

Nov 06

## BUSINESS ACQUISITIONS

### OVER THE ODDS?

**Brown-Forman shelled out a substantial sum for Herradura tequila. Stuart Whitwell considers the reasons why the company paid a premium**

BROWN-FORMAN appears to have paid a super premium for its recent acquisition of the tequila brands of Herradura and El Jimador. The most likely rationale for such a hefty price tag – US\$876m – is the cost of having to get into a “must-be-in” growth category.

Throughout the years we have seen similar strategies being employed by large drinks groups, who were desperate to get hold of a significant brand in a key category. For example, Seagram’s acquisition of Martell Cognac was priced at over 30 times earnings and Allied Domecq’s acquisition of Beefeater from Whitbread in the early 1990s was at a similar premium. Neither deal lived up to its promise and effectively diluted shareholder value.

So how about Herradura and El Jimador? El Jimador, with approximately 1.3 million cases has not grown sales over the last five years, and the same goes for Herradura. The tequila brand’s sales of approximately 300,000 cases have remained static over the last five years. Both brands hardly penetrate the key US market, selling around 200,000 cases between them.

When you compare this to the market leaders Jose Cuervo and Sauza, which sell 5.2m and 3.0m cases respectively with dominant positions in all key international markets and approximately half of their volumes coming from the highly valuable US market, Herradura and El Jimador look relatively inconsequential.



The motivation for Brown-Forman has to be the belief that they can really make a move with these brands in the US market, this is the only way they are going to generate a financial return. They also realise that not having a credible tequila brand in the portfolio severely disadvantages them against the likes of Beam Global Spirits & Wine, Diageo and Pernod Ricard, which dominate the US spirits market.

The addition of Herradura and El Jimador gives Brown-Forman access to the fastest growing spirits category in both the US and Mexico.

The US and Mexico account for 86% of the global tequila market, with 46% and 40% respectively, meaning Brown-Forman has a significant opportunity in the US where both brands have a relatively unsubstantial presence. While tequila volume may have

experienced growth over recent years, value growth has been largely stagnant. Herradura is positioned as a super-premium brand and El Jimador at the premium level. Both have significant heritage and enjoy nearly 100% awareness in Mexico.

Authentic Mexican brands with a strong heritage give Brown-Forman the opportunity to compete against the dominant Jose Cuervo and Sauza by targeting the growing Mexican and Hispanic population in the US as well as the affluent cocktail-culture market. The brands will also support Brown-Forman’s existing portfolio as well as benefiting from the portfolio to secure the all-important distribution needed to stand a chance of getting a return on the company’s investment.

Brown-Forman will have to spend

heavily and deal with the backlash of competitive forces in its home market from more powerful adversaries in Diageo and Beam Global. This is going to be tough and may be a stretch too far.

Another consideration from a tequila perspective across the whole category is dealing with the agave over-supply problem. This requires ensuring long term essential tequila supply is maintained in a market where growers are not making a return that enables them to generate a living. This is a very serious issue for the tequila business and the Mexican economy as a whole. Brown-Forman is now involved with this issue as are the rest of the players in the market.

If you look at the deal Fortune and Beam Global did to take out some of Allied Domecq’s brands which included Sauza, Courvoisier, Maker’s Mark, Canadian Club, Laphroaig, Teacher’s, Harveys, Cockburn’s, Fundador, and a number of significant regional brands in Spain and Germany for US\$5 bn. The Brown-Forman deal really does look expensive, but it is likely that the company felt it had little choice as there are very few really high quality assets available in the sector and money at present is relatively cheap.

So what next on the acquisition trail? Everybody sees V&S Vin & Spirit of Absolut fame, Cruzan rum and Plymouth gin, as a really obvious one for the future if the business is de-nationalised. Another one has to be Rémy Cointreau for my money and I think they will go first. Let’s just hope potential buyers’ spirits aren’t dampened after seeing the generous payment Casa Herradura managed to squeeze out of Brown-Forman.

*Stuart Whitwell is joint managing director of Intangible Business*