# Value-Based Management:
## Getting the Deal Done
***By Lamont Seckman***

## *Acquisition Financing Gets the Deal Done in the First Place and Impacts the Long-Term Success of the Transaction*

"A bank is a place that will lend you money…if you can prove that you don't need it."
*- Bob Hope*

A quick "*Google"* search yielded an unexpected source of this familiar old slap at traditional financing. And while the entertainer's cut at the banking industry may have had a grain of truth at one time, bankers and financiers now rightly claim more of a partnering status with the business community.

Indeed, in an industry highly impacted by consolidation, outside debt capital is like the grease that keeps the machine running. The acquirers who make the best use of this resource will derive a strategic advantage in the marketplace and will position themselves to be long-term players in the industry. Those who stumble in the financing endeavor will learn lessons the hard way about loan covenants, workouts, and the sleazy smiles of bankruptcy attorneys.

This article explores the arcane world of wholesaler financing with a particular emphasis on the financing of beer distributor acquisitions. Of course, acquisition financing in general is a complicated and complex issue much written about over the years. The point here is not to provide a comprehensive dissertation of the topic or dwell on discussions of esoteric financial theory but to focus on certain particular issues relevant to a wholesaler considering debt as a tool for building business value.

To shed light on these issues, I spoke with some of the leading sources of traditional financing for the beer distribution industry. I found their perspectives enlightening and instructive for wholesalers using leverage to build bigger – and hopefully better – businesses.

"We really bank people."
*- Roger Peitsch, Comerica Bank*

## How Lenders View Distributors

Spending time with bankers leads one to believe quite readily…these guys *really do want to lend money*. It's actually quite simple: the more money lent, the more money made. That's the business they're in. And contrary to Mr. Hope's rap, if they only lent money to those that didn't need it, the profit pool in the banking industry would be a lot smaller. With that said, a banker's career would likely be quite short if money were lent willy-nilly to anyone with a nice smile and a puffed-up appraisal. *Remember the savings and loan crisis?*

Therefore, an understanding of how a lender analyzes a loan candidate should be instructive for the borrower. The lessons learned can impact more than just whether or not financing is actually secured but, perhaps more importantly, on what terms and conditions. "Banks do not look at prior performance as much as you might think," said Tom O'Neill of Banc of America, referred to in the trade as "B" of "A". This venerable institution is considered by others as the granddaddy of wholesaler financing and has developed quite a deep understanding of various beverage distribution businesses. O'Neill indicates that while historic margins, EBITDA, and mix trends are certainly reviewed, the primary factors lenders use to assess wholesaler "bank-ability" are two-fold and future-oriented: a leverage ratio and a cash-flow coverage ratio. Wholesalers considering large-scale financings will want to make sure CFOs are conversant in funded *Debt-to-EBITDA* and *Fixed Charge Coverage* (FCC) measurements.

