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. – Aveleda: Performing an LBO takeover in the main Portuguese *Vinho Verde* producer

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

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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 forecasted returns (3.4x Money Multiple and 27.5% Internal Rate of Return) highlight the unique opportunity that is investing in Aveleda. Underpinned by the proper management incentives, the construction of both conservative and optimistic scenarios and the optimization of Aveleda's capital structure, this investment presents an unparallel financial and strategic opportunity.

Keywords

Wine; Vallado; Internationalization; LBO

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PROJECT REFLECTIONS

Tomás Almeida de Carvalho

PERSONAL DEVELOPMENT

To be part of this work project was challenging and thrilling, yet a very well rewarded opportunity to further develop my hard and soft skills. On the one hand, I feel that my interpersonal skills were trully enhanced. By having to follow a strict time schedule, I have increased my ability to manage time, whilst never compromising the quality of the work. Furthermore, by working in group, I have developed my communication skills, social interaction and, very importantly, I have polished my capacity of hearing others' opinions and be able to collectively build content that is the fruit of the contribution of all the group members.

On the other hand, I feel that the exposure we have had to different professionals that work within the Finance world helped me increase my awareness on how things are done in real life and how important it is to be able to communicate correctly and in a timely manner, in order to be as acute as possible when being advised by more experienced people.

All in all, I feel that the essential element of the good work we have developed was the friendship shared between the group members, which was a very important boost when things were going less well. I would like to thank my friends, Duarte, Manuel and José for this amazing semester and academic experience.

PROFESSIONAL DEVELOPMENT

This project was a very good way of being involved from end-to-end in an LBO takeover. In the last year I have made the Private Equity course, and, by that time, I felt that the IC paper that we developed in the course was sometimes simple (given the time constraint it is normal) and there were topics that I would have liked to go deeper. Luckily, this work project was exactly what I was expecting in terms of professional development. We were challenged for every tiny detail for everything to be pristine and well based. In professional terms, this thesis helped me increasing my rigor when using Excel and PowerPoint, increased my financial modeling and financial statement analysis skills and raised my awareness for important topics that are essential to develop a successful Leveraged Buyout.

After interning last year in a Portuguese PE firm, I feel that this thesis steps and processes are very similar to how Private Equity firms act in the real world. Due to the large amount of concepts that I have cemented throughout this thesis, I feel that, today, I am very well prepared to work within the Private Equity industry, not only due to the technical skills that I have developed, but also given all the soft skills that were endured during the Thesis.

FINAL CONSIDERATIONS

I would like to leave here a special thanks to Professor Inês, Professor Luis and Professor Fábio. Throughout this demanding semester, the constant guidance of the three was essential to overcome difficulties that emerged. Moreover, I would like to highlight the fact that constant feedback was given to us during the semester, which was essential to always keep both parts as well informed as possible.

This thesis was a very complete one. In terms of hard skills I would say that my "knowledge baggage" is completely full of very interesting and important concepts. In terms of soft skills, I would say that I learned very important lessons on how to work with a diverse and large number of people and that this will be very useful for my future.

