

Wenatchee Growers

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ABSTRACT

Darrel Reynolds, executive vice president of Wenatchee Growers and grandson of its founder, had been approached by owners of another family-owned fruit company about a buyout. If Darrel accepted their offer, Wenatchee would immediately expand from Washington state into California, becoming the largest producer of cherries in North America. While this would greatly lengthen Wenatchee's selling season, it would also mean new management and logistical challenges. Darrel needed to decide if the acquisition makes sense, and if so, how much to pay for his closely-held target.

INTRODUCTION

Wenatchee Growers is named for its hometown, deep in Washington's apple country, a place of mythological proportions, a lush land where fruit grows like nowhere else, America's fruit bowl, a cornucopia of agricultural wealth.

Every year, the region produces enough apples "to reach to the moon and halfway back."¹ But Washington grows more than apples, and so does Wenatchee Growers. Over 60% of the apples, pears, and cherries that Washington state residents find in their produce departments come from Wenatchee Growers. Cherries, in particular, are big business for the company, since cherries are three times as profitable as apples. Cherries would be an even bigger business if Wenatchee acquired West Coast Fruit (WCF), the producer of 18% of the cherry crop from California.

Wenatchee Growers is the largest shipper of fresh sweet cherries in North America. West Coast Fruit, one of the largest cherry operations in California, has access to that state's earliest-available cherries. Together, they would guarantee their customers the availability of fresh cherries for longer than any other grower/shipper/marketer ("from shipping point to customer") in North America. Darrel Reynolds, the executive vice president of Wenatchee, had been pondering such an alliance since three of WCF's five partners approached him in early 2003, asking to be bought out. Valuing this offer was the first real challenge of Darrel's management career. He had only worked full-time in the family business for two years, since earning a business degree and becoming the first member of his family to graduate from college. His sudden rise to a key position at Wenatchee stirred up some resentment among his family members, especially among those with extensive experience in the fruit industry. Regardless, Darrel's family had entrusted him with the fate of Wenatchee Growers, and he was the driving force behind the potential merger with West Coast Fruit Company. He had to value the offer correctly.

THE REYNOLDS FAMILY AND WENATCHEE GROWERS

Wenatchee Growers was founded by Hank Reynolds, Darrel's grandfather. Hank started growing cherries in the late 1950s, but after earning only \$89 his first year, he worried that growing fruit would not allow him to support his mother, wife, and three children. During a trip to the buyers' market, Hank discovered part of his problem: his cherries were being sold there in an acidic and dehydrated state. "You have to realize that was a whole year's work for me," Hank said. "It really made me think. I wasn't about to give up or sell out, but I did start looking at new ways of doing things. I figured the only way to get good fruit to market was to pack and sell it myself."

¹ All of these quotes are taken from *Washington Apple Country*, by Rick Steigmeyer and John Marshall (Graphic Arts Cebter Publishing Portland, OR, 1995).

Hank wanted to find a new way to harvest, pack, and sell his cherries so that they would arrive to market in their original quality state. Over the next three years, despite numerous difficulties and a tight budget, Hank was able to save enough money to purchase his own cherry-packing equipment and build a small warehouse—the initial inputs for Wenatchee Growers. His business plan was simple: he would “pick in the morning and pack in the afternoon.” Better able to manage and control the quality of his crops, Hank finally sold his first box of cherries at the New York Growers Auction in 1962. This was the beginning of a new era for Hank. Now, more than three decades later, several of Hank’s sons and his grandson Darrel ran Hank’s company—the largest cherry shipper in North America.

Much of Wenatchee Growers’ success could be attributed to intense quality control. They aggressively invested their profits into research and development, and were an industry leader in responsible consumer packaging and environmental practices. “We put whatever money is needed into the product, so that it will be the best in the world,” said Darrel, “but we also put resources into finding a balance to keep things going for the next generation of Reynolds’.” Today, the company’s year-round “quality control” shipping policies benefit 350 Northwest growers, not to mention millions of consumers in the more than thirty countries that import their fruit.

Wenatchee grew pears, apricots, cherries, and apples. Every year, they produced roughly 6 million cases of apples and 2.5 million cases of cherries (about 30% of the state’s cherry crop); ten percent of this was organic. Cherries were three times more profitable than apples. During the winter, the company employed 750 workers, but during the peak growing season it employed 2,000-3,000. Wenatchee also had 250 affiliated, independent growers in Washington, California, New Zealand, and Chile, from whom they got 30-40% of the fruit they distributed. The rest they grew themselves. Wenatchee had 5,400 acres of its own orchard land, but had regional contracts translating into 10,000 total “captive” acres. This was a significant advantage for them: orchards are the critical fixed asset for cherry production, making entry into the market difficult. Wenatchee sold its produce all over the world. They had greatly benefited from the emergence of global trade, given their positioning as a free trader. “More than 20 percent of our shipments went overseas last year,” said Darrel. “We have no problem with the idea of a global economy. It has really turned out to be a win for us in places like Mexico and the Pacific Rim.”

