



INTERNATIONAL VALUATION STANDARDS COUNCIL

ILLUSTRATIVE EXAMPLES

Chapter 1 – Bases of Value

EXPOSURE DRAFT

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CommentLetters@ivsc.org

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Introduction to Exposure Draft

This draft represents the first chapter of a rolling project to provide Illustrative Examples for many of the valuation concepts and principles discussed in the **IVS Framework**. The purpose of the project is to assist practitioners to better understand the concepts by illustrating their application in various scenarios. The Illustrative Examples do not form part of the International Valuation Standards and do not alter or amend any of the standards.

The intention is to develop further chapters on other topics including, but not limited to:

- Market Participants
- Market
- Proper Marketing
- Forced Sales
- Assumptions and Special Assumptions
- Aggregation and Unit of Account
- Highest and Best Use
- Transaction Costs
- Valuation Date

Questions for Respondents

The IVSC Professional Board invites responses to the following questions. Not all questions need to be answered but to assist in the analysis of responses received please use the question numbers in this paper to indicate to which question your comments relate. Further comments on any aspect of the Exposure Draft are also welcome.

Notes for respondents:

In order for us to analyse and give due weight to your comments please observe the following:

1. Responses should be made in letter format, where appropriate on the organisation's letter heading.
2. Comments should not be submitted on an edited version of the Exposure Draft.
3. Unless anonymity is requested, all comments received may be displayed on the IVSC website.
4. Comments letters should be sent as an email attachment in either MS Word or an **unlocked** PDF format and no larger than 1mb. All documents will be converted to secured PDF files before being placed on the web site. **Please include "Illustrative Examples – Chapter 1" in the subject line of the email.**
5. The e mail should be sent to commentletters@ivsc.org

Questions

1. Do you consider the differences among the IVS bases of value have been adequately illustrated? If not, what additional illustrations might be helpful?
2. Do you perceive any issues or unintended consequences arising from any of the illustrations? If you do, please explain what these are.
3. Do you consider that there are any other differences between Market Value and IFRS 13 Fair Value that should be discussed and illustrated?
4. Does the term “arm’s length” in the Market Value definition need explanation?
5. Do you find the graphics in the document helpful in understanding the relationships between the bases of value and other pertinent concepts?
6. Below are examples of other topics within the scope of the Illustrative Examples project which the Board is planning to cover in future chapters:
 - Market Participants
 - Market
 - Proper Marketing
 - Forced Sales
 - Assumptions and Special Assumptions
 - Aggregation and Unit of Account
 - Highest and Best Use
 - Transaction Costs
 - Valuation Date

Please indicate the perceived priorities from this list and if there are any additional concepts or issues within the IVS Framework that you believe it would be helpful to address.

ILLUSTRATIVE EXAMPLES

Chapter 1 – Bases of Value

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Introduction

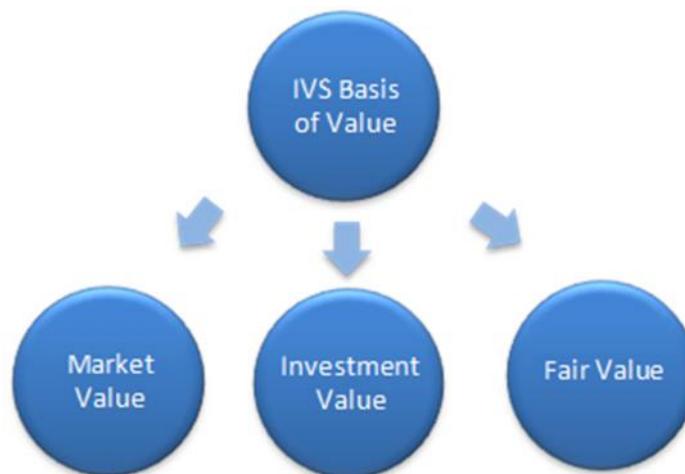
1. The role of the IVSC not only includes developing and maintaining the International Valuation Standards (IVSs) but also supporting their adoption and use. In accordance with this second objective the IVSC Professional Board is developing a series of “Illustrative Examples” to explain some of the concepts in the IVS Framework. This is the first chapter of that series. These Illustrative Examples do not form part of the IVSs. The references to the IVSs in this chapter refer to those in issue on 1 July 2013 but do not alter or amend any of those standards.
2. This chapter illustrates and compares different bases of value. The IVSs require the bases of value to be stated in both the scope of work and the report, see IVS 101 2(e) and IVS 103 5(e). The basis of value must be appropriate for the purpose for which the valuation is required and the source of the definition of the basis must be provided or the basis otherwise explained.
3. The IVS Framework includes definitions and explanations for several different bases of value which are discussed in this chapter. Paragraph 28 of the IVS Framework states that while the bases of value defined in the IVSs will cover most purposes for which valuations are required, bases with different titles or definitions may be required in practice. This is often the case where the valuation is governed by a statute, regulation or contract that stipulates a certain basis or definition of the type of value required.
4. It is impractical for the IVSC to identify all bases that may be required in different jurisdictions around the world and outside its remit and to discuss their application. Bases of value that are not defined in the IVS Framework are therefore generally excluded from this chapter. The exceptions are two bases defined by the International Accounting Standards Board: fair value as defined in IFRS 13 *Fair Value Measurement* and value in use as defined in IAS 36 *Impairment of Assets*. Because International Financial Reporting Standards are widely used and are discussed in IVS 300 *Valuations for Financial Reporting*, these are included in the discussion.
5. The discussion and examples in this chapter aim to provide high-level illustrations of the application of certain concepts, and more importantly, the thought process behind them. In practice, assumptions and judgments may vary in different situations, reflecting specific facts and circumstances, and the conclusions reached may differ from the ones in the illustrations.
6. The illustrative examples in this chapter are not intended to capture all possible nuances that are associated with the IVS bases of value or their interplay. Further, the focus of the illustrations is on the IVS bases of value applied to the entity as a whole (business enterprise) rather than interests in that entity, which could be controlling or non-controlling (minority) interests. Further, the examples in this chapter are focused on assets only, and references to asset and business (no debt assumed for simplicity) may be used interchangeably depending on the context.

