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. - Creating Value in the Wine Industry

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25890

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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 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

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PROJECT REFLECTIONS

Manuel Duarte Guerreiro

AVELEDA

PERSONAL DEVELOPMENT

The development of soft skills is key in a competitive landscape as the financial world. Being differentiated by the personal touch and capacity to build trust among the work colleagues is crucial for the professional success. Along the development of this thesis we were able to conciliate schedules, build trust in each others work and above all learn with each other.

The confidence created among the group is not only something that helped to construct this investment paper but also improve our friendship. I would like to also highlight the importance that Nova had on my personal development. The opportunity to enjoy the new campus and more importantly the transaction from the old one to the new one made me feel a part of this new era. Its hard to express in words the impact that has had on my professional and “maybe” more important on my personal development. Arriving at 18 in a completely new world we were prepared to be “powerful minds”, apt to be shaped. Now, after whole intense years I have lived in Nova I am ready to my professional career – a “New Horizon”.

PROFESSIONAL DEVELOPMENT

The exposure to the true reality of a private equity deal allows for a more realistic opportunity to develop a toolbox to face the professional environment. The ability to learn, absorb and adapt throughout the construction of this investment committee paper creates the perfect circumstances to further develop technical skills (Power Point, Excel) and also financial skills (LBO Model, Leverage model and Business model). Moreover, one cannot avoid to highlight the great experience to build, during these months, a project in which the capacity to conciliate the schedule of a group of four (in which three were working fulltime) and the ability to define a proper work methodology to follow was extremely important to build discipline, self motivation and positivism.

It is my strong belief that when entering the professional life these learnings will be crucial and will define me as a professional. Having the opportunity to perfect and experience all these during my Master’s thesis was an incredible help to be more confident and conscious of the challenges and joys I will face during my first working years.

FINAL CONSIDERATIONS

In this final considerations I would like to thank my family for all the support and patience during the Master’s. To my parents that gave me the ability to pursue all my dreams and to my brothers that were crucial to define my ambitions I can only be grateful for their support and trustworthiness.

To my friends, I would like to thank for all the joys and hard moments we lived together. As Thomas Watson said: “Don’t make friends who are comfortable to be with. Make friends who will force you to lever yourself up.” This is the true meaning of friendship.

To all my professors, that were a true inspirations to aspire for the best, to aspire for the excellence. From my first years in Nova to the Masters, I have learned the importance of discipline, excellence and ethics and those are the values I want to keep for my professional life.

AGENDA

INVESTMENT THESIS

Aveleda, leader in the *Vinho Verde* market, holds a privileged position as it can acquire and assimilate other players

AVELEDA

1. Buy-and-Build | *Opportunity to follow a pro-consolidation market strategy*

- The highly dispersed market setup, with several privately-owned small grape growers and **lower degrees of operational efficiency**, represent an attractive opportunity for Aveleda to play a role of market consolidator
- Thus, there is an opportunity for the acquisition of a high-quality wine producer (especially red wine), **complementing Aveleda's product offering**. This strategy allows to **explore markets with high potential,** where Aveleda is **currently underperforming or where red wine is the entry door** (Buy-and-Build is meant to fuel the internationalization process)
- After successful integration of the acquired targets, there is a clear opportunity to benefit from synergies related to: a) **costs savings**; b) **increased bargaining power;** and c) **sales** growth, leveraging on **Aveleda's global net of distributors**
- **Increased revenue volume** will make Aveleda a more **attractive target for international players**

2. Internationalization | *Opportunity to leverage on an already established international strategy, to exploit high-growth potential markets*

- Aveleda offers a wide spectrum of wines and spirits, made with exclusive **native grape varieties**, representing a competitive advantage against international players. Moreover, **Aveleda´s exportation volume has been steadily increasing** throughout the past 10 years, with presence in more than 80 countries
- **The exportation structure is already established**, with exports accounting for 69% of total revenue, meaning that **there is no need to entail in significant development costs.** Thus, the current distributors network and strong relationship can be used to ease the internationalization process
- There are markets (such as China and Canada) where Aveleda **is still not operating at full potential**, mainly due to: (i) not having the **most demanded wine types** (which will be addressed with the Buy-and-Build strategy) or (ii) **not having a well-defined expansion plan / team** to analyze the most efficient alternatives

