

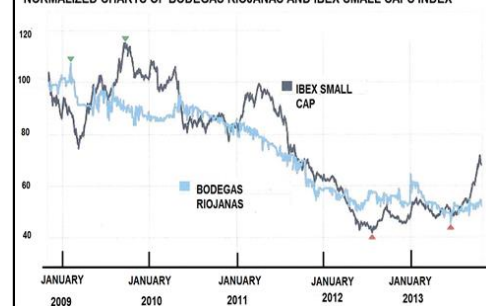
- Bodegas Riojanas is a Spanish winery that makes and commercializes mainly Premium wines, principally from the Rioja region, which is the Spanish Designation of Origin (D.O.) with largest domestic market share in Spanish Premium wines. In the domestic market, the only channel showing signs of continued growth is Consumer and Retail, which is growing its demand of premium D.O. wines, which is where Bodegas Riojanas concentrates the bulk of its production. Moreover, the company enjoys a high Gross Margin/Sales owing to the fact that aged premium wines have a higher added value. Finally, the company's positioning in quality wines segment makes it well placed to take advantage of an eventual pick up in the cycle.
- *The company's winery infrastructure* (presses, tanks, barrels, racks, bottling facilities) has benefited from successive investments, upgrades and increases in capacity. This allows Bodegas Riojanas to follow its strategy of concentrating in the production of quality aged wines without the need for further investments.
- *Its international projection is still low but growing.* Bodegas Riojanas is reinforcing its commercial presence outside Spain, and 1H 2013 shows a strong growth of their international revenue (+62% against 1H 2012), accounting for a growing proportion of their total revenue, 16% against 11% in 1H 2012.
- *The cost of debt is being reduced thanks to its implementation of a debt reduction program:* With financial costs representing more than half of EBIT, we view favourably that the company is keeping with its objective of reducing debt over the period 2011 - 2014. At the close of 1H 2013, Bodegas Riojanas had a Net Debt of 16,03 million €, which represents a reduction of 21% over levels of two years ago.
- *1H 2013 data confirms the expected improvements:* (i) Gross Margin to Sales is now 65,9% for the last 12 months, compared to 63.0% for the preceding period, to a great extent owing to the coming into the market of stocks of aged wine produced with harvests where grape costs had been very low (2009 and 2010). (ii) leverage is being reduced, and so are the associated financial costs. Both factors are contributing to an improved generation of profits (+33,8% 1H 2013 / 1H 2012). This is relevant since Bodegas Riojanas has a return on resources below the average of comparable companies, and trades at a lower P/BV close to 1. As sales will translate to a greater degree into profits, with less financial costs and less raw material costs, this will improve the return on resources and we expect a gradual improvement in the stock price and in the P/BV ratio.
- *Earnings up, stock-price down:* Since the end of 2009 (when the sector experienced a severe adjustment) until now, Bodegas Riojanas has increased annually its Sales, Gross Margin/Sales and Net Profit and according to the projections of this report, will continue to do so. In spite of this improved performance, the stock-price has fallen by 40% since the beginning of 2010. And, more recently, the stock-price has not participated in the market rally started in September, as shown in the adjoined chart.
- This report uses two different valuation methods (Discounted Cash Flows and Comparable Multiples) which give an intrinsic value per share for Bodegas Riojanas of 5,32 € and 5,57 €, which gives a potential average upside of 16% when compared to the current stock-price of 4,60 €. This valuation is subject, to a great extent, to the company's fulfillment of its debt reduction program and its reflection in lower financial costs. This is why it is important for Bodegas Riojanas both to maintain a resilient level of sales in the face of a generally lower demand for wine, and to achieve improved operating margins on the basis of lower raw material costs associated to the entry of stocks produced during the cheaper harvests of 2009 and 2010.

