A Work Project presented as part of the requirements for the Award of a Master Degree in Finance from the NOVA – School of Business and Economics.

Private Equity Investment Committee Paper on

Aveleda, S.A. – Wine development through the eyes of Aveleda, S.A.

Duarte da Cunha Alves Pereira

25862

A Project carried out on the Master in Finance Program, under the supervision of:

Professor Inês Lopo de Carvalho

Professor Fábio Soares Santos

03/01/2020

Abstract

Aveleda represents one of the most recent success cases of Portuguese wine producers. Leveraging on its heritage and reshaping *Vinho Verde*'s prestige around the world, Aveleda has taken advantage of the recent market trends. The Private Equity market appetite for companies with stable cash flows, further development opportunities and efficiency gains determines this investment decision.

Aveleda's business plan is grounded on a Buy-and-Build strategy (with the acquisition of Quinta do Vallado), internationalization intensification and a complementing real estate strategy.

The implied returns (3.4x Money Multiple and 27.5% Internal Rate of Return) highlight the unique opportunity that is investing in Aveleda.

Keywords

Wine; Vallado; Internationalization; LBO

This work used infrastructure and resources funded by Fundação para a Ciência e a Tecnologia (UID/ECO/00124/2013, UID/ECO/00124/2019 and Social Sciences DataLab, Project 22209), POR Lisboa (LISBOA-01-0145-FEDER-007722 and Social Sciences DataLab, Project 22209) and POR Norte (Social Sciences DataLab, Project 22209).

PROJECT REFLECTIONS

Duarte Alves Pereira

PERSONAL DEVELOPMENT

The Private Equity Challenge allowed me to have a broader understanding of what is an end-to-end IC paper process, with a deeper dive into the details and the rationale of a deal.

Moreover, by being working during this semester along 2 other members of our group, this demanded a lot of time management and team-working. Not only did we learn how to overcome the most significant obstacles with time constraints (such as unavailability, absence of a member or long working hours), but we were still able to create a thesis that we consider to be in a very high standard. Furthermore, I do believe that the constraints we had made us mindful of the difficulties along the whole process, which improved the output. The only thing I would do differently would be a weekly meeting with professors, as their inputs were always the most determining part of the project and we ended up making more than one structural adjustment to the paper, due to the lack of these meetings. However, realizing this mistake was a crucial part of the learning process throughout these months.

Finally, by doing the thesis in a group, I consider it was key for our learning. This was a real life proof of the benefits of working in a team, with more inputs and different views over the same topic. Maybe we were lucky that we got along so well, but the fact that we were in a group was undoubtedly a determinant factor for a better project.

PROFESSIONAL DEVELOPMENT

As stated before, I was working during the thesis in a Private Equity firm in Portugal, which I am still working. Consequently, the Private Equity Challenge was very helpful along these months, not only in the more technical parts such as Excel or PowerPoint skills, but most importantly to think critically over the investment rationale.

Also, understanding the process in more detail and the different steps was crucial. The structuring of the output as well as the basis for each investment thesis is a tool I know will be useful along my whole career and despite being or not in Private Equity. On top of this, the fact that we were in groups and had to work with our colleagues posed a much more realistic example of what our professional lives will be, hence giving a good preparation for our future.

Concluding, this thesis was particularly helpful as it demanded three important determinants in any professional life: devote time, critical thinking and technical skills. I believe these factors are common across different areas and are the basis for success in life.

FINAL CONSIDERATIONS

As final considerations I would like to thank to Nova SBE and to the professors Luís Mota Duarte, Inês Lopo de Carvalho and Fábio Santos.

The professors always showed availability to answer our questions along the semester and were an essential bridge between the academic work we were performing and what are the common practices in real life Private Equity. This allowed us to, not only understand the most important factors when looking into a target company, but also to understand the reason why the academic process follows the path we are taught.

As for Nova, it is very good to understand that the university supports thesis that, despite not being the more most traditional ones (*i.e.* dissertations), are definitely the most useful for students studying finance and eager to pursue a career in this field.

Thank you, it was a pleasure to end my academic path with such an insightful project.

AGENDA

MARKET OVERVIEW

The wine industry has been growing significantly and this trend is set to last in the upcoming years

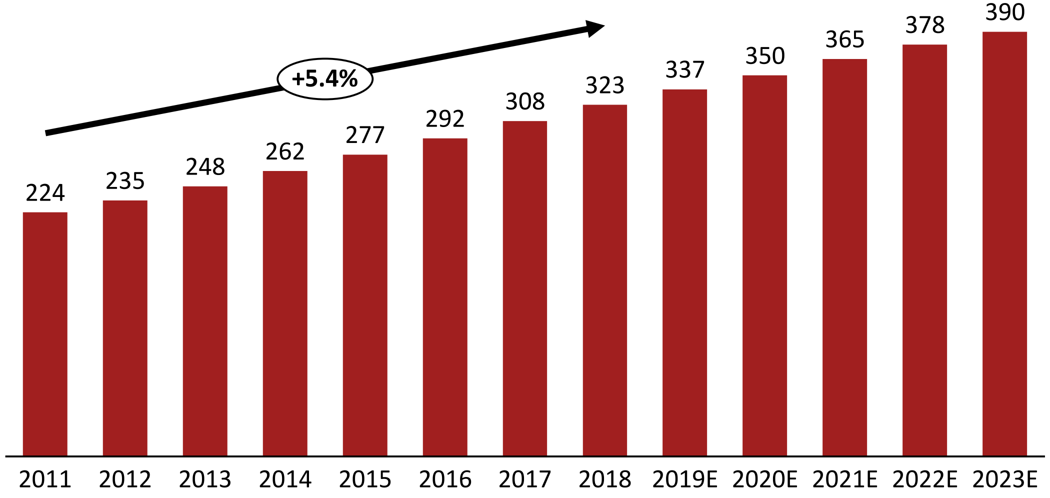
INTERNATIONAL | *Global overview*

- Global wine market has been growing steadily at a **5.4% CAGR (2011-18)** and this trend is expected to continue until 2023
- The largest five markets in the world are **United States**, **China**, **France**, **Australia** and **Italy**
- **Future growth** is expected to be more acute in **Asia-Pacific**, as the number of companies producing wine in **China, India and Japan is increasing at a high pace**
- **Several drivers** have set the pace for the international growth

1. **Worldwide increase in disposable income** and a **more globalized world**
2. **Growing importance of wine**, in Asia for example, with the current **increase in population** and general **cultural change towards wine consumption**
3. **Increase in the variety of wine offered**, both in type of wine and price range – larger number of consumers see their preferences addressed

- **The main obstacle is the weather unpredictability** and exposure to climate conditions: after a decrease of 8% in worldwide grape production in 2017, there was an increase of 17% in the year after, illustrating the volatility of this sector. Companies mitigate this risk through diversification in business and geography

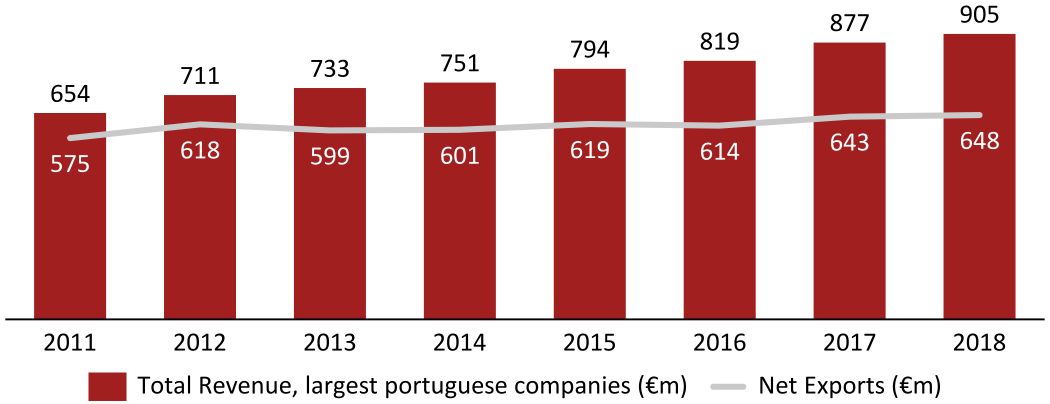
Total Wine Market Revenue Worldwide (€b)



PORTUGAL | *Domestic overview*

- Portuguese main players' revenues have been growing at a **5.0% CAGR (2011-17)**. Being Portugal a country with a strong wine tradition, the **boom in tourism** and **foreign investment** have been pushing total revenue up
- For Portuguese players, exports are still a considerable share of income, which has been increasing consistently since 2013
- As a consequence of these two factors, the number of companies producing wine in Portugal has been increasing, emphasizing **competitive pressures** and **market fragmentation**
- Following the international trend, Portuguese grape production has been inconsistent, decreasing by roughly 20% in 2017 and increasing the year after

Portuguese Revenue (main players) and Net Exports (€m)



