



Presents:

What's Your Winery Worth Optimizing Your Winery Value

December 4, 2018



DISCUSSION TOPICS



Zepponi & Company

Business Fundamentals


Valuation Process

Value Considerations

Takeaway Points


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ZEPPONI & COMPANY – OVERVIEW



Industry Expertise	<ul style="list-style-type: none"> ▪ Global beverage alcohol merger and acquisition advisory firm ▪ Pre-transaction valuation and strategic advisory services
Transaction and Advisory Services	<ul style="list-style-type: none"> ▪ Industry specialists in transactions involving: <ul style="list-style-type: none"> - Wine, beer and spirits brands - Distribution companies - Agricultural and production assets ▪ Strategic business and succession planning advisory services
Transaction Objectives	<ul style="list-style-type: none"> ▪ Understand client’s motivations, goals and expectations ▪ Evaluate and define strategic options to maximize value of assets ▪ Creativity in negotiating and structuring transactions



















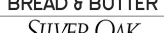



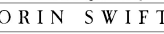











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ZEPPONI & COMPANY – SELECT TRANSACTIONS

Zepponi & Company has been the most active M&A advisor in the wine industry

Date	Client	Asset Type	Representation	Acquirer/Target
October 2018		Vineyards & Winery	Sell Side	 COPPOLA
August 2018		Brand & Winery	Sell Side	 The Great Oregon Wine Company
August 2018		Brand	Sell Side	 THE WINE GROUP
July 2018		Brand	Sell Side	 AXA MILLÉSIMES
July 2018		Distribution Company	Sell Side	 WILSON DANIELS
May 2018	Rancho Real Vineyard	Vineyard	Sell Side	 E&J Gallo Winery
April 2018		Brand	Sell Side	 FOLEY FAMILY WINES
February 2018	Cross Canyon Vineyard	Vineyard	Sell Side	 PAUL HOBBS WINERY
November 2017	 Soda Rock Vineyard	Vineyard	Sell Side	 E&J Gallo Winery
April 2017		Vineyards	Sell Side	 E&J Gallo Winery
April 2017		Brand	Sell Side	 WX
April 2017		Geyserville Winery Facility	Sell Side	 MICHAEL DAVID WINERY
June 2016		Brand	Sell Side	 E&J Gallo Winery
April 2016		Brand & Winery	Sell Side	
April 2016		Brand & Winery	Sell Side	
August 2015		Brand	Buy Side	 MEIOMI
August 2015		Brand	Sell Side	
May 2014		Integrated Winery	Sell Side	 Pernod Ricard

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ZEPPONI & COMPANY – M&A DRIVERS 

Current market environment remains favorable to sellers of strong brands and desirable winery assets

Premiumization	<ul style="list-style-type: none"> ▪ Constellation, Gallo, and The Wine Group shifting to higher priced brands ▪ Acquisitions by large wine companies primarily at >\$20 retail price points ▪ Emphasis on migrating existing grape sourcing to higher priced brands
Access to Market	<ul style="list-style-type: none"> ▪ Distributor and retailer consolidation favors large strategic producers ▪ Simplicity in # of SKUs and branding strategy required to navigate changing environment
Portfolio Diversification	<ul style="list-style-type: none"> ▪ Large wine companies broadening portfolio and investing in other beverage alcohol categories ▪ Constellation is prime example of aggressive push into other beverage alcohol categories
Vertical Integration	<ul style="list-style-type: none"> ▪ Large wineries seek control of production assets to reach and maintain profitability of brands ▪ Gallo acquisitions positioning itself for long-term growth in Napa Valley

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BUSINESS FUNDAMENTALS 

Brand Identity	<ul style="list-style-type: none"> ▪ Core retail price-points ▪ Varietal emphasis ▪ Origin of sourcing
Route to Market	<ul style="list-style-type: none"> ▪ Three-tier wholesale distribution ▪ Direct to retail/trade ▪ Direct-to-consumer (DTC)
Sourcing and Production Capacity	<ul style="list-style-type: none"> ▪ Sufficient supply to scale brand ▪ Stable long-term cost structure ▪ Consistency in quality ▪ Tradeoff between asset efficiency vs. vertical integration
Quality of Management	<ul style="list-style-type: none"> ▪ Committed professional management ▪ Proficiency at directing and execution
Economics	<ul style="list-style-type: none"> ▪ Adequate gross margins given sourcing and sales channel mix ▪ Appropriate operating and financial leverage


