Opportunities For Ownership Succession In The Beer Wholesaler Industry

Has Your Beer Lost Some Fizz?

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MERCER CAPITAL
BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Introduction

The last 6 to 18 months have been wrought with challenging economic and industry conditions. For many U.S. wholesalers (particularly ABI houses), a regression to lower pre-COVID sales volumes coupled with unprecedented brand disruption have contributed to a softening of sales and profitability. The narrative appears to vary more by brewery affiliation and territory than ever before.

According to the Brewers Association, U.S. beer sales volume continues its downward path with a decline of 3.1% in 2022. In 2022, the standard drink was more likely delivered in a cocktail glass rather than a beer mug – a consumer first, even if only slightly so. And an imported Mexican lager (Constellation's Modelo Especial) now sits on the top shelf of U.S. beer sales replacing AB InBev's Bud Light. Softening the decline from recent years' performance has been consumers' willingness to spend on premium labels and growing NA and RTD category products as well as higher pricing. But will a potential impending economic downcycle reverse some of this premiumization and put a stall on recent pricing patterns?

Wholesalers seeking a strategic exit may be facing tighter market valuations. But the downside in previously robust transaction trends may represent a silver lining for wholesalers needing to achieve overdue ownership succession and favorable estate planning objectives.

Mercer Capital's experience in the industry prompts us to alert our clients and friends in the beer distribution space to several marketplace realities that are currently exerting downward pressure on the fair market value of many distributorships.

Our message to readers – take advantage of current market conditions to enhance the outcome of your ownership succession and estate planning strategies.

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What's Causing Valuations to Decline?

We discuss several considerations and developments that are currently influencing valuations in the industry. Note that only an experienced valuation practitioner in the space understands how these trends and expectations are properly quantified in a valuation.

INTEREST RATES

Some of us are happy to see the yield on certain of our investment holdings improve in this environment of elevated interest rates. But, if you are paying these rates on your past capital expenditures and acquisitions, the current rates are painful.

Higher interest rates increase the cost of capital used in business valuations. The higher the cost of capital, the lower the value of the business.

Other things held constant in the business valuation equation, the increase in interest rates beginning in early 2022 suppressed equity valuations by 20%-30% in many industries and the effects continue to burden valuations in 2023.

Of course, there are exceptions, particularly for certain wholesalers who have benefited from the current market share upheaval and higher product pricing. Fair market value and strategic value remain potentially quite different for many wholesalers. Regardless, no one is immune to the value suppressing force of higher interest rates.

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INFLATION AND PRICING

As suppliers adjust their prices, wholesalers reprice to the retail tier. The dynamics for many in recent years resulted in higher pricing growth than volume growth. For many wholesalers, catch-up pricing in 2022 offset volume declines, which has netted to relatively modest growth in overall sales in the recent period.

Price-motivated growth eventually succumbs to the laws of gravity. Beer and other consumer discretionary products are competing against higher prices for consumer essentials (housing, food, and fuel) potentially leaving less purchasing power for product premiumization and leisure consumption in general.

SHARE OF MOUTH

Apparently, “joe six-pack” became “johnny cocktail” in 2022. Twenty years ago, preference for beer among alcohol drinkers was almost twice what it is now. Spirit-based RTDs aren't helping matters as consumer choice expands and competing suppliers leverage their brands to siphon off tradition beer drinkers.

CATEGORY DIVERSIFICATION

Beer wholesalers are expected to continue augmenting their portfolios with various non-alcoholic products. Margins for these products typically fall short of the beer portfolio. Additionally, these suppliers are not subject to the same regulatory oversight as alcoholic beverage suppliers, making such volumes risker to the wholesaler and less valuable in the marketplace.

We have seen many wholesalers invest heavily to grow a product and then suffer the loss of a supplier due to upstream consolidation or realignment.

If 10%-30% of your volume is worth half as many turns of gross as your legacy beer portfolio, that can have a material effect on your whole-house valuation. These dynamics fall on top of the increased warehouse shelf and isle space called for in an ever-increasing world of SKUs.

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DEMOGRAPHY AND MIGRATION

The benefits of high density in population and account proximity are reduced when drinkers spread throughout or exit your territory and volumes are delivered at the fringe of your territory versus the geographic core of your market.

