2016 Top Deals

Mergers & Acquisitions Review

Favorable economic conditions lead to a flurry of transactions

George Coope

George Coope, senior director of strategy and analysis, 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. He 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. George holds Series 7 (General Securities Representative), 24 (General Securities Principal) and 63 (California Securities Representative) securities registrations and a Certified Valuation Analyst (CVA) designation from the National Association of Certified Valuators and Analysts.

THE CLOSING OF THE sale of **Diageo**'s U.S. wine assets to **Treasury Wine Estates** in January kicked off another banner year for transaction activity, with a continuation of many of the same themes and trends observed in 2015. Low interest rates, a strong stock market and moderate growth in the U.S. economy and in overall wine sales contributed to a generally positive environment for transactions. The second quarter of 2016 marked the ninth quarter in a row of growth in U.S. gross domestic product, with a resurgent labor market supporting consumer spending. Total wine sales in the U.S., which grew 5.1 percent in 2015 versus 2014, continued the trend into 2016, with wine dollar volume in the **Nielsen** food and liquor channels increasing 5.2 percent year-to-date as of August 13, 2016 in comparison to the same period in 2015.

As in 2015, major suppliers, including **Constellation Brands**, **E&J Gallo** and **Jackson Family Wines**, focused their acquisition dollars on the high end of the market, adding brands in the $20 and above price segment to their portfolios. At the other end of the acquirer size spectrum, various iconic luxury wineries, including **Kosta Browne** and **Realm Cellars**, acquired strategic vineyards or production facilities to strengthen and/or expand their existing brands and business models. A number of high-end vineyards transacted, with a particularly strong cluster of activity in the Napa Valley. Consistent with recent history, transactions involving private equity firms were few in number. However, the ones that did occur in 2016 were big-ticket, headline deals at the high end of the market.

Premiumization Marches On

Premiumization is widely acknowledged as perhaps the most important trend shaping today's U.S. wine industry. Commenting on the April 2016 acquisition of **The Prisoner Wine Company**, **Bill Newlands**, president of Constellation Brands' wine and spirits division, stated that the company's goal is "to continue to premiumize our portfolio" and that The Prisoner acquisition enables Constellation "to further capitalize on U.S. market trends that favor high-end wine brands." The consumer buying behavior driving this trend is apparent in the August 16, 2016 year-to-date Nielsen U.S. food and liquor channel data. Dollar volume for wines retailing at less than $10 was essentially flat at +0.4 percent versus the prior year period while the dollar volume of wines priced at $10 and above grew at a healthy 11.1 percent.

Consistent with the premiumization trend, 2016 was marked by an impressive series of high-profile luxury brand acquisitions by both large and mid-tier wine companies. **Crimson Wine Group** strengthened its presence in Washington state with the January acquisition of **Seven Hills Winery**, a pioneering Walla Walla winery known for its high-end red Bordeaux varietals and blends. In February, **Foley Family Wines** purchased the historic **Chalone Estate Vineyard**, which represents Foley's first major foray into Monterey County. **Orin Swift Cellars**, **Dave Phinney**'s post-Prisoner portfolio of creative brands retailing between $30 and over $100, was acquired by

