

Arcus: Asset-Light, Cash-Generative Nordic Leader in Wine and Spirits

Jose Antonio Larraz of Equam Capital presented his in-depth investment thesis on Arcus (Oslo: ARCUS, Frankfurt: A48) at European Investing Summit 2017.

Arcus is a Nordic branded consumer goods company which produces, imports and distributes wine and spirits in the Nordic region, holding leading positions in various markets. The company operates an asset-light business model, which allows for a high return on capital and strong cash flow generation. Following an IPO at the end of 2016, the company recently traded at an attractive valuation, as suggested by FCF yield of 8%.

The following transcript has been edited for space and clarity.

At Equam Capital we leverage the private equity experience of both partners. We have been investing for more than twenty years in non-quoted companies. We have been participating in the boards of directors for companies and helping management teams to develop their strategy and create value over time. When you invest in non-quoted companies you get used to investing for the long run. We were invested in companies for six, seven years, or even more.

We now invest in the public markets. It gives us an advantage because on many occasions in the market people invest more with a short-term mindset. If you are patient instead of trying to gain in the short term, you can take advantage and make extraordinary investments.

Key Investment Criteria

When we look for an investment, we consider four important criteria:

First, we want to invest in good businesses or in stable businesses that have a good visibility, and have certain competitive advantages or barriers of entry.

Second, we want to invest in companies that have low risk, i.e., low debt. We avoid companies that could encounter financial difficulties.

Third, we want to invest in companies that are owner-operated — companies where management is aligned with the rest of the shareholders, where there is a shareholder in control or, at the very least, management takes a long-term view.

Finally, we want to buy cheaply, and if not cheaply then at least at a reasonable valuation.

The “perfect” company that meets these four criteria is difficult to find. We try to find companies that have a good balance between these four criteria. Every morning you wake up, if you’re investing in Europe, you have four thousand companies you can invest in. It is difficult to know where to find the companies that could meet these four criteria.

There are two big areas of opportunity: First, companies that are having temporary problems — because of the short-term view of the market. When the market is overreacting and penalizing such companies, if you are patient and willing to wait two to three years, you can find a nice opportunity.

The second area is companies the market is ignoring. This is typically because they are small caps, they working in a small niche, or are local companies in specific geographic area.

In-Depth Investment Thesis on Arcus

Arcus (Oslo: ARCUS, Frankfurt: A48) is a Norwegian company based in Oslo. It is a branded consumer goods company that sells wine and spirits in the Nordic countries. It has a market cap of ~€320 million. The company was created in 1996 as a spinoff from the retail monopolist in Norway, which sells spirits and wine in the Nordic countries.

The latter was a state-owned company, privatized in 2004. In 2005, the company was acquired by a Nordic private equity called Ratos. Ratos developed an aggressive growth strategy. The company had operated in Norway only, with a limited number of products. It became a pan-Nordic company, operating in all Nordic countries with a full range of products in the wine and spirits segments. The company grew rapidly and became a market leader in the Nordics.

In 2016, Arcus was listed on the Oslo stock exchange through an IPO that included Ratos selling a large part of its stake and a capital increase that injected NOK 775 million to reduce debt. It was a private equity-owned company and had a lot of leverage. The capital increase reduced leverage from around 4x EBITDA to the recent level of 2x EBITDA.

The company has revenue of NOK 2.6 billion (€275 million) and EBITDA of NOK 335 million (€35 million). It has 400+ employees. It was listed at €43-44 per share. The share price has not done much since then.

Arcus has three businesses. The largest in terms of revenue is the wine distribution business. Second is the spirits distribution business. These two businesses operate in all Nordic countries and a bit in Germany. Arcus also has a logistics distribution business that operates in Norway only.

Arcus holds a top-three position in most of the countries in which it operates. Norway and Sweden are the largest geographies in terms of revenue, with around 40% each. Arcus has a smaller presence in Finland, as Finland is a smaller market.

Over the last twelve years, the company has grown at a compounded annual rate of 11%, of which 7% has been organic growth. This is remarkable as the market for wine and spirits in the Nordics has not grown at around 3-4%.

It's important to understand how the retail distribution of wines and spirit works in the Nordic countries, because it's completely different from other European countries and the U.S.

Alcohol sales in Norway, Finland, and Sweden are done through regulated, state-owned retail monopolies. There are three distribution channels — HORECA (restaurants and bars), retail monopolies, and duty free at airports. 90% of sales are done through retail monopolies — Vinmonopolet in Norway, Systembolaget in Sweden, and Alko in Finland.

They work in a similar way. You cannot buy wine or spirits outside of these monopolies. You cannot go to a supermarket, such as Carrefour, to buy wine or vodka because you will not find it there. You have to go through these retail monopolies.

The second characteristic is that advertising is either prohibited, like in Norway, or very restrictive. You cannot have strong competition based on advertising.

The retail monopolies select products through a tender process, i.e., they invite companies to present their proposals to sell vodka or gin, for example. The companies have to meet the criteria specified in the tender. The monopolies have experts in-house who select which vodka they will put in stores. You have to go through this tender process. If you manage to get through this tender process, you are guaranteed to be in the retail system of these monopolies at an established price, and you only compete with others that also won the tender process. That limits competition.

This system may seem strange and non-attractive but it has gone on for many years, and it has strong support in the population. The objective from the point of view of the governments is to regulate and ensure responsible sales of alcohol.

While 90% of sales are done through retail monopolies, the remaining 10% is duty free and HORECA (restaurants and bars). These segments represent a small portion of the market but play an important role for brand building and establishing “trendsetting” products and categories. Despite being a small part of the business, it’s an important part.

Let’s describe the three businesses of Arcus.

The Spirits Business

Spirits constitutes around 30% of revenue. In terms of EBITDA it’s similar to the wine business because it has higher gross margins and higher EBITDA margins. Within the spirits business, around 90% of revenue comes from their own products, produced in their plant in the surroundings of Oslo, in Norway. Only 10% of the products they sell are agency-produced and belong to third-party players.

They maintain a strong position in all the markets. Especially because they are the market leaders in a product that is specific to the Nordics, a spirit called Aquavit. This spirit has broad and long roots in the Nordic region. It is the liquor they chose for holidays and special events. It is a great part of the segment of the spirits in the Nordics. Arcus has strong market positions for this product. In Norway, they have around 83% market share. In other markets, it ranges from 30-60%.

The Aquavit spirit is also quite popular in the Northern part of Germany. That explains Arcus’ presence in Germany. They only sell Aquavit, a specific product, but in that product category, they have a leading market position in Germany.

Another characteristic of the spirit business — it’s a concentrated market in the Nordics. You have few players. In total, they have a great majority of the market. On one side, the other competitors are large international companies like Pernod Ricard and Diageo. On the other side, there are local companies, especially one company which is called Altia, a company similar to Arcus but it’s based in Finland. Altia was the spinoff of Alko, which is the monopoly in the Finnish market.

Why is it a concentrated market? Few players and strong position of Arcus especially because of their great presence in Aquavit. They also sell their spirit products like cognac and vodka, because it’s important for them to have a full product range.

In terms of the development of the spirits business in the Nordic countries, this is a segment that is not growing rapidly. It is not growing all at in volumes, pretty stable. There has been a trend in recent years of premiumization. People are willing to consume less, but to consume better products. Despite the stability or slight decline in volumes, development in terms of

value, has been good. The sector has been growing at 2-3%.

Within the spirits segment, the Aquavit product has been performing better than other products. A decade or two ago, Aquavit was mainly consumed during the Christmas period or other festivities. Now it is consumed throughout the year and not only on special occasions. It has allowed this product to grow faster than all the products.

2015 was a bad year for the company in this segment. They had some problems and had to do a special promotion for certain products, which eroded profitability. They also had an interruption of a business. They were selling some brands of vodka in the U.S., which was out of the core business, and they decided to interrupt that business. That explains the fall in 2015. In 2016, the company recovered and the margins were back to normal levels.

The Wine Business

Wine shares some characteristics with the other business because it's also sold through the monopolies. But, it has important differences from the spirit business.

The first important difference is the spirits business is quite stable and not growing much. In the case of the wine business, the consumption in the Nordic countries, the consumption per capita, has been and continues to increase quite significantly. It's a segment with strong growth. It is coming from low levels compared to other European countries, because the consumption per capita used to be low and that allows to have good growth in the segment.