The IVS Bases of Value

7. The IVS Framework defines a basis of value as “a statement of the fundamental measurement assumptions of a valuation”. A basis of value will normally have a title , eg “market value”, and an accompanying definition that sets out the hypothesis on which the value is to be determined, eg whether or not an exchange is involved and, if so, the nature of the parties involved and the relationship between them.

The IVS Framework defines three principal bases of value:

- **Market value** 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 after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.
- **Investment value** is the value of the asset to the owner or a prospective owner for individual investment or operational objectives.
- **Fair value** is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.

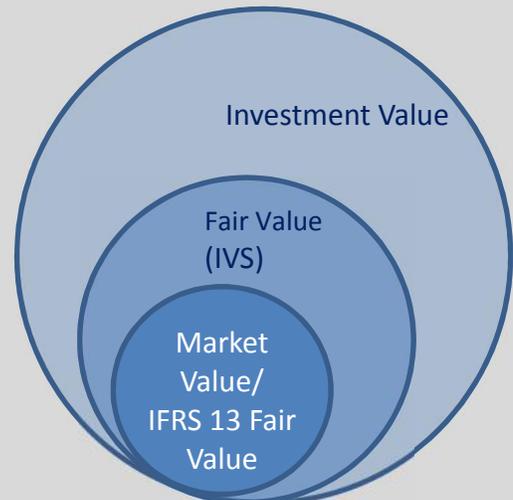


8. These three bases are discussed in the IVS Framework. Market Value is probably the most frequently used of these bases and as such is accompanied by a conceptual framework (see IVS Framework para 30) which is to be followed when applying the definition. The Framework provides an explanation of each component of the definition, eg the characteristics of a “willing buyer” or what is meant by an “arm’s length” transaction, and the need to reflect highest and best use when determining market value. The IVS Framework includes comprehensive explanatory information to support Market Value. This chapter focusses on explaining how Fair Value and Investment Value differ from Market Value.

9. The definition of Fair Value in the IVS Framework differs from that used in accounting standards and in particular the definition in IFRS13 *Fair Value Measurements*. To distinguish the two meanings of the term the terms Fair Value (IVS) and IFRS 13 Fair Value are used in this chapter.
10. Investment Value is an entity specific basis, ie it is a measure of the value to a particular party of owning an asset, which may be different from the price that could be obtained in a sale. Investment value in itself does not presume a transaction or a hypothetical exchange.
11. There is no general rule as to which basis of value yields the highest or lowest amount. There may be circumstances in which one or more would be equivalent, and there may be circumstances in which they differ from each other by virtue of incorporating an incremental element of value.

Figure 1: Specific Buyer

An arm's-length transaction for an asset has taken place at a price incorporating the intentions and attributes of the specific buyer and seller (a *Fair Value* exchange), which differ from those of market participants. The specific buyer could justify paying an amount above the price that would be paid by market participants¹ (*Market Value / IFRS 13 Fair Value*²). The asset is more valuable to the particular buyer (*Investment Value*) than to others, and the seller negotiated some of this value with the buyer.

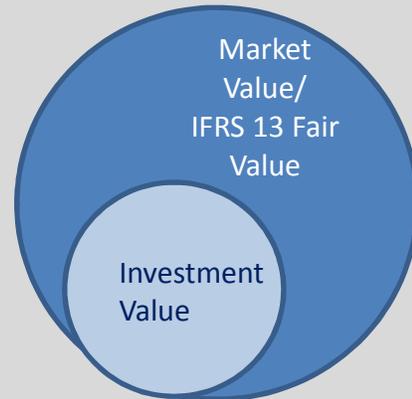


¹ Market participants may be broadly described as typical buyers and sellers of the asset. The IVS Framework contains a discussion of the characteristics of market participants.

² See par. 26-30 of this document, which compare Market Value and IFRS 13 Fair Value.

Figure 2: Family Business

An investor holds and operates a third generation family business, which lacks access to capital to expand the operation. In the specific facts and circumstances, the *Investment Value* of the business to the current owner is lower than the amount market participants would pay (*Market Value/ Fair Value IFRS 13*), having greater ability to invest and expand the operation.