3. Real Estate Strategy | *Opportunity to increase the likes of the family of selling the firm, leaving them with the real estate's ownership*

- This strategy is aimed at **unlocking the sale of Aveleda**, given the strong **attachment of the family to the firm**. It consists in not acquiring the lands of Aveleda and the Guedes' Family house, which will decrease the Equity Value paid for Aveleda, while giving a **strong incentive for the family to sell**
- On top of that, this will allow the family **to continue receiving an annual fixed income** (c. €1m) which will substitute the annual dividend distribution
- Given the wine production business dependence on lands**, a well-defined integration plan must be designed**. The land's rental contract will have a **perpetual term**, with detailed conditions which will **prevent future buyers from demanding a lower Exit Multiple due to risk of contractual breaching with landlord**

AGENDA

VALUE CREATION | BUY-AND-BUILD

Vallado's acquisition would allow the entry in unexplored markets with premium red wine

AVELEDA

The rationale behind the acquisition of Quinta do Vallado is to **penetrate high-potential markets**. By leveraging on Vallado's quality wines and its **historical heritage**, it is possible to gain awareness in these countries, in order to then **introduce other Aveleda brands**

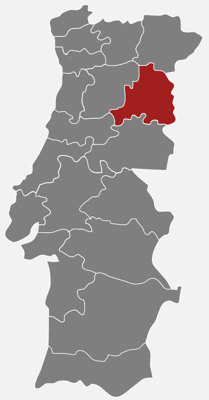
Target Analysis

QUINTA DO VALLADO

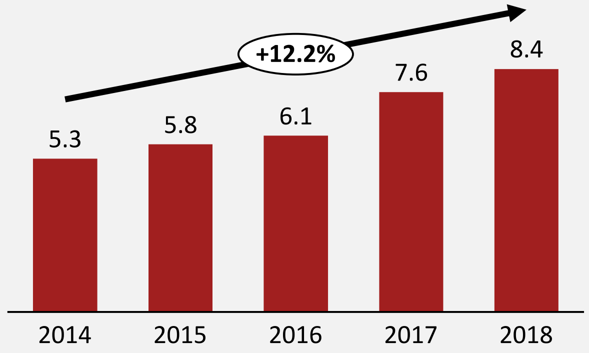
Located in the Douro Valley, with more than 300 years of history, Quinta do Vallado is one of the most preeminent wine producers in Portugal. With red wine as its core product, Vallado has been able to increase its revenues throughout the past years at a steady pace. Recently, Vallado has invested in the Wine Tourism sector, earning €1.5m in 2018

Location	Douro Valley, Northern Portugal
Revenues (2018)	€ 8.4 m
EBITDA (2018)	€ 2.2 m
EBITDA Margin	26%
Exports (%)	37%
Valuation	€28.5 m[1] (10.4x EV/EBITDA)
Synergies	Costs, Sales

Geographic and Performance Context



Vallado Sales Growth from 2014 to 2018 (€m)



Pro-Deal Reasons

- Different from all the products Aveleda has, leading to **residual cannibalization effect**
- Growing sales, with **clear global appreciation (high exports rate)**
- Opportunity to **enter new markets** and to run **operational improvements**
- **Synergies with Vale D. Maria estate**
- Strong **wine tourism** revenue stream

Anti-Deal Reasons

- Held in the same family for centuries, which can be **reluctant to sell** the company
- **Execution risk,** putting at stake part of the **internationalization strategy** if the deal collapses
- The firm's acquisition can **raise Aveleda's debt burden** to dangerous amounts, given its high implied valuation

Vallado's product offering (**premium red wine**) along with **high synergies potential** and its **strong wine tourism business unit**, matches all the defined requirements for the Investment Thesis. Therefore, **Quinta do Vallado will be acquired in 2020**

Sources: Mergermarket, Sabi, Vallado website

1. Based on forecasted 2019 EBITDA of €2.7m

VALUE CREATION | **INTERNATIONALIZATION**

Setting the pace for the long-term markets, whilst maintaining strong short-term cash flow generation

