Wholesaler Seminar

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Valuing Beer Distributors:

Dispelling Gross Profit Multiples, Per-Case Multiples, and Other Old-Wives' Tales

By Lamont Seckman

Old wives' tales keep being told, I suppose, because sometimes they have a modicum of truth. A common old wives' tale is that "*an apple a day keeps the doctor away*". Of course fresh produce has antioxidants which can lower the risk of heart disease, stroke, cancer, and other diseases. However, the same can be said of many other fruits and vegetables ... no need to focus on just the apple.

And how about this one: the blue sky for beer distributors is valued at 1.5x gross profits, or $5 per case. I'm not sure why many old wives would be sitting around discussing intangible asset values in the beer industry, but these tales keep re-surfacing. And, similar to the tale of the apple, there is a modicum of truth to such "*rules-of-thumb*."

But of course focusing solely on rules-of-thumb is a mistake. In fact, speaking of old wives, many believe the origination of the term rule-of-thumb is derived from references in old legal works to the idea that a man may legally beat his wife, provided that he use a stick no thicker than his thumb. Many researchers have dispelled this myth but are unclear on the real derivation of the term. Most conclude it relates to the use of the distance from the point of the thumb to the first knuckle as approximating an inch. In my never-relenting quest for further understanding I measured this distance on my own thumb and arrived at a figure of one-and-three-eighths inches. In other words, if I were to use my thumb to approximate an inch, I would be off by *nearly 38%*! Perhaps such levels of precision are satisfactory in some situations, but I would propose that buying or selling beer brands and/or distributor operations requires more.

Rules-of-thumb should be understood and used for what they are: very broad attempts at describing the values that have resulted from a variety of transactions impacted by a variety of transaction-specific dynamics. While rules-of-thumb, like some old wives' tales, can have a modicum of truth, they can be significantly wild off the mark in valuing any given brand or distributor operation.

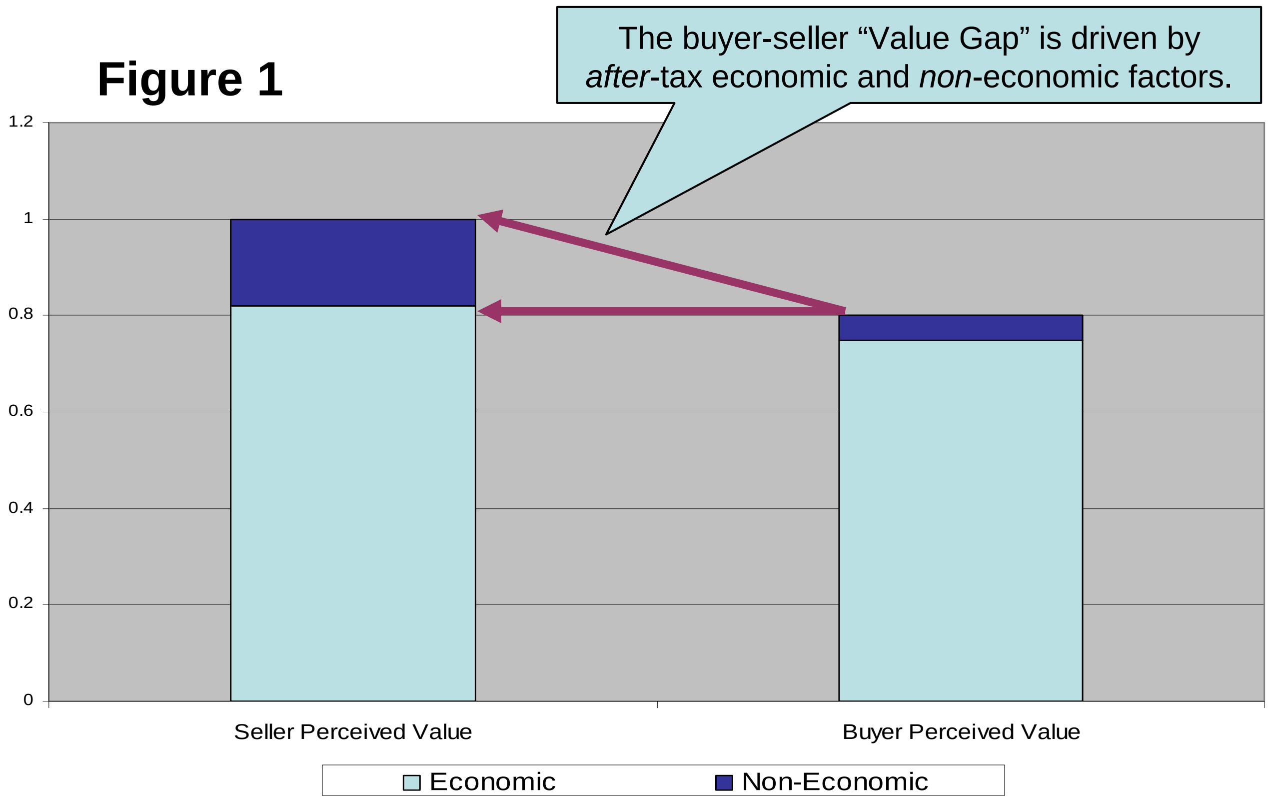
Value is Different than Price

For good measure, here's another old wives' tale in the beer industry: beer distributors have a single value. Such a statement, of course, confuses value with price. A beer distributor sells for a single price, but simultaneously, has many values.

What is the value of my beer wholesaler? To be consistent with what was just proposed, the only proper answer to this question has to be another question: from whose perspective? (*Note: if you're going to last long in the consulting business you have to be good at answering a question with a question*.)

The value perspective of both potential sellers and potential buyers is driven by a variety of factors that can be lumped into two broad categories: economic and *non*-economic. (**See Figure 1**.)

Figure 1



Gaps in Value Perception

The economic category is somewhat self-explanatory and obviously comprises a majority of the total value perception. Essentially this component of the bar chart is comprised of the net present value (NPV in financial analysis parlance) of whatever projected amounts the owner is expected to receive from the business. It is important to note this analysis must consider the "after-tax" returns to the owner and factor in actual compensation, owner returns, and owner "perks" such as expensed T&E, tickets to events, etc.

The *non*-economic category includes many non-quantifiable items such as the ego strokes derived from business ownership, the potential the business holds for employing family members and friends, and, for many owners, the productive use of their time. In addition, there are numerous other non-economic factors impacting the decision process such as supplier pressures, succession issues, etc. Of course, **it is impossible to precisely equate such items to dollars and cents** in the analysis but it is easy to understand this is a minority, but important, component of the seller's total value perception of the business.

In many potential transactions, deals do not materialize because buyers run discounted cash flow analyses and apply reasonable payback requirements on projected returns and determine an **NPV** that is too far below the seller's total perceived value of the business. An astute potential seller should be analyzing the NPV of the business from his/her perspective and may find, due to *non*-economic factors, and the impact of taxes that the value gap is too high to sell. In such cases, if a seller does not compromise, or the buyer does not come to the table and pay a premium beyond what a "*buy-side*" NPV analysis may indicate, a deal is not consummated. Perspective purchasers of businesses should have a good understanding of this dynamic and should run detailed NPVs from both buyer and seller perspective. Such analyses better define the parameters of potential negotiating dynamics than what many buyers work with--simple rules-of-thumb of company values, and "buy-side" analyses of value. Unfortunately, these elements only provide part of the picture.

Summary

So-called rules-of-thumb must be used cautiously in valuing beer brands and distributor operations. Keep in mind these are really "*back-of-the-napkin*" approaches to valuation that attempt to incorporate a very broad understanding of market conditions into any specific situation. Excessive focus on rules-of-thumb results in improper valuations and actually prevents some deals from getting done.

There are, in fact, various "value perspectives" than can apply in any potential transaction. The first step in understanding the dynamics that may impact negotiating postures taken is to analyze the value perspectives of both buyer and seller and identify any value gaps. In some cases, the value gaps may be due to differing perceptions more so than actual economics. The successful deal maker will work to reduce the perceived value gap and enable all players in potential transactions to understand the real after-tax implications to both buyers and sellers of various transaction scenarios. The resulting transactions may be consistent with industry rules-of-thumb, or they may be wildly off the mark. **Thats what makes this work so much fun**

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