Successful Strategies for Selling your BC Winery

Al Hudec, *Farris LLP*

Recent high profile sales

Andrew Peller's purchases of 3 leading Okanagan wineries

	Annual Revenues	Employees	Vineyards	Selling Price
Black Hills Estate Winery	$6 million	16	50 acres	$31.3 million
Gray Monk Cellars Ltd.	$11 million	50	50 acres	$34.5 million
Tinhorn Creek Vineyards Ltd.	$7 million	50	150 acres	$28.9 million

Peller's 5 Year Forecast

Sales $24.5 $35

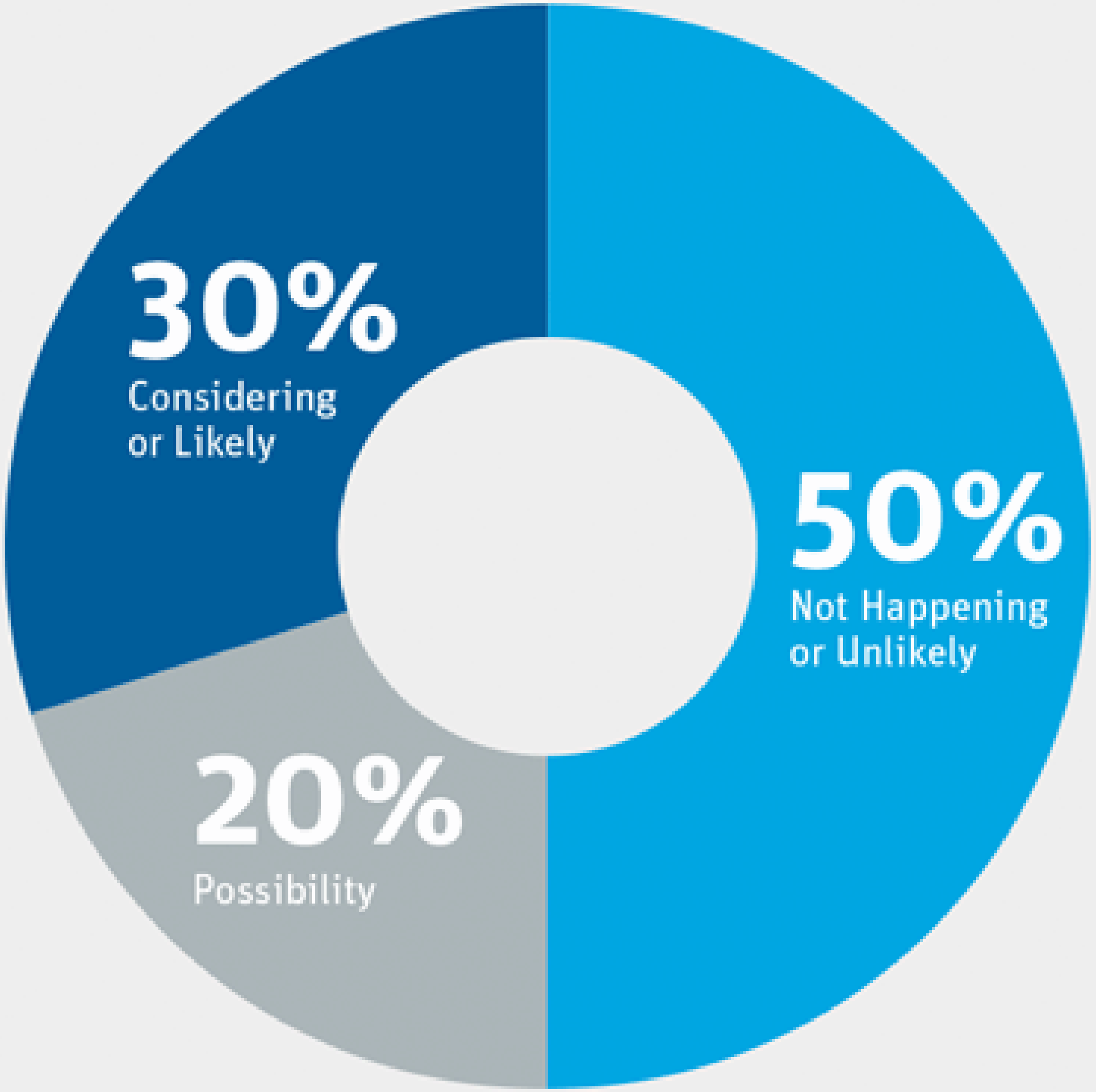
EBITDA $8.2 $15

Other notable transactions

- Laughing Stock sale to Arterra
- Phantom Creek purchase of Road 13 Vineyard from C.C. Jentsch
- Sea Star (David Goudge) purchase of Saturna (Larry Page)
- Mt. Boucherie/Rustico- receivership sales
- Sale of Church and State to Chinese buyers

Part of huge inter-generational transfer of assets

- $1.9 trillion of Canadian business assets will change hands over the next 5 years
- 60% of business owners, age 55-64 have not yet discussed their exit or succession plans
- 50% of vineyards will change hands in the next five years (Silicon Valley Bank)



