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# Project Bubbles
## *Champagne Leblanc-Lenoir: Corporate Valuation in an M&A Context*

This case was written by Francis Declerck, Professor in the Finance Department of ESSEC, and Thomas Gounel, ESSEC alumnus specialized in Corporate Finance and Valuation



The case was compiled from generalised experience.



This case is accompanied by a **Teaching Note** to be purchased separately

# Project Bubbles
# *Champagne Leblanc-Lenoir:*
# *Corporate Valuation in an M&A Context*



The objective of this case study is to determine the Enterprise Value ("EV") and the Market Value of Equity ("Eq V") of a non-listed company using different valuation approaches, and analyze the resulting values.

This value analysis will concern a transaction under consideration by the G. Idjow Spirits company ("G. Idjow"), a US global company which owns a large portfolio of leading brands in the major hard liquor markets.

G. Idjow is contemplating the possibility of developing a premium positioning in champagne and diversifying its brand portfolio. The group is considering the acquisition of the champagne house *Champagne Leblanc-Lenoir*.

The investment bank Anata Drink, where you work as a brilliant analyst, has been engaged by G. Idjow as its advisor for this potential acquisition, with the task of determining the operation's feasibility. First, you must perform a valuation of *Champagne Leblanc-Lenoir*, as a going concern and on a standalone basis, as at January 1, year N. Then you will be asked to determine an acquisition price on the basis of your valuation and analysis of potential synergies.

## 1. Business and financial overview of *Champagne Leblanc-Lenoir*

### 1.1 Business description

*Champagne Leblanc-Lenoir* is a well-known family-owned champagne producer, which has always been independent.

Since 1865, the Rayzins family and its ancestors, the original founders of *Champagne Leblanc-Lenoir*, have been producing high quality champagne that is among the most renowned in the world. The quality of its champagne mirrors the richness and quality of its vineyard, mixing lightness, taste and intense fruity aroma. The company's product range covers the whole spectrum of champagne wines: basic champagne, and special varieties such as "Blanc de blanc" and "Blanc de noir", as well as a few vintage champagnes and pink champagne, which is a booming market.

*Champagne Leblanc-Lenoir* has actively pursued excellence and recognition from the market, developing attractive partnerships with other luxury brands and special events, as well as an exclusive partnership with the World Polo Championship Final.

Both in and outside France, *Champagne Leblanc-Lenoir* embodies a demand for a high quality champagne that is recognized and appreciated by experts. It maintains its reputation by carrying out numerous investments for continuous improvement in product control, protection and storage.

*Champagne Leblanc-Lenoir's* growth has been fueled by strong exports (revenues in France represent only 15% of total revenues). The main countries where its products are sold are the United Kingdom (31% of revenues), Italy (17%), Germany (12%), the United States (8%), Japan (8%), China (5%), Spain (3%) and Brazil (1%).

The company's vineyard covers an area of 45 hectares (~110 acres) and is mainly used for vintage champagne production (the most premium products), mostly using 100% Grand Cru grapes or 99% Premier Cru grapes. Long-term partnerships have also been put in place with local independent winegrowers to support the company's own production.

Three varieties of grapes are used to make champagne: Chardonnay to produce the elegant, refined "Blanc de blanc" champagne, and Pinot noir and Pinot meunier to produce the highly aromatic "Blanc de noir" champagne. Any variety can be used to produce pink champagne!

A detailed overview of the champagne market is presented in the document below: "*6. Appendices 2*".

### 1.2 Financial information

The main financial data for Champagne Leblanc-Lenoir as at December 31, N-1 and December 31, N are as follows:

| Key financial information in M€ | N-1 Estimation | N Budget |
|---|---|---|
| Sales | 65,0 | 66,3 |
| EBITDA | 15,3 | 16,6 |
| EBIT | 11,5 | 13,1 |
| Total assets | 194,0 | na |

Cost control and volume growth, together with a steady increase in unit prices, have enabled Champagne Leblanc-Lenoir to strongly develop its revenue and profitability over the last decade. The company has also simultaneously improved product quality and developed its branding through significant, well-targeted advertising campaigns, while also rigorously controlling costs.

*Champagne Leblanc-Lenoir* is in good financial health compared to its main peers, with a moderate level of debt (28 M€) and equity of 139 M€.

The business plan was finalized in November N-1. Forecasts based on volumes at June 30, N-1 indicated that the year would be more difficult than expected, even though most sales in the champagne business take place during the second half-year.

