

# How to sell a winery – What have we learned from recent transactions?

**Fortify Conference 2018**

**Artisan Fermenters and Distillers Business Conference  
Penticton, BC**

***Al Hudec, Farris LLP***



# What have we learned from recent prominent transactions?

- |   |   |
|---|---|
| <ul style="list-style-type: none"><li>• Peller acquisitions of Black Hills, Grey Monk and Tinhorn</li><li>• Arterra purchase of Laughing Stock</li><li>• Phantom Creek purchase of Road 13 Vineyard from C.C. Jentsch</li><li>• Sea Star (David Goudge) purchase of Saturna (Larry Page)</li><li>• Mt. Boucherie/Rustico- receivership sales</li><li>• Time sale to Phantom Creek</li><li>• Church and State sale to Chinese buyers</li></ul> | <ul style="list-style-type: none"><li>• Backyard Vineyards sale to Diamond Estates</li><li>• Foxtrot sale to Douglas Barzelay</li></ul> |
|---|---|

# Further comments on recent sales

## Diamond Estates purchase of Backyard Vineyards

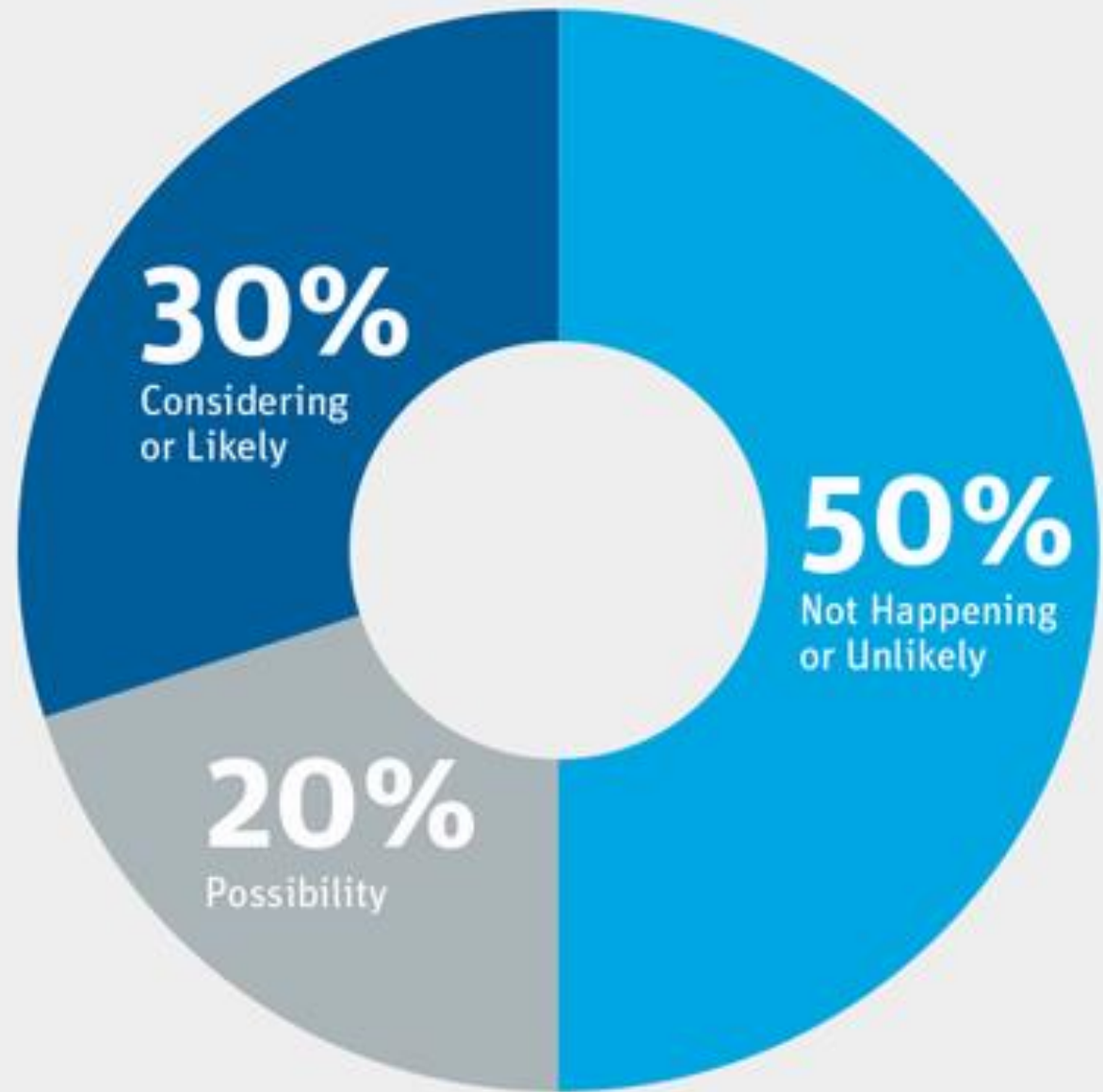
- Diamond is a large TSX Venture listed producer of mid-priced VQA wines
- Bought Backyard, which has excess production capacity, to take their brands national (cheaper to produce in BC, rather than ship from Ontario)
- Will joint venture a new \$7 million winery on the Naramata Bench with Ewen Stewart