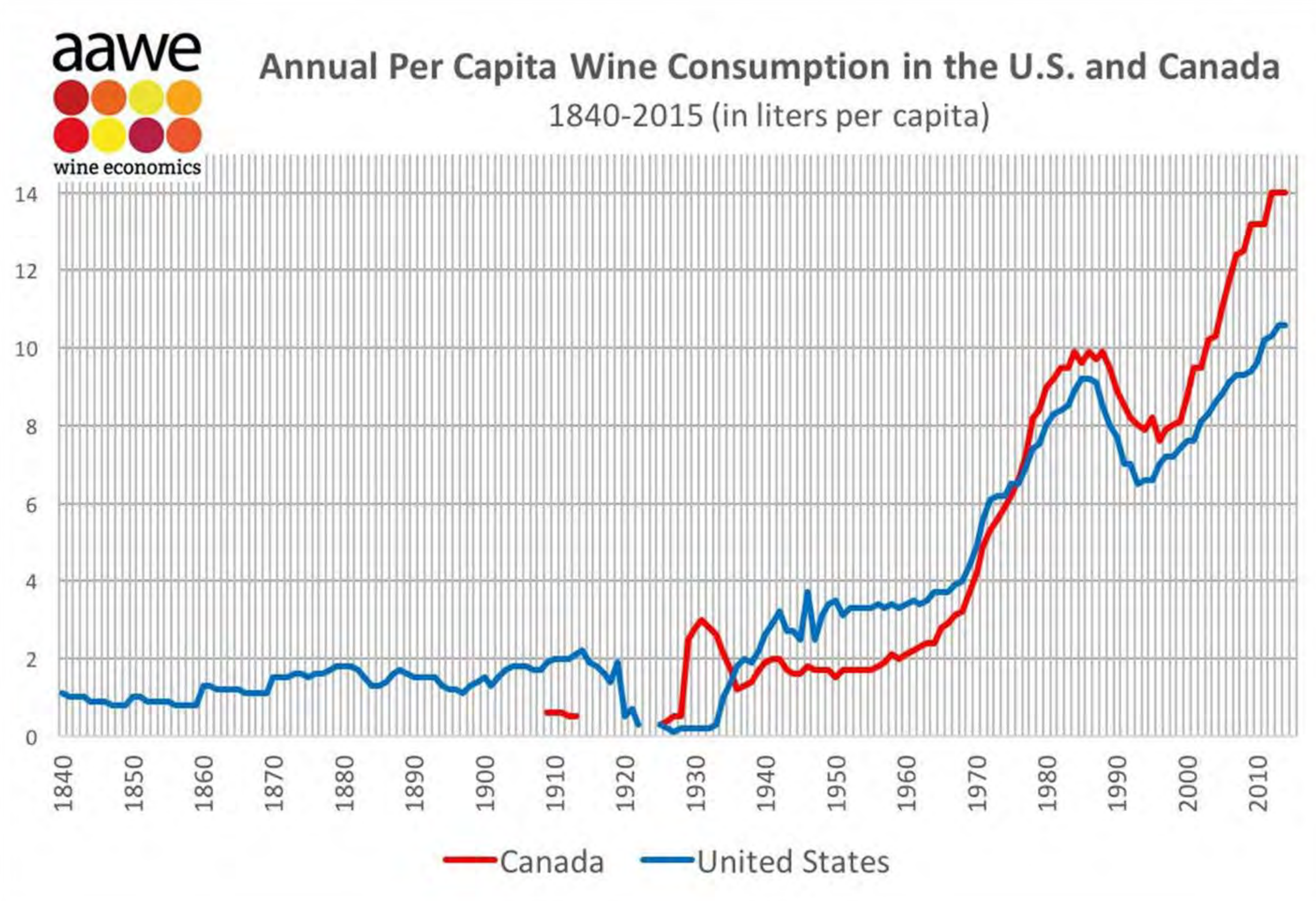
State of the Wine Industry 2017, Figure 16
Source: 2016 SVB Annual Wine Conditions Survey

Favourable market conditions

- High growth rate of wine consumption in Canada, particularly in premium price category increasing percentage of alcohol sales, Premiumization
- Increasing recognition of Okanagan as a premier tourist destination
- 9 continuous years of strong economy and markets – price/earnings ratios are at a cyclical high
- Low interest rate environment

Is it time to sell?

- Huge volume of inter-generational asset sales over the next 5 years may overhang the market and depress pricing multiples
- Recent high profile sales may cause ‘fence sitters’ to flood the market, increasing buyer leverage
- Good times don’t last forever – We are in the 9th year of general economic growth – Okanagan wines are a luxury good that will be negatively impacted by a cyclical downturn
- Stock markets and P/E multiples at all time high
- Competition with legal cannabis – legalization has lowered wine sales 13% in other jurisdictions
- Risk of adverse SCC ruling on *Comeau* shutting off inter-provincial shipments
- Risk of adverse international trade ruling striking down industry preferences



Source: SVB, State of the Wine Industry 2018

Are storm clouds gathering?

- Market Overhang
- Prospects of Recession
- Alberta Embargo
- Competition from Legal Cannabis
- Adverse SCC Ruling on Comeau
- Adverse GATT Ruling
- Forest Fires/Adverse Growing Season

Are you ready to sell?

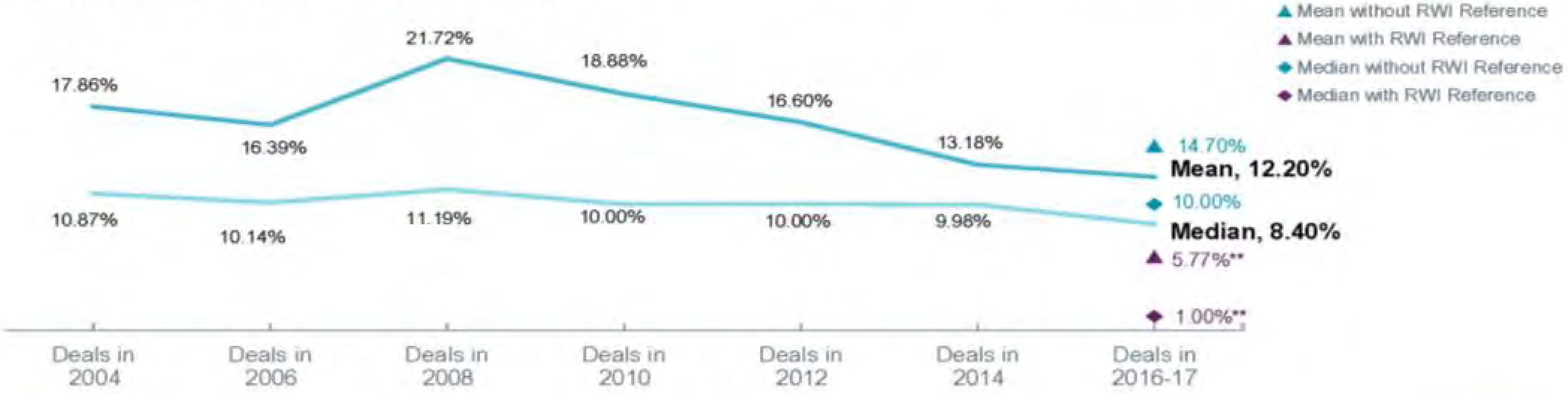
- Are you psychologically and financially ready to sell?
- Have you done everything you can to exploit near term and low risk growth opportunities?
- Have you developed a ‘flagship’ wine worthy of a super premium price point?
- Have you maximized the production volumes of your premium labels from your existing production facilities? – contracting out of lower margin labels, offsite barrel storage
- Have you developed a second or ‘flanker’ brand to lever off flagship brand at lower price point and high volumes
- Have you maximized sales through high margin sales channels – DTC, wine club, internet, restaurants
- Are your grape supplies secure – high quality, healthy vineyards focused on popular varietals and clones

Have you optimized your tax structure?

- Organize your business in a manner that will permit sheltering gains with simultaneous access to
  - Principal residence exemption
  - Lifetime capital gains exemption
  - Lifetime farming capital gains exemption
- Estate planning
  - Estate freeze
  - Income sprinkling
- Inter-generational transfer – Have you extracted enough cash for retirement?

CAPS – AMOUNTS AS % OF TRANSACTION VALUE*

(Subset: deals with determinable caps)



Deals in:	2004	2006	2008	2010	2012	2014	2016-17		
	All Deals	All Deals	All Deals	All Deals	All Deals	All Deals	All Deals	Without RWI Reference	With RWI Reference**
Minimum	1.7%	1%	1.23%	1.23%	2.7%	0.33%	0.01%	0.01%	0.50%
Maximum	137.04%	80%	100%	100%	114.7%	114.7%	100%	100%	100%

* Caps generally applicable to contractual indemnification obligations; does not take into account different caps for specific items (see "Cap Carve Outs").

