

Q&A, Mario Zepponi on the Outlook for Mergers & Acquisitions

More Transactions Expected This Year

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Five major transactions involving California wineries were announced or completed so far in 2021. In January, E & J Gallo closed on its big transaction with Constellation Brands. More recent announcements include pending sales of St. Michelle Wine Estates to Sycamore Partners; and Francis Ford Coppola to Delicato. Earlier this year, Duckhorn Vineyards and Vintage Wine Estates went public. We discuss the M&A outlook with Mario Zepponi of Zepponi & Company, an M&A firm specializing in the wine industry. Excerpts follow.

WBM: We have some recent deals that are big. What's the state of mergers and acquisitions in the wine sector now?

What's happening is a reflection of the markets. Transactions went dry last year in Q2, Q3 and Q4, as a result of the pandemic. It was lazy start to Q1 and Q2 but as vaccinations rolled out, we see people returning to a more regular stream of commerce. As a result, you're going to see more M&A activity. Not every deal is going to be like the (\$1.2 billion) Ste. Michelle deal, but you are going to see bigger strategic wineries looking to go ahead and become more relevant with retailers and wholesalers through acquisitions. They're going to be doing things to position themselves - as long as it doesn't cannibalize existing brands - to add high growth brands that have nice niches in their existing portfolios.

WBM: People will be bolting on brands?

Yes. The only thing missing right now from the market, and it's going to maybe take a few more months, is the return of the Europeans to the transaction table. It's because travel has been hampered. The French have been the most active of the foreign investors but it's pretty difficult for them to do anything when they can't travel here.

WBM: What's your take on Vintage Wine Estates and Duckhorn Going Public?

The Vintage Wine Estates and Duckhorn transactions are good for the industry. They're not one winery buying another winery, where it's more consolidation. These are wineries that are forging their own pathway and exposing the wine industry to public markets. There's a lot of cynicism in the current conversation when it comes to wineries and public markets - that they're not a good match - but what we see here with two new entrants is giving everybody new promise and provides liquidity for the industry. In the case of Duckhorn, a highly successful company, the valuation premiums they're showing are good for the industry. It may lead to a copycat mentality with other wineries that are positioned to go ahead and do what Duckhorn did. In the Vintage Wine Estates situation, you've got (chief executive) Pat Roney building a nice portfolio of brands quite differently than Duckhorn. He is looking to grow and went public to grow even more.

To pivot to the other two big acquisitions, there's Delicato. To me it's a clear signal that they took a plunge into a commitment to say, 'We're here to stay, we're going to grow and we know we have to grow.' That's a big step and makes sense because their target in Coppola is culturally a fit. They had a gap in their portfolio. This is pushing Delicato in a direction they know they need to go.

Then there's Ste. Michelle. Honestly, that was past due. I think Altria was satisfied with it as long as it was performing. When they hit missteps three to five years ago, they were the subject of rumors of selling. The fact that it is selling to private equity is a good thing because Ste. Michelle is remaining independent. In the wine industry, nothing is a quick fix. The good news is they've got a plethora of assets to work from. They've got very good executive management at the Ste. Michelle level.

WBM: Did Vintage Wine Estates and Duckhorn go public because they were too big to buy?

In my opinion, yes.

WBM: Would Sycamore want to take Ste. Michelle public like Duckhorn?

When you get to the point where Sycamore holds it and repositions the portfolio, however many years that takes, it puts the Ste. Michelle portfolio in the position where there are a lot of different options: you can take it public or merge it with another large portfolio and take that public, etc.

WBM: What's next?

More brands are going to trade. You're going to see some luxury brands trade and some mid-tier players, trade. This is also an opportunity for some of the larger wine companies to divest non-core brands. One thing that has not changed in the industry is that it continues to get harder to sell wine, not easier. As a result, there's going to be pressure for wine companies to review their portfolios to see the winners and maybe trim the losers or look at off spinning off what they can't focus on. Sometimes it's just a matter of focus. A lot of companies can focus on five brands or eight brands that really drive profitability.

The 80-20 rule is 20 percent (of a business) makes up 80 percent of profitability. Well, of the other 80 percent, what do you keep? Sometimes there are gems that have been neglected. I always hope there'll be new entrants that'll take an opportunity to go ahead and pick up non-core brands and invest and re-energize those brands. There will be an opportunity to do so. That comes down to management.

WBM: How about the vineyard side? Some companies are asset light versus asset heavy and it goes in cycles. What do people want to do?

The vineyard side is interesting because going into 2020, it was tough. In California, we were in an oversupply, particularly in the Central Coast. Then in Oregon, relatively speaking, it was more or less balanced. In Washington, it was way out of balance.

Fast forward to the pandemic and the fires and it helped absorb excess wine inventory and finished goods, and highlighted the need for more grapes. It hasn't totally corrected the landscape. In Oregon, you've got anywhere from under-supplied to a balanced market; In California, depending on the pocket, it's more in balance but not entirely in balance. In Washington, they're still in an oversupply, just because Ste. Michelle accounts for two-thirds of the Washington wine industry and until they are completely healthy, it will be a drag on vineyard markets and for growers.

WBM: M&A activity is going to pick up the rest of this year but the vineyard side not so much?

The vineyard side will be slow and steady. We are approaching harvest. Usually the vineyard side picks up after harvest. I think it's going to take everybody reassessing their sourcing needs - then we'll see a pickup. I don't want to lead you to believe that the vineyard market is dead. It's not. There's just a lot of selectivity to what's being sold.

I don't want to be Dr. Doom, but with these fires, I don't think anybody expects the fire anxiety to go away but we all hope it goes away. In the wine business, you have to have wine to sell and if we go through another vintage or two like we did in 2020, and don't have a wine sell, at what point is it going to put pressure on wineries to diversify their geographic risk? Are you going to see North Coast wineries investing in the Central Coast or in Washington? There's already been investment in Oregon but that might happen too. It's not that other regions are immune from fires: It's just that if you at least have some diversity, chances are if you have a tough harvest in one region, you may at least have the benefit of a better harvest in another region. That story will slowly unfold.

WBM: Some wineries can't get any fire insurance at any price. If you can't get fire insurance, can you sell your winery?

It's challenging to get it. You can sell your winery. A lot of these companies that are large, diversified companies can fit coverage under their portfolio but if you're a stand-alone or a small winery owner, it's pretty challenging. WBM

Editor's Note: Wine Business Monthly (WBM) will host its annual [Wine Industry Financial Symposium](#) as a two-day event this fall. The Wine Industry Financial Symposium, the premier event covering the financial, business and strategic issues of the wine industry is set for Tuesday, Nov. 9 and Wednesday, Nov. 10, 2021 at the CIA at Copia in Napa, California.