

Craft Beer Industry Update M&A and Liquidity Transactions Survey

November 2016



By: Kyle Leingang, Esq.,
Dorsey & Whitney LLP

(P): 714.800.1425
(E): Leingang.Kyle@dorsey.com

We are nearing the end of a very active year for liquidity transactions in the craft beer industry. Since last year's edition of my annual survey article¹, there have been approximately twenty-two notable liquidity transactions.

Those transactions paint five major themes:

- (1) It has been a year of strategic (rather than financial) acquisitions, with much more activity by AB InBev and MillerCoors and nearly all of the deals involving some form of strategic acquirer.
- (2) The year's deals boldly announce that many foreign breweries are actively pursuing craft beer acquisitions and these transactions are being particularly considered by craft breweries growing their brands internationally.
- (3) This year finally gave the industry multiple precedents for "craft-on-craft" acquisitions and foreshadows the formation of multiple new craft brewery groups and partnerships in the coming years.
- (4) The quantity of financial buyer transactions was down from prior years, although private equity investors remain willing to take a minority position in certain circumstances and some breweries are beginning to consider the benefits of public markets.
- (5) The emerging competitive landscape is leading to multiple facility acquisition transactions involving a brewery buyer, and this trend is likely to continue as founders of more recent breweries seek exits and growing breweries need to quickly increase production.

¹ Last published August 2015. Previous publications can be found under the "News" tab of <https://www.dorsey.com/people/1/leingang-kyle>

Coming off the heels of a prior year with multiple Employee Stock Option Plan ("ESOP") transactions and more private equity activity, transactions in the craft beer industry took a very different shape during the past 14 months, with larger breweries implementing an aggressive acquisition strategy and out-bidding financial investors on multiple transactions. Together, AB InBev and MillerCoors alone accounted for twelve transactions.

AB InBev and MillerCoors Transactions

<u>Target</u>	<u>Buyer/Investor</u>	<u>Date</u>
Golden Road Brewing	AB InBev	September 2015
Virtue Cider ²	AB InBev	September 2015
Saint Archer Brewing Co.	Tenth and Blake Beer Co. ²	September 2015
Breckenridge Brewery	AB InBev	December 2015
Four Peaks Brewing Co.	AB InBev	December 2015
Devils Backbone Brewing Co.	AB InBev	April 2016
Terrapin Beer Co.	Tenth and Blake Beer Co.	July 2016
Hop Valley Brewing Co.	Tenth and Blake Beer Co.	July 2016
Revolver Brewing	Tenth and Blake Beer Co.	August 2016
Bosteels Brewery ³	AB InBev	September 2016
Northern Brewer LLC and Midwest Supplies ²	AB InBev	October 2016
Karbach Brewing Co.	AB InBev	November 2016

AB InBev picked up producers in Los Angeles, Michigan, Colorado, Arizona, Virginia, Houston and

² Tenth and Blake Beer Co. is a wholly owned division of MillerCoors.

³ While not US craft breweries (Northern Brewer LLC and Midwest Supplies are homebrew suppliers, Virtue Cider is a craft cider producer and Bosteels Brewery is outside the U.S.), these transactions have been included to provide additional context for the high level of acquisition activity by these large brewers.

Belgium. MillerCoors added breweries in San Diego, Oregon, Maryland, and Texas.

AB InBev’s acquisitions during this time – each in regions where it previously did not own any breweries – suggest it is implementing a regional acquisition strategy that will lean heavily on distributing these brands locally and regionally (with perhaps an exception for its Goose Island beers, which already see heavy national distribution). It is also acquiring and managing the breweries through a separate division called “The High End”. The deals are some evidence that AB InBev may be giving up its fight against “local” and, rather, embracing the time-tested philosophy of “if you can’t beat ‘em, join ‘em”.

In comparison, the MillerCoors acquisition approach has been less aggressive thus far and suggests it prefers to acquire and manage fewer craft brands than AB InBev. This further implies that Tenth and Blake may be implementing a blended approach toward recent acquisitions, with certain targets (e.g. Saint Archer) destined for broad distribution regionally, or even nationally, with other acquisitions designed to strengthen the group’s presence in important local markets where the MillerCoors portfolio may have lost the most ground to craft brands.