According to these forecasts, champagne sales volumes are not expected to regain their N-3 level before N+2, with an average growth rate of 5% per year and the following factors:

- A significant slowdown in champagne sales in the first half of N-1 (-30% vs. N-2) with improving figures during the second half-year,
- The N-1 decline was accentuated by retailer destocking, and accordingly, recovery in N should be triggered by clients rebuilding their inventories to prepare for a recovery in consumption in N+1,

- The previous crises (1991, 2001) have shown us that the Champagne region, as a whole, returned to pre-crisis volumes within 6 years. The business plan forecasts a recovery over a comparable period of time.

# 2. Valuation of *Champagne Leblanc-Lenoir*

Using the business plan presented in Appendix 5.2, determine the market value of *Champagne Leblanc-Lenoir* as at January 1, N.

## 2.1 Market Multiples Approach

a. Analyze the two groups of listed peers: champagne houses and wine & liquor producers, according to the selection criteria you deem most appropriate given the specificities of *Champagne Leblanc-Lenoir*.
b. Determine the trading multiples you would apply to *Champagne Leblanc-Lenoir* (give the reasons for your selection): EV/Sales; EV/EBITDA; EV/EBIT, etc.
c. Value *Champagne Leblanc-Lenoir* using trading multiples and the multiples you have selected.
d. Value *Champagne Leblanc-Lenoir* using transaction multiples.
e. Compare results and analyze potential variances.

## 2.2 Cash Flow Approach

Using the business plan mentioned above, apply the Discounted Cash Flows method.

You will have to determine:

a. The Weighted Average Cost of Capital ("WACC").
b. The Enterprise Value of *Champagne Leblanc-Lenoir*.
c. The Market Value of Equity of *Champagne Leblanc-Lenoir*.

*Additional information:*

- *Book value of equity: 139 M€*
- *International Monetary Fund long-term inflation forecast for Eurozone and the USA: 2.0%*
- *Tax rates as at January 1, N: France 34.4%, Germany 29.5%, United Kingdom 22.0%, USA 40.0%, Japan 40.7%, Italy 31.4%, China 25.0%, Spain 30.0%, Brazil 34.0%*
- *Risk free rate as at January 1, N (treasury bonds with ten year maturity): France 3.193%, Germany 3.384%, United Kingdom 4.12%, USA 3.839%, Japan 1.285%, Italy 4.134%, China 3.626%, Spain 3.927%, Brazil 5.088%*
- *Equity risk premium: 5%*
- *Size premium based on long-term historical returns observed in the stock markets:*
    - *- Mid-capitalization: 0.98% (market capitalization between €1.2bn and €6.0bn)*
    - *- Low-capitalization: 1.85% (market capitalization between €0.2bn and €1.2bn)*
    - *- Micro-capitalization: 3.74% (market capitalization below €0.2bn)*

*Note: this size-related phenomenon has prompted a revision of the Capital Asset Pricing Model, which includes a size premium.*

### 2.3 Net Asset Value Approach

In order to determine the net asset value of *Champagne Leblanc-Lenoir*, you need to reappraise the value of certain assets in order to determine the market value of equity at the valuation date.

a. Determine the market value of *Champagne Leblanc-Lenoir*'s vinery, buildings and inventory.
b. Determine the value of the *Champagne Leblanc-Lenoir* brand with the help of the information below and the “Relief from Royalty Approach Overview” (refer to Appendix 5.5).
c. Deduce the market value of *Champagne Leblanc-Lenoir's* equity according to this approach.
d. Identify (but do not value) other assets which could have been valued/revalued for this exercise.

*Additional information:*

- *The vinery land's book value in the balance sheet (15.0 M€) does not correspond to its market value. The average price for a hectare of vinery generally observed in the Champagne area is currently 0.8 M€/ha.*
- *The Champagne Leblanc-Lenoir brand is not a recognized asset in the balance sheet. Observed royalty rates in the wine and liquor industry (including champagne producers) usually range from 3.0% to 9.0%.*
- *Independent appraisal of the buildings on September 30, N-1 concluded that their market value was 17.0 M€. The book value is 14.0 M€. This difference is mainly explained by the ownership of a unique “hotel particulier” mansion in Paris.*
- *Due to damage sustained following the renovation of the production facility (a bottle exploded, causing a chain reaction), a write-down of 14.0 M€ will have to be booked on inventories as at December 31, N-1.*

### 2.4 Conclusion

After analysis of the methods and results of these approaches, determine the market value of *Champagne Leblanc-Lenoir*'s equity as at January 1, N.

