



PAUL R. HYDE
EA, MCBA, ASA, MAI

HYDE Valuations, Inc.

**We Value Both Real Estate and Businesses
Including Machinery & Equipment**

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UNFAIR & BIASED APPRAISALS

APPRAISERS:

PAUL R. HYDE, EA, MCBA, ASA, MAI
SHAWN M. HYDE, CBA
BRIAN D. HYDE
JOSEPH PHELON, CBA

I recently was asked to review an appraisal of a minority interest in a business enterprise that was made for the purpose of buying out a minority shareholder whose employment had been terminated. The appraisal was very short, violated a number of appraisal standards, and concluded that the business had no value and therefore the departed minority shareholder was owed nothing for the stock.

This was a fascinating appraisal with a number of very serious problems. If it did not so adversely affect someone's life, it would have been funny.

First, the appraisal was done by the company's accountant – a clear conflict of interest. The accountant was paid regularly by the company to do its accounting, taxes, etc. and this relationship was expected to continue. It seems unreasonable to expect that someone with a vested interest in a continuing business relationship could be objective and fair (especially if the majority shareholders expected the concluded value for the minority interest to be nothing). The appraisal did not even mention that the appraiser was also the company accountant – a violation of the Uniform Standards of Professional Appraisal Practice (USPAP).

Second, the appraiser has no valuation credential and little, if any, valuation training.

Third, the standard of value used in the appraisal was Fair Market Value – this seems unfair as each of the shareholders bought into the company on a pro rata basis, but per the company accountant's appraisal, the departed minority shareholder was to be bought out on a discounted basis.

Fourth, the appraiser/company accountant used a weighted historical average of earnings to value the company instead of a detailed and well supported income forecast. According to all of the valuation textbooks with which I am familiar, the economic value of virtually any investment is based on its "anticipated future benefits." In other words: the value of an operating company is based on the anticipated future cash flows expected to be received from both its operations and its potential future sale discounted at an appropriate rate based upon the risk of achieving those expected returns. This company had lower revenue over the last few years, however, its earnings and cash flow had increased rather dramatically over its historical results despite the recent years economic and industry problems. Its recent financial results were really quite impressive; however, they were totally ignored by the appraiser/company accountant.

Fifth and so on... Well there were numerous other appraisal issue problems in the appraisal report. Basically, it appeared to come down to the fact that the remaining shareholders wanted to get rid of a shareholder that they no longer got along with and didn't want to pay the shareholder anything when that person was forced out. It looks like they asked their buddy, the firm's CPA, to prepare an "appraisal" showing that the company wasn't worth anything so that they could get rid of this individual with no cost to them.


Standard rules aside, from a common sense point of view, there was also another serious problem. The company was purchased by this shareholder group about 18 months prior to the force out. The departing shareholder was not even offered a return of his original cash investment. The company has paid its acquisition debt down more rapidly than scheduled during the time of ownership indicating that they were doing pretty well and were likely financially capable of offering at least a refund of the cash invested.

The whole deal appears to be unfair and unreasonable – and supported by an unfair and biased appraisal.

In my opinion, this story points out yet again the basic reasoning for using an independent and well qualified appraiser when it becomes necessary to value an investment.

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 both real estate and businesses including machinery & equipment.**

Sincerely,



Paul R. Hyde, EA, MCBA, ASA, MAI
Enrolled Agent – Enrolled to Practice Before the IRS
Master Certified Business Appraiser
Accredited Senior Appraiser – Business Valuations
Designated Member – Appraisal Institute (MAI)
Certified General Real Estate Appraiser
Accredited Equine, Livestock & Farm Machinery Appraiser

504 Grove Avenue • P. O. Box 9 • Parma, Idaho 83660 • (208) 722-7272
www.hydevaluations.com Email: prh@hydevaluations.com