## Doug Barzelay purchase of Foxtrot

- Torsten and Kicki Allander sold to Douglas Barzelay, a world leading authority on the wines of Burgundy and co-author of the newly published *Burgundy Vintages – A History from 1844*
- “We were attracted by the consistent high quality of the wines produced at Foxtrot and believe that the Naramata Bench is poised to claim its place among the top *terroirs* for pinot noir in the world”

# Generational issues motivating sellers

- \$1.9 trillion of Canadian business assets will change hands over the next 5 years
- 60% of business owners, age 55-64 have not yet discussed their exit or succession plans
- 50% of vineyards will change hands in the next five years (Silicon Valley Bank)



**State of the Wine Industry 2017, Figure 16**

Source: 2016 SVB Annual Wine Conditions Survey

# Other factors driving sales activity

1

**DESIRE OF LARGEST  
PRODUCERS TO  
ACQUIRE SUPER  
PREMIUM BRANDS**

2

**CHALLENGES OF  
ACHIEVING SCALE  
ECONOMIES IN A  
FRAGMENTED  
INDUSTRY**

3

**SHIFT SCARE, HIGH  
PRICED LAND TO ITS  
HIGHEST AND BEST  
USE**

4

**DESIRE TO  
DIVERSIFY BY  
REGION AND  
VARIETALS**

# Market conditions are currently extremely favourable

- 10 continuous years of strong economy and markets
- price/earnings ratios are at a cyclical high
- Low interest rate environment
- High growth rate of wine consumption in Canada
- Strong growth in the premium price category
- Increasing international recognition of Okanagan for the quality of its wines and as a premier tourist destination
- Shortage of acreage in the Valley suitable for quality grapes and inflating land values
- Trend towards consolidation in the industry



# Are storm clouds gathering?

**Prospects of Recession**

**Market Overhang**

**Competition from Legal Cannabis**

**Prohibitions on DTC to customers in other provinces**

**Loss of exclusivity for VQA wine in grocery and other trade challenges**

**Climate change/Forest Fires**

**Shifting age cohorts, slowing of premiumization trend**



# Recent headlines

- Constellation Brands' invests \$5 billion in Canopy Growth
- Constellation seeks to sell some of its US wine brands in a deal that could be worth US\$3 billion – underscores the shift to beer and cannabis products targeting a younger demographic
- Coppola family purchases Oregon vineyard
- Francis Ford Coppola launches an appellation-specific organic brand of cannabis flowers
  - “Wine and cannabis are two ancient and bounteous gifts of Mother Nature, linked by great care, terroir and temperateness. Expertise making one applies to the other,” Coppola said.