The second characteristic in the spirits business the products are quite stable and the brands don't change so much. In the case of the wine business you don't have any production of wine in the Nordics for obvious reasons, you are selling products which are coming from all parts of the world, Europe, US, Australia etc. The life cycle of these products is shorter, because you have many products to sell, and the tendencies and the modes are different. The consumers are always looking to try something new. The product doesn't stay for too long, for many years, as the most popular product. They tend to change quite a lot.

The third characteristic in the spirits business is a concentrated segment where few players are having the great bulk of the market. In the wine business, it is more fragmented. It's fragmented for better reasons because you have more products and different geographical areas where you can get wine due to the life cycle of the product being shorter. There are certain areas where you have the Chilean wine that is more in demand, then you go to the Spanish wines, and etc. It make the market more fragmented.

Arcus' position in the market is strong, as is the case in spirits. However, in the wine business, Arcus is only concentrated in three markets, Norway, Sweden, and Finland. It's only operating in those businesses where they operate with retail monopolies. They have the top three positions in the three markets. The competitors in this market are also similar to the spirits business. You have Altia, Pernod Ricard, and other local competitors.

If you look at the performance of the business segmentation in recent years, you can see there has been a strong top line growth. It is a segment which is growing. There has been certain erosion in the margins. But the company has been effective with the depreciation of the local currencies. They are importing products in Euros or US dollars and selling in local currencies. This devolvement of the local currencies caused an erosion in the margins.

What is interesting in the wine business is the way the company is operating. Because they have a decentralized and entrepreneurial business model. The company has a large number

of subsidiaries which are led by one entrepreneur. These entrepreneurs then make contacts with local producers in one geographic area. The entrepreneurs sell their products in the Nordic countries together with Arcus and they are leveraging on the close relationships of Arcus with the monopolies. Arcus is benefiting from these entrepreneurs' strong knowledge of the local producers. There is a strong alignment of interest and the entrepreneurs have a small stake in each of the subsidiaries. It is an alignment of interests that assures the long time commitment of entrepreneurs.

This system and the structure allow to maximize the percentage of Arcus in the different tenders. For example, in some of the tenders for a particular wine, you could have two or three subsidiaries of Arcus that are competing against each other. It is good for Arcus because they maximize the possibilities they will be the winners in a particular tender.

In the case of the wine business, a large part of the products are sold with the brand of the local producers. They are selling third party products. But, they also have a business of certain wine products they are selling with their own brands which they are producing in the local factory the company has in Oslo. They buy wine in bulk or they develop the product with a local producer to adapt to the characteristics of the Nordic countries. Then they bottle that wine in Norway, and they sell it in the Nordics. This is particularly true in Norway, because the partying box wine, which is a box with capacity of three liters, is popular. It is an area where Arcus has been developing and has been successful in Norway, achieving high growth.

The Logistics Business

It is the smaller business and is only operating in Norway. The company is providing logistic services internally to Arcus and also to third party players in the Norwegian markets. They had some difficulties in 2012 when they built a new manufacturing plant. During the transfer from the old plant to the new one they had some problems and the quality of the service deteriorated significantly. That made some customers to interrupt working with Arcus. They started having important losses to the business.

For the last few years the management has been working hard to turn around the business, making a strong reaction program and also winning back the trust of customers. It takes time and it is slow, but the company has been improving a lot. In 2016, they finally reached the breakeven of the business. The objective of the company is to achieve at least 5-7% EBITDA market in the coming years.

There are strong merits for this company. First, the company is operating in an attractive market and it's a non-cyclical market. It's a stable market in the case of the spirits, and a growing marketing in the case of wine. It's a business which has a volatile visibility.

The companies are operating in a market where there is a monopoly in the system. It allows a strong market positioned company like Arcus to benefit because of the close relationships they have with the monopolies. It makes small companies to gain markets and also for new entrants to come into the market.

There are important barriers for entry, also the fact that. You cannot advertise. Once you enter in the tender and you are within the segment of the monopoly, as long as the sales are performing well, you are going to be selling through the monopoly without any problems, and for a long time. It creates a balance of entry.

The company, in addition to the organic growth they have achieved throughout years, has constantly been doing bolt-on acquisitions. These bolt-on acquisitions create a lot of value because Arcus is the perfect platform for these acquisitions.

