

2015 Top Deals

Wine Industry

Merger & Acquisition Review

George Coope



George Coope, senior vice president at Zepponi & Company, has more than 25 years of investment banking and advisory experience in the wine, beer and distilled spirits industries. Prior to joining Zepponi & Company, Coope held senior roles at several boutique investment banks in San Francisco and was a founding member of the consumer practice group at Hambrecht & Quist LLC. Coope also worked in R&D and operations at Miller Brewing Company and is a former director of Patz & Hall Wine Company and The Coppola Companies. Coope graduated with a BA from Stanford University, an MS in food science with a specialization in viticulture and enology from UC Davis and an MBA from Harvard Business School. Prior to attending UC Davis, he worked as an apprentice to the general manager and winemaker at Domaine Comte Georges de Vogüé in Chambolle-Musigny, France.

THE STRONG PACE OF wine industry merger and acquisition activity established over the past few years continued unabated in 2015, fueled by low interest rates, a generally improving economy and a growing United States wine market. While the year witnessed a very broad range of acquisition activity, a number of unifying themes and significant trends can be discerned.

Major producers focused their acquisition dollars primarily on ultra-premium and luxury-priced brands in an ongoing effort to migrate their brand portfolios to higher price points. The primary purpose of the year's mega-deal, the \$600 million acquisition by **Treasury Wine Estates** (TWE) of most of **Diageo's** premium wine brands, was to strengthen TWE's presence at the high end of the U.S. market.

From a varietal standpoint, Pinot Noir claimed the transaction spotlight during the year, with multiple acquisitions of wine brands that specialize in this booming varietal. Consistent with previous years, there was a steady stream of notable transactions that involved vineyards and facilities. As usual, financial investors of various shapes and sizes circled the industry and displayed interest but proved highly selective when it came to actually pulling the trigger. To no one's surprise, **E&J Gallo** and **Vintage Wine Estates** again confirmed their status as two of the most active "serial" acquirers in the industry, each with multiple transactions that involved brands, vineyards and/or facilities.

Major Producers Moving Upscale Through Acquisition

The long-term "premiumization" trend, slowed only temporarily by the recession, continued inexorably. Similar to the experience in the spirits and brewing industries, growth in the wine industry was increasingly concentrated in the higher-priced categories while lower price segments languished or even declined. This year was no exception. **Nielsen** data for 2015 showed sales of wines priced at \$10 or higher per bottle growing at low double-digit rates versus 2014 while sales volumes of wines under \$10 actually declined. At the specific brand level, we saw many of the large "jug" and popular premium brands that at various times defined the California wine industry, such as **Franzia**, **Carlo Rossi**, **Sutter Home** and **Fetzer**, in decline.

With the demand for lower-priced wines stagnant or shrinking, these categories are becoming increasingly price-competitive. In response, we witnessed a steady migration of the major wine marketers to higher price segments, with brand acquisitions playing a major role. TWE's acquisition of Diageo's **Beaulieu Vineyards**, **Sterling Vineyards**, **Provenance Vineyards**, **Rosenblum Cellars** and **Acacia Vineyard** brands essentially doubles the company's revenue in the luxury and "masstige" categories of the market,

defined by TWE as over \$20 per bottle and between \$10 and \$20 per bottle, respectively. For Diageo, the transaction marks the effective end of the company's involvement in the U.S. wine business, which began in 1987 with predecessor **Grand Metropolitan's** acquisition of **Heublein Inc.**

Among other producers, **Jackson Family Wines** bolstered their strategic emphasis on the over-\$20 per bottle price segment with their January acquisition of **Siduri Wines**, renowned for its California and Oregon single-vineyard Pinot Noirs. **The Wine Group (TWG)**, a company whose center of gravity has traditionally been in the sub-\$10 price segments with brands such as **Corbett Canyon** and **Franzia**, acquired **Benziger Winery**, a Sonoma-based brand that retails primarily in the \$12 to \$25 per bottle range. Benziger joined **Cupcake** and **Save Me San Francisco** in TWG's growing stable of brands that sell at near or above \$10 per bottle. Many of the other acquisitions discussed in the following sections also exemplify this strategic shift to higher price points.

