Top Deals and Trends in Transactions

Acquisition interest from international beverage companies continues while mid-sized private wine companies remain active in making brand and winery investments.

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THIS YEAR MAY NOT have produced many surprise transactions within the wine industry, but it did solidify a number of emerging trends that have been building up over the past few years. International strategic and lifestyle buyers continued to canvass the United States wine industry for acquisitions, particularly asset-heavy opportunities. Additionally, mid-sized private wine companies remained active in making strategic brand and winery investments. Several companies focused their efforts on frontier wine regions, such as Oregon and Washington. Perhaps the most noteworthy developments in 2014 were the movement to expand wine portfolios through sales and marketing relationships with larger wine companies and the ongoing saga of **Treasury Wine Estates.**

Increasing Role of Foreign Investment in the U.S. Wine Industry

In recent years, the U.S. wine market has experienced a major uptick in interest from large, international beverage alcohol companies because of favorable consumption patterns. Only a few years ago, the U.S. overtook France in terms of overall wine consumption, despite the fact that its per capita consumption rate lags behind almost half of all countries worldwide. In response, international beverage conglomerates have found that the easiest way to access the U.S. market with their imported wine brands is to acquire a sizeable domestic brand to gain a meaningful presence within the three-tier distribution system. **Pernod Ricard**'s acquisition of **Kenwood Vineyards** in May is a good example of this approach.

Kenwood Vineyards was an ideal cross-border acquisition target for a number of reasons. The approximately 600,000-case brand was positioned in a price category that has been recovering since 2008 and was well-represented in wholesale markets by a large national sales and marketing team. The winery's established presence and core real property assets in the Sonoma Valley offered a high degree of brand authenticity and sourcing stability, both of which support a long-term growth strategy. The expectation is that Pernod Ricard will grow the Kenwood brand to more than 1 million cases over the next five to seven years and in the process advance its influence in the U.S. distribution system.

The inflow of capital from Chinese investors continues despite China's crackdown on mainland government spending on alcoholic beverage products. The most notable transaction this year occurred in July when China-based **Jinta Vineyards & Winery** acquired Napa Valley's **Quixote Winery** from owner **Carl Doumani**. Quixote is located in the Stags Leap appellation of Napa and sells approximately 4,000 cases annually. The winery's distinguishing feature is its unique architecture, which was designed by the Austrian artist **Friedensreich Hundertwasser**. Jinta made a reported full price offer to purchase Quixote Winery.

Mid-sized Private Wine Companies Continue to Lead the Charge in Acquisitions

A decade ago, **Constellation Brands** made headlines with its $1.03 billion acquisition of **Robert Mondavi Winery.** At the time, the publicly traded company was in the midst of a buying spree that totaled more than $4 billion between 2003 and 2007 and dwarfed the cumulative acquisitions made by its privately held counterparts during the same time period. In 2008, the Great Recession changed the wine mergers and acquisitions (M&A) landscape dramatically; over the past seven years there have been four large-scale winery acquisitions made by publicly traded wine companies. **Diageo** purchased **Rosenblum Cellars** in 2008, **Concha y Toro** acquired **Fetzer Vineyards** in 2011, Constellation Brands added **Mark West Wines** in 2012 and Pernod Ricard acquired Kenwood Vineyards this year. Recent history demonstrates that privately owned wine companies dominate the post-recession M&A environment—2014 is no exception to this trend.

Earlier in the year, **Winery Exchange** completed its third major brand acquisition in four years with the purchase of **Chronic Cellars.** Based out of Paso Robles, Chronic Cellars is a red blend wine brand that retails for approximately $15 to $25 per bottle. The 18,000-case brand has a loyal consumer following, and the owners saw an opportunity to accelerate the business' growth with additional resources from a larger wine company. Winery Exchange's superior sales infrastructure was a key consideration in bringing about the transaction.