The distance each CE moves to find its retail home has a bearing on your two most labor-intensive activities (selling and delivery).

A 1% change in the margin structure of your business can easily represent 10%-15% of your total business value.

OTHER ISSUES

The alcoholic beverage distribution industry has many specific concerns. But the pains of the industry are compounded by the same fears and challenges facing all business owners.

Operating costs for labor, roughly 50% of total operating expenses in the middle tier, haven risen dramatically in recent years. Finding qualified staff remains a challenge amidst strong labor markets and low unemployment.

Macroeconomic fears of an impending downturn in the economy in 2024 remain as weak housing markets and inverted yield curves are generally leading indicators of recession. These industry and macroeconomic factors may be further complicated by realities on the ground in your territory.

The Impact of High Interest Rates on the Rule of Thumb

We all know of the prevalence of rules of thumb based on supplier gross profit. Confusion reigns as it always has regarding the translation of supplier multiples based on brand growth, territory population, and logistical efficiency.

Rules of thumb are dangerous and typically do not apply across the differing scenarios under which a valuation may be developed. A standalone going concern premise under fair market value can be quite different than a valuation resulting from an actual business combination where territories are combined, and overhead expenses are rationalized.

Having qualified the issues with rules of thumb – what influence do high interest rates currently have on gross profit multiples?

Taking into consideration the complications of inflation and interest rates, portfolio valuations are potentially down 15%-20%, and potentially down further for market share losers suffering from the current AB InBev calamity and flat to modestly down for houses that gained share from ABI. Actual M&A results can vary based on the unique motivations of specific buyers and sellers. What deals do happen in the currently weakened borrowing environment are likely the result of special circumstances and unique motivations.

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The Takeaway

For those wholesalers contemplating succession, now is the time to act.

Under current conditions, wholesalers with depressed market share and/or increasingly diverse NA portfolios could see a material reduction in their valuations. In addition, wholesalers who have persevered through recent years to emerge stronger are still subject to the realities of high interest rates so it's wise not to delay.

And for those distributors who might see value increases, higher interest rates and the eventual new norms of post-pandemic market patterns are still likely to influence your valuation.

Regardless of your succession strategy, a common requirement in the succession process is obtaining a business valuation. Many business appraisers can lay claim to having valued a beer distributorship at one time or another. But few have performed scores (I'm losing count at 30 years of advisory practice) of valuations for scores of alcoholic beverage distributors in over 20 states.

If you are interested in understanding how Mercer Capital's beverage industry expertise can help you achieve a viable plan of succession, please call or email to discuss your situation.

MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Food and Beverage Valuation Services

Mercer Capital is a full-service business valuation and financial advisory firm. We offer a broad range of services, including corporate valuation, financial institution valuation, financial reporting valuation, gift and estate tax valuation, M&A advisory, fairness opinions, ESOP and ERISA valuation services, and litigation and expert testimony consulting. We have provided thousands of valuation opinions for corporations of all sizes in a wide variety of industries. Our valuation opinions are well-reasoned and thoroughly documented, providing critical support for any potential engagement.

Specifically, Mercer Capital provides beverage wholesalers and distributors across the nation with corporate valuation, transaction advisory, financial reporting valuation, and related services.

For over 40 years, Mercer Capital has been bringing uncommon professionalism, intellectual rigor, technical expertise, and superior client service to a broad range of public and private companies and financial institutions located throughout the world.

Services

- Distribution rights & intangible asset valuation
- Trust & estate valuations
- Valuations for continuity planning purposes
- Transaction advisory, fairness & solvency opinions
- Litigation support for marital dissolutions & shareholder disputes
- Buy-sell agreement design & dispute resolution
- Strategy assessments
- Board & shareholder education
- Financing assistance & underwriting
- Quality of earnings assessments

Industry Segments

- Beer wholesaler & distributorships
- Wine & spirits wholesalers & distributorships
- Breweries
- Retail channels
- Non-alcoholic beverage production & distributorships

Food & Beverage Industry Team

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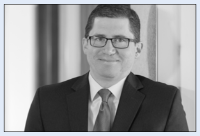

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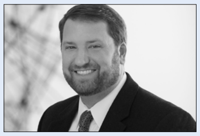

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