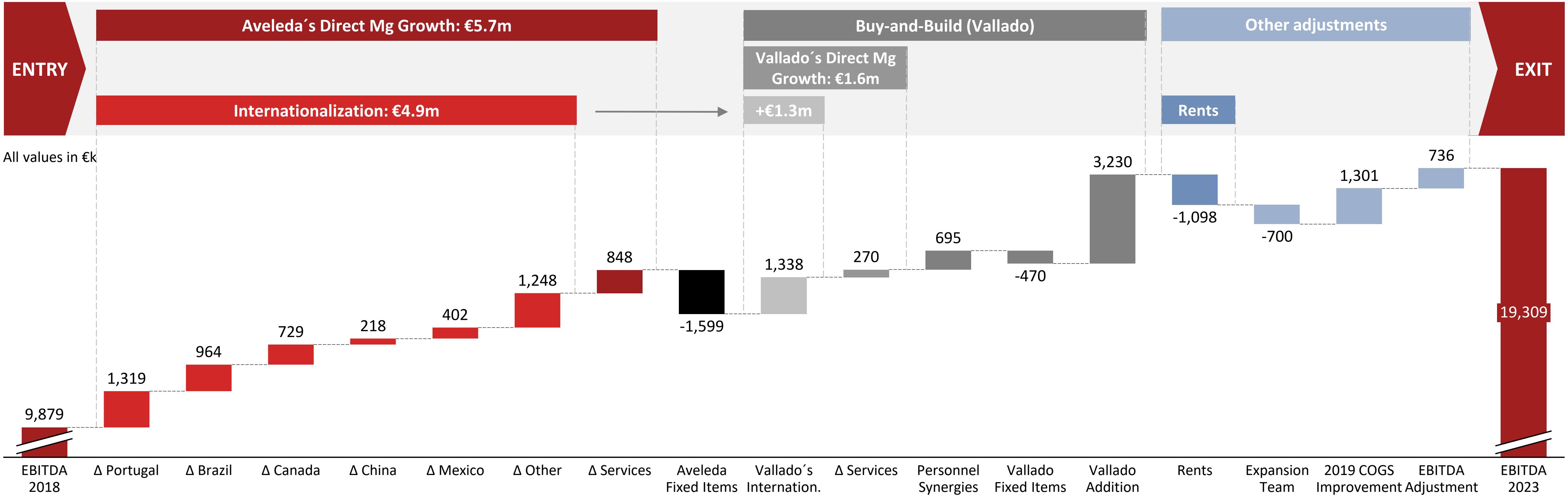
Finally, I think that Nova should keep doing and creating thesis that are made in team, because the reality is that when us, students, go to the job market, the most valuable assets that we can have, in order to thrive, is the ability to merge and work with people that speak different languages and have different cultures and customs.

AGENDA

AVELEDA

EBITDA BRIDGE

The three value creation strategies will help to deliver a 95% increase in adjusted EBITDA in the next 5 years



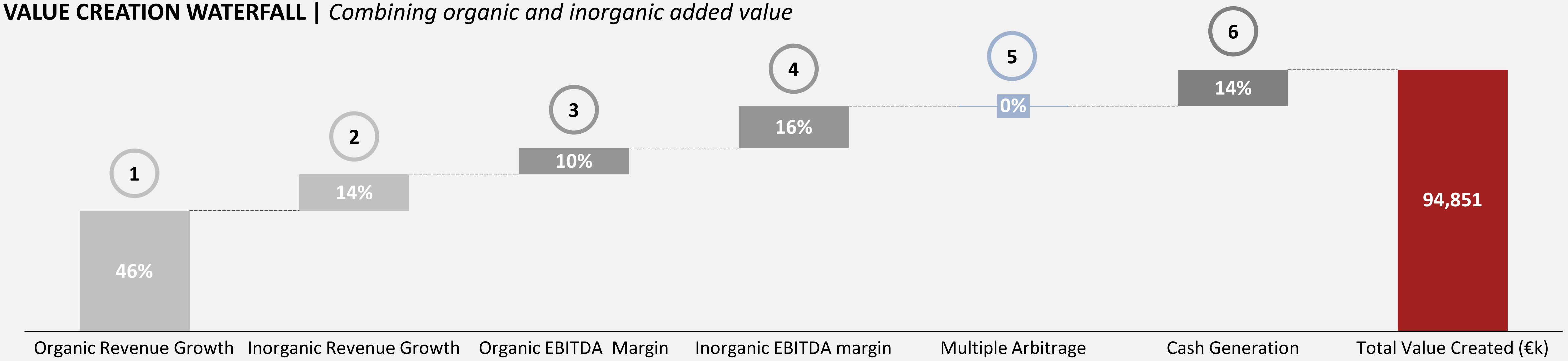
EBITDA Growth | *EBITDA growth of 95% at the exit, in 2023*

- **Internationalization** accounts for an impact of **€4.9m on Aveleda´s Direct Margin and €1.3m on Vallado´s Direct Margin.** This value creation strategy will be supported by the hiring of a full **commercial expansion team** of 10 specialists, which will impact negatively Aveleda´s cash accounts in **€700k**
- A higher focus on **wine tourism (services)** will also foster a **Direct Margin increase of €1.1m** (€848k in Aveleda and €270k in Vallado)
- **Quinta do Vallado´s acquisition** will impact immediately the company´s **EBITDA in €3.2m** in 2020, adding to the **€695k saved in personnel synergies for Vallado´s properties**. Fixed items comprehend fixed personnel, SG&A and Other G&L, which total -€1.6m from Aveleda and -€470k from Vallado
- Other variations comprise an **increase in operational efficiency of €1.3m** (COGS) and the **subsidy normalization of €736k**, in 2019, together with a recurrent cost of **€1m in rents** for the sold lands to the Guedes family

