



## WHY WINE ACQUISITIONS ARE ON THE RISE AGAIN

### Turning the Corner in M&A Activity:

Don Smith

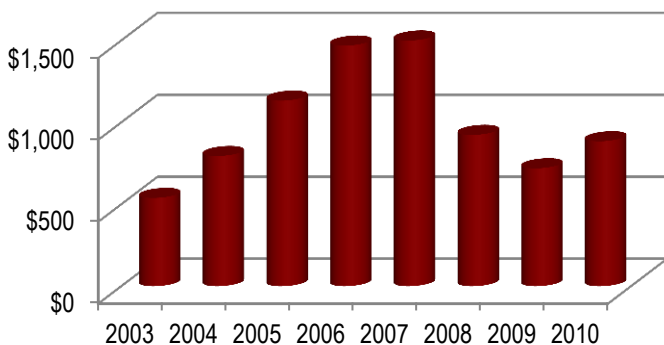


There is an old investment adage that goes, “follow the smart money”. Taking that advice in the business acquisitions industry would have had you under a mattress for much of the past few years.

But a review of recently released merger and acquisition data shows a remarkable increase in deal activity in 2010. While the overall economy

was still struggling for traction, those ‘smart money’ business buyers pulled out their checkbooks and began placing their bets on rebound targets. M&A activity, as measured by total deal value, ended up increasing a surprising 23% in 2010.

■ M&A ACTIVITY: 2003 - 2010  
(VALUE OF U.S. DEALS - \$BIL)



Source: Thomas Reuters

The turnaround is even more pronounced when you look further into the quarterly numbers for 2010. M&A activity lagged each of the first three quarters of the year, but a flood of deals began to emerge from closing tables around the country. In fact, 75% of the M&A volume happened in the 4<sup>th</sup> quarter of 2010.

### Wine Industry Acquisitions

Let’s contrast those national numbers with what we have seen in the wine industry’s recent history. Deals were certainly coming hard and fast during the lead-up to the recession: Rex Hill, Stags Leap, Duckhorn, Rosenblum – to name just a few of the record number of acquisitions consummated in 2006 and 2007. By our count here at Global Wine Partners, over a dozen larger (over \$40 million) wineries and brands were transacted in those years.

But as the economic storm clouds gathered in 2008, the larger wine industry players quickly retreated into their cellars, and stayed there for much of the last two years. The transactions that were consummated in that period were mostly distressed sales. Of course, there were some notable exceptions, like Kosta Browne – a stellar performer among a sea of struggling brands. But for the most part, the large wine industry players were in no mood or financial shape to add to their stable of brands.

And certainly for much of 2010, the dearth of deals continued. But late last year we began to see buyers emerge to restart the deal-making machine. Four Vines, Justin, and several smaller brand deals seem to mark a buyer movement from sidelines to playing field. So, are these deals a sign of a true resurgence of consolidation and ‘growth through acquisition’?

### 2011: “The Year of M&A”

Optimism certainly abounds in the broader M&A industry. **Forbes.com** recently proclaimed 2011 as “The Year of M&A”. **Thomson Reuters** projected that acquisitions will “surge 36% in 2011” (and twice that rate for real estate oriented M&A). And here at GWP, we are seeing a noticeable change in buyer activity – both in quantity and quality. Our phones are ringing more – much as they are in investment banking offices throughout the country.

But what has changed so dramatically for deal making in a landscape where the mantra “slow, steady economic recovery” dominates? The answer can be found in the myriad of positive environment factors: low capital financing rates, pent up demand, large amounts of accumulated acquisition capital, fears of capital gains tax increases, and fading worry of a double dip recession,

etc. Confidence has improved and buyers seem to have realized that the bottom of a cycle is turning upward.

Strategic buyers are now looking to accelerate growth and gain competitive advantage. Corporations find themselves not only competing with industry players but also with well-funded private equity (PE) firms. These financial buyers are sitting on cash balances they need to invest. There is a clear mandate among PE firm managers to put that capital to work. And with the stock market on the move again, these managers need higher returns on cash balances to compete for investor's dollars. That is just part of the 'smart money' driving acquisitions in 2011.

### Next Wave of Wine Business Buyers

The major players that dominated the wine industry M&A flurry in the early / mid 2000s will not be as big a factor this time around. Today, the strategic buyers are more often mid-sized companies looking to expand their portfolio. Some are in other segments of the wine industry and are moving into wine production.

Also, we're seeing more buyer interest from outside the industry. The allure of the wine business remains strong and, if anything, has been heightened by recessionary forces. High-net-worth individuals (lifestyle) buyers are active in their search activities and have been bolstered by stock market gains over the last six months.