** Does not account for RWI that may have been required or obtained outside of the express terms of the agreement.

Source: The 2017 Private Target Mergers & Acquisitions Deal Points Study prepared by the Business Law Section M&A Committee's Market Trends Subcommittee

What do you have to sell? – Alternative business models

1. *Fully integrated operation* – winery, vineyards and developed brands with a loyal following – distinguish between profitable and non-profitable
2. *Virtual winery* – Asset light business model – custom crush and purchased grapes – Can you ensure a supply of quality grapes without ownership?
3. *Vineyard only* – sales tend to be under the radar – no press coverage
4. *Negotiate brands*

How to price your winery

1. Top line growth of sales and revenues (CAGR)
2. LTM Normalized EBITDA multiple (5-12X)
3. Asset Backing
4. Intangibles
5. Scalability of the business
6. Fashionable product category
7. Market timing

Pricing: What is your winery worth?

- ***CAGR of sales and revenue*** – Top line growth is a key indicator of a solid market penetration of the brand and growth potential
- ***EBITDA Multiple*** – range 5-12X – recent Peller acquisitions - 11.6X
  - LTM
  - Adjusted for non-recurring income or expenses eg SHRED credits; and excluded assets
  - Normalized ***(scrubbed to remove personal and non-recurring expenses)***
    - Shareholders discretionary expenses
    - Shareholder remuneration
    - Is it well managed by a financially astute operator – evidenced my high margin and EBITDA
- ***Asset backing*** – value of vineyards, plant and equipment, residence
- ***Comparable market transactions***

The intangibles of pricing

- Too many variables in business models and asset structures for any single metric to be truly predictive
- EBITDA multiple is only a simple proxy for what is really a very complex issue
- Not really paying for EBIT – because cost synergies for selling and administrative overhead are quickly realized
- Real world drivers include
    - Market timing – Is the market at a strategic inflection point?
    - Is the business scaleable – both from a production and marketing standpoint?
    - Is the product category fashionable?
- Ultimately, the only real determinate of value is what will the buyer pay?

Your business is worth dramatically more to a strategic buyer than it is to you

- A strategic buyer will quickly experience an EBIT ‘bump’ from the realization of marketing and distribution and administrative cost synergies
- Distribution capability
- Vineyard holdings
- E-commerce platform
- Ability to shift production to other facilities
- Capital to grow the business
- Administrative efficiencies and reduced overhead

Strategic buyers add immediate value to the business

- Distribution capability
- Vineyard holdings
- E-commerce platform
- Ability to shift production to other facilities
- Capital to grow the business
- Administrative efficiencies and reduced overhead

Newsworthy exits are not available to everyone

- Most Okanagan wineries don’t have the scale and profitability required to garner top dollar pricing
- Prerequisites include strong top line revenue growth and strong earnings history and high margins derived by super-premium pricing and high margin DTC sales channels
- Sufficient scale to attract buyer interest
- Growth opportunities
- Asset backed – high quality vineyards, production facilities and tasting room/event center
- Sellers whose brands are marginally profitable, lack product focus or are poorly prepared to go to market will likely face increasing headwinds

Available alternatives are driven by your circumstances

1. Profitable, sufficiently scaled business
2. Unmatured business with potential for the current owner to continue to add value
3. Non-profitable and underscaled winery
4. Wineries owned by investment syndicates
5. Established multi-generational business
6. Opportunistic sellers

Noteworthy exits are not available to everyone

Sellers whose brands are marginally profitable, lack product focus or are severely underscaled will face strong headwinds

Consolidated industry income statement (2015)

	Bottom quartile ($30,000-120,000)	Lower middle ($120,000-255,000)	Upper middle ($255,000-650,000)	Top quartile ($650,000-5 million)
Total revenue	70.5	177.2	410.6	1,688.5
Cost of Sales (direct expenses)	26.7	67.6	179.1	740.5
Operating expenses (indirect expenses)	70.6	112.0	232.9	863.9
Total expenses	97.3	179.6	412.0	1,604.4
Net profit/loss	-26.8	-2.4	-1.4	84.0

Your circumstances determine your alternatives

- External sale
  - External sale to a strategic buyer – if business has strategic value to acquirer it will yield a premium price
  - External sale to a financial buyer – Usually the investment arm of a well to do family
- Inter-generational transfer – potentially the most satisfying but unfavourable generational success rates are daunting
- Retaining the business but turning it over to professional management
- Receivership sale / Liquidation

The universe of buyers

- Large industry buyers
- Middle sized players with strong balance sheets
- Investment syndicates
- Private equity buyer
- Chinese and other Asian buyers
- Romantic lifestyle buyer

Buyer Motivations

Premiumization

Scale and Diversification

Cash Flow

WHAT ARE ACQUIRER'S LOOKING FOR?

A flagship brand with a stellar reputation

Secondary or flanker brand - volume sales through levering off of primary brand reputation

Sufficient Scale

Growth Opportunities

Asset Backing

Tangible Assets

Proven vineyard sites

Strong, Loyal DtC Business → High Margin Sales Channels

Buyer motivations

- Strategic buyers at the high end of the market are looking to add super premium brands. Premiumization is the most important trend currently shaping the industry.
- Existing well capitalized winery, including mid market players, are looking to acquire strategic vineyards and production facilities to strength/expand their existing brands and business models by gaining greater control over their sourcing and production or by additional grape varietals (update portfolio to match changing consumer preferences) or geographic diversification

U.S. winery sales - 2017

Closing Date	Target	Acquirer	Assets Acquired	Location
January	Cameron Hughes Wine, Inc.	Vintage Wine Estates	Brand and Inventory	California
April	Jamieson Ranch and Reata Brands	WX Brands	Brand and Inventory	Napa, California
April	Bread & Butter	WX Brands	Brand and Inventory	California
April	Blossom Hill Winery	Delicato Family Vineyards	Facility	Central Coast, California
April	Stagecoach Vineyard	E&J Gallo	Vineyard	Napa, California
April	Geyserville Facility (Silver Oak Cellars)	Michael-David Winery	Facility	Sonoma, California
April	Klipsun Vineyard	Terlato Wines International	Vineyard	Red Mountain, Washington
April	Beaux Frères	Maisons & Domaines Henriot	Brand, Facility and Vineyards	Newberg, Oregon
April	Ovid Napa Valley	Silver Oak Cellars	Brand, Facility and Vineyard	Napa, California
May	Brewer-Clifton	Jackson Family Wines	Brand, Vineyards and Facility Lease	Sta. Rita Hills, California
June	Firesteed Cellars	Vintage Wine Estates	Brand and Inventory	Willamette Valley, Oregon
June	Bartolucci – Stice Lane Vineyard	Raymond Vineyards/ Boisset Collection	Vineyard	Napa, California
June	Schrader Cellars	Constellation Brands	Brand and Inventory	Napa, California
June	Hawks View Cellars	Ponte Family Estate	Brand, Facility and Vineyard	Sherwood, Oregon
June	Standing Stone Vineyards	Hermann J. Wiemer Winery	Brand, Facility and Vineyards	Finger Lakes, New York
August	Calera Wine Company	Duckhorn Wine Company/ TSG	Brand, Facility and Vineyards	Central Coast, California
August	Germain-Robin	E&J Gallo	Brand and Inventory	Mendocino, California
September	Prince Hill Vineyard	Silver Oak Cellars	Vineyard	Willamette Valley, Oregon

