Evaluating Business Opportunities for the Alaska Seafood Industry

Anchorage, Alaska
December 11, 2007

Alaska Sea Grant Marine Advisory Program
Evaluating a Business Opportunity

- Concepts
- Various methods
- Application
Evaluating a Business Opportunity

- **Concepts**
  - Risk v. return
    - Do you feel lucky?
      - T-Bills v. a Herring Permit
  - Time
    - Money is worth more today than tomorrow
Evaluating a Business Opportunity

- Concepts
  - Diversification
    - Value in spreading out wealth
  - A Going Concern
    - Worth more than the sum of the parts
Evaluating a Business Opportunity

- Concepts
  - Types of Investments – Passive v. Active
    - A standard to apply to investments
  - Size of the Investment
    - Keeping it real
Evaluating a Business Opportunity

- Various methods
  - Asset value
  - Comparables
  - Multipliers
  - Discounted Cash Flows
Evaluating a Business Opportunity

- **Asset value**
  - Liquidation value of the assets of a business
    - Generally the lowest value
    - Does not consider the “going concern” value of an enterprise.

Example: The estimated value of all farm supplies, equipment and leases equals the farm value.
Evaluating a Business Opportunity

- Comparables
  - The price paid for a business is based on the sales value of other “like” businesses.
    - Requires knowing values of other transactions.
    - Common in terrestrial farms – based on value of land, not earning potential of farm.

- Example: Fishing vessels of similar size, build, engine condition and harvest use might sell for roughly the same amount, plus or minus for wear and tear.
Evaluating a Business Opportunity

- Multipliers
  - Value of a business is based on common industry multipliers.
    - Requires industry information – database.

  - Example: Business appraisers value corner convenience stores from 3 to 5 times their adjusted gross income, plus inventory.
    - If the 7-11 has a great location and strong historical earnings, it might have a multiplier of 5.
    - Adjusted gross earnings - $55,000
    - Inventory - $107,000
    - ($55,000 x 5) + $107,000 = $382,000
<table>
<thead>
<tr>
<th>Year</th>
<th>1999</th>
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<td></td>
<td>Kodiak Seine Permit Values</td>
<td>$29,800</td>
<td>$20,400</td>
<td>$17,100</td>
<td>$9,900</td>
<td>$8,600</td>
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<td>Kodiak Seine Permit Average quartile earnings</td>
<td>$142,915</td>
<td>$107,671</td>
<td>$130,768</td>
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<td>Permit/Earnings Multiplier</td>
<td>21%</td>
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<td>13%</td>
<td>10%</td>
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<td>Standard Deviation</td>
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<td>Drift Permit Values</td>
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<td>Bristol Bay Drift Permit Average quartile earnings</td>
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<td>Southeast Power Troll Permit Values</td>
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Evaluating a Business Opportunity

- Discounted Cash Flows
  - Takes projected cash flows and discounts them back to present day based on an expected “rate of return” or “discount factor”
    - Requires determination of risk factor
    - Requires determination of pro forma

- Example: Small 10 person business expects cash flow of $30,000 for next five years. Owner will invest $25,000 and expect a rate of return of 20%.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flows</th>
<th>Expected rate of return</th>
<th>Initial investment</th>
<th>Value of Business</th>
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<td>1</td>
<td>$30,000</td>
<td>20%</td>
<td>($25,000)</td>
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Value of Business: $64,718
Evaluating a Business Opportunity

- Application
  - Past Performance
  - Recasting Pro Formas
  - Running the Numbers
  - Organizing Personal and Business Portfolios
  - Engaging a Lender
Evaluating a Business Opportunity

- Real examples
  - Using the pro forma model
  - Vessels
  - Permits/IFQs
  - Processing opportunities
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