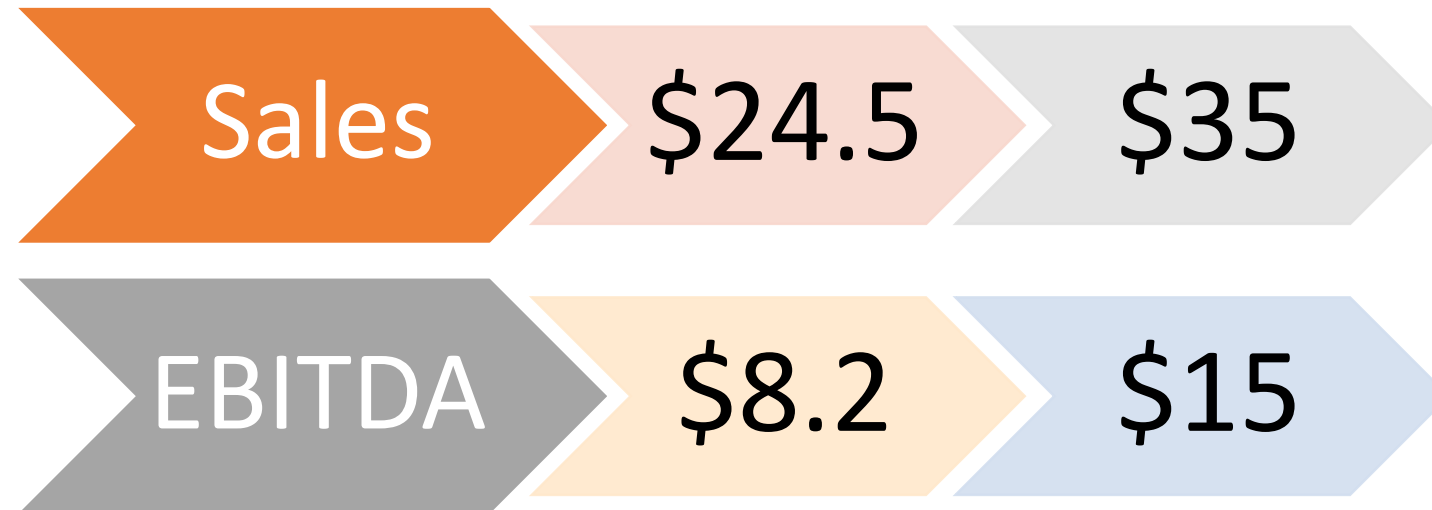


# Top prices are being paid for premium wineries

## Andrew Peller's purchases of 3 leading Okanagan wineries

|                              | Annual Revenues | Employees | Vineyards | Selling Price  |
|------------------------------|-----------------|-----------|-----------|----------------|
| Black Hills Estate Winery    | \$6 million     | 16        | 50 acres  | \$31.3 million |
| Gray Monk Cellars Ltd.       | \$11 million    | 50        | 50 acres  | \$34.5 million |
| Tinhorn Creek Vineyards Ltd. | \$7 million     | 50        | 150 acres | \$28.9 million |

## Peller's 5 Year Forecast



# Your business is worth more to a strategic buyer

- Distribution capability
- Vineyard holdings
- E-commerce platform
- Ability to shift production to other facilities
- Capital to grow the business
- Administrative efficiencies and reduced overhead





# The universe of buyers

- Large industry buyers
- Middle sized players with strong balance sheets
- Investment syndicates
- Private equity buyer
- Chinese and other Asian buyers
- Romantic lifestyle buyer

