



Value vs. Price

Many owners view the value and price of businesses as the same, which can be a misconception.

by Mark D. Working

Price and value are not always the same. Price represents what actually occurs as a result of specific supply and demand conditions, while value is an economic concept that equates all future benefits from owning an asset to a single current amount. Price is what “is” and value is what “should be.” When an imbalance of supply and demand occurs, there can be a discrepancy between the two. It is this disconnect between price and value that is the stock and trade of legendary investors such as Benjamin Graham and Warren Buffett and was at the root of the dot.com bubble. In a public market, adjustments are constant, as prices change on every trade. The market is always moving. In contrast, a private market has no such adjustment mechanism.

INTRINSIC VALUE VS. PRICE

Ultimately, the value of any asset is equal to the present value of expected future cash flows to be generated by the asset. Because future events are the driving determinant of value, there is plenty of room to debate all the variables that affect future cash flows, not to mention the timing of the cash flows or the discount appropriate for the risk of the business. Nevertheless, in many cases a good financial analyst should be able to determine a range of “expectations” that knowledgeable investors would consider reasonable.

The price of an asset at any particular time is determined by supply and demand for the asset. The supply and demand dynamics are normally influenced by the availability of substitutes. In the case of a business, the availability of other similar business risk investments provides balancing pricing forces over a large market.

A NORTHWEST VALUE-PRICE DISCREPANCY

There currently appears to be just such a price-value anomaly in the market for North Pacific seafood processing quotas, most notably the pollock resource (the principal supply of filets for fish and chips and surimi, or “Krab”). In the 1990s, this important fishery was an economic basket case, as a surplus of Seattle-based processors inefficiently competed head-to-head to process the allowed catch

\$ in thousand	AMERICAN SEAFOODS		
	2002	2003	2004
Metric Tons Owned (000's)	216	217	217
Revenue	\$ 333,000	\$ 411,000	\$ 462,000
EBITDA	84,000	101,000	88,000
EBITDA / Ton	\$ 389	\$ 465	\$ 406
Enterprise Value			\$ 550,000
Less Working Capital			(58,500)
Quota and Processing Asset Value			\$491,500
Value per Ton			\$2,265

in an Olympic-style (race to catch) fishery. In 1999, the American Fisheries Act set in motion the rationalization of the industry by granting catch/processing quotas to individual vessels and shore-based plants. In turn, the allocation of quota allowed optimization of fleets, crew, and processing time, with the result being more efficient use of the resource and a tremendous increase in profitability and, therefore, value.

There remain meaningful opportunities for consolidation within the industry to further drive efficiency. But, efforts in that regard are currently frustrated by price expectations among quota owners that are well in excess of

the economic value that most potential buyers can justify.

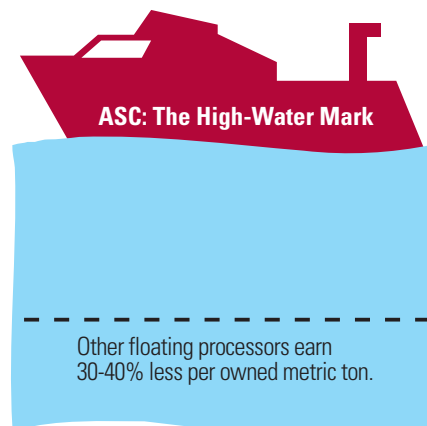
One of the provisions of the Act was to grant 10% of the pollock resource to regional Community Development Quota (CDQ) groups, in an effort to foster local participation in the fishery and economic development. CDQ groups are empowered to “sell” the right to capture the resource to processors and to reinvest the proceeds in the industry. This has been a windfall for CDQ groups, as they have derived millions of dollars for their share of the resource. They are obliged to reinvest a large portion of the earnings in the seafood industry. With overflowing coffers and few places to invest, CDQ groups have had the resources to bid aggressively for industry assets.

THE HIGH WATER MARK

North Pacific floating processors are the most efficient of all methods of capturing and processing the pollock and related species. The industry leader is American Seafoods Company (ASC), which, as a result of its scale, is recognized as the most efficient (and profitable) of all of the floating processors. As such, the value of the quota it controls should be the highest in the industry.

Using publicly available data on ASC, here's how “pollock math” works. Continuation of ASC's recent level of performance implies a discounted cash flow value of roughly \$600 million for the business. Part of ASC's value is associated with non-ASC owned resources. Granting \$50 million to those activities yields a \$550 million value for the processing capacity, working capital to conduct the business, and pollock quota, as illustrated in the above table.

As the industry's most efficient processor and the only source of public data, most quota owners view ASC's value per metric ton as the definitive value benchmark. In reality, it should not be the standard, but rather the high-water mark based on the company's industry leading performance. Although information is not publicly available, indications are that other floating processors earn 30% to 40% less per owned metric ton than ASC. Shore-based and mothership processors purportedly earn even



less per ton. Accordingly, the value of quota held by smaller floating processors, catcher vessels, motherships, and shore-based processors should be less.

In every industry, there is unrelenting pressure to drive ever-greater efficiency. There is more efficiency to be created in the bottom-fishing industry through further consolidation of the quota and processing assets. But, unrealistic value expectations set on the basis of ASC operating performance, and reinforced by CDQ investment transactions, have stymied the efforts of investors to buy or invest in businesses in the industry over the past five years. When it is all boiled down to dollars per

ton, owners continue to have trouble seeing that a ton of their quota is not worth as much as ASC's quota. Speculation of even higher values for ASC have left even the most aggressive CDQ groups unable to complete transactions at premium prices.

The effect of the growing amount of CDQ wealth, the requirement for reinvestment in the seafood industry, and the willingness of owners to wait for the "CDQ deal" has slowed transactions in an industry in which the age of ownership and the potential of consolidation synergies should be stimulating brisk activity.

Price and value disconnects do not continue unabated indefinitely. In this case, one

simple event could "let the air" out of the balloon. CDQ groups, which represent the pricing force in the industry, are currently restricted, in terms of new investments, to the Alaskan seafood industry. A modification of the rules to allow CDQ groups to broaden their investment focus beyond the seafood industry would put North Pacific investments on the same grounds as other opportunities in the world. When that occurs, price and value will start to converge. Our view is that industry shareholders would be well served to consider consolidation opportunities, even if the prices do not reach ASC's high water-mark. ♦



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