## BODEGAS RIOJANAS

### COMPANY DATA

TICKER	RIO
PRICE (1 NOVEMBER 2013)	4,60 €
SECTOR	Alimentación y Bebidas
Nº OF SHARES (in 000)	5.385,6
CAPITALIZATION (in 000 €)	24.774
FREE FLOAT	26,7%
DAILY VOLUME TRADED LAST 12 MONTHS (in 000 €)	6,9
MAXIMUM PRICE (LAST 12 MONTHS)	5,32 €
MINIMUM PRICE (LAST 12 MONTHS)	3,74 €
SHARE PRICE VARIATION LAST MONTH	+0,67%
SHARE PRICE VARIATION LAST 3 MONTHS	+1,82%
SHARE PRICE VARIATION LAST 12 MONTHS	-5,68%

NORMALIZED CHARTS OF BODEGAS RIOJANAS AND IBEX SMALL CAPS INDEX



### KEY FINANCIAL DATA (in 000 €)

1 NOVEMBER 2013	2010	2011	2012(e)	2013(e)
SALES	15.063	15.132	15.400	16.600
EBITDA	2.856	3.144	3.258	3.200
NET RESULT	699	730	744	807
ROE	2,83%	2,96%	3,00%	3,20%
NET DEBT	22.934	21.922	20.453	17.593

### PER SHARE DATA (€)

NOVEMBER 2013	2010	2011	2012(e)	2013(e)
DPS	0,10	0,10	0,10	0,10
EPS	0,128	0,134	0,136	0,150
BVPS	4,53	4,54	4,56	4,68

### RATIOS

NOVEMBER 2013	2010	2011	2012(e)	2013(e)
P/E	55,3 x	36,8 x	31,5 x	30,7 x
Dividend Yield	1,4%	2,0%	2,3%	2,2%
P/BV	1,57 x	1,09 x	0,93 x	0,98 x

COMPANY UPDATE OF  
**BODEGAS RIOJANAS**

**DESCRIPTION OF BODEGAS RIOJANAS**

Bodegas Riojanas produces and commercializes wine from the Classified Rioja Wine Region, and a smaller quantity of wines from the Toro Region, both for the domestic market and for the international market. They also maintain agreements with other wine producers of other Classified Regions to commercialize their wine. A great share of the firm’s sales corresponds to red wines from the Rioja Designation of Origin (Denominación de Origen -D.O.) with ageing (such as Crianza, Reserva and Gran Reserva). Their main brands are “Viña Albina”, “Monte Real” and “Puerta Vieja”.

**STRATEGY OF BODEGAS RIOJANAS.**

**A philosophy based on quality: producing mainly quality wines aged in vats.**

This allows Bodegas Riojanas to: i) Maintain higher prices and obtain a higher Gross Margin; ii) generate a greater loyalty from the consumers who have become more selective and who have increased their consumption of aged wines with a Denomination of Origin, an upward trend started in the 90’s; iii) support the commercialization as their wines are rewarded with prizes and awards.

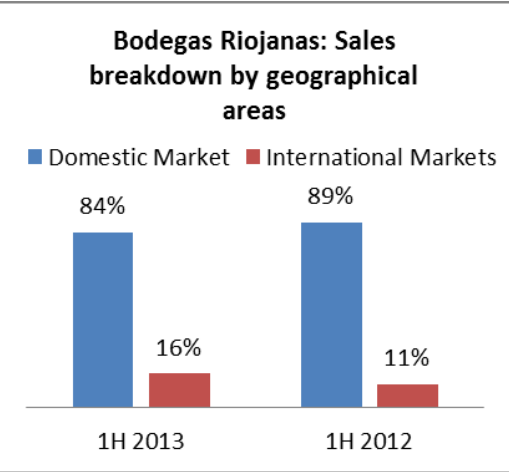
The drive to improve quality also requires a strategy focused on wines aged in vats. The introduction of this strategy has not only meant investing in technological improvements and in modernizing the installations, but it has also meant increases in the capacity of grape processing, of ageing and of storage. The development of this type of strategy requires a minimum size for wineries, a high degree of professionalism and a proper business plan to be able to finance the necessary investments by means of internal cash flow generation and / or by securing access to financial credit.

By following this path, the winery has reached a position where the quality and the brand can generate customer loyalty. This is important since while the HORECA (Hotel, Restaurants and Cafeterias) channel has suffered a gradual deterioration, the company has seen how the retail channel has been increasing its consumption, owing mainly to its increased demand for premium wines with a D.O. provenance (principally the Rioja D.O.).