# Buyer Motivations

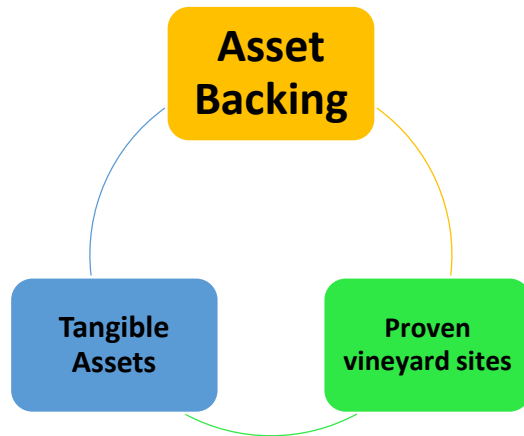
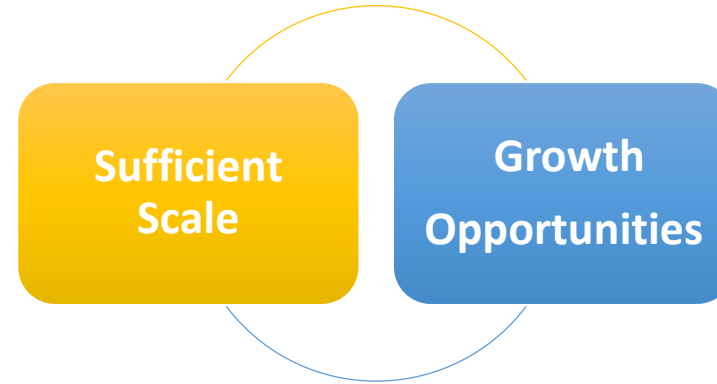
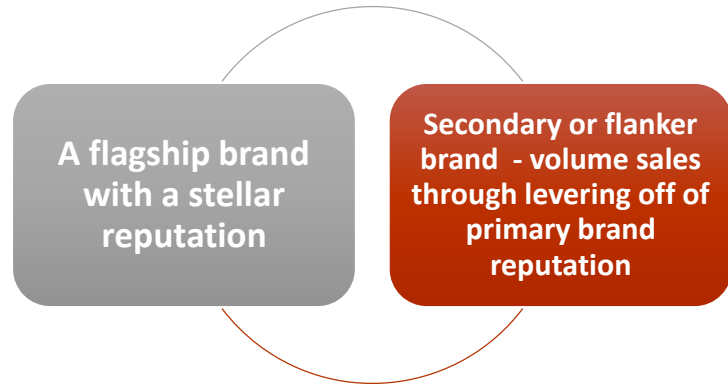
**Premiumization**

**Scale and  
Diversification**

**Cash Flow**



# What Are Acquirers Looking For?



# U.S. winery sales - 2017

| Closing Date | Target                                    | Acquirer                              | Assets Acquired                     | Location                    |
|--------------|---|---------------------------------------|-------------------------------------|-----------------------------|
| January      | Cameron Hughes Wine, Inc.                 | Vintage Wine Estates                  | Brand and Inventory                 | California                  |
| April        | Jamieson Ranch and Reata Brands           | WX Brands                             | Brand and Inventory                 | Napa, California            |
| April        | Bread & Butter                            | WX Brands                             | Brand and Inventory                 | California                  |
| April        | Blossom Hill Winery                       | Delicato Family Vineyards             | Facility                            | Central Coast, California   |
| April        | Stagecoach Vineyard                       | E&J Gallo                             | Vineyard                            | Napa, California            |
| April        | Geyserville Facility (Silver Oak Cellars) | Michael-David Winery                  | Facility                            | Sonoma, California          |
| April        | Klipsun Vineyard                          | Terlato Wines International           | Vineyard                            | Red Mountain, Washington    |
| April        | Beaux Frères                              | Maisons & Domaines Henriot            | Brand, Facility and Vineyards       | Newberg, Oregon             |
| April        | Ovid Napa Valley                          | Silver Oak Cellars                    | Brand, Facility and Vineyard        | Napa, California            |
| May          | Brewer-Clifton                            | Jackson Family Wines                  | Brand, Vineyards and Facility Lease | Sta. Rita Hills, California |
| June         | Firesteed Cellars                         | Vintage Wine Estates                  | Brand and Inventory                 | Willamette Valley, Oregon   |
| June         | Bartolucci – Stice Lane Vineyard          | Raymond Vineyards/ Boisset Collection | Vineyard                            | Napa, California            |
| June         | Schrader Cellars                          | Constellation Brands                  | Brand and Inventory                 | Napa, California            |
| June         | Hawks View Cellars                        | Ponte Family Estate                   | Brand, Facility and Vineyard        | Sherwood, Oregon            |
| June         | Standing Stone Vineyards                  | Hermann J. Wiemer Winery              | Brand, Facility and Vineyards       | Finger Lakes, New York      |
| August       | Calera Wine Company                       | Duckhorn Wine Company/ TSG            | Brand, Facility and Vineyards       | Central Coast, California   |
| August       | Germain-Robin                             | E&J Gallo                             | Brand and Inventory                 | Mendocino, California       |
| September    | Prince Hill Vineyard                      | Silver Oak Cellars                    | Vineyard                            | Willamette Valley, Oregon   |



