Obtaining Fair Market Value

Valuing the Assets of the Business

Every VR Business Sales intermediary understands the importance of fair market value when appraising a business to sell. Most business brokers merely rely on book value or the owner's best estimate; even an arbitrary discount or premium based on the type of asset involved. However, this is not correct. Through your VR Business Sales intermediary performing a business valuation, you will be able to arrive at fair market value – for example, assets, inventory, current revenue streams and intellectual property.

Using Past and Future Financial Analysis

When performing a business valuation, it's important to use both historical and projected financial analysis to normalize discretionary net profit. If the costs of the assets are off, at a capitalization rate of 25%, every one thousand dollars of discretionary net profit can equal 4 times that amount when capitalizing the income; therefore, having a drastic impact on the overall value of the company.

You have to take into consideration the many calculations in the various approaches when valuing the assets. Even with those valuations not directly impacted by methodology involving the assets, they are still taken from capitalization of the income stream. This can result in dramatic differences in value.

One popular method of valuation is a combination of:

Assets + Multiple of Earnings

Almost every methodology relies on the normalized income stream – assets can play a significant role in the overall estimate of value of the business. Depending on the size of the business and the various methods of valuation used, an error in valuing the assets can affect price greatly.

ANALYZING THE ASSETS

Real Estate

When valuing a business, you have to be thorough to research the value of the real estate to determine the fair market rent to be deducted from expenses. This will allow the real estate to be added to the fair market value of the business as an *investment value*.

Hard Assets

There are various categories of hard assets:

- Furniture, Fixtures and Equipment,
- Vehicles or rolling stock,
- Inventory (both for resale and parts for everyday repairs),
- Leasehold improvements,
- Licenses, Patents and Trademarks.

You have to analyze individually every category of assets. In some cases, you may have to arrive at a *value in use* of the equipment in addition to the fair market value.

By definition, "*Value in Use"* is:

The value of an economic good to its owner/user is based on the production (privacies in income; utility or amenity form) of the economic good to a specific individual. This is a subjective value however, and may not necessarily represent market value.

Valuation Scenarios for Furniture, Fixtures and Equipment

Several situations can happen when trying to research the values of furniture, fixtures and equipment. There are two scenarios that can take place when contacting used equipment dealers, trade association magazines and owners of similar businesses:

- **Everyone seems to know the value** of the various pieces of equipment;
- **No one can give you a straight answer** until they see the equipment and its condition.

Everyone Knows the Value

To reflect the fair market value of the assets, you can adjust the equipment on the balance sheet by adding to or deducting from depreciation.

No One Knows the Value

This is an indication that age, condition and/or model has a significant impact on value. Although the worth of the equipment may not be known to the contact or owner, all should definitely know how long each piece of equipment will last. This is where you will apply the *Remaining Useful Life* (RUL) method.

Always take note of who you talk to and the estimate they give on the useful life of each piece of equipment. Based on a range of life expectancy, you can deduct a fair and reasonable life for each piece of equipment. The calculations are a simple mathematical method of recasting the depreciation schedule that the accountant has used.