Sources: Informa DB, Statista

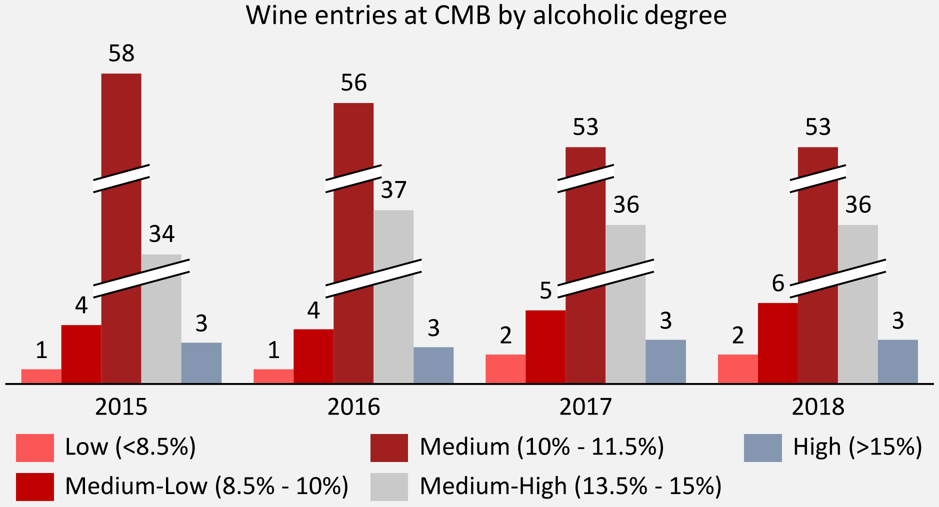
MARKET OVERVIEW

"The future will be to produce fresh, fruity, pure and with lower alcohol content wine" Baudouin Havaux, CMB Chairman[1]

AVELEDA

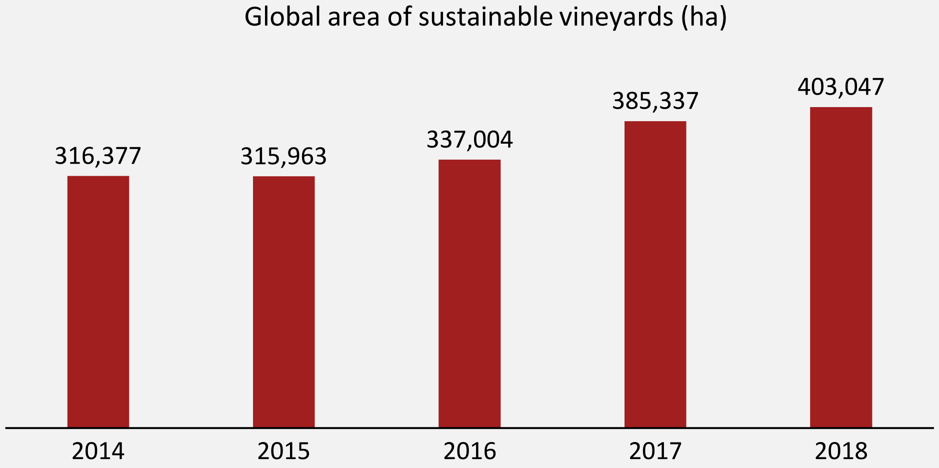
TREND 1 | *Fresh and light wine*

- Since 2015, **low alcohol wines** have been consistently dominating consumer preferences
- Due to the increase in health consciousness, wine **consumers are shifting towards fresher and lighter wines**, in order to enjoy the product while consuming less alcohol
- Following the strong trend of **decreasing consumption of red meats**, wine consumers are more into light wines which is a better complement to the adopted diet (fish, white meat)
- Given the climactic changes which have been registered, grape picking is taking place later in the year. This increases the **concentration of sugar in the grapes**, leading to a lower alcoholic degree of the wines
- **Given the stability of the pluviosity** in northern geographies, productivity is shifting towards new lands located in these areas, hence maintaining a lower alcoholic degree



TREND 2 | *Sustainable wine*

- As the environmental awareness gains traction throughout the world, a significant portion of wine consumers tend to look towards **sustainable wines, even if this entails higher costs per bottle**
- From 2013 to 2017, vineyards' **global sustainable area rose 27%**, from 316,377 ha to 403,047 ha
- The sustainable wine market niche is evolving at a frenetic pace. In Spain, which is one of the largest wine producers in the world, sustainable wine consumption reached 7% of total production in 2015. **In 2018, this number already represented 20%**
- According to a study developed by Sonoma State Professor Liz Thach, 30% of the inquired population was willing to pay an extra amount of **€5 per bottle of sustainable wine** compared to a regular one
- Consequently, wine producers are being presented with a clear **opportunity to increase margins per bottle**: this consumer segment is willing to pay an extra amount for the sustainability stamp



Sources: CMB, Statista

1. CMB – Concours Mondial de Bruxelles

MARKET OVERVIEW

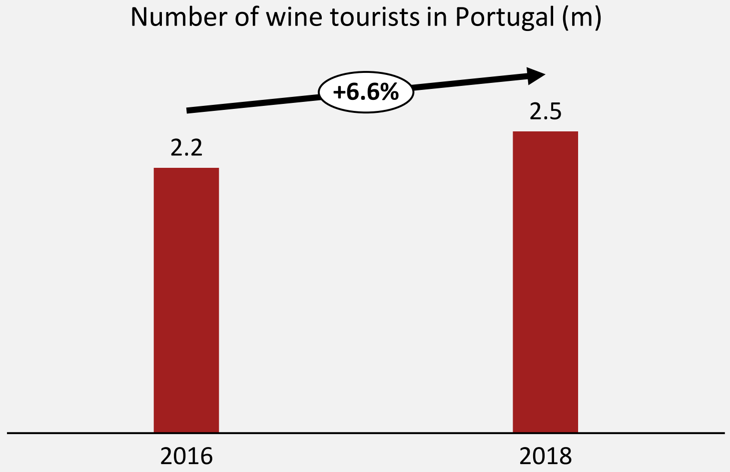
Nowadays, consumers also require a taste of the production process and winemaking environment