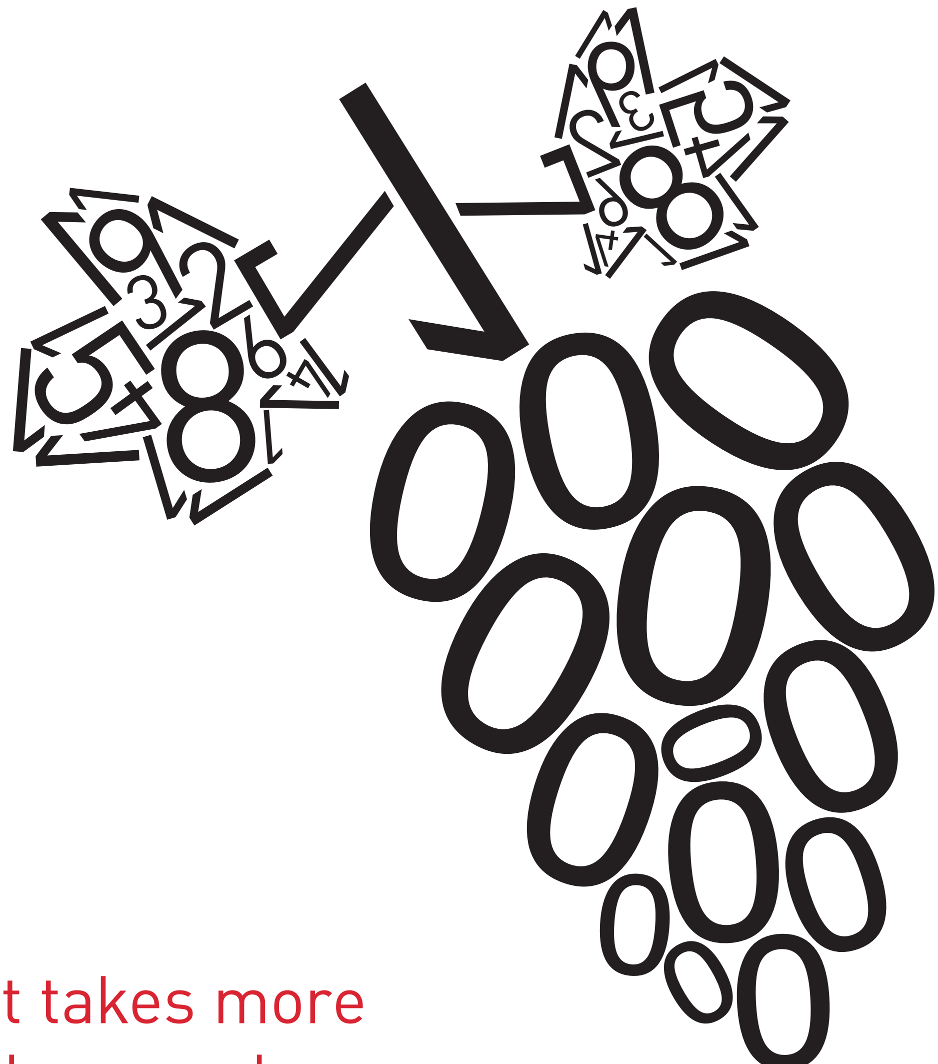

TABLE: **Notable Wine Industry Transactions Announced in 2016**

Closing Date	Target	Acquirer	Assets Acquired	County/Region
January	Kosta Browne	J.W. Childs Associates	Brand and Facility	Sonoma
January	Diageo's U.S. wine business	Treasury Wine Estates	Brands and Facilities	Various - California
January	Hop Kiln Winery	Landmark Vineyards (Wonderful Company)	Facility and Vineyard	Sonoma
January	Seven Hills Winery	Crimson Wine Group	Brand and Facility	Washington
January	Acacia Vineyard and Winery	Peju Province Winery	Facility and Vineyard	Napa
February	Chalone Estate Vineyard	Foley Family Wines	Brand, Facility and Vineyard	Monterey
February	Hartwell Estate Winery	Realm Cellars	Facility and Vineyard	Napa
February	Dancing Hares Vineyard	Tuck Beckstoffer	Brand, Facility and Vineyard	Napa
April	The Prisoner Wine Company	Constellation Brands	Brands	Various - California
April	Patz & Hall Wine Company	Ste. Michelle Wine Estates	Brand and Facility	Sonoma
April	Penner-Ash Wine Cellars	Jackson Family Wines	Brand and Facility	Oregon
April	Stryker Sonoma Winery	Foley Family Wines	Facility and Vineyard	Sonoma
May	Copain Wines	Jackson Family Wines	Brand	Sonoma
May	Far Niente Wine Estates	GI Partners	Brand and Facility	Napa
May	River Road Vineyard	Delicato Family Vineyards	Vineyard	Monterey
June	Orin Swift Cellars	E&J Gallo	Brands	Napa
July	Robert Hall Winery	O'Neill Vintners & Distillers	Brand, Facility and Vineyard	Paso Robles
July	Knez Vineyard Estate	Kosta Browne Winery	Vineyard and Facility	Mendocino
July	Oak Knoll Ranch Vineyard	Hancock Ag Investment Group	Vineyard	Napa
July	Milliken Creek Vineyard	Private Investment Group	Vineyard	Napa
July	Goldrock Ridge Vineyard	Paul Hobbs	Vineyard	Sonoma
July	VML Winery	Huneeus Vintners	Facility	Sonoma
August	Saitone Vineyard	Williams Selyem Winery	Vineyard	Sonoma
August	Rita's Crown Vineyard	Sea Smoke Cellars	Vineyard	Santa Barbara
August	Duckhorn Wine Company	TSG Consumer Partners	Brands, Facilities and Vineyards	Various - California and Washington
August	Oakville 88 Vineyard	UBS	Vineyard	Napa
October	WillaKenzie Estate	Jackson Family Wines	Brand, Facility and Vineyard	Oregon
October	Charles Smith Wines	Constellation Brands	Brands	Washington