VALUE CREATION

The value creation strategy will comprehend a strong growth in Equity, with organic revenue growth as the main driver

VALUE CREATION WATERFALL | *Combining organic and inorganic added value*



1 **Organic Revenue Growth** mirrors the developments and expansionary policy in Aveleda's business model. The internationalization process, with special focus in the already mentioned countries, will be crucial for Aveleda's gain in market share and revenue growth. **This item accounts for 46% of value creation**

2 **Inorganic Revenue Growth** represents Vallado's acquisition and its effect in the consolidated Income Statement. Leveraging on Aveleda's strong distribution network, Vallado will allow for a higher portfolio diversification. **This item accounts for 14% of the value creation**

3 **Organic EBITDA margin** evolution translates the efficiency gains that result from the increases in size and bargaining power. **This item accounts for 10% of value creation**

4 **Inorganic EBITDA margin** evolution reflects the increasing efficiency in Vallado's operations. The operational efficiency will be mainly a result of synergies originated by the integration of Vallado in Aveleda's cost structure. **This item accounts for 16% of value creation**

5 **Multiple Arbitrage** is not affecting the value creation of Aveleda. Although significant efficiency improvements are expected in Aveleda as well as a more preeminent international presence, it is forecasted both the entry and exit multiple to be the same

6 **Cash generation** will increase the value created by the firm, due to the improvement of the firm's cash position, aligned with the natural capability of Aveleda to generate cash. **This item accounts for 14% of the value creation**

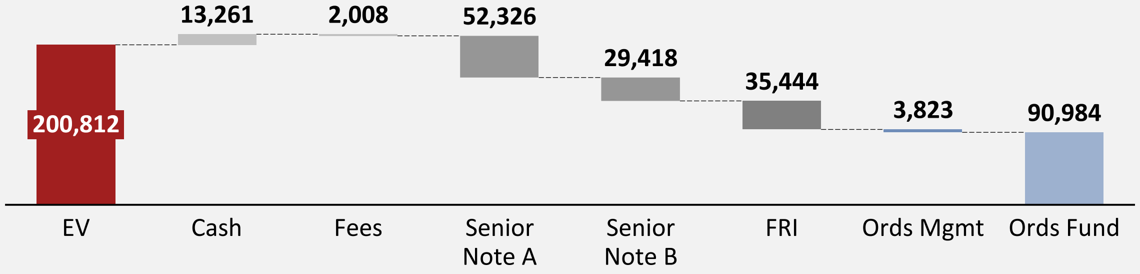
RETURNS

The LBO highlights Aveleda's strong capacity to generate cash, sustain a high debt level and yield strong returns for investors

AVELEDA

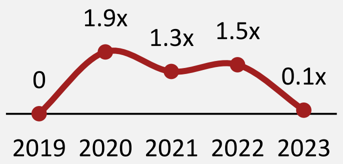
EXIT WATERFALL | *Decomposing the final Enterprise Value*

- **2019: Aveleda is expected to be acquired by an EV of c. €87m** (excluding lands and the main house). In addition, **Vallado´s acquisition EV amounts to c. €28m**, which, combined with fees, builds a **total of uses of c. €118m**
- **2023:** Upon the decided exit year, Aveleda is expected to have an EBITDA of c. €19m thus, resulting in an **EV of €200.8m**. The exit waterfall will leave space for both equity and bondholders have high returns on their investments