Source: 2017 Year in Review: Notable Wine Industry Transactions Announced in 2017

U.S. winery sales – buyer motivations

Target	Acquirer	Premiumization	Assets to Support Growth	Mid-tier Players Building Scale	Geographic Diversification	Private Equity Platform
Orin Swift	E&J Gallo	•				
Robert Hall Winery	O'Neill Vintners & Distillers			•	•	
Duckhorn Vineyards	TSG Consumer Partners					•
Charles Smith Wines	Constellation Brands				•	
WillaKenzie Estate	Jackson Family Wines				•	
Bread & Butter	WX Brands			•		
Stagecoach Vineyard	E&J Gallo		•			
Beaux Frères	Maisons Domaines Henriot				•	
Ovid Napa Valley	Silver Oak	•				
Schrader	Constellation Brands	•				
Calera Wine Company	Duckhorn Vineyards			•	•	

Source: 2017 Year in Review: M&A Transaction Activity – Primary Drivers

Model Acquirors

- Successful Models
  - GI Partners
  - Ste. Michelle
  - Vineyard Funds

The role of private equity

- Silverado Investment Management Company – one of the most active vineyard investors in California
- PI investors struggle with the question of how they can add value to a brand in an industry where winners determined by scale and distribution leverage
- One successful model - GI Partners (eg acquisition of Duckhorn, Far Niente)
  - Invest in a strong brand at the luxury end of the market – a brand with high price points, a strong reputation for quality and a loyal following through DTC – such brands have on intrinsically high margin and value notwithstanding their lack of scale or strength in traditional high volume channels
  - Pump dollars into areas that will increase growth and profitability
    - high quality estate vineyards
    - state of the art equipment and production facilities
    - showcase hospitality facilities
    - marketing talent
    - web portals to grow high margin DTC and internet sales
    - ‘flanker’ brands that benefit from the flagship brand’s reputation but at a Lower price point and greater volume potential (eg Decoy)

The GI Partners Model

- Flagship wine
- Max volumes of flagship brand
- Develop secondary or flanker brand
- Max sales through high margin channels
- Experience center
- Secure quality grape supply

St Michelle - String of Pearls Model

Ste Michele owns a portfolio of premium wineries which are operated separately from the parent and which produce distinctive wines from authentic estate vineyards. In each case, the corporate parent provides capital for the financing of vineyard and winemaking operations, together with administrative and marketing support.

Internationally, Chateau Ste Michelle is generally recognized as a leader in the development of this business model, which it refers to as its ‘string of pearls’ philosophy.

Ste Michelle Wine Estates, which is owned ultimately by Altria (Philip Morris tobacco), owns a collection of 25 distinctive estate wineries which together own 3500 acres of vineyards and generating over $750 million of annual sales.
The parent company provides the capital necessary to develop first class vineyards and wineries, which in turn attracts talented vineyard managers and noteworthy winemakers.

St. Michelle also provides marketing and sales support, including the back bone of an internet platform for each winery.

The Ste Michelle ‘string of pearls’ includes not only Chateau St. Michelle, which founded the Washington State wine industry and remains as its epicenter, but also other extraordinary wineries such as the legendary Stags Leap Cellars in the Napa Valley (whose cabernet sauvignon won the Judgment of Paris in 1973), Villa Mt. Eden (whose roots in the Napa Valley trace back to 1881) and, as of last year, Patz & Hall, the renowned Sonoma single vineyard producer of Chardonnay and Pinot Noir, Patz & Hall. In addition, Ste Michelle is the United States distributor for 19 prestigious international brands, Ste Michelle is committed to maintaining the separate and distinct character of each of its wineries, with vineyard and winemaking decisions made locally within the individual estate wineries.

Farm land funds

New York-based TIAA-CREF (the initials stand for Teachers Insurance and Annuity Association and College Retirement Equities Fund) owns more than 20,000 acres of vineyards, which in turn produce grapes for more than 190 vintners, including Stag’s Leap, CakebreadCellars, Robert Mondavi, Sutter Home, and others.

TIAA-CREF manages much of its wine operations through Silverado Premium Properties, a Napa, Calif.-based investment and management company it owns that purchases and plans the development of vineyards and seeks to maximize the revenue it can extract from its harvests.

WSJ – April 4, 2018

- SYDNEY – Private equity firm, The Carlyle Group, agreed to buy Australian vintner Accolade Wines Ltd. for 1 billion Australian dollars (US$772 million), gaining a portfolio of popular mass-market brands.
- Carlyle is buying the operation from Champ Private Equity, which created Accolade in early 2011 after buying two wine divisions from Constellation Brands Inc. for A$290 million.
- Accolade, which last year abandoned plans for an initial public offering, gets over two thirds of its earnings from wine sales outside Australia, including from inexpensive brands such as Hardys. In recent years, it has been building up its fine-wine portfolio, such as the premium brands it bought from Australian drinks company, Lion, in 2016, and has focused on exports to China.

Embarking on an exit plan

- Start early and remain flexible
- Prepare financially and emotionally
- Be objective in assessing the alternatives
- Hire advisors and establish a clear plan
- Timing – personal time horizons, industry specific cycles, general economic conditions
- Back up plan if preferred alternative not achieved
- Time to decide and prepare to sell, conduct a sale process, final a buyer, negotiate and close a transaction

Selling a profitable winery

- Advance planning – Is your winery ready to sell?
- Are you emotionally and financially ready to sell it?
- Hiring advisors
- Engagement letters
- Structuring a controlled auction
- Packaging your winery for sale
- Teasers
- Confidentiality agreements
- Pricing
- Typical buyer due diligence
- Purchase Agreement

Engagement letter

- Hire an investment banker on a success fee basis to package the winery for sale and to run a sale process in which the winery is marketed discreetly to a targeted group of qualified purchasers
- Assist in assembling a data room and preparing pro-forma normalized financials
- Marketing materials
- Work fee + success fee (base 4%) + out of pocket expenses
- Trailer fee

Confidentiality is crucial

- Controlled auction process where only pre-qualified buyers are invited to participate
- Premature leak could be extremely prejudicial to relations wth growers, staff, customers

