

KALASHNIKOV VODKA

A look at The Kalashnikov Joint Stock Vodka Company (1947) plc

What product or service do you offer

The Kalashnikov Joint Stock Vodka Company (1947) plc owns two vodka brands,

(1) 'Kalashnikov' and 'AK47'. The former is distilled in Russia, imported into the UK in bulk, and bottled under contract. It is distilled to a strength 1% above the standard 40% alcohol by volume (ABV), and is positioned as a Premium Brand.

(2) 'AK47' is distilled in the UK, to 37.5% ABV, and competes in the Standard Vodka market.

(3) A third brand, 'Gun Metal', is being developed – initially for the American market, to compete at the top end of the Super Premium segment (which started to develop in the late nineties, led by Absolut), and potentially in the Ultra Premium Segment.

Both the Kalashnikov and AK47 (Automatic Kalashnikov 1947) names refer to the Russian WW2 veteran, and then distinguished engineer, General Mikhail T. Kalashnikov, who designed the eponymous weapon, and the product has;

- A strong internationally recognised Russian brand name, licensed from and supported by General Mikhail T. Kalashnikov, one of the few living national heroes of Russia.

- An ideal brand for both, the traditional markets of the USA, developed Europe and Australasia and the

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Emerging Markets, in particular for "New Europe" and Africa where international drinks companies are looking to penetrate.

- The vodka has consistently been acknowledged as appealing by consumers and won Silver & Bronze Medals at the International Wine & Spirits Exhibition in 2005 & 2007 in London.

- The product design has also been acknowledged as appealing by consumers and won a 'Shine' design award in 2005 in London.

- The Company has obtained and registered the trademark for 'Kalashnikov' and 'AK47' in 67 countries

- The company believes that the wide international recognition and obvious close association with Russia (one of the sources of perceived "real" vodka) of the brand names provide an outstanding global marketing opportunity. The General is Honorary Chairman of the company.

Some information about our market:

- Global vodka sales amount to over 388 million cases annually and account for 25% of all spirit drinks consumed. It is the fastest growing international spirit sector

- The Premium & Super Premium vodka sectors in USA comprises 11 million of the 34 million annual US vodka case sales. "In volume terms the real growth is undoubtedly occurring within the imported vodka segment ...in brands from Scandinavia and Eastern Europe" states Brown-Forman Global Creative Director Jennie Meador in The Spirit Business May 08.

- "The US premium vodka market has grown by at least 20% in each of the past five years ... There is plenty of vodka-fuelled activity to come" as stated in The Financial Times, Lex Column, 13th Feb '08' commenting on purchase of 50% Ketel One by Diageo for US\$900m instead of Absolut due to it having more growth potential

Who is the management? (Describe background of CEO, CFO, COO to underline competence)

General Mikhail T. Kalashnikov, Honorary Chairman
General Kalashnikov (aged 87) entered the Red Army in 1938 and served as a tank commander in the Second World War, until wounded in October 1941. He became a weapons designer and developed a number of rifle and submachine gun models. In 1947 he created the "7.62 Avtomat systemy Kalashnikova obrazetz 1947 goda", known to the world as the AK-47. For this he was awarded the Stalin Prize, First Class, and in 1958 was made a National Hero of Socialist Labour. He later developed the AK-74 assault rifle, in 1974, for which, in 1976, he was awarded a Gold Star of the Hammer and Sickle and the Order of Lenin.

John Florey – Managing Director

John Florey founded the company, in collaboration with General Kalashnikov, in 2003. His academic qualifications include degrees in Law from London University and in Land Economy from Cambridge, and an MBA from Tanaka Business School at Imperial College.

Developing new and varied ventures around the world has been his speciality. He first worked as a property planning consultant in the UK (1990-92), before moving to Southeast Asia as a corporate strategist (1993-95). In 1996 he returned to London, where he established a property management business and took over the running of London Educational Services, a body concerned with the promotion of British higher education around the world. Then in 1999 he set up The London & Oriental Trading Company, which traded commodities, foodstuffs and consumer goods internationally. At the same time he acted as an international financial and business development consultant, arranging loans and insurance and mediating between global businesses. From 1999 till 2003 he was also chess grand master Garry Kasparov's London representative in brand licensing. He is a founder and non-executive director of the British Russian Institute of Management and an Honorary Professor at the Moscow Business School.

David Bromige – Branding and Creative Director

What David Bromige, mainly brings to the party is his experience in the development of premium spirits brands. In 1999 he designed and created Polstar vodka and its flavoured derivative brands for the style bar market. The product has subsequently been sold to the William Grant company. He is also a director of the Reformed Spirits Company, which was formed in 1999 and makes Martin Miller's Gin and other spirit brand and Kindred Spirits a USA Spirit Importer. This product, distilled in England and then sent to Iceland for blending with spring water, is positioned as a top premium brand, and is exported to Australia, Ireland, Russia and the US. Mr Bromige is a co-founder of The Drinks Consultancy, which was also set up in 1999, and provides an advisory service to both drinks manufacturers and the licensed trade.