# U.S. winery sales – buyer motivations

| Target              | Acquirer                      | Premiumization | Assets to Support Growth | Mid-tier Players Building Scale | Geographic Diversification | Private Equity Platform |
|---------------------|-------------------------------|----------------|--------------------------|---------------------------------|----------------------------|-------------------------|
| Orin Swift          | E&J Gallo                     | •              |                          |                                 |                            |                         |
| Robert Hall Winery  | O'Neill Vintners & Distillers |                |                          | •                               | •                          |                         |
| Duckhorn Vineyards  | TSG Consumer Partners         |                |                          |                                 |                            | •                       |
| Charles Smith Wines | Constellation Brands          |                |                          |                                 | •                          |                         |
| WillaKenzie Estate  | Jackson Family Wines          |                |                          |                                 | •                          |                         |
| Bread & Butter      | WX Brands                     |                |                          | •                               |                            |                         |
| Stagecoach Vineyard | E&J Gallo                     |                | •                        |                                 |                            |                         |
| Beaux Frères        | Maisons Domaines Henriot      |                |                          |                                 | •                          |                         |
| Ovid Napa Valley    | Silver Oak                    | •              |                          |                                 |                            |                         |
| Schrader            | Constellation Brands          | •              |                          |                                 |                            |                         |
| Calera Wine Company | Duckhorn Vineyards            |                |                          | •                               | •                          |                         |

# Successful Acquisition Models





# The GI Partners Model

- Flagship wine
- Max volumes of flagship brand
- Develop secondary or flanker brand
- Max sales through high margin channels
- Experience center
- Secure quality grape supply



# St Michelle - String of Pearls Model

St Michele owns a portfolio of premium wineries which are operated separately from the parent and which produce distinctive wines from authentic estate vineyards. In each case, the corporate parent provides capital for the financing of vineyard and winemaking operations, together with administrative and marketing support.

# The role of private equity

- Most prominent Canadian example is Ontario Teachers Pension Plan purchasing Constellation Canada
- Silverado Investment Management Company – one of the most active vineyard investors in California
- PE investors struggle with the question of how they can add value to a brand in an industry where winners determined by scale and distribution leverage
- One successful model - GI Partners (eg acquisition of Duckhorn, Far Niente)
  - Invest in a strong brand at the luxury end of the market – a brand with high price points, a strong reputation for quality and a loyal following through DTC – such brands have an intrinsically high margin and value notwithstanding their lack of scale or strength in traditional high volume channels
  - Pump dollars into areas that will increase growth and profitability
    - high quality estate vineyards
    - state of the art equipment and production facilities
    - showcase hospitality facilities
    - marketing talent
    - web portals to grow high margin DTC and internet sales
    - ‘flanker’ brands that benefit from the flagship brand’s reputation but at a lower price point and greater volume potential (eg Decoy)



# Farm land funds

New York-based TIAA-CREF (the initials stand for Teachers Insurance and Annuity Association and College Retirement Equities Fund) owns more than 20,000 acres of vineyards, which in turn produce grapes for more than 190 vintners, including Stag's Leap, Cakebread Cellars, Robert Mondavi, Sutter Home, and others.

TIAA-CREF manages much of its wine operations through Silverado Premium Properties, a Napa, Calif.-based investment and management company it owns that purchases and plans the development of vineyards and seeks to maximize the revenue it can extract from its harvests.

# Noteworthy exits are not available to everyone

Sellers whose brands are marginally profitable, lack product focus or are severely underscaled will face strong headwinds

# Newsworthy exits are not available to everyone

- Most Okanagan wineries don't have the scale and profitability required to garner top dollar pricing
- Prerequisites include strong top line revenue growth and strong earnings history and high margins derived by super-premium pricing and high margin DTC sales channels
- Sufficient scale to attract buyer interest
- Growth opportunities
- Asset backed – high quality vineyards, production facilities and tasting room/event center
- Sellers whose brands are marginally profitable, lack product focus or are poorly prepared to go to market will likely face increasing headwinds



# Consolidated industry income statement (2015)

|  | <b>Bottom<br/>quartile<br/>(\$30,000-<br/>120,000)</b> | <b>Lower<br/>middle<br/>(\$120,000-<br/>255,000)</b> | <b>Upper<br/>middle<br/>(\$255,000-<br/>650,000)</b> | <b>Top<br/>quartile<br/>(\$650,000-5 million)</b> |
|--|--|--|--|---|
| Total revenue                          | 70.5   | 177.2  | 410.6  | 1,688.5   |
| Cost of Sales (direct expenses)        | 26.7   | 67.6   | 179.1  | 740.5   |
| Operating expenses (indirect expenses) | 70.6   | 112.0  | 232.9  | 863.9   |
| Total expenses                         | 97.3   | 179.6  | 412.0  | 1,604.4   |
| Net profit/loss                        | -26.8  | -2.4   | -1.4   | 84.0  |

# Are there other exit strategies for small wineries

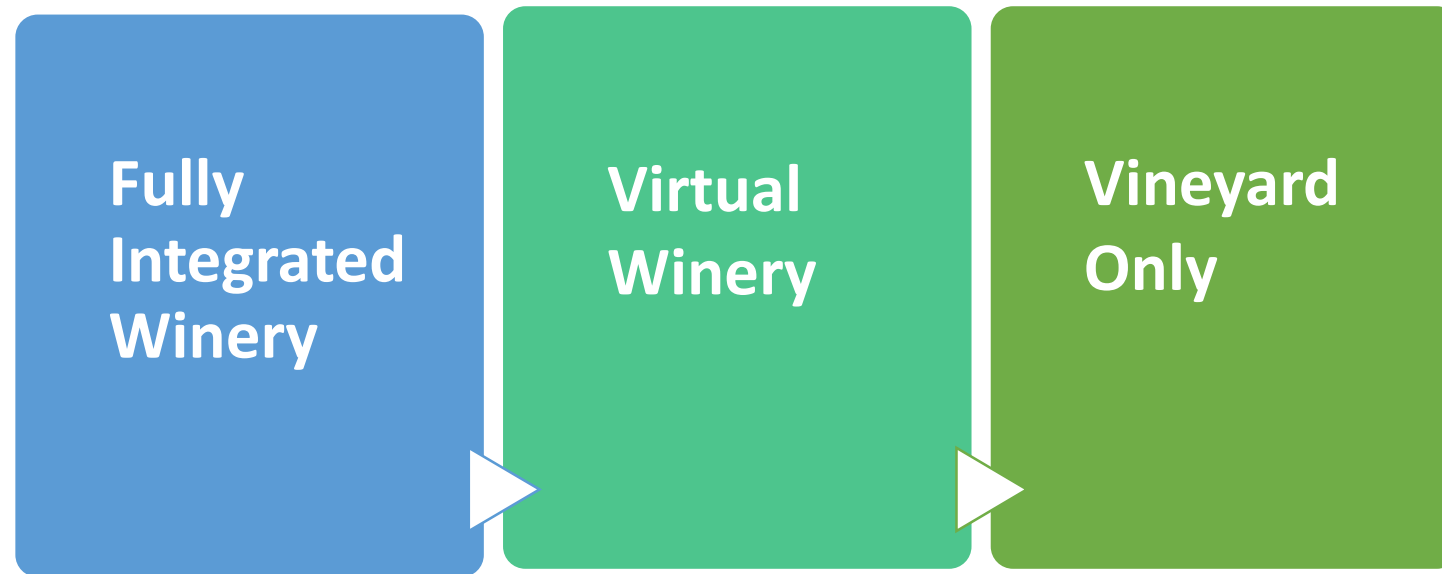
- Real estate sale
- Saxon Winery/Bottega Wine Studio
- Tarrabella Wineries

