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2<sup>nd</sup> October 2018

Dear Fellow Black Sheep shareholder and other interested parties,

**Re. The Black Sheep Brewery PLC (“Company”)**

As I’d promised, I attended last week’s (Thursday 27<sup>th</sup> September) Black Sheep AGM in Masham (“AGM” or “Meeting”) to hear at first-hand the Board’s proposals for the further development of our Company, and now, particularly for those of you who were unable to attend, I provide commentary on what I learned there as follows:

**The AGM**

The AGM was well-attended, though because it was held at our Company’s Distribution Centre on Fearby Road, Masham (“Fearby Road Centre”), in a differently configured room to last year’s Masham Town Hall meeting, it was difficult to tell whether attendance was up or down. I would have guessed it was slightly down, but do not know for sure.

Also, though Black Sheep’s corporate adviser, the respected Mark Brady of SPARK Advisory Partners, was in attendance, I was not aware of any representation from Asset Match, Black Sheep’s market-maker. Certainly, nobody from Asset Match spoke at the Meeting, but again I cannot be sure whether they were or were not in attendance.

Because I did not want to create further tension at the Meeting, I did not speak or ask any questions and simply listened respectfully to the Board’s presentations and made careful notes.

All of the twelve (12) resolutions were majority approved on a show of hands, though with some dissenters and in the cases of the *in my view* malign resolutions 11 and 12, our Chairman, Andy Slee (“Andy”) apologised they’d not been properly explained and promised the rights conferred would only be used in exceptional circumstances. We shall see.

## The Good

Andy referred to Black Sheep returning to banking with a local High Street lender. He did not mention Lloyds Bank by name, but given Black Sheep's two year's long relationship with Lloyds' Thirsk branch, *I am assuming* that is what he meant.

I hope that is reassuring news, Black Sheep having also recently banked with HSBC in Ripon and Close Brothers.

Andy further announced the planned installation of a new, two million pounds (£2,000,000) bottling plant ("Bottling Plant") to be built adjacent to our Company's Fearby Road Centre. This will once complete he claimed, in according to Rob Theakston, our Managing Director ("Rob") projected twelve (12) months' time-frame, contribute an additional four hundred thousand pounds (£400,000) of costs savings in Year 1 when compared to Black Sheep's current, costly off-site bottling arrangements.

Andy also announced that Black Sheep has registered a new company named "Black Sheep Brewery Retail", with the intention of acquiring a group of pubs as the basis of an estate. He claimed that Management have identified nine-hundred (900) potential sites and are holding "substantive conversations", but quite rightly assured us he would not be rushed in his and the Board's determination to acquire well-sited and profitable outlets. Quite right too.

Inter alia, Andy also promised (i) a re-vamped "Investor Section" on the Black Sheep web-site, though at the time of writing this letter nothing has yet appeared, (ii) to deliver an extended investors' update in November, (iii) the creation of a "Risk Committee" and (iv) better shareholder communication. All welcome and timely initiatives. Doubtless Andy and the Board would/will claim that all of these very necessary changes were well advanced before my intervention! Shareholders will draw their own conclusions.

Rob informed us that sales of Black Sheep's beers are currently split 60% / 40% between the "On Trade" i.e. pubs and the "Off Trade" i.e. take-home sales from supermarkets etc.. This compares to the industry as a whole, where the "Off Trade" accounts for 50%+ of market share.

He also pointed out that one per cent (1%) of the Yorkshire lager market equivalent to twenty-six and a half thousand (26,500) barrels against the one thousand (v. 1,000) barrels of lager Black Sheep sold last year, so it sounds as if there is all to play for.

And Rob also announced the possibility of Black Sheep taking on contract brewing work to provide an additional income stream. Why that was not done long ago I cannot understand, but it also sounds like good news.

And in financial terms, Andy made three exciting promises that:

Black Sheep will achieve sustainable annual operating profits of one and three quarter million pounds (£1,750,000 p.a.) by its 2020 / 2021 financial year i.e. three (3) years from now;

Black Sheep would achieve a twenty per cent per annum (20% p.a.) compound growth in profits over the same period; and that

Black Sheep would once more return to the dividend paying ranks in respect of its 2020 / 2021 financial year.

If achieved, these compelling numbers will be excellent news for Shareholders, so we must all monitor our Company's progress carefully.

### **The Disappointing**

In announcing the planned installation of the Bottling Plant, Andy flashed before us a screen-projection of its proposed floor-plan, but disappointingly there was no scale model for Shareholders to look at more closely, and vitally, there was no discussion of how Management had arrived at such a round £2 million overall number, either in terms of the possibility of sourcing high quality second hand plant (traditionally a Black Sheep speciality) or holding a competitive tender for delivery, construction and completion.