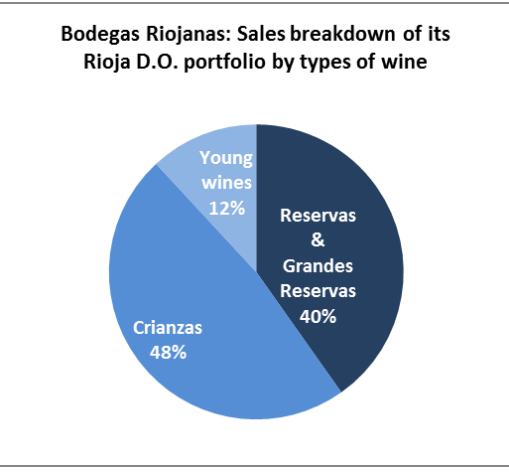
It is a profitable strategy since once the investments have taken place, the costs related to ageing and storage (including the amortization of the vats, the cleaning of the vats, transfers and other costs related to the storage in vats) is clearly inferior to the average price increase which vintage wines and great vintage wines command.

A study of the wine sector elaborated by the Consultants MKF in 2007 for the State of Virginia stated that the viable and profitable wineries showed a Gross Margin/Sales of at least 50%. This report gathered certain key factors such as the capacity to face the necessary investments to develop aged quality wines, a sufficient size to enjoy economies of scale in sales, distribution and marketing. Bodegas Riojanas enjoys these characteristics and in particular currently operates with a Gross Margin/Sales which exceeds 65%, thus reflecting the advantages of having a sales product mix tilted towards aged wines of quality which command higher margins.

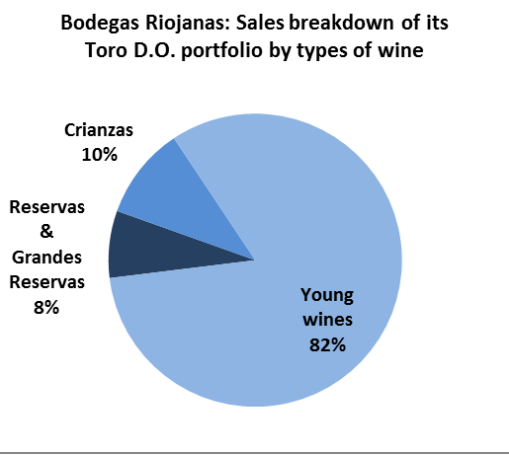
**Chart 1:**



**Chart 2:**



**Chart 3:**



### **A strong focus on commercialization and marketing activities.**

Even if this activity can represent 30% of the sales costs, it is of primary importance in a fragmented and competitive environment in order to detect changes and opportunities in consumer behaviour, to obtain consumer loyalty and to arrive more directly at the consumer without depending on an excess of intermediaries, as these increase the final cost of the product (thus reducing its competitiveness) and have little or no brand loyalty.

The control of the distribution channel and of a dedicated commercial force allows for the final selling price to be less costly for the consumer, a key factor to stabilize demand in an environment of crisis where the consumers are sensitive to price.

Less than 30% of the producers have direct sales and commercialization to the HORECA channel.

Bodegas Riojanas controls very clearly this aspect of the wine business and in a certain way it can be said that there are two firms in one: One company engaged in wine production and another organized as a commercializing entity. This, we think, explains in good measure the positive evolution of sales from 2009 to 2011 in spite of an environment of greater weakness in demand.

We must also mention, within the retail channel (food chains and supermarkets), what could be named as the alternative channels. By alternative channels we make a special emphasis on the Christmas Campaign: here there are two strong sources of demand, corporate gifts and to the special Christmas promotions and campaigns developed by large department stores. Although it is true that sales related to this activity are accounted under the retail channel, we think (and so does Bodegas Riojanas) that this distribution channel shows a different behaviour from typical home consumption, with strong seasonality (Christmas) and a strong dependence on the prevailing business and economic climate.

In the campaigns of the last years since 2009, coinciding with the full brunt of the crisis, the clients of this alternative channel have gradually reduced their orders. But Bodegas Riojanas, thanks to their commercial activity, have been able to compensate this adverse factor with the incorporation of new clients, achieving through the crisis that all the Christmas Campaigns have maintained a stable level and even slight increases in sales. Last year's Xmas 2012 Campaign fully met with expectations, contributing to the positive evolution of sales (+3,9%) in the face of what proved to be yet another difficult year for the sector.

### **A renewed effort to continue boosting up sales in the international markets:**

Aware of the importance of the export activity, and aiming at strengthening the distribution in the U.S.A., Bodegas Riojanas constituted in 2010 the firm "Bodegas Riojanas USA Corporation", with Head Office in New Jersey. Presently, sales in the USA represent for Bodegas Riojanas 15% of their total exports.