STEP 3 | *Selection Phase 2 – Final Decision*

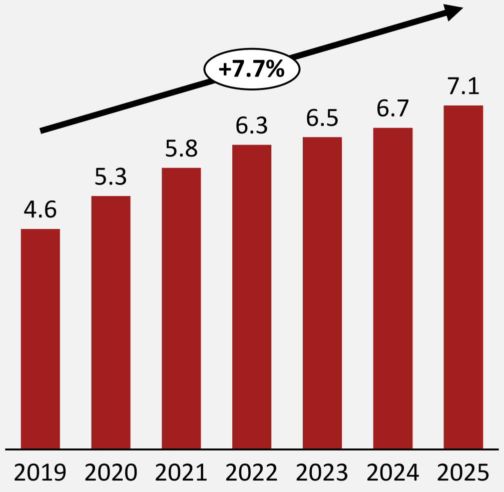
FINAL DECISION

Quick Wins

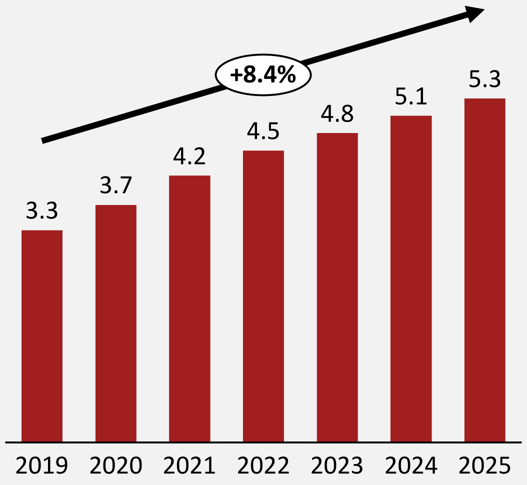
Long Term Investment

- Bearing in mind the information described, the final decision is to invest in **Brazil**, **Canada**, **China** and **Mexico**. This decision is based in two main goals:
    1. **Quick Wins:** Markets that **already have a high preference for white, low level of alcohol and fresh wines and in which Aveleda is already ramping up sales** and creating a momentum in the revenue curve. This means that these markets will allow for an **immediate (and sustainable) cash generation**
    2. **Long Term Investments:** Markets with **significant opportunities, with shifting preferences in young generations towards Aveleda's type of wines and solid consumer base, but are not yet at its full potential**, meaning that returns will not be immediate. However, through Vallado acquisition, which broadens Aveleda's portfolio and will allow: (i) to introduce **highly appreciated red wines in China**; and (ii) taking advantage of **Mexico recent appeal for smooth and fresh wines** with Casal Garcia introduction

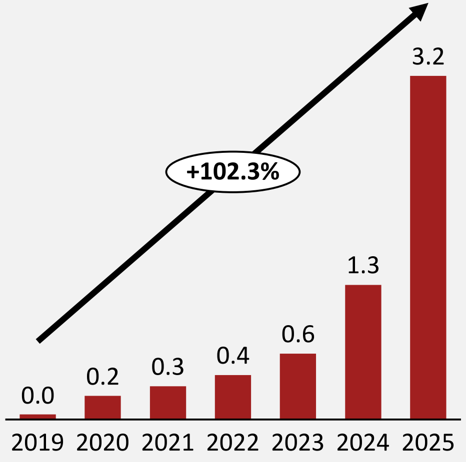
Brazil Revenue Forecast (€m)



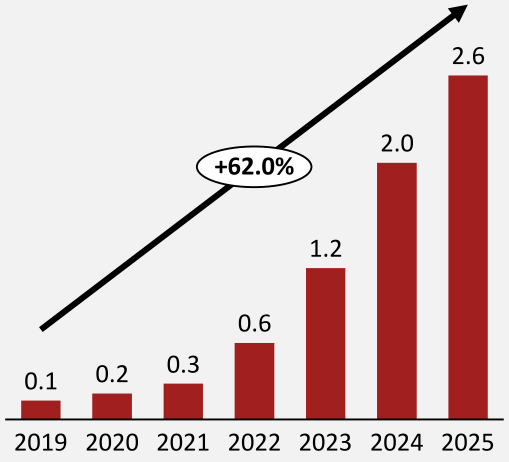
Canada Revenue Forecast (€m)



China Revenue Forecast (€m)



Mexico Revenue Forecast (€m)



VALUE CREATION | REAL ESTATE STRATEGY

Upon Aveleda´s buyout, the lands will remain with the Guedes family in exchange of a usage annual rent