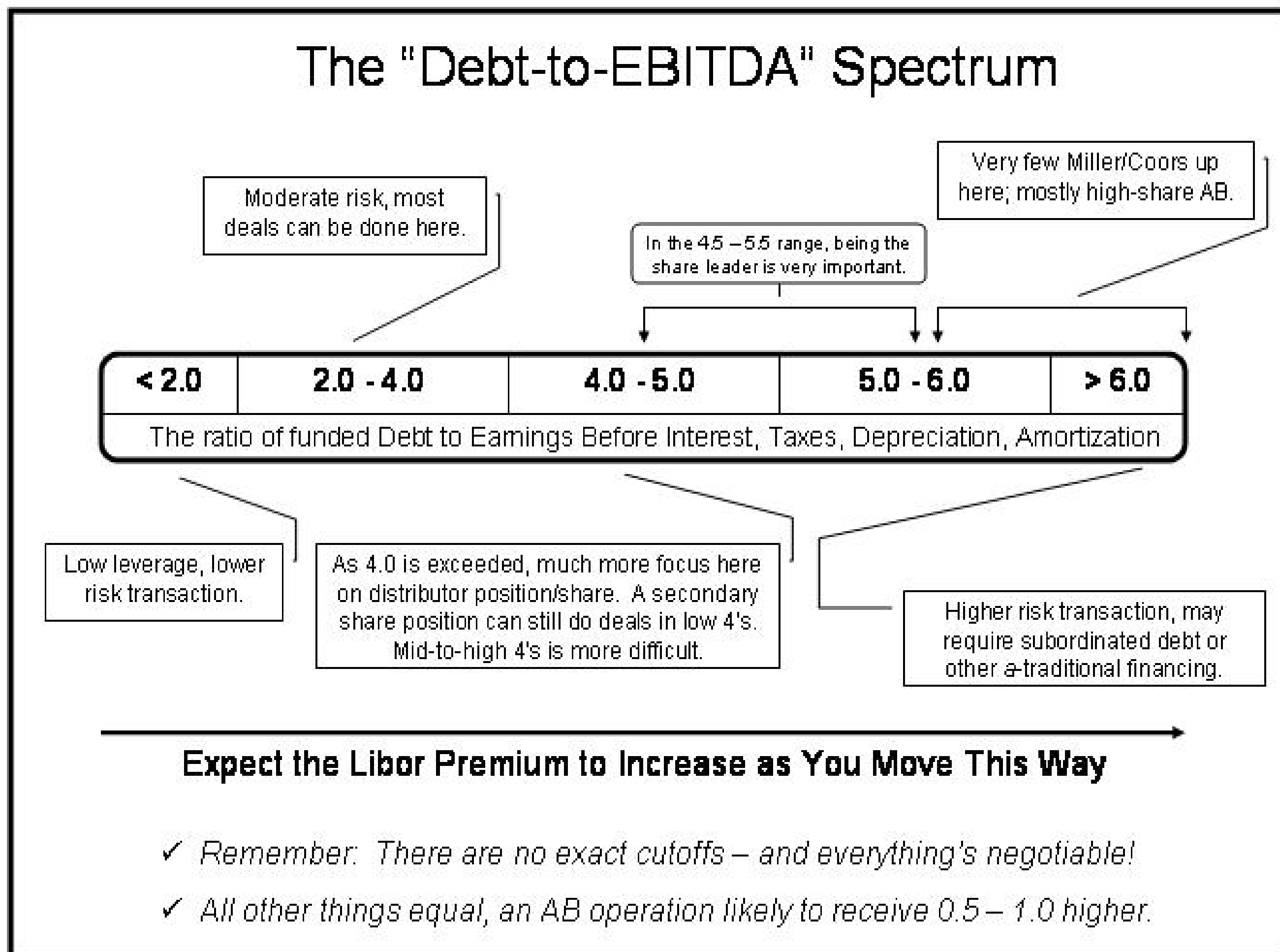
Generally, lenders view a beer wholesaler as being highly leveraged as the amount of funded Debt-to-"EBITDA" rises into the high 5's or 6 to one. EBITDA, short for Earnings Before Interest, Taxes, Depreciation, and Amortization, is used by many as a proxy for the operating cash flow of a business and thus a multiple of this is an important gauge to the relative amount of debt a business can support. To a certain extent, the *Debt-to-EBITDA* measurement serves as a kind of ceiling as to the size of an acquisition (or, conversely, how much per case can be paid for a deal) before more *a*-traditional financing must be considered.

Whereas the *Debt-to-EBITDA* ratio represents a larger view of acquisition economics at the outset, the FCC is more a measurement of ongoing performance that ensures a margin of safety exists between what the company is earning and how much it owes the lender. Some lenders have slightly different methods of calculating an FCC ratio but usually 1.1 is considered a minimum target.