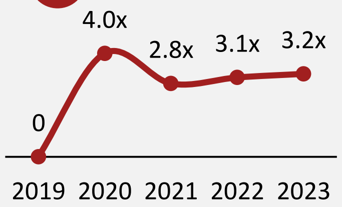


COVENANTS | *Cash and Interest cover breach: 1.5x and ND/EBITDA: 6.75x*

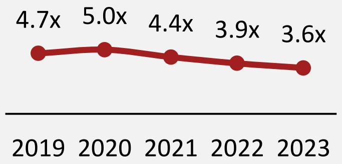
1 Cash Cover



2 Interest Cover



3 Net Debt to EBITDA



1. The ratio is expected to be stable over the years. The **highest pressure** is expected to happen in **2021**, with Vallado's debt. However, Invesco confirmed that even with a minor breach in the covenant in 2021, the lender would allow to maintain the **same spread margin**
2. Strong **capacity to sustain the determined interest payments**
3. Decreasing ratio exclusively due to **EBITDA increase, since debt remains constant**

RETURNS | *Management and institutional payback*

i) Management

Exit Multiple	MM	Exit Year 2022	2023	2024
	9.4x	3.0x	3.5x	4.0x
	10.4x	3.3x	**3.7x**	4.3x
	11.4x	3.7x	4.1x	4.7x

Exit Multiple	IRR	Exit Year 2022	2023	2024
	9.4x	32.1%	28.2%	25.8%
	10.4x	34.6%	**30.1%**	27.4%
	11.4x	38.2%	32.8%	29.5%

The management team is expected to be **highly rewarded by the fulfillment of the projected business plan**. Management will receive Sweet Equity, which requires an investment of €465k (2x annual management salary), corresponding to 5% of Ordinary Shares. In year 2, this Sweet Equity will be sold to the fund and 75%[1] of the proceeds will be reinvested in the company, mirroring the Fund´s investment mix between FRI and Ordinary Shares. The three components (FRI, Ordinary Shares and cashed-out Sweet Equity) correspond to the expected management returns of 3.7x Money Multiple and IRR of 30.1%. **The expected envy ratio is 1.0x**

ii) Fund

Exit Multiple	MM	Exit Year 2022	2023	2024
	9.4x	2.9x	2.9x	3.4x
	10.4x	4.0x	**3.4x**	3.9x
	11.4x	3.4x	3.9x	4.5x

Exit Multiple	IRR	Exit Year 2022	2023	2024
	9.4x	25.3%	23.5%	22.5%
	10.4x	30.8%	**27.5%**	25.5%
	11.4x	35.7%	31.1%	28.3%

The fund's projected Money Multiple and IRR will be 3.4x and 27.5%, respectively, in the base scenario. The two main components of the fund's returns are: **i) FRI** that will repay the fund €34.2m in 2023, as a result of the initial equity loan injection and **ii) Institutional Ords** that after the full repayment of Debt obligations will return the fund €91.0m

The forecasted scenarios reveal that investing in Aveleda will provide both the fund and management high returns in a low-yield economic environment