Michael Davenhill – Finance Director

Michael Davenhill and has extensive experience in finance in a wide range of industries. He was for seven years with Unilever and then for ten years was a financial controller at Schlumberger, the Texas-based international oilfield services provider. He has also been Finance Director at the advertising agencies, J. Walter Thompson and D'Arcy Masius Benton & Bowles, and at the artwork publishers, Marshall Cavendish. He has a degree in mathematics and is a Fellow of the Association of Chartered Certified Accountants.

Jonathan Allen has recently joined the Board as a Non Executive Director, bringing with him experience of working in international markets as an investment banker and has advised a number of foreign companies on the regulatory requirements in respect of seeking admission

to the AIM Market.

His family owned the Tomatin Distillery in Scotland until it was purchased by Japanese shareholders in 1986.

He served in the Armed Forces (Scots Guards) from 1964 to 1978, being awarded an MBE in 1974, when he was involved in intelligence in Northern Ireland and was awarded the Queen's Jubilee Medal in 1977.

Who is supporting the project? (strategic partners; key suppliers; key clients)

To this end the company is the first spirits company to have reached an extremely significant agreement with the National Rifle Association of America (NRA), which has 4 million members, in January 2008. General Kalashnikov is a Life Member of the NRA, and the latter has agreed to support the brand by carrying advertisements in its monthly magazine, which has 1.3 million subscribers, consisting of a letter from the General, with an attached "Request Purchase Coupon" which readers can use to order the brand from their local liquor store. The advertising will be along the lines that the man who created the best rifle in the world has now created the best vodka in the world. Kalashnikov Vodka is currently stocked by Distributors in; California, Colorado, Arizona, Texas, Tennessee, Florida, Louisiana, Georgia, South Carolina, North Carolina, Maryland, Oklahoma, Missouri, Michigan, Wisconsin and New York

What is the long term corporate plan (5 years; 10 years)?

The Company intends to use the proceeds of the fundraising for:

- Increased investment in sales and marketing in existing markets of Greece, Cyprus & Italy.

- Expansion of operations, into North America and Australasia.

- Working capital to underpin the expected growth in the volume of sales.

What does your company base its (future) success on?

The Brands; Kalashnikov and 'AK47'

The global growth of the Vodka market, especially in the USA market where over the period 2002-2006 US sales of vodka priced at \$16.99-23.99 (premium), grew by around 25%, while sales at \$25.99-31.99 (super premium), grew by over 200%. According to the market research company, just-drinks.com, sales of these two categories combined rose by 92% in this same period.

The reasons for all this are not hard to find. First, demographic trends mean that in recent years millions of Americans have been reaching legal drinking age (something which will continue for several years to come). Second, America is the land of the cocktail, and vodka's almost total lack of flavour, colour and odour render it ideal for this purpose, in both the bar and take-home trades. In 2004 vodka became the largest spirit category in the US -

and the second largest vodka market in the world behind Russia. Third, Americans are intensely both aspirational and brand-conscious, with the overwhelming majority of drinks in the on-trade being ordered by brand name. It is estimated that the US accounts for 61% of global consumption of premium or higher brands.

It has to be said that just-drinks.com has also suggested that growth in case sales of premium and super premium brands is set to slow to a rate in mid-to-high single figures, and that a brand shake-out is at some point inevitable. But apart from the fact that even this is the sort of growth of which many industries can only dream, we believe that the provenance and the associations of Kalashnikov (premium) and its derivative brand, Gun Metal (super premium), provide an excellent basis for success in this competitive but potentially very profitable market.

How was your company financed until this point? What do you need funding for?

The company was incorporated in 2003 in the UK and since March of that year it has raised just over £1.3m through share issues:

The 1 million shares issued in 2003 are classified as 5p Ordinary Shares and the rest as 5p Participating Shares, but both classes rank pari passu in all respects. There are 1.157m outstanding warrants, exercisable at between 30p and 55p, and the directors have options over 745,000 shares, exercisable at 30p. The authorised but unissued capital amounts to 50,000 Ordinary Shares and around 4.43m Participating Shares. There are just over 100 shareholders in all.

The company is currently seeking £1m at £0.30p a share by way of a private placement and in total £6m over next 3 years, to be spent over three years in expanding business in existing markets, most importantly America, and in penetrating two new markets, Australia and Canada.

