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MANAGEMENT

Getting Ready for a Sale

Advisors detail ways to assess winery value

By Robert Nicholson and Josh Grace of International Wine Associates

With the recent rate of winery and brand acquisitions accelerating—and with a large number of long-term winery owners looking to retire in the coming years—it is becoming increasingly important for winery owners to focus on what they can do to prepare their businesses for the rigors of the sales process. Often, the greatest challenges to completing the sale of a small- to medium-sized winery can be avoided with some focused work in the early phases of the sale-preparation process, before the winery is actually on the market. Many of these items are analogous to a homeowner putting on a coat of paint, however, some are more substantial, like replacing the roof.

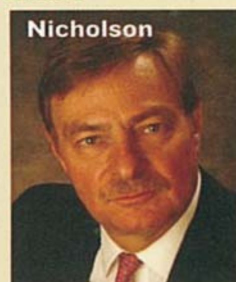
Hopefully, this list will be instructive to those who are now considering a sale but, like many family-owned wineries, have heretofore run their businesses with different goals and objectives in mind.

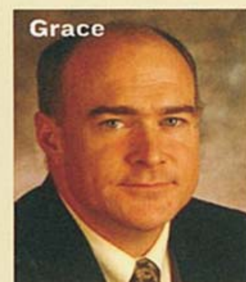
Because a sales process can take 12 months or longer, it is important to review the following items 18 to 24 months before beginning the process in order not to delay the sale any longer than necessary, since delays can lead to erosion of value. In our experience, we have found that a review of the following items would help the sales process of most wineries:

Improve data collection: Buyers will want to have access to detailed reports showing how much each product costs to produce, how profitable each brand is, what the future growth projections of the company are and how distributor depletions and inventory are tracking. Many wineries do not report in enough detail or forecast future growth.

Clean up the balance sheet: Make sure all receivables and payables are current and that any items related to other entities are clearly identified.

Robert Nicholson and Josh Grace





Robert Nicholson and Josh Grace work for International Wine Associates, the Healdsburg, Calif.-based boutique strategic advisory firm that provides corporate finance, mergers and acquisition services to the wine industry. Their recent news-making mergers and acquisitions include the 2008 sale of various Constellation wineries and brands to Ascentia Wine Estates, the 2010 Pacific Rim Winemakers sale, the 2011 Laurel Glen Vineyard sale to private investors and the recent sale of Edna Valley Vineyard from Diageo to Gallo. Incorporated in 1990, IWA has completed transactions valued at more than $1 billion. Beginning on page 76 of this issue, Nicholson and Grace share how winery owners should prepare for a sale, including the valuation process.

Indentify "family expenses": Many wineries reduce taxable income by paying salaries to family members, giving them company cars or paying for certain expenses. These need to be clearly identified so potential buyers will not include them when valuing the business.

Restate financial statements: Work with a CPA or an advisory firm such as our company, International Wine Associates, to recast statements. As above, most wineries report their books in such a way as to minimize income (and therefore taxes). However, in a sale we work hard to show each winery's profits in the best light, which entails restating earnings as if to interested shareholders looking to invest.

Deal with unsalable inventory: Many wineries hold old inventory that makes the brand appear to be behind a vintage or two. It is preferable to show potential buyers that the winery has no old inventory (other than a library) and is releasing on schedule. Old inventory should be disposed of or written off, preferably in the year prior to a sale.

Get key agreements in writing: Many small wineries operate on handshake agreements with growers, staff, family members, leases, etc. While this works for day-to-day business operations, these types of agreements need to be formalized before undertaking a sales process, or a buyer will not give them value.

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Trademarks and permits: Oftentimes trademarks and permits are overlooked, but having a flaw in either can derail the sale of a winery. Each trademark and permit should be reviewed to make sure each is current and valid before considering a sale.

Estate and tax planning: The final phase of a sale is not the time to try to gift shares to offspring, nor is it the time to try to move assets between companies to minimize taxation. These items should be reviewed with an estate planner before the sale is initiated.

Identify assets to be retained: Many sellers will want to keep a small brand (perhaps one that has a family name) or a vineyard. Each seller should review the assets owned by the company and decide ahead of time which ones he or she intends to keep. Retaining these assets can have an economic impact on the transaction, so each decision should be discussed with an advisor beforehand.