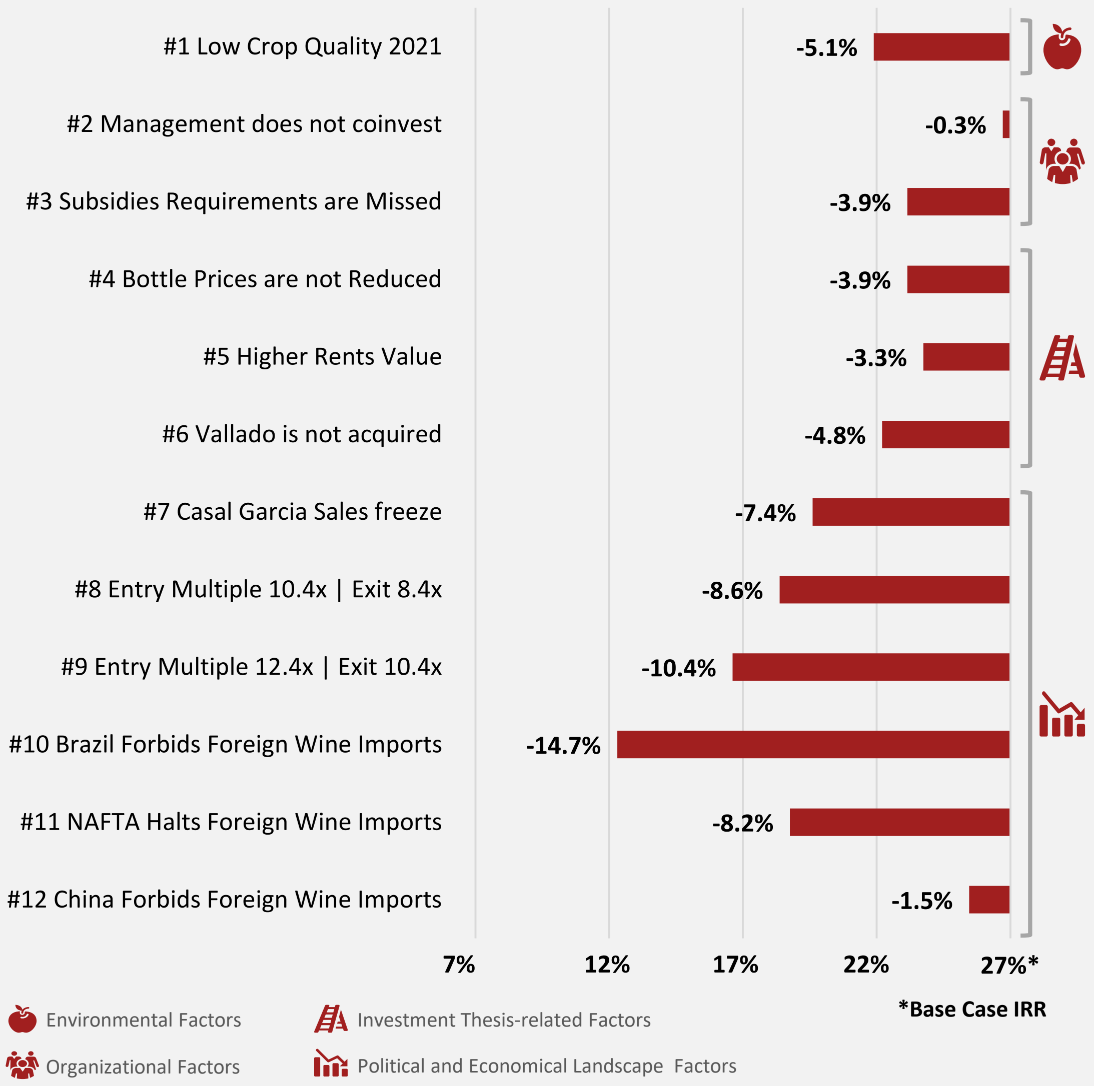
1. The remaining 25% correspond to €465k in order to fully cover the initially invested capital by the management

SCENARIO ANALYSIS | DOWNSIDE SCENARIOS

Different scenarios were analyzed, concluding that Aveleda shows capacity of hedging against most of the potential risks

AVELEDA

12 HYPOTHETICAL SCENARIOS | *Impact on exit year's (2023) IRR*



ASSESING RISKS | *Evaluating impact and drafting a risk mitigation action plan*

#1. With a low-quality crop in 2021, sales would be affected 5%. This would directly decrease the sales of *Vinho Verde* in 2022, given that this wine has a lower than 1-year aging period. Only in 2022 red wine sales would be affected, given the higher aging period. **The fact that Aveleda holds lands in different geographies, hedges against crop risks**

#2. Even if management does not coinvest, **the fact that they are also receiving rents from lands would incentivize them to be aligned with the interests of the owners**, meaning that IRR would not be strongly affected

#3. The impact that subsidies have on the IRR is relevant. However, given the ease that Aveleda has to comply with the requirements, efforts will be made to ensure compliance

#4. Bottle prices have a relevant impact on the IRR. Given that the competition in the segment has been increasing, it would seem unreasonable that the supplier, given the incremental size that Aveleda will acquire, would not decrease the bottle prices

#5. Significant impact on the IRR if rents double. The family would not lock the deal for this reason, given that if they rent their lands to others, they would lose Aveleda brand

#6. Not acquiring Vallado would limit the growth to China and would impact a lot the sales of Aveleda and Casal Garcia white wine and Vale D.Maria red wine. To mitigate this risk, previously analysed alternatives (Crasto/Esporão), would be possible targets

#7. The decrease in the dependence of Casal Garcia allows for a lower impact of sales variations on IRR, in 2023. Still, this scenario would have a considerable impact on IRR

#8/#9. These options seem unlikely given the low dispersion of multiples that were paid in past 10 years comparable transactions and the **general improvement in the company**