Finally, it is important to mention that Bodegas Riojanas maintain their decided objective to develop the international market, by opening at the beginning of 2012 commercial offices in China and Germany to be added to their commercial offices in the United Kingdom and Mexico.

First half results for 2013 show a strong increase in International sales of 62% (over 1H 2012), and their respective weight as a percentage of total group sales has increased from 11% in the 1H 2012 to 16% in the 1H 2013.

## FINANCIAL ANALYSIS OF RESULTS PUBLISHED FOR THE FIRST HALF OF 2013.

This note is published to analyze the results published for the first half of 2013.

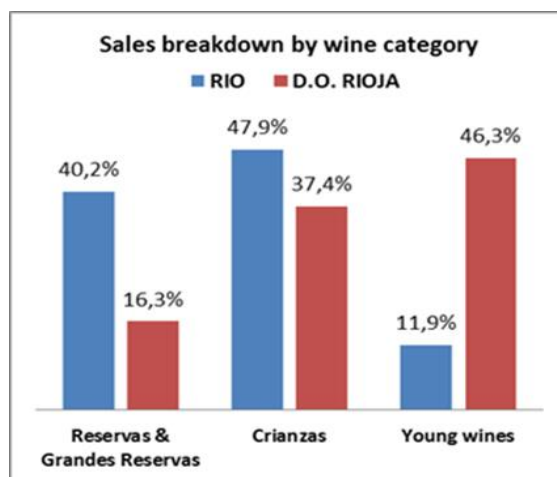
Table 1: Profit & Loss comparison between 1H 2012 and 1H 2013.

PROFIT & LOSS (000 EUROS)	1S 2012	1S2013	var. %
Net sales	4.098	4.631	13,0%
Other income	0	-6	
<b>TOTAL INCOME</b>	<b>4.098</b>	<b>4.625</b>	<b>12,9%</b>
Raw materials costs	-443	-621	40,2%
<b>GROSS MARGIN</b>	<b>3.655</b>	<b>4.004</b>	<b>9,5%</b>
Labour costs	-1.556	-1.796	15,4%
Other	-766	-856	11,7%
<b>EBITDA</b>	<b>1.333</b>	<b>1.352</b>	<b>1,4%</b>
Amortization	-609	-597	-2,0%
Provisions	0	0	
<b>EBIT</b>	<b>724</b>	<b>755</b>	<b>4,3%</b>
Participated companies	0	0	
Net financial results	-512	-472	-7,8%
Other	0	0	
<b>PBT</b>	<b>212</b>	<b>283</b>	<b>33,5%</b>
Taxes	-64	-85	32,8%
<b>NET PROFIT BEFORE MINORITIES</b>	<b>148</b>	<b>198</b>	<b>33,8%</b>
Minorities	0	0	
<b>NET PROFIT</b>	<b>148</b>	<b>198</b>	<b>33,8%</b>

### Sales:

During the first half of 2013, Bodegas Riojanas has kept its growth momentum with an increase in total revenues of 13%. If we compare this with the evolution of all Rioja D.O. sales, we observe that domestic sales for the D.O. grew 4,7%, and international sales 11,9% for the same period. For the Toro D.O., 1H 2013 sales grew 11,9%. The better performance of Bodegas Riojanas is explained to a great extent by their concentration in aged and Premium wines, which not only offer greater added value but also contribute to maintain the company's market share.

CHART 4



COMPANY UPDATE OF  
**BODEGAS RIOJANAS**

At this point, we must be reminded of the seasonal character of sales in the wine trade, where first semester sales account for less than 30% of yearly sales, with the bulk of revenues coming from the fourth quarter. So, even if first half results have been very positive, we will have to wait for the close of the year to get the overall picture.

**Debt:**

As from year end 2012 Net Debt has fallen from 21,3 million € to 16,0 million €.

Once again, because of the aforementioned seasonality of the business, we prefer to compare Net debt levels for the same end periods (1H 2012 and 1H 2013) in order to get a more balanced view of debt reduction. The fourth quarter typically shows a temporary pick-up in short term debt as all expenses are incurred to finance the Xmas Campaign, while corresponding cash inflows usually are obtained in the following first quarter, where the spike in short term debt is repaid. For this reason, comparing year-end debt levels with half-year levels would not be entirely consistent.

