Spare an Extra Billion? Evaluating Vultaggio's Options

Max Rothman Posted on October 17, 2014 at 4:50 pm

One. Billion. Dollars. It's a hefty bill. And that means it's decision time for Don Vultaggio, co-founder and chairman of AriZona Beverage Company.

A New York state judge has ruled that AriZona must pay about $1 billion to acquire the 50 percent stake of AriZona's other co-founder, John Ferolito, who had tried to get Vultaggio to let an investor buy him out, but was eventually frozen out.

The question on our minds: unless Vultaggio has a really, really big safe somewhere, where does that money come from?

By building a multidimensional company with more than $1 billion in annual revenue, Vultaggio has established a sizable network and given himself some options. Nicolas A. McCoy, managing director of investment banking firm Silverwood Partners, spoke with BevNET and broke down a few of those options. AriZona declined to provide comment for this story.

Perhaps the most obvious payment method comes from cash already in hand. Vultaggio has led the rise of one of the most successful privately-held consumer product goods companies in recent history, and that carries with it a hefty cash flow. Aside from its lucrative tea business, AriZona has made plays of varying profitability in lemonade, coffee, enhanced water and even craft beer. As a private company, few parties know how much cash lies in AriZona's coffers. But the company's attorney, Louis M. Solomon, a partner with Cadwalader, Wickersham & Taft LLP, alluded to the potential ramifications of such a payout right after the judge's ruling, saying that he believed a court would eventually reduce the award, which, he said, would help protect the jobs and livelihoods of nearly 1,000 employees.

Another option, which would include far more variables, involves a seller note. This option would allow Vultaggio and his team to pay Ferolito over a certain period of time that would be manageable for the business and its cash flow. A seller note would likely serve as a piece of the larger pie, McCoy said, which would amount to 10 or 15 percent of the total figure. It would include an interest rate, but would be light on covenants. A seller note could also include a contingency piece to compensate for a potential boom in company revenue. This option, he said, is typically paid out in one to five years.

Considering Vultaggio's longstanding resistance to a corporate sale and the difficulty of just pulling a cool billion out of pocket, he may opt to incur debt. This route in the current lending market is "pretty attractive," McCoy said, because a company with, for example, $10 million in earnings before interest, taxes, depreciation and amortization (EBITDA) and a private equity partner could raise about 5 to 6.5 times that figure. This compares favorably to 2009-10, when the multiple might have been at 3 to 4 times the EBITDA, or before the financial crisis, when interest rates were much higher and a deal might not have been possible.

McCoy has spoken with a number of lenders over the past one to two years and found that somebody is always undercutting fees or expressing a willingness to get more aggressive with a final number.

"The competitiveness of the lending market right now is very, very high," he said.

With revenue of around $1 billion and a 40 or so percent market share of a $6 billion tea market, he said, AriZona would need an EBITDA margin of 25 percent or more, growth indicators and no debt to support an all-debt deal. He said it's more likely a large private equity firm enters the equation, similar to the role of The Blackstone Group in the Market Basket sale. In that case, Arthur T. Demoulas purchased his cousin's 50.5 percent stake in the company for approximately $1.5 billion, with Blackstone contributing more than $500 million.

McCoy added that by taking on debt and bringing on a private equity group, which would provide cash and take on equity, AriZona would be able to provide itself with a level of security. If the business starts to struggle or growth slows, a private equity group wouldn't want to lose its stake for nothing. Instead, the group may prefer to keep feeding the business to encourage its progress and reach an eventual exit. But because most funds are in place to realize a large return on investment capital and not to take on profit in a passive mode, there's also a time limit placed on the fund's investment — which is one of the reasons Vultaggio has resisted private equity in the past.

"By bringing in a fund like that, you've kind of given yourself a ticking time bomb of the day that you have to sell your company, or IPO, or do something other than staying private," McCoy said.

Bill Sipper, managing partner of Cascadia Managing Brands, personally knows Vultaggio and believes he will pony up — pay the $1 billion and get 100 percent equity of the company. That said, Sipper didn't exactly agree with Vultaggio's own valuation of AriZona during the trial, which put the company's worth at about $426 million.

"That's one of the funniest things I've seen that was not on Saturday Night Live," he said.

Judge Timothy S. Driscoll of Nassau County clearly ruled in Ferolito's favor, he said, even if current multiples bring the company's valuation closer to $4 or $5 billion.

Sipper suggested that AriZona could also loop in another large company to contribute, similar to The Coca-Cola Co.'s recent $2.15 billion investment for 16.7 percent of Monster Beverage Corp. Vultaggio could unload 20-25 percent of the company for $1 billion and use that money to pay off Ferolito, he said.

Yet as a consultant who regularly works with emerging brands — from the smaller Molly's Milk Truck to larger outfits like Zico — Sipper views the ruling as a way for entrepreneurs to step back and find a lesson.

Sipper asked: what are the buyout terms of an agreement? Who can execute it, for how much, and when?

"For new entrepreneurs, the one thing that I always see people not worry about is the operating agreement," he said. "What is the right of each partner?"

Because of a cloudy operating agreement, Ferolito could have lost a bunch of money, he said. Instead, Vultaggio must now pay up. At least he's got a few ways to get there.

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