# 3. From market value to price

Now that you have determined the market value of *Champagne Leblanc-Lenoir's* equity, it is time to advise your client on a price range for acquisition of 100% of *Champagne Leblanc-Lenoir*.

Based on your meetings with G. Idjow's top management, the following synergies have been considered:

1. Lowering overhead costs, to achieve 0.5 M€ savings per annum after a restructuring plan that should cost 0.2 M€.
2. Rationalizing the distribution network, resulting in 1.0 M€ savings per annum.
3. Expanding *Champagne Leblanc-Lenoir's* sales in North America, resulting in revenues increasing by 3.0 M€ in N, 4.0 M€ in N+1, and 4.5 M€ per annum subsequently for a cost of 0.7 M€ a year.

- Determine the value of each of these synergies.
- Determine a price range you consider reasonable.



 

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# 5. Appendices 1

### 5.1 Balance sheet as of January 1, N

| Assets | M€ |
|---|---|
| Tangible assets | 35 |
| *PP&E* | *20* |
| *Land* | *15* |
| Inventory | 124 |
| Receivables | 30 |
| Cash | 3 |
| Other | 2 |
| **Total** | **194** |

| Liabilities | M€ |
|---|---|
| Shareholders' equity | 139 |
| Financial debt | 28 |
| Payables | 25 |
| Other | 2 |
| **Total** | **194** |

### 5.2 Business plan

| M€ | N-1 | N | N+1 | N+2 | N+3 | N+4 | N+5 |
|---|---|---|---|---|---|---|---|
| Sales | 65,0 | 66,3 | 70,4 | 75,5 | 80,2 | 85,1 | 88,5 |
| % growth | | 2,0% | 6,2% | 7,2% | 6,3% | 6,1% | 4,0% |
| EBITDA | 15,3 | 16,6 | 18,1 | 20,3 | 22,7 | 24,4 | 25,7 |
| % sales | 23,5% | 25,1% | 25,7% | 26,9% | 28,3% | 28,7% | 29,0% |
| D&A | 3,8 | 3,5 | 4,0 | 4,1 | 4,0 | 4,1 | 3,0 |
| % sales | 5,8% | 5,3% | 5,7% | 5,4% | 5,0% | 4,8% | 3,4% |
| EBIT | 11,5 | 13,1 | 14,1 | 16,2 | 18,7 | 20,3 | 22,7 |
| % sales | 20,6% | 18,9% | 18,5% | 20,0% | 21,0% | 22,3% | 24,1% |
| Capital expenditure | 1,5 | 1,6 | 1,6 | 1,7 | 1,6 | 1,6 | 1,5 |
| % sales | 2,3% | 2,4% | 2,3% | 2,3% | 2,0% | 1,9% | 1,7% |
| Working capital requirement | 129,0 | 86,2 | 91,5 | 98,1 | 104,3 | 110,7 | 115,1 |
| % sales | | 130,0% | 130,0% | 130,0% | 130,0% | 130,0% | 130,0% |
| Tax rate | 34,4% | | | | | | |

## 5.3 Comparable companies

| Name | Currency | Share Price | Shares Outstanding (m) | Free float (% of shares) | Net Debt (m) | Leveraged beta | Cost of debt | Tax Rate |
|---|---|---|---|---|---|---|---|---|
| **Champagne houses** | | | | | | | | |
| Laurent Perrier SA | EUR | 54,0 | 5,9 | 42,0% | 289 | 0,47 | 3,7% | 34,4% |
| Vranken Pommery Monopole SA | EUR | 29,7 | 6,7 | 100,0% | 520 | 0,48 | 4,5% | 34,4% |
| Boizel Chanoine Champagne SA | EUR | 41,2 | 4,6 | 47,9% | 535 | 0,55 | 3,8% | 34,4% |
| **Wine & Liquor producers** | | | | | | | | |
| Diageo Plc | GBP | 10,8 | 2503,8 | 99,8% | 8750 | 0,68 | 5,9% | 28,0% |
| Pernod Ricard SA | EUR | 59,9 | 263,9 | 70,3% | 12680 | 1,17 | 5,2% | 34,4% |
| Davide Campari-Milano SpA | EUR | 7,295 | 290,4 | 98,0% | 334 | 0,84 | 6,2% | 31,4% |
| Rémy Cointreau SA | EUR | 35,605 | 48,4 | 44,1% | 437 | 0,83 | 5,5% | 34,4% |