Andy warned that it was still "Tough out there" and while Robert and Jo Theakston, talked a good game, stressing Black Sheep's "Quality", "Authenticity" and "Branding", their "Targeting younger drinkers", "Premiumisation", "Innovation" and "Developing within the growth sectors of the Market", there was no suggestion that our Company's beer volumes are increasing, but rather that Management had just "held volume for three (3) years".

Rob also said that developing our Company's "brewing reputation" takes time. Indeed, but no one from the floor cared to ask whether twenty-six years should surely have been long enough to do that!

Rob displayed a map of the world and spoke about exporting to twenty-one (21) countries, but both Paul Theakston ("Paul") and Andy confirmed to me afterwards at the Visitor Centre that export sales represent no more than three per cent (<3%) of Black Sheep's revenues.

There was much talk about Black Sheep being an iconic, independent Yorkshire brand and management's continuing focus on "owning Yorkshire", it having a population of five million, three-hundred thousand (5.3 million) people, larger than either Norway or New Zealand, but *I had the feeling* that Management was simply displaying the limited horizons of their ambition.

Worryingly, Black Sheep's executive management has no known track record of running a chain of pubs, and while Andy evidently does, his role at Black Sheep is only non-executive and he has other external responsibilities on his plate.

### **The Bad**

But the really concerning matters are as follows:

Andy announced that the new Bottling Plant will be entirely debt financed!

With (i) Black Sheep's existing over-extended level of debt, which was not mentioned once at the Meeting and increased by 27.6% last year, (ii) no suggestion that revenues (beer sales) are on the increase in any meaningful way, (iii) no suggestion that our Company would achieve any more than break-even in the current year and (iv) the prospect of continuing gentle rises in UK interest rates, this *sounds to me* like betting the farm.

Put another way, Andy and the Board are proposing to take on an additional £2,000,000 of debt over the next twelve months, increasing our Company's overall debt by it looks like circa fifty-five per cent (+c.55%), with no certainty the project will be delivered on time or that it will work at full operational capacity from Day 1. A big bet financed entirely by debt!

I can only say I regard this form of speculative financing to be somewhere between fiscally irresponsible and financially illiterate and am shocked that our Company's bankers are allowing it.

Next Andy announced that Black Sheep will be making a "rights issue" to raise new equity, not to rebalance Black Sheep's stretched balance sheet, but to part-fund the proposed acquisition of some pubs, i.e. our Board apparently proposes as a part of purchasing some pubs, to load up our Company with even more debt on top of that for the Bottling Plant!

When, at the Meeting, a shareholder asked how much the Board intended to raise by way of the rights issue, he was told it would depend on the cost of the pubs proposed to be acquired.

In other words, the Board made no suggestion that any new equity raised would be directed towards achieving growth by either increasing brewing capacity or re-branding.

Shockingly, at the Meeting, Andy made no mention of quantum, timing or price of the proposed rights issue and in my conversation with Paul Nolan afterwards at the Visitors' Centre, it was clear that no pricing terms have yet been agreed nor moneys raised.

In other words, a Black Sheep shareholder considering either buying or selling shares at the next Asset Match auction, scheduled for Wednesday 10<sup>th</sup> October 2018, would be dealing blind, with no idea of whether the forthcoming rights issue will be priced at a premium or discount to the current indicative price. **This sort of corporate negligence is almost beyond belief in 2018** and *I'm very surprised* that the FCA regulated Asset Match are allowing the announced auction to proceed before full details of the proposed rights issue have been announced.

And finally, when Paul, addressed the Meeting, kindly stating that he no longer "either trusted or respected me", he finally admitted to the Meeting what I'd suspected all along, that there was indeed an "approach" from Marston's but the Board took it upon themselves to reject it, because they believed it undervalued our Company.

In my meeting with Andy and Paul Nolan on 28<sup>th</sup> August and in subsequent conversation with Andy, they went to great lengths to stress to me that there had never been a bid and of course that's technically correct, but only because Paul and his then board must have made it clear to Marston's that they were not minded to accept one. Given the subsequent poor performance of our Company's indicative share price, now, nearly two years later, trading at fifty-three-point-seven per cent below (-53.7%) the indicative "approach" price of four pounds (£4) per share, **I continue to believe this was a disgraceful betrayal of Shareholders' best interests.**

As stated before, I will work hard to seek to deliver radical change for the benefit of all of Black Sheep's stakeholders, and promise to continue keeping you posted at [www.buiildingabetterblacksheep.com](http://www.buiildingabetterblacksheep.com), so please keep checking our web-site.

Yours sincerely,

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

David Nabarro

Deeply concerned Black Sheep Shareholder