



Holland Views: Becle SAB – Price MXN28; MCap: US\$5.3bn

## Tequila Sunrise meets Capital cycle

In a post MIFID world we think genuine idea generation is short in supply. Thus, we will try to share more of our ideas with clients without the need for always writing reports long hand. Rest assured we have done much background work on any idea we air, hence the extensive list of links we give at the end of this piece to aid your further research.

- Our daily quest for finding great businesses, priced-like-Ok ones continues. To remind you, we are looking for businesses with Franchise qualities that are under-earning and under-valued.
- Everyone knows that the best Spirits companies (Diageo, Remy Martin et al) are great businesses enjoying high margins (see Fig.2) and strong returns thanks to low input costs, excellent brands and strong distribution channels. As such it is rare to find a potential mispriced Spirits business with great brands. We think we have.
- That this is newly-listed (in Mexico) should not put you off. This is a world class spirits business with heritage brands, dominant market position and majority (85%) family ownership. It also has an ADR and a \$5bn Mcap cap (but a limited free-float we accept).
- We have read extensively on this company; what follows is just our highlighted thoughts:
- Becle SAB is better known as the owner of 200-year old Cuervo premium Tequila brand. With c.43% of global market volumes it is the clear global market leader in *premium* Tequila (Becle also owns Bushmills Whiskey and Kraken rum). It also owns good US distribution assets to which it is committing more resource. It has only been listed since 2017 and investors will have to wait another few weeks for the first English translation of the report and accounts (we have been working off of an abbreviated version). This is not a well-known stock. It is down 20% from its IPO.
- Tequila, is analogous to Champagne in that premium quality Tequila **must originate from a particular region in Mexico** and be made from the Agave plant. This is important as you are about to see. Demand for Tequila has been very strong (volumes +7% cagr last 5 years), particularly demand for premium Tequila as the companies that control the top end brands (Becle and a Byron Trott controlled company interestingly) have successfully sold a premiumisation message. Ironically it is this strong demand that has thrown the tequila industry profits and in turn Becle stock off-course. This is the opportunity.
- Becle's problem boils down to a temporary shortage of Agave (cactus looking!) plants in Mexico suitable for Agave juice production. This has had material implications as higher Agave costs have hit margins. Because premium Tequila uses twice the amount of Agave juice as regular tequila the sectors success in its premiumisation strategy has created a shortage of agave plants. Whilst Becle has the largest in-house source of agave plants of all Tequila producers, outside stocks have become much more expensive for it and competitors to source. Some product price rises have compensated (but a competitor brand owned by Suntory has been slow to follow suit). Equally more agave plants are being planted, but they take 6-7 years to reach maturity.

- We encounter all sorts of operational problems in our company research on a weekly basis and we are not being flippant here, but surely Cactus supply is down the list of serious long-term problems a 200-year old company with a wonderful brand might face?
- On a headline valuation of 25x PE, Becele certainly does not *look* cheap at first glance, but importantly that is struck off a 2018 EBIT margin of 20% (vs. the 25-26% in recent years pre-IPO). Consensus forecasts are extrapolating recent depressed margins through 2020 as we show below. This is the crux of the investment case today. Company conference call Q+A reveals an analytical/investor community that is a little scarred post the profit/share price fall, but also one that is obsessed on forecasting when Agave GOGS costs will come down. Only then seemingly will they be more optimistic (6 out of 13 analysts that cover it have a “Sell” rating on the stock). We are however prepared to stand back from this issue and assert that:
  - Cost inflation issues are rarely **long-term** drivers of margins in spirits companies
  - Short term production difficulties are usually just that- short term in nature
  - In time market forces will solve this problem, with either pricing increasing or the supply of Agave plants increasing - indeed Becele have admitted they have planted 20% more plants than usual in the last 2 years. (Our best guess is that both might occur, i.e. lower costs and better pricing)
  - Capital cycles are a funny thing and in the case of agave plants a prickly thing! At the time of IPO Becele told investors of its plan to bring more agave production in house (currently it is at c.60%) but the recent super-boom in agave prices (**up 6 fold in 5 years!**) has likely lead to farmers being a little more flush, thus less inclined to sell their plantations. Becele has adapted accordingly, logically stating that its long-term intention is to still bring more production in house, but short term it is not paying up. We see that as a highly logical response; others seem to see it more like a U-turn..

Fig.1: Becele vs. Global spirit company peers

Peers	Remy	Diageo	Campari	Becele	Becele Recent
EBIT margin range	13-23%	27-31%	19-23%	22-25%	20%
EV/EBITA	19-23x	16-23x	12-23x	15-16x	18x
gross margin	55-63%	52-62%	53-60%	57-61%	57%
sales growth	5%	3%	6%	good?	
RoNTA	15%	35%	20-30%	23-40%	23%
ROE	11%	25-35%	10-18%	8-20%	
<b>Becele Consensus</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20</b>	
sales	1,376	1,456	1,539	1,702	
gross profit	854	842	834	938	
gross margin	62%	58%	54%	55%	
EBIT	353	292	312	365	
EBIT margin	26%	20%	20%	21%	

Source: Holland Advisors, Bloomberg – Becele forecasts in US dollars

To view the remainder of this in-depth report, please contact Andrew Hollingworth,  
[Andrew@hollandadvisors.co.uk](mailto:Andrew@hollandadvisors.co.uk) for a complete PDF copy.

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