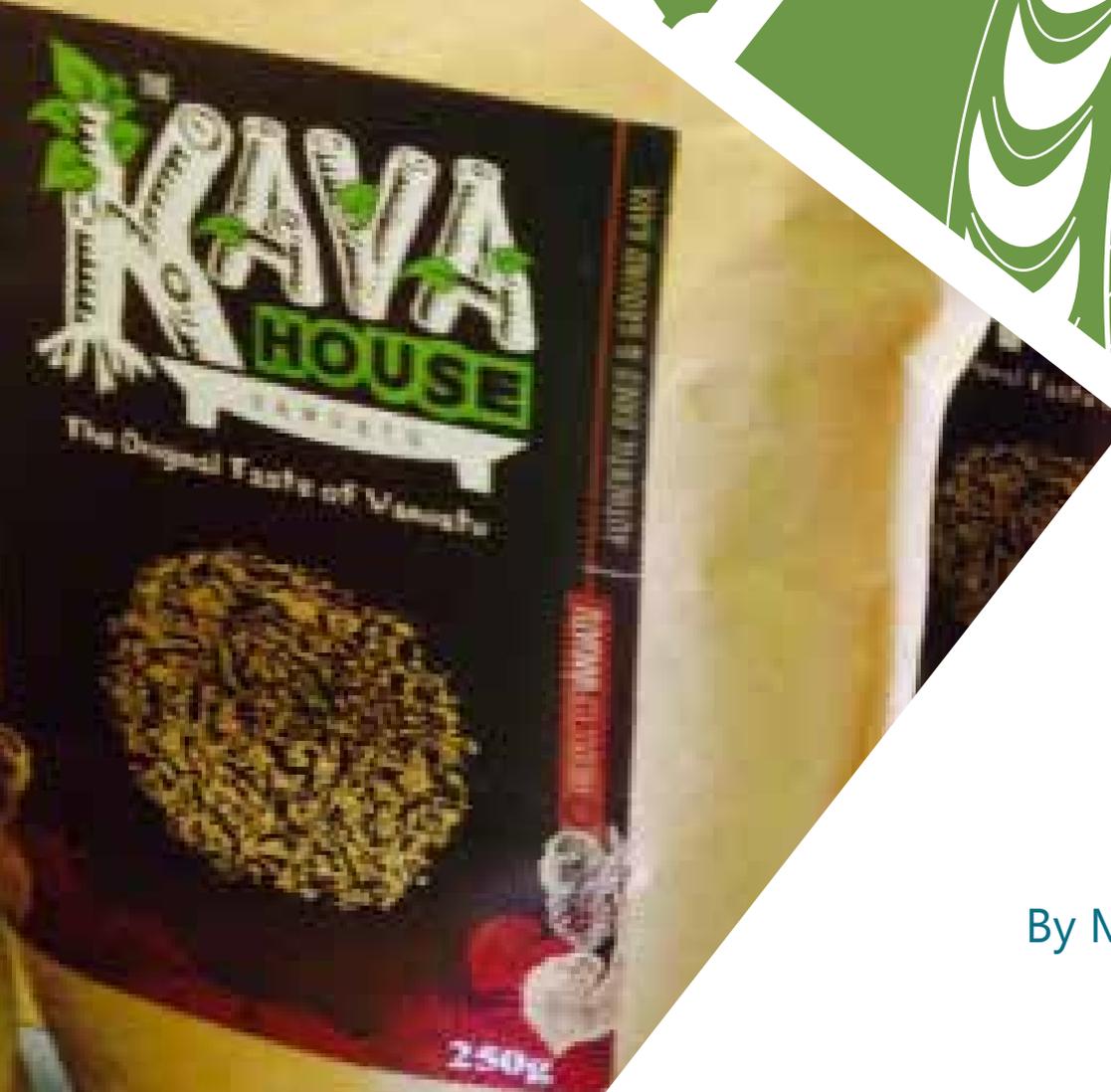




# THE KAVA HOUSE

Vanuatu



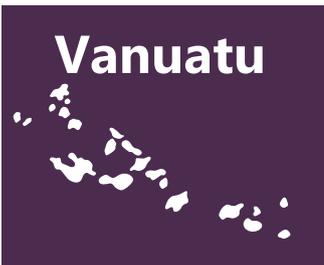
**Investment  
Case Study**

By Michael Pusinelli

# THE KAVA HOUSE

## Country

Vanuatu



## Sector

Agriculture



## Type

Local Investment



## Investor Background

Frank (known as Frank Jnr) and Julia King, who are both from Mele Village on Efate and have known each other from childhood, are the joint owners and co-directors of The Kava House business. Frank's European father, Frank King Snr., married a woman from Mele Village, (both since deceased) and Frank Jnr was born in 1983. Julia comes from the Malas family, one of the largest families in the village, and the former owners of Evergreen Tours, a long-established in-bound and local ground tour operator.

Julia worked for the company for 14 years until the end of 2016 as the Sales & Marketing Manager.

## Investment Background

The King family's involvement in the industry came via a rather roundabout route, as the business was originally started by another expatriate by the name of Stan Uren, back in 1999. Frank Snr had been one of the early pioneers of the local tour industry, having established a ground tour operation called Frank King's Tours. However, by 1999, he had fallen on hard times with the collapse of his tour business, coupled with the burning down of his business premises and loss of his house to the bank after the fire, he had been taken in by Stan; who gave him some living space above his offices in Port Vila. Stan also gave him the opportunity to make a small living by managing Stan's kava business, using Frank Snr's former contacts in the islands from his



**Julia (in the nakamal) and Frank King at the Kava House, Mele Village**

Source: Image provided by Michael Pusinelli

tour operator days to buy the kava. The business grew, and Frank Snr took it over, trading under the name Kava Trader. In due course, Frank Snr brought Frank Jnr into the business, but after only about 9 months training under his father and still aged only 20 at the time, Frank Jr was obliged to take over the business following his father's untimely death in 2004. He continued to operate under the name Kava Trader until 2007, when he formed the company Kava House Limited, changing the trading name to The Kava House.

The business originally operated out of leased premises in Port Vila, but the property owner, who lived in New Caledonia, was getting old and eventually decided to sell off the property. He gave Frank the option of either buying the premises or moving out. Frank Jnr decided to move out, but now had to look for alternative premises, and eventually decided to move the business base closer to Mele Village, as many of his employees were already from Mele. They were also by now handling quite large quantities of kava, and needed to ensure that they had safe and secure premises.