AVELEDA

TREND 3 | *Wine Tourism*

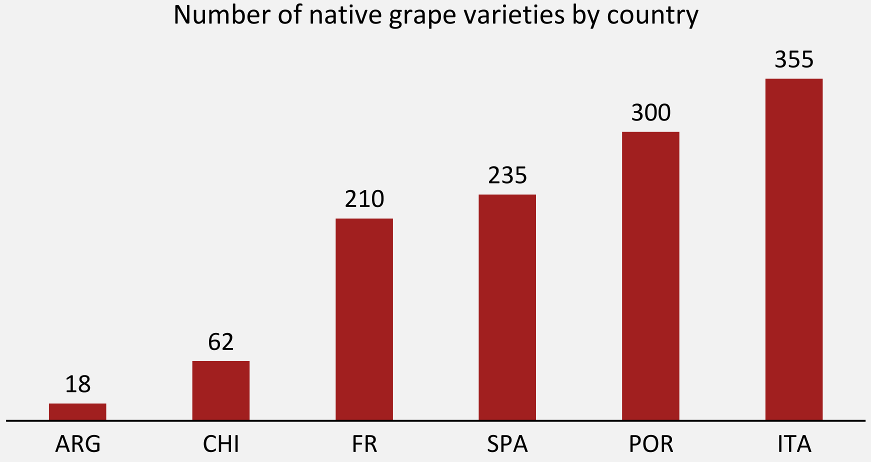
- **Wine tourism** has been growing at a steady and strong pace
- 12% of the tourists that visited Portugal in 2018, came to **experience wine tourism**
- The wine tourism boom brings considerable benefits for wine makers, namely:

1. By investing in wine tourism, producers create **additional revenue streams**, such as hotels, guided tours or wine tasting events
2. It allows producers to **increase awareness and loyalty** on its customer base, as the tourists become emotionally attached to the brand. Moreover, visitants, through word of mouth, end up increasing the producer's client base
3. By investing in wine tourism units, wine producers can directly sell their product to clients, **reducing intermediary fees**, thus improving margins



TREND 4 | *Native and Premium wine*

- Once, native grape varieties were more used to produce wine in New World countries. Hence, most of these countries **can produce similar wines using the same varieties**
- Old World producers and New World producers are **converging to the same wine quality**. Experts state that, for the most used varieties (*Cabernet Sauvignon*, *Merlot*, etc.), vast countries like China will be able to produce the best wines using these varieties in the upcoming years
- This fact makes wine consumers increasingly **interested in different types of wine**. The **demand for premium wines** (prices above $10) and wines produced with indigenous grape varieties is **growing at a strong pace**
- For Italian, Greek and Portuguese wine producers, wine entries using indigenous grapes were the most awarded in the CMB contest in 2018



Sources: CMB, Statista, IVV

AGENDA

COMPANY OVERVIEW

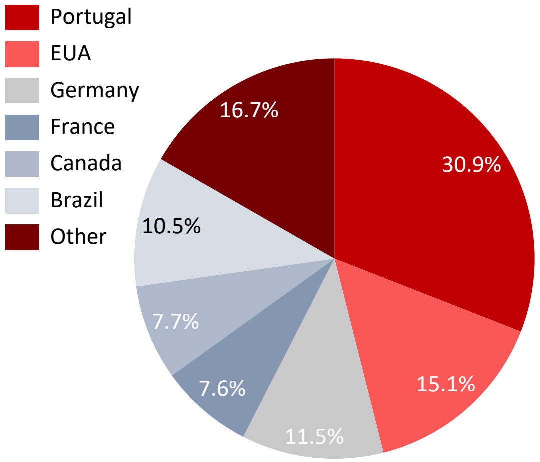
Aveleda's sales have been growing steadily along recent years, with a 5.9% CAGR (2015-18)

AVELEDA

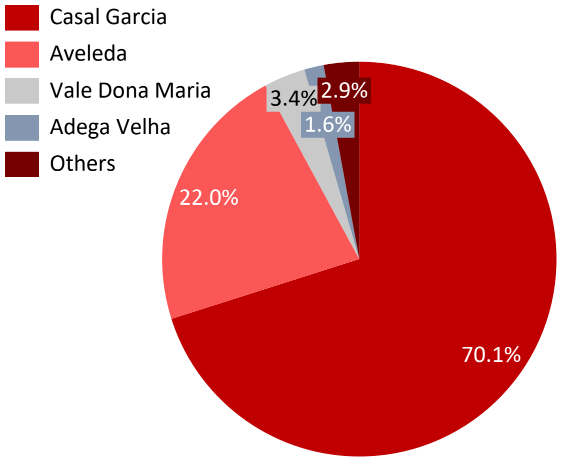
SALES AND DISTRIBUTION | *How much is sold each year?*