In May, **Vintage Wine Estates** partnered with **Canopy Management**, a virtual sales and marketing company best known for its Middle Sister brand and related Wine Sisterhood social media network. The approximately 300,000-case brand portfolio is positioned within the $10 to $15 per bottle price range and is a leader in the female-focused brand category. The acquisition was Vintage Wine Estates' third notable transaction within a 12-month period. In August 2013, the company acquired **Clos Pegase Winery** in Napa,

Notable Transactions Involving U.S.-based Wine Companies in 2014

Date	Target	Seller	Acquirer	County/Region
March 2014	Chronic Cellars	Chronic Cellars	Winery Exchange	Paso Robles
March 2014	Four Graces Winery	Four Graces Winery	Foley Family Wines	Willamette Valley
April 2014	Ledgewood Winery	Ledgewood Winery	Gallo	Solano
May 2014	Kenwood Vineyards	Korbel	Pernod Ricard USA	Sonoma
June 2014	Carneros wine facility and vineyards	Michael Mondavi Family Winery	Kieu Hoang Winery	Napa
July 2014	Canopy Management	Canopy Management	Vintage Wine Estates	California
July 2014	Quixote Winery	Quixote Winery	Jinta Vineyards & Winery	Napa
Sales and Marketing Partnerships				
April 2014	Cycles Gladiator Brand	Hahn Family Wines	Wine Hooligans	California
July 2014	Gruet Winery	Gruet Winery	Precept Brands	New Mexico

followed by its purchase of Sonoma Valley's **Viansa Winery** in October 2013. The deal with Canopy Management will likely push Vintage Wine Estates' annual sales past the 1 million case mark.

In March of this year, **Foley Family Wines** purchased Pinot Noir specialist **The Four Graces Winery** in the Dundee Hills region of Oregon's Willamette Valley. The winery produces approximately 22,000 cases per year at retail prices in the range of $18 to $45 per bottle. With this transaction, Foley Family Wines now has a presence domestically in California, Oregon and Washington, and internationally in New Zealand.

"Frontier" Wine Regions Gaining Attention

The Pacific Northwest has become an industry hot spot in recent years, in terms of both wine acclaim and investment. Compared to many premium wine regions in California, Oregon and Washington offer less expensive land and fewer vineyard development and farming costs. While this has been the case for years, the greater motivating factor for the current investment trend is likely due to growing recognition for wine quality and the region's strong association with particular grape varietals. In 2013, an Oregon Pinot Noir ranked No. 3 on ***Wine Spectator***'s Top 100 Wines list, making it the top domestic wine of the year. In 2009, Washington had the No. 1 ranked wine, followed by the No. 6 wine in 2011.

Several California wineries have been searching for a foothold in Washington's Columbia Valley and its sub-appellations. **E&J Gallo** made a powerful entrance in 2012 with its purchase of **Columbia Winery** and **Covey Run Winery**, which included brand assets totaling more than 250,000 annual case sales. In contrast to its extensive vineyard holdings in California, however, Gallo's sourcing strategy in Washington has relied on developing relationships with outside growers.

At the end of 2013, **Duckhorn Vineyards** announced its intention to develop a new Washington state Cabernet Sauvignon brand called **Canvasback**, which will retail for $40 per bottle and initially source estate grapes from the company's recently-planted 20-acre vineyard in the Red Mountain appellation. Although Duckhorn's current vineyard holdings are limited, its appetite for Washington should not be underestimated. Last year, the company was a top bidder in a high-profile auction for more than 500 acres of prime Red Mountain vineyard land. Duckhorn was ultimately outbid by **Aquilini Investment Group**, a privately held investment firm which has also been actively combing the region for acquisitions. The British Columbia-based company doubled down in April by purchasing an additional 335 acres of vineyards in the Horse Heaven Hills appellation. Although Aquilini's long-term strategy within the wine industry remains to be seen, the financial motivation behind its recent investments underscores Washington's elevated visibility in the U.S. wine industry.

Expanding Portfolios Through Sales and Marketing Relationships

The industry witnessed a string of transactions in 2014 whereby larger wine companies expanded portfolios by entering into sales and marketing relationships with wineries that lacked the internal resources to broaden their wholesale distribution.

Recent upstart **Wine Hooligans** acquired the sales agency rights to **Hahn Family Wines' Cycles Gladiator** brand. Hahn wanted to focus on its ultra-premium and luxury-priced Hahn Estate wine portfolio and determined that the $8 to $12 per bottle Cycles Gladiator brand was a distraction to its core portfolio. For Wine Hooligans, the brand was an ideal launch point to build upon due to its recognizable name and label. Similarly, **V2 Wine Group** entered into separate agency agreements with Washington's **Hedges Family Estate** and California's **Cameron Hughes Wine**. These two additions allowed V2 Wine Group to fill varietal and geographic gaps within its portfolio, as well as expand its sales influence with distributors to upwards of 500,000 cases annually.