AVELEDA

OPERATION | *Scenario impact on the company*

- As previously stated, one of the main obstacles of buying a business that is not only family owned, but has also a long tradition and several shareholders, is that it becomes harder for the owners to accept the deal. **The real estate strategy aims at easing the acquisition of Aveleda** by allowing:
    1. The possibility for the family to **remain as the owner of the lands and the family house**: This will ensure that the family keeps its attachment to the firm. Not only the family will keep its long-time heritage and centre of family retreats, but it will be also the owner of a vital part of the business
    2. The assurance of a constant **financial compensation from rents**: As the financial component is also an important determinant for the family, the fact that dividends will no longer be received will be mitigated by giving an annual rent to the landowners
- For the buyer, this operation **decreases the equity paid to shareholders**, as the book value of the two noncore assets (land and house) accounts for c. €15.6m and do not affect the operational side of the company. The annual rental fee paid to the family **amounts to 7% of the land´s value *per annum* (c. €1m)** and will be annually adjusted to inflation
- A consequence of not acquiring part of Aveleda's real assets, is that **the amount of available assets to be given as financial debt collateral is reduced**. However, this will be mitigated **using senior stretch loans, which bear higher interest costs** (this will be furtherly analysed in the leverage chapter)
- An important consideration is the **land expansion policy** currently being pursued by the family and that will continue to be followed. This policy consists in **acquiring lands from regional grape suppliers** in order to hedge against the ageing of the local grape suppliers (currently 76% of the grapes are acquired from external producers and the firm wants to reduce this exposure). The land that will be acquired after the acquisition will be owned by the company (not the family), as opposed to the existing land of Aveleda

Aveleda's Main House Value	
Base Value (€m)	0.6
Area (m²)	1,500
Affection Coefficient	1
Location Coefficient	1.2
Quality and Comfort Coefficient	1.5
Age Coefficient	0.4
Total Book Value (€k)	**651**

The value of the main house was calculated using Portuguese Fiscal Authority's method, which consists in **calculating the asset's taxable base**. This method applies the **four determinant coefficients of value to the area and base value of the property**

Land Value in 2018 (€k)	Ha	Price/ha	Total Value
Douro	42	45	**1,890**
Vinho Verde	395	32	**12,718**
Algarve	14	25	**350**
Total	**451**	**33**	**14,958**

Adding to the **increased operational efficiency of the company**, the real estate strategy will strengthen Aveleda's position as an **attractive target for possible future acquirers**

Sources: CBRE Research, Aveleda 2019 Annual Presentation, Alentejo Landowner, Autoridade Tributária e Aduaneira

AGENDA

BUSINESS PLAN | **REVENUE**

Revenues are set to increase, fueled by organic and inorganic streams, both in wine and complementary services