- **Aveleda offers a wide range of products covering all market segments**. From the most commercial products, with a minor request for quality (however a need for higher production capacity, as Casal Garcia), to more exquisite wines with higher quality, such as Adega Velha
- The company also provides some **tactical labels in order to target specific markets** e.g. Charamba is the most sold Douro wine in the US
- In total, Aveleda detains **31 products** among spirits, port, white and red wine
- More specifically, **Casal Garcia**, which is the most sold wine in Portugal and *Vinho Verde* wine in the world, **clearly poses as Aveleda´s main revenue stream**, accounting for c. **70% of its sales**. In addition, **Aveleda brand represents almost a fourth of all the company's revenue**
- Aveleda has a highly concentrated distribution of its products, with **PrimeDrinks accounting for 88% of all the revenue in Portugal** (PrimeDrinks does not operate outside of Portugal)
  - PrimeDrinks was created as a consortium in order to **give more power to wine producers** in the distribution and selling phases of the value chain
  - **Aveleda joined PrimeDrinks in 2005, detaining 15% of the distributor´s capital**, along with Esporão´s 50% and William Grant & Sons´ 35%
  - This investment allows Aveleda to have a **higher margin in its own products**
- Aveleda **exports 69%** of its production to more than **80 countries**, being the most relevant ones: USA, Germany, Brazil, Canada and France
- **Aveleda is widely known as being R&D concerned**, having received hundreds of awards across the globe due to its effort to have the highest possible quality standards: 11 consecutive years as the "Winery of the Year"

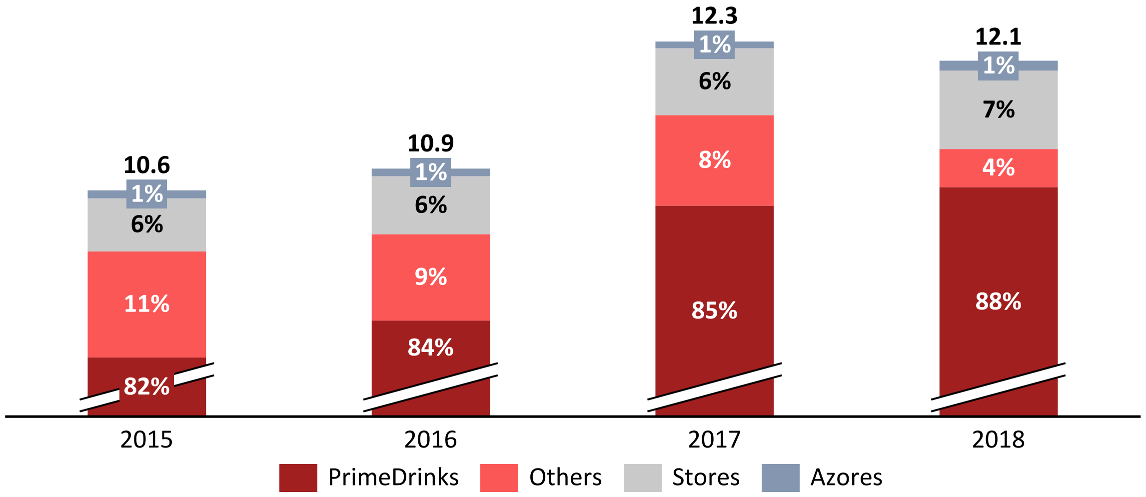
Sales geographical segmentation, 2018



Sales label segmentation, 2018



Distribution channels in Portugal (€m)



Sources: Aveleda Financial Department information, Aveleda Annual Reports

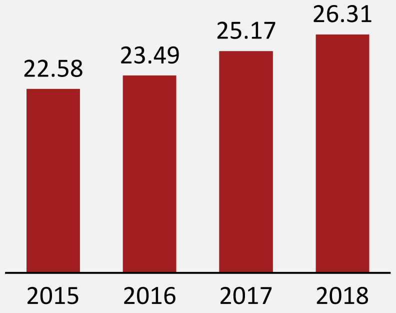
COMPANY OVERVIEW

Portfolio diversification and brand positioning set the pace for Aveleda's future growth

AVELEDA

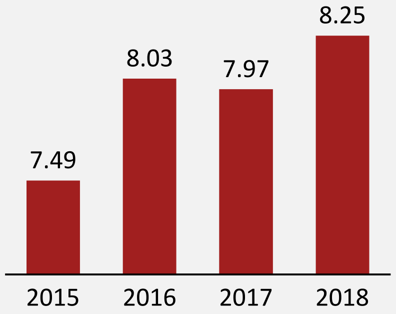
TIER 1 BRANDS | *Annual Revenue (€m) and KPIs*

