TheStreet

Liquor Sector to See More Consolidation in 2018

The Patrón and Avión tequila purchases likely will not be the last deals this year for producers of tequila, whiskey and gin.

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By Cathaleen Chen

So much for dry January.

So far this year, there have been two major deals in the spirits industry: Bacardi Ltd.'s acquisition of Patrón Spirits International AG, and Pernod Ricard SA's purchase of the remainder of Avión Spirits LLC, both hip hop-approved tequila brands.

Thanks to heightened consumer demand and the fragmentation of liquor brands now offered on the market, the industry can expect to see even more mergers ahead, industry sources said, especially among whiskey, tequila and gin producers.

"Being acquired by a major player is the dream for people who build these smaller brands," said Ken Austin, founder of Avión. "Typically, what happens for them is they get to second base, and to bring it home, they try to get acquired."

Part of the obstacle to scaling up for growing brands is the issue of distribution, as U.S. regulatory measures largely prohibit direct-to-consumer outreach from distillers. Instead, in a three-tier system, wineries and distilleries must go through distributors, or wholesalers, to reach retailers -- stores, bars and so on -- which only then access the consumer.

"It's a really challenging space for smaller brands to build architecture because there are so many channels of distribution you must populate," said Derek Benham, founder of Graton Distilling Co. as well as multiple wine brands. Graton, based in namesake Graton, Calif., produces D. George Benham's Sonoma Dry Gin, Redwood Empire American Whiskey and D. George Benham's Vodka Vodka, the latter not a typo but a "vodka-flavored vodka."

"Each of these distribution channels requires a different type of investment and expertise, and it's always a battle because when you get to this second tier, you're battling the huge brands with [deep pockets] for market share," he said. The solution, then, is to be acquired by a large player, such as Pernod or Constellation Brands Inc. (**STZ**) .

The spirits industry, across the board, is in a sweet spot, and the stock charts say it all. Jack Daniel's, Herradura and Finlandia producer Brown-Forman Corp. (**BF.B**) , for instance, has seen shares skyrocket more than 52% in the past year. Stock in Constellation, home of Casa Noble tequila and High West whiskey, not to mention Corona, Modelo and Pacifico beer, is up more than 46%, and shares in Pernod (Jameson whiskey, Beefeater gin, Absolut vodka) have jumped more than 16%.

The reason for investors' love of spirits producers is that alcohol consumption in the U.S. is higher than ever. According to an August study published in medical journal JAMA Psychiatry, alcohol use rose from 65% of the adult population to 73% in a 12-month period.

Not every drinker, of course, toasts with the same drink -- and the strongest consumer segment, according to Austin, is millennials.

"The younger consumers are looking for better products. They want to know the story behind a brand, they want to understand the taste profiles, and they don't want alcohol with artificial ingredients," he said. That's why, he added, small, local distilleries are on the rise.

According to bar analytics firm BevSpot Inc., the three most ordered spirits are whiskey, vodka and tequila. Whiskey and tequila in particular are seeing a number of deals, said Jim Cassel, co-founder of investment banking firm Cassel Salpeter & Co., but gin is the up-and-comer.

"One space that hasn't seen a lot of M&A is gin, but there are a lot of smaller gin brands out there now," he said, pointing to The Botanist, made by Scotland's Bruichladdich Distillery Co. Ltd., as an example of a brand that's gaining traction. Bruichladdich, however, is owned by Rémy Cointreau Group, the French entity behind Rémy Martin cognac and Cointreau liqueur.

As for future acquisition targets, Benham pointed to the Michter's whiskey brand of Louisville, Ky., and Sonoma, Calif.'s 3 Badge Beverage Corp., which produces a range of spirits and wines, as two of the few distilleries that remain private.

"We are a dwindling species!" he said. "The ones that haven't been bought are tiny companies."

As for his own company, Benham said, "If something comes along that's a generous offer that makes sense, as a businessman I'll look at it." (He previously sold the Mark West wine brand to Constellation in July 2012 for $159.3 million and the Blackstone and Codera brands in October 2001 to a Constellation joint venture for $138.1 million.)

There also could be larger consolidation deals down the line, such as Constellation swallowing Brown-Forman, Benham added. Other smaller liquor companies that remain private include Jose Cuervo, Bushmills and Hangar 1 maker Proximo Spirits Inc. and Heaven Hill Distilleries Inc., producer of Evan Williams bourbon and Christian Brothers brandy.

But there is another elephant in the room: Tito's Handmade Vodka, the Austin, Texas, distillery that makes what was recently billed as the world's fastest-growing vodka. Founded 20 years ago, Tito's went from producing 150,000 cases in 2006 to 2.78 million in 2015, according to Impact Databank. Between 2016 and 2017, Tito's sales grew 44% to nearly $190 million, becoming the top-selling spirits brand in the U.S., Wine & Spirits Daily reported last October.

The company has remained private under founder and sole owner Bert "Tito" Beveridge.

"I'm sure the guy gets calls multiple times a week. It's grown almost logarithmically," Benham said. "But what I've heard is that he's just not willing to sell."

Tito's could not immediately be reached for comment.