Who is West Coast Fruit?

West Coast Fruit (WCF) was started in the 1920s by two brothers from Sicily, one of whom was now 82. It had always been family-run. It was currently structured as a general partnership, with 30% owned by the general partner, 30% by one limited partner, and the remaining 40% split equally among three other limited partners. Wenatchee was offered one of the 30% stakes and two of the smaller ones. Management of the company had now passed to the third and fourth generation of the family, and Darrel says that “at generation three, the wheels fell off the tricycle.” Hence the incentive for a buyout.

WCF was a vertically integrated grower, packer, and marketer of fresh sweet cherries produced in the San Joaquin Valley of California. They processed and marketed about 1 million cases every year, or about 18% of the fresh cherries grown in California. They had earned a high level of respect and an excellent strategic position in the California cherry industry during their 75 years’ of cherry-packing experience. West Coast Fruit’s business strategy was to deliver the earliest, highest-quality sweet cherries to the world premium markets, getting the highest prices and the highest returns for its growers.

WCF had been a consistent leader in the introduction of new processing and handling methods. They pioneered the pre-cooling, hydro-cooling, and water-flow transport processes that they used in their packing facility. These major innovations make WCF’s 320,000 square foot facility completely state-of-the-art, capable of packing 40,000, 18-pound boxes of finished fruit per day and moving them from field to export in 72 hours. As part of the buyout offer, Wenatchee could buy this facility for \$6.5 million; Darrel estimated that it would cost \$8 million to build it from scratch.

The Cherry Industry

In 2003, on average, the United States produced more than 350 million tons of tart and sweet cherries (see Exhibits 1 and 2). 78,600 tons, the equivalent of 8,730,000 18-pound cases, comes from the Northwest. The Northwest’s record for the most cherries produced in a single harvest season was 2001’s 97,000 tons. The 2002 crop came up 3,600 tons short of the five-year average, at 75,000 tons. (Wenatchee’s experience for this period mirrored that of the state as a whole: Wenatchee produced 22,000 tons in 2001 but only 16,000 in 2002. Their revenues were unaffected, however, since the “shortage” led to higher prices.)

The biggest threat to the Washington cherry industry is eastern Washington’s cold weather, which often lasts through mid- to late April. The cherry pollination process is inhibited by cold, wet, and windy weather. (For example, in Michigan, spring frosts and poor pollination have been known to destroy up to 90% of the year’s cherry crops, leaving growers with little to no income.) The threat of potential losses from severe weather is completely unpredictable.

Weather is just one of the challenges facing cherry growers. (As Darrel said, “Producing cherries is like a medical triage center—it’s complete chaos.”) Another is the basic fragility of the fruit. For example, some cherries like the Rainier (which has a “notoriously temperamental personality”)² must be picked “early in the morning before the fruit overheats and gets too soft to handle”; they then must be picked and packed by hand because they “show every bruise from rough handling” and would reach the consumer “look[ing] as sad as overripe bananas.” Typically, cherries can survive up to four weeks if kept in a plastic bag (where the oxygen level is lower) at temperatures below 32 degrees Fahrenheit. Once the cold chain is broken, however, they can survive only a week at most. The quality of distribution and storage is therefore crucial to extending the life of a cherry; the packaging methods must be state-of-the-art. Even in the best circumstances, though, velocity remains a more important strategic consideration than price.

The cherry season varies by region, but is always short. (In fact, many of the cherry varieties we see today were developed to ripen earlier or later than older varieties, so that the cherry-buying season could be extended.³) For example, the California cherry season is from April 25 through the beginning of July, while the Washington cherry season begins in mid-June and continues through the end of August (see the chart on the next page). Thus, California cherries ripen before Washington’s, and when the cherry season is ending in California, it is just beginning in Washington. What this means for retailers is that they must clear the shelves after the California harvest and wait for the larger Washington harvest to come in. This results in logistical challenges for growers, retailers, and consumers alike.

Conventional Cherry Availability

2003	APRIL		MAY					JUNE					JULY				AUGUST			
	Week 18	Week 19	Week 20	Week 21	Week 22	Week 23	Week 24	Week 25	Week 26	Week 27	Week 28	Week 29	Week 30	Week 31	Week 32	Week 33	Week 34	Week 35		
California dark-sweet																				
Washington dark-sweet																				
Washington Rainier																				
Washington organic dark-sweet																				
Washington organic Rainier																				

² Quoted from “The Other Rainier,” by Stuart Eskenazi (*Seattle Times*, 6/27/04).

³ *ibid.*

Strategic Considerations

Darrel Reynolds believed the acquisition of West Coast Fruit would create new opportunities for the joint company. He saw most of the value from this merger coming from the increase in demand that would accompany an extension of the fruit season, the opportunity to better market the crop in coordination with retailers, and the possibility of consolidating operating facilities.

