CVC to acquire Unilever's tea business, the leading global tea producer, for €4.5bn

Introduction

On November 18th, CVC Capital Partners announced that it reached an agreement with Unilever to acquire its tea business for €4.5bn on a cash-free, debt-free basis. The deal is expected to close in the second half of 2022. The agreement concludes a two-year process of reviewing and unbundling the division, which is the world's largest tea producer. The announcement was overshadowed by the fact that two of the three bidders in the last round, namely Advent and Carlyle, had not submitted a bid for the entire division. This was due to concerns about working conditions on tea plantations and about the unit's recent trading.

About Ekaterra

Ekaterra is the leading global tea business and serves circa 385 million consumers every day representing 5% of the world's tea supply supporting a workforce of around 1 million people in 21 different countries and 4 different continents. These range from India and China to Argentina and Australia, as well as its own plantations in Kenya, Tanzania and Rwanda and a factory in Turkey that processes the tea bought from tea farmers.

Ekaterra owns 34 brands including Lipton, PG tips, Pukka, T2 and Tazo and turned over €2bn last year. The company has 11 production factories on four continents and tea estates in three countries. 90% of Ekaterra tea business is made up by black and green tea, made from leaves of the Camellia sinensis plant. It also produces plant-based herbal teas (or 'tisanes'), infusions and non-teas made from flowers, herbs and plants other than Camellia sinensis (such as chamomile, peppermint and rooibos).

There have been many talks about Ekaterra's ESG particularly regarding its African territory, where there are claims saying that its Kenyan business failed to adequately help workers affected by an attack on its Kericho plantation amid ethnic violence in 2007. In addition, The Kenyan plantation has also been the scene of reported sexual harassment of women workers by some managers. Ekaterra has responded by implementing measures including more female leaders, training, and an ethics hotline. Pay in the tea industry is low but PG Tips, one of Unilever's brands, says it pays workers at Kericho approximately 2.5 times the statutory minimum agricultural income in Kenya. This was raised to the equivalent of just over £53 a month in 2018. Furthermore, around 8,500 people are permanently employed on the Unilever plantations in Kenya, Tanzania and Rwanda, and this rises to about 16,000 when temporary workers are added in peak season, said Unilever.

About CVC

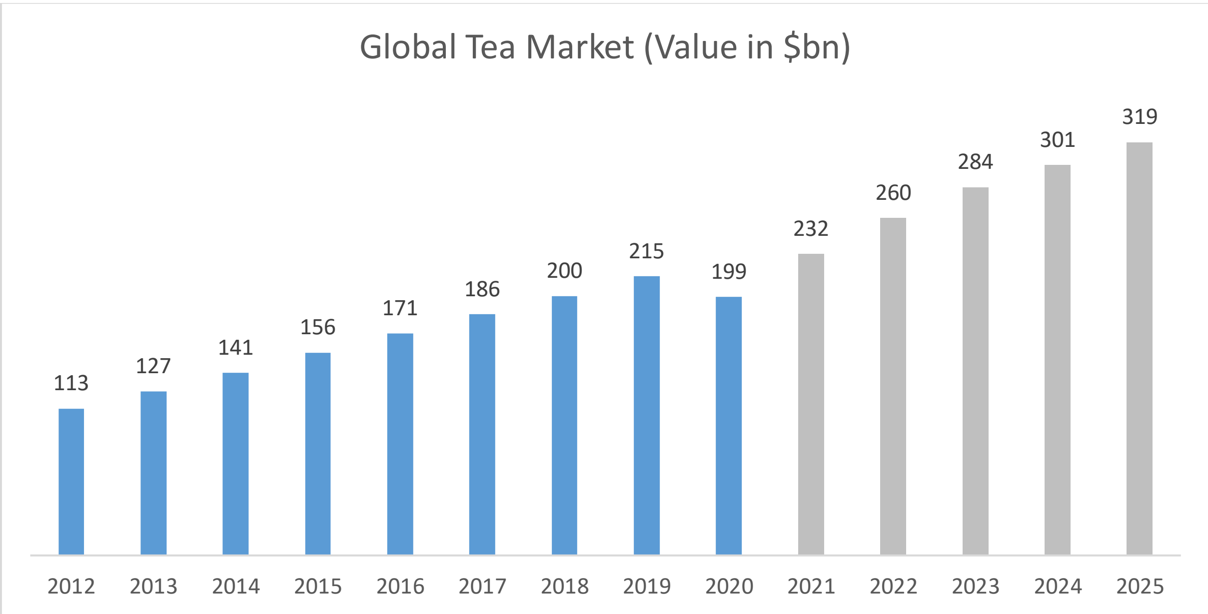
Since its establishment in 1981, CVC Capital partners has become a world leader in private equity and credit with $125bn of assets under management, $165bn of funds committed and a global network of 25 local offices: 16 across Europe and the Americas and nine in the Asia Pacific region. The firm is mainly owned by its employees and led by its Managing Partners. Each office is led by a team of local professionals who understand the distinct business environment in which they operate, and its breadth and depth of this global platform greatly benefits its investors and portfolio companies. The company has 34 Managing Partners with an average tenure of 15 years with CVC. This highly experienced and stable senior team aims to generate attractive risk-adjusted returns across multiple economic, industry and market cycles.

CVC's private equity platform manages $97bn of assets and comprises four strategies: Europe/Americas; Asia; Strategic Opportunities; and Growth Partners, each of which benefits from the company's global platform. The ability to bear the full extent of its global resources in any situation gives it a competitive advantage both when sourcing new investment opportunities and when creating value during CVC's ownership period.

CVC manages funds from over 300 investors from across the world. Many of these investors are pension plans that have invested with the firm since the early 1990s and have confidence in its ability to help them to deliver pensions to their beneficiaries, which include teachers, police officers, nurses, and fire fighters.