These are both *post*-transaction, *moving*-forward measurements and should be focused on quite readily as they likely will directly factor into loan covenants. A key *pre*-transaction measurement lenders increasingly use is market share. Lenders are keen for political reasons to shy away from differentiating their approach to wholesalers by major supplier. But it is fair to say that more aggressive financing terms are definitely available for market share leaders, versus market share followers. Lenders are definitely more aggressive on leverage ratios, interest rates, covenants, and amortization periods when dealing with a market share leader. Conversely, lenders are placing increasing scrutiny on wholesalers that are facing "challenging" market share disadvantages. A rule of thumb here is that any wholesaler with less than half of his competitor's share is truly "challenged" in a market share sense.

Of course, in many cases share levels fairly readily equate to brands carried and more than one lender confessed to me that, all other things being equal, Anheuser-Busch wholesalers are more aggressively financed. “With an AB distributor, it’s not so much whether or not they’re going to pay, but just how long it takes,” said one. As an Anheuser-Busch distributor, expect a lender to be more aggressive in understanding the intangible values of your business (as well as the target’s) and to have more options in structuring long-term amortization schedules and higher leverage ratios. Generally, I find that the all-important Debt-to-EBITDA ratio is from one-half to a full point higher for AB distributors.

Figure 1




Aside from the purely quantitative measures, a lender is like anyone else and would prefer to work with someone they like. “We bank people,” says Roger Peitsch of Comerica Bank. Most everyone I talked with emphasized the human element of these transactions. Lenders place value on the chemistry they have with customers and the confidence they have in key managers. Bill Pyle, of SWBT Securities takes into account the experience of wholesaler management in the integration of prior acquisitions. Less experience in this regard translates into a higher integration risk. And risk, of course, impacts pricing and terms. From a lender’s perspective, higher confidence in management reduces the likelihood of a troubled loan and the related hassle factors of loan management.

An increased comfort level means the lender is more likely to "go to bat" for that wholesaler within the lending institution itself.

This can be very important in getting the best terms at the outset – and also for making structural changes to the debt situation during more challenging times.

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"Finance is the art of passing money from hand to hand until it finally disappears."
*Robert W. Sarnoff*

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## How Distributors *Should* View Lenders

Assuming one buys in to the premise that a lender is going to be a sort of business partner over time, the choice of institution is obviously an important one and goes beyond mere *dollars-and-sense* comparisons. Generally, the larger decisions of wholesaler financing revolve around the physical location of the institution and the level of expertise and experience the financing source has in your industry.

In fact, Tom O'Neill is hard pressed to recommend alternatives to local banking relationships if the need for financing is limited. "Almost any bank can provide financing for certain things."

For such things as trucks, equipment and the like, a local banking relationship is likely just fine, says O'Neill. But as wholesalers achieve certain levels of critical mass, and consider leveraged-acquisitions as growth opportunities, the physical presence of the institution becomes less important than industry knowledge and familiarity.

Above all, lenders must be comfortable with "cash-flow" lending as a concept, and familiar with the particulars of how brewer equity agreements impact the financing relationship. Most traditional banks come from a paradigm of financing things they can "touch, see, and feel" (i.e. "tangible" assets) that have values in fairly defined and understood ranges. They like the idea of having a direct claim on such assets for purposes of collateralization. But most beer distributors derive a majority of their asset values from "intangible" assets. Greg Knudsen, of US Bank, believes wholesalers can get more aggressive financing proposals from lenders familiar with industry dynamics as they understand the cash flows that result from distribution rights and can work within the constraints imposed by brewers in their equity contracts. For example, many brewers prohibit lenders from staking direct claims to distribution rights. This point has been a real stumbling block for many potential lenders.

"I have run across several security agreements in the past that are in direct violation of the wholesaler's equity agreement," says Sean McLaren of GE Commercial Finance/Franchise Finance. According to McLaren, one of the most important things wholesalers should do "is to make certain the lender understands the prohibitions of their equity agreements."

Pyle takes the issue further. He believes an industry-experienced lender will "structure a proposal that reflects industry knowledge" of such factors as seasonality, product pricing trends, and specific risks associated with integration. He says that in a post-acquisition

scenario "the surprises shouldn't be ones the experienced lender hasn't seen before."
It is common that enthusiasm runs high during an acquisition. You want to have optimistic managers. But the most compelling factor driving the choice of a lender may be how that lender treats its clients during down times. "When you're having rough times…that is when the banking relationship matters the most," says Roger Peitsch of Comerica. "You don't cut and run."