#10. Given the historical bond between Portugal and Brazil it would seem very unlikely that Portuguese products would suffer this kind of *embargo*. Moreover, the expansion policies undertaken hamper the impact on IRR of failing in Brazil

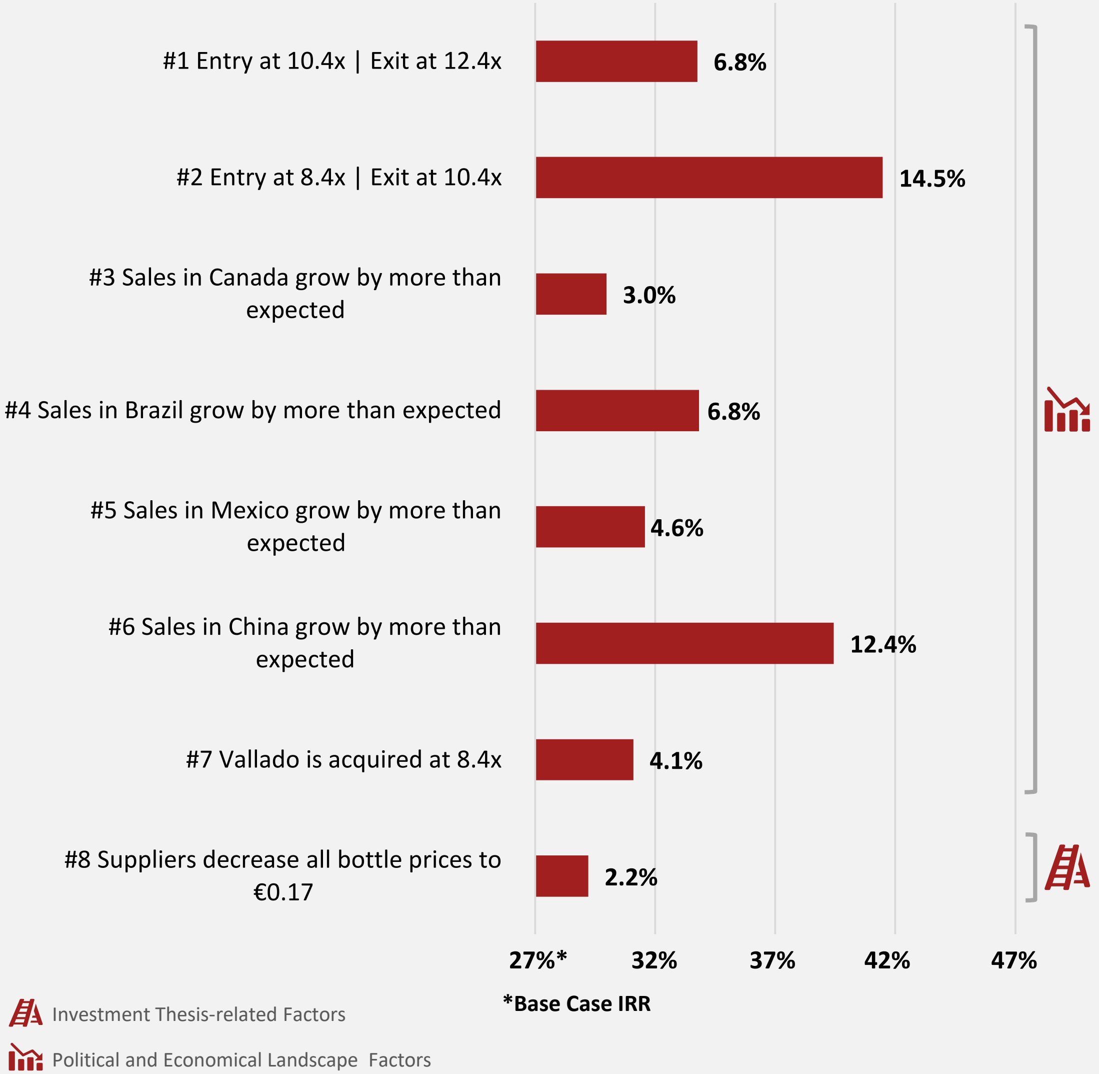
#11/#12. Possible scenarios but with very restricted impact on the projected IRR

SCENARIO ANALYSIS | UPSIDE SCENARIOS

Upside scenarios were forecasted, demonstrating Aveleda's capacity to absorb favorable scenarios