**Table 2: Net Debt levels at the end of the first semester.**

DEBT (000 EUROS)	1S 2011	1S 2012	1S 2013
Net Debt	20.365	18.768	16.025
Difference		-1.597	-2.743

**1H 2013 CONCLUSIONS:**

Based on the results published by Bodegas Riojanas for the first semester of 2013, the company still delivers:

- A capacity to grow its revenues, in spite of the difficulties experienced by the wine sector in Spain: The retail channel has kept growing, company sales to the depressed HORECA channel have held, and international sales have expanded (the latter as a result of reinforcing its international marketing arm in 2012).
- A positive evolution in international markets, which now account for 16% of sales.
- A capacity to reduce debt. Here we have to highlight that Bodegas Riojanas is meeting and even exceeding its Debt Reduction Program. If we take the end of the 1H 2011 as a starting point, the planned debt reduction by 25% in the period 2011-2014 implies reducing debt by 5,9 million €, of which 4,34 million € have been reduced already at the close of 1H 2013 (that is, 74% of the Debt Reduction Program has been achieved so far).

**CHANGES IN OUR FORECASTS:**

- Based on a faster than expected pace of debt reduction, our estimates have been revised accordingly. As a result financial costs have also been reduced over the 2013-2016 forecast period.
- Sales forecasts have been revised upwards, taking into account Bodegas Riojanas' domestic resilience and international penetration.
- Other adjustments are directly linked to higher sales figures, where we now have higher cost of goods sold and higher labour costs.

COMPANY UPDATE OF  
**BODEGAS RIOJANAS**

Table 3: New Profit & Loss forecasts.

PROFIT & LOSS ACCOUNT (in 000 EUROS)	2011	2012 adj.	2013e	2014e	2015e	2016e
Net Sales	16.105	16.289	16.600	16.757	16.915	17.076
Other Income	-973	-889	-900	-900	-900	-900
<b>TOTAL INCOME</b>	<b>15.132</b>	<b>15.400</b>	<b>15.700</b>	<b>15.857</b>	<b>16.015</b>	<b>16.176</b>
Raw Material Costs	-5.673	-5.401	-5.528	-5.614	-5.667	-5.720
<b>GROSS MARGIN</b>	<b>9.459</b>	<b>9.999</b>	<b>10.172</b>	<b>10.243</b>	<b>10.349</b>	<b>10.455</b>
Labour Costs	-3.040	-3.244	-3.361	-3.435	-3.468	-3.500
Other	-3.275	-3.497	-3.569	-3.603	-3.637	-3.671
<b>EBITDA</b>	<b>3.144</b>	<b>3.258</b>	<b>3.242</b>	<b>3.205</b>	<b>3.244</b>	<b>3.284</b>
Amortizations	-1.204	-1.223	-1.180	-1.160	-1.140	-1.140
Provisions	0	0	0	0	0	0
<b>EBIT</b>	<b>1.940</b>	<b>2.035</b>	<b>2.062</b>	<b>2.045</b>	<b>2.104</b>	<b>2.144</b>
Participated Companies	0	0	0	0	0	0
Net Financial Results	-1.015	-1.058	-985	-858	-773	-707
Other	0	0	0	0	0	0
<b>PBT</b>	<b>925</b>	<b>977</b>	<b>1.076</b>	<b>1.188</b>	<b>1.332</b>	<b>1.436</b>
Taxes	-195	-233	-237	-261	-293	-316
<b>NET PROFIT BEFORE MINORITIES</b>	<b>730</b>	<b>744</b>	<b>840</b>	<b>927</b>	<b>1.039</b>	<b>1.120</b>
Minorities	0	0	0	0	0	0
<b>NET PROFIT</b>	<b>730</b>	<b>744</b>	<b>840</b>	<b>927</b>	<b>1.039</b>	<b>1.120</b>

DCF VALUATION:

Table 4: Discounted Cash Flow model and valuation.