A number of renowned boutique and cult brands acquired strategic vineyard or production assets to augment their brands and gain greater control over sourcing and production.

Gallo in June. As a brand-only transaction, this deal signaled an interesting departure for Gallo from its historical preference for asset-heavy acquisitions.

The April purchase of **Patz & Hall Wine Company** was the first California brand acquisition by **Ste. Michelle Wine Estates** (SMWE) since the **Stag's Leap Wine Cellars** transaction in 2007. In the context of SMWE's "string of pearls" strategy for its portfolio of fine wine properties, Patz & Hall takes its place in the collection as the Sonoma County "pearl" focused on Pinot Noir and Chardonnay. The brand is the perfect complement to the Napa Cabernet Sauvignon focus of Stag's Leap. Also in April, Jackson Family Wines (JFW) further expanded its footprint in Oregon with the acquisition of **Penner-Ash Wine Cellars**, a highly-regarded Willamette Valley Pinot Noir specialist based in Newberg, as well as **WillaKenzie Estate** in October. JFW continued its deal streak the following month with the purchase of Healdsburg's **Copain Wines.** This deal, along with Penner-Ash, WillaKenzie and Patz & Hall, is a testament to the market's continued appetite for high-end brands specializing in the Burgundian varietals, Pinot Noir and Chardonnay.

Luxury Brands Secure Strategic Assets

Major wine companies in search of higher price point brands were not the only active acquirers in the market in 2016. A number of renowned boutique and cult brands acquired strategic vineyard or production assets to augment their brands and gain greater control over sourcing and production. Realm Cellars, a producer of highly-allocated $175+ Napa red wines, acquired **Hartwell Estate Vineyards**' winery facility in the Stag's Leap district of Napa, as well as selected vineyards on the property. Before acquiring this new production home, Realm had made its wines at a third-party facility. In July, Kosta Browne Winery acquired the vineyard assets and production facility of **Knez Vineyard Estate** in the Anderson Valley. The purchase included the highly-regarded Cerise, Knez and Demuth Pinot Noir and Chardonnay vineyards, and represents another milestone in Kosta Browne's long-term strategy of increasing its foundation of estate vineyard holdings.

Also in July, **Paul Hobbs Winery** purchased **Goldrock Ridge Vineyard**, a unique property in the far reaches of the Sonoma Coast AVA near the town of Annapolis. Goldrock Ridge had been a key source of Pinot Noir for the Paul Hobbs brand for five years and also provides fruit for a number of other high-end Pinot brands. Paul Hobbs characterizes the vineyard as "a rare diamond" and "pillar for our future." Similarly, **Sea Smoke Cellars** acquired the 61-acre **Rita's Crown Vineyard** in the Sta. Rita Hills appellation of Santa Barbara County in August. Rita's Crown is planted to Pinot Noir and Chardonnay and is located directly adjacent to Sea Smoke's estate vineyards. Sea

Smoke plans to convert Rita's Crown to organic and biodynamic farming, a transition already underway for the estate vineyard. August saw the purchase of the historic 33-acre **Saitone Vineyard** by **Williams Selyem Winery**. Saitone, located in Sonoma County's Russian River AVA, includes acreage planted to over 100-year-old Zinfandel vines. Williams Selyem plans to add the vineyard to its portfolio of single-vineyard bottlings.