CASAL GARCIA
SINCE 1939



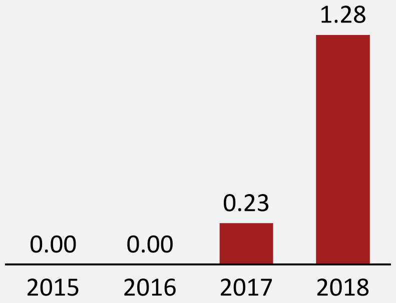
- Most sold *Vinho Verde* in the world
- **Revenues** have been increasing at a **5.2% CAGR**
- **Average price** of €21.7/bx
- **Gross Margin of 53%**

AVELEDA
ESTABLISHED 1870



- Fresh and low alcohol wine
- **Revenues** have been increasing at a **3.3% CAGR**
- **Average price** of €24.3/bx
- **Gross Margin of 52%**

QUINTA
VALE D. MARIA

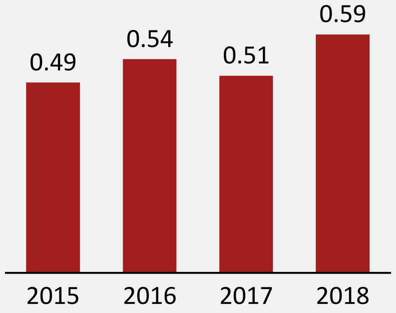


- Premium wines
- **Average price** of €125/bx
- **Gross Margin of 53%**

**Bx stands for box. One box equals 9 liters/kg of wine/cheese*

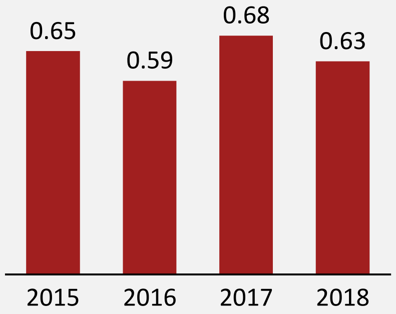
TIER 2 BRANDS | *Annual Revenue (€m) and KPIs*

ADEGA VELHA



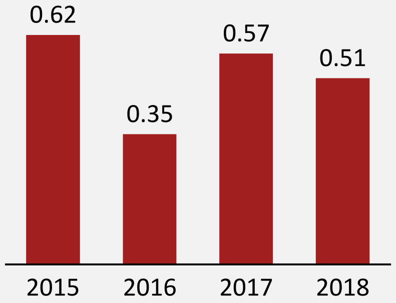
- Premium range of spirits
- **Revenues** have been increasing at a **6.3% CAGR**
- **Average price** of €198/bx
- **Gross Margin of 46%**

(Tactical Brands)



- **7 Tactical Brands** broadly used to enter in new countries
- **Revenues** have been **volatile**
- **Average price** of €43.1/bx
- **Gross Margin of 6%**

(Other Products)



- Mid market positioning
- **Revenues** have been decreasing
- **Average price** of €134/bx

Sources: Aveleda Annual Reports

COMPANY OVERVIEW | INCOME STATEMENT

Aveleda has witnessed a stable revenue growth, however there is still room for improvement in EBITDA margin

AVELEDA

P&L ('000€)	2015	2016	2017	2018
Sales and services	31,999	33,204	35,457	38,036
% change		*3.77%*	*6.79%*	*7.27%*
Variation in production	(60)	289	249	380
COGS	(14,431)	(14,545)	(15,599)	(18,255)
% change		*0.79%*	*7.25%*	*17.02%*
Gross Margin	17,508	18,947	20,107	20,161
% Gross margin	*54.72%*	*57.06%*	*56.71%*	*53.01%*
Direct SG&A	(3,990)	(4,527)	(5,201)	(6,319)
Direct SG&A / Sales		*13.63%*	*14.67%*	*16.61%*
Direct Personnel expenses	(1,548)	(1,566)	(1,992)	(2,101)
Direct Personnel / Sales		*4.71%*	*5.62%*	*5.52%*
Direct Margin	11,971	12,855	12,914	11,741
% Direct margin	*37.41%*	*38.71%*	*36.42%*	*30.87%*
Structural SG&A	(669)	(742)	(819)	(1,048)
% change		*10.87%*	*10.44%*	*27.91%*
Structural Personnel expenses	(1,670)	(1,913)	(1,911)	(1,845)
% change		*14.52%*	*-0.08%*	*-3.49%*
Other recurrent gains and losses	594	633	331	1,031
EBITDA Adjusted	10,225	10,833	10,514	9,879
% EBITDA Adjusted margin	*31.96%*	*32.63%*	*29.65%*	*25.97%*
Other non-recurrent gains and losses	-	-	-	736
EBITDA	10,225	10,833	10,514	10,615
% EBITDA margin	*31.96%*	*32.63%*	*29.65%*	*27.91%*
D&A	(990)	(1,337)	(1,555)	(1,614)
EBIT	9,235	9,497	8,959	9,001
% EBIT margin	*28.86%*	*28.60%*	*25.27%*	*23.67%*
Financial Result	96	(399)	(300)	(109)
EBT	9,331	9,098	8,659	8,893
% EBT margin	*29.16%*	*27.40%*	*24.42%*	*23.38%*
Deferred tax	250	128	346	986
% Deferred tax rate	*2.68%*	*1.41%*	*4.00%*	*11.09%*
Income tax	(2,256)	(2,390)	(2,296)	(2,267)
% Effective tax rate	*24.18%*	*26.27%*	*26.51%*	*25.49%*
Net income	7,325	6,836	6,710	7,611
% Net margin	*22.89%*	*20.59%*	*18.92%*	*20.01%*

