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# Bacchus Capital, Unorthodox Financiers

## Firm provides capital and expertise without removing management

*By Ben Narasin*

Sam Bronfman completed his two-year stint at Diageo in 2004, after the wine and spirits behemoth acquired Seagram, the business his grandfather founded and his family had run for three generations. He set out to find a winery or wineries to buy, to return to the industry where he had spent his professional life. This turned out to be far more difficult than he had expected.

Bronfman recruited his lifelong friend Peter Kaufman and Kaufman's business partner, Henry Owsley of Gordian Group, to act as his investment bankers, but whenever they found a winery to pursue, they got outbid. "We realized we wouldn't win auctions," Bronfman said. "It was just too tough to win."

In one instance, when bidding on Chalone Vineyard in Monterey County, Calif., Diageo ended up buying the business for 50% more than Bronfman's group had offered. "We kept getting grossly overbid by strategics," Kaufman said. "We'd bid 12 times EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization), and they'd bid 18 times."

The team began to look at the obstruction as an opportunity. "We decided that while (paying high multiples of EBITDA) wasn't a good place to be as a buyer, if you were lending to the same companies, having that big valuation cushion beneath you would be a pretty good thing," Kaufman said.

Peter Kaufman, Sam Bronfman and Henry Owsley (from left) co-founded Bacchus Capital Management, where they also serve as managing partners.

The idea of lending created an opportunity to craft an alternative form of finance that would provide capital and expertise without having to remove the management team from the equation—or bid irrationally against other bidders. Of course, with a lifetime of experience in the industry, Bronfman also wanted to find a way to leverage his knowledge and contacts—and see the value of those assets recognized in the transaction.

"We looked for ways to use my expertise and Gordian's financial acumen," Bronfman said. "Henry came up with idea to see if there was room for second-lien funding in the wine business." With that idea, Bacchus Capital Management was created.

### Private equity business

The business was structured as a Private Equity (PE) business. A typical PE model is to create a limited partnership whereby the operating principles—known as general partners, in this case Bronfman, Kaufman and Owsley—run the fund and provide a small initial investment in exchange for an annual fee and a percentage of the profits. The bulk of PE businesses are then funded by outside investors, be they private institutions or otherwise, who take no active role but receive the majority of the returns generated over the life of the fund in exchange for providing the capital to use for the fund's investments. Funds typically last 10 to 12 years, although the money they raise may

## HIGHLIGHTS

- **Outbid in attempts to buy West Coast wineries, Sam Bronfman and partners decided to lend to the wineries instead.**
- **Their firm, Bacchus Capital Management, evolved from mezzanine lending to taking equity stakes in Oregon, Washington and California wine companies.**
- **Now with a focus on supporting proven winemakers, Bacchus leverages its talents in marketing, distribution and sales.**

be invested in a much shorter period.

Bacchus launched as a second lien (or "mezzanine") fund with an equity side pocket (a small allocation of capital to do direct equity investing within the fund's charter). They raised between $40 million and $50 million and closed on the fund to pursue the model with wineries in January 2008.

While commonplace in many other industries, before Bacchus the concept of second-lien finance did not exist in the wine industry. A second lien is much like a second mortgage: The lender provides capital in the form of a loan, but their security position stands behind the primary lender, *i.e.,* the first mortgage. Because of the weaker security position, these loans are viewed as higher risk and command either higher interest rates, equity-style participation, or both. Equity-style participation could take a variety of forms: a percentage of profit, success fees, an equity percentage in the business or warrants or options to create the right to buy a portion of the business at a pre-agreed price if so desired by the lender.

In addition, while the security position is "behind" the primary lender (such as the bank that lent on the land or building, the insurance company that provided long-term finance or the line of credit used for grape purchases), the security interest typically includes the right to "foreclose" on the business in the event of a loan default—although generally in coordination with, or upon commitment to repay, the primary lender.

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The advantage to wineries and related businesses is the ability to draw additional capital when no capital would otherwise be available from primary lenders, and to continue to run their business without having to sell out. In addition, in the case of Bacchus, Bronfman's extensive network and his team's expertise in winery operations, distribution, sales and marketing could be an exceptional value. The Gordian team also brought financial expertise when needed.

"The original idea, before the fund, was to get a string of pearls," Bronfman said. "Buy high-end brands and put together the sales and marketing into a joint effort. As it turns out, that's what we looked for in Bacchus: high-end wineries that needed additional growth capital or financial support."

"We did our first deal fairly quickly," Bronfman said, "Cameron Hughes in 2008." Cameron Hughes, a *négociant*-style U.S. wine business, was "growing really fast, and the growth was outstripping their capital from their primary lender. So we made a second-lien loan to them, and they did a fantastic job of continuing growth." Hughes later repaid the loan, "our one realized event," Bronfman said.