“Strategically this alliance creates a mirrored philosophy of extended cherry harvest from both locations,” said Darrel. A newly allied Wenatchee/West Coast Fruit would be the first to market and the last out. A seamless extension of the season would stimulate consumer demand. As it is, retailers typically lost a full week of sales between the California and Washington seasons. During this cherry hiatus, retailers must fill their empty cherry shelves with something else, only to clear the shelves again when the Washington cherries began to arrive. Consumers were never quite sure if they would find cherries in the store or not. If Wenatchee/WCF could guarantee a constant supply of cherries throughout the summer, they could get to the retailers sooner and lock up their shelf space. In late June/early July—the period that Darrel called the “peak of product”—retailers usually dedicated about 10 feet of shelf space to cherries. Until then, it was closer to 3 feet. By increasing space at an earlier date, and by offering a higher volume of product, Wenatchee could generate a better velocity of sales. Increasing velocity meant that consumers would have a better experience. Quality, availability, and regularity would build consumer demand and generate incremental sales. In Darrel’s words, “Sell-through and forced distribution will allow Wenatchee to hit the ground running, creating good velocity and good demand.” He saw this as “a natural step in aligning growers with retailers in a go-to-market strategy to connect with the end consumer.”

Wenatchee could capitalize on the increased demand to enhance its dealings with both small and large retailers. Wenatchee would inherit the good relationships that West Coast Fruit had already established with the smaller retailers in its area. It might also gain more clout with the larger retailers. Larger growers had a higher likelihood of establishing partnerships with national grocery chains, since the chains were consolidating the number of growers from which they buy to facilitate coordination. Being larger might also give Wenatchee more control over the way the stores handle and store the fruit. Given the fragility of the fruit, improper handling could easily mean bad experiences for customers.

A combined Wenatchee/WCF wouldn’t just use its size to strong-arm retailers: it would also have something unique to offer. The expansion of the cherry season meant the retailers could avoid changing displays from cherries to something else and then back again. More product could mean more momentum and more sales. Sales could be further increased since there would be new opportunities to advertise. As it was, retailers were understandably reluctant to advertise cherries around the transition period between the California and Washington seasons, since they had to coordinate from growers in both states. If Wenatchee/WCF could ensure that fruit will be available throughout the transition, retailers might be less “gun-shy” to go on ad during this period. They might also be able to take advantage of advertising among regions. Darrel said his strategic approach is partnering— coordinating merchandising and marketing with the retailers and creating relationships that allowed retailers to trust forecasted demand for Wenatchee’s product. When that happened, Wenatchee could negotiate contractual pricing. Darrel’s goal was to be “in bed” with the retailers, “going to market with the retailer to connect with the consumer.”

In addition to improving relations with retailers and consumers, a merger with WCF might also offer Wenatchee the potential for operating consolidation. Being able to provide product from multiple locations could diversify Wenatchee’s operating risks. Were Wenatchee able to utilize West Coast’s advanced facility, it could put money used currently to maintain their operational facilities to other uses. Taking advantage of these opportunities means logistical challenges, however. It is a 15-hour, 931-mile drive from Wenatchee to West Coast’s facility in Stockton. The price of transporting freight was based on weight and mileage, with the standard load for a trailer of 25,000 pounds. According to an estimate from Artic Express, a transportation company specializing in refrigerated shipping, it would cost approximately \$1,301.40 for a shipment between Stockton and Wenatchee, plus a gas surcharge of \$132.55. This did not include any sort of loading costs, and it assumed there would be no detention time (time the driver has to wait) at either facility or on the road.

Valuing West Coast Fruit

Darrel was well aware of the numerous strategic advantages of a merger with West Coast Fruit. But the impact of such a merger on his family’s company—and on his reputation within it—depended on correctly translating those advantages into dollars. West Coast Fruit was a valuable company—but how valuable? To help him find out, Darrel had collected financial information about both Wenatchee Growers and on West Coast Fruit. This is presented in Exhibits 6 and 7, respectively. For financing, Darrel planned to rely heavily on internal funds; he said Wenatchee had a very low debt/equity ratio, and he wanted to keep it that way. Wenatchee’s corporate finance chief had suggested that they use a 15% discount rate to evaluate WCF, a rate which Darrel said incorporates a premium “because of the risk—wind, heat, rain, frost, fog, hail—of cherries.” The rate of inflation for the food industry was 1.4%, while the average rate for all items is at 3.2%. The marginal personal and corporate tax rate was 37%. Other macroeconomic data are presented in Exhibit 5.

In the past, Wenatchee’s managers had made merger and buyout decisions based on EBITDA (for example, estimating a firm’s value as 4.5 times EBITDA). Cash flow and ability to service debt were also critical. Darrel’s response to this particular problem? “We could have a conversation about that over 3 bottles of wine.”

Darrel was convinced that a merger with West Coast would be profitable for Wenatchee. However, to give him some flexibility in case his analyses suggest otherwise, he negotiated a one-month option to opt out of the deal. Exercising this option would cost Wenatchee \$2 million.