First, they buy small companies, or small brands, and they normally are able to buy those at attractive prices. Second, once they integrate these small acquisitions in their platform they can leverage on the strong persons Arcus has in the different geographical markets. It creates another value. The last acquisition was a vodka brand called Dworek. This vodka was produced in another plant, and what they did was they closed the factory and they moved the production to their own factory allowing them to create a lot of operational leverage.

Another merit is they have strong operational leverage. In 2012 the company invested 1b NOK in a completely new factory, which included the bottling and the manufacturing of the spirits, and it also has the distribution business. This plant is at around 60% capacity. Any growth on any additional volume you put into the plant has a tremendous impact on the profitability of the company, because of the high operational leverage.

The other important thing is that, because of the large investment they did some years ago, the current investment level of the company is extremely low. They have a Maintenance capex of around NOK 20 million per year. Whereas, they have a depreciation level of around NOK 50 million.

The company has strong cash flow generation capacity. Firstly, because they hardly have to do any capex. Secondly, the company generates important margins and has low capital needs. The return on capital is high. Third, which is also important, the working capital needs of the company are low. They are collecting the taxes from the spirits business because there is a strong tax on this product. 70% of the retail final price is taxes. These taxes are collected by Arcus and they are benefiting from that because they are getting paid by the monopolies before they have to give the taxes back to the authorities. They hardly have any working capital. The combination of low CAPEX, low working capital needs, high return on capital business, and high margins, is generating extraordinary amount of cash flow.

Valuation

Arcus is an attractive business at an attractive valuation. The shares recently traded at an 8% FCF yield — cheap for a company with a strong investment heritage. In absolute terms, a company like this should be traded for more around 6% FCF yield, which would mean there's a 30% upside to the recent price.

We don't look at comparables. But if you look at other companies, which have a similar business model, you can see they trade at 4-5% FCF yield. For example, Pernod Ricard, or Diageo, are better companies, they are international, and they have higher margins. 4% FCF yield is reasonable for this company. But, 6% should be a normal level for Arcus, and that's why they have 30% potential on the recent situation.

It is a company which has been growing significantly throughout many years. The management team has put in place certain financial values for the coming years which are reasonable. We compared them to the historical levels. Not the historical levels for the last 10-12 years, but the historical levels of the company in the last 3-4 years.

Even if we assume they will not be able to achieve these financial targets and make more conservative assumptions, if we are patient and wait for 3-4 years, the potential upside of

this opportunity is high. A compound average investment return of around 18-20% in the next 3-4 years. It is the returns we expect for this investment.

Risks

Changes to alcohol duties or to the regulation of monopolies: First, if there is a change in regulation, if there is an increase of taxes, or if they decide to interrupt the monopolies system in other countries, some of the advantage Arcus has would disappear. However, it is unlikely. The monopoly system has been working in the Nordic countries for many years, and is working well. There is also a strong support in the population. There is no incentive from the government to change the system, because it's working well.

In the big wine business we saw that, because of the deterioration of the NOK and the other local currencies, the margins of the wine business has been suffering. There is the risk that continues to be a deterioration, then values will continue suffering. We see that as an upside because the local Nordic currencies are at historical low levels. It should be recovering in coming years, and this should allow to improve margins in the wine business.

The other risk is key people leaving the company, especially the entrepreneurs in the wine business. The company does not depend on any particular person. This risk is not as high as the other ones.

Another important risk is they operate from one only plant, which is in the surroundings of Oslo. Should there be any problem at that plant, there would be an interruption of production, and there would be some temporary problems for the company.

The business has grown quite stable over time but remains seasonal — strong in the fourth quarter around the Christmas period. It is not a big problem, like in a retail business, where there is more uncertainty about whether their current collection will be working well or not. In this case the business is more stable.