Private equity groups, as noted, have cash to spend and are in the acquisition mode. Some previous PE group ventures into the industry have certainly been less than successful to date, but it is still viewed as attractive for investment. Many understand that wine still has tremendous future growth potential. PE group managers I have spoken with believe there is money to be made in this industry as the economy continues to mend and discretionary consumer spending rebounds.

The largest wine companies will continue to consider acquisitions for growth – albeit with a more selective approach to the market. These companies are still licking their wounds and struggling to absorb some of their past acquisitions. But no one wants to be left behind in what is expected to be a resurgent year in the industry and buy signals are again being flashed by selected industry leaders.

### Wine Business Sale Prospects

What does all this mean to a winery or vineyard owner contemplating a potential sale in 2011? Well, we clearly have a much improved environment for selling a wine business in 2011. The economic recession is fading into

our collective rear view mirrors, and the mood is optimistic.

Buyers are active again and growing in numbers – but the 'irrational exuberance' of a few years ago has clearly been traded in for a measured approach to acquisitions. Yes, that pesky 'smart money' will require quite a bit more preparation and positioning this time around. But there appears to be no shortage of suitors for healthy businesses made ready to enter the marketplace.

Two years ago, wine business sales were all about the market. Today, the sales climate is back to being about the business. And for those of us in the M&A industry charged with managing the process on behalf of our clients, that is a very good thing.

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## HAVE WINE BUSINESS VALUES CHANGED?

*Vic Motto*

Has the value of your wine business changed since the recession? Or, to use the popular recession cliché: are lower valuations the 'new normal'?

Since the *Meltdown*, the buzz has been: *It's a buyers' market. Bargains are widely available.*

Are there a lot of bargains in the wine M&A market?  
Are values lower?

Bargains are in the eye of the beholder, of course. So, if having the opportunity to buy a wine business that's distressed, unprofitable and declining, i.e., one that requires a lot of capital, skill, time and risk to turn around – if that is a bargain, then yes, we've seen some real bargains in the past two years and some of these bargains are still available.

### Valuations have not changed.

The wine market cycle changed. It shifted from the growth phase to a down phase. So, the M&A transactions completed during this down phase are reflective of that change. Most of the M&A transactions were of distressed businesses and their selling prices reflected that.

Don Smith's accompanying article mentions transactions that closed during the recession and singles out Kosta Browne as an exception. While other recession deals were seen as 'bargains', Kosta Browne commanded a strong price – at the depth of the downturn. That's because it turns out that the real *exceptions* seen in the recession were not the valuations, but rather the conditions of the businesses being sold. A great business sold for a great price, while less than stellar businesses were priced accordingly.

Buyers are not naïve.

Value is relative. That is, comparative, or considered in relation to something else. If yours is better than hers, than it's worth more. If yours has more of what buyers want, and particularly if more buyers want it, then it's worth more.

What determines value? Is it a "multiple" of earnings? That's the measure most commonly and widely used. It's simple. Just multiply last year's earnings times the magic number and that's the answer. No. Sorry. That's too easy.

What if there are no earnings? Or what if, for example, two businesses have the same earnings? Is their value then also the same? No; of course not.

Say that one of them is growing and the other is declining. Then certainly their values are quite different. Does location matter? Track record? Reputation? Price point? Everything matters, not just earnings.

It turns out that the "multiple" is really a vast oversimplification of value and certainly not a singular tool to reliably determine value. It's like the average depth of the ocean – a very broad reference point.

In fact, value is a very complex principle based on many factors. Fundamentally, the value of a business depends on its future (not current) earnings, including both operating profits and capital appreciation. However, measuring this requires understanding a lot about the things driving the business plus making some very important assumptions about the future.

- What is the past performance of the business and what is its future outlook?
- How does it fit the opportunities available in the current and near-term market?
- What are the key drivers of these results?
- Do these success factors exist within the business or must they be added or enhanced?
- What are the projected future results and how much risk or uncertainty is inherent?

- How much additional capital is required?
- How will the business assets likely appreciate (or not) over time?
- How confident is the buyer in the answer to these and many other questions?

Answer these questions and you'll have a much better idea of what your business worth. A 'multiple' won't do that.

Valuations have not changed.

However, many other things have changed, including the wine market, the capital markets, the keys to success in wine, and the winners and losers in the industry.

The winners today are worth just as much as the winners during boom times. So are the losers. It's just that today there are a few more losers.

Would you like to sell your business at a good price? You can. And you can do that today. All you have to do is make it look like a **winner** and instill some **confidence** in the minds of prospective buyers that it truly is a winner. It's really just that simple. And that complicated.

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Global Wine Partners is the leading provider of financial advisory services to the wine industry and the only dedicated wine investment bank.

Global Wine Partners services include mergers & acquisitions, valuations, strategic advisory, asset management and corporate finance.

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