

Opinion: The most important part of any craft beer M&A deal: Keep it local

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Craft beer is a community endeavor. The story of the failed purchase of Ballast Point is a prime example



New York-based Constellation Brands had bought San Diego's Ballast Point for \$1 billion but later sold it at a loss as beer fans balked at drinking the conglomerate's brew. Getty Images

The connection that craft breweries have with local communities is an impressive aspect of their rise as an industry. The fact that communities are fighting to preserve them during the coronavirus outbreak attests to that.

That loyalty had driven an uptick in mergers and acquisitions (M&A) activity in the sector, and if the coronavirus' economic drag remains a short-term phenomenon, expect more deals.

But consumer loyalty will be an important part of any comeback, and all parties need to remember that. Ballast Point is a cautionary tale.

The San Diego-based brewery, renowned for its citrus-infused IPAs, imperial porters and American sours, had the kind of loyal following among young beer aficionados that allowed it to charge a previously unheard of \$15 for a six-pack.

It was preparing to go public in 2015 when Constellation Brands US:STZ, a New York-based alcoholic-drinks giant, swooped in and bought it for \$1 billion, expensive but not too surprising given Ballast Point's growth and perceived profitability.

Reversal of fortune

Just four years later, Constellation effectively dumped it, selling Ballast Point to a tiny Illinois brewery for an undisclosed sum that was undoubtedly less than \$1 billion.

What happened? Ballast Point's national sales went into free fall, dropping more than 50% from its 2016 peak of 431,000 barrels. It turned out that Ballast Point's prestige and "cool factor" had been based on its identity as a local brewery.

Once it was in the hands of a \$30 billion New York corporate giant, consumers appeared to switch to other craft brews that still had that local authenticity. And there is no shortage of those.

The lesson for investors and brewers alike is that it's not enough to have great tasting, popular brews; maintaining that local flavor is critical to a strong brand identity that can endure any buyout activity.

Thirst for craft beer is growing

The pre-COVID-19 context is that the \$28 billion craft beer segment has been growing at an annual rate of over 10% because Americans have for years been spending more on their beer while drinking less of it.

The country's more than 7,500 independent craft breweries have produced the quality and variety that consumers want and compelling brand narratives that resonate with consumers who favor local producers over distant corporations.

Against that backdrop, once the coronavirus scare abates and federal stimulus kicks in, the name of the game for bigger breweries will continue to be a "buy and build" strategy using any cash stockpiles and stock to snap up fast-growing craft brewers.

M&A activity in the beer sector has been strong, picking up in early 2019 after a brief slowdown. Breweries hoping to benefit from this interest need to keep their eye on competition and evolving tastes.

Ballast Point's products weren't so unique that competitors weren't able to make their own citrus-infused IPAs and other artisanal beers at more affordable price points.

The recent trend toward "hard seltzers" underlines how the beer industry is continuously innovating with new subcategories and flavors that can eclipse previously popular styles. (Remember the *ice* and *dry* beer trends from the 90s?)

Key factors to watch

For beverage companies and investors interested in pursuing acquisitions, they need to do their due diligence to really understand how loyal the target's consumers are and how defensible those products are from copycats.

Given the power of the "locavore" movement, acquirers also need to do everything possible to retain the brand's local authenticity in the eyes of its consumers, making sure that it hires locally and is actively involved in its local community.

Recent big transactions have valued the importance of long-tenured brand loyalty. In May 2019, Boston Beer Co. US:SAM paid \$300 million for Dogfish Head, an example of an established, much loved 25-year-old brewer that is unlikely to be undermined by newcomers.

In November, a subsidiary of Japanese giant Kirin announced it would acquire Colorado's New Belgium Brewing and its signature Fat Tire brand. Founded in 1988, New Belgium has long stood at the forefront of the craft brewing boom with a deep local connection.

As for Ballast Point, its story isn't over yet. It's been re-designated as a craft brew under its new owners, who are planning to hire 70 new sales staff and focus on reviving the brand. With an emphasis on local authenticity.

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