**Difficulty gaining traction**

After that initial fast close on a first deal, things ground to a halt. "We had a heck of a time getting traction within the industry," Kaufman said. "People didn't understand what a second lien was, and finding investments we felt comfortable with from a valuation standpoint wasn't easy. We only did one deal in the first three-and-a-half years."

The firm eventually did more second-lien deals, but the partners soon learned that the barrier of communicating a new style of finance was more significant than expected.

"The model evolved," Bronfman said. "The private-equity side of things became more interesting—to portfolio companies and to us—while the second-lien idea didn't seem to catch on as well."

"We got off a couple more loans and suddenly fell into this new model in the industry of partnering with winemaker-owners from an equity perspective," Kaufman said. "They do what they do best, which is make great wine, and we do what we do well: aid in running wineries and putting in people to help with marketing and the rest."

"We focus on brands where our value-add is in marketing, distribution and sales," Bronfman said. "That's where my expertise is."

Part of that focus has been to find great winemakers and back them. "The equity focus came about when we started talking with people like Ed Sbragia," Bronfman said. Sbragia is the former winemaster for Beringer Vineyards and founder of Sbragia Family Vineyards in Geyserville, Calif. "Ed is a fantastic winemaker, getting great scores, but (he) wasn't as strong on the business side and needed a partner to free him up to do what he does best: the wine."

Sbragia, who goes "way back" with Bronfman, started talking to Bacchus when "Sam's bird dog Quinton Jay came around," Sbragia said. (Jay serves as managing director at Bacchus, where he is responsible for sourcing and evaluating potential transactions.) Sbragia had a lot of options, but he went with Bacchus for more than just capital. "I'm an operating guy. I needed marketing muscle." Bacchus brought that muscle by providing marketing, communication and finance assistance and even hiring an experienced GM, Steve Cousins.

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> **—Sam Bronfman**

Sbragia raised money from Bacchus in 2011, while the impact of the financial collapse was still draining the wine business. "When tough times come around, people go into a shell and try to protect what they have," Sbragia said. "That's not going to grow a business. I didn't want to do that." Bacchus also got the business focused. "They got us on track.…Bacchus came in and gave us resources and incentives."

**Helping winemakers grow**

After Sbragia, Bacchus went on to do deals with Maritime Wine, Panther Creek Cellars, Madrigal Family Winery and De Lille Cellars. Their focus on partnering with exceptional winemakers runs throughout the portfolio, including Joe Dobbes, founder and winemaker of Wine By Joe and Dobbes Family Estate in Dundee, Ore., and Bob Lindquist, founder and winemaker of Qupé in Santa Maria, Calif.

"These people want to stay in the wine business," Bronfman said. "Ed is a winemaker. Joe Dobbes and Chris Upchurch (founding partner and winemaker of De Lille Cellars in Redmond, Wash.) are winemakers. They don't want to sell their businesses. They need money to grow them. We can bring money and expertise. People see us as effective and good partners."

And so a model was established that allowed Bacchus to deploy capital and expertise, much in line with the original focus on creating a "string of pearls" that predated the creation of the fund. Today, there are eight pearls on the string, and the team at Bacchus is working on raising their second fund, perhaps to add another strand. W&V

## THE BACCHUS PORTFOLIO

**The Bacchus Capital Management portfolio is made of eight total deals: two debt and six equity, of which one is debt and equity, according to Bronfman. The firm is headquartered in San Francisco, Calif.**

| | Location | Annual Case Production | Vineyard Acreage | Founder/ Winemaker |
|---|---|---|---|---|
| **DEBT** | | | | |
| Cameron Hughes (Exited) | San Francisco, Calif. | 250,000 | 0 | Cameron Hughes |
| Andretti Winery | Napa, Calif. | 30,000 | 42 | Mario Andretti |
| Qupé | Santa Maria, Calif. | 36,000 | 54 | Bob Lindquist |
| **DEBT & EQUITY** | | | | |
| Wine by Joe | Dundee, Ore. | 125,000 | 214 | Joe Dobbes |
| **EQUITY** | | | | |
| DeLille Cellars | Woodinville, Wash. | 16,000 | 60 | Chris Upchurch |
| Madrigal Family Winery | Calistoga, Calif. | 6,000 | 40 | Chris Madrigal |
| Maritime Wine Trading Collective, Nine North | San Francisco, Calif. Napa, Calif. | 150,000 | 0 | Chris Nickolopoulos |
| Sbragia Family Vineyards | Geyserville, Calif. | 16,000 | 52 | Ed Sbragia |
| **100% ACQUISITION** | | | | |
| Panther Creek Cellars | McMinnville, Ore. | 7,500 | 0 | Tony Rynders, consulting |