In Mele custom, family land ownership passes through the male side, but as only Frank's mother comes from Mele, he has no customary entitlement to land himself, so he knew he was going to have to acquire whatever land he needed through more conventional commercial routes.

## The Site

With Frank's help, a friend of Frank's had taken a 75-year rural lease on a piece of rather swampy low-lying land on the outskirts of Mele Village, at the intersection of the round-island road and the Devil's Point Road turn-off. However, he was not in a position to do anything with the land at the time as he had run out of money. His intention was to build a kava bar on the land, but he could not afford

to do so. By now, two or three years had passed and Frank's friend was now in trouble with his bank, so he turned to Frank for assistance. Because the land was so swampy, there was not much restriction placed on the uses to which it could be put, but it was still lying vacant and could well have ended up being sold off to a foreign investor. The friend had a garage business that owed money, so Frank agreed to pay off his debts in exchange for the assignment of the lease. The land, which actually belongs to the matrilineal side of Frank's family, still had the balance of the 75 years to run on the lease, so he agreed to take it over from his friend at the original rental, knowing that he would have to spend a considerable amount of time and money to make the land usable. As the rent was only based on the original lease agreement, and did not reflect the economic activity now taking place, it was an acceptable arrangement. Even so, there were cultural issues for the Kings to address. The land is very close to the Mele cemetery and many families in the village felt uncomfortable about having a commercial undertaking operating so close to the remains of their ancestors, so they have had to deal with a little bit of local opposition in the past.

The site is strategically very significant, because



**The Kava House with the Chinese-owned hotel under construction opposite**

Source: Image provided by Michael Pusinelli

of its roadside location at a prominent intersection on the round-island road, with a considerable amount of both commercial and residential activity in immediate proximity. There is consequently good demand for a prime location in that area.