McLaren of GE shares that view and refers to what he calls, "patient capital". Lenders almost always want to work out troubled loans as best as possible with current ownership and management as that is generally their best option. For that reason, loan covenants are generally waived or changed and serve mostly as a "red flag" for lenders that something is amiss. Distributors are well-advised to stay on top of these covenants and warn lenders early of potential violations. One sure way to damage lender chemistry is to attempt to hide or dismiss issues impacting loan covenants.

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"Creditors have better memories than debtors."
*- Benjamin Franklyn*

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## Developing a Lender Presentation and Reviewing Proposals

When lenders are asked about the most common mistakes made by companies in the quest for financing, the relatively poor quality of financial presentations is high on the list. According to Knudsen, "the larger the loan, the more need I have to feel good" about the company and its prospects. The era of dumping raw green-bar reports in front of a lender are over. Consider a meeting with a lender as a selling situation: act as if you are selling a potential business partner on your company, its plan, and its outlook. "Use the presentation to direct the process," advises O'Neill. "…instead of throwing yourself on the mercy of the court."

When a total loan commitment exceeds $5 million some lenders may request an audit. However, if the leverage of a transaction is relatively low that cutoff can rise and in many situations an audit can be avoided. In any case, a "normalized" portrayal of the company's financial performance, netting out extraordinary expenses, owner-related items, non-recurring costs, etc. with full explanation of adjustments is a minimum in these times.
Most lenders advise developing a relationship with lenders sooner – rather than later. Don't wait until weeks before the deal is set to close to begin providing numbers to a potential lender. In fact, O'Neill urges wholesalers to contact local banks and do some dry runs to better gauge lender perspectives and fine tune their pitch before approaching industry specialists. Develop a professional business plan with normalized historical and projected performance. Use reasonable assumptions and calculate key performance ratios. Show how even a lowered view of performance will still allow the business to meet its debt obligations. Sell the lender on your management's plan and abilities to implement the acquisition. If necessary, bring in outside professionals to assist in the process.

Above all, make your presentation to more than a few institutions and keep an open mind during these discussions. O'Neill believes some wholesalers leave money on the table by keeping the field of prospective lenders too narrow. "Some end up paying exorbitant rates by not testing the market," he said.

He also advises a more "give-and-take" approach on the part of borrowers can lead to a more positive lender relationship. Some borrowers tend to focus on certain key factors of a loan structure, such as interest rate, and ignore other important aspects of transaction financing. This can lead to poor transaction structures that quickly lead to problems. "Do not assume a banks' proposal works," cautions McLaren. "Sometimes, the proposals do not even work in the base case." Indeed, there are plenty of examples of wholesalers who didn't thoroughly investigate the market for acquisition financing and likely ended up paying too much – both through higher rates, and fees and penalties resulting from poorly structured deals. In many cases you could argue that loan covenant violations during the initial quarters after a transaction closing are as much the fault of the lending institution who designed the structure as the borrower that accepted the deal.

As in many business transactions, acquisition financing is the result of a negotiation process. And a wholesaler owner will be in a stronger negotiating position when taking the lead in the process, by soliciting proposals from multiple lending sources, and by understanding the nuances of lender term sheets. According to McLaren, the term sheets from some financial institutions are "relatively vague." He urges potential borrowers to make institutions explain their term sheets so that every condition is fully understood. This should allow for a better comparison of proposals across lenders and facilitate the process of converting the term sheet from the chosen lender to an actual financing agreement.

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"A banker is a fellow who lends you his umbrella when the sun is shining,

but wants it back the minute it begins to rain ."