In summary, Arcus meets the criteria we looking for in good investments. First, it's under the radar. The company has been recently quoted, at the end of 2016, and is only covered by two local brokers in the Nordic companies. It's not well-known by the market. Second, it's a good business with a high ROCE, stable demand, low cyclicity, barriers to entry and low capital needs. It's an attractive business. It has a 2x net debt to EBITDA. It's not low, but considering the strong cash flow generation capacity of the company, it is reasonable. Management doesn't have a great participation in the company, but following the IPO and when the private equity was sold, two new investors came into the company. One of them is a Norwegian Citizen, Erik Hagen. He's the chairman of another branded consumer good company called Orkla. He's an entrepreneur and a long-term investor. There is another investor, John Frederickson, who took 9% in the company, and who is also a Norwegian citizen. He's an entrepreneur in the oil industry. We are together with these two entrepreneurs, or long term investors, and the majority shareholders of the company.

The following are excerpts of the Q&A session with Jose Antonio Larraz:

Q: If we turn to slide #3. I noticed the company previously was owned by a private equity. Could you please elaborate why they chose to IPO as opposed to perhaps selling to a strategic owner?

A: The Ratos private equity had been in the company for 11 years. After a successful strategy it was time for them to exit. I don't know why they choose the IPO. It is a question

for them. It's difficult to answer from the outside. I haven't contacted them. But they tried to sell it to industrial players. Maybe there was not much interest in the business so they thought they could maximize their proceeds through the IPO.

Q: John Fredriksen, who has become a public shareholder, has a history of value creation. Do you know if he might be involved with financial engineering or helping to unlock the earnings power or valuation discrepancy?

A: I'm not sure. What I do know is that, at least at the moment, he's not in the board of directors of the company. He has a more passive attitude regarding this investment. On the contrary, the other larger shareholder, the chairman of Orkla, Mr. Hagen, has a larger stake in the company at 33% versus the 9% of John Fredriksen. He is in the board of directors. He has taken a more active position in the company. In any case, we feel comfortable these two successful entrepreneurs have decided to enter into Arcus.

Q: What are your thoughts on the segment mix in three, five or ten years?

A: I don't think it will be different in terms of geographic breakdown. But, management has told us Finland is a natural opportunity for them because their presence in that country is not big and that market is growing more than the others. It might be that in three or four years the Finnish business might be bit bigger than now. But, Finland is what it is. It cannot become 40% of the business because the country is not big and the population is smaller than the other countries. There might be some small changes but I don't see deep changes.

In terms of business segments, they have wines and the spirits. Wine is growing quicker than spirits. We could see a greater part of the business coming from the wine business. But that won't be a significant change. Maybe they move from 60% to 65 or 70%. But in any case, the spirits business has a higher margin. In terms of EBITDA the Chinese will not be significant either.

Q: Turning to slide #5. This is my first time learning about Nordic monopolies. How could people learn more? Are there any books, any resources?

A: I haven't seen any books but all these monopolies have their own websites and there's quite a lot of information on those websites where you can get information on them. Also the prospectus of the IPO of Arcus includes vital information on how these monopolies work because it's different from other countries in the world. It's an interesting story.

In the case of Arcus, it's something we see as a strength because it allows them to have this star market position and also to benefit them from certain barriers.

Q: Looking at slide #6, I'm seeing at the other players' data; is it appropriate to think the margins of Altia, Diageo might be relevant in this situation over time?

A: If you look at Altia, Diageo, the margins are higher. But they are large companies and if we look at the margins, we don't have an exposure of which margins they are getting in the Nordic countries. It's difficult to make a comparison.

In the case of Altia, it is a Finnish company which has a similar business model and the margins are lower. But the market position of this company is not as important as in the case of Arcus because Arcus has its position on Aquavit. Arcus is more or less in the middle between the large international players and some local players which have lower margins but also lower market position.

Q: If we please turn to slide 9. The margins of the wine have not recovered since 2013 whereas the margins of the spirit business apparently did recover. Could you elaborate why one segment had a recovery and the other one is yet to improve?

A: In the case of the spirit business, 90% of the products they sell are their own products which they are manufacturing in their own plants in Norway. They do not have any exposure to currency risk.

In the case of the wine business, 90% of the business is coming from third-party products which come from other countries and they are both in euros and dollars. They buy in Euros and dollars but they sell in the local currency. There's been a stronger deterioration of the Nordic currencies in recent years and that explains why the margins of the wine business has been deteriorating. We may be in historical minimum levels of the currencies. There could be some further deterioration in the future but we see this more as an upside because the deterioration of the Nordic currencies has been related to oil prices.