Pinot Noir Acquisitions Dominated the News

Pinot Noir was not only one of the fastest growing varieties in 2015 but also the variety fetching the highest average price among all wine varieties according to Nielsen data. Not surprisingly, 2015 was the year when multiple players made acquisitions to stake out or strengthen their positions in this increasingly popular variety, particularly at price points of \$20 per bottle and above.

In fact, it was a one-of-a-kind Pinot Noir opportunity that motivated **Constellation Brands** to come off the bench after a lengthy hiatus from the acquisition game. In one of the most visible and talked about transactions of 2015, Constellation purchased the **Meiomi** brand from **Copper Cane Wines** in August for an announced price of \$315 million. Meiomi, the brainchild of

TABLE: Notable Wine Industry Transactions Announced in 2015

| Month | Target | Acquirer | Transaction Type | County/Region |
|-----------|---------------------------------|---------------------------------|--------------------------------|-------------------------------|
| January | Kosta Browne | J.W. Childs Associates | Brand and facility | Sonoma |
| January | Brewer-Clifton | Private investor group | Brand and facility | Santa Barbara |
| January | Triere Estate Vineyard | Heitz Wine Cellars | Facility and vineyard | Napa |
| January | Siduri | Jackson Family Wines | Brand and facility | Sonoma |
| January | Sugarloaf East Vineyard | Silverado Premium Properties | Vineyard | Napa |
| March | J Vineyards & Winery | E&J Gallo | Brand, facility and vineyards | Sonoma |
| March | Cuvaison's Calistoga winery | Criswell Radovan | Facility | Napa |
| May | Cypress Ranch | E&J Gallo | Vineyard | Napa (Pope Valley) |
| June | Benzinger Family Winery | The Wine Group | Brands, facility and vineyards | Sonoma |
| June | Anderson Valley vineyard | Hall family (Long Meadow Ranch) | Vineyard | Mendocino |
| July | Circle S Ranch | Peter Read & investors | Vineyard | Napa |
| July | Fahrig Ranch | Staglin Family Vineyards | Vineyard | Napa |
| July | B.R. Cohn Winery | Vintage Wine Estates | Brand, facility and vineyards | Sonoma |
| July | Asti Winery and Souverain brand | E&J Gallo | Facility and brand | Sonoma |
| August | Meiomi | Constellation Brands | Brand | Sonoma/Monterey/Santa Barbara |
| August | Talbott Vineyards | E&J Gallo | Brand, facility and vineyards | Monterey |
| September | Swanson Vineyards | Vintage Wine Estates | Brand and facility | Napa |
| September | Chehalem Mountain Vineyard | The Capra Company (Judy Jordan) | Vineyard | Oregon |
| September | Eola Springs Vineyard | The Capra Company | Vineyard | Oregon |
| September | Sage Canyon Vineyard | The Capra Company | Vineyard | Napa |
| October | Diageo Chateau & Estate brands | Treasury Wine Estates | Brands and facilities | Various |

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Joe Wagner, is a brand that didn't exist seven years ago and has since rocketed to more than 700,000 cases with no sign of slowing down. This acquisition represents not only the filling of a "white space" in Constellation's portfolio for an ultra-premium Pinot Noir brand with significant volume, but also a strategic move to expand and revitalize its market presence in the \$20+ price category, joining **Robert Mondavi Winery** and **Franciscan Estate** in the portfolio. Similarly, the Siduri acquisition strengthened Jackson Family Wines' position in luxury Pinot Noir and is also expected to provide an outlet for the company's growing collection of premium Pinot Noir vineyards on the West Coast.