| Name | Currency | Sales (m) | | | EBITDA (m) | | | EBIT (m) | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | N-1 | N | N+1 | N-1 | N | N+1 | N-1 | N | N+1 |
| **Champagne houses** | | | | | | | | | | |
| Laurent Perrier SA | EUR | 159 | 170 | 182 | 33 | 38 | 45 | 29 | 36 | 42 |
| Vranken Pommery Monopole SA | EUR | 270 | 313 | 353 | 51 | 57 | 66 | 42 | 47 | 55 |
| Boizel Chanoine Champagne SA | EUR | 276 | 285 | 307 | 45 | 51 | 62 | 35 | 42 | 54 |
| **Wine & Liquor producers** | | | | | | | | | | |
| Diageo Plc | GBP | 9 309 | 9 740 | 10 195 | 2 918 | 3 062 | 3 235 | 2 667 | 2 796 | 2 982 |
| Pernod Ricard SA | EUR | 7 188 | 6 983 | 7 241 | 2 028 | 1 986 | 2 096 | 1 808 | 1 784 | 1 913 |
| Davide Campari-Milano SpA | EUR | 1 022 | 1 090 | 1 138 | 255 | 277 | 290 | 231 | 251 | 266 |
| Rémy Cointreau SA | EUR | 730 | 762 | 806 | 157 | 173 | 191 | 139 | 156 | 175 |

## 5.4 Comparable transactions

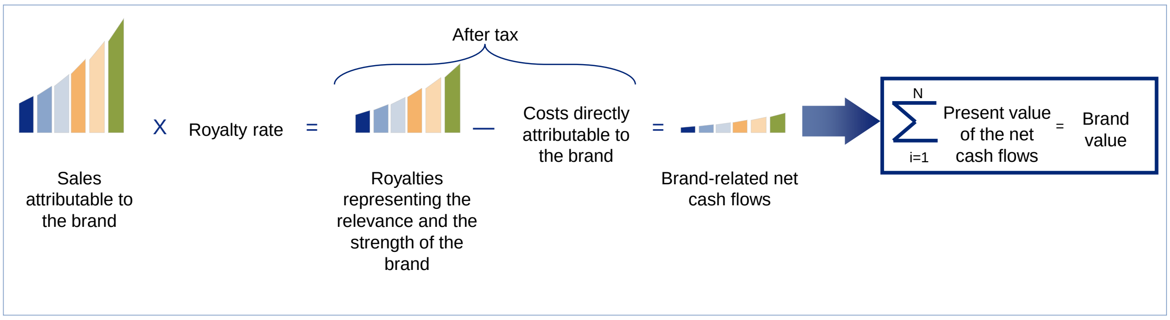
| Completion Date | Target Company | Target Description | Bidder Company | Bidder Description | Sales Multiple | EBITDA Multiple | EBIT Multiple |
|---|---|---|---|---|---|---|---|
| 24/04/2012 | Sichuan Swellfun Co Ltd | Chinese liquor producer | Diageo Plc | UK based company engaged in premium drinks business, producing various brands of spirits, wine and beer | 6,1x | 20,2x | 20,9x |
| 24/07/2008 | Vin & Sprit AB | Sweden based producer and distributor of spirits and wines | Pernod Ricard SA | France based producer and distributor of spirits and wines | 5,1x | 23,3x | 25,5x |
| 12/12/2006 | 42 BELOW Limited | New Zealand based maker of spirits | Bacardi Ltd | Cuba based manufacturer and marketer of spirits and wine | 9,4x | 11,6x | 12,5x |
| 20/01/2006 | Groupe Lanson International | French champagne house | Boizel Chanoine Champagne | French champagne house | 6,3x | 43,1x | 61,3x |
| 12/10/2005 | Polmos Bialystok SA | Polish alcohol producer | Central European Distribution Corporation | Poland based company engaged in producing, importing, and distributing alcoholic beverages | 1,5x | | 20,1x |
| 28/12/2004 | Glenmorangie plc | Scottish whisky distiller | Moet Hennessy Investissements | Scotland based whiskey producer | 4,9x | 22,7x | 28,6x |
| 04/12/2003 | Barbero 1891 SpA | Italian producer of wines and spirits | Davide Campari-Milano S.p.A. | Italy based alcoholic beverage company with a portfolio that spans three business segments: spirits, wines, and soft drinks | 3,0x | 15,0x | |
| 21/12/2001 | Seagram Wine & Spirit Business | Canadian producer of various wines and spirits | Pernod Ricard SA; Diageo Plc | France based producer and distributor of spirits and wines; UK based company engaged in premium drinks business, producing various brands of spirits, wine and beer | 1,6x | 11,2x | 13,5x |

