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Bond sale turns heads

Liquor distributor raises $110M to hunt prey in merger jungle

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When it comes to distributing wine and liquor, National Wine & Spirits Inc. is no small fry. The Indianapolis-based distributor ranks ninth in the country with more than $500 million in revenue in 1998.

But in a rapidly consolidating industry, the gap between the biggest and smallest is getting wider all the time. The largest distributor, Miami-based Southern Wine & Spirits, brings in an estimated $2.3 billion in revenue and controls about 11 percent of the market.

The reality is simple: Eat or be eaten. National Wine & Spirits Inc. clearly plans to be holding the knife and fork. So on Feb. 16, National turned to the public markets to raise $110 million through the sale of high-yield or "junk" bonds.

IBJ PHOTO/ROBIN JERSTAD

CFO Smoke Wallin helped National Wine & Spirits tap public capital markets.

"We look at this as capital that will allow us to grow the business," said Smoke Wallin, chief financial officer of National.

"We look to continue the consolidation process and be one of the acquirers.

"We took some of the bond proceeds and paid off our banks. We now have a large line of credit available, and we can go back to the debt market for additional capital if necessary."

The bonds were underwritten by some of Wall Street's heavyweights, including lead manager Donaldson Lufkin & Jenrette Securities Corp., and co-managers Bear Stearns & Co. and First Chicago Capital Markets Inc.

High-yield bonds aren't much of a leap for investment bankers, who use them to finance everything from credit-card debt to subprime mortgages for trailers. But National's move marks a first for wholesale distributors, who until now have shunned capital markets in favor of using their own money or traditional bank financing.

"It's the first that I know of for a distributor," said David Dickerson, spokesman for the Wine and Spirits Wholesalers of America in Washington, D.C. "Up 'til now, the partnerships and consolidations in the industry have occurred without the companies going to those markets. For these privately held companies, it is a huge step for them to break away from that mindset."

But consolidation requires cash, which has a way of opening minds to new ideas.

▶ See NATIONAL on back

NATIONAL

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"To remain a player in the highly competitive, increasingly multistate market in which major wine and spirits wholesalers operate, it's not surprising that a group like NWS is tapping national capital markets for financing," said David Ross, managing editor of *Market Watch*, a beverage-industry trade journal.

National came to the conclusion that it could no longer finance growth through internal cash flow and bank debt.

"We had been successful for 25 years, but we ran that as far as it will go," Wallin said. "My guess is you'll see other people in the industry look seriously at this [corporate debt] market in the next two to three years."

National was a local distributor when it was bought by Jim LaCrosse in 1973. Since then, the company has made 16 acquisitions and started four operations from scratch. It now distributes liquor and wine in Chicago, Indiana, Michigan and Kentucky. Revenue has skyrocketed from $14.1 million in 1973 to $543.7 million in 1998.

Along the way, National had pretty well exhausted traditional bank lending and needed other sources of financing, Wallin said. It considered raising money from private investors or using mezzanine funding, which is cheaper than venture capital but more expensive than bank debt.

Private investment or mezzanine funding also generally requires the borrower to give up a stake in the company, which didn't appeal to National.

Instead, the company opted for 10-year bonds that carry an annual interest rate of 10.125 percent.

"We can write off the interest on the debt, so that brings our cost of capital down to about 6 percent," Wallin said. "We were able to do this deal and not sell any of the company, and get equity-type capital. Ten years, that's pretty long-term funding. This is a business that has great cash flow by its nature, so we can service the debt."

The business makes for an attractive investment, said Bill Ficca, director of research at Conseco Capital Management, the money-management subsidiary of Conseco Inc., which bought some of the bonds. It was CCM that encouraged National to explore the public debt market and introduced the company to the investment-banking community.

"There's a lot of high-quality attributes to this business as an investment," Ficca said. "There are high barriers to entry, and the business has stable cash flows that have proven to be recession-resistant. It's a solid company, not a business that's struggling to assert itself."

In exchange for using the public debt market, National will have to file quarterly and annual reports with the Securities and Exchange Commission. The first filing is expected in June.

Although the requirements aren't nearly as invasive as those for publicly traded companies, National will have to disclose revenue and income, something liquor distributors have traditionally loathed.

Wallin acknowledged the trade-off, but said it's justified.

"We feel it's a small sacrifice for access to capital," he said. "Access to capital is going to be the deciding factor in consolidation. If we weren't planning to be a leader in the consolidation process, we wouldn't have done this."

National has no plans to become a publicly traded company, though, Wallin said.

"We don't think we could get the kind of premium we would want as a [price-to-earnings] multiple," he added. "We think we've got the best of both worlds."

Wallin declined to offer specifics about National's growth plans, but said the company will keep an eye out "in current and contiguous markets."

National may have gotten a wake-up call last year when Olinger Distributing Co., its largest local competitor, was courted by two of the country's largest distributors. At one point, Olinger, which had about $120 million in sales, planned to sell to Southern Wine & Spirits, the industry titan.

The deal hit a snag and Olinger eventually sold to a partnership including Glazer's Wholesale Distributing and Romano Brothers. Glazer's, based in Dallas, is the No. 5 distributor with an estimated nearly $1 billion in revenue, according to *IMPACT Newsletter*, a sister publication of *Market Watch*. Romano is No. 12 with about $320 million in revenue.

A powerful force driving consolidation among suppliers and wholesalers is a steady drop of about 2 percent annually in consumption of hard liquor in the last two decades, according to the Wine and Spirits Wholesalers of America.

"With less product being sold, and fewer brand owners, almost inevitably you'll have fewer partners at the wholesale level," said Dickerson, the group's spokesman.•

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Where National stands

1998 revenue (in millions)*

Southern Wine & Spirits of America	$2,620
Charmer Industries Inc.-Sunbelt Beverage Corp.	1,505
National Distribution Co. Inc.	1,080
Young's Market Co.	1,045
Glazer's Wholesale Distributors	975
Wirtz Corp.	660
Peerless Importers Inc.	625
Johnson Brothers Wholesale Liquor Co.	550
National Wine & Spirits Corp.	**544**
Republic Beverage	425

**from wine and distilled spirits products (estimated)* Source: "Impact Newsletter"