E&J Gallo made a quantum leap in its high-end Pinot Noir business in 2015 with the March acquisition of **J Vineyards** and the August purchase of **Talbott Vineyards**. In addition to its well-known sparkling wines, J Vineyards provides Gallo with a respected line of luxury-priced, single-vineyard and appellation Pinot Noir bottlings, supported by more than 300 acres of estate vineyards in the Russian River Valley and Sonoma Coast. The Talbott Vineyards transaction secured Gallo a similarly strong Pinot Noir (and Chardonnay) position in Monterey County at \$20+ price points, anchored by the 565-acre **Sleepy Hollow Vineyard** in the Santa Lucia Highlands. Gallo has no doubt identified Talbott's Kali Hart label as an attractive product with significant expansion potential positioned at a price point similar to Meiomi.

E&J Gallo and Vintage Wine Estates Lead the Charge

Acquisitions, which once were an occasional opportunistic event at E&J Gallo, have become a central part of the company's growth strategy. Gallo claimed the unofficial title of most active acquirer in 2015 with the two major brand acquisitions discussed above (J Vineyards and Talbott), a large facility transaction (**Asti** winery) and a number of sizable vineyard transactions. The Asti acquisition also included the winery's 535-acre Alexander Valley property and vineyards and, as an afterthought, the long-neglected Soverain brand, whose annual sales volume has shrunk to less than 100,000 cases.

Vintage Wine Estates (VWE) was in close second position with two notable brand transactions, continuing its strategy of building critical mass through acquisitions with an increasing emphasis on higher-priced brands. In July, VWE acquired **B.R. Cohn Winery** in Sonoma Valley, adding a 75,000-case brand with an expandable \$20+ Cabernet Sauvignon position (Silver Label) plus a winery with a unique location, a liberal public events permit and 70 acres of vineyards. VWE brings resolution to B.R. Cohn's long quest to increase its influence and traction in the wholesale distribution channel. Soon after the B.R. Cohn transaction, in September, VWE purchased **Swanson Vineyards'** brand and winery, adding a respected luxury-priced Merlot-centric brand to its Napa Valley portfolio, which already included **Girard, Clos Pegase** and **Cosentino**.



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Steady Stream of Vineyard and Facility Transactions

Vineyard values, as well as the level of vineyard transaction activity, remained high in 2015 as competition for key grape sources intensified. Contributing factors to the interest in quality vineyards included the continued growth in the U.S. wine market, an increased focus on upgrading wine quality consistent with the premiumization trend discussed earlier and the realization following the reduced 2015 harvest that grapes may again be in short supply in the near future. Buyers included wineries as well as financial investors, and the year saw a significant number of transactions involving premium North Coast vineyards, particularly in Napa.

The activity began with the January purchase by **Silverado Premium Properties** of the 160-acre Sugarloaf East Vineyard in southern Napa Valley, which joins nearby Sugarloaf West Vineyard in Silverado's Napa portfolio. In May, one of Napa's most iconic properties changed hands when **Duckhorn Wine Company** acquired Three Palms Vineyard from the **Upton** family. Duckhorn has bottled a Three Palms Vineyard Merlot since 1978 and began purchasing all of the grapes from the 83-acre vineyard in 2011. In a different part of Napa, Gallo acquired **Cypress Ranch** and part of the Palisades Vineyard in Pope Valley, also in May. The two properties total 642 gross acres, including 258 vineyard acres planted to Cabernet Sauvignon, Merlot, Zinfandel and Malbec.

In June, the **Hall** family, owners of Long Meadow Ranch in Napa, acquired a 145-acre property in Mendocino's Anderson Valley planted to 69 acres of Pinot Noir, Chardonnay and Pinot Gris. They joined other Napa and Sonoma wineries that have previously invested in Anderson Valley's potential for Burgundian varietals, including Duckhorn and Jackson Family Wines. Back in Napa, **Staglin Family Vineyards** joined forces with a neighbor in July to purchase the **Fahrig Ranch** property that adjoins both of their vineyards. Also in July, a private investment group purchased **Circle S Ranch**, an approximately 1,500-acre property in Napa's Atlas Peak appellation with 26 acres planted to Cabernet Sauvignon and over 200 additional plantable acres.