A Chinese national has been building a large hotel directly opposite on the seaward side of the road for the last three years, which the Kings hope will be finished by next year. Less than a kilometre up the road towards Klems Hill are the Mele Cascades, a major tourist attraction with a ground tour also operated by Evergreen Tours.

Although the Cascades were diverted as a result of damage caused by Cyclone Pam in 2015, causing the closure of a popular abseiling business, the pools and facilities at the lower levels continued to function, even though the river itself eventually dried out last year. With the arrival of heavy rain in the current wet season, the river has started to flow again, and Evergreen Tours have resumed their tour activities there. Frank was able to borrow from his bank, the ANZ, to fund both the rehabilitation of the land and the subsequent building of the factory, against the future valuation of the site on an "as-if-complete" basis.

## The Kava House Business

The primary activity of the Kava House is the purchase and processing of kava in both root and stump form, primarily through buying agents in the outer islands, especially Pentecost, and transforming it into a commercially marketable format.

There are approximately 80 different types of kava, but the most valuable types, of which there are about 10 varieties, are known as noble kava. It is Government policy, for reasons of quality control, to restrict the export of kava to only the noble varieties. A Kava Industry Working Group has been set



### The Kava House head office

Source: Image provided by Michael Pusinelli

up to ensure that quality standards are maintained through rigorous testing of the export product. The Kava House buys, dries and cleans this noble kava in root form, and exports it, still in root form, to a company based in North Carolina. This company is a global producer of pharmaceutical products, buying a range of natural ingredients from around the world. Kava is ranked as their number five most important ingredient. Frank Snr had set up the original export distribution channel to this company through a middleman, but over time Frank Jnr started having reliability issues with him. However, he has been successful in cutting him out completely and now deals directly with the company himself.

Kava made from the root is the most potent and hence most valuable and sought after form. It represents about 20 percent of the whole plant. It is used in the manufacture of pharmaceuticals, in both capsule and liquid form, in the health and wellness industries in North America and Europe.

The pharmaceutical quality kava accounts for about 60 percent of their export business.



### **Noble kava root dried and bagged, ready for export**

Source: Image provided by Michael Pusinelli

The stump kava is “chipped” by hand at the Kava House factory, dried and ground into powder. This powdered kava is exported to the Marshall Islands, Kauai in Hawaii and Fiji. It is shipped in reefer shipping containers.

A ni-Vanuatu national based in Portland, Oregon, also buys between 200 and 300 kgs a month of ground kava from them, despatched by airfreight, for distribution elsewhere in the USA.



### **Drying the kava roots and the chips**

Source: Image provided by Michael Pusinelli

Because of their experience of selling the pharmaceutical quality kava, they have acquired a good reputation for the standard of their other products as well, and are looking to expand their export markets further. They have even received a recent enquiry from Mozambique. Kiribati is a big buyer of Vanuatu kava, where it is drunk in quantities and a manner similar to Fiji. The main supplier currently exports the kava directly from Santo, but Frank is now looking at ways of breaking into this market himself.

Vanuatu also exports around 20 tonnes a month of raw kava to New Caledonia. The Kava House has recently started exporting kava to New Caledonia as well. They also export reasonable quantities of the ground powder to New Zealand and Australia for the RSE workers.



### **A kava plant growing in the grounds of the factory**

Source: Image provided by Michael Pusinelli

Frank Jnr continues to handle the export markets, but now that Julia has started working directly in the business, she handles the domestic marketing, which has started to build up well. They even ship as far as the Torres Islands, where there is no fresh kava available. However, Julia has also introduced a new component to the Kava Factory business mix since

she left Evergreen Tours, drawing on her knowledge and experience from her former tourism roles. She has built a small meetinghouse, or “nakamal”, in the grounds of the factory, and is starting a kava tour business as a side activity. In the nakamal she has developed an information and interpretation facility that tells the history of kava, its processing and manufacture.

She is starting to take in tour groups, who now have the opportunity to learn about kava, see how it is made, to taste and buy it. This project is still in its infancy, but she is confident that as visitor numbers start to rise again, it will become a very profitable addition to the Kava Factory’s business.

