



Standards of Value

Intrinsic Value

Intrinsic value, also known as fundamental value, is most commonly used by analyst to determine a purchase price a stock. Analyst will base their buy, hold, or sell recommendations using fundamental analysis. This analysis is based on the financial statements, interviews with management, capital structure, and growth and income potential. From this analysis, analysts determine whether or not a stock is under or over valued on the public stock exchange.

As you may have already realized, intrinsic value is the value an investor will determine to be the true value or worth of a particular stock. In our case, the true value of a business. How then is intrinsic value different from investment value? Intrinsic value is the analytical value based on characteristics that the analysts perceive to be present in the investment. Investment value is based on one investor and their criteria as opposed to comparing several analysts. This is an important difference, as the business may have a particular true value based on fundamentals, but the investor may have different requirements in order for them to invest in a stock or business.

The three standards of value (fair market value, fair value, and investment value) we discussed in previous issues differ from intrinsic value in that intrinsic value is based on the income approach. The other three usually uses all three approaches: income approach, market approach, and asset approach.

So were would you use the intrinsic value. Typically, if you were evaluating a business for investment purposes for a client, you would use the intrinsic value to determine if the business was undervalued compared to the market. Much like analyst will determine if a publicly traded stock is under or over valued on a public exchange. You could also use the intrinsic value when or if you are in need of verifying an appraisal.

Example: An appraisal generated a value of \$500,000 using the market approach and the income approach generated a value of \$975,000. For the purpose of this example, the asset approach was not considered. To estimate the value of the business, you would reconcile these figures. Part of reconciling the figures is to determine why there are discrepancies. In order to support your estimate of value, you must be able to show how you arrived at the estimated value based on more than just your opinion. You may discover that the public values are trading lower than the intrinsic value. Your research reveals that the analysts covering the related industry have a recommendation of buy on most of the stocks in that industry. The buy recommendation is based on the fact that the market value is lower than the intrinsic value. You now have the beginning basis and support for the reconciliation of values.

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