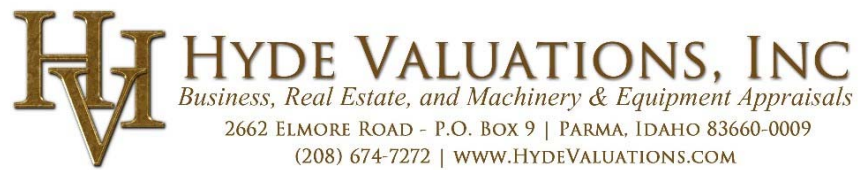




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November/December 2017

Uncertainty & Risk

Merry Christmas!



Investors dislike uncertainty. They always have and they always will. The greater the perceived degree of uncertainty, the higher the risk associated with an investment.

While risk and uncertainty have been around since the beginning of time. The concepts are, in my mind, best understood by considering entrepreneurs in England years ago that would make a massive investment in acquiring a ship and crew and send them off to purchase and bring back some exotic cargo that could be sold for a fortune. Numerous huge risks were associated with such an endeavor. I believe that the saying "...when my ship comes in" comes from this time period. If and when the investor's ship returned with its exotic cargo, the investor received an enormous return on the original investment. However, in many cases the ship sunk and the total investment was lost. At some point, enterprising individuals came up with the concept of insurance – sharing the risk of total loss for a fee. Such insurance lessened the uncertainty and thereby the risk of the investment.

Many things can be and often are done to lessen the uncertainty and thus the risk associated with an investment. Businesses routinely enter into many agreements such as leases, contracts with suppliers, purchase agreements, etc. in the attempt to reduce uncertainty regarding future earnings. Farmers sometimes use forward contracts or other agreements to assure that the goods they produce can be sold for an amount that will generate a profit or at least minimize a loss.

Uncertainty and risk are directly associated with the value of an investment. The higher the perceived uncertainty and risk, generally the lower the fair market value of an investment within a likely range. Appraisers assess the level of risk due to uncertainty and other factors and determine the impact on the value of investments. This is done by analyzing the specific investment that is the subject of the appraisal and comparing it to other similar investments. Factors that increase the uncertainty regarding the future earnings or proceeds from a potential sale of the subject, increase the risk and lower the value in comparison to other similar investments. Conversely, factors that lower the uncertainty regarding the

future earnings or proceeds from a potential sale of the subject, decrease the risk and increase the value in comparison to other similar investments.

The appraisal process, regardless of the nature of the subject, includes some subjective decisions by the appraiser – which is why appraisal conclusions are typically referred to as “opinions of value.” An appraisal’s accuracy and the degree upon which it may be relied is totally dependent on the experience, qualifications, and the amount of work done by the appraiser. A good appraisal report prepared by and experienced, competent appraiser should set forth in clear, easy to understand terms, exactly what was done and explain and support the value conclusion(s).

I am often amazed to find that the purchaser of an appraisal simply looks at the value conclusion without reading the report to see how the conclusion was reached and whether or not it makes sense. Even among well qualified and experienced appraisers, concluded opinions may vary; sometimes by a large amount. However, I have found that by carefully reading reports of differing opinions, the reason for the difference is usually readily apparent. Generally, it comes down to different assumptions relating to the uncertainty or risk associated with the future earnings of the investment or the likely future selling price.

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.**



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