In August, **Russian River Partners**, a vineyard investment fund, acquired the 31-acre Platt Vineyard, a far western Sonoma Coast vineyard that supplies grapes to a number of highly-regarded Sonoma boutique Pinot Noir and Chardonnay producers. **Judy Jordan**, founder and recent seller of J Vineyards, jumped back into the fray in September with the purchase of two vineyards in Oregon's Willamette Valley and one in Napa Valley through the **Capra Company**, her vineyard company established to fund youth mentorship programs.

There was an active market for production and hospitality assets of all sizes in 2015 as a number of facilities changed hands. This interest in facilities reflects the increasing need for production capacity to accommodate market growth, as well as the escalating cost and uncertainty involved in building new facilities in many regions.

The huge Asti winery, shed by Treasury Wine Estates as part of its global business rationalization and acquired by Gallo in July, represents an additional 2.5 million cases of production capacity for Gallo in Northern Sonoma, complementing its existing 4.9 million case Healdsburg facility. This is a facility that probably could not be built in today's Sonoma County regulatory environment. There were two notable Napa facility transactions involving long-established industry names. In January, **Heitz Wine Cellars** purchased the **Triere Estate Vineyard** in the Oak Knoll District, which included a production facility with a 45,000-gallon permit. In March, **Cuvaision** completed its transition to being a 100 percent Carneros-based estate winery with the sale of its original Calistoga facility on the Silverado Trail to a private investment group. The buyer also took over the facility's existing custom processing business.

Financial Investors Remain Highly Selective

The term "financial investor" includes a broad spectrum of private equity firms, family offices and specialized equity and debt funds in the business of making direct private investments on behalf of their limited partners. More than a few of these entities have historically spent time analyzing the wine industry, attracted by its track record of steady market growth. Relatively few have actually invested, typically citing the industry's convoluted distribution structure, the lack of a public market exit option for all but the largest wineries and competition from the high multiples offered by strategic buyers. Some notable historical exceptions include **GI Partners** (Duckhorn), **Champ Private Equity** (Accolade Wines), **TPG/Vincraft** (Kosta Browne) and **Madison Capital** (Kirkland Ranch).

This year was no exception to the pattern, and the few deals that actually closed tended to involve investors with pre-existing industry connections. In January, **J.W. Childs**, a Boston-based private equity firm that specializes in consumer investments, announced their acquisition of TPG/Vincraft's equity stake in Kosta Browne Winery. The founding partner of the firm, **John Childs**, had a pre-existing relationship with **Michael Browne** and was an original investor in Browne's **CIRQ Estate**. Also in January, a private investor group acquired a majority interest in **Brewer-Clifton**, one of the top producers of luxury Pinot Noir and Chardonnay from the Sta. Rita Hills appellation. The investor group is led by **Ken Fredrickson**, a Master Sommelier and founder of a fine wine importer and distributor in Chicago.

Continued Activity

It was a busy year in all sectors of the industry, with a broad variety of buyers pursuing brand, vineyard and facilities acquisitions. We anticipate continued strength in the M&A market in 2016, particularly in the vineyard sector in the wake of the smaller 2015 harvest as wineries move to secure future sources of supply. With the premiumization trend in consumer purchasing behavior apparently here to stay, we expect that acquirers will continue to show a high degree of interest in premium brands positioned over \$20 per bottle, especially those demonstrating rapid growth and strong distribution. **WBM**

About Zepponi & Company

Zepponi & Company is a mergers and acquisitions advisory firm dedicated exclusively to the global alcohol beverage industry. Headquartered in Santa Rosa, California, the firm's three principals, Mario Zepponi, Matt Franklin and Joe Ciatti, are established wine industry veterans, with expertise in strategic transaction analysis, valuations and creativity in structuring complex transactions. Zepponi & Company served as advisor on a number of notable transactions in 2015, including the acquisition of the Meiomi brand by Constellation Brands, in which the firm served as advisor to the buyer. For more information, please visit www.zepponi.com.