Consolidation's Brutal Questions

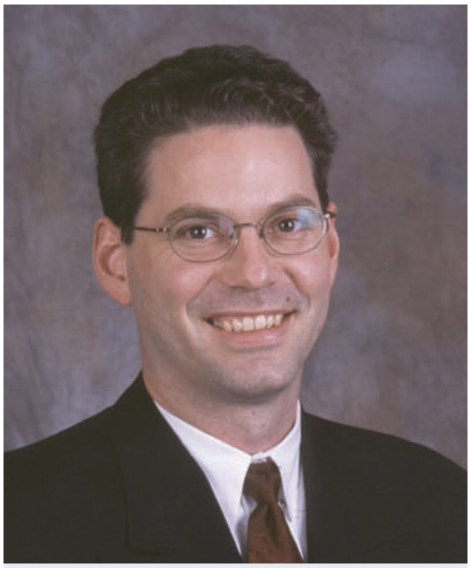
by Tim Coughlin, President, DMG Financial

DMG Financial

DMG Financial has advocated consolidation for years. Historically ideas held by DMG Financial and other consolidation advocates were treated with great skepticism. DMGF was often told our costs savings expectations were unrealistic and shared houses would hurt brand execution. *You can't take that many people off the street and out of the warehouse. It will destroy customer service. You can't have the same guy selling Coors Light and Miller Lite. It will kill the brands.* Do you remember those days? They may be long gone but they were not long ago.

Individuals who formerly rejected DMGF's consolidation assumptions are some of the ones setting the blistering pace of consolidation. They now see vast oceans of cost savings and they have come to believe in the power of increased critical mass. They envision cost savings and improved scale driving brand growth. And most amazingly, they devised a plan with salesmen selling two important and directly competitive products (*oh yeah, that's right, they're complimentary now*) at the same time *(it's a beverage distribution technology once held exclusively by wine and spirits distributors).*

Consolidation is no longer a *possible* option for beer distributors. For most distributors it is now an economic imperative and for a shocking number, it appears to have become a supplier mandate. Confronting consolidation can no longer be deferred. As I composed this article for MBA's print relaunch, MillerCoors issued its new distribution agreement and consolidation switched from something that was 'suggested' and



Tim Coughlin *is the president of DMG Financial of Littleton, CO. He can be reached at tcoughlin@dmgfinancial.com.*

'desired' to something that will, where possible, be imposed. The clarity of this transformation was delivered abruptly.

Owners are now face-to-face with consolidation's brutal questions.

Is consolidation essential to our Company's survival

DMG Financial believes for most wholesalers the answer to this question is a decided yes. DMGF expects few distributors will be able to survive without tapping into the efficiencies of consolidation. The efficiencies of consolidation will be an essential part of managing earnings because volume growth and pricing trends simply aren't going to be enough to offset expense increases in today's cost environment. For many distributors keeping a lid on expense growth will require the economics of consolidation.

What does your Company's future look like without consolidation? What are the best and worst case scenarios for the Company's top line? How much lift can come from market volume growth, share gains, price increases and mix shift? How rapidly are costs going to rise? Does a future without consolidation mean a future of stagnate or declining earnings? Without consolidation can the company make the personnel and capital investments essential to competitiveness?

For most operations the answers to these questions collectively affirm what most distributors know and feel, *we've got to get into the consolidation game or we're not going to make it long term.*

What are our Company's Consolidation Options?

It seems now that for a great many distributors the only available option is an exit at the highest price possible because the supplier isn't offering anything else. Well, as the old saying goes, *things are not always what they seem.* If you're highly reluctant to sell your family business, then explore your options. And don't explore your options alone. Get quality professional advice. Sure powerhouse lawyers are expensive but this isn't the place to seek cost savings. You want the best team of advisors available. You don't want to find out someone like you just won the case you lost. If you want to stay in the game, look for a way to make it happen. In the past, *black sheep* have become *golden boys* have they not?

That said, don't make a horrendous financial decision because you can't bring yourself to contemplate leaving this industry. Do the math on a financially attractive and relatively painless exit. Don't stay in the business if someone is offering a pile of cash you could never match by staying in the business.

Questions related to supplier desires and legal possibilities are not the only tough consolidation questions owners must answer. Once you've accepted consolidation is an imperative, then you have to answer who, where and what are our acquisition opportunities. The list of realistic consolidation opportunities is quite short for most distributors. For most companies, there are not that many acquisition scenarios that offer compelling economics. You've got to focus on that short list because those are the deals which you can afford to bid competitively. If stepping up is what you have to do to get the deal that truly works for you financially, then do it.

Can we really afford today's prices?

Well let's say you're in the acquisition game. It's all tilting your way. The suppliers have blessed you. You've got the competitive economics. You still have to answer several multi-million dollar questions.

What amount is it going to take to create a willing seller? Is such an amount really affordable? Can we borrow that much? If we borrow that much do we have the equity to survive some tough years? If the answers to these questions are NOs, then you are probably someone who has to give the GO proposition some serious examination. If you're saying yes to all these questions, then get aggressive and get it done.

Don't be afraid of an acquisition just because it seems to carry high per case or gross profit multiples. Give these multiples consideration but if the deal cash flows under realistic assumptions with a good margin of safety, pay the amount it takes to make that person or persons say yes to leaving this wonderful industry.

