



TOPIC: STRATEGY & FINANCE

HOW TO VALUE YOUR CRAFT BREWING COMPANY

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The following article provides an overview of the basis of valuation and the approaches that would be considered in a craft brewery valuation. This discussion is followed by a review of valuation multiples seen in the craft brewing industry in the United States and Canada.

Basis of Valuation

A basis of valuation is an assumption regarding a set of very likely transactional circumstances that may be applicable to the subject valuation and typically involves either a **going concern** or a **liquidation assumption**.

If the entity is likely to continue operating in its current form, with the potential for an economic level of earnings, it is valued as a going concern. In this situation, three generally accepted approaches to determining fair market value are considered:

1. The Income Approach

2. The Market Approach

3. The Asset Approach

If the entity is likely to cease operating – either because it is not viable, or the return on the assets from operating the business is not adequate – it is valued in liquidation. Fair market value in liquidation is the net realizable value on an orderly disposition of assets made in a manner that minimizes the loss and/or taxes thereon.

Many start-up craft breweries have been unable to generate enough revenue to earn a profit from their operations. This has occurred for a variety of reasons, including:

- A high level of brand proliferation in the craft brewing space has made it difficult for companies to secure retail shelf space or tap lines for their products in the face of overwhelming competition.
- Many new entrants do not have the working capital to absorb the losses that normally occur in the first two to three years of operations. Thus, they find it difficult to invest enough in sales and marketing to generate an adequate sales volume.

Consequently, these struggling craft breweries are constantly looking for new equity capital to shore up their finances. They are seeking fresh capital to service their debt, pay their suppliers, meet their payroll and stay afloat in the hopes that something will change.

In these circumstances, an equity financing transaction is often based on net asset value and will usually require some sort of turn-around plan. If the brewery is unable to turn things around, the valuation is typically no more than the expected value in liquidation.

Going Concern Valuation Approaches

INCOME APPROACH

The Income Approach is a prospective valuation approach that involves quantifying the present value of future economic benefits associated with ownership of the business using a rate of return that is appropriate for the risks associated with realizing those benefits.

The Income Approach is commonly used to value companies that generate income available for distribution to shareholders. Common valuation methods within this approach include the Discounted Cash Flow and Capitalized Cash Flow Methods.

The Discounted Cash Flow Method is preferred in situations where the business has not yet stabilized, and reliable long-term financial forecasts are not yet available. The difficulty with this approach relates to the complexity associated with developing such forecasts.

The Capitalized Cash Flow Method is preferred where the business has matured, and operating results have stabilized enough that it is possible to estimate a single level of maintainable discretionary after-tax cash flows that may be capitalized into perpetuity to produce a present value sum.

MARKET APPROACH

The Market Approach measures the value of a business based on prices set by market participants in actual transactions that have taken place in the open market. This assumes the transaction prices reflect their collective expectations about the prospective future economic benefits and risks associated with ownership.

The Market Approach involves reviewing actual transactions involving businesses that are considered comparable to the subject company in the relevant respects, such as size, geographic market coverage, risk and growth potential.

The observed market transactions are usually expressed as some form of valuation ratio or multiple such as Enterprise Value (EV) / EBITDA, EV/revenue or EV/book value. The dominant valuation multiple used in the brewing industry is EV / EBITDA.

Guideline Public Company Method

The Guideline Public Company Method considers the trading multiples of public company stocks. At December 31st, 2023, large brewers were trading at approximately 8.5x EBITDA (Molson Coors) to 11.1x EBITDA (Anheuser-Busch InBev) and 12.6x (Heineken N.V).

Craft brewers are trading at higher multiples due to higher anticipated growth and a stronger resonance with younger generations. For example, the Boston Beer Company was trading at 17.1x EBITDA as of December 31st, 2023.

However, given their higher profitability (from economies of scale), greater depth of professional management and access to capital markets to fund expansion opportunities, it is frequently considered inappropriate to use public company multiples to value smaller privately held breweries^[1]. At a minimum, the observed trading multiples would need to be adjusted to reflect differences between the subject company and the guideline public companies.