## Investment Process

### Business Motivation

Considering the circumstances under which he took over the business, Frank Jnr’s main motivation to make the business a success has been his desire ever since 2004. Ultimately, to make the business a great legacy to his father, (as Frank Snr had always told him that he was never going to make a go of it!), and to be able to pass this legacy on to his own children. However, there is also a determination on Julia’s part too, arising out of her cultural background. She comes from a large family, where the girls are traditionally expected to find rich husbands, i.e. men who have good land holdings.

Because Frank’s ni-Vanuatu lineage is only through his mother’s side, which meant that he had no natural land entitlement, he had nothing other than his father’s business to offer, so there was some resistance within Julia’s family to her even marrying him. This however has made her even more determined to make a success of their business!

## Financing the Development

Because Frank had acquired an existing registered lease, and based on their previous relationship with the bank, the ANZ provided them with the initial funding to rehabilitate the land and build the factory, providing them with 100% finance over a 20-year loan period, based on a Loan-to-Valuation Ratio (LVR) of between 60% and 70% of the “as-finished” development. The bank took an assignment of the lease as security, backed up by the high valuation placed by the valuer on the “as-finished” development.

Starting in 2008, Frank spent a total of VT5 million on buying and dumping fill on the land, levelling and compacting it, allowing a full 12 months for the ground to stabilise, settle and become usable. He designed and built the factory himself, using local labour, in about 5 months, and while the kava workers had no kava to chip, they were driving the buses to keep the income coming in.

They have been with the ANZ since 2008, and would not be where they are today without the support that the bank has provided. Their only problem is the high interest rate. Because their borrowing rate is fairly high, they have supplemented their income for a number of years by operating a small fleet of mini-buses, contracted to provide guest pick-up and delivery services for tourists. They provide a transfer service for cruise ship passengers to Hideaway Island and the zorbing and kayaking adventure tours on Devil’s Point Road.

The drivers are mainly family members who would otherwise be working in the kava factory, but if the kava business is slow, then they fall back on the buses. The Kings finance the drivers into ownership of the buses, and their fleet size has ranged in the past from 3 to 10 buses.

## Facilitating Factors to the Investment

Their local knowledge and family connections have been a contributing factor to their ability to get the current premises up and running, as well as the support from their bank. The ANZ Bank has always been very supportive. However, they have had no assistance from any Government agencies, and indeed there has been a lot of politics surrounding the kava industry that has caused them problems, including the imposition of a 5% kava export tax, based on invoice value. They are very disappointed with the level of support they have received from the Government in the past. For example, they had an opportunity to meet with some Fiji exporters, who get a grant from their government when they exceed their export targets, which they can use to buy more machinery. There is no such assistance in Vanuatu. There is an initiative to promote agri-tourism in Vanuatu at the moment, which they are well placed to take advantage of. However, despite their approaches to the people involved in this programme, including the Chamber of Commerce, they have still not been invited to be involved.

## Total Investments

Rehabilitating their site cost about VT5 million. The factory was then purpose-built by Frank with local labour at relatively low cost, and their equipment moved in from the Vila premises. They could not put a figure on this, nor on the total worth of the business, but they clearly fit into the SME category.

Frank and Julia have no other investments in Vanuatu, apart from Julia's residual family interest in Evergreen Tours, nor elsewhere in the Pacific. However, they are now looking at the possibility of establishing their own regional distribution outlets in some of the other Pacific Islands.

## Employees

They generally have between 8 and 10 people working in the factory, all of them ni-Vanuatu, including 4 women. However, not all their labour is sourced or employed in the conventional manner.

The King family has been heavily involved in supporting a soccer team in Mele Village for many years, and sponsor players from the outer islands. Some of these young people are brought down to Mele for soccer training. While they are there, they are given employment in the kava factory as part of their programme on a "quid pro quo" basis, often being able to obtain 5 or 6 months of work experience while still training, but also providing the Kings with a source of cheap labour.

## Local Supply Chains

The Kava House is entirely dependent upon the reliability of their buying agents in the islands for their sources of kava, as it would be logistically impossible for them to try to undertake a direct buying operation. The buyers themselves are licensed and approved by their own local councils.