These economies, especially Norway, are related to the oil and because of the oil price reduction and oil prices been deteriorating significantly. It explains the deterioration of the margin in the wine business.

Q: If you could please turn to slide #10. I'd love to ask where you got this data from and how we could explore this data in more detail. What's the source and any other information about this?

A: This is coming from the prospectus of the IPO. It's detailed on how the business structure is executed at Arcus. It explains the success of Arcus in the wine business and it's a business model that is working well. But it also allows the company to grow significantly in the future because as long as they are able to find new entrepreneurs who want join the company, they can continue putting more products into their product portfolio. They'll then be able to succeed in the different tenders of their monopolies.

When we last talked to the management team, they explained that in the recent months they have two new entrepreneurs who wanted to join with two new subsidiaries by putting new products in the portfolio. For example, one of the entrepreneurs that joined Arcus was a former employee of one of the Norwegian monopoly. He knew what the needs of the monopoly were and he also had some contacts in Tiller, in this case with Tillerian manufacturers. By joining the Arcus, they can use the platform to be able to serve these products into the monopoly system. It is a model which is attractive for our consumer, and it explains the good success of the wine business.

Q: On slide 11, you mention operating difficulties and some customers leaving. Is it public information where those customers went?

A: There are two other players in the logistic business which are competing with Ventura. They went to these competitors. It has been difficult years for Arcus in this business but the good thing is that after some years and hard work by the company, they are starting to gain and recover the trust of the customers. It is a volume business because once you have been lose trust Arcus has. For the time being they've been able to recover the break-even point but the management is quite confident that in the coming years with some additional customers, this would be in this 5-7% EBITDA margin the company is targeting. It is one of the area where the company can create value.

Q: If we could please turn to slide 13. I notice the language in the first bullet point, “difficult to launch new brands because marketing is forbidden.” Is there a risk that it’s easier to create brands in the era of social media?

A: It might be the case especially for the young people. It is a way they could avoid basic limitation on advertising. But that would be a long-term trend. In any case, it’s Norway where the advertising is completely prohibited. In the case of Sweden and Finland, you still can continue to do advertising. You can use Twitter and all the social media platforms, but Arcus cannot simply use those. It’s long-term and it will take time to pursue.

Q: On slide 14, you mentioned spare capacity to improve margins. Could you elaborate?

A: They need to grow. But as we have seen in the case of spirits business, it doesn’t go quickly in terms of volumes. It’s difficult. The most important thing is to find the bolt-on acquisitions. In the previous slide, in slide 13, I put some examples of recent acquisitions they have done and it is bringing additional volume. But, bolt-on acquisitions come when they come. You might have two, three years without any acquisition because the opportunity doesn’t come through. Then suddenly it does come.

The acquisition of Dworek vodka is a good example because it was 1.6 million liters of additional capacity. They bought this brand, they closed their factory which was somewhere else and they brought this capacity to their plant. It allowed them to have a huge and interesting leverage levels. You never know when these bolt-on acquisitions are coming.

There are opportunities in the market. There are many small brands in the market which could be bought but you need to be patient. What management doesn’t want to do is to buy anything at whatever price because that doesn’t make sense. They want to be patient and buy the correct opportunity at the right price.

Q: You mention taxes on slide 14 — any thoughts on why the tax rate should not change?

A: It could be increased. But they are already high. 70% of the retail price is already taxes. That’s one of the reasons they could increase and put it in the investment reach stage. But I don’t think they will be going much further.

In any case, like the spirit business, there is pre-meditation. People not willing to pay more, they are looking for better products. Sometimes, what is more expensive looks like a better product and you are willing to buy that because you want to share that in the special dinner with your friends. You bought an Aquavit which is 50 Euros a bottle and you share with your friends, you’re happy. The risk on the tax issue is limited.

Q: I’m looking at slide #15; I’m noticing there’s also a confectionery chocolate products manufacturing company with the 6.9%. That also seems to be interesting. I’m wondering if there’s a reason why you chose not to talk about that. Maybe it’s worth looking at separately?

A: It’s also an interesting company. We haven’t got into the details of that company. But even if you compare that company with Arcus, it’s more expensive because we are only at 7% FCF yield, whereas Arcus is at 8% FCF yield. Also, there is no monopoly on selling chocolate products. This company does not benefit from the various opportunities Arcus has because of the minute monopoly situation. It’s an interesting business but it’s more expensive and we believe in less value opportunity or less market leader position in the case of Arcus.