Industry overview

The consumption of tea has a long tradition, with recorded use dating back to the 3rd century AD. Presumably originated in China as a medicinal beverage, the drink became popular for recreational use during the Tang dynasty. From there it spread to other Asian countries and, with the help of the increasing trading culture in the 16th century, to Europe. Today, the global tea market is valued at nearly $200bn. The global market leader by revenue is Unilever (incl. Ekaterra), followed by Associated British Foods (e.g., Twinings) and Tata Global Beverages (e.g., Tetley).



(Source: Statista.com)

Today, China is still the leading global tea producer with an output of over 2.5m tons in 2017. India and Kenya are other significant global suppliers for tea. When looking at demand, Turkey has the highest per capita consumption (around seven pounds per year in 2016) whereas China has the highest total consumption and Pakistan is the biggest importer of tea.

Even though the global outlook for tea is bullish with an expected CAGR of more than 9% over the next five years, the growth is significantly varying depending on the region. In developed countries, the demand growth has slowed down as consumers have switched to coffee, herbal tea, and alternatives such as kombucha. For example, coffee retail sales went up by 9.8% in the UK during the lockdown whereas teas retail sales wen up only by 4.8%

over the same period. However, emerging markets such as India and Indonesia are experiencing a high rise in consumption. Even retail sales for black and green teas, Ekaterra's main product lines, are growing quickly in these regions.

Deal structure

The sale of Unilver's global tea business, renamed to Ekaterra, is valued at an enterprise value of €4.5bn. Considering Ekaterra's 2020 revenues of around €2bn, the EV constitutes a multiple of approximately 2.2x revenue. The completion is expected in the second half of 2022 and is subject to regulatory approvals. Furthermore, the deal includes a two-year process of reviewing and unbundling the division, given the complexity of the spin off. The acting fund is the CVC Capital Partners Fund VIII, raised by CVC in 2020.

The newly formed company Ekaterra includes a portfolio of 34 brands including Lipton, PG tips, Pukka, T2 and TAZO. The transaction excludes Unilever's Tea business in India, Nepal and Indonesia as well as Unilever's interests in the Pepsi Lipton ready-to-drink Tea joint ventures and associated distribution businesses. These units of the tea business, consisting primarily of high growth segments, generate another roughly €1bn of sales. Therefore, Unilever will remain a relevant player in the global tea market.

Deal Rationale

The deal strikes as a strong answer to an unsettling question: is the tea business' race finally slowing down? As aromatic water and coffee espresso are gaining a premium following especially in Western countries, the market for black and green has become rather saturated and Unilever saw its chance to let go of a business that has been a drag on its growth for the past decade. As a matter of fact, while the business produces $2bn of annual revenues, demand is slowly decreasing in most world markets and Unilever is looking to evolve into higher-growth industries such as plant-based foods and high-end skincare. However, as tea consumption is not homogeneously dropping, Unilever has decided to keep its tea divisions in India and Indonesia to ride the rising tea demand wave that the two countries are facing. The latter alone generates indeed $1bn of revenues. The sale also strategically comes in the wake of the several major conglomerates' spin-offs like those of General Electric and Johnson & Johnson, which could contribute to possible increasing pressure for other break-ups within Unilever. Nevertheless, the deal shows several synergies, and the hope is also for the sale to help boost the share price, which has shed over 13% of its value in the past year.

CVC on its end is attracted by the idea of reinvigorating and reshaping a low-priority unit. As Ekaterra's business is very cash generative and its debt is expected to be low, CVC will pursue a classic LBO strategy that exploits the tea business' leading market position. The firm will also probably consider ESG related improvements, like a new marketing plan, and do some operational improvements and small investments in growth. Indeed, the competing buyers saw an opportunity in pouring fresh investment in marketing and advertising to revive the growth that could not be undertaken within a giant conglomerate. In addition, although tea has been losing momentum, Emilie Holmes, founder of Good & Proper Tea in London, highlighted that smart working has contributed to increasing sales: "People have a bit more time to devote to daily rituals, rather than dunk and dash." Moreover, managing Partners at CVC are confident that Ekaterra's strong foundation of leading brands well positions the group to accelerate its future growth.

Market Reaction

The market did not react excessively to the deal, also in the wake of the strategic review announcement made in January. Unilever's shares dropped slightly by 0.8% to £38.23 right after the acquisition announcement. Nevertheless, the deal raised some eyebrows. While some might be bothered by the sale of historical brands like Lipton, Tips, and Brooke Bonds, the deal falls right into place in the spin-off fever and share prices are bouncing back both in NYSE and in the London SE. The hot question however relates to the sustainability of such a business. Ekaterra, initially contended between CVC, Carlyle, and Advent International, saw the latter two bidders stepping back because of human rights and fair pay worries in African plantations. Similarly, Blackstone did not bid altogether because of "massive ESG issues". The decision highlights the evolving social interest of investors even within private equity firms and lays the ground for potential important talks. In addition, it is worth it to note that the drop in competition hindered the sale process and lowered the acquisition price of Ekaterra, potentially disappointing some of its investors. While Unilever defends its programs to limit tea's "social challenges", underlining that "working conditions are fully in line with global company health and safety standards that exceed local requirements", the several buyers put-off by plantations tell a different story. Only time will tell whether Carlyle's concern for the upcoming Kenyan general elections in August 2022 will transform into violent riots as they did in 2007, when several tea plantation workers were killed and injured.

Financial Advisors

Spayne Lindsay acted as financial advisor to CVC. Other financial advisors involved in the transaction were not disclosed.

TAGS: Unilever, CVC, Food & Beverages, LBO, Private Equity