There were four transactions by other foreign strategic buyers other than AB InBev during this period.

Foreign Strategic Buyers

<u>Target</u>	<u>Buyer/Investor</u>	<u>Date</u>
Lagunitas Brewing Co.	Heineken Holding NV	September 2015
Ballast Point Brewing & Spirits	Constellation	November 2015
Brooklyn Brewery	Kirin Company	October 2016
Two Beers Brewing Co. and Seattle Cider Co.	Agrial Group	September 2016

Consistent with prior transactions by Firestone Walker and Founders, these transactions affirm that many breweries with traditional and strong footprints outside the U.S. are now buyers. These new ranks to the buyer pool may replace some buyer demand should AB InBev and MillerCoors back off this year’s elevated acquisition pace. Also, more importantly, many of these buyers will be a better cultural and long-term fit for certain sellers, particularly those looking to remain involved and work toward growing brands in international markets.

The Lagunitas and Brooklyn transactions similarly involved the acquisition of less than a majority ownership, as Heineken acquired 50% of Lagunitas and Kirin acquired 25% of Brooklyn Brewery. It never seemed a question of “if” a large Japanese brewery was going to make an investment in U.S. craft beer; rather, only “when”. Kirin’s transaction seems likely to push at least one other to follow suit.

In perhaps the most discussed transaction on this list, Constellation’s acquisition of Ballast Point for \$1 billion is Constellation’s first craft beer transaction and is poised to be as important to Constellation as the acquisition of Goose Island was to AB InBev. In contrast to the seemingly regional approach of AB InBev and blended approach of MillerCoors, integration efforts will be tremendously important to this deal as Constellation commits the brand to broad national distribution as the sole “craft” offering within its brand portfolio. Much has already been written about this deal and it continues to buoy the financial expectations of sellers. It also has been the foundation of much “per barrel” price discussion and comparisons amongst commentators, even though it has been my experience that the language of these price negotiations more typically relies upon revenue or EBITDA multiples, depending on the sophistication of the seller’s financial statements and other relevant financial indicators.

The sale by Two Beers Brewing and Seattle Cider, two companies that were already owned and controlled by the same ownership group, is to a France-based coop purchaser. Coops are common organizational structures for agricultural enterprises, reflective of Agrial’s holdings of apple orchards and other agricultural businesses in France. This transaction raises the prospect of other companies in the craft beer supply chain, including hop growers and grain producers that may also be organized as coops, becoming a new class of prospective buyers for craft breweries.

Next, five recent transactions were “craft-on-craft” deals, with two of them private equity financed:

Craft-on-Craft Transactions

<u>Target</u>	<u>Buyer/Investor</u>	<u>Date</u>
American Brewing Co.	Pacific Brewing & Malting Co.	October 2016
Victory Brewing Co.	Ulysses Management LLC (through Southern Tier Brewing)	October 2016
Cigar City Brewing	Fireman Capital Partners (through Oskar Blues)	March 2016

Prairie Artisan Ales	Krebs Brewing Co.	June 2016
Hilliard's Beer	Odin Brewing Co.	June 2016

All five of these transactions are important markers of a movement toward craft-on-craft acquisitions becoming more common, although with varying structures. The acquisition of American Brewing by Pacific, a maltster that began its own brewing operations in 2014, foreshadows future acquisitions of brewers (and the development of brewing operations) by those in the supply chain, particularly maltsters, hop growers and yeast banks.

On the other hand, the acquisitions of Victory and Cigar City stand together in having relied upon private equity to facilitate the combinations, with the fund owning multiple craft breweries as a result. While no transactions have yet been done, these deals echo Stone's announcement of True Craft and its \$100 million funding partnership with financial investors to make investments in craft breweries, as well as the formation of Enjoy Beer by the former Harpoon CEO. Finally, the acquisitions of Prairie Artisan Ales and Hilliard's Beer (by Krebs and Odin Brewing, respectively), on the other hand, did not involve direct private equity ownership. These transactions are likely forerunners to future transactions involving mid-sized breweries joining forces in equity partnerships for distribution advantages and to spread their risk across multiple geographies and brands. Other transactions of this type are nearly certain to follow. The advent of craft-on-craft acquisitions has arrived and is here to stay.

