

Case Study

Brewery exit dilemma

You are Investment Officer at Gulf International (“GI”) responsible for its portfolio investment in CEBrew, a Central European brewery. Your Director wants you to develop an exit strategy, to sell the brewery through a trade sale.

CEBrew was acquired by GI in late 2012. The investment was an acquisition of the Company from the government through privatisation, coupled with some money-in to restructure the Company and upgrade its facilities. GI executed a successful turnaround, turning a loss in 2013 into a prospective profit of around €6m in 2015. The total investment was €10m for a 60% stake. The remaining shareholders are some government funds, who play no active role in the management and who have entered into drag and tag along agreements with GI, so that a 100% stake may be offered to prospective acquirors.

There is due to be a Board meeting of CEBrew soon, at which your Director will participate and decisions need to be made about the Company in view of the planned exit. We are now in late November 2015, so that any sale of the Company will be based upon the balance sheet as of the end of 2015.

Along with a GI analyst, you have developed a series of financial forecasts to 2020, based upon a “steady state” scenario. Your scenario assumes steady single digit growth, based upon the assumption the Company will more or less maintain its current 25% market share (the other biggest players have shares of 20% and 15% respectively), no major new capex will be required, and that there will be some minor incremental operating efficiencies. This plan will be the basis for discussion with the Board and your Director; and following these discussions, the plan may be amended. The amended plan will then be used to present the Company to potential trade investors.

The intention is to sell 100% of the Company to a major multinational brewery, through a competitive tender which you shall be charged with managing. Your success will be judged by having as many offers as possible, maximising the price paid and managing a transparent and efficient process that will tell the market that GI is capable of managing a serious exit, and that its companies are good investments. Your criteria are, therefore, maximising offers, maximising valuation and generating a good reputation. It’s possible you may have to make trade offs between these three factors. Your Director is not the type who gives detailed guidance, so you are on your own.

One of the decisions you need to make is whether to conduct a sell side due diligence. GI has made a lot of progress with the Company since 2012, but there are still some areas of concern including whether depreciation was properly done, whether the inventory levels are correct, the expenses have often been misclassified, direct and indirect labour was also mixed up, the MIS system was supposedly well functioning, but there have been increasing glitches and delays in the reports. There is also a concern with the local authority about a potential environmental claim, with the authority claiming there is effluent damage. There is also a potential ownership restitution claim on part of the Company land by supposed former owners, although the law is unclear on this. You need to decide on whether to conduct a sell side due diligence and what type of consultants to involve (accounting, legal, technical, environmental). You have been quoted costs in the range of €75-125K. The other 40% shareholders are opposed because they see no need for it and feel that any bidder is “expert enough not to need materials from us”.

Another decision you need to make is whether to use an advisor to assist with the sale. The Advisor would coordinate the sales process, prepare management, as well as assist with any sell side due diligence. The Advisor would also put together a data room for prospective bidders. You have an offer from a good local M&A firm for their services, based upon a monthly retainer of €10K for 6 months, plus a 2% success fee. This is negotiable. You have received ambiguous signals from your Director about this (“what are we paying you for if we will hire an advisor?”), but if you push it GI will accept your recommendation.

Another open question is whether the sell side due diligence costs should be borne by the Company in their 2015 accounts, which might lead a bidder to complain that this cost should be for the account of the shareholders and not the Company.

Over the last couple of years, you have had contracts with potential buyers, through occasional meetings when their business development managers would drop by, meetings at conferences, news about other acquisitions they made over the years, as well as general gossip in the business community. You are confident that the following four companies are seriously interested.

InBrew

A middle European major brewery. They like keeping local brands and believe in decentralised management. The Development Manager sees this acquisition as an opportunity for him to switch to becoming CEO of the Company if acquired, which would be a major career move. They usually assess investments with a WACC of 20%; they use an EV/HL valuation of €55/hectolitre; and a PE multiple of 12. The Development Manager has hinted he might have room to up these by 20% if the Company has a clean sell side due diligence.