*- Mark Twain*

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## Covenant Violations

The first sign of trouble in a lending relationship is usually the triggering of a loan covenant violation. Lenders generally report that a misunderstanding of loan covenants at the outset of a deal is the leading reason they are violated in the first place. While many business principles seeking financing focus on such top line factors as interest rates and personal guarantees, they miss the impact loan covenants can have on business operations. Make sure your CFO has properly analyzed the cash needs of your business after an acquisition and has a loan covenant pro forma by quarter. Everyone should understand the limitations these covenants may place on such things as capital expenditures and owner distributions.

Don't always look at the acquisition through "rose-colored" glasses. A big factor contributing to covenant violations is simply paying too much for an acquisition. While the probabilities of this, according to McLaren, are "mitigated somewhat by the breweries' work," it can happen when acquirers are too aggressive in projecting operating synergies.

Pyle encourages companies without experience in the integration of acquisitions to seek professional assistance at the design stage to reduce the likelihood of "unforeseen costs in fully integrating" the purchased business. It can be very useful to have outside, objective input at the outset to lessen the impact of the "*trophy*" mentality on the acquisition pro forma. The influence of the "I gotta have it" (or "trophy") mentality on the numbers often

results in manipulation: the pro forma is backfilled to drive the purchase price that is perceived necessary to get the deal done. This is the reverse of how the process should work which is that reasonably-developed projections, in turn, lead to rational value conclusions.

In addition to a “top-to-bottom” understanding of the numbers, the lesson here is that before entering into a relationship with a lender check references that can tell you how that institution treats its customers during more challenging periods.
“When you’re having tough times…that is when the banking relationship matters the most,” says Roger Peitsch of Comerica. “You don’t cut and run.”

Most institutions use loan covenant violations simply as an indicator that something has happened that requires attention. Often the lender can positively address a situation in which the company has honestly communicated the situation to the lender and has a plan for working it out. However, do not assume violations will always be waived without associated penalties. Understand that many institutions have an approval process required to waive violations that will bring in others that do not have a personal relationship with you or likely any knowledge of your business or industry.

Therefore, no matter how much you like your individual contact at the lender, you need to understand the philosophy by which the institution itself approaches difficult situations. Get to know more than one individual if you can. Remember, individuals leave but institutions remain. You never know when you might find yourself in a rough spot negotiating with a representative from your lender that you’ve never met before.

“You should always live within your income, even if you have to borrow to do so.”
*- Josh Billings*

## Details of the Financing Structure are Important

Bankers generally indicate that less-than-optimal deal structure is perhaps the most common factor leading to difficulties during the life of an acquisition loan. Often, business owners tend to delegate decisions involving the intricacies of acquisition financing structure to their financial advisers and bankers.

Let’s face it: acquisition financing minutiae is just not the fun part of doing deals. By the time deal financing is addressed, business principals often are mentally and emotionally

drained from the challenges of negotiating the transaction. Many owners can specifically quote the interest rates on their loan balances – and whether or not personal guarantees are in place - but many tend to leave the crucial details of financing structure to others. And the devil, as they say, can be in the details.

The good news is that the development of a debt structure in most beer distributor transactions is a straightforward process relative to the financing scenarios used in other industries. According to Sean McLaren of GE Commercial Finance/Franchise Finance, "…it is rare for wholesalers to have to go beyond the traditional term loan/revolver to finance their business."

Still, there are important and challenging decisions impacting the long-term success of an acquisition. One of the most critical choices involves the level of risk the buyer is willing to take on with respect to fixed and variable financing.

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"There are two times in a man's life when he should not speculate:
when he can't afford it, and when he can."
*- Mark Twain*

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## Fixed and Variable Financing

Anybody doubting the "globalization" of the economy need only look at how interest rates are now commonly quoted for business loans. The so-called "prime" rate is practically a thing of the past as most bankers now speak with reference to something called, LIBOR.

LIBOR, the acronym for the London Inter-Bank Offer Rate, is the rate at which banks lend each other money and is determined daily by a small group of, ahem, London banks [America-firsters out there take note].