Two remaining transactions are beneath the general umbrella of "financial investor", although each was very different in its structure, purpose and effect on the industry. These are below:

Financial Transactions

Target	Buyer/Investor	Date
Dogfish Head Craft Brewery, Inc.	LNK Partners	September 2015
Evans Brewing Company Inc	Kodiak Capital Group, LLC	October 2016

LNK's transaction with Dogfish Head was an investment for a 15% equity stake and stands alone as the only traditional private equity deal. It carries particular weight within the industry given that Dogfish Head and its founder, Sam Calagione, are iconic innovators in craft beer. The transaction continues last year's trend of private equity investors being willing to accept less than majority ownership if coupled with the right target and appropriate investor rights.

The relatively modest \$1 million transaction by Evans Brewing Company (OTCQB: ALES) is notable as the first investment offering in the craft beer industry successfully registered with the SEC since registered offerings in the mid-1990s.⁴ The offering by Evans Brewing Company was not a direct public offering; rather, the Form S-1 registers shares for resale by Kodiak Capital Group, who can resell shares as an underwriter after they are issued. The use of this financing structure, while common in other industries, is new for craft beer. Its emergence this year in craft beer suggests that growth and industry consolidation may lead to other breweries (including aforementioned craft beer combinations) to consider public financing sources and more sophisticated financing structures in the future. In fact, the small number of retail investment opportunities in craft beer now feels like a void that won't remain unfilled for long, rather than a resource ill-suited for the industry.

Finally, while perhaps not primarily "liquidity" transactions, it bears mentioning the following two acquisitions of brewing locations between craft breweries:

Facility Transactions

Seller	Buyer	Date
Beach City Brewery	Beachwood Brewing	March 2016
Cismontane Brewing Company	Laguna Beach Beer Co.	October 2016

In connection with the closing of Beach City Brewery in Huntington Beach, CA, Beachwood Brewing acquired Beach City's brewing location. This transaction allowed Beachwood Brewing to more quickly increase its existing brewing production. In October 2016, Laguna Beach Ales & Lagers announced an acquisition of the Rancho Santa Margarita location of Cismontane Brewing, including its original brewery and tasting room. This transaction will give Laguna Beach Beer Co. its first tasting room, while helping Cismontane transition to its larger Santa Ana production facility and tasting room (already open) and its prospective distillery project.

These transactions likely do not make up the full list of brewery-to-brewery facility acquisitions, as some occur from time to time with little-to-no publicity; however,

⁴ Boston Beer Co. and the Craft Brew Alliance each conducted registered offerings on Form S-1 in 1995. Note that multiple registration statements on Form S-8 were filed since then, which register shares issuable pursuant to incentive plans, and at least one on Form S-4, registering shares related to an acquisition. I have excluded these registrations because they are not "investment" oriented.

the acquisitions by Beachwood Brewing and Laguna Beach Beer Co. exemplify the benefits of facility asset acquisitions for breweries at various stages of growth. I believe these transactions will become more frequent as growth tempers across the industry, founders of certain smaller, more recent upstarts look to exit and others with expanding distribution footprints look for quick ways to add supply. Another local brewer is often the best buyer for a small brewery since, when available, a facility acquisition offers a quicker route to begin production than new construction or acquiring equipment piece-by-piece on the secondary market.

In summary, the craft beer industry continues to evolve beneath our feet. The recent period produced significant investments by large strategic investors in craft beer, although I don't expect AB InBev and MillerCoors to continue their recent acquisition pace indefinitely. The trends over that last fourteen months suggest that, when their activity levels off, it will be replaced by acquisitions by other large foreign breweries, large craft breweries and regional breweries funded with private equity and other investment fund capital.

November 2016

Kyle Leingang is a corporate attorney in the Southern California office of Dorsey & Whitney LLP. Kyle's law practice focuses on representing craft breweries and investors in M&A and financing transactions, including ESOPs, and is a frequent speaker at craft beer industry events. Kyle is also a certified BJCP judge and an avid homebrewer. Kyle can be reached at leingang.kyle@dorsey.com.

Disclosure Note: *Kyle represented various parties in certain of the transactions described in this article; however, to preserve confidentiality, the facts disclosed about all transactions are limited to information previously publicized as of the date hereof.*