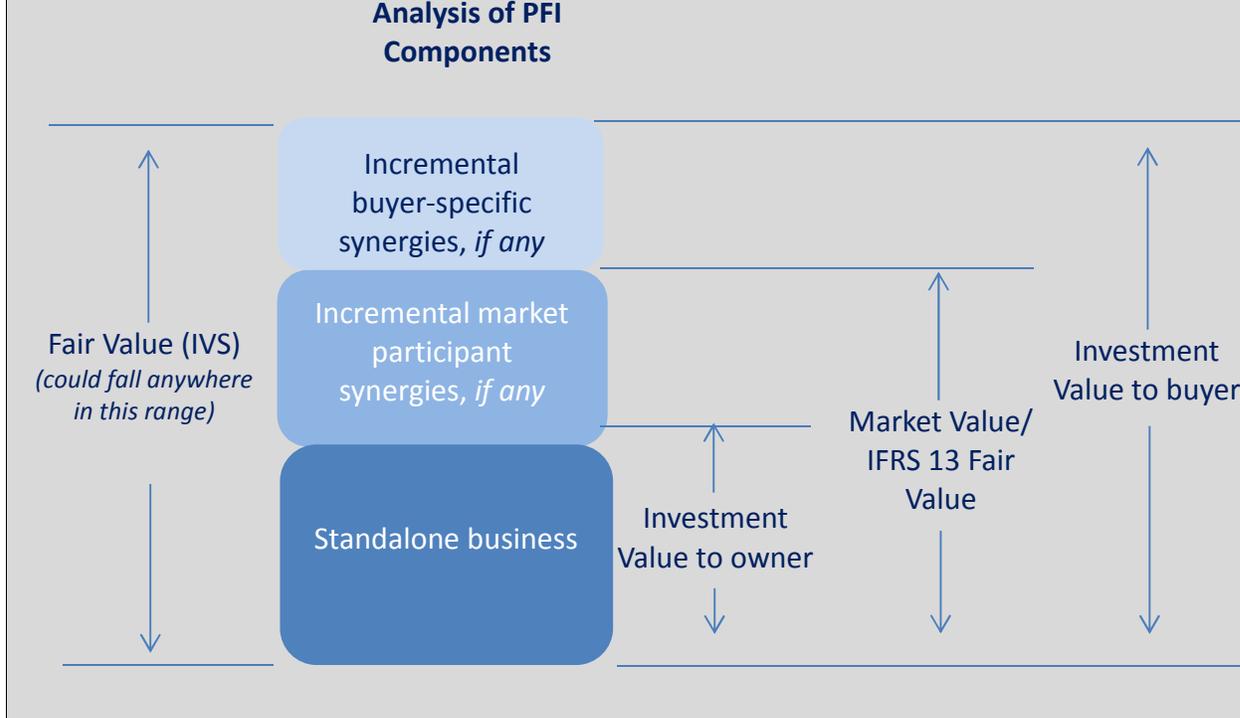
Relationship between Bases of Value

12. In many cases in which projected information exists for the asset, it is useful to gain insight into the assumptions that went into forecasting the Prospective Financial Information (PFI)³. When the analysis is performed in the context of a transaction, it is helpful to get an understanding of both the buyer's and seller's expectations for the operation of the business and the cash flows it would generate. This type of analysis will highlight and help isolate the potential bases of value embedded in the projections, and enable the valuer to focus on the proper elements in supporting the basis of value required in the valuation assignment. Note that this analysis and related concepts are relevant for the application of both the income and the market approach. *Fundamentally the distinctions between the different bases of value reflect different expectations regarding cash flows and risk.*
13. Figure 3 on the next page illustrates how the different bases can apply to a business that is marketed for sale. The appropriate basis or bases to use will depend on the purpose of the valuation.

³ TIP 1, **Discounted Cash Flow**, describes PFI as projected income (cash inflows) and expenditure (cash outflows).

Figure 3: PFI analysis of Bases of Value

One possible analysis of PFI is graphically illustrated below. The subject of the valuation is an entire business marketed for sale.

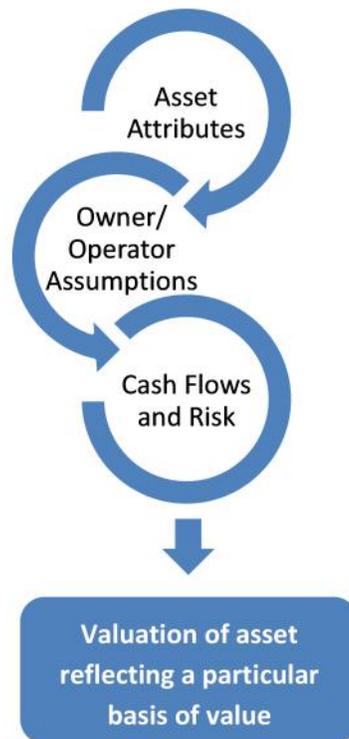


14. Note that Investment Value will be specific to and different for both the owner and buyer of the business, while Market Value and IFRS 13 Fair Value will be common to market participants, or a subset thereof. In contrast, the concluded amount under Fair Value (IVS) can fall anywhere in the range of the previous bases of value, as long as it was negotiated at arm's length. As discussed in the IVS Framework in the context of Fair Value (IVS), although the parties are unrelated and negotiating at arm's length, the asset is not necessarily exposed in the market, and the price agreed may be one that reflects the specific advantages or disadvantages of ownership to the parties involved, rather than the market at large (see IVS Framework, para 28).
15. The core building block in the value continuum illustrated in Figure 3 is the value attached to the business operated standalone, or separately, which is the Investment Value to the owner. In many cases, this value may be equivalent to the value that would be realised in a transaction with a financial buyer that does not produce any incremental synergies (and would represent Market Value/IFRS 13 Fair Value if the concluded type of market participant is a financial buyer). Examples of factors that could create exceptions to the above include, but are not limited to, differences in tax rates and tax attributes of the owner vis-à-vis market participant financial buyers; and whether the business is operated optimally by the current

owner relative to market participants who are presumed to operate the asset in accordance with its highest and best use (optimally). Also, note that some financial buyers may in fact be able to realise synergies; this may be the case of a private equity firm buyer that owns complementary portfolio companies.

16. In contrast to most financial buyers, a transaction for the target business involving a strategic buyer may produce incremental synergies. To the extent a strategic buyer's assumptions are consistent with those of market participants the resulting value would represent Market Value / IFRS 13 Fair Value.
17. At the same time, the Investment Value to a specific buyer may be higher than Market Value and IFRS 13 Fair Value, as illustrated in Figure 3.
18. The facts and circumstances would dictate how the various bases of value align. Note that whether Market Value and IFRS 13 Fair Value include or exclude any market participant synergies, and the nature thereof, depends on the pool of market participants in each situation. For example, when it is concluded that market participants have the characteristics of financial buyers, Market Value and IFRS 13 Fair Value may align with or be equal to the standalone valuation of the business when operated optimally. If, on the other hand, it is concluded that market participants have the characteristics of strategic buyers generating incremental market participant synergies, Market Value and IFRS 13 Fair Value would likely be higher than the standalone valuation of the business.
19. In each of the building blocks in Figure 3, value may be underpinned by different sets of expectations about **cash flows** and **risk**. These expectations are a function of the **attributes of the asset** and **the assumptions of parties** (owners/operators/prospective purchasers of the asset) developed to be consistent with the definition of a specific basis of value. The interplay of these elements and the subtle shifts thereof under varying facts and circumstances may produce different valuation conclusions, and may at times cause different bases of value to overlap.

Figure 4: Building Blocks of Basis of Value



Special Value and Synergistic Value

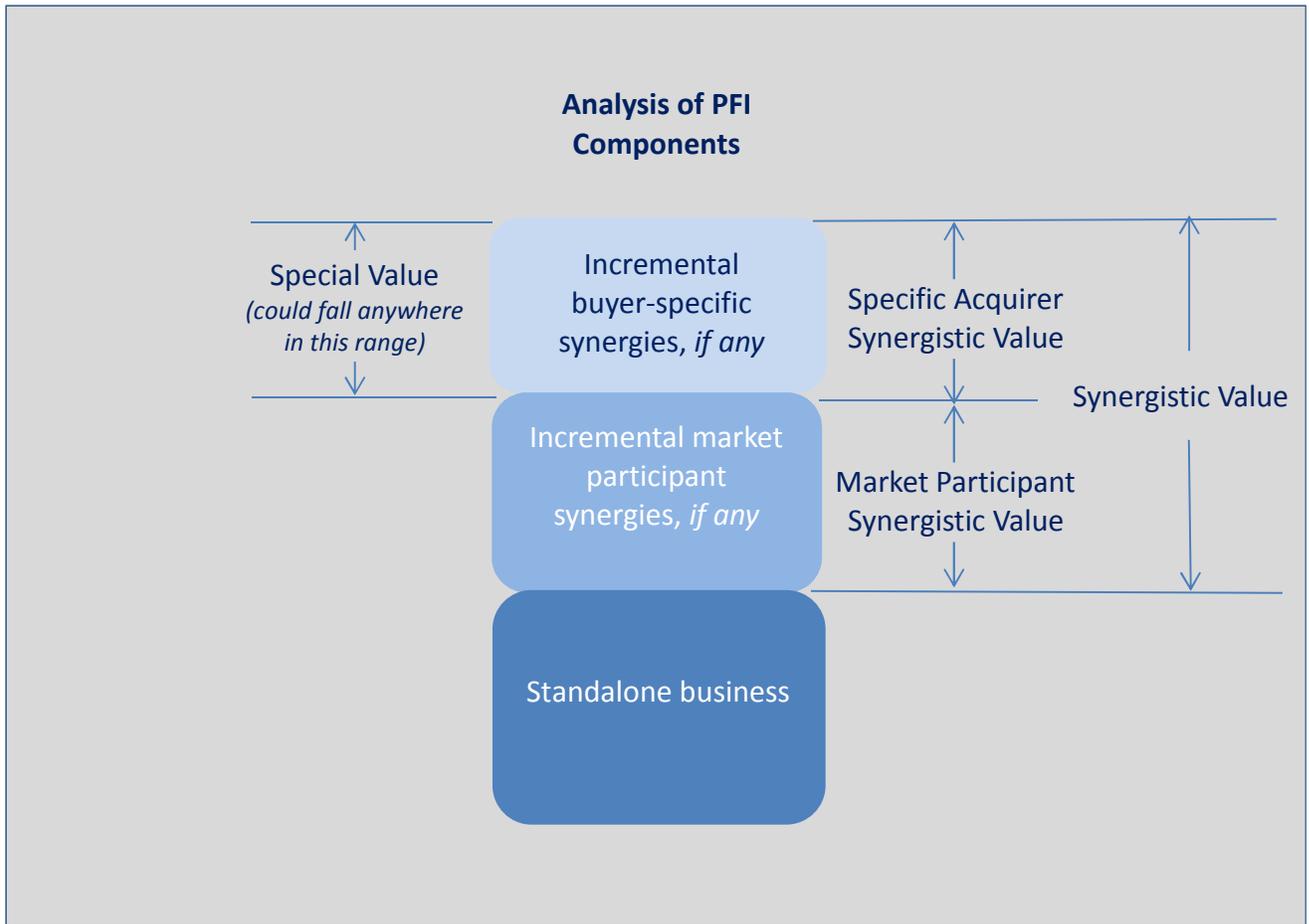
20. The IVS Framework also defines Special Value and Synergistic Value which can be identified and reported separately but which are a component of one or more of Market Value, Investment Value or Fair Value.

The IVS Definitions are as follows: (IVS Framework par. 44-48):

- **Synergistic Value** is an additional element of value created by the combination of two or more assets or interests where the combined value is more than the sum of the separate values.
- **Special Value** is an amount that reflects particular attributes of an asset that are only of value to a **special purchaser**.

21. Special Value arises where an asset has attributes that make it more attractive to a particular buyer than to any other buyers in the market. Market Value expressly excludes any element of Special Value, as described in the IVS Framework para 30 (a). Special Value is the amount over and above Market Value that a specific buyer would be willing to pay for that asset. Thus Special Value is embedded in Fair Value (IVS), which is assumed to be a price that would be agreed between identified knowledgeable and willing parties that reflects their respective interests. Fair Value (IVS) can therefore reflect special value.
22. The amount of Special Value will depend on the facts and circumstances, and in particular on the assumed knowledge and negotiating positions of the parties stipulated in the required basis of value. If the parties to a hypothetical transaction are deemed to be acting knowledgeably and prudently the seller will be aware of the prospective buyer's special interest and will negotiate accordingly. On the other hand the buyer would not willingly pay the whole of the additional value that it would accrue from ownership. The realisable Special Value will therefore normally fall between the Market Value and the Investment Value to the special purchaser.
23. Special Value is most often created because a special purchaser is the only prospective buyer able to realise the benefit of synergies from a transaction. If synergies are only available to one specific buyer and are reflected in the price paid for the asset it is an example of Special Value, and is expressly excluded from Market Value. Special Value reflects the incremental benefit of owning an asset for a specific party captured in the price paid for the asset by that party; thus it involves a transaction.
24. Synergistic Value can be distinguished from Special Value because synergies may be capable of being realised by market participants generally and not only by a special purchaser. Therefore, unlike Special Value, Synergistic Value can be a component of either Market Value or Fair Value (IVS) in the context of a transaction, including a hypothetical transaction.
25. Synergistic Value can also be a component of Investment Value, which does not involve a hypothetical exchange. Also note that if a buyer were contemplating entering a transaction, it would not willingly pay the whole of the synergistic value up to the Investment Value that it would accrue from owning and operating the assets together.

Figure 5: PFI Relationship to Synergistic and Special Value



Select Bases of Value in IFRS

- 26. As noted in IVS 300 *Valuations for Financial Reporting* IFRS 13 Fair Value⁴ is generally consistent with Market Value. Effectively, it is established based on the same assumptions as Market Value; both concepts involve a hypothetical transaction following exposure of the asset in the open market between willing and able parties which are acting freely. Moreover, operating the asset to its highest and best use is inherent in both concepts. However, there are certain differences between the measurement processes for of IFRS 13 Fair Value and Market Value which may lead to different results in a limited number of situations.
- 27. The valuation process to determine IFRS 13 Fair Value follows a specific framework described in the following paragraph.

⁴ IFRS 13 defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

28. *“The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current^{5]} market conditions. A fair value measurement requires a reporting entity to determine all of the following:*
- a. The particular asset or liability that is the subject of the measurement (consistent with its unit of account^{6]});*
 - b. For a nonfinancial asset, the valuation premise that is appropriate for the measurement (consistent with its highest and best use);*
 - c. The principal (or most advantageous) market for the asset or liability;*
 - d. The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.”⁷*
29. The differences that may arise between Market Value and IFRS 13 Fair Value are as follows:
- Differences in the unit of account required for financial reporting purposes under IFRS and the aggregation assumptions required for another purpose for which Market Value is required.
 - Differences arising from the fact that IFRS 13 Fair Value prohibits the use of blockage factors.⁸
 - Differences arising from the fact that certain concepts, such as defensive value, may be unique to IFRS 13 Fair Value measurements.
30. IFRS 13 includes an input hierarchy that requires greatest priority be given to Level 1 inputs, ie unadjusted quoted prices, in active markets for identical assets and liabilities, and the lowest priority to Level 3 inputs, ie inputs which are unobservable in the market. It should be noted that the hierarchy prioritises the inputs to valuation techniques, not the valuation techniques themselves. While the IVS Framework does not specify a hierarchy of inputs it does state that the inputs and assumptions used should be consistent with the basis of value sought, and that in the case of Market Value the methods used should reflect the inputs that would be used and assumptions that would be made by market participants. Consequently, the fact that IFRS 13 Fair Value defines and prioritises different inputs should not be a reason for a different valuation conclusion to one reached when applying the Market Value definition in accordance with the IVS Framework.

⁵ “Current” refers to a valuation performed as of the valuation date; ie current as of the valuation date.

⁶ Unit of account refers to the subject of the valuation, as specified by the financial reporting standard.

⁷ IFRS 13 *Fair Value Measurement*, Appendix B: Application Guidance, para B2.

⁸ Par. 69 of IFRS 13 describes a blockage factor as a premium or discount that reflects size as a characteristic of the entity’s holding that adjusts the quoted price of an asset or a liability because the market’s normal daily trading volume is not sufficient to absorb the quantity held by the entity.

31. The concept of a value incorporating certain entity specific inputs can also be found in financial reporting. IAS 36 *Impairment of Assets* requires the carrying amount of an asset to be compared with its recoverable amount, which is the higher of its fair value (IFRS 13 Fair Value) less costs of disposal and its Value in Use. Value in Use is defined as the present value of the future cash flows expected to be derived from an asset or cash-generating unit, which incorporates certain entity-specific assumptions while other assumptions, eg the discount rate, are market-based. IAS 36 stipulates matters that should be reflected in the estimate of future cash flows when calculating Value in Use, some of which may not necessarily reflect those that would be made by market participants generally. Just as IFRS 13 Fair Value is closely aligned with Market Value, Value in Use bears some similarities to Investment Value.

Application Examples

32. The following examples illustrate the application of and differences between the IVS bases of value and related nuances.

Note that the examples below serve as a framework outlining a thought process for illustrative purposes only. In practice, the data necessary to perform this type of analysis may not be available, or different judgments may be made. The ultimate conclusions reached in a specific situation will depend on the facts and circumstances.

In all the examples there is a presumption, that in the absence of evidence to the contrary, the price paid in an arm's length transaction is Market Value.

Example 1: IVS Bases of Value - Hotel Operation

Market Value: A local hotel owner is considering selling its hotel property in the open market and engages a valuer to estimate the Market Value. The valuer considers possible alternative uses, determines that the highest and best use of the subject property is the existing use and establishes the market within which the property is more likely to be exchanged. The valuer gathers market data, including performance data of similar hotels and data concerning the subject hotel's historical performance. This data is then analysed and applied to the subject hotel in order to estimate the Market Value.

Investment Value: An international hotel chain owner, a prospective buyer, is considering how much the local hotel is worth to its business. The valuer engaged to perform the valuation gathers market data, including performance data of similar properties and data on the subject hotel's historical performance. The buyer concludes that it could operate the hotel more efficiently than any competitors because of specific synergies with its other properties which would result in higher net cash flows.

While the valuer employs the data gathered, market-derived data and appropriate valuation techniques, the valuation also incorporates the assumption that the international buyer will be a more efficient operator, which is supported by the facts and circumstance of the case. The value derived constitutes the Investment Value from the perspective of the international hotel chain owner. It differs from Market Value due to the entity-specific assumption regarding the specific buyer's operational efficiency and certain complementary assets which are considered to be different from those of market participants.

Special Value: Adjacent to the local hotel there is a beach owned by another party. The hotel owner wishes to acquire ownership of the beach because its proximity to the hotel property will provide guests with additional amenities, and will enhance the hotel's performance and profitability. These benefits would not be available to other hotel operations. From the perspective of an owner of the local hotel, the beach has a Special Value which is supported by the increased value of the hotel operation when combined with the beach.

This Special Value (though not the whole of the additional value that will accrue from ownership) is likely to be reflected in the price for the beach, as both parties are presumably aware of the buyer's special interest and will negotiate accordingly.

Likewise, if the beach owner were to purchase or operate the adjacent hotel, the hotel will have Special Value to the beach owner compared with any other hotel property with similar attributes, primarily arising from the proximity of the two properties. This Special Value (though not the whole of the additional value that will accrue from ownership) is likely to be reflected in the price for the hotel, as both parties are presumably aware of the buyer's special interest and will negotiate accordingly.

Fair Value (IVS): In negotiating a potential transaction, both the hotel owner and beach owner realise that this particular beach is more attractive to the hotel owner than any other beach in the area, primarily due to its location. Therefore the value that the hotel owner perceives in the beach is higher than the Market Value of the beach to market participants generally. Additionally, an existing relationship is already in place, whereby the resort is allowed to use the beach property for special events, pursuant to a contract between the two parties. An arm's length exchange between the resort owner and the beach owner in connection with acquiring the beach property would take into account the specific motivations and attributes of the two parties, including any existing relationship, thus creating an element of Special Value for each of the parties involved. The amount for the exchange would reflect the interests of these two specific parties and would constitute Fair Value (IVS). The element of Special Value incorporated into Fair Value (IVS) under the circumstances, as well as the fact that the property is not necessarily marketed in the open market, differentiates this basis of value from Market Value.