Key due diligence issues

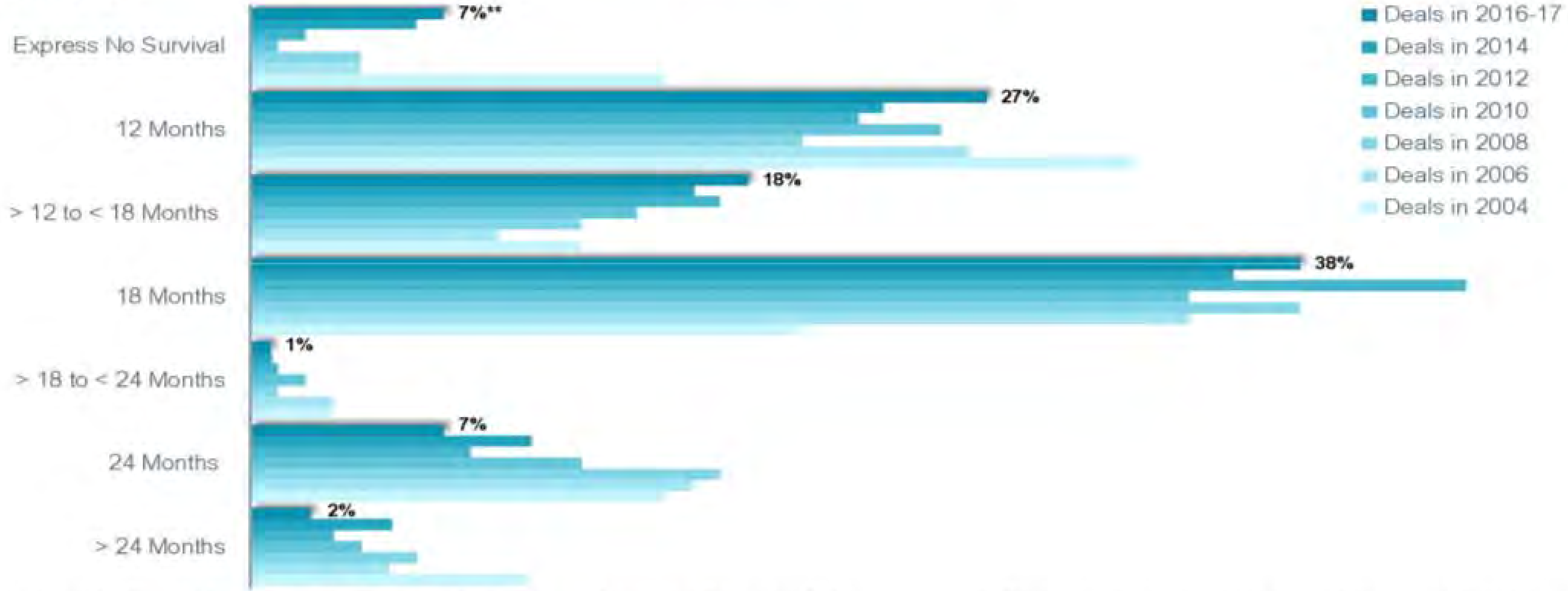
- Inter-provincial shipments
- Sales of kegs and other non-VQA formats to hospitality
- Vineyards healthy, being properly farmed and maintained, with berry counts and estimated yields consistent with prior years
- Access to sufficient high-quality third party grapes to meet production forecasts
- All inventory saleable with no material obsolescence
- Buildings and equipment adequate and appropriate for continued operation, in good condition

Typical sale terms

- Share sale v asset sale
- Pre-Sale restructuring transactions
- Indemnities/escrow holdbacks
- Employment agreements/non-competes

SURVIVAL/TIME TO ASSERT CLAIMS

(generally*)



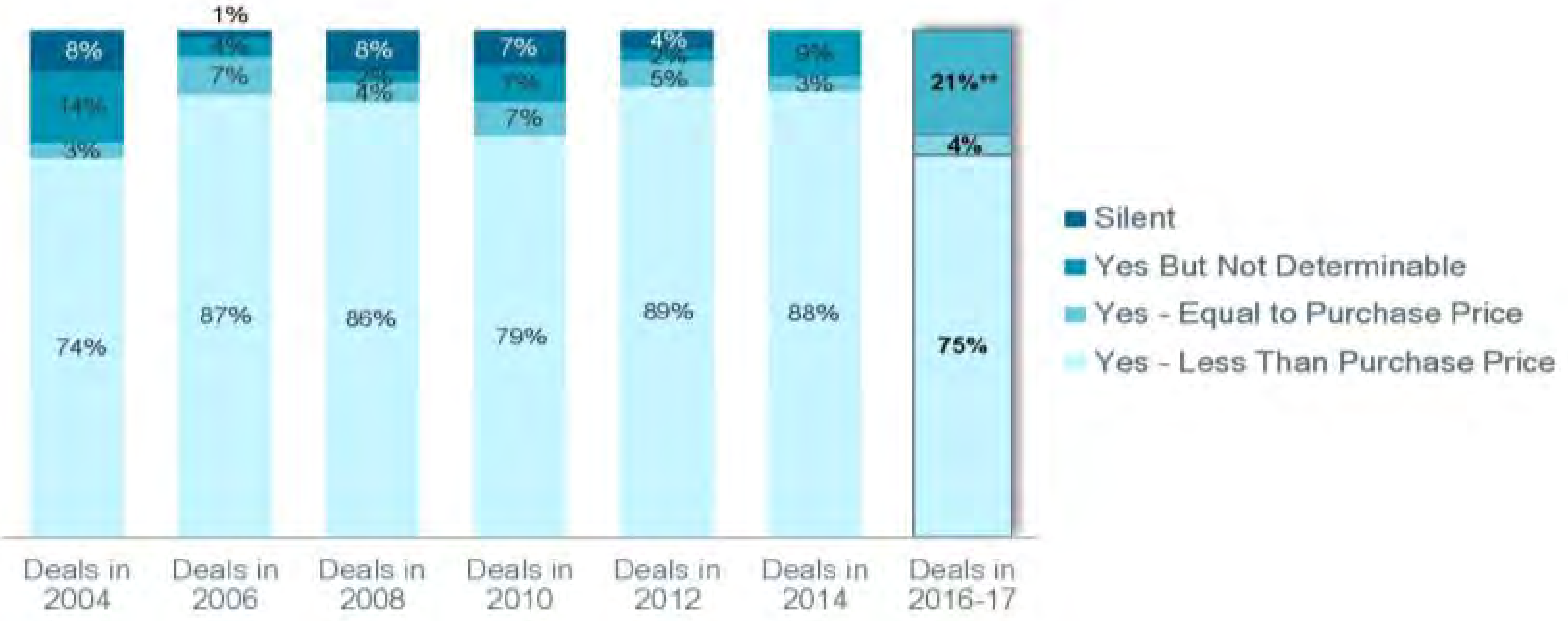
* These periods apply to most representations and warranties; certain representations and warranties may be carved out in order to survive for other specified periods. Excludes four deals with redacted or indeterminable survival periods. Only includes categories reflected in deals in 2016-17 (not shown: Silent, <12 months, Statute of Limitations).