Rates for financing instruments are generally quoted as a premium to LIBOR. The quoted premium is generally reflective of the risk inherent in the loan – and the financial institution's perspective of desired returns-on-capital. A major factor in the determination of risk is the time by which the institution has to hold the interest rate in place. Of course, a fixed-rate loan provides a higher risk for the institution and therefore, a higher premium is charged for this service. A variable rate loan reduces the risk for the institution and the premium is, therefore, lowered.

From the borrower's perspective, the choice of fixed versus variable financing really comes down to the stomach one has for betting on the future of interest rates. But, keep in mind, especially in the low interest rate environment we've been operating in, fixing the entire portion of acquisition debt can be an expensive proposition.

While there are a multitude of more formal ways of analyzing the fixed versus variable decision, perhaps the best way is to develop a breakeven point at which the variable election becomes more costly than the fixed. Even if rates are expected to rise over time, and reasonable assumptions of interest rate rises are used, one may find that a number of years would need to pass before the variable approach becomes more costly than the fixed. If a realistic acquisition model assumes significant debt reduction before this breakeven point is reached, there may a strong argument to take a larger interest rate risk.

The lenders interviewed for this article generally report recent increases in the fixed-rate portion of acquisition loans as the consensus increasingly leans toward an expected rise in interest rates. If there is a benchmark right now, it is probably a mix of 50-60% of total debt with a fixed rate. In fact, some lenders will require a minimum percentage of debt to be at fixed rates – especially for higher-leveraged deals. In the end, McLaren advises wholesalers to "…do whatever will make you sleep better at night" with respect to the fixed versus variable mix.

Unfortunately, discussions with lenders and borrowers indicate that advice on the subject of fixed/variable debt structures from the financial institutions themselves is often wanting. In fact, some lenders indicate they actually shy away from making specific fixed versus variable recommendations to clients. Other institutions view such services as a resource for clients.

According to Banc of America's Tom O'Neill, wholesalers are mistaken to fix high percentages of debt financing and then studiously avoid any kind of "dynamic management" of their debt structure. "BOA tries to sit down with a client each quarter and analyze fixed versus variable splits, and the optimum financial structure for the client," said O'Neill. This involves developing an understanding of the appetite the client has for risk, and the particular financial performance of the post-acquisition business. And such things do change over time - often presenting profit opportunities. Many distributor owners would be surprised at the profit potential that may be identified as a result of a thorough review of their operations' financial structure.

## Financing Costs

As I write this column, the one-year LIBOR rate is around 1.85%. And while the LIBOR premiums (or "margins") are all over the board, I generally find them to be in the range of 1.00 to 3.00 for variable rate financing. For example, if your LIBOR premium was 3% at the outset of a current acquisition, your financing cost now would begin at 4.85% [i.e. 3.00 + 1.85). At this time, a 3 point LIBOR premium is considered pricey for a beer distributor acquisition and would mostly apply to *higher*-risk and/or *lower*-collateralized situations. Most qualified buyers in this industry should be able to beat that number.
In addition, most institutions quote such premiums in a "menu" format that allows for reducing LIBOR premiums in tandem with improved performance ratios. Specifically, expect more aggressive proposals for LIBOR premiums as your debt-to-EBITDA ratios come down. In fact, I have clients with LIBOR premiums *below* 1.0. Such figures are, in part, reflective of the power of franchise agreements with successful suppliers. Says Bill Pyle of SWBT Securities, "Make no mistake about it, the beer industry is financed at attractive costs-of-capital compared to other industries."

Lenders indicate a common mistake is for wholesalers to only focus on the LIBOR premium as it relates to *variable rate* debt, and then leave the fixed rate portion almost as a kind of after-thought. With many wholesalers allocating ½ or more of total debt at a fixed rate, this approach can leave money on the table. It is common now to derive fixed rate debt by "swapping" the variable. Swapping is generally a profitable enterprise for lenders, so make sure inordinate profits from this activity are not coming out of your operation. The quotes from institutional "swap" desks need to be checked for market competitiveness

during your financing proposal review process. Get quotes for fixed-rate swaps early in the process to ensure the fixed-rate portion of your lender's financing is as competitive as the variable-rate proposals.