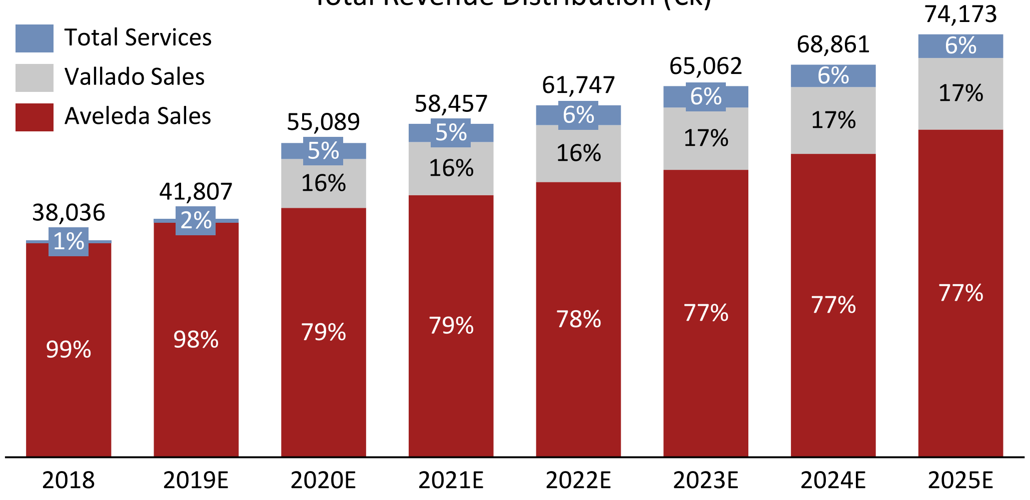
AVELEDA

GROWTH DRIVERS | *Sources of future growth*

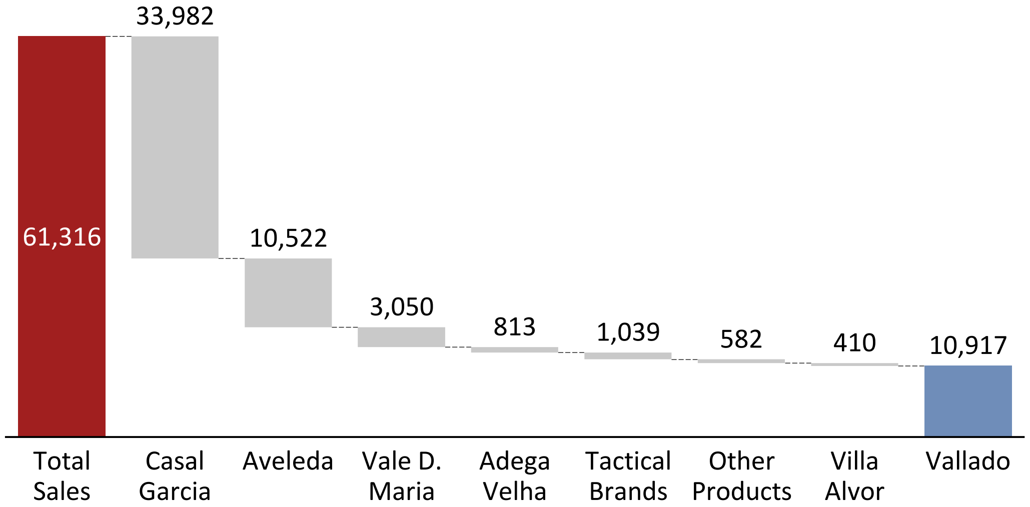
- Following the presented Value Creation strategies, **Aveleda's sales are expected to increase by 71% in the next 5 years**, which represents a **11.2% CAGR**
- This growth will be fueled by three determinants:

1. **Organic Growth**
   - Leveraging on markets where Aveleda is either **already growing at a fast pace** (Brazil, Canada) or, after implementation of international expansion measures and backed by the acquisition of Vallado, **will begin to grow exponentially** (China, Mexico)
   - The products, countries and brands where the sales are expected to grow the most are:
     - **Aveleda and Casal Garcia white wine in Mexico**, which will both grow at an estimated **CAGR of 64.6%** (2018-23), respectively. These two products' combined sales will represent €1.2m of 2023 total wine sales
     - **White wine, both Casal Garcia and Aveleda**, will also be very significant in **Canada**, growing at a combined **CAGR of 10.5%** (2018-23), representing, in 2023, €4.3m of total wine sales
2. **Inorganic Growth**
   - **Investing on the acquisition of Quinta do Vallado**, enabling Aveleda to enter high potential markets with premium red wine, **to introduce white wine products afterwards**
     - **Vallado's exports to non-EU countries,** fueled by red wine sales in China, will grow significantly, at a **18.0% CAGR (2018-23),** going from €927k in 2018 to €2.1m in 2023
3. **Wine Tourism**
   - The **growing importance of wine tourism** in Aveleda's forecasted revenues will be mostly due to the acquisition of Vallado, which has a strong unit of this service. Growing in this sector will **allow Aveleda to diversify its product portfolio**

Total Revenue Distribution (€k)



Wine Sales by Brand, in Exit Year (2023), €k



BUSINESS PLAN | **OPERATING MODEL**

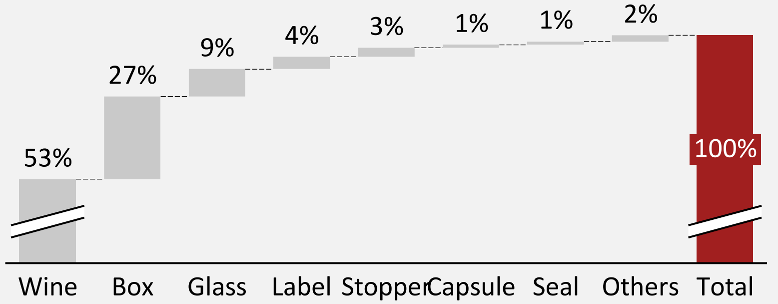
Operational efficiency will normalize after full integration of acquisitions