** Includes one deal that had survival periods for covenants and fundamental representations only and four deals in which only a minority of the representations survived closing.

Source: The 2017 Private Target Mergers & Acquisitions Deal Points Study prepared by the Business Law Section M&A Committee's Market Trends Subcommittee

CAPS*

(Subset: deals with survival provisions)



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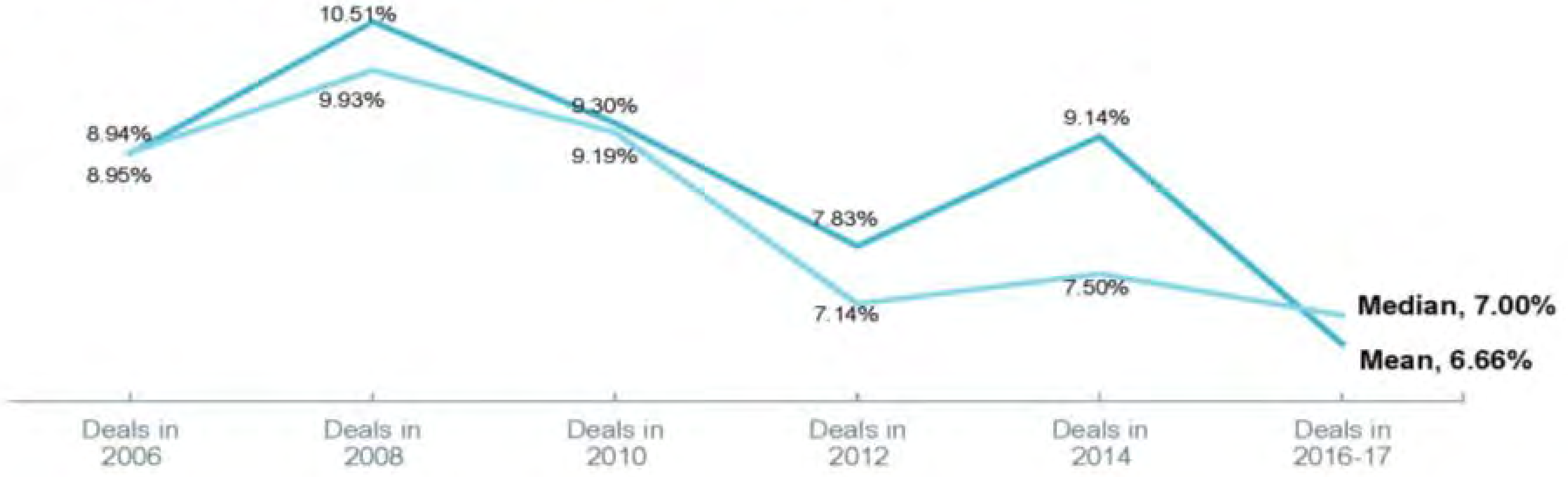
** Includes ten deals that were not determinable because caps were stated as percentages of adjustable purchase prices.

Source: The 2017 Private Target Mergers & Acquisitions Deal Points Study prepared by the Business Law Section M&A Committee's Market Trends Subcommittee

ESCROWS/HOLDBACKS AS % OF TRANSACTION VALUE

(statistical summary)
(Subset: deals with determinable escrows/holdbacks)



Deals in:	2006	2008	2010	2012	2014	**2016-17**
Minimum	1.23%	0.33%	0.33%	0.41%	0.75%	**0.50%**
Maximum	25.00%	37.30%	27.34%	25.16%	53.68%	**41.18%**

Source: The 2017 Private Target Mergers & Acquisitions Deal Points Study prepared by the Business Law Section M&A Committee's Market Trends Subcommittee

Asking the big questions

1. **What does the recent consolidation mean for our industry?**
2. **What is the role of the industry leaders?**
3. **How can the small independents continue to survive and prosper?**