They deal with their agents entirely on trust, based on long-standing relationships built up over many years, and so far, they have had no bad experiences. All the kava purchase transactions are spot cash, but they are able to channel all the necessary funds through the agents' bank accounts these days, so no longer have the risk of large amounts of their physical cash being carried around the islands.

They have to import their packaging for the powdered product from overseas, as it is quite expensive and they have had problems in the past. However, they have been inspired by the Tanna Coffee factory down the road to find a better solution. Their labels are printed locally, but they too are

expensive, and the supplier is not particularly reliable. They are looking for an alternative printer at the moment. One option is to print their own stickers if they could, or get the packaging pre-printed.

Aside from their specialised machinery, they are able to get most of their other requirements locally, except for the large polybags that they use to bring the kava in from the islands and in which the root kava is exported. They go through about 2,000 bags a month, and recently the price of the bags has increased. They now pay about NZ\$1.50 a bag.

## Key Challenges

The greatest challenge they currently have is being able to retain their skilled workers, as the RSE programme in New Zealand provides an earning opportunity that they cannot compete with on their local wage structure. However, they also have concerns over the reliability of their kava supplies, as Cyclone Pam destroyed many of the national crops, and much of the replanting will not come into full production for another 3 to 5 years.

The Vanuatu Commodities Marketing Board, which is responsible for ensuring the quality of the exported kava and for issuing the necessary licenses has been subject to political interference in the past, causing them various problems. However, the Government has recognised this and has dealt with the issue, reducing the level of this political interference.

The introduction of the new law restricting exporting to noble kava only has not affected them as much as other exporters, given that their focus has always been on noble kava. However, quality control issues are a challenge, as Vanuatu relies upon its reputation to get access to a number of its markets. The new law was only gazetted last year, but they have already set up three buying stations with drying facilities on Pentecost that will only buy the

noble varieties from now on, buying fresh rather than dry, and doing the drying themselves. They do this through one agent in each particular area on Pentecost, who deals with the growers on their behalf. This entails a lot of extra work for them, but it is a necessary precaution. However, the agencies charged with enforcing this new law are not being very co-operative at the moment and they are still arguing with the Government over this. They feel that the introduction of this new legislation was premature, given that the growers are still recovering from the effects of Cyclone Pam.

Now that they are focused on the noble kava, they have recognised that they need to strengthen the whole marketing side of the business. However, they still find that personality issues in a number of the agencies restrict the flow of information.

## Looking Forward

If given the opportunity to make any changes during the investment, they would have acquired some land and planted their own kava. Lack of capital has prevented them from being able to do so yet, and they would probably be able to grow enough on Efate that they would not have to worry about bringing it in from the islands. People offering to invest with them on a partnership basis have approached them in the past, but they have not felt confident enough with these approaches to go into such an arrangement yet.

They have “not yet” achieved their original objectives, but they are confident they are moving in the right direction. Frank has been waiting for some time for Julia to join him in the business full-time, and now that she is there, her new venture into the kava tours business is, in their own words, the “final piece in the puzzle”. In terms of regarding their investment as a success, they are quite proud of the way things have gone so far, although they

also recognise that they still have a lot of challenges ahead. The product is performing well, but it could get better.

At the moment, there is so much attention on the kava industry that they feel confident that the market will continue to grow over the next few years. However, they accept that they have to keep training and re-investing to keep their place in the market. The replanting since the cyclone has been significant, so there should be a good increase in supply over the next few years. Aside from the kava business, they might look to expand their tour bus side, as they still want to use Julia's experience in tourism to better advantage.

The investors would recommend Vanuatu as a place to invest, especially more in tourism related areas. However, the restricted categorisation of some of the business activities does limit the opportunities for outside investors. They would also like to see more investment in import-substitution, for example, egg production, as this used to be undertaken locally, but now most of the eggs are imported.

## Top tips for New Investors

- Create a business that will boost local employment opportunities
- Make sure that all your ground lease arrangements are properly documented and signed off before you start doing any thing else
- Don't rush in – do your homework first
- Get the right advice from the locals and the local business community



Source: Image provided by <http://www.thekavahousevanuatu.com/powder-kava-merchandise/>