Example 2: Net Operating Loss

A business has a standalone (separate) operating value of CU⁹ 1,000. Significant net operating losses (NOLs) have been accumulated over the last few years. However, the business has now turned around and is profitable. The local tax code allows the deduction of the former losses in profitable years. The value of the NOLs, treated as a non-operating asset, has been estimated at CU 200. In a change of control transaction, the local tax code would limit the value of the NOLs to CU 100 in the specific circumstances. Therefore:

- The *Investment Value* of the business to the current owners is CU 1,200 (CU 1000 + CU 200). This presumes continuing to operate the business and realising the tax benefits over time.
- In contrast, the *Market Value and Fair Value* (including the *IFRS 13 Fair Value*) of the business would be CU 1,100, all else being equal. While the tax benefits are an attribute of the business, a portion of them would be foregone in a transaction. In other words, In the absence of certain transaction-related tax

⁹ CU – Currency Unit

structuring (if permitted by the local tax and other laws) or synergies that would benefit the current owners in a sale of the business by being reflected in a higher sale price, the Investment Value of the business would exceed the value that could be realised in a transaction. In order for a transaction to occur, the incremental benefits that the current owners would receive need to be equal to or exceed CU 100 (for a total value of CU 1,200 or higher).

Economic Relationship between the IVS Bases of Value

33. The differences between the bases of value discussed earlier can be reconciled by taking into account economic factors, such as synergies. Synergies represent value arising from combining two or more assets or operations and can be operational or financial in nature. While typically synergies are positive, they may sometimes be negative (dis-synergies). The types of synergies incorporated in a valuation may have a bearing on the basis of value that is used. Thus, if one can properly characterise and quantify the impact of synergies, one could theoretically bridge the various IVS bases of value.
34. The following set of examples illustrates the impact of synergies on the concluded basis of value.

Example 3: Investment Value vs Market Value

A manufacturer is contemplating an acquisition of another business. The target has been a supplier of certain materials to the acquirer and its competitors, and also sells finished goods to third parties. In analysing the target, the potential acquirer estimates the following:

- The standalone (separate) valuation of the target, assuming it is managed optimally, is approximately CU 1,000.
- The potential acquirer plans to implement certain cost-cutting initiatives. Of those, general and administrative (G&A) savings due to the consolidation of operations are valued at CU 10. It is believed that if the target were acquired by other acquirer(s), there would be opportunity to realise similar savings.
- Transportation savings due to the proximity of certain acquirer and target production facilities are valued at CU 30. These are expected as the target will become an exclusive supplier of materials to the acquirer. There are no other companies with similar facilities in the vicinity, making this attribute unique to the acquirer and target.
- By using the acquirer's distribution channels, the target can increase sales of its finished goods into new markets, valued at CU 200. It is believed that the target can achieve similar benefits by leveraging the channels of other potential acquirer(s).
- By using certain complementary technology owned by the target, the acquirer believes it can accelerate the development of one of its new product lines. The value of this acceleration opportunity is valued at CU 300, and is thought to be specific to the acquirer.
- By using know-how developed by the target, the acquirer believes it can reduce waste and improve productivity in its own business. The value of this opportunity is valued at

CU 50. It is believed that this know-how can benefit other acquirers as well.

- The standalone (separate) valuation of the acquirer's business, assuming it is managed optimally, is CU 2,000.

The IVSs define **Investment Value** as the value of the asset to the owner or a prospective owner for individual investment or operational objectives. Therefore, from the perspective of the acquirer, the Investment Value of the two businesses together could be up to CU 3,590 based on the data provided earlier:

Chart 1

Standalone valuation of target	1,000
G&A savings	10
Transportation savings	30
Distribution channel leverage	200
Product line opportunity	300
Waste reduction/productivity increase	50
Standalone valuation of acquirer	2,000
Investment Value of combined businesses to (Specific) Acquirer	3,590

The IVSs define **Synergistic Value** as an additional element of value created by the combination of two or more assets or interests where the combined value is more than the separate values. The Synergistic Value in this example is therefore CU 590.

Chart 2

Investment Value of combined businesses to (Specific) Acquirer	3,590
Less: Standalone valuation of target	1,000
Less: Standalone valuation of acquirer	2,000
Synergistic Value to Acquirer	590

However, the Investment Value of the target of CU 1,590 (CU 1,000 standalone valuation plus CU 590 Synergistic Value) is not necessarily the price that this specific buyer would pay for the target. The value each party brings to the table; their negotiating skills; other potential bidders benefiting from similar or unique opportunities; and market dynamics in general may affect the price paid in the transaction. Further, certain synergies may be generally available to market participants as well.

In the context of the earlier fact pattern, one could analyse which party "owns" or "enables" the particular opportunity which gives rise to Synergistic Value. Based on the earlier discussion, Chart 3 summarises whether the opportunity is primarily enabled by

the target, a market participant acquirer, the specific acquirer, or jointly by the parties.

Chart 3

Opportunity	Enabler of Opportunity	
	Target	Acquirer
		MP Acquirer* Specific Acquirer
G&A savings		✓
Transportation savings		✓
Distribution channel leverage		✓
Product line opportunity**	✓	✓
Waste reduction/productivity increase	✓	

* market participant acquirer
 ** a jointly enabled opportunity

- To the extent similar opportunities would benefit more than one potential acquirer (as would be the case with market participant synergies), the expectation is that competitive dynamics would factor the value of such opportunities into the price paid for the target.
- To the extent the opportunity is enabled by the target and would benefit market participants, the expectation is also that it will be factored into the price ultimately paid for the target.
- To the extent an opportunity is enabled by a specific acquirer, in theory, its value should not find its way into the price paid for the target; however, if it is jointly enabled by the target and a specific acquirer, and is subject to competitive dynamics, there may be room for negotiation.