CASH FLOW ANALYSIS (000 €)	2012 adj.	2013e	2014e	2015e	2016e
NOPAT = EBIT*(1-t)	1.550	1.608	1.595	1.641	1.672
(+) Amortizations	1.223	1.180	1.160	1.140	1.140
(-) Change in Working Capital	-827	-1.653	-1.302	-663	-134
(-) Capex	721	700	600	600	600
<b>Free Cash Flow</b>	<b>2.879</b>	<b>3.741</b>	<b>3.457</b>	<b>2.844</b>	<b>2.346</b>
Adjustment factor	1,00000	0,94491	0,89286	0,84368	0,79720
Present Value of Free Cash Flow	<b>2.879</b>	<b>3.535</b>	<b>3.087</b>	<b>2.400</b>	<b>1.870</b>
Present Value of Sum of Free Cash 2012 to 2016	<b>13.771</b>				
<b>Calculating leveraged Beta</b>					
Implicit Beta versus IBEX Small Caps (Bloomberg)	0,45				
t = Tax rate	23,85%				
1-t	76,15%				
Debt / Equity (1H 2013)	66,67%				
Adjustment to lever Beta	0,23				
<b>Leveraged Beta</b>	<b>0,68</b>				
<b>Calculating WACC (Weighted Average Cost of Capital)</b>					
Risk Free Rate (Average of German and Spanish 10 yr bonds)	2,84%		Bund GER 10yr 1,69%	Bono ESP 10yr 3,98%	
Leveraged Beta	0,678				
Equity Risk Premium (estimated)	5,70%				
t (average tax rate of last 3 years)	22,43%				
Cost of Equity	6,70%				
Average cost of Debt (before applying t)	6,28%				
Average cost of Debt (after tax effect)	4,87%				
Capital structure (% of Equity in the Balance Sheet as of 1H 2013)	52,29%				
<b>WACC</b>	<b>5,83%</b>				
<b>Calculating constant growth "g" of Free Cash Flow to obtain Terminal Value</b>					
	2012adj.	2013e	2014e	2015e	2016e
Growth rate of Free Cash Flow	11,66%	29,96%	-7,58%	-17,73%	-17,52%
Simple arithmetic average of annual growths	-0,24%				
<b>g (growth of Free Cash Flows to obtain Terminal Value)</b>	<b>-0,24%</b>				
<b>Terminal Value of Free Cash Flows</b>					
TV of Cash Flows post 2016	38.535				
Adjustment factor	0,79720				
<b>Present Value of TV of Cash Flows post 2016</b>	<b>30.720</b>				
<b>VALUATION OF BODEGAS RIOJANAS</b>					
(+) Present Value of Cash Flows for estimated period 2012-2016	13.771				
(+) Present Value of Terminal Value of Cash Flows post 2016	30.720				
(+) Cash in Balance Sheet (1H 2013)	180				
(-) Total Net debt in Balance Sheet (1H 2013)	16.025				
= Intrinsic Value of the company	28.645				
nº of shares	5.386				
= <b>Intrinsic Value per share</b>	<b>5,32 €</b>				

### COMPARABLE MULTIPLES VALUATION:

There are not many quoted companies which can easily be considered comparable to Bodegas Riojanas (in Spain we only have Baron de Ley) and our selection of peers spans across USA, Chile, New Zealand, Australia because of the difficulty to find wineries which combine both winemaking and sales & marketing and which only produce wine. Even so, the business models of the chosen companies are quite diverse, and there is some significant dispersion.

When valuing Bodegas Riojanas through the method of Comparable Multiples, we have opted to include the following ratios: PE, EV/EBITDA, P/BV and P/FCF.

Table 5: PE of Bodegas Riojanas and comparable companies.

Prices at close of 01/11/2013	PE
ANDREW PELLER LTD	13,07
BARON DE LEY	17,07
Bloomberg Vintners Principal Index	16,22
Bloomberg Wine & Cheese Index	20,29
CONSTELLATION BRANDS	16,80
VINA CONCHA Y TORO SA	28,33
TREASURY WINE ESTATES LTD	n.a.
<b>Average without Bodegas Riojanas</b>	<b>18,63</b>
<b>Bodegas Riojanas</b>	<b>30,67</b>

Source: Bloomberg

Table 6: EV/EBITDA of Bodegas Riojanas and comparable companies.

Prices at close of 01/11/2013	EV/EBITDA
ANDREW PELLER LTD	9,23
BARON DE LEY	10,70
CONSTELLATION BRANDS	18,14
VINA CONCHA Y TORO SA	22,08
TREASURY WINE ESTATES LTD	22,32
<b>Average without Bodegas Riojanas</b>	<b>16,49</b>
<b>Bodegas Riojanas</b>	<b>12,45</b>

Sources: Bloomberg, Morningstar and own estimates

Table 7: P/BV of Bodegas Riojanas and comparable companies.