DMGF agrees with others who say things like *prices have never been higher*. However, we differ with those who use the term *value bubble*. To me, "value bubble" implies over valuation. It suggests prices being paid are unwarranted and not economically justifiable. Bottom line, ever since I entered this industry I've felt prices at current levels could be justified for the right business combinations.

The economics of consolidation are real. Consolidation produces efficiencies and substantial costs can come out of the system. In the past many distributors and suppliers were skeptical of the expense saving and sales synergies suggested by consolidation advocates like DMGF. This is no longer the case. Rest assured, when the breweries go fishing for their billions in savings beer's middle tier will be seen as part of that vast blue ocean of synergies.

If the combination produces the right synergies, a consolidator can pay a big premium and still realize a huge return on equity. But if you don't have the economics and the equity, don't compete on price with those who do. Odds are you'll lose your equity.

Is ownership and management ready to be a consolidator?

When you step up to today's prices, you don't have room for delayed integration. If you pull the trigger and write the check for the acquisition, then you have to flip the switch on the organization the first day of operations

Flipping the organizational switch triggers brutal personnel questions. Larger organizations have larger spans of control and require increased sophistication. Management and the rest of the organization have to be up to the task. The costs have to go and that means total head count is coming down. You won't be able to keep all of the hard working loyal employees the two organizations currently have on the street and in the warehouse. Duplicative management positions will have to go. And you'll need to do this for reasons beyond cost cutting. You need to make hard choices like this to ensure you have a healthy organization. You can't have a dysfunctional organization with confused roles and responsibilities and built-in inefficiencies.

Assess the new organization's needs and select the best people for the job based on their individual talents. Then comes the brutal task of letting good employees go. Getting outside advice and/or assistance can be helpful. You want to avoid legal missteps and be as fair, objective and consistent as possible.

Is selling the family business the right thing to do?

This question has always been the toughest. There have been rough times before but in the end, the family's beer distributorship has been as source of income for generations. The business has always or almost always had positive cash flow. Over the long run it's grown and it has been a solid business through good and bad economic times. These historical facts drive one to ask, why would anyone want to liquidate their ownership in such a business?

Well, one argument is that maximizing shareholder value means exiting the beer business. Ultimately that was the call Anheuser-Busch's board's made when InBev put $70 per share on the table. Thing is, it was a call that was subjected to Wall Street's impatient equity, more than it was a call mandated by an outrageously high purchase price. It wasn't a particularly high consumer goods multiple and I've seen higher multiples at the distributor level.

Maximizing shareholder value is a choice based on future expectations and as such, it's an inherently uncertain decision that is only proven right or wrong over time. That makes deciding to sell a business that has survived for generations difficult and if there are some owners that believe perpetuating the family business over time is more important than maximizing shareholder value now, the difficulty of the decision is compounded.

Whether or not selling the business is the right choice is a tough call. It has to be ownership's call. Lawyers, tax experts and valuators can provide valuable perspective but not the decision. In the end, none of us really knows what the future holds and you know your business best. Often the challenge for ownership is keeping emotional attachment from impairing objectivity and realism.

When is enough enough?

When is the offer too big to turn down? When is there enough downside risk in the business and tax changes to make selling now the right decision? When does the diminishment in your control over your own business cause you to seek a different occupation? When do you have enough facts and law on your side to stay in the business? When are the costs and risks of litigation or arbitration *(it's litigation lite and like Olestra, it's good for you)* enough to make taking the money and leaving the right decision? If these kinds of questions could be answered with precision and confidence they would be a little less brutal.

Professional advisors cannot tell you what is enough for you and your distributorship. They can provide you expert analyses, an objective perspective and offer their opinions but ultimately it has to be ownership's call.

If we do exit, then what?

Honestly for most owners this question isn't that rough. They're very talented and have lots of options. It's just that this industry is tough to match. Tim Arnold nailed it in an August 11th Ad Age article when he said, "*Then I got to go to heaven without have to die first: I landed in the beer business.*" I could totally empathize. And that's not my strong suit. Ask my wife.

Finding a business opportunity as financially compelling as a beer distributorship has always been a tall order. You don't even have to factor in the fun to make it a difficult proposition. What's made answering this question more complicated is the current economy. It's hard to cash out of the beer business when its economic resilience is being vindicated and prestige banks are writing off billions and seeking capital from sovereign funds.

Conclusion

Consolidation has always forced hard questions. Should I stay in or should I get out? Should I take on that much debt? Is it right to sell the family business? What is the right price? These aren't new questions and they have never been easy, but now they are more immediate and difficult. If you can't face down consolidation's brutal questions and decidedly respond, *yes our company is ready willing and able to be a consolidator,* then you need to take a good hard look at how attractive today's exit window is. DMG Financial does not believe current prices are reflective of over-valuation, but today's prices won't last forever and they won't be as financial compelling if taxes are increased. The buyer pool is shrinking and as it does the exit window closes. An election is approaching and it would seem there is a better than even chance taxes are going up.

Tim Coughlin is President of DMG Financial. DMG Financial is a nationally recognized financial consulting firm specializing in the beverage distribution industry. The company's primary service offerings are business valuations and M & A services. Mr. Coughlin has two decades of professional experience in the areas of business valuations, financial analysis, organizational planning and litigation support. He can be reached at tcoughlin@dmgfinancial.com