# Are you ready to sell?

- Are you psychologically and financially ready to sell?
- Have you done everything you can to exploit near term and low risk growth opportunities?
- Have you optimized your tax structure?
- Organize your business in a manner that will permit sheltering gains with simultaneous access to
  - Principal residence exemption
  - Lifetime capital gains exemption
  - Lifetime farming capital gains exemption
- Estate planning
  - Estate freeze
  - Income sprinkling
- Inter-generational transfer – Have you extracted enough cash for retirement?



# Industry Business Models



# Available alternatives are driven by your circumstances

1. Profitable, sufficiently scaled business
2. Unmatured business with potential for the current owner to continue to add value
3. Non-profitable and underscaled winery
4. Wineries owned by investment syndicates
5. Established multi-generational business
6. Opportunistic sellers

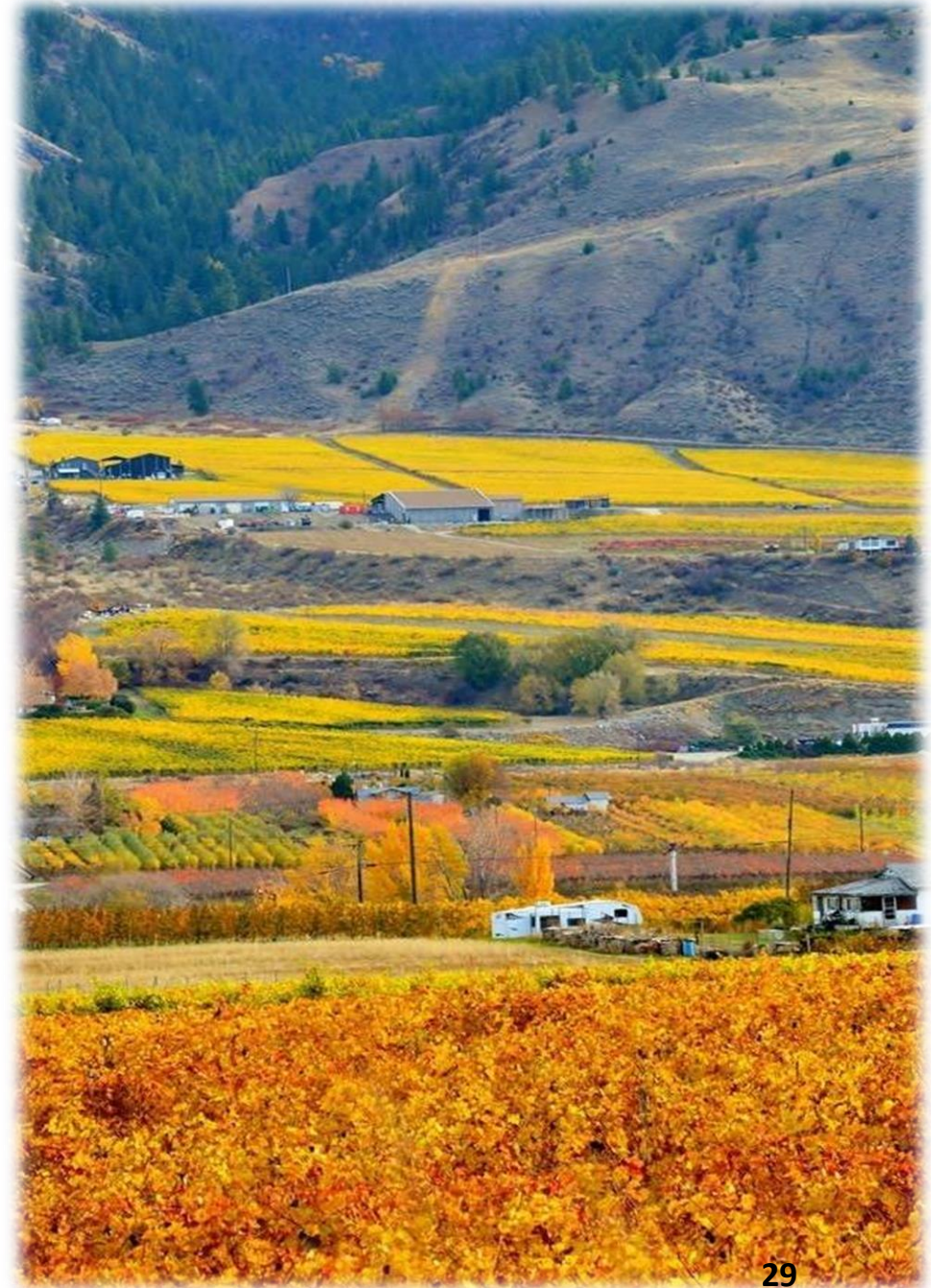
# Ask yourself these questions?