AVELEDA

GROSS MARGIN | *Improvement as a consequence of COGS reduction*

- Gross Margin is expected to **decrease in the first years of operation as a result of Vallado's incorporation**
- Gross Margin will then recover based on **operational improvements, synergies and higher bargaining power with suppliers** (glass, bottles, labels and boxes)
- In 2019, **COGS as % of Sales will decrease by 3.2%**, due to a decrease in bottle and labelling costs
- Although it is expected an operational efficiency improvement, given that: (i) **53% of total COGS come from wine** (the wine liquid itself and corresponding process); and (ii) Aveleda's efficiency, **there is little room for improvement**

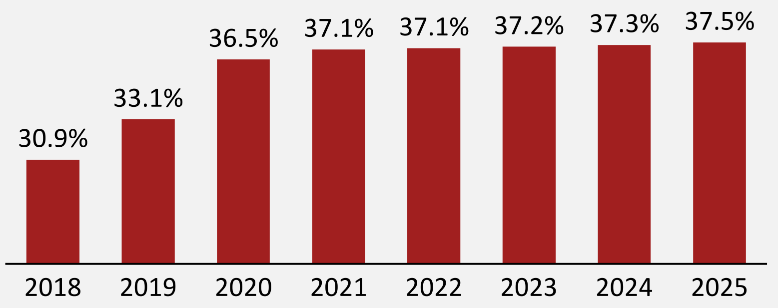
COGS Breakdown, 2019-2024



DIRECT MARGIN | *Economies of scale driving better efficiency*

- Direct Margin is forecasted to improve in the upcoming years. The **acquisition of Vallado will allow higher personnel allocation efficiency** (less people to produce the same quantity)
- Vallado's integration (with a Direct Margin of 59.6% in 2018) will promote the existence of **economies of scale,** improving the Direct Margin from 2019 to 2020 and steadily increasing, thereafter, **hovering around 37%**
- **The growing importance of China in revenues will allow an increase in Direct Margin**, given that red wine will be the flagship product in the country and has a **higher Direct Margin**
- **Marketing expenses are predicted to increase in 2020**, as a result of **Aveleda's 150th anniversary**

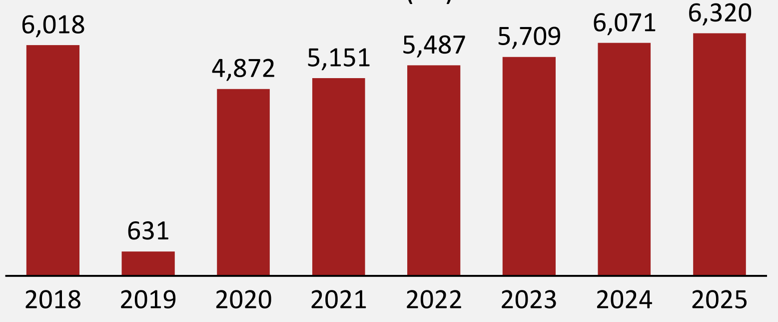
Direct Margin



CAPEX | *Constant investment in lands to reduce external dependency*

- CAPEX will be key to support Aveleda´s growth strategy. The boost in sales increases the need for internal grape supply, therefore **land and vineyard acquisition will be crucial to maintain long-term sustainability**
- In 2019, **CAPEX will be halted** in order to support 2020´s Quinta do Vallado´s acquisition
- **Quinta do Vallado acquisition will represent the most significant financial endeavour in the upcoming years**, which will be financed through a mix of debt and available cash
- Quinta do Vallado is valued at **10.4x with an EBITDA of €2.7m**, yielding an **EV of roughly €28.5m**

CAPEX (€k)



BUSINESS PLAN | OPERATIONAL CASH FLOW

The acquisition of Vallado and increasing operational efficiency will fuel strong unlevered Free Cash Flows

AVELEDA

Cashflows ('000€)	2018	2019	2020	2021	2022	2023	2024	2025
EBIT	**9,001**	**9,225**	**12,689**	**14,094**	**15,244**	**16,328**	**17,637**	**19,565**
+ Depreciation, Amort., Impairm. Losses on Fixed Assets	1,614	1,592	2,575	2,723	2,847	2,981	3,140	3,289
EBITDA	**10,615**	**10,817**	**15,264**	**16,817**	**18,091**	**19,309**	**20,777**	**22,854**
- Change in Working Capital	932	(2,130)	(3,361)	(908)	(790)	(1,089)	(1,058)	(1,561)
- Change in Trade Receivables	(1,621)	1,052	(2,532)	(729)	(518)	(616)	(726)	(984)
- Change in Inventories	(403)	(334)	(3,780)	(1,026)	(965)	(972)	(1,115)	(1,617)
+ Change in Trade Payables	2,955	(2,848)	2,951	847	693	499	784	1,040
- Current tax	(2,267)	(2,343)	(3,224)	(3,588)	(3,888)	(4,169)	(4,506)	(4,998)
- Maintenance Capex	(1,131)	(1,151)	(2,149)	(2,196)	(2,253)	(2,310)	(2,370)	(2,432)
NET CASH FLOW FROM OPERATING ACTIVITIES	**8,149**	**5 192**	**6,530**	**10,125**	**11,160**	**11,741**	**12,844**	**13,863**
-Investment in Fixed Assets	(6,631)	14,527	(28,472)	(2,497)	(2,474)	(2,443)	(2,645)	(2,741)
- Expansion Capex	(5,143)	14,492	(28,471)	(2,531)	(2,509)	(2,478)	(2,680)	(2,741)
- Financial Investments	(1,488)	35	(1)	35	35	35	35	-
- Dividends Paid and Other Cash Outflow from Equity	(1,593)	(14,958)	-	-	-	-	-	-
+ Losses from Investment Sales	48	6	66	45	56	58	57	54
CASH FLOW FROM INVESTING ACTIVITIES	**(8,175)**	**(366)**	**(28,405)**	**(2,451)**	**(2,418)**	**(2,385)**	**(2,589)**	**(2,687)**
+ Financial Result	(42)	(33)	(42)	(22)	5	23	37	39
+ Government Grants Related to Assets	716	(242)	(208)	(168)	(168)	(168)	(166)	(165)
+ Change in Non-Current Borrowings	1,820	(3,680)	463	170	302	231	354	1,175
- Other Financial Borrowings	850	(683)	(683)	(683)	(683)	(683)	(683)	-
- Others	970	(2,997)	1,147	854	986	914	1,037	1,175
+ Change in Current Borrowings	(3,495)	(49)	28,929	14	14	14	12	217
- Finance Lease Liabilities	(375)	-	-	-	-	-	-	-
- Other Financial Borrowings	136	(207)	(206)	(206)	(206)	(206)	(206)	-
- Shareholders / Associated Companies	(576)	247	28,862	-	-	-	-	-
- Others	(2,680)	(89)	272	220	220	220	218	217
+ Change in Derivatives	(0)	(2)	(6)	(4)	(5)	(4)	(5)	-
+ Adjustments	0	(0)	122	196	237	226	260	294
CASH FLOW FROM FINANCING ACTIVITIES	**(1,001)**	**(4,006)**	**29,258**	**186**	**386**	**322**	**492**	**1,559**
Change in Cash	(1,027)	820	7,383	7,860	9,128	9,678	10,747	12,735
BoP Cash and equivalents	1,061	34	854	8,236	16,096	25,224	34,902	45,650
EoP Cash and equivalents	34	854	8,236	16,096	25,224	34,902	45,650	58,385

DESCRIPTION | *Main highlights*

- The effective **Tax Rate is 25.5%**, the same value in the 2018 Annual Report
- **Depreciations are expected to increase, due to Vallado's integration**, going from €1.6m in 2019 to €2.6m in 2020, which will increase the fixed asset base of the consolidated firm.
- EBITDA margin will constantly increase throughout the investment period from 26.0% in 2018 to 29.7% at exit, due to: (i) **increasing bargaining power with suppliers**; and (ii) **Vallado's integration**, which will generate cost synergies
- The Real Estate strategy will generate a **decrease in trade payables,** increasing the net working capital in 2019. This is due to a decrease in farming property valuation, which **decreases the deferred tax payables**
- **Net Working Capital suffered a large increase in 2020 mainly from Vallado's acquisition**. This operation will negatively affect the consolidated cash flow, **mainly due to increase in inventory** (Vallado's wine is kept more time in cellar)
- CAPEX represents a significant portion of the investing cash flow because of the **continuous strategy of land acquisition**