75% of the new money is to go on marketing, of which more than two-thirds will be spent in America. Vodka is now the largest spirits brand in America, and premium and super-premium brands are expected to grow at a rate in mid-to-high single digits. America accounts for 61% of global consumption of these two segments.

The company estimates that total case sales of its three brands can reach around 35,000 in Year 1 post-funding, 150,000+ in Year 2 and 250,000+ in Year 3. On this basis it would still be loss-making in Year 2, but would thereafter move into significant profit. On the company's profit projections and our assumptions as to the terms of the current fund-raising, we would estimate EPS in Year 3 of 4.25p.

The company's long-term profit projections, based – inter alia - on a significant slowing of volume growth after Year 3, would still lead to EPS more than doubling over the following three years. Thus if by early 2011 4.25p is looking a realistic estimate, and the long-term targets are looking achievable, the shares could well reach 80-90p – a PER of around 20, coming down to between 8 and 9 over three years.



In a sector, however, where brands regularly change hands, the 42 Below story is very cheering; for it was bought in 2006 for an enterprise value of £37m (equivalent), representing a price per case by no means out of line with other vodka brand trade sales. The same case valuation applied to Kalashnikov on the basis of its own Year 3 volume target would equate to 296p per share, while just the same total consideration as was paid for 42 Below, with its prospective 107,000 cases, would be worth 126p

The funds will be used to grow sales in the company's existing markets of the USA, Greece, Italy and Cyprus, and to gain entry to Canada and Austrasia. The company will continue to sell to its importers in its other European markets and Jordan but will itself not be providing marketing support.

What market do you operate in and what are its key characteristics (competition)?

USA

The company believes that because Kalashnikov is already a well known "premium" name in America, the brand can be placed directly into the retail market that is, without first being seeded into selected style bars; and it has decided, on local advice, to target the game hunting fraternity, which is said to number 12.5 million, and gun supporting members of the population To this end the company has already reached what it expects to be an extremely significant agreement with the National Rifle Association, which has 4 million members. General Kalashnikov is a Life Member of the NRA, and the latter has agreed to support the brand by carrying advertisements in its monthly magazine, which has 1.3 million subscribers, consisting of a letter from the General, with an attached "Request Purchase Coupon" which readers can use to order the brand from their local liquor store. The advertising will be along the lines that the man. The company expects to obtain a 0.4% USA market share by year 3. Kalashnikov Vodka is currently stocked by 16

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USA Distributors in: California, Colorado, Arizona, Texas, Tennessee, Florida, Louisiana, Georgia, South Carolina, North Carolina, Maryland, Oklahoma, Missouri, Michigan, Wisconsin and New York

Greece

The Greek vodka market comprises 900,000 cases, and is relatively unfragmented, with just four brands accounting for 83% of the market. These are Absolut, Smirnoff and Stolichnaya, all marketed as standard brands, and a value for money offering, namely, Serkova. The company will be selling only its Kalashnikov brand, which will be priced in line with the three mentioned above. Against sales in the year to July of 2007 of 1,300 cases, the company is estimating sales in Year 1 after the enhanced marketing spend gets under way of a little over 3,000 cases, and in Year 3 close to 16,000 cases. Greece has already started to develop as a base for sales into Crete, the Balkans and Romania, and the company believes, looking further ahead, that Hungary, as well as North African markets, can also be brought into the net. The company expects to obtain a 1.4% Greek market share by year 3.

Italy

The Italian vodka market is around 400,000 cases, and is considerably more fragmented than the Greek market, with little differentiation in terms of price or market segment. Kalashnikov and AK47, however, are clearly positioned as premium and value for money, and the company believes that this, and the absence of any really dominant brands, provides an excellent opportunity to grow its own brands. Accordingly, it is budgeting for sales of Kalashnikov to grow from just 200 cases in the year to July 2007 to 3,000 in Year 3, and AK47 from 400 to 9,500 over the same period. The company expects to obtain a 3.1% Italian market share by year 3.

Canada

The push into Canada, by far the largest of the company's target markets after the US, with annual vodka consumption of 9.4 million cases, is planned to begin a year or so on from the start of the US campaign. The Canadian vodka market is not as segmentalised as the American market. There are two super premium brands, Grey Goose (owned by Bacardi) and Belvedere (LVMH/Millennium) and a host of premiums, including such as Smirnoff, Finlandia, Absolut and Stolichnaya, with which Kalashnikov will compete head-on. The company is budgeting for case sales of 85,000 in Year 3. The company expects to obtain a 0.4% Canadian market share by year 3.