Industry fundamentals

1

EXTREME CONCENTRATION AND EXTREME FRAGMENTATION

2

SCARCITY OF LAND FOR VINEYARDS

3

DIVERSITY OF VARIETALS

SYNERGY WITH TOURISM

4

CHALLENGES OF ACHIEVING SCALE EFFICIENCIES

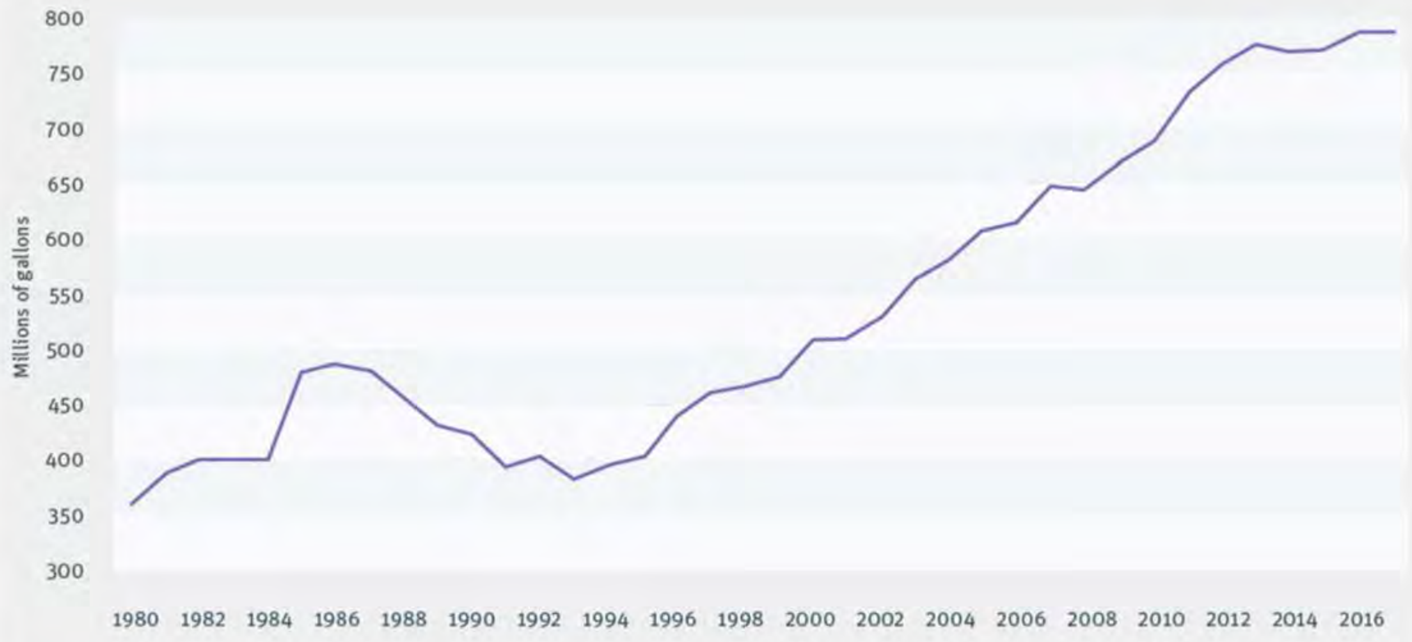
Industry Business Models

Fully Integrated Winery

Virtual Winery

Vineyard Only

Over 20 years of continuous industry growth



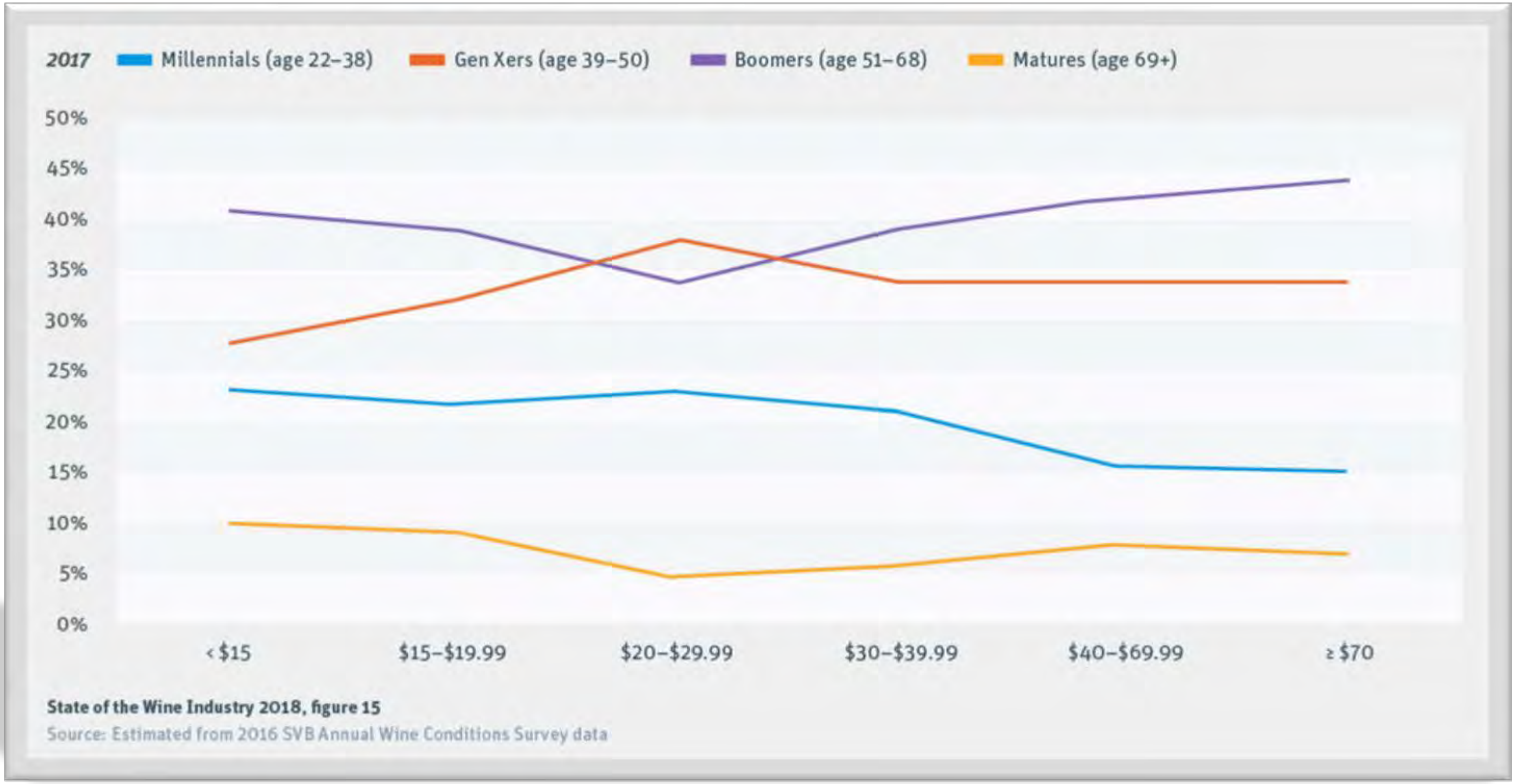
State of the Wine Industry 2018, figure 1

Sources: California Wine Institute, Gomberg-Fredrikson, BW166

Premiumization has been the dominant industry trend

State of the Wine Industry 2018, figure 5
Sources: Nielsen Beverage Group, SVB Analysis 4

Shifting age cohorts



Tough questions on marketing

“The industry’s 20-year growth trajectory cannot be repeated. The factors that made you successful to this point will not enable you to sustain that success. This means the winning sales strategies you are leveraging in the operating environment today will slowly prove fallible tomorrow. “

“The US wine industry is at the tail end of a 20-year growth period ---Successful wineries 10 years from now will be those that adapted to a different consumer with different values – a customer who uses the internet in new and interactive ways, is frugal and has less discretionary income than their generational predecessors.