Prices at close of 01/11/2013	P/BV
TREASURY WINE ESTATES LTD	1,00
BARON DE LEY	1,44
ANDREW PELLER LTD	1,62
VINA CONCHA Y TORO SA	1,66
Bloomberg Wine & Cheese Index	1,70
Bloomberg Vintners Principal Index	1,82
CONSTELLATION BRANDS INC	2,80
<b>Average without Bodegas Riojanas</b>	<b>1,72</b>
<b>BODEGAS RIOJANAS SA</b>	<b>1,02</b>

Sources: Bloomberg, Morningstar and own estimates



Table 8: P/FCF of Bodegas Riojanas and comparable companies.

Prices at close of 01/11/2013	P/FCF
BARON DE LEY	7,21
Bloomberg Wine & Cheese Index	11,03
Bloomberg Vintners Principal Index	14,42
CONSTELLATION BRANDS INC	18,90
TREASURY WINE ESTATES LTD	26,90
VIÑA CONCHA Y TORO SA	n.a.
ANDREW PELLER	n.a.
<b>Average without Bodegas Riojanas</b>	<b>15,69</b>
<b>BODEGAS RIOJANAS SA</b>	<b>6,42</b>

Sources: Bloomberg, Morningstar and own estimates

As previously mentioned in our Full Company Report of October 2012, we think that after the 2009 crisis of the sector in Spain and with the gradual recovery of Bodegas Riojanas observed since then, in particular with forecasts of debt reduction from 2011 to 2014, it would be more appropriate to use for Bodegas Riojanas the ratios of a “normalized” year when establishing comparisons. As a result we have opted for the utilization of forecast data of year 2016; we now show in Table 9 the Present Value of each magnitude after applying the necessary adjustment factor.

Table 9: Present Value of 2016 data used for valuation by the method of comparable multiples.

(000 €)	2016e	Adjustment factor	PV of 2016e
Net Profit	1.119	0,79720	892
Net Debt	13.680	0,79720	10.906
EBITDA	3.426	0,79720	2.731
Free Cash Flow	2.678	0,79720	2.135
Book Value	26.984	0,79720	21.512

Table 10: Valuation based on the method of comparable multiples.

Applied to adjusted data (Present Value) of year 2016e	Ratio to be applied	Intrinsic Value (000 €)	Intrinsic Value per share
Por PER de comparables	18,63	16.619	3,05 €
Por EV/EBITDA de comparables	16,49	34.142	6,28 €
Por P/CF de comparables	15,69	33.501	6,16 €
Por P/VC de comparables	1,72	36.989	6,80 €
<b>MEDIA de los cuatro ratios</b>		<b>30.313</b>	<b>5,57 €</b>

## VALUATION SUMMARY:

Table 11: Summary of valuations.

Método de valoración	Intrinsic Value per share	Intrinsic Value of Bodegas Riojanas (000 €)	Current market capitalization (000 €)	Market Discount
DCF	5,32 €	28.941	24.774	-14%
Comparable multiples	5,57 €	30.313	24.774	-18%
Average of both methods	5,45 €	29.627	24.774	-16%

Compared to the last stock price of 4,60 € (as of 1 November 2013) of Bodegas Riojanas, the company trades with a discount of 16% against its average valuation of 5,45 €.

## CONCLUSION AND INVESTMENT THESIS:

Bodegas Riojanas is a well-managed firm located in a sector which is threatened by the gradual decrease of the consumption in the domestic market.

The forecasts for the generation of cash flow, supported by a forecast of higher sales and by improving or stable margins over sales for the coming years support the firm's objective to reduce its indebtedness. This reduction of debt, which is already well advanced, is a point which we view favourably.

In spite of the difficulties of the sector, the sales of Bodegas Riojanas are on the increase thanks to their high rate of penetration in the Spanish market, supported by a product of quality, by their belonging to a preponderant well perceived Classified Region, as well as by a well-known brand portfolio and by a renovated drive in their Sales & Marketing departments, both at home and abroad. The margins over sales have begun to improve by selling the stocks of wines which were elaborated with the 2009 harvest where the price of the grape had fallen by 42%. All this, while keeping a stable level of investments and a stable dividend.

The valuation methods used (DCF and comparable multiples) point to an intrinsic value which sets an average target price per share higher by 16% over the actual price of the share. Based on these facts, and in spite of the risks inherent to the sector, we understand that Bodegas Riojanas offers an important investment opportunity to invest, particularly since its capacity to reduce debt (and at the same time reduce its financial costs) will allow them to obtain an even larger profit on sales (and in particular to close the P/BV gap with its comparables).