Australia

The Australian vodka market amounts to just over 1 million cases, and although vodka is the fastest growing category in the local spirits market, consumption per head is low by international standards, and in fact just under a third of what it is in the US, which obviously provides scope for significant growth. Perhaps reflecting this, there is no lack of brands at all levels of the market. The Kalashnikov brand will be competing with Absolut, Smirnoff Black and Stolichnaya, and AK47 with Finlandia and Wyborowa. Looking much further ahead, Gun Metal is likely to be up against Ciroc, Grey Goose and Belvedere at the top of the market. Around two-thirds of the three-year

marketing spend in Australia will be put behind the lower-end AK47 brand. The company intends to begin operations there within a year of the fund-raising and it believes that AK47 can achieve sales of 30,000 cases in Year 3 of its development, Kalashnikov 10,000 and Gun Metal 8,000. The company expects to obtain a 2% Australian market share by year 3.

What is your demographic and geographic market potential?

Vodka is the fastest growing spirit segment in the world with 399 million cases consumed annually which accounts for 25% of all spirit consumption. The majority of consumers are between 20 and 45 years old in both sexes.

What do you offer investors?

3.3 million shares at £0.30p per Share

Is your business profitable? If not, for when do you project profitability?

The company will be profitable in Year 3 on the company's profit projections of the current fund-raising, it would estimate an EPS in Year 3 of 4.25p. The company's long-term profit projections, based - inter alia - on a significant slowing of volume growth after Year 3, would still lead to EPS more than doubling over the following three years. Thus if by early 2011 4.25p is looking a realistic estimate, and the long-term targets are looking achievable, the shares could well reach 80-90p - a PER of around 20, coming down to between 8 and 9 over three years.

In a sector, however, where brands regularly change hands, a brand case sale valuation for a trade sale applied to Kalashnikov on the basis of its own Year 3 volume target would equate to 296p per share valuation.

What is the estimated exit timing for investors?

The company envisages listing on either PLUS Markets or AiM in the first quarter of 2009 and thereafter it is expected that given the dynamics of the international spirits industry and the tradition of the major players snapping up successful new brands, the directors of Kalashnikov have made clear that a key part of their strategy will be to seek a buyer once the business is established.

The New Zealand company, 42 Below, started selling its eponymous premium vodka brand in Australasia in 1999, and by 2003, on the back of private equity investment of £1m (equivalent), had reached annual case sales of 5,000 - rather like Kalashnikov now. Towards the end of that year it raised the equivalent of £5.7m in an IPO, and, having invested the new money in international expansion, saw its sales grow to 18,000 cases in the following year, then to 55,000 and then 90, in 2006. In 2007 the company was expecting to sell 107,000 cases.

Below 42 itself sought a trade buyer, and in late 2006

went to Bacardi for the equivalent of around £45m, and an enterprise value of around £37m. We show below the prices at which this and other vodka brands have changed hands over recent years, expressed in US dollars:

At the end of March Pernod Ricard announced that it had prevailed in the auction to purchase from the Swedish government the internationally renowned premium vodka brand, Absolut. The brand sells a massive 10.7m cases a year and fetched \$8.9bn. This implies a price per case of \$832, that is, somewhere between the per case prices at which the two preceding deals - for 42 Below and Ketel One - were done.

Given the wide disparity amongst the valuations of case sales shown above, it is hard - impossible, in fact - to infer from them with any confidence an appropriate valuation for Kalashnikov. All that can be pointed out is that since the Skyy sale, which was seven years ago, no brand has gone for less than \$445 per case; and that 42 Below fetched the figure of \$679 despite the fact that the business had made a loss in every year of its existence, and, indeed, was forecasting a further loss for the financial year in which it was bought.

On the basis of the Kalashnikov company's hoped-for sales of its three brands in Year 3 of 254,700 cases, the 42 Below per case valuation implies a value for the business of \$173m, or £87m at a rate of \$1.98 to the £. This would equate to a price per share, on the basis of our suggested share capital of 29.4m shares of 296p

What risks do you anticipate for your company?

- The key risk are distribution and raw material costs, as the market ' is not so much about ad spend as bartenders become more knowledgeable, consumers have more opportunity to make a decision based on heritage, authenticity and raw materials 'according to Claire Smith Global Communications Manager for Moet Hennessy in The Spirit Business May 2008 and the American consumer ...' tend to select brands based on sexy, glamorous attributes rather than the product itself ..are much more label orientated..there is much more need for a convincing product truth in the UK than the USA'

- In terms of a slow down in the economy this should not affect alcohol sales as empirical research shows that as Americans face tougher times from a slowing economy, they are consuming more alcohol. Reuters reported in Jan. 12. "People are drinking more, because people tend to drink more during tough times," said JP Morgan beverage analyst John Faucher. Typically, sales of alcohol increase during recessions. According to industry figures. Data also shows that more people are consuming alcohol at home rather than in restaurants. "I would agree with the theory that people have been drinking more," said Davenport & Co.,analyst Ann Gurkin, who follows a number of beverage companies.

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