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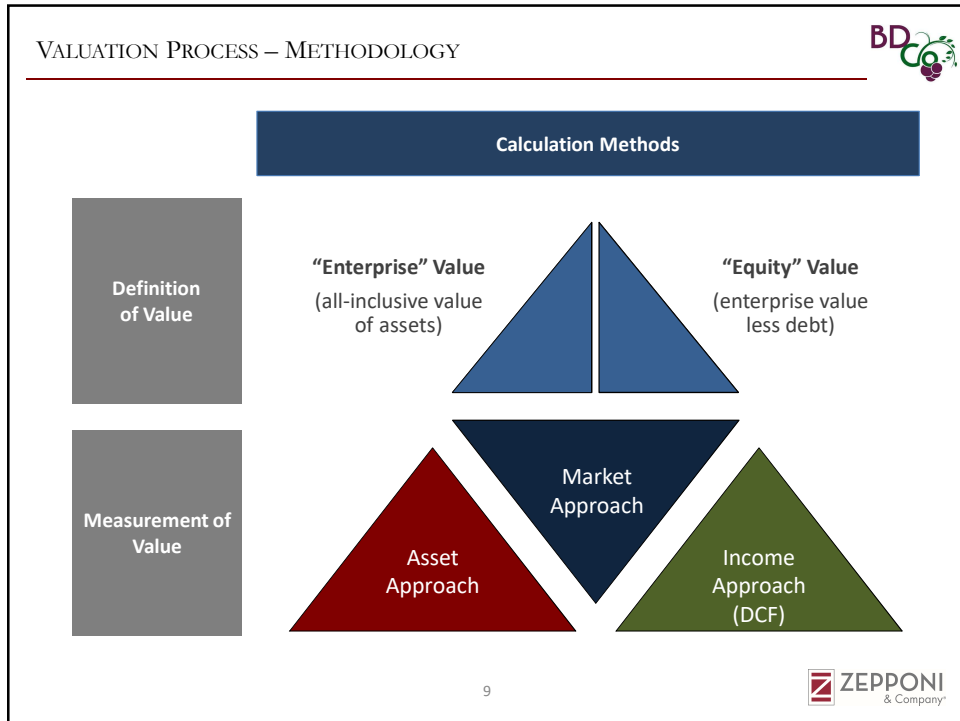


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VALUATION PROCESS – ASSET APPROACH

Description	<ul style="list-style-type: none"> ▪ Summation of value of each individual asset ▪ Used to value wineries that lack sufficient cash flow or earnings
Strengths and Benefits	<ul style="list-style-type: none"> ▪ Appropriate for valuing asset intensive business (investment or real estate holding company) ▪ Value lies more in underlying assets than in income generated by assets
Weaknesses and Shortfalls	<ul style="list-style-type: none"> ▪ Does not capture value of intangible assets for strong cash flow business with minimal hard assets ▪ Approach often used to define low-end or “floor” of valuation range

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VALUATION PROCESS – ASSET APPROACH (EXAMPLE)


Land			
Assets	Acres	Value \$ / Unit	Total \$ Value
Estate Home (and related Building Site)	2	\$ 1,000,000	\$ 2,000,000
Vineyard	15	\$ 300,000	4,500,000
Plantable Acres	5	\$ 200,000	1,000,000
Ancillary (Non-Plantable) Land	30	\$ 10,000	300,000
Subtotal	52		\$ 7,800,000


Improvements			
Assets	Sq. Ft.	Value \$ / Unit	Total \$ Value
Residence	2,000	\$ 500	\$ 1,000,000
Winery Building	6,000	\$ 300	1,800,000
Other Site Improvements		\$ 500,000	500,000
Subtotal	8,000		\$ 3,300,000

Equipment, Inventory			
Assets		Value \$ / Unit	Total \$ Value
Equipment		\$ 400,000	\$ 400,000
Inventory		\$ 3,000,000	3,000,000
Trademarks & Miscellaneous		\$ 100,000	100,000
Subtotal			\$ 3,500,000

Total Value of Assets	
Total - Land, Improvements, Equipment and Inventory	\$ 14,600,000

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VALUATION PROCESS – MARKET APPROACH

