HYDE Valuations, Inc.

We Value Both Real Estate and Businesses
Including Machinery & Equipment

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The Buyer Type May Determine the Value

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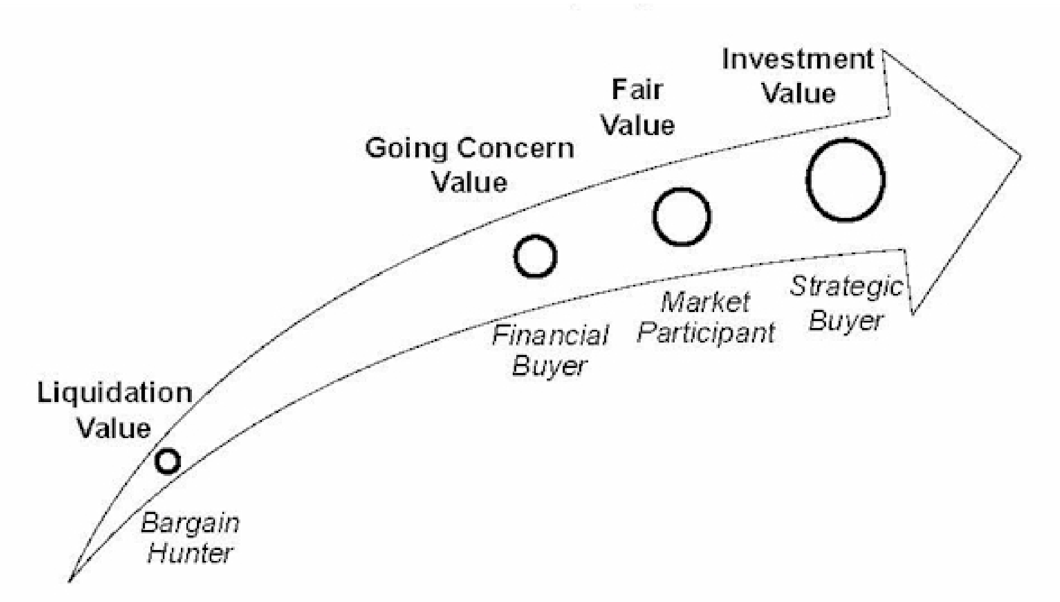
It is critically important to clearly define the purpose and use of an appraisal, particularly a business appraisal as well as the effective date of the value conclusion. Many people have a hard time understanding how a business could have a very different value depending on the motivation of the buyer. The chart below helps make this difficult concept easier to understand:



Source of Chart: Josh Cashman JD | ASA | CFA and Josh Harrison CPA/ABV | CFE | CFA - Intrinsic LLC

The difference between the values to the first two types of buyers is relatively easy to understand. A "Bargain Hunter" is only willing to pay liquidation value, i.e. the amount that could likely be realized from a sale of the business assets after paying off all creditors and accounting for the liquidation costs. If a business can be purchased for liquidation value and then turned around so that it generates profits, the buyer can resell relatively quickly and realize a substantial profit. Of course, the Seller must be willing to sell or highly motivated for any one of many reasons to accept such a low value. A "Financial Buyer" is one that bases the decision to purchase and the amount to be paid on the value of the business as a "going concern." This is typically a "fair market value" appraisal – the most commonly requested standard of value requested from business appraisers.

The key to understanding the difference between a purchase at liquidation value versus a purchase at a going concern value is whether or not the business has any intangible value, i.e. does the business generate a profit larger than the typical return that would be expected on its tangible assets. In other words, is the business worth more dead than alive? A business that is not making any money or much money (and is not expected to do so in the future) can be a candidate for liquidation. Of course, sometimes the owner of the business has no choice in the matter. If the business runs out of cash and cannot get any more cash, it typically must fold up and liquidate. If the proceeds from the liquidation are insufficient to cover all of the liabilities, the business may have no value. If the owners of the business have personally guaranteed some or all of the debt, it is conceivable that the owners will have to contribute personal funds or liquidate personal assets in order to complete the liquidation of the business; a very messy and uncomfortable situation.

The other two values shown in the chart: that which a “Market Participant” or a “Strategic Buyer” might pay are a little more difficult to understand. A “Fair Value” conclusion – the amount that would typically be paid by a “Market Participant” is generally higher than a “Fair Market Value” conclusion – the amount that a “Financial Buyer” would pay. This value is generally requested when valuing larger privately held companies and public companies in the mergers and acquisition market. Fair value appraisals are typically seen when valuing intangible assets for public companies, when valuing a company for dissenting shareholder or oppressed shareholder litigation, and sometimes for merger and acquisition work. The value to a “Strategic Buyer” is conceptually easier to understand, but much more difficult to clearly identify. The value to a strategic buyer, called “Investment Value” or the value to a specific buyer is based on such things as using the buyers lower cost of funds, by making assumptions for savings that the buyer believes will be possible after the acquisition by doing things like eliminating a sales force, an accounting department, closing some plants and facilities because existing plants and facilities can handle the work, etc. The assumptions made may or may not actually be accurate (they generally overstate the expected earnings). Many strategic purchases do not work out too well.

Business sellers always want to find a strategic buyer – someone that will overpay for the business based on what they hope they can do with it to make more money. Strategic buyers are hard to find: most approach the company they wish to acquire rather than the other way around. Market participants that purchase businesses are typically public companies or very large privately held companies. Sellers can do well in some of these situations particularly if they can find more than one suiter and get an auction going. Most business sales that actually occur are sales to financial buyers at fair market value – a negotiated amount that both the buyer and the seller agree upon assuming that both are subject to normal motivations and other typical factors. When a business must be sold due to financial constraints or other compelling reasons, bargain buyers emerge and they typically base their pricing decision on liquidation value; i.e. what they can sell off the pieces of the business for after paying off all debts and the costs of liquidating the assets. This way if things don’t work out, they can get their purchase price back (or at least most of it back).

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**

Sincerely,

Paul R. Hyde, EA, MCBA, ASA, MAI
Enrolled to Practice Before the IRS (Enrolled Agent)
Master Certified Business Appraiser
Accredited Senior Appraiser – Business Valuation
Designated Member (MAI) - Appraisal Institute
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