**5.5 Relief from royalty approach overview**

## Brand Valuation Analysis

### Relief from royalty approach - Overview

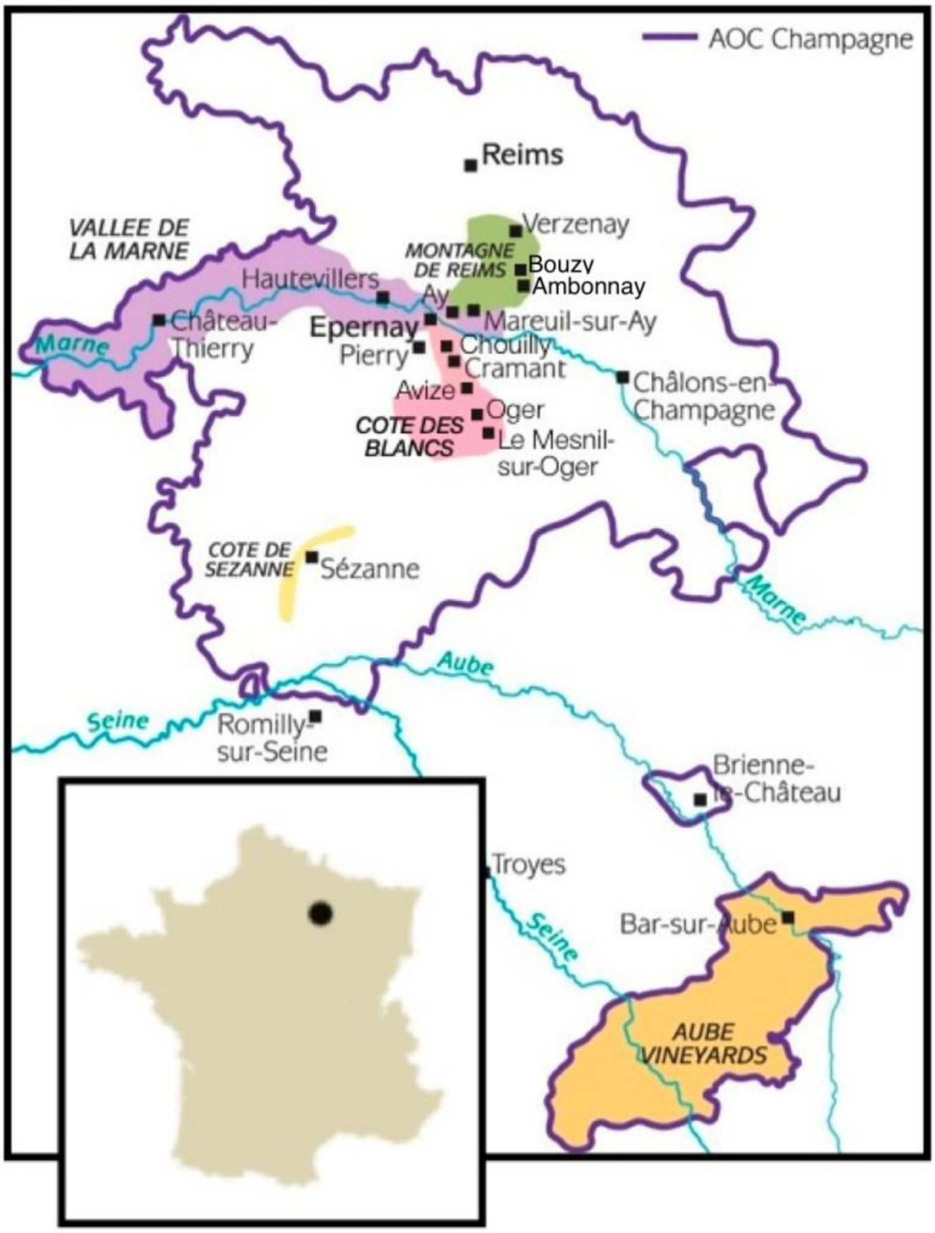
- The royalty rate is based on empirical, market-derived royalty rates paid for the use of comparable brands
- All costs associated with brand protection (referencing, legal protection, etc) must be deducted from the royalties generated by the asset in order to derive the net cash flows (after tax) specifically attributable to the brand
- These net cash flows are then discounted back to present value taking into consideration the time value of money and the risk of the asset