Is a merger with West Coast Fruit a good idea for Wenatchee Growers? If so, how much should Darrel pay for 51% of West Coast’s equity?

APPENDIX

Exhibit 1: Cherry Production

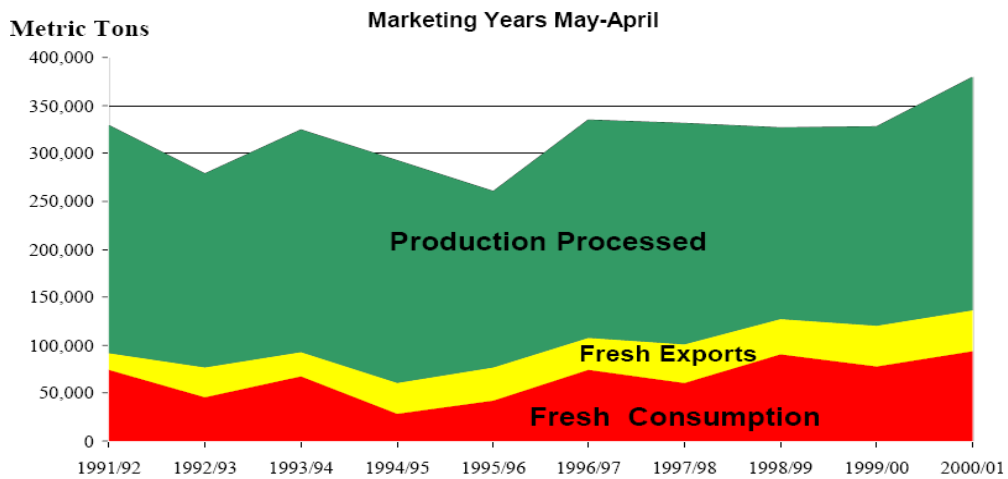
U.S. Production of Cherries



Source: USDA National Agricultural Statistics Service

Exhibit 2: Consumption And Exports

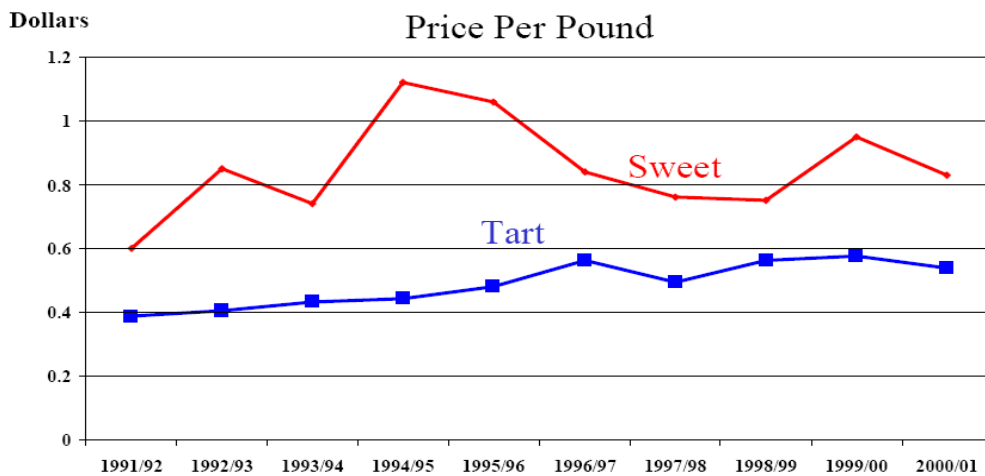
U.S. Cherry Production Climbs; While Fresh Consumption & Processing Expands, Exports Slow



Source: USDA National Agricultural Statistics Service

Exhibit 3: Prices

U.S. Fresh Cherry Prices



Source: USDA National Agricultural Statistics Service

Exhibit 4: Types Of Cherries

<i>California</i>	Brooks	The Brooks is a very large, firm, and well colored fruit.
	Tulares	A large, brighter red, heart shaped fruit.
	Garnets	A cherry that is large, sweet and brighter red.
	Bings	Most popular variety in the United States. Later in CA, large and firm, with a dark skin and flesh.
<i>Washington</i>	Brooks	The Brooks is a very large, firm, and well colored fruit.
	Chelans	Skin and flesh are mahogany in color and the cherry is very large and firm. Its taste is sweet and tart.
	Bings	Most popular variety in the United States. Early in WA, large and firm, with a dark skin and flesh.
	Rainiers	Golden yellow cherry with pink/red blush. Recognized for being sweet, plump, juicy and intense flavor.
	Lamberts	This late variety becomes available two weeks after the Bing. Large and very dark in color.
	Lapins	Very large, firm and dark late season cherry similar to sweetheart.
	Sonatas	Dark red, heart-shaped. Larger than the Bing with a rich, full-bodied flavor.
	Hill Bings	Same as other Bings. Later due to elevation.
	Hill Lamberts	Same as other Lamberts. Later due to elevation.