- Have you developed a 'flagship' wine worthy of a super premium price point?
- Have you maximized the production volumes of your premium labels from your existing production facilities? – contracting out of lower margin labels, offsite barrel storage
- Have you developed a second or 'flanker' brand to lever off flagship brand at lower price point and high volumes
- Have you maximized sales through high margin sales channels – DTC, wine club, internet, restaurants
- Are your grape supplies secure – high quality, healthy vineyards focused on popular varietals and clones



# How to price your winery

1. Top line growth of sales and revenues (CAGR)
2. LTM Normalized EBITDA multiple (5-12X)
3. Asset Backing
4. Intangibles
5. Scalability of the business
6. Fashionable product category
7. Market timing



# Pricing: What is your winery worth?

- **CAGR of sales and revenue** – Top line growth is a key indicator of a solid market penetration of the brand and growth potential
- **EBITDA Multiple** – range 5-12X – recent Peller acquisitions - 11.6X
  - LTM
  - Adjusted for non-recurring income or expenses eg SHRED credits; and excluded assets
  - Normalized (***scrubbed to remove personal and non-recurring expenses***)
    - Shareholders discretionary expenses
    - Shareholder remuneration
    - Is it well managed by a financially astute operator – evidenced my high margin and EBITDA
- **Asset backing** – value of vineyards, plant and equipment, residence
- **Comparable market transactions**

# Ultimately, the price is what a buyer is willing to pay

- Too many variables in business models and asset structures for any single metric to be truly predictive
- EBITDA multiple is only a simple proxy for what is really a very complex issue
- Not really paying for EBIT – because cost synergies for selling and administrative overhead are quickly realized
- Real world drivers include
  - Market timing – Is the market at a strategic inflection point?
  - Is the business scalable – both from a production and marketing standpoint?
  - Is the product category fashionable?
- Ultimately, the only real determinate of value is what will the buyer pay?

# Key due diligence issues

- Vineyards healthy, being properly farmed and maintained, with berry counts and estimated yields consistent with prior years
- Access to sufficient high-quality third party grapes to meet production forecasts
- All inventory saleable with no material obsolescence
- Buildings and equipment adequate and appropriate for continued operation, in good condition
- Inter-provincial shipments
- Sales of kegs and other non-VQA formats to hospitality



# Conclusions

- Build your business with a view to future sale
- The path to a successful sale depends on what you have to sell and the universe of potential buyers
- Advance preparation is key, as is hiring the right advisors
- Don't underestimate the time and effort involved in achieving a successful exit

# Contacts



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