# 6. Appendices 2 : “Overview of the Champagne Market”

- Total Champagne sales amount to about 300 million bottles per year, for a value of about €4 billion.
- “Champagne” wine is a product protected by a the label “Protected Designation of Origin (PDO), called “Appellation d’Origine Protégée”, in French. It is a EU legal protection of the collective “Champagne” brand, planting rights and wine making activity. The grapes and wine must be produced in the area designated by this appellation, which covers some 35,000 hectares (86,900 acres) in Eastern France and is almost fully planted.
- The double-fermentation wine making process required by law takes about 3 years from the grape harvest until the bottles are ready to be sold.
- Every September before the grape harvest, the representatives of vine growers and champagne makers meet to set the maximum yield of grapes to harvest in order to respond to the expected demand for bottles of champagne in three years’ time. Champagne makers want to avoid financing of unsold bottles since they already have to store ageing bottles for 3 years. Vine growers are willing to restrict supply in order to avoid any fall in grape prices.
- 15,000 small vine growers own about 90% of the vineyard, but only sell 33% of bottles directly or through their co-ops. Most of them sell grapes to wine makers, who account for 67% of champagne sales.
- Most champagne makers are family-owned SMEs employing fewer than 50 persons. However, large firms like LVMH, Pernod-Ricard, Lanson-BCC,Taittinger and Vranken-Pommery Monopole hold the market in terms of sales. These companies have achieved their international reputation by regularly improving the quality of their products and their product offers.