Post-close plans: Each seller should devote considerable time to thinking about what they intend to do after selling. If the seller wants to stay in the business or even stay involved with his or her winery after a sale, then that should be considered up front so the winery offering can be structured in the right way. Not every seller has to sign a non-compete agreement, but we find that an early discussion of these issues helps to clearly define the parameters of such an agreement and helps to smooth the transition process.

Setting a value

As winery owners try to decide whether they have taken their brand and assets far enough or whether there is more work to be done to build further equity, one of the most common questions we get asked is, "What's my winery worth?"

We are frequently asked to value wineries and brands, most often when the owners are preparing for a sale in the near future. Although the process and metrics of valuing wineries is often talked about (particularly when a significant deal has just taken place), it is quite often misunderstood. The following explanation will detail the winery-valuation process and clear up the potential confusion that sometimes exists around wine industry deals.

A number of methods are used to value businesses, and although this is a brief outline of several of them, it is but a fraction of the total information and analysis available on the subject. We consider the benefits of each method as well as our knowledge of the winery being valued before selecting which method is most appropriate to each situation.

Asset values

Asset values are perhaps the easiest method to understand. Each asset (inventory, land, buildings, equipment, vineyard, etc.) on the winery's balance sheet is given a market value. Typically, the inventory and real estate will have values exceeding those on the winery's balance sheet and become incremental to the historical cost figures shown there. In some cases, a liquidation valuation would be considered—usually at values below the balance sheet.

Newly developed wineries—those that are not cash-flow positive, or are experiencing declining sales—are typically valued using asset value; however, we find that it can be valuable to assess the asset value of every winery we value.

Each seller should review the company assets and decide ahead of time which ones he or she intends to keep.

"Multiples" explained

Discussions of multiples are common both before a deal begins and after it has been announced. The multiples most commonly used are the multiple of revenues and EBITDA (earnings before interest taxes and depreciation). For example, a winery that generates $15 million in annual revenue and sells for $30 million would be said to have sold for a "two times" revenue multiple ($30 ÷ $15 = 2), and a winery with EBITDA of $2 million that sells for $20 million would be said to have achieved a "10 times" EBITDA multiple ($20 ÷ $2 = 10). The value of multiples is that they give buyers, sellers and advisors a yardstick with which they can evaluate comparative values across multiple deals. If a Sonoma winery owner hears that his competitor sold for "2.5 times" revenues, he can get a ballpark value of his own winery.

The limitation of multiples, however, is that they are crude estimates and don't take into consideration what can often be differences between types of buyers and sellers, particularly when one seller owns significant vineyards and another does not. Some buyers might pay a price that is five times revenues for Winery A but would not be willing to pay two times revenues for Winery B, despite the fact that Winery B seems very similar. It is only through deeper analysis that the actual value can be better estimated, and the greater value of Winery A will be made clear.

Discounted cash flow

A discounted cash flow (DCF) is the analysis that sophisticated buyers will use to arrive at the present-day value of future cash flows generated by a business. This process involves projecting future revenues, subtracting future costs, eliminating duplicative expenses (costs that a buyer can eliminate and are part of the savings, or synergies, that a business will benefit from in an acquisition) and arriving at the cash flow produced annually by the business. The benefit to sellers of our DCF analysis is that it uses the winery's internal projections of future sales and performance, which can then be used to present the longer term potential of the business to buyers. Although we do not share specifics of our DCF analysis with buyers, projecting the winery's future cash flow allows us to explain how and why businesses will grow under ownership.

One criticism of the DCF valuation is the inevitable variation in the projections used in the analysis of future results achieved by the winery. However, a DCF analysis is the valuation process undertaken by serious buyers who may as a result of their DCF be able to justify a higher valuation for their winery acquisitions. Thus, the DCF has the benefit of establishing a present-day value that the business offers to a buyer, even if the analysis is not entirely accurate in predicting future results.

Other methods

While there are other methods such as "excess earnings" and comparisons to publicly traded (and thus publicly valued) companies, we find that winery buyers do not use these methods, thus they are not instructive in determining a potential market value for a winery or brand. W&V

Robert Nicholson and Josh Grace work for International Wine Associates, a leading provider of strategic advisory, valuation, merger and acquisition services to the global wine industry. Incorporated in 1990 and headquartered in Healdsburg, Calif., IWA has completed transactions valued at more than $1 billion and has worked with most of the leading multinationals and many small, family-owned wine estates.

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