Consolidating activities such as cash management services with the lender that provides you with long-term acquisition financing can also improve your interest rate quotations. But beware, this can be a trade-off. The so-called operating accounts business is, in fact, a sought-after profit center for traditional lending institutions. Make sure you understand what fees come along with these services - and that they are comparable to what you already pay. Otherwise, the difference should be viewed as an offset to any interest rate reductions. You may find the local institution providing these services for you currently remains your best alternative.

## Other Transaction Costs/Fees

An important tip in negotiating with lenders is to understand the role fees play in the overall picture. While understandably many focus on interest rates in trying to get a handle on total financing costs, often the related fee impact is overlooked. On the other hand, lenders certainly focus on fees as an attractive revenue source. For lenders, up front fees cover some of their set-up costs, but much of these payments are pure profit. From a lender's perspective, fees are also attractive as they represent profit realized at the closing of a loan – instead of profit derived over the life of a loan.

It is common to see financing proposals that are competitive on key structural items – but end up killing you on fees. Many of these fees are negotiable items if a lender wants your business bad enough. And keep in mind that failure to negotiate fees can significantly increase the effective cost of money for you on a net present value basis.

## Amortization of Loan Principle

Loan amortization is perhaps one of the least understood aspects of transaction financing - yet can have significant impacts on post-transaction cash flow performance. Simply stated, amortization refers to the schedule by which loan principle (i.e. not interest) payments become due. There are generally two types of amortization: mortgage-style and direct. In a mortgage-style amortization schedule, total debt service (i.e. principle plus interest) is fixed each payment period while increasing portions of payments go toward principal as you move through the life of the loan. In a direct amortization structure, contributions toward principle remain fixed in each payment while the total payment amount declines over time as interest charges on reducing principle balances decrease. Your business loan can certainly be structured with one of these two "off-the-shelf" approaches. Or, your amortization schedule can be more customized to your specific business situation.

For example, as we all know, the beer business is seasonal – even more so in markets impacted by recreational areas. Lenders can alter amortization such that more principle is reduced during peak periods of the year and less during slow times.

Making a significant reduction in required amortization in the early years after a sizable acquisition is also a realistic objective. In sizable combinations, especially of the Miller/Coors variety, do not underestimate the time it takes to properly integrate the

acquisition and realize the planned synergies. Reducing total debt service during the first few years can provide management with a needed cushion until the real synergies of the transaction actually drive operating cash flows.

The use of a revolving line-of-credit can also effectively reduce amortization schedules as this instrument does not typically have any amortization but simply a maturity date. While this tool can provide payment flexibility, beware of the fees tied to the unused balances which can effectively increase your total financing costs beyond expectations.

Like many things in life, loan amortization is a balance between structuring a post-acquisition payment schedule flexible enough to provide management with certain performance cushions – and yet not stretching out payments so far that payback becomes prohibitive. When payback periods extend beyond certain limits, one should ask if the acquisition is indeed too pricey.

"Too many people today know the price of everything and the value of nothing."
*- Ann Landers*

## Valuation Trends in the Beer Wholesale Business

While key lenders in this business generally agree that valuation trends are difficult to precisely track over time, most feel that values have increased in recent years – primarily due to the higher operating cash flows generated by many wholesalers.

However, "the beer distribution business is not an efficient market," according to Tom O'Neill. "A distributor is hardly ever going to sell for what his cash flow is really worth to him," he said.

Taxes that apply to business transactions play a role in this, of course, but O'Neill also attributes this to the active supplier role in the approval process. Indeed, values could rise significantly "…if breweries embraced large, multi-state wine and spirits operators as owners," says Pyle. "…or if public ownership of wholesalers was allowed values could be influenced dramatically upward."