Heinen

A major northern European brewery with a global brand. They have no interest in local brands and have a centralised management system. They use a WACC of 28%, EV/HL of €40/HL and a PE multiple of 12. If the Company meets their very high technical and environmental standards (which for them would mean at least two of projects 3, 5 and 7 below being done), they have indicated they would use a PE of 15 times and reduce WACC by 2%. They would pull out of any deal which they felt was not totally transparent.

Calbik

A major Scandinavian brewery with both a global brand and which likes to use local brands. They have a management system where they keep management but put in an expat CFO. They work with a WACC of 25%, EV/HL of €40 and PE of 12. If they are confident the management is good and happy, they would cut WACC 3% and increase PE to 15. They dislike having to conduct complicated due diligence exercises, due to the small team they have at HQ. They also do not like inheriting capex commitments not yet executed.

Paloni

An Italian family brewery. They like to manage in an informal way and prefer saving on capex, by using second hand Italian equipment. One of the cousins would relocate to become CEO. They use a WACC of 20%, EV/HL of €100 and PE of 8. They are a bit nervous about tenders, and prefer an “unofficial” style of negotiation. They are known for being happy to make “unofficial” payments to get deals done in Emerging Markets where they operate. Their financial guy is a bit weak on DCF and prefers the other methods.

For the upcoming Board meeting, there are a series of operational decisions which need to be made. These will all have a material impact on the proposed transaction. There are seven major decisions to be taken.

1) Channel stuff: the sales manager has proposed calling his closest distributors, to get them to place a bunch of orders in December. This exercise would boost 2015 sales by €1m, and result in 2016 sales falling €1m below plan. Receivables would be up €1m, as payment would be made in 2016.

2) Production boost: the production manager has suggested it would be a good idea to use some spare capacity to produce for inventory, as this would be cheaper than in other periods. He suggests producing an extra 50K HL in December. This would show up in 2015 production figures.

3) New bottling line: there is a proposal to order a new bottling line. This would be a €10m investment, depreciated over 7 years, which could be vendor debt financed at attractive conditions; and would boost sales by €2m from 2016. It would also make the Company more technically attractive.

4) Basketball team: it is proposed that the Company commit to sponsoring a local basketball team. This would create goodwill with the local authorities (which could help with effluent and restitutions issue), and help to promote the brands of the Company. Annual cost would be €0.25m.

5) Effluent plant: it is proposed to install an upgrade to the effluent treatment plant. This would take care of any environmental concerns and claims, as well as enhance the image of the Company. Investment would be €3m which could be debt financed from a soft loan from a DFI, depreciated over 10 years.

6) Management: the management are concerned about their positions, and you need their cooperation for the sale process. They want a bonus for helping the sale, as well as “golden parachutes” in case any of them are dismissed post sale. There would be a one off cost in 2015 of €0.75m.

7) New tanks: it is proposed to commit to buying new fermentation and storage tanks, to take advantage of an exceptional buying opportunity open only for a couple of weeks. The investment of 4m would occur in 2016 and have an effect from 2018 on sales of 3m. According to local rules, they could be depreciated in an accelerated schedule of 5 years (although useful life is 15 years), to produce a tax shield. The investment could be debt financed from an export credit programme.

In order to help you assess the impact of these decisions, your analyst has developed a model which simulates their impact on Company forecasts. He has also added a valuation sheet to simulate how potential bidders might value CEBrew.

You now have to conduct your analysis and make a recommendation on exit strategy to the Board, which should cover:

- whether to conduct sell side due diligence;
- where these costs should be put;
- whether to use an advisor;
- which of the seven projects to go ahead with;
- how many offers are likely;
- what price range the offers are likely to be;
- any trade offs between number of offers and price?

Bearing in mind that the quantitative analysis is only one part of the whole picture.

Film

Watch the discussion of the case on the YouTube channel PEConfidential.

<https://youtu.be/cG84VeCPWZU>