Rob McMillan
2018 SVB Wine Report

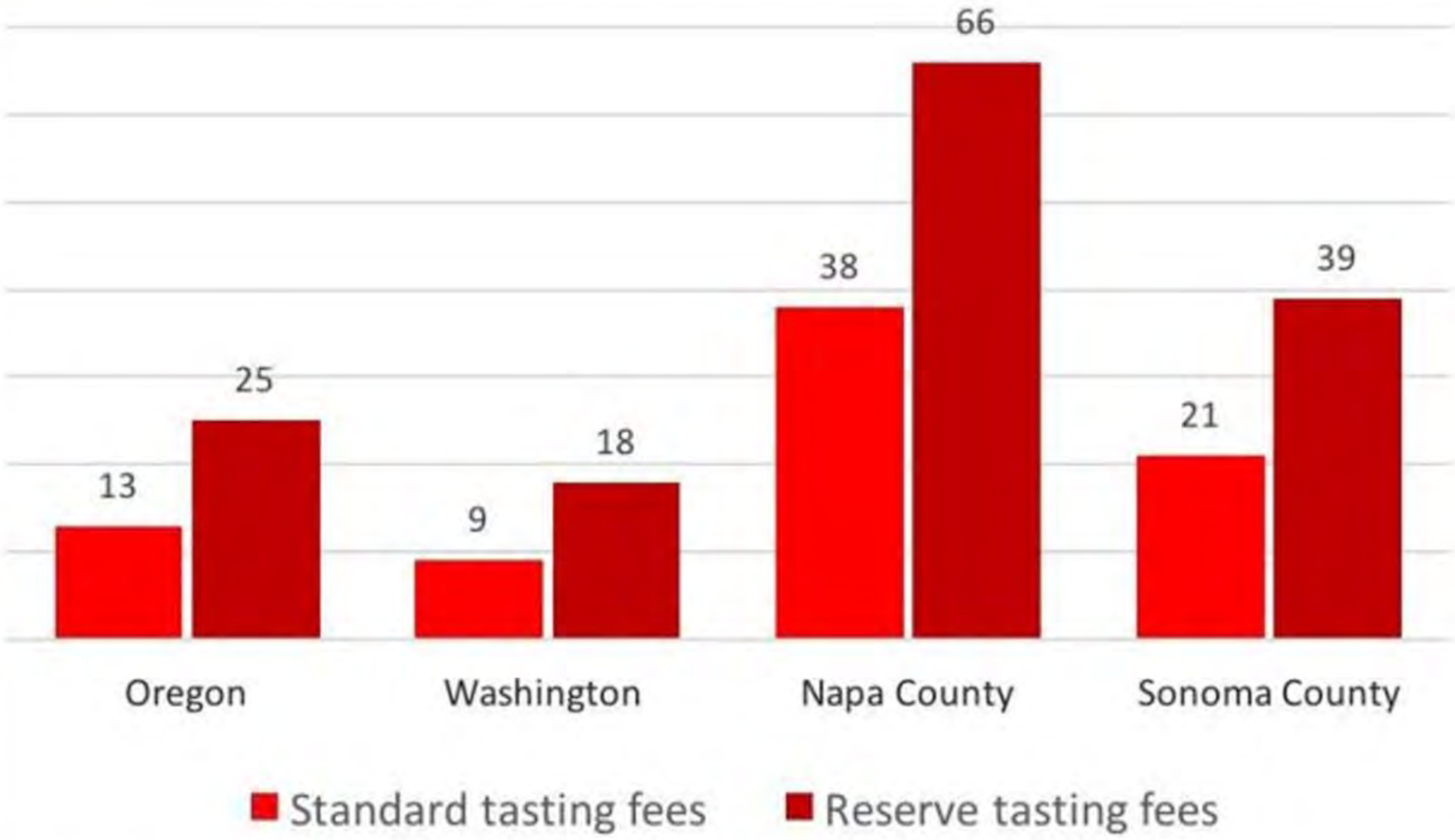
Tough questions on marketing

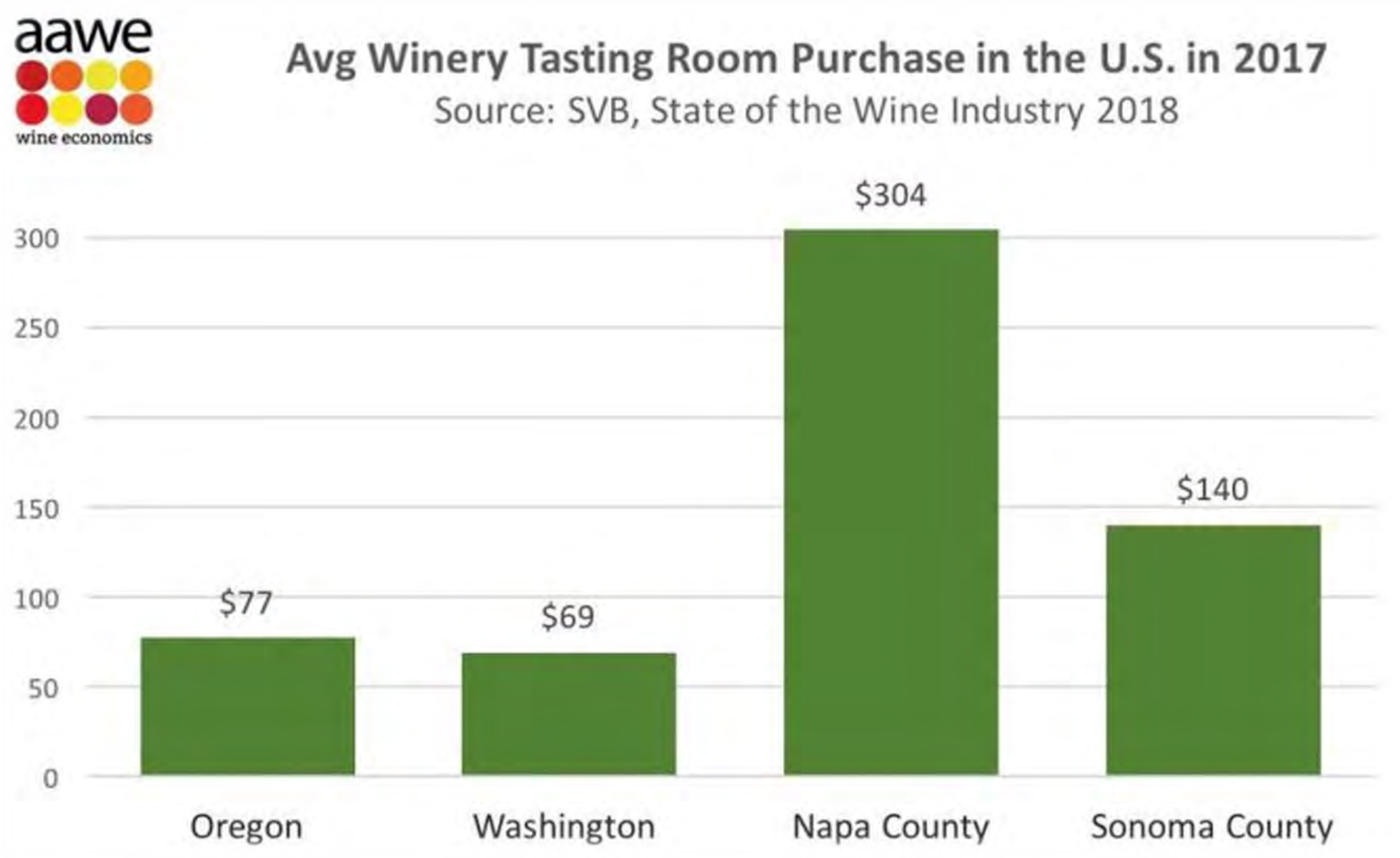
1. **How do you market to millennials?**
2. **Internet sales**
3. **Imports**
4. **Where are restaurant sales going?**
5. **Tasting rooms**
6. **Urban wineries / secondary tasting rooms**

aawe
wine economics

Winery Tasting Room Fees in the U.S. in 2017

in $ per tasting; Source: SVB, State of the Wine Industry 2018




aawe
wine economics
Avg Winery Tasting Room Purchase in the U.S. in 2017
Source: SVB, State of the Wine Industry 2018
300
250
200
150
100
50
0
$77
$69
$304
$140
Oregon
Washington
Napa County
Sonoma County

Conclusions

- Build your business with a view to future sale
- The path to a successful sale depends on what you have to sell and the universe of potential buyers
- Advance preparation is key, as is hiring the right advisors
- Don’t underestimate the time and effort involved in achieving a successful exit

Contacts

Al Hudec
Tel: (604) 661-9356
Cell: (778) 886-9356
Email: ahudec@farris.com