#### Strengths of Bodegas Riojanas

**Market positioning:** i) Bodegas Riojanas produces mainly red wines of the Classified Rioja Region, which is the wine segment with the largest penetration in the domestic market. ii) Bodegas Riojanas elaborates mainly quality aged wines which enjoy presently the largest increase in domestic demand. (Most of this increase in demand comes from the retail channel).

**Productive structure:** Bodegas Riojanas has already disbursed the main investments in elaboration capacity, bottling plants, ageing techniques and storage which are absolutely necessary to carry out its strategy of specialization in aged wines, vintage and great vintage wines.

**High penetration of the domestic market:** In the domestic market Bodegas Riojanas has a high rate of penetration due to their specialization in the most demanded segment of Premium wines with Classified Origin and in particular form the Rioja.

**Competitive advantage:** The management of Bodegas Riojanas is divided between two main axes: Production and Sales & Marketing. Only 28% of the wineries have their own marketing and commercial teams.

We value positively the capital reduction of 1% approved in the last Annual General Shareholders Meeting on 14 June 2013.

#### Risks and weaknesses of Bodegas Riojanas

**Supply risk:** Bodegas Riojanas buys 90% of the grape for the elaboration of its Rioja wines. This makes them quite dependent on the supply costs associated with the fluctuation in the price of the raw material, which in turn can be affected by uncontrollable factors such as the climate. It also poses other problems: how to secure the supplies and how to secure the quality of the grape.

*Palliative: Bodegas Riojanas has long term agreements with a group of chosen wine growers. These agreements comprise various factors which solve many uncertainties: Bodegas Riojanas determines the technological and phytosanitary investments needed to guarantee the quality of the soil and of the grape. In this manner, if all the requirements are met, they commit to purchase the harvest. With this system long term agreements are beneficial to both parties, with winegrowers guaranteeing their sales and with Bodegas Riojanas obtaining a greater stability in the supply, and a thorough control of the levels of quality needed to elaborate Premium wines.*

**The sales of Bodegas Riojanas are dependent in excess on the alternative channel of the Christmas Campaign** which represents each year between 30% and 40% of their turnover.

*Palliative: The commercial and marketing teams of Bodegas Riojanas are in charge of maintaining and strengthening these relations. In fact, during the last three campaigns (2010, 2011 and 2012), in the thick of the economic crisis, sales in this channel were stable, even slightly higher. Thanks to their efforts, new clients were obtained, compensating the fact that the volume demanded per client turned out to be less than in previous years.*

**Debt:** The debt of Bodegas Riojanas is high and the firm is penalized mainly by the weight of the cost of financing the debt as shown in the Profit & Loss Account.

**Low yield on resources (assets, equity, invested capital)** when compared to other firms.

*Palliative: Bodegas Riojanas has begun to reduce its level of the debt. This in accordance with its plan to reduce debt throughout 2011-2014. This is being implemented and is generating less financial costs and therefore will allow for a better translation of sales into profits. As a direct result of this the yield on resources will improve.*

**The short-term "Flow Back" risk basically disappears:** On the 28th September of 2012, the Real Estate Company "Libertas 7", the biggest shareholder of the winery with 12,7% of the capital (692.262 shares), transferred all of its shares to Banco de Valencia to settle a debt with this bank. As a nationalized bank, Banco de Valencia was under the control of the "Fondo de Reestructuración Ordenada Bancaria" (FROB), and there was a risk that the FROB would try to sell all these shares of Bodegas Riojanas shortly. After the absorption of Banco de Valencia by Caixabank (12 June 2013) we consider there is now no pressing need to sell the Bodegas Riojanas position.

#### Risks and weaknesses of the wine sector

**Consumption habits:** The wine sector is vulnerable to changes in consumption habits. For example the shift from wine to beer, fruit juices, soft drinks and even bottled mineral waters, and a reduction of liters of wine consumed in Spain per person.

**Wine production is entirely dependent on its raw material, grapes, and thus depends on the quality and the productivity of each harvest.** This also depends on various uncontrollable factors: in particular the climate, and also on what the other producers will do with their vineyards (abandon them, uproot them, invest in better quality soil, improve the irrigation systems, or change the variety of the planted grape).

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