



Approaches and Methods

Asset Approach

Net Asset Value Method

The Net Asset Value Method (also referred to as the Adjusted Book Value Method) is particular well suited to appraise: Manufacturing companies, Holding companies, Asset-intensive companies, Not-for-Profit organizations, and Controlling interests. Basically, it is organizations that do not have much, if any, income or are asset intensive. That should stand to reason that this approach and method is not suitable for companies such as: service businesses, asset-light businesses, operating companies with intangible assets (value), or minority interests.

To perform this method, you simply determine the fair market value of the assets and deduct the fair market value of the liabilities. Obviously, you would only deduct the liabilities if the liabilities would be included in a potential sale. I refer to a reseller of the used assets, if there is a small amount of assets, to arrive at the fair market value. A licensed commercial equipment and real estate appraiser is consulted if there are excessive assets. Any such assistance is noted in the report.

Excess Earnings Method

Some appraisers place the Excess Earnings Method under the Income Approach. I place it under the Asset Approach (no I am not the only one, the IBA supports this madness) for reasons that should be evident shortly.

This is a complex calculation and will be covered in detail in a later education piece. I have however, provided a basic formula for the Excess Earnings Method below. Do not get tied up in the numbers, as they are only for illustration purposes only:

Estimated Future Income (normalized)		\$1,000,000
Less: Return on <u>net</u> tangible assets	-	<u>\$ 119,000</u>
(\$700,000 x 17%)		
Excess Earnings		\$ 881,000
Capitalization Rate	/	<u>38%</u>
Excess Earnings Method (Intangible Value)		\$2,318,421
Plus: Net Asset (Adjusted Book) Value	+	<u>\$ 700,000</u>
Total Asset Approach Value		\$3,018,421

It should be obvious as to why I include the Excess Earnings Method under the Asset Approach. You need to know the fair market value of the net (sound familiar) tangible assets and the required return on those assets. Also, the Excess Earnings Method is used to determine the value of intangible assets. It should be noted that Revenue Ruling 68-609 states that the Excess Earnings Method should be used to value only intangible assets and not an entire business. To value an entire business, add the value arrived from the Net Asset Method to the Excess Earnings Method value. The complicated portion of this method is the necessity to support and defend how you arrived at the capitalization rate and the rate of return on tangible assets.

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