SALES

- Increasing for the last 4 years at a **CAGR of 5.9%**, mainly supported by Casal Garcia sales variation, the Brazilian market growth and wine tourism revenue increase because of extensive investment plan
  - **2016:** Increase of **€750k** in sales of newly-born **Casal Garcia´s red sangria**. In geographical terms, these increment in sales have mainly come from the top-5 foreign markets (USA, Germany, France, Canada and Brazil), with special focus on USA and France
  - **2017:** Significant raise in every segment of Casal Garcia wine sales, with **special focus on the white wine** with a growth of €1.2m alone. This is a consequence of a **higher production capacity after the acquisition of several properties**, such as Seis Quintas
  - **2018:** Full integration of **Vale Dona Maria´s €1.3m in sales**, after its acquisition in 2017. Geographically, the Brazilian market suffered a positive variation of 81% in the last year, allowing for a full coverage of national wine sales decline of 3.0%
- Since 2013, Aveleda launched 21 new products, many of them tactical, to explore thoroughly specific geographic and sectorial markets, accounting for 10% of all revenue in 2018

Sales and services by brand ('000€)	2015	2016	2017	2018
Casal Garcia	22,583	23,491	25,166	26,313
Aveleda	7,492	8,025	7,970	8,251
Vale Dona Maria	0	0	230	1,277
Adega Velha	491	539	505	590
Tactical Brands	645	586	676	625
Other products	622	353	571	505
Services	166	209	338	474
Total	**31,999**	**33,204**	**35,457**	**38,036**

Sources: Aveleda Annual Reports

COMPANY OVERVIEW | BALANCE SHEET

Aveleda has seen its assets increase abruptly in accordance to its high investments, majorly financed with own capital

AVELEDA

Balance Sheet ('000€)	2015	2016	2017	2018
Tangible assets	25,017	31,165	33,498	37,714
Intangible assets	10	430	2,410	2,537
Investment property	3,868	3,868	3,868	3,966
Financial investments	1,258	908	3,715	4,829
Biological assets	405	703	1,055	1,546
Non-Current Assets	**30,559**	**37,073**	**44,546**	**50,593**
Net deferred taxes	**(3,033)**	**(3,101)**	**(3,128)**	**(3,262)**
Inventory	10,068	10,371	12,594	12,998
Biological assets	126	196	245	245
Acc. Receivables	4,539	5,442	6,254	6,363
Other current assets	982	261	666	5,440
Acc. Payables	(4,539)	(5,148)	(6,268)	(6,122)
Other current liabilities	(2,356)	(2,918)	(3,175)	(5,701)
Working Capital	**8,821**	**8,205**	**10,316**	**13,223**
TOTAL CAPITAL EMPLOYED	**36,346**	**42,177**	**51,734**	**60,554**
EQUITY AND NET DEBT				
Share capital	3,927	3,927	3,982	3,982
Capital reserves	8,253	13,839	18,908	24,025
Share premium	-	-	1,195	1,195
Revaluation surplus	12,104	12,060	12,057	12,231
Other variations	(117)	(349)	(25)	(25)
Net income	7,325	6,836	6,710	7,611
Equity	**31,492**	**36,313**	**42,826**	**49,019**
Other non-current liabilities	**5,351**	**5,055**	**5,618**	**6,232**
Financial debt LT	-	-	3,250	4,100
Financial debt ST	3,000	3,000	1,101	1,237
Cash and equivalentes	(3,496)	(2,191)	(1,061)	(34)
Net financial debt	**(496)**	**809**	**3,289**	**5,303**
TOTAL EQUITY AND NET DEBT	**36,346**	**42,177**	**51,734**	**60,554**

Sources: Aveleda Annual Reports

TANGIBLE ASSETS

- Asset item with the largest increase in 2018. Most of the variation is related to **€5.8m of construction in progress** (vineyards will begin its production in 2019)
- **Land accounts for roughly €24m** of the total tangible assets value, being the most substantial share of Aveleda´s assets