Other Notable Vineyard Transactions

A significant number of vineyard sales occurred throughout California and the Pacific Northwest. Many vineyard transactions fly under the radar, with no formal announcements or press coverage.

A certain number of vineyard transactions stood out because of their size, location or the entities involved.

In May, **Delicato Family Vineyards** added the 243-acre **River Road Vineyard** in the Santa Lucia Highlands (SLH) to their Monterey County vineyard portfolio, which already includes the massive **San Bernabe Vineyard**. River Road is planted mainly to Chardonnay and Pinot Noir and is located in the northern end of the SLH AVA, bordering the **Sleepy Hollow Vineyard**. In the Napa Valley, 2016 witnessed a cluster of sales transactions by **Silverado Investment Management Company** (SIMCO), one of the most active vineyard investors in California. Taking advantage of the strong Napa vineyard market, SIMCO monetized a number of its holdings, including **Oak Knoll Ranch Vineyard**, **Milliken Creek Vineyard** and the **Oakville 88 Vineyard**, all of which are located in the Oak Knoll AVA. The Oakville 88 sale also included the **Cabral** and **Vallejo Vineyards** in Carneros. Also in Carneros, **Joe Wagner**, creator of **Meiomi**, purchased the **Abbott Vineyard** on Cutting's Wharf Road in February.

Private Equity Targets Marquee Luxury Brands

In 2016, the wine industry witnessed two high-profile luxury brand transactions involving private equity (PE) firms, both deals having price tags well into the hundreds of millions of dollars. In May, **GI Partners**, owners of **Duckhorn Wine Company**, acquired control of Napa's **Far Niente Wine Estates**, including **Nickel & Nickel** and other related brands. GI Partners subsequently monetized their 2007 investment in Duckhorn with the sale of the business to another well-known PE firm, **TSG Consumer Partners**, in August.

PE firms have long struggled with the question of how financial investors can add value to a wine brand when the winners in the industry are often determined by scale and distribution leverage. However, there seems to be an emerging consensus that a very promising PE strategy is to invest in strong brands at the high end of the market. In the luxury price segment, established brands with a loyal consumer following and strong direct-to-consumer distribution have high margin potential and at least some degree of insulation from the competitive fray in the three-tier channel.

With luxury brands, financial investors have the opportunity to do what they do best: pump dollars into areas that will stimulate growth and increase profitability. These include investments in assets that improve wine quality, such as vineyard acquisitions to expand estate programs, and investments in state-of-the-art equipment and production facilities. PE investors are also well positioned to expand the direct-to-consumer business by building showcase hospitality facilities and investing in the best systems and marketing talent to drive growth in high-margin wine club and online sales. And, with established luxury brands, there is the opportunity to introduce flanker brands in price tiers below the parent brand where they benefit from the parent brand's reputation and distribution but enjoy much greater volume potential.

This model is consistent with GI Partners' apparent investment strategy during their involvement with Duckhorn. Extensive investment was made in vineyards, wine quality, visitor facilities and, most importantly, the growth of the highly successful **Decoy** brand, which is positioned in the above $20 price segment. As the new owner of Duckhorn, TSG inherits a strong management team and major brands that are still growing at more than 20 percent. Whether the firm can identify additional growth opportunities to equal the success of Decoy remains to be seen.

What's Next?

The robust M&A activity that characterized 2015 continued unabated into 2016, with an emphasis on transactions involving high-end brands and wineries, particularly those with a focus on Pinot Noir. Recognizing the strong market, many potential sellers who were previously "on the fence" are deciding to take the leap and offer their winery assets for sale. Not surprisingly, there seems to be a growing consensus that the sheer number of sellers is shifting some leverage to the buyers' side. Anecdotal evidence indicates that active acquirers' desks are stacked with record numbers of offer memorandums, and buyers have commented that they have a wide range of opportunities from which to pick and choose. As a result, we suspect that sellers whose brands and businesses are marginally profitable, lack product focus or are poorly prepared to go to market, will likely face increasing headwinds in getting purchasers' attention and closing a transaction. However, we also believe that, barring any significant downturns in the economy or the U.S. wine market, the strongest brands and most desirable assets will continue to transact at healthy valuations well into 2017. **WBM**