Q: Turning to slide #16. I'd love to understand how you came up with these assumptions. They seemed to be a bit conservative or on a lower side. Any thoughts on how you chose these numbers?

A: We wanted to do some conservative numbers, being not only on the lower side but the low management target and to show that even if the company is not able to go above those numbers the investment return in this company would be attractive because with the conservative assumptions we get an annual investment return in the 18 to 20% range. We get that valuing the company at this 6% FCF yield we are assuming in the previous slide. If you put 8% then the return would be lower. But we strongly consider that a company like this should be valued more at the 6% level than at the 8% level.

Q: I'm wondering is there any place for share buyback or in this case dividends are the way going forward?

A: So far the company is not open to do share buybacks. First, they want to use their leverage, at 2.1x. It's not high but they want to reduce debt and they want to pay dividends. Also, they want to dedicate cash flow, if possible, to bolt-on acquisitions. In their priorities, it's not the share buyback. But the management don't discard that in the future. If they don't have any bolt-on acquisitions and once they have reduced leverage, they could do a share buyback. But it's not on the agenda of their management team.

Q: Slide 18 shows low leverage on the balance sheet. Why doesn't a private equity company buy it?

A: Good question. It would be nice if they buy them at a premium. We would be happy. But I don't know if that's a possibility. It is a perfect target for a private equity and Ratos did it well. There could be an opportunity.

That's related to one of your questions they did deal on. They didn't sell to another player, private equity or strategic. Maybe there was no appetite. It is a company that private equity would be happy to buy because of the strong cash flow generation capacity of the company.

Q: If we could please turn to slide #19, the final slide. I would guess the balance sheet, over time, gets more valuable. The value of spirits and wine appreciates. Perhaps the balance sheet might be understated. Do you have any thoughts if this might be the case and if so, what the balance sheet might be worth on a fair market value?

A: You mean on the inventory they have?

Q: Correct. As wine ages, its worth more, I assume.

A: Yes. Maybe that could be the case. In any case, it's not a huge amount they have on inventory. Even if it's valued more, I don't think it has a big impact on the valuation of the company. This is inventory that you are selling constantly.

Q: It's wonderful to learn from your experience and your perspective and the way you see the world. I'd like to ask why you are giving us so much of your time and so much of your wisdom. What's motivating you to share?

A: We love to share our investment ideas because we like to talk to people with different experiences, and who have different ways to approach to the investment in the stock market. We would love to hear from the audience and receive questions, receive comments or



receive different point of views that could enrich and help us improve our investment process.

Q: What questions or feedback would be most helpful to you?

A: If anybody has a different point of view on the investment merit, has seen any risk we haven't included in the presentation, doesn't agree with the valuation, or the approach we have, it would be useful for us because it would help us to get to know things we haven't thought about.

Q: I'm seeing we have a telephone number and a website. What's the best way to contact you?

A: Both of them. We are happy to receive feedback and be in contact with MOI Global members.

[/wcm_restrict]

About the instructor:

José Antonio Larraz is a founding partner of Equam Capital. Jose has 12 years of experience as a partner in Capital Alianza Private Equity, investing in Spanish private companies in the middle market. He has investment experience in chemical, food, retail, outsourcing and telecommunications sectors, having participated in the board of directors of six different companies. Jose has 4 years of experience in financial advisory, corporate finance and M&A at Lehman Brothers in London and New York and He is a Professor at Instituto de Empresa since 2008. Jose holds a degree in Law and Business Administration from ICADE University and MBA from Insead.

Members, log in below to access the full session.<?php echo date("Y-m-d"); ?>

Username or email address *

Password *

Or log in as follows:

Remember me [Log in](#)

[Lost your password?](#)

Not a member?

Thank you for your interest. Please note that MOI Global is closed to new members at this



time. If you would like to join the waiting list, complete the following form:

First name:

Last name:

Email address:

City / state / country:

Company:

How did you hear about MOI Global? ▼

If referral, please provide member's name:

Which of the following applies most closely to you? ▼

How do you hope to add value to the community?

Leave this field empty if you're human: