



Standards of Value — Which One Works When?

Consider a toddler's tattered blanket. What is its value?

To the average person, the blanket is worth nothing. It's small, old and worn out. But to the toddler — and to his or her parents looking for the beloved blanket at naptime — the tattered treasure is absolutely priceless.

This illustration underscores the importance of knowing the purpose behind a business valuation. In other words, what is the business or property worth *to whom*? Who's the end user of the valuation report?

Different situations require different "standards of value." Is the business value being assessed for sale? For estate planning? For divorce proceedings? The conclusions drawn in a valuation report may vary based on the intended user. Some standards are legally mandated. Others simply make sense. Here's a look at the most common standards of value.

Fair Market Value

The most commonly used standard, fair market value, is used in virtually all state and federal tax matters, including gift and estate taxes. It is defined by Revenue Ruling 59-60 as "the amount at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy, and the latter is not under any compulsion to sell ..."

Investment Value

Unlike fair market value, this standard assumes that certain synergies exist between buyer and seller. It's typically defined as the value of a business or property to a *specific* buyer. For example, an investor may have specific requirements for an acquisition. If the business being appraised meets all of those criteria, its value is obviously enhanced. Investment value is often used in mergers and acquisitions.

Note that fair market value is often lower than investment value because investment value is calculated with a specific buyer in mind.

Intrinsic or Fundamental Value

Frequently used in the analysis of stocks, this term refers to what a financial analyst believes is the "real" or "true" value of a security. It is based on the perceived characteristics of the investment according to a security analyst's fundamental analysis of the company's assets, earning power and other factors. (If the market value is below the intrinsic value, the analyst will consider the stock a "buy.") Intrinsic value becomes fair market value when investors reach the same conclusions.

Fair Value

This standard is used in cases of dissenting stockholders' disputes. Many states define fair value with respect to dissenters' shares as "the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects." This standard of value typically dictates that no valuation discounts are applicable.

Obviously the valuation amount may differ depending on which standard is used. At the beginning of every valuation engagement, the business valuation professional will work closely with the client to discern which standard is appropriate.

Do you have questions about valuation standards? Please contact our office and we'll be happy to discuss them with you.

Value to Whom?	
<u>Valuation Purpose</u>	<u>Applicable Standard</u>
Taxes/contributions	Fair market value
Purchase or Sale	Usually fair market value, sometimes investment value
Divorce	Depends on state and case law
Buy/sell agreements	Depends on what parties prefer
Dissenting stockholders/ minority oppression	Generally fair value
ESOPs	Fair market value
Going private	Fair value in most states
Antitrust cases	Varies
Other damage cases	Mostly governed by state statutes

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