AVELEDA

8 HYPOTHETICAL SCENARIOS | *Impact on Exit Year's (2023) IRR*



ASSESING OPPORTUNITES | *Evaluating impact and probability of occurrence*

#1. This case seems realistic given the fact that, on exit year, Aveleda will become a large player, not only nationally, but also internationally. Moreover, with Vallado's add-on, Aveleda will gain a different EBITDA scale, which may call for larger players that are willing to pay higher prices

#2. Given the specificity of Aveleda and the family ownership, it seems very unlikely that the **owners would sell it for a below market multiple** (8.4x)

#3. The already **strong presence that Aveleda has in Canada, does not support the possibility to experiment an exponential growth in sales** in this country

#4. Aveleda already has a strong presence in Brazil, yet, **with the inclusion of Vallado and general investment in internationalization, sales in Brazil can grow more than expected**, yielding a significant increase on the fund's IRR

#5. Given the small presence that Aveleda has in Mexico, **there is the possibility that, with a strong marketing and awareness campaign, higher-than-forecasted sales growth takes place**

#6. Aveleda has a very small presence in China. **With the inclusion of Vallado and general investment in internationalization, Aveleda's sales may grow at a faster pace**, firstly after introducing Vallado's premium wines and, after it, by pumping into the Chinese economy very good price/quality wine, with idiosyncratic characteristics. A sign that China is an important piece in the internationalization strategy is the effect that it causes in the fund's IRR

#7. Given Vallado's smaller dimension, it seems realistic that the acquisition multiple could be lower than the multiple for Aveleda. Yet, given the strong family influence, allied with many centuries of history and prestige, it is unlikely that the family would agree to sell at a lower multiple than the market value

#8. Given the several wine types that Aveleda will sell in 2020, it would seem very difficult that bottle suppliers would agree to sell all bottle types at €0.17 (minimum market value). Given the long aging periods that premium wine has, it is necessary that these wine bottles have a larger (and more expensive) glass

AGENDA

AVELEDA

- EXECUTIVE SUMMARY
- MARKET OVERVIEW
- COMPANY OVERVIEW
- INVESTMENT THESIS
- VALUE CREATION
- BUSINESS PLAN
- VALUATION
- CAPITAL STRUCTURE
- EXIT OPTIONS
- RETURNS
- **DUE DILIGENCE**
  Deep Analysis of Critical Points
- APPENDIX

DUE DILIGENCE

An effective commercial and real estate Due Diligence will be crucial for Aveleda's business model credibility

AVELEDA

	Focus	Under Analysis	Critical Points	Provider	Estimated Time
Commercial	Growth forecast and outlook	▪ Macroeconomic metrics analysis (inflation, GDP, etc.) ▪ Model macroeconomic assumptions verification	▪ Assure assumptions' rationale ▪ Draw a forecasted economical outlook	McKinsey&Company	30 Days
	Peers Assessment	▪ Competitive landscape description ▪ Aveleda strategic position and market share in key markets	▪ Develop deep research on competitors ▪ Analyze key international markets' dynamics		
	Buy-and-Build	▪ Quinta do Vallado's feasibility and efficiency gains ▪ Alternative acquisitions hypothesis and its suitability	▪ Deep dive in Vallado's acquisition rationale ▪ Detailed analysis of potential deals		
	Business Model	▪ In-depth analysis of revenue mix ▪ Interaction with key stakeholders (suppliers, clients, etc.)	▪ Draw a report on future market trends ▪ Outline optimal stakeholder structure		
	Market Entries	▪ Assess most appropriate market entry strategies ▪ Identify relevant markets for Aveleda expansion	▪ Perform deep analysis on expansion needs ▪ Draw an expansion map		
Real Estate	Property Valuation	▪ Validate property book value ▪ Potential capital gains over property	▪ Accounting rules and past compliance ▪ Use network to identify similar lands	CBRE	45 Days
	Property Management	▪ Conduct analysis over rental and land lease agreements ▪ Confirm maintenance capex needs for the vineyards	▪ Assess contractual terms with 3rd parties ▪ Identify potential contractual issues		
Insurance	Contracts	▪ Verify insurance contracts currently in place ▪ Determine suitability for the wine industry	▪ Assure insurance covers all the legal requirements	Willis Towers Watson	45 Days
	Coverage	▪ Benchmark insurance contract's terms and prices ▪ Analyze best practices for the wine sector	▪ Identify key insured areas ▪ Draft a full insurance map		

DUE DILIGENCE

Accounts accuracy, legal verifications and agricultural assessments are cornerstones for Aveleda valuation

AVELEDA

Focus		Under Analysis	Critical Points	Provider	Estimated Time
Financial	Accounting	▪ Analyze accounting methodologies and accuracy ▪ Analyze accounts consolidation and cash management	▪ Check for any material misstatements ▪ Confirm inexistence of fraudulent schemes	EY Building a better working world	40 Days
	Fiscal	▪ Tax compliance ▪ Audit model tax assumptions	▪ Assure tax payments' schedule is updated ▪ Look for any outstanding tax litigations		
	Acquisition	▪ Verify cash flow generation profile to acquire Vallado ▪ Audit Vallado's financial model for the integration	▪ Evaluate past financing contracts' terms ▪ Guarantee no overdue amounts		
Legal	Licensing	▪ Verify production, exploration and commercial licenses ▪ Determine firm's legal capacity to operate in the sector	▪ Assure compliance with international commerce principals	Campos Ferreira Sá Carneiro & Associados	60 Days
	Litigations	▪ Understand pending ligations and on-going process ▪ Determine major legal liabilities with key stakeholders	▪ Validate provisions' level of credibility ▪ Assess potential future financial impacts		
	Contracts in place	▪ Review contracts with suppliers and clients ▪ Identify potential losses for Aveleda	▪ Revise contractual clauses ▪ Draft future land rental terms		
Agricultural	Subsidies	▪ Determine subsidies recurrence ▪ Provide potential investment subsidized opportunities	▪ Revise European regulatory requirements ▪ Define upcoming subsidies to be attributed	SGS	60 Days
	Soil	▪ Determine soil PH and mineral compositions ▪ Water leakage capacity and soil renovation needs	▪ Run exhaustive soil tests ▪ Assure soils' capacity and quality		
	Vineyards	▪ Identify potential plagues and weather volatility ▪ Vineyards maintenance and efficiency assessment	▪ Confirm stated vineyards efficiency ▪ Test for plague and fungal occurrences		

DUE DILIGENCE

Proper management incentives and business supply chain full understanding are required for the acquisition

AVELEDA

Focus		Under Analysis	Critical Points	Provider	Estimated Time
Management	Management Team	▪ Evaluate Aveleda's management recent performance ▪ Structure a suitable bonus system for the company	▪ Identify improvement opportunities ▪ Draft a bonus system based on performance	Michael Page	40 Days
	New Hires	▪ Identify key hiring profiles to address expansion strategy ▪ Define performance assessment metrics	▪ Extensive profile screening ▪ Run interviews and assess candidates' skills		
Governance	Control Structure	▪ Clearly define the management roles ▪ Benchmark best governance practices in the industry	▪ Draft an exhaustive organogram ▪ Assess roles assuring no conflict of interests	KPMG	15 Days
	Culture	▪ Define company culture to determine main challenges ▪ Ensure competence and alignment of interests	▪ Identify eventual cultural breaches ▪ Raise red flags on integration problems		
Logistics	Distribution Channels	▪ Assess current distributors contracts and sellers' network ▪ Identify opportunities of enhancing contract terms	▪ Present a distributors map per region ▪ Arrange meetings with suppliers	Deloitte.	30 Days
	Supply Chain	▪ Evaluate current conditions of goods supply ▪ Design processes maps to describe the value chain	▪ Identification of all suppliers ▪ Map each suppliers' role and dependence		
Valuation	Valuation	▪ Ask for advisory on the potential deal value ▪ Conduct exhaustive analysis to identify hidden assets	▪ Present well-based valuation ▪ Test for different hypothetical scenarios	Santander Corporate & Investment Banking	60 Days
	Exit Options	▪ Advise on optimal exit strategy ▪ Contact potential investors and prepare for roadshow	▪ Draft optimal exit option ▪ Find investors and mediate deal		
Full Due Diligence			**Total Cost**	**€230k**	**Max: 60 Days**