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Sometimes we are asked to value only the machinery and equipment for a business instead of its value as an ongoing enterprise. Whether or not you do the machinery and equipment appraisal yourself or have someone else do it, picking the correct standard and premise of value is critical. Selecting the “wrong” standard and premise of value often results in a value conclusion that is misleading and may cause serious problems.

An Example

Let's assume that a piece of equipment purchased new for \$50,000 five years ago and used in a manufacturing process is being appraised. The following are various “correct” appraisal conclusions that could be reached depending on the choice of standard and premise of value:

	Value Conclusion	Standard & Premise of Value
1	\$50,000	Historical Purchase Price
2	\$40,000	Fair Market Value – Removal
3	\$60,000	Fair Market Value in Place and in Continued Use
4	\$55,000	Fair Market Value – Installed
5	\$37,500	Liquidation Value – Orderly
6	\$25,000	Liquidation Value – Forced
7	\$45,000	Liquidation Value in Place
8	\$10,000	Salvage Value
9	\$2,500	Scrap Value
10	\$75,000	Insurance Replacement Cost
11	\$45,000	Insurance Value Depreciated

As this example illustrates, the value conclusions vary considerably. Reliance on a value conclusion performed under a standard and premise of value that is different from what is needed could cause real problems. For instance, if the machine is to be sold as part of a group in place and in continued use the value for the equipment could be \$60,000 or if sold in a forced liquidation scenario, it could be worth only \$25,000.

Editor's Column – How Can the Value be Different?

Machinery & Equipment Standard and Premise of Value Options

The following chart illustrates the options of typical combinations of standards of value and premises of value from which a selection must be made.¹ The choice of which standard of value and related premise of value makes a substantial difference in the final conclusion of value determined under the appraisal.

Standard & Premise of Value	Definition
Fair Market Value – Removal	Fair market value – removal is the estimated amount, expressed in terms of money, that may reasonably be expected for a property, in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell and both fully aware of all relevant facts, as of a specific date, considering the cost of removal of the property to another location.
Fair Market Value in Place and in Continued Use	Fair market value in place and in continued use is the estimated amount, expressed in terms of money, that may reasonably be expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, including installation, as of a specific date and assuming that the business earnings support the value reported. This amount includes all normal direct and indirect costs, such as installation and other assemblage costs to make the property fully operational.
Fair Market Value – Installed	Fair market value – installed is the estimated amount, expressed in terms of money, that may reasonably be expected for an installed property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, including installation, as of a specific date. This amount includes all normal direct and indirect costs, such as installation and other assemblage costs, necessary to make the property fully operational.
Liquidation Value – Orderly	Orderly liquidation value is the estimated gross amount, expressed in terms of money, that could be typically realized from a liquidation sale, given a reasonable period of time to find a buyer or buyers with the seller being compelled to sell on an as-is, where-is basis, as of a specific date.
Liquidation Value – Forced	Forced liquidation value is the estimated gross amount, expressed in terms of money, that could typically be realized from a properly advertised and conducted public auction, with the seller being compelled to sell with a sense of immediacy on an as-is, where-is basis, as of specific date
Liquidation Value in Place	Liquidation value in place is the estimated gross amount, expressed in terms of money, that could typically be realized from a failed facility, assuming that the entire facility would be sold intact with a limited time to complete the sale as of a specific date.
Salvage value	Salvage value is the estimated amount expressed in terms of money that may be expected for the whole property or a component of the whole property that is retired from service for use elsewhere.
Scrap value	Scrap value is the estimated amount expressed in terms of money that could be realized for the property if it were sold for its material content, not for a productive use.
Insurance replacement cost	Insurance replacement cost is the replacement cost new as defined in the insurance policy less the replacement cost new of the items specifically excluded in the policy, if any.
Insurance value depreciated	Insurance value depreciated is the insurance replacement cost new less accrued depreciation considered for insurance purposes, as defined in the insurance policy or other agreements.

¹*Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery and Technical Assets*, (Chicago: American Society of Appraisers, 2000), p. 2-4.

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Even if your firm does not do machinery & equipment appraisals, understanding the various options of standards and premises of value is important as you may include the value derived in your business appraisal. Particular care must be exercised when an equipment broker or auction house does the appraisal as most of these “appraisals” do not specify which standard and premise of value was used.

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