While a handful of large wine and spirits players have become more active in the marketplace, and have paid high multiples on occasion, lenders caution that potential sellers should not hold their breath waiting for beer producers to allow for a publicly-traded consolidator similar to Coca-Cola Enterprises to emerge. Even with brewery blessings, the regulatory structure of the industry remains a big obstacle to a publicly-traded consolidator. Regulations make consolidation across state lines more difficult – and can serve to limit the efficiencies of larger operators who must figure out how to comply with varying local laws.

Generally, the lenders I interviewed for these articles seem increasingly sensitive to the risks posed by potential regulatory changes that could result from various challenges to the three-tier system. In addition, there are the normal economic risks faced by any industry.

Value increases for distributors during the past few years have been fueled mostly by the healthy pricing environment as volume growth has been relatively stagnant. This situation could turn on a dime with a downturn in the economy.

While the industry has high capacity utilization, which is usually a strong motivator for suppliers to increase prices, other indicators are not so positive. Price increases for beer products have outpaced those in spirits and the wine grape glut has made this beverage choice cheaper in comparison. Beer CPI increases have been strong in recent years but have generally lagged inflation in the long run. Will the industry return to such a position? In the last few years, industry suppliers smartly recognized that a product price increase has greater leverage on bottom-line performance than corresponding emphasis toward volume growth. This supplier shift from a “move the box at any cost” mentality to a “move the box profitably” perspective has benefited many players in the industry.

But what will happen to distributor cash flows in a low-volume growth environment if pricing weakens?

The consensus in the financial community seems to be that valuation multiples for beer distributors will be flat at best and down slightly at worst over the coming years. McLaren sees the high purchase price for “tuck-in” brands leveling off as growth rates for such high flying brands as Corona begin to decline.

Some expressed concern that values will be pressured as we wind our way through the consolidation curve and the number of potential buyers for wholesalers entering the market dwindles. Expectations are that the number of transactions may be reduced – especially as rising interest rates increase the cost of acquisition funding, and if favorable capital gains treatment on sale proceeds is rolled back.

## Summary

Financing business acquisitions is a heady topic that can take a variety of directions. The intent behind these two articles was not to provide a comprehensive survey of the issue, but rather to shed some light on specific aspects particularly relevant to beer wholesalers in the context of today’s environment of consolidation.

Business valuations in any industry are significantly impacted by consolidation activity.

There is a general consensus emerging that the US beer industry still has too many wholesale operations. The relatively high prices that continue to be paid to selling wholesalers reflect this notion. And while beer distributor valuations are impacted by a variety of operating issues, values have undoubtedly been supported in recent years by the relatively cheap money available to buyers to finance acquisitions. Astute buyers have made use of this cheap money to build larger, more profitable enterprises – even while paying sellers solid values for their operations.

This dynamic is not sustainable and must come to an end at some point.

Key players in the financial end of the beer distribution industry generally agree that distributor valuation multiples will likely be flat. Probabilities are, in fact, higher that multiples will go down before they go up due to projected interest rate increases, a potentially weakening pricing environment, and the risk of changes in the regulatory structure of the industry, among other factors.

Effectively, what is created by this dynamic is a window of opportunity. A window of opportunity exists for distributor owners not likely to be long-term players to exit the industry with higher valuation multiples - and favorable tax treatment on the proceeds. Conversely, for buyers, the opportunity exists to pay the price it takes to facilitate needed consolidation and still create larger, high-value operations of their own.

Key to the success of this endeavor will be the effective use of debt financing. Those skilled in this area and making use of the resource while it is cheap will drive value. Others risk missing the boat entirely - or perhaps taking on water after they jump in.

Which camp will you be in?

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**Lamont Seckman** is a nationally-recognized consultant to the beverage distribution industry. Since 1991, he has worked with hundreds of distributors all over the country on a variety of issues including: sales planning and market development, compensation planning, route logistics, warehouse layout and manpower planning, and business valuations, mergers, and acquisitions. As a noted public speaker, author, and principal in recognized consulting firms, Seckman has been a key contributor to the beverage and food distribution industries over the last decade.

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More information on business valuation and profit-enhancement strategies can be found at: www.distributing-company.com