In July, Seattle-based **Precept Wine** entered into a complex sales and marketing agreement with sparkling wine producer **Gruet Winery**. Based out of New Mexico, Gruet is the state's most recognized winery, producing 120,000 cases annually. Though it had reached significant sales momentum on its own, the winery recognized that it had reached a point where a dedicated national sales and marketing team would be necessary to elevate the brand to the next level. For Precept, the partnership was an opportunity to expand the company's geographic reach outside of the Pacific Northwest and add a key sparkling wine element to its portfolio.

Steady Vineyard Acquisitions Continue in Desirable Appellations

It is well chronicled that the 2012 and 2013 grape harvests in California were exceptional. Many believe that the 2014 harvest will be of strong quality, even if it produces less tonnage than the prior two years. While these back-to-back bountiful harvests have relieved the escalating pricing pressure on grapes and bulk wine, they should not be misinterpreted as a sign that the supply cycle is shifting toward a period of excess. Vineyard values continue to remain high due to competition among wineries for key grape sources.

Along the Pacific Coast, prime Pinot Noir vineyards remain the most popular acquisition targets for strategic buyers. Oregon's Willamette Valley saw a number of significant transactions take place in 2014, with **Chateau Ste. Michelle**, **Elk Grove Vineyards** and **Adelsheim Winery** each acquiring vineyards in various sub-appellations of the northern part of the valley. Additionally, Napa-based **Atlas Vineyard Management** took ownership of two southern Willamette Valley properties it had been managing: **Cooper Creek Vineyard** and **Fern Creek Vineyard**.

In California, several Russian River Valley and "true" Sonoma Coast vineyards were picked up by well-known luxury Pinot Noir producers, including **Jackson Family Wines**, **Williams Selyem** and **J Vineyards**. Atlas Vineyard Management teamed up with **Price Family Vineyards** to purchase the 20-acre **Walala Vineyard** in the northwest corner of the Sonoma Coast AVA. In Santa Barbara, the **Kroenke Group**, which owns Santa Barbara wine brands **Jonata** and **The Hilt**, as well as Napa cult wine producer **Screaming Eagle**, acquired **Salsipuedes Vineyard** in the Santa Rita Hills AVA. Salsipuedes consists of roughly 200 vineyard acres located at the far west end of the Santa Rita Hills AVA and supplies grapes to a number of high-end wine producers throughout the state.

Additional notable vineyard transactions in 2014 include Gallo's acquisition of **Valley Oaks Vineyard** in Galt, California, and Washington state fruit-tree producer **Allan Brothers**' purchase of **Sagemoor Vineyards** in the Columbia Valley. Institutional investment in vineyards remains a powerful force in California despite drought concerns and growing wine inventories over the last two years. In the North Coast, **UBS Agrivest** added to its vineyard portfolio with the addition of **Huichica Vineyards, LLC** in the Sonoma Valley while nearby a very large Carneros vineyard changed hands between two large institutional investors. Farther south, **Brodiaea, Inc.**, which is affiliated with the **Harvard University** endowment, has been amassing large swaths of vineyard-capable land in the Central Coast.

California's drought conditions and heightened attention to the regulation of water rights have added a further complication to the transaction landscape. Many believe that some of the recent large vineyard land transactions may have a strategic tie-in to the dwindling availability of water.

A Possible Conclusion to the Treasury Wine Estates Saga

Treasury Wine Estates embarked on a not-so-confidential exploratory sales process throughout much of the year. Despite the significant turnaround challenge that an acquisition of Treasury would pose to a buyer, suitors of the publicly traded wine company were intrigued by the opportunity to take advantage of the significant tax losses that the company has amassed over the years. The risk associated with acquiring and quickly repositioning Treasury's wine portfolio proved to be too daunting for a publicly traded beverage alcohol company to undertake. Consequently, two private equity firms, **Kohlberg Kravis Roberts** and **Texas Pacific Group**, were the lead bidders to acquire the Australian wine company.

Treasury ultimately decided not to pursue a buyout transaction. The company will likely explore opportunities to spin off under-utilized and non-core wine assets in order to expedite its turnaround. In California, Treasury owns more than a half dozen wineries and approximately 6,500 planted vineyard acres in the northern and central coastal regions. Even though a buyout transaction appears to be off the table for now, Treasury's ongoing restructuring activities are likely to generate additional M&A activity in the coming years.

Outlook for 2015

It is likely that the current pace of wine industry mergers and acquisitions will continue into 2015; the increasing momentum of transactions over the past few years supports these expectations. However, one should not be surprised if a few more transactions are announced before the conclusion of the 2014 calendar year. **WBM**