### 6.1 Geographical Overview

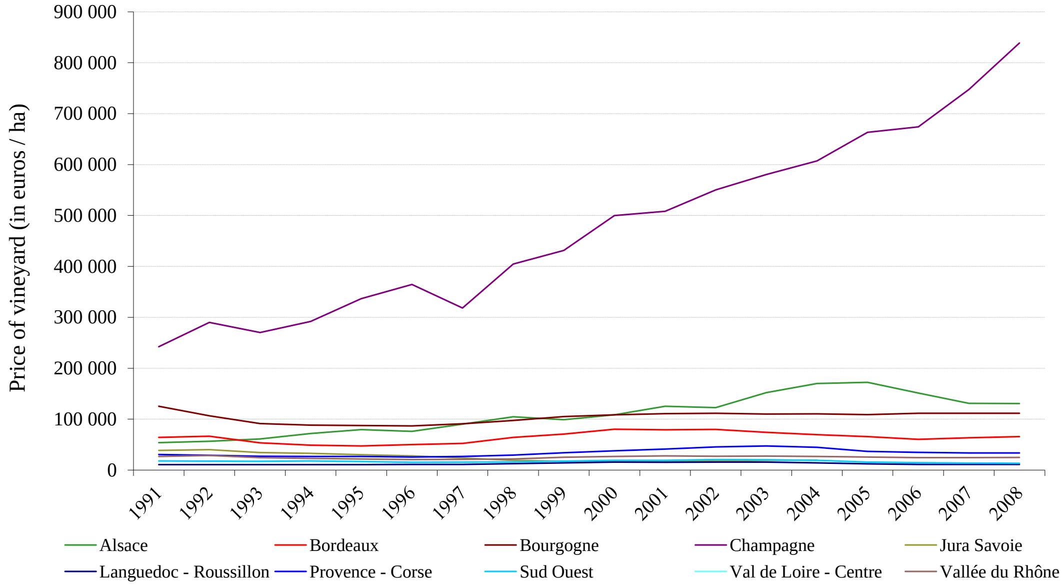



*Source of data: Quentin Sadler's wine page*

## 6.2 Champagne Vineyards Production Overview


*Source of data: CIVC*

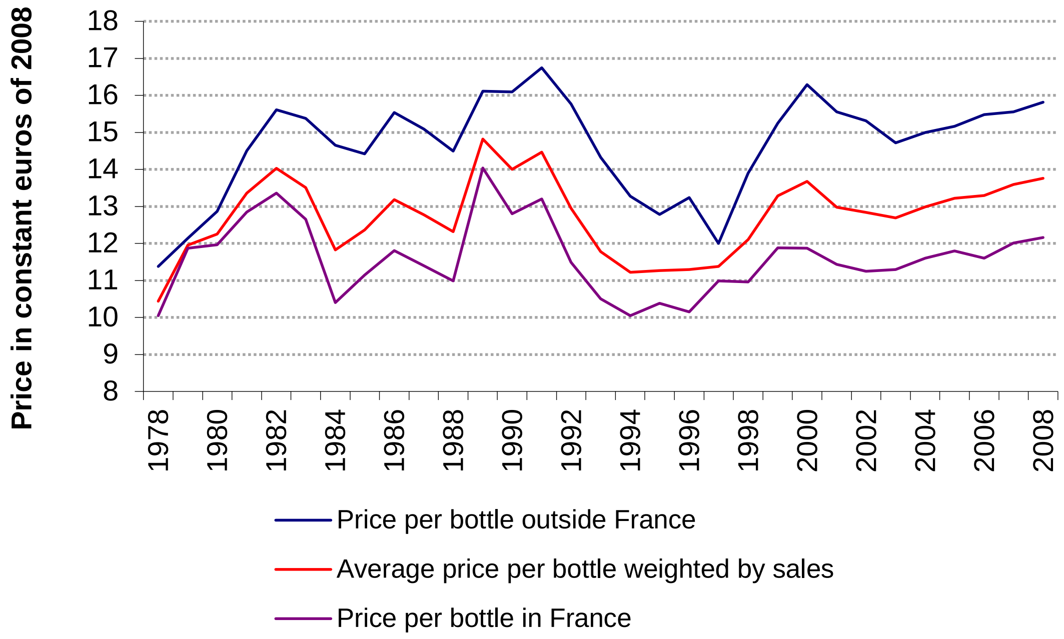
### 6.3 Price of French Vineyards




*Source : SAFER*

- Since the “champagne” appellation is almost fully planted, the price of champagne vineyards has increased significantly since 1995

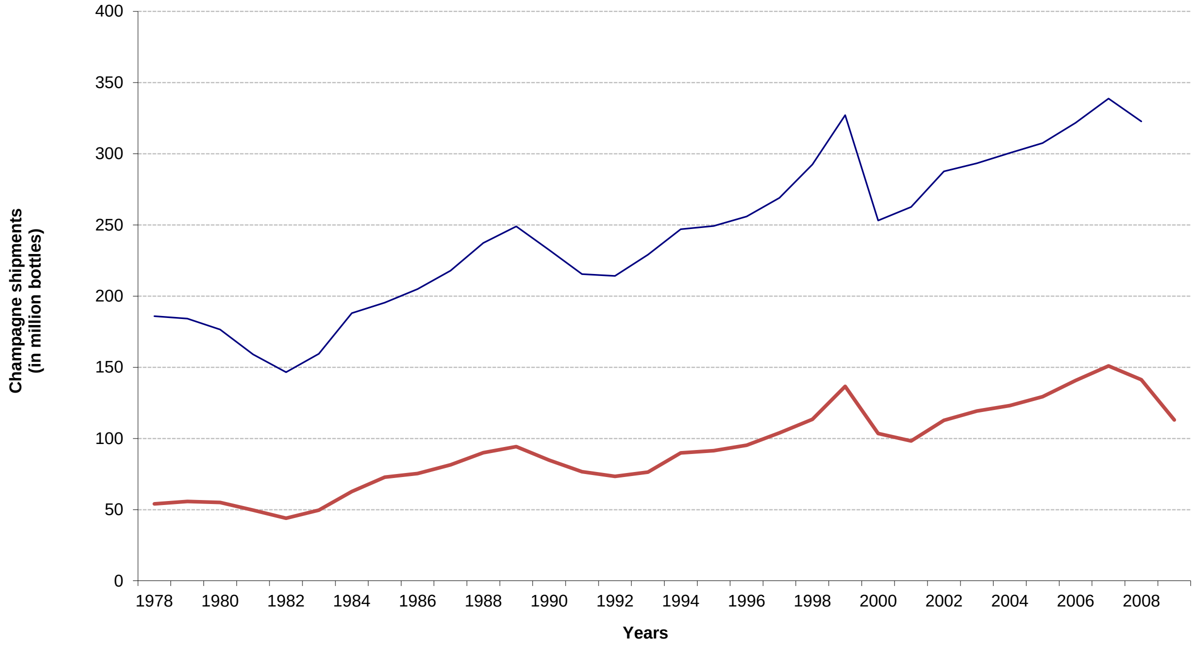
### 6.4 Price of a Bottle of Champagne




*Source : Authors’ computation from CIVC data*

- The average price per bottle sold outside France is a lot higher than the average price in the domestic French market