Description	<ul style="list-style-type: none"> ▪ Value based on market prices of comparable private transactions or guideline public companies ▪ Reflects what strategic acquirer may be willing to pay for business assets
Strengths and Benefits	<ul style="list-style-type: none"> ▪ Provides market-based value reflective of actual transactions ▪ Reflects supply and demand for saleable businesses
Weaknesses and Shortfalls	<ul style="list-style-type: none"> ▪ Rarely are past transactions truly comparable ▪ Publicly available data for private transactions can be limited or incomplete ▪ Volatile market conditions make application of this methodology more difficult

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VALUATION PROCESS – MARKET APPROACH (EXAMPLE)


Revenue Based Valuation		
(\$ in thousands)		
	LOW	HIGH
Revenue (Net)	\$ 8,000	\$ 8,000
Transaction Multiple	2.0	2.5
Indicated Enterprise Value	16,000	20,000
Less: Debt	(3,000)	(3,000)
Indicated Equity Value	\$ 13,000	\$ 17,000

EBITDA Based Valuation		
(\$ in thousands)		
	LOW	HIGH
EBITDA (Adjusted)	\$ 1,800	\$ 1,800
Transaction Multiple	10.0	12.0
Indicated Enterprise Value	18,000	21,600
Less: Debt	(3,000)	(3,000)
Indicated Equity Value	\$ 15,000	\$ 18,600

EBITDA = Earnings Before Interest, Taxes, Depreciation, and Amortization

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VALUATION PROCESS – INCOME APPROACH

Description	<ul style="list-style-type: none"> ▪ Present value of projected cash flows (earnings) of business assets ▪ Reflects current value of future cash flows to a prospective buyer
Strengths and Benefits	<ul style="list-style-type: none"> ▪ Takes into consideration future earnings growth of business assets ▪ Flexibility to perform scenario analysis by adjusting projections and changing assumptions
Weaknesses and Shortfalls	<ul style="list-style-type: none"> ▪ Relies on management growth projections ▪ Highly sensitive to changes in assumptions (cost of capital, projected growth rates, terminal value, etc.)

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VALUATION PROCESS – INCOME APPROACH (VALUE DRIVERS)



- Cash Flow Potential
- Anticipated Long-Term Growth
- Assumed Investment Risk
- Basic Model:

$$\text{Enterprise Value} = \frac{\text{Yr 1 cashflow}}{\text{Risk}^1} + \frac{\text{Yr 2 cashflow}}{\text{Risk}^2} + \dots + \frac{\text{terminal yr cashflow}}{(\text{Risk} - \text{Growth})^t}$$



VALUATION PROCESS – INCOME APPROACH (EXAMPLE)



Income Approach - Discounted Cash Flow Method

(\$ in thousands)

Years ending December 31,	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Adjusted EBIT		\$1,600	\$1,920	\$2,304	\$2,765	\$3,318
Less: Income Tax	21%	(336)	(403)	(484)	(581)	(697)
Adjusted EBIT After Tax		\$1,264	\$1,517	\$1,820	\$2,184	\$2,621
Plus: Depreciation and Amortization		200	210	221	232	243
Less: Incremental "debt-free" working capital needs		(90)	(95)	(99)	(104)	(109)
Less: Incremental capital expenditure needs		(210)	(221)	(232)	(243)	(255)
After-tax Net Cash Flow to Invested Capital		\$1,164	\$1,412	\$1,710	\$2,068	\$2,499


Value Calculation:

Present value of future cash flow using a discount rate of:	15.0%	\$5,629	
Year 5 Terminal value using a capitalization rate of:	12.0%		21,454
Present value of terminal value using a discount rate of:	15.0%	10,666	
Indicated Enterprise Value		\$16,295	
Less: Debt		(3,000)	
Indicated Equity Value		\$13,295	


Enterprise Value Sensitivity Analysis:

Discount Rate		Long-Term Growth Rate		
		2.5%	3.0%	3.5%
16.0%		14,500	14,900	15,300
15.0%		15,800	16,300	16,800
14.0%		17,400	17,900	18,600




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VALUE CONSIDERATIONS – ADJUSTMENTS TO FINANCIAL STATEMENTS 

“Net” Revenue	<ul style="list-style-type: none"> ▪ Account for DA’s, discounts, etc. ▪ Awareness of pricing strategy ▪ Pricing relative to peer group
Excess and Non-Operating Assets	<ul style="list-style-type: none"> ▪ Non-winery related revenue and assets ▪ Lifestyle toys (e.g., jets, luxury cars) ▪ Income streams from custom crush business and private labels may be valued differently
Extraordinary and Owner Discretionary Expenses	<ul style="list-style-type: none"> ▪ Non-recurring material expenses ▪ Disguised lifestyle expenses ▪ “Add-backs” must be credible
Normalizing Adjustments	<ul style="list-style-type: none"> ▪ GAAP basis financial statements ▪ Excess or nonexistent owners/executive compensation ▪ Related party transactions ▪ Depreciation method and life of assets ▪ LIFO vs. FIFO for inventory costing