Comparable Transaction Method

The Comparable Transaction Method considers the transaction multiples reflected in private company acquisitions.

There is often difficulty, however, in finding relevant transactions involving comparable companies as no two companies are identical. Furthermore, access to private company transaction data may be limited as details are not usually publicly disclosed.

For example, in a recent summary of 48 brewery industry transactions, only one transaction included valuation metrics (Russell Breweries, which had an EV / EBITDA multiple of 7.6x).

When a public company is taken private in an acquisition transaction, there is frequently a lot of data available on the transaction metrics. For example, on December 14, 2022, Waterloo Brewing Ltd. (TSX: WBR) announced that it had entered into a definitive agreement with Carlsberg Group (CPSE: CARL A, CARL B) pursuant to which Carlsberg agreed to acquire all of the issued and outstanding shares of Waterloo. Under the terms of the transaction Waterloo shareholders received C\$4.00 in cash for each Waterloo share held, which implies an aggregate equity value for Waterloo of ~C\$144 million, and an enterprise value of ~C\$217 million, implying an EBITDA multiple of 12.4x.

Craft Beer Valuation Multiples^[2]

In the current market^[3], EV/EBITDA multiples for privately held brewing companies generally fall into three main categories depending on their size, risk profile, profitability^[4] and growth potential:

3.0x to 5.0x

- Less than \$1,000,000 of EBITDA (mostly from on-site tap room and restaurant sales)
- Local brands (not well known, not a big retail presence)
- Limited growth potential
- Operated as a family business (not professional managers) and higher risk (earnings variability)
- Limited pool of buyers (other entrepreneurs)

6.0x to 10.0x

- EBITDA of \$1.0 to \$2.0 million
- Strong retail presence and brand recognition (but limited to one State or Province)
- Good potential for growth (10% or more per year)
- Professionally run business with good management and reporting systems
- Attractive to a wider pool of buyers (private equity and possibly strategic buyers)

10.0x to 15.0x

- EBITDA > \$2.0 million to \$10.0 million
- Strong double-digit growth over the past several years
- Well known brands that have growth potential in multiple regions
- Professionally run, with access to capital for expansion
- Strong innovation
- Very attractive targets for publicly traded and strategic buyers, as well as private equity

Other Factors Affecting transaction Multiples

Other factors that tend to affect the transaction multiple include:

- Negotiating strengths of the buyer versus the seller
- Level of motivation to complete the transaction
- Any non-cash consideration or earn-out component included in the price
- The buyer's willingness to pay a Special Purchaser premium, as described below

In some instances, there are buyers who believe they can enjoy post-acquisition economies of scale, synergies or strategic advantages, by combining the acquired business of a target company with their own. These buyers are known as Special Purchasers and typically include strategic industry buyers. They are often willing to pay a premium over financial buyers (i.e. private equity investors) because they can take advantage of excess capacity or leverage other existing assets, such as a distribution network, that result in higher expected future earnings relative to a financial buyer.

Several acquisitions completed by Anheuser-Busch InBev SA/NV (ABI) provide a good example of this scenario:

| Date | Target Acquired |
|-------------|---------------------------------|
| Nov 2014 | 10 Barrel Brewing Company |
| Jan 2015 | Elysian Brewing Company |
| Sep 2015 | Golden Road Brewing |
| Apr 2016 | Devils Backbone Brewing Company |
| May 2017 | Wicked Weed Brewing |

In summary, there is no single EBITDA multiple applicable to a craft brewing company. Like any other acquisition, the applicable valuation multiple will depend on numerous factors including size, profitability, risk profile, growth potential and the ability to attract a strategic buyer.

[1]In addition to these advantages, investments in public companies are more liquid than investments in private companies. All other things being equal, the illiquidity of private company investments often results in a discounted valuation multiple relative to their publicly traded counterparts.

[2]The multiples provided below reflect Enterprise Value as a multiple of latest twelve-month normalized EBITDA.

[3]It should be noted that market multiples tend to change over time due to several factors, including investor sentiment towards a particular industry.

[4]Profitability refers to both the amount and the rate of profitability. Firms with a higher EBITDA margin are generally more attractive.

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