Source: company

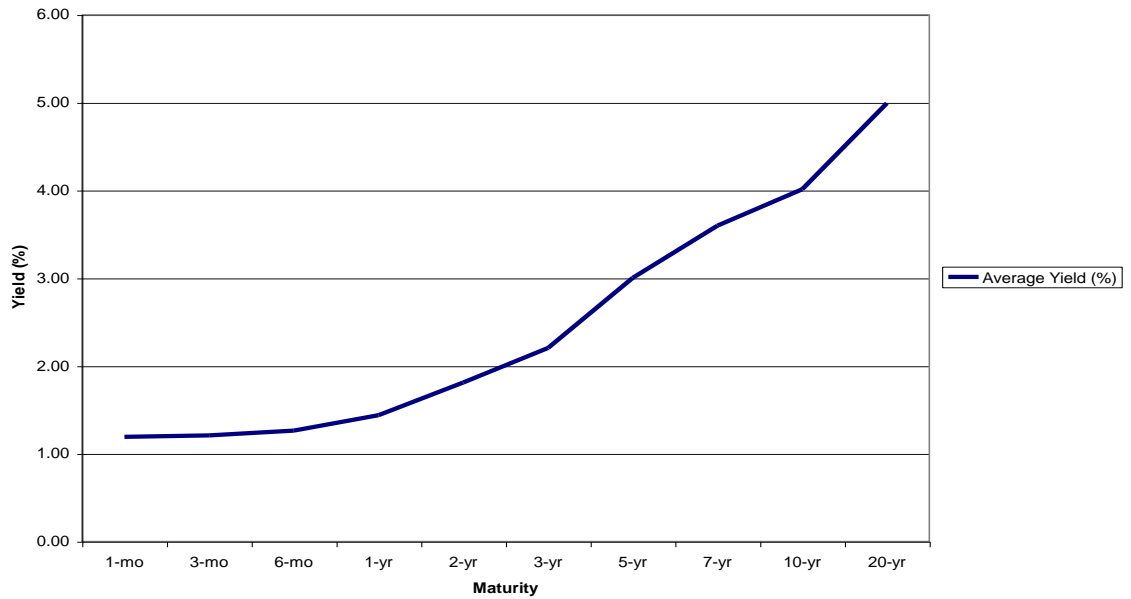
Exhibit 5: Macroeconomic Data

Prime Rate: The base rate on corporate loans posted by at least 75% of the nation's 30 largest banks.	Rate	Effective Date
	4.00 %	06/27/02
Discount Rate: The charge on loans to depository institutions by the Federal Reserve Banks.	Rate	Effective Date
	2.00 %	06/25/02
Federal Funds: Reserves traded among commercial banks for overnight use in amounts of \$1 million or more. FOMC target rate effective 06/25/02.	Rate	
	1.0000 %	FOMC target rate
	1.0313 %	High
	1.0000 %	Low
	1.0000 %	Near Closing Bid
	1.0313 %	Offered

Treasury Yield Curve, December 2002

<u>date</u>	<u>1-mo.</u>	<u>3-mo.</u>	<u>6-mo.</u>	<u>1-yr.</u>	<u>2-yr.</u>	<u>3-yr.</u>	<u>5-yr.</u>	<u>7-yr.</u>	<u>10-yr.</u>	<u>20-yr.</u>
12/27/2002	1.07	1.16	1.23	1.36	1.60	1.97	2.79	3.36	3.83	4.83
12/30/2002	1.15	1.22	1.24	1.36	1.61	1.95	2.76	3.34	3.82	4.82
12/31/2002	1.20	1.22	1.23	1.32	1.61	1.99	2.78	3.36	3.83	4.83

Yield Curve: December 2002



Source: *Wall Street Journal*

Exhibit 6: Wenatchee Growers Financial Data

Wenatchee Growers					
Balance Sheet					
	December 31,			December 31,	
Assets	2002	2001	Liab & Shareholders' Equity	2002	2001
Current Assets			Current Liabilities		
Cash and Cash Equivalents	5,814,753	496,979	Accounts Payable		
Accounts Receivable			Trade	5,836,069	6,401,571
Trade	19,166,768	17,445,173	Undistributed fruit proceeds	12,845,297	3,099,663
Growers	2,444,028	2,608,483	Growers	4,622,933	5,305,794
Other	647,331	557,931	Related Parties	60,185	37,639
Related parties, curr port	3,754,930	5,375,573	Other	6,883	627,819
Packing supplies inventory	2,264,639	1,999,198	Accrued expenses	1,170,760	1,231,653
Fruit inventory	383,221	2,929,565	Line of Credit	0	4,500,000
Prepaid expenses	878,048	293,724	Crop Loans	182,731	344,922
Total current assets	35,353,718	31,706,626	Current portion of LT debt and obligations under capital leases	5,424,123	6,261,833
Land, Building, & Equipment			Total current liabilities	30,148,981	27,810,894
Land and improvements	6,687,767	5,426,727	LT Debt and Oblig		
Buildings	48,640,924	47,115,100	Under Capital Leases, net of current portion	37,642,014	33,448,834
Machinery, equip, & furnit	63,067,215	51,956,839	Subordinated Debt	4,033,658	4,033,658
Orchard development	2,874,875	2,781,939	Deferred Compensation	123,462	120,011
	121,270,781	107,280,605	Minority Interests	444,901	511,501
Less accumulated deprec	51,221,872	45,066,357	Stockholders' Equity		
	70,048,909	62,214,248	Common stock, \$100 par, 750 shares authorized, 700 shares issued and outstanding	70,000	70,000
Construction in progress	1,180,399	2,684,352	Additional paid-in capital	625,307	625,307
	71,229,308	64,898,600	Accumulated other comprehensive loss	-698,359	-507,900
Related-Party Receivables			Retained earnings	40,221,272	34,306,841
net of current portion	4,255,968	3,004,547		40,218,220	34,494,248
Other Assets				112,611,236	100,419,146
Investments	555,907	97,277			
Grower rec, net of curr port	610,403	712,096			
Other Assets	605,932	712,096			
	1,772,242	809,373			
	112,611,236	100,419,146			

Exhibit 6: Continued

Wenatchee Growers, Inc.

Consolidated Statement of Income

	December 31, 2002
Packing & Warehouse Revenue	71,294,671
Cost of Packing & Warehouse	<u>54,473,857</u>
Gross Profit	16,820,814
Selling, General, & Administrative	<u>8,516,529</u>
Income from Operations	8,304,285
Other Income	
Interest income	501,040
Interest expense	-3,191,991
Other income, net	<u>481,865</u>
	<u>-2,209,086</u>
Income before Minority Interest	6,095,199
Minority Interest in Subsidiary Income	<u>-180,768</u>
Net Income	<u><u>5,914,431</u></u>

Wenatchee Growers, Inc.

**Consolidated Statement of Changes
in Stockholders' Equity**

	December 31, 2002				
	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance, December 31, 2001	70,000	625,307	-507,900	34,306,841	34,494,248
Comprehensive Income					
Other comprehensive income					
Unrealized loss on interest rate swap			-190,459		-190,459
Net Income				5,914,431	5,914,431
Total comprehensive income			<u>-190,459</u>	<u>5,914,431</u>	<u>5,723,972</u>
Balance, December 31, 2002	<u>70,000</u>	<u>625,307</u>	<u>-698,359</u>	<u>40,221,272</u>	<u>40,218,220</u>

Exhibit 6: Continued

Wenatchee Growers, Inc.	
Consolidated Statement of Cash Flows	
Year Ended December 31, 2002	
Net Cash from Operating Activities	
Net Income	5,914,431
Adjustments to reconcile net income to net cash from operating activities	
Depreciation & Amortization	6,071,178
Minority Interest in subsidiary income	180,768
Income from investments	-258,524
Allowance from doubtful accounts	298,565
Increase (decrease) in cash due to changes in assets and liabilities	
Accounts receivable	-1,910,995
Inventory	2,280,903
Prepaid Expenses	-454,341
Grower Receivable	-844,619
Other Assets	90,658
Accounts payable	7,898,881
Accrued expenses	-61,591
Accrued interest	698
Deferred compensation	3,451
Net Cash from Operations	<u>19,209,463</u>
Cash Flows from Investing Activities	
Loans issuance costs	-30,140
Purchases of land, buildings, and equip	-4,452,973
Net repayments on related-party receivables	<u>369,222</u>
Net Cash from investing activities	<u>-4,113,891</u>
Cash Flows from Financing Activities	
Proceeds from crop loans	997,835
Payments made on crop loans	-1,160,026
Net payments made on line-of-credit facility	-4,500,000
Payments made on long-term debt	-15,482,141
Additional borrowings on long-term debt	10,613,902
Capital distributions to LLC member	<u>-247,368</u>
Net Cash from financing activities	<u>-9,777,798</u>
Net Increase in Cash and Cash Equivalents	5,317,774
Cash and Cash Equivalents, December 31, 2001	<u>496,979</u>
Cash and Cash Equivalents, December 31, 2002	<u><u>5,814,753</u></u>

Exhibit 6: Completed

Supplemental disclosure of cash flows information:

- Interest received in cash during the year \$501,040
- Interest paid in cash during the year 3,275,193

Schedule of noncash investing and financing activities:

- During the year ended December 31, 2002, the Company had an unrealized loss on interest rate swaps of \$190,459. The effect of this is an increase in long-term debt of \$190,459 and a decrease in other comprehensive income of \$190,459.
- As of December 31, 2002 and 2001, the Company had capitalized, as prepaid expenses, \$432,033 and \$302,647, respectively, of depreciation expense associated with cherry packing equipment.
- During the year ended December 31, 2002, the Company exchanged \$200,106 of grower receivable balances into ownership of two orchard investments.
- During the year ended December 31, 2002, the Company entered into fixed asset capital leases for \$8,033,250.

