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Editor's Column – Using Relevant Economic Data

Paul R. Hyde, EA, MCBA, BVAL, ASA, MAI

Over the years, I have reviewed many business appraisal reports. I find it interesting that rarely is there any apparent reason that an economic section is included in the report other than "because it is supposed to be there." The industry report is occasionally referenced elsewhere in the report, but often it is also simply included to meet a "requirement".

The point of including economic and industry sections in appraisal reports is to assist in identifying risks facing the business. We should be looking for risk and value drivers and referencing them throughout the entire report. I believe that many appraisers do not really consider how the economic and industry data included in their reports affects the outlook of the business being appraised.

Another issue often encountered in appraisal reviews is the irrelevance of economic data included. If a local hotdog stand is the subject of the appraisal, how relevant is the U.S. trade imbalance with Japan? When appraising a local business which generates all of its sales in the local area, aren't local demographics, expected population fluctuation, and personal disposable income, etc. relevant? Yet, this relevant data is seldom included and discussed in business appraisal reports.

A relatively recent appraisal of a rural veterinary practice as part of a contemplated purchase/sale brought this point home to me. The following are some excerpts from this report – the name of the local community has been changed to 'Small Town' to preserve confidentiality. Please note the likely difference in assumptions that would have been made in the report if the local economic outlook had not been used.

National Economy

The U.S. economy is expected to slow down due to the cooling housing market and the accompanying slowdown in consumer spending. However, the drop in energy prices will provide a counterpoint to the housing market. Unemployment is expected to reach full employment levels in the next couple of years, and currently the federal deficit is trending downward. Overall, the U. S. economic outlook is positive and bodes well for business.

State Economy

Idaho and Eastern Oregon's economy has been expanding strongly over the past few months. Idaho and Eastern Oregon nonfarm employment grew at a 4.6% annual rate in the third quarter of 2005, and a 5.8% rate in the fourth quarter. As a result of this strong growth, Idaho and Eastern Oregon ended 2005 with 623,400 jobs, with one of the strongest performing sectors being construction employment. It is expected that Idaho and Eastern Oregon's job count will reach 682,500 by

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2009, and Idaho and Eastern Oregon's population is expected to grow by just over 2% annually.

Local Economy

The local area population has been stagnant since 2000 and the five year population forecast does not expect any growth in population. In fact, a decline in local population is expected. The local sugar factory, the areas' largest employer, downsized significantly about two years ago laying off many people. The area has not yet recovered from this downturn in employment.

The current year estimated median household income is \$33,053, compared to the US median which is \$51,546.

Currently, 86.3% of the civilian labor force in the market area is employed with 13.7% unemployed. In comparison, 93.4% of the U.S. civilian labor force is employed, and 6.6% are unemployed. In five years the rate of employment in the area is expected to be 87.2% with 12.8% unemployment.

Little development has occurred in Small Town over the last five years or so. What development has occurred has primarily been along the main highway through town.

Residential development consists primarily of many older homes, a mobile home park in the area, and one small residential subdivision. No new residential subdivisions for the area are planned or contemplated according to local planning and zoning officials.

Summary

If the appraisal had not included the local economic and demographic information, the appraisal forecast and selected multiples might have been very different. In this case, the national and state information was very different from the local economic information, which was more relevant to the business being appraised.

<p>Paul R. Hyde, EA, MCBA, BVAL, ASA, MAI is the President of Hyde Valuations, Inc., a business and real estate appraisal firm based in Parma, Idaho. His firm is a member of the National Business Valuation Group network.</p>
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