



## THE BIG APPLE

C&C recently announced that they have agreed to buy the biggest producer of cider in America for over \$300m. Is this money well spent or is this a management team that is desperate to find growth and have ended up paying too much? These are the difficult questions that I am currently asking myself and hope to expand on in this opinion piece. (To further complicate the situation C&C also recently announced that they have agreed to acquire the beverage company M.J. Gleeson)

Before I start looking at the proposed acquisition of the Vermont Hard Cider Company I just want to recap on where C&C was positioned before this was announced.

- Bulmers Cider is a franchise brand in the Irish Republic generating significant free cash flow.
- The Tennents beer brand has been revitalised by C&C after previous owners neglected it. It is particularly strong in Scotland.
- Cider in the UK market was a bit of a puzzle because of the multiple brands and tough competition but Magners does appear to be well positioned in Scotland.
- The 2011 acquisition of Hornsby gave them some exposure to the high growth American cider market.
- Their balance sheet was strong with net cash from the sale of their Whiskey brand Tullamore Dew.
- No major capital expenditure was required because of significant spare capacity.
- Annual free cash flow of about €100m per year gave them room for a significant increase in dividends.

In other words I was happy to own C&C on a free cash flow yield of about 8% and I felt that the share price had further upside potential.

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I have to admit that I was surprised when the Vermont acquisition was announced. I had assumed that Hornsby was going to be their American brand and I had thought that they had the resources to grow it into a major player.

I have listened to their analyst presentation to try to understand their logic for buying Vermont. Essentially I can summarise their case as follows:

- Cider is growing rapidly in America
- Cider appears to be following the same trend as craft beers. (rapid growth to a significant share of the drinks market)
- Vermont with its Woodchuck brand is a market leader
- Vermont allows C&C to become a national player because Hornsby had been primarily a West Coast product.
- They had to pay a premium price to get their hands on this unique asset.

My problem is that I do not know whether this is an accurate assessment of the situation. Obviously there is no question that the cider market is growing rapidly at the moment but I have no sense as to whether this can be sustained. Secondly I am not sure if the comparison with craft beers makes sense because I have not followed the development of that market. Thirdly I have no idea as to the strength of the Woodchuck brand and finally I have no real sense of how hard it would be to get national distribution for the Hornsby brand.

Not knowing all these things leaves me in a difficult position because I honestly think that even if I devoted significant time to answering these questions I would struggle to get to the point where I could answer them. The only conclusion I can reach is to make sure that I do not make the same mistake as I made in the past where I was too optimistic about potential growth in the UK market (see opinion piece 55). The most important thing I need to do is make sure that I make conservative assumptions.

Using conservative assumptions would suggest that I should assume that the rapid growth does not last and that cider remains a small insignificant niche in the American drinks market and that Vermont does not gain market share. If these assumptions prove accurate there will come a point when analysts will say that C&C overpaid for Vermont but that does not make C&C a sell because of the value in the rest of the business.

(The acquisition of M.J. Gleeson concerns me far less because I am familiar with their products and market and I feel it is not going to be a major issue either positive or negative and therefore I do not need to go into detail on it).

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For the time being I am going to give C&C the benefit of the doubt but I am nervous because their net cash position has suddenly become a net debt situation and they have acquired a business in a market I do not understand. My margin of safety has been eroded but hopefully this is only temporary and with a bit of luck Woodchuck might turn into an inspired acquisition.

C&C Share Price:

