

THE VALUE OF ASSET VALUATION

It is critical that SMEs have a good handle on the value of their assets, especially when they have manufacturing operations in different locations

BY MILTON TAN

AT A TIME when small and medium-sized enterprises (SMEs) are going through challenges in their businesses, it is critical that they have a good handle on the value of their assets, especially when they have manufacturing operations in different locations.

Valuation provides a scientific and consistent assessment of assets across a company's geographies, and allows SMEs to understand and unleash the true value of their assets. It is a technique that accurately describes and prescribes a market value which is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction.

This is arrived at after proper marketing and where the parties had each acted knowledgeably and prudently; and this should be distinguished from planned depreciation (accounting depreciation), where the recorded decline in the cost of an asset is tied to its business life.

Assets such as plant and machinery which – when combined with other items including industrial infrastructure, utilities, building services installations and specialised buildings – form a dedicated assemblage in a manufacturing operation.

WHEN ASSET VALUATION IS REQUIRED

There are many situations when SMEs require asset valuation to be conducted. Among them: mergers & acquisitions, liquidation, financial reporting, financing, transfer of assets, impairment, mediation support and obtaining a second opinion. It could also simply be to understand the market value of the company's capital assets so as to make an informed business decision.

Nowadays, there is a strong emphasis on internal controls and governance under standards established by the International Valuation Standards Council (IVSC), the Royal Institute of Chartered Surveyors (RICS), the Institute of Valuers and Appraisers of Singapore (IVAS), International Financial Reporting Standards (IFRS) and others. Because of guidelines set by the various standards boards, there is growing demand by companies to conduct valuations and to understand the value of their assets that reside in their manufacturing facilities.

It is never too early to conduct a valuation

as it is one of the best practices that provides an independent value of the capital assets to investors, shareholders, financial institutions, funders, regulators and others. The valuation, in turn, allows management and other decision makers to make informed decisions that will create an environment of trust for the target company that is being valued.

Potential investors or existing shareholders also want to be better informed of what they are investing in. Valuations conducted at regular intervals provide them with a good insight of the value and condition of the assets. From valuations, they can ascertain the quality of operations management. The valuations also enable them to plan ahead or make certain decisions to improve the overall management or business strategy.

WHAT ARE SOME OF THE COMMON ERRORS DISCOVERED DURING ASSET VALUATION?

For instance, disconnection may occur between the financial and ground operations, especially for companies with manufacturing facilities in other countries far from their incorporated headquarters. The disconnection may include errors arising from simple counting of units of machines that may have been separately accounted for as “each” in the accounts and a “set” in the ground operations.

This is because machines are viewed differently in ground operations vis-à-vis machines from a finance perspective. After several years, the finance department may be told, for instance, that a CNC machining centre that was classified as “each”/“one” machine does not include a worktable, spindle, chucks, transformer, controller etc. This may give rise to a potential false count and false asset cost that differs from the value of the asset when it was first purchased.

Another common error is asset tagging. Such errors are usually not discovered until a valuation is conducted. There have been cases of ground operations showing the same asset to the accountant multiple times and identifying it as different line items within the same asset listing. This can lead to a highly overstated situation in the asset listing.

Discrepancies in the description of assets from the actual assets on the ground are also common. This gives rise to an artificially inflated value if an inspection was not conducted. One example that Colliers had encountered was a 200T

die-casting machine that was wrongly described as a 450T, resulting in an inaccurate statement of the asset's value.

Should such issues occur, a valuation is recommended to be conducted to rectify them and also provide an accurate value of the assets.

VALUATION PROCESSES

Before an SME rushes into a valuation, it is important to determine the purpose of a valuation. Indeed, it is the first step that an organisation should consider, and it should be articulated clearly to the valuer.

The valuation's purpose must also be discussed with various stakeholders, such as shareholders, board of directors, accountants and audit committee (if any), before instructions are provided to the valuer.

Once the purpose is clearly defined and communicated to the valuer, the valuer will then discuss and advise on suitable and relevant methodologies and approaches for the exercise.

The organisation's finance team will provide a detailed asset listing that reconciles with the financial statements and management accounts for the valuer to determine the coverage and timeframe to complete the entire valuation.

The more detailed the information that the valuer receives, the better it would be, as this would save time during the valuation process and asset inspection. When a valuer is asked to undertake a valuation on the basis of limited information, the nature of the limitation must be agreed upon. The valuation implications of the limitation have to be confirmed in writing to the client, before the valuation results are reported. ■

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HOW ASSET VALUATION HELPED TWO CASES

CASE 1

The services of a valuer were engaged when two feuding partners in a spare parts manufacturing business wanted to go their separate ways. How to split the business in an equitable manner, based on each contribution to the booming business, turned out to be a major issue.

Each partner engaged lawyers to act for them but the negotiations were bogged down for a couple of years on the split of the business to the point where the two partners were prepared to go to court to resolve the matter.

However, just before they took the dispute to court, one of the lawyers suggested engaging a valuer to assess their tangible assets heavy business. Both partners agreed, and a valuer was jointly appointed by them. The valuer got down to work quickly and came up with a robust and fair valuation of the assets which subsequently enabled both partners to go their separate ways in an equitable manner without going to court – which would have cost them more money and time than the services of a valuer.

CASE 2

Another case involved Company A which was cash-rich and casting around for diversification. It spotted a synergistic opportunity in Company B, an SME manufacturing company which had potential and was looking to scale-up its operations. Company B was receptive to A's overtures.

The next step was to put a value to B's assets to determine how much cash A should inject for the equity stake it had in mind. A valuer was appointed jointly by both parties – the acquirer (A) and acquiree (B) to map out the assets' value.

Company B is now part of the larger Company A.

These two cases highlight the value of a valuer, whether in a break-up or “marriage” situation. In both cases, the valuer was jointly appointed by both parties – underlining the trust that they had in the valuer as an independent professional to come up with unbiased opinions.

THE STANDARD BEARERS OF GOOD VALUATION SERVICE

The following associations provide good quality valuers for plant and machinery. They have minimum standards and guidelines to which valuers have to adhere.

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- **The International Valuation Standards Council (IVSC)** is an independent, not-for-profit organisation that produces and implements universally accepted standards for the valuation of assets in the interest of the general public. IVSC provides accreditation to companies but not to individuals.
 - **The Royal Institute of Chartered Surveyors (RICS)** regulates and promotes the profession. It maintains the highest educational and professional standards, protects clients and consumers via a strict code of ethics. It provides impartial advice and guidance.
 - **The Machinery and Business Assets Professional Group** is the professional association for the machinery and business assets sector that focuses on four main areas: standards, professional statements, market insights and regulatory issues.
 - **The American Society of Appraisers (ASA)** in the US trains professional appraisers who become members with a good grounding in the appraisal principles in many asset classes.
- Valuers who are members of the RICS can append MRICS (Member of the Royal Institute of Chartered Surveyors) after their name. Having the title Registered Valuer of RICS shows that the RICS has provided further recognition of the valuer, and similarly for ASA.