Exhibit 7: West Coast Fruit Financial Data**PER UNIT SUMMARY (Data Provided By WCF's Accountant):**

	BOX	POUNDS	
variable income	\$14.06	\$0.59	\$12,104,697
fixed income	0.00	0.00	\$2,537
total income	14.06	0.59	\$12,107,234
variable labor	3.69	0.16	\$3,180,399
variable operating costs	4.21	0.18	\$3,621,102
total VC	7.90	0.34	\$6,801,501
fixed labor	0.84	0.04	\$726,844
interest cost	0.39	0.02	\$331,607
fixed costs	3.33	0.14	\$2,868,452
total FC	4.56	0.20	\$3,926,903
total costs	12.46	0.54	\$10,728,404
net income	1.60	0.05	\$1,378,830
contribution margin	6.16	0.26	
break even	637,058	15,072,914	

Additional Information:

1. West Coast Fruit (WCF) uses a line of credit to meet its seasonal working capital needs. It may borrow up to a total of \$5,000,000 between January and August. The minimum initial draw is \$300,000. Interest is paid at the end of the month on the balance outstanding at the beginning of the month, at a stated rate of 4.5%.

When the firm generates available cash flow, it is first applied to any outstanding balance from this line. All borrowings must be repaid by October 1.

2. Cherry production projections for WCF:

<u>MONTH</u>	<u># of boxes</u>
APRIL	42,377
MAY	450,950
JUN	403,399
JULY	8,327

3. Most of WCF’s sales are made on account, charged and paid during the harvest cycle (April through July). There are also approximately \$3.5 million in cash sales during these months, made in proportion to the number of boxes produced.
4. Between April and July, WCF makes cash payments to its growers of approximately \$3 million. These are also made in proportion to production.
5. WCF’s fixed administrative payroll is \$28,730. In January and August, inventory, maintenance, and accounting statement preparation cause this portion of payroll to 4 and 5 times normal, respectively. February and March also require extra labor inputs, as WCF gears up for harvest. Total administrative payroll is 1.5 times normal in these two months.
6. Variable labor charges for harvest labor is determined as \$3.69/box produced.
7. WCF’s bookkeeper has prepared some basic pro-forma monthly balance sheets for 2003. These are shown on the next page. However, he did not adjust the current liabilities to reflect payments of the current portion of long-term debt; changes in total current liabilities reflect only payments on trade accounts payable. Required debt payments are shown in the table below.
8. WCF leases certain portions of CJL Orchards. The lease calls for varying monthly payments, corresponding to the harvest cycle. Required payments are listed in the table below.

<u>MONTH</u>	<u>REQUIRED PAYMENTS ON LONG-TERM DEBT</u>	<u>ORCHARD PAYMENTS</u>
JAN	\$58,177	\$219,244
FEB	\$51,358	\$30,000
MAR	\$44,400	\$30,000
APR	\$51,611	\$60,000
MAY	\$44,500	\$100,000
JUN	\$44,500	\$100,000
JUL	\$51,867	\$100,000
AUG	\$44,600	\$30,000
SEP	\$44,700	\$30,000
OCT	\$64,285	\$30,000
NOV	\$45,100	\$30,000
DEC	\$44,800	\$30,000

9. Rent for WCF’s office space is \$55,000/month.
10. WCF’s owners’ capital draws total \$33,000/month.
11. WCF’s long-term debt carries a stated rate of 6%.

APPENDIX

Summary

Wenatchee Growers, a third-generation family firm based in Wenatchee, Washington, was considering the acquisition of West Coast Fruit Company (WCF) of California. Three of the five family members who control WCF were ready to divest themselves of their shares, and had approached the managers of Wenatchee with an offer to buy 51% of WCF's equity. The challenge for Wenatchee (and the students) was to determine the value of that equity stake.

Target Courses/Intended Audience

This case was partially written by students in a senior-level advanced corporate finance course, and was designed to be used in future sections of that course. The case addresses many of the salient issues of corporate finance, including estimating the opportunity cost of capital and the required return on equity; adjusting betas and/or discount rates for varying capital structures; deciphering financial statements and using ratio analysis; projecting project cash flows; and estimating the benefits of a merger. However, the significant strategic elements of the case make it equally appropriate for a capstone strategy course.

Suggested Questions

1. How should Wenatchee evaluate the potential acquisition of WCF?
2. How should Wenatchee determine the appropriate discount rate to use to value WCF's cash flows?
3. What is the value of WCF as a stand-alone business? How should this value affect Wenatchee's assessment of the potential acquisition?
4. What is the value of Wenatchee Growers as a stand-alone business?
5. What are the significant strategic elements that Wenatchee must consider when evaluating the potential acquisition?
6. How much should Wenatchee pay for 51% of WCF's equity?