### 6.5 World Shipments of Champagne

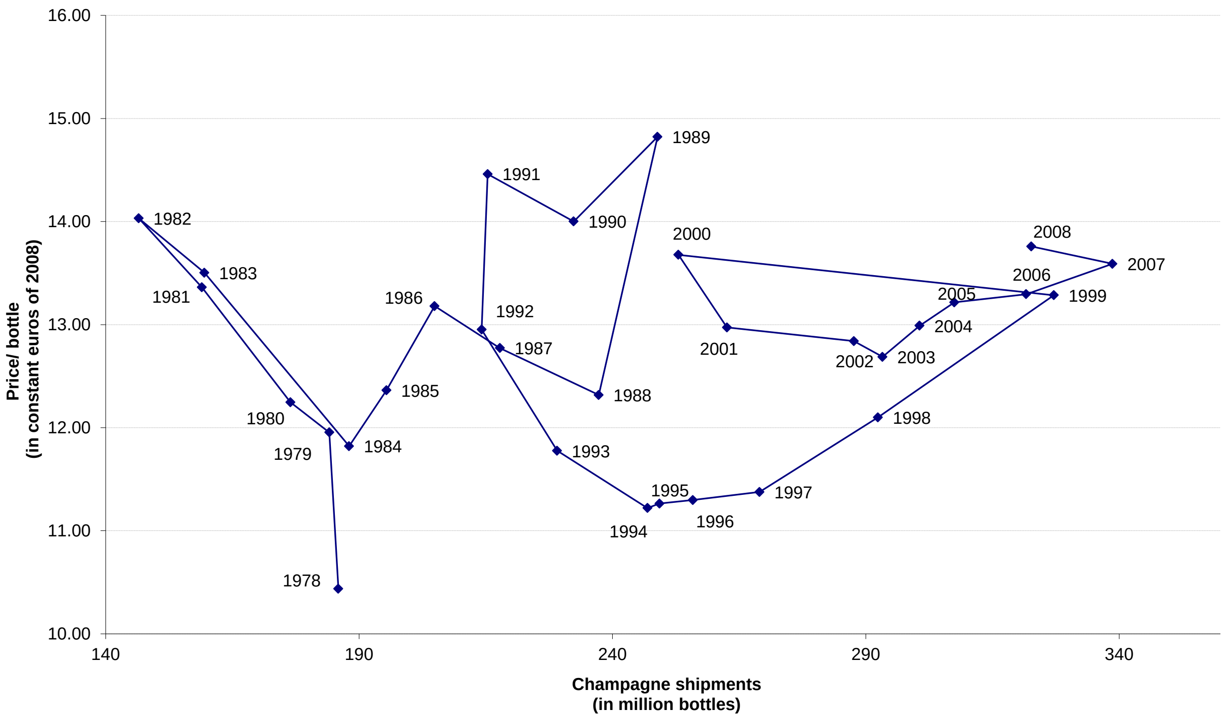



*Source of data: CIVC*

- The blue curve shows the total demand for champagne, which has roughly doubled in 30 years, although the area used for vineyards is almost fully planted.

- The red curve exhibits exports, which account for 38% of volumes sold, but 50% of sales in value.

### 6.6 World Shipments and Price per Bottle of Champagne




*Source : Authors' computation from CIVC data*

- Wine makers cannot anticipate strong economic booms or recessions. Since champagne production decisions are made 3 years before bottles will be ready for consumption (due to the ageing process in cellars), supply of champagne has difficulties in adjusting to demand. Consequently, a production-consumption cycle can be observed. Rises and falls in bottle prices help to adjust supply to demand in the short run.

- Notice that the deflated price is slightly increasing over time at a high level (about €13 plus VAT). The price of other sparkling wines is usually €3 to €7.

### 6.7 Major Champagne Houses

| Major Champagne houses | Group | Sales in 2008-2009 (in € million) | Consumer price per bottle (in €) |
|---|---|---|---|
| Moët & Chandon | LVMH | 1169 | 28-29 |
| Veuve-Clicquot Ponsardin | LVMH | 574 | 30-32 |
| Lanson | Lanson-BCC | 455 | 24-25 |
| Taittinger | Taittinger | 225 | 28-29 |
| Piper Heidsieck | Rémy Cointreau | 129 | 23-24 |
| Pommery | Vranken Pommery | 120 | 27-28 |
| Mumm | Pernod-Ricard | 112 | 24-25 |

*Source : Orbis data bank (for sales), the authors for consumer price per bottle*