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VALUE CONSIDERATIONS – QUALITATIVE ITEMS

Positive Impact		Negative Impact
<ul style="list-style-type: none"> ▪ Brand fills “gap” in market ▪ “Gap” = retail \$, varietal or geography ▪ Specialized sales channel 	Identity	<ul style="list-style-type: none"> ▪ Too many SKUs creates identity crisis ▪ Owner’s personality dominates brand
<ul style="list-style-type: none"> ▪ History of consistent growth/velocity ▪ Core SKU with high growth potential ▪ Possible line extensions (varietal, packaging, etc.) 	Growth	<ul style="list-style-type: none"> ▪ Sales succumbing to “law of gravity” ▪ Distribution channels backed up ▪ Improper focus on breadth over depth ▪ Excessive discounting/ promotional activity
<ul style="list-style-type: none"> ▪ Strong record of profitability ▪ Core “halo” SKU has pricing strength 	Profitability	<ul style="list-style-type: none"> ▪ Business model must be transferable ▪ Larger buyers undervalue direct sales
<ul style="list-style-type: none"> ▪ Stable 3 to 5-year supply contracts ▪ Opportunity for volume expansion 	Sourcing	<ul style="list-style-type: none"> ▪ Lack of stable sourcing relationships ▪ Current cost structure not sustainable
<ul style="list-style-type: none"> ▪ Experienced executive team ▪ Capacity to increase production 	Infrastructure	<ul style="list-style-type: none"> ▪ Overreliance on one key person ▪ Weak asset base

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TAKEAWAY POINTS - VALUATION

Valuation process is not exact science	<ul style="list-style-type: none"> ▪ Valuation approaches vary by situation ▪ Use caution when extrapolating trends and growth rates ▪ Market and Income Approaches usually result in higher valuations
Financial reporting and proper documentation	<ul style="list-style-type: none"> ▪ Important to maintain accurate, timely financial and management reporting systems ▪ Ensure agreements are properly documented and retained
Strong correlation between brand identity and value	<ul style="list-style-type: none"> ▪ Strong brand identity key to marketability ▪ Concentrate on niches and categories or varieties ▪ Avoid overreliance on winemaker/ owner
Focus on growth and profitability	<ul style="list-style-type: none"> ▪ High growth brands always attract interest ▪ Exception: brands with poor gross margins ▪ Bias against ability to fix negative growth brands
Appropriate asset base	<ul style="list-style-type: none"> ▪ Commercial, wholesale-focused brands = assets less important ▪ Luxury, DTC-focused brands = assets more important

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TAKEAWAY POINTS – SALE PREPARATION

Careful planning and preparation required prior to initiating a sale process

Understand Value	<ul style="list-style-type: none"> ▪ Perform preliminary valuation of business ▪ Evaluate strategic options for growth and succession ▪ Assess tax implications of a sale
Retain Experienced Transaction Professionals	<ul style="list-style-type: none"> ▪ Experienced transaction attorney ▪ Accountant/tax advisor ▪ Compliance and permit consultants, as necessary
Clean Up Financial Information	<ul style="list-style-type: none"> ▪ Prepare audited or reviewed financial statements, as necessary ▪ Review and restate financial information ▪ Create credible 3 to 5-year financial forecast
Review IP and Permits	<ul style="list-style-type: none"> ▪ Review IP, contracts and leases ▪ Verify terms of operating permits and licenses ▪ Ensure assignability of IP, contracts, leases, permits and licenses
Identify and Resolve or Disclose Open Issues	<ul style="list-style-type: none"> ▪ Resolve open business and miscellaneous issues ▪ Disclose potential liabilities and unresolved issues

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TAKEAWAY POINTS – ESTATE TAX PLANNING


Old Law

- 2018 decedent would have excluded \$5.6 million or \$11.2 million for a married couple

Effective in 2018

- 2018 decedent able to exclude \$11.18 million or \$22.36 million for a married couple

Portability Rules

- Surviving spouse gets unused exemption
- Elect with the Estate Tax return of the first decedent

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 Mergers &
 Acquisitions

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