EPILOGUE

Wenatchee did buy West Coast Fruit, for about \$10 million. Wenatchee's finance chief had valued the WCF at between \$10-\$12 million, using the discount rate of 15% and an average annual cash flow of about \$2.25 million. In 2003, cherry sales were up in the market as a whole by almost 40%.

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NOTE: This case is based on real events. The financial statements and other information presented are based on the actual numbers used by the participants (although some scaling may have been applied and other adjustments may have been made for clarity of exposition). The data was collected using plant visits and phone and e-mail communications. The first version of this case was written by students in an advanced corporate finance course at the University of Puget Sound.

Exhibit 7: (Continued)

WEST COAST FRUIT							
Pro-Forma Balance Sheets: 2003							
	<u>Dec-02</u>	<u>Jan-03</u>	<u>Feb-03</u>	<u>Mar-03</u>	<u>Apr-03</u>	<u>May-03</u>	<u>Jun-03</u>
<u>ASSETS</u>							
total cash	\$90,508	\$102,595	\$0	\$0	\$0	\$0	\$4,618,618
A/R fruit sales	\$95,651	\$251,386	\$88,788	\$1,236	\$738,336	\$8,641,128	\$7,895,543
total other A/R	\$1,223,121	\$1,224,181	\$1,224,181	\$1,224,181	\$1,224,181	\$1,224,181	\$1,224,181
total other current assets	\$756,039	\$756,039	\$756,039	\$756,039	\$756,039	\$756,039	\$756,039
total PP&E	\$5,817,769	\$6,003,563	\$5,999,163	\$5,994,763	\$6,020,363	\$6,085,963	\$6,151,563
total loans receivable	\$240,945	\$773,364	\$973,364	\$973,364	\$973,364	\$973,364	\$973,364
TOTAL ASSETS	\$8,224,033	\$9,111,128	\$9,041,535	\$8,949,583	\$9,712,283	\$17,680,675	\$21,619,308
<u>LIABILITIES</u>							
total current liabilities	\$989,491	\$1,792,545	\$2,032,163	\$2,365,759	\$3,236,374	\$8,363,797	\$10,647,768
total long-term debt	<u>\$2,812,555</u>	<u>\$2,754,438</u>	<u>\$2,703,080</u>	<u>\$2,658,680</u>	<u>\$2,607,069</u>	<u>\$2,562,569</u>	<u>\$2,518,069</u>
total liabilities	\$3,806,200	\$4,251,779	\$4,646,682	\$5,124,439	\$5,586,756	\$5,053,022	\$4,489,494
total stockholders' equity	<u>\$4,417,833</u>	<u>\$4,859,349</u>	<u>\$4,394,853</u>	<u>\$3,825,144</u>	<u>\$4,125,527</u>	<u>\$12,627,653</u>	<u>\$17,129,814</u>
TOTAL L&OE	\$8,224,033	\$9,111,128	\$9,041,535	\$8,949,583	\$9,712,283	\$17,680,675	\$21,619,308

Exhibit 7: (concluded)

WEST COAST FRUIT
Pro-Forma Balance Sheets: 2003

	<u>Jul-03</u>	<u>Aug-03</u>	<u>Sep-03</u>	<u>Oct-03</u>	<u>Nov-03</u>	<u>Dec-03</u>
<u>ASSETS</u>						
total cash	\$8,833,204	\$1,250,381	\$1,162,922	\$842,177	\$576,897	\$309,132
A/R fruit sales	\$1,699,983	\$340,985	\$1,236	\$1,236	\$1,236	\$1,236
total other A/R	\$1,224,181	\$1,224,181	\$1,224,181	\$1,224,181	\$1,224,181	\$1,224,181
total other current assets	\$756,039	\$756,039	\$756,039	\$756,039	\$756,039	\$756,039
total PP&E	\$6,217,163	\$6,212,763	\$6,208,363	\$6,203,963	\$6,199,563	\$6,195,163
total loans receivable	\$973,364	\$973,364	\$973,364	\$973,364	\$973,364	\$973,364
TOTAL ASSETS	\$19,703,934	\$10,757,713	\$10,326,105	\$10,000,960	\$9,731,280	\$9,459,115
<u>LIABILITIES</u>						
total current liabilities	\$9,913,292	\$1,360,557	\$1,217,899	\$1,160,634	\$1,140,388	\$1,141,726
total long-term debt	\$2,466,202	\$2,421,602	\$2,376,902	\$2,312,617	\$2,267,517	\$2,222,717
total liabilities	\$4,203,151	\$3,782,159	\$3,594,801	\$3,473,251	\$3,407,905	\$3,364,443
total stockholders' equity	\$15,500,783	\$6,975,554	\$6,731,304	\$6,527,709	\$6,323,375	\$6,094,672
TOTAL L&OE	\$19,703,934	\$10,757,713	\$10,326,105	\$10,000,960	\$9,731,280	\$9,459,115