INTANGIBLE ASSETS

- Sharp increase between 2015 and 2017 as a result of Aveleda´s **€400k software acquisition** in 2016 and increase of roughly **€2m in goodwill** from **Quinta Vale D. Maria´s acquisition**

FINANCIAL INVESTMENTS

- Gradual increase reflects **acquisition of properties**, such as *Sociedade Agropecuária Gradim* in 2018 and **Quinta Vale D. Maria** in 2017, valued at €1.2m and €970k, respectively
- On top of the acquisitions, **Aveleda loaned €1.8m to Quinta Vale D. Maria**, as shareholder in 2018

INVENTORY

- **Increase of €2.2m** in 2017, since Quinta Vale D. Maria wines are **aged for longer periods (>1 year) in oak barrels**, resulting in higher amounts of wine kept in cellars (inventory)

FINANCIAL DEBT LT AND ST

- At this moment, Aveleda has **six ongoing loans**, which were all considered to be repaid in six years in a straight line depreciation method
- **These loans amount to a total value of €5.3m.** Average interest rate of 1.0%

COMPANY OVERVIEW | CASH FLOW STATEMENT

Recent negative cash flows show that the company is committed to a continuous expansion plan

AVELEDA

Cashflows ('000€)	2015	2016	2017	2018
EBIT	**9,235**	**9,497**	**8,959**	**9,001**
+ Depreciation, Amort., Impairm. Losses on Fixed Assets	990	1,337	1,555	1,614
EBITDA	**10,225**	**10,833**	**10,514**	**10,615**
- Change in Working Capital	-	(59)	(1,791)	932
- Change in Trade Receivables		(181)	(1,247)	(1,621)
- Change in Inventories		(374)	(2,272)	(403)
+ Change in Trade Payables		496	1,729	2,955
- Current tax	(2,256)	(2,390)	(2,296)	(2,267)
- Maintenance Capex	(1,107)	(1,125)	(1,126)	(1,131)
NET CASH FLOW FROM OPERATING ACTIVITIES	**6,862**	**7,259**	**5,302**	**8,149**
- Investment in Fixed Assets	-	(7,110)	(8,155)	(6,631)
- Expansion Capex		(7,121)	(5,098)	(5,143)
- Financial Investments		11	(3,057)	(1,488)
- Dividends Paid and Other Cash Outflow from Equity		(1,739)	(517)	(1,593)
+ Losses from Investment Sales	63	151	1	48
CASH FLOW FROM INVESTING ACTIVITIES	**63**	**(8,698)**	**(8,671)**	**(8,175)**
+ Financial Result	96	(59)	(50)	(42)
+ Goverment Grants Related to Assets		(167)	63	716
+ Change in Non-Current Borrowings	-	(83)	4,123	1,820
- Other Financial Borrowings		-	3,250	850
- Others		(83)	873	970
+ Change in Current Borrowings	-	461	(1,841)	(3,495)
- Finance Lease Liabilities		461	(390)	(375)
- Other Financial Borrowings		-	(1,899)	136
- Shareholders / Associated Companies		87	327	(576)
- Others		(88)	122	(2,680)
+ Change in Derivatives		(18)	(55)	(0)
+ Adjustments		(0)	(0)	0
CASH FLOW FROM FINANCING ACTIVITIES	**96**	**134**	**2,240**	**(1,001)**
Change in Cash		(1,305)	(1,130)	(1,027)
BoP Cash and equivalents		**3,496**	**2,191**	**1,061**
EoP Cash and equivalents	**3,496**	**2,191**	**1,061**	**34**

Sources: Aveleda Annual Reports

NET CASH FLOW FROM OPERATING ACTIVITIES

- Sharp **decrease in OCF as a percentage of revenues**. This can be majorly explained by the **increase in COGS** after the acquisition of Quinta Vale D. Maria. These wines have **higher costs of production** and did not generate a proportional increase in revenues, thus affecting the firm's OCF

EXPANSION CAPEX

- Strong **increase in tangible assets** throughout 2015-2018 justify the outflow of cash. **In 2015**: Plantation and vineyard restructuring (€1.0m). **In 2016**: acquisition of Seis Quintas (€3.9m) and Quinta dos Ruivães (€1.6m). **In 2017:** Plantation of new vineyards in Seis Quintas and Quinta de Ruivães. **In 2018:** investment of €4m in new vineyards and equipment for production lines

FINANCIAL INVESTMENTS

- In 2017, it should be highlighted the outflow of almost €2m in intangible assets, as a result of the **acquisition of Quinta Vale D. Maria**, where the amount of **€2m was registered as Goodwill**

GOVERNMENT GRANTS RELATED TO ASSETS

- In 2018, a significant inflow of cash resulted from investment subsidies grants. In order to fuel the **development of local cultures**, the Portuguese Government awarded Aveleda with a net value of €716k

CHANGE IN CURRENT BORROWINGS – OTHERS

- In 2018, given **the changes in the accounting method** used to **recognize subsidies**, a total amount of c. **€2.3m was recognized as accrued subsidies**