarro
Executive Director of MathEngine PLC and
a continually deeply concerned Black Sheep shareholder