In light of the above:

- The G&A savings would be generally available to market participants. While the target does not enable this opportunity, a competitive bid process would likely factor their value (CU 10) into the price paid for the target.
- The transportation savings are specific to the acquirer in this example. Market participants would not be able to benefit from them. Thus the value of the CU 30 opportunity would accrue to the specific acquirer. In theory, this element of value would not be included in the purchase price paid for the target (since this is an acquirer-specific synergy). However, market dynamics and negotiations may result in the inclusion of a portion of it in purchase price.
- The distribution channel synergy is enabled by market participants. Thus a competitive bid process would likely factor the incremental value of this opportunity (CU 200) into the price paid for the target.
- The product line opportunity is specific to the acquirer in this example, but is enabled jointly by the target and the acquirer. By using certain complementary technology owned by the target the acquirer believes it can accelerate the development of one of its new lines; it is not believed this opportunity is available to market participants. In theory, this element of value (CU 300) would not be included in the purchase price

paid for the target (since this is an acquirer-specific synergy). However, market dynamics and negotiations and the fact that the synergy is in part enabled by the target may result in the inclusion of a portion of it in the purchase price.

- The waste reduction know-how that the target brings to the table can enhance the business of market participants generally. Thus, in this example, CU 50 would likely be included in the purchase price paid for the target by both market participants and the specific acquirer.

Below are the values of these synergy opportunities:

Chart 4

Opportunity	Value of Opportunity	
	Target	Acquirer
		MP Acquirer
G&A savings		10
Transportation savings		30
Distribution channel leverage	200	
Product line opportunity*	300 in total	300 in total
Waste reduction/productivity increase	50	

* a jointly enabled opportunity

In an actual transaction, the target is likely to receive a price that is less than its Investment Value to the acquirer and more aligned with its Market Value, considering the elements that would be generally available to market participants that may be included in Market Value.

Chart 5

Standalone valuation of target	1,000
MP synergies:	
G&A savings	10
Distribution channel leverage	200
Waste reduction/productivity increase	50
MP Synergistic Value	260
Market Value	1,260

Thus, the Market Value of the target is CU 1,260, which comprises the standalone valuation of the target of CU 1,000 and the Synergistic Value to market participants estimated at approximately CU 260.

Given the facts of this specific example, it is likely that the conclusion as to the IFRS 13 Fair Value of the target would also be CU 1,260.

Example 4: Market Value vs. Fair Value (IVS)

This example uses the facts presented in Example 3 to illustrate the conceptual difference between Fair Value (IVS) and Market Value. IVS defines Fair Value (IVS) as *“the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.”* By virtue of this, given the facts of Example 3, Fair Value (IVS) may embody the impact of certain factors that would not be incorporated in Market Value; ie, certain synergies unique to the parties may be reflected in Fair Value (IVS) as long as they are bargained for and the transaction is executed at arm’s length¹⁰. Based on the facts of the earlier example, note the following:

- The G&A savings, distribution channel leverage and know-how (waste reduction/productivity increase) would be available to market participants, and are therefore are elements of market participant (MP) Synergistic Value. These synergies, valued at CU 10, CU 200 and CU 50, respectively, will be part of Market Value and IFRS 13 Fair Value.
- The transportation savings are specific to the acquirer in this example. Market participants would not be able to benefit from them. Thus the value of the CU 30 opportunity would accrue to the specific acquirer. Since this is an acquirer-specific synergy, in theory, this element of value would not be included in the purchase price paid for the target. However, market dynamics, special considerations of the transacting parties and negotiations may result in the inclusion of a portion of it in the purchase price. The inclusion in purchase price of this element, in whole or in part, may not be inconsistent with Fair Value (IVS) as long as it has been negotiated at arms’ length. In this particular case, the acquirer included CU 20 of the total expected benefit in the purchase price.
- The product line opportunity is specific to the acquirer and not available to market participants (by using certain complementary technology of the target, the acquirer believes it can accelerate the development of one of its new product lines). In theory, this element of value (CU 300) would not be included in the purchase price paid for the target (since this is an acquirer-specific synergy). However, market dynamics, special considerations of the transacting parties and negotiations, and the fact that the synergy is in part enabled by the target may result in the inclusion of a portion of it in purchase price. The inclusion in purchase price of this element, in whole or in part, may not be inconsistent with Fair Value (IVS) as long as it has been negotiated at arm’s length. In this particular case, the acquirer included CU 120 of the total expected benefit in the purchase price for the target.

¹⁰ As discussed in para 14 and Figure 3 of this document, provided it was negotiated at arm’s length, Fair Value (IVS) can fall anywhere within a range of values, reflecting different circumstances.

Chart 6

Standalone valuation of target (a)	1,000
G&A savings	10
Distribution channel leverage	200
Waste reduction/productivity increase	50
MP Synergistic Value (b)	260
Transportation Savings	20
Product Line Opportunity	120
Specific Synergistic Value (c)	140
Total Synergistic Value to Acquirer (b+c)	400
Fair Value (IVS) (a+b+c)*	1,400
Market Value (a+b)	1,260
<i>* negotiated at arm's length in this situation</i>	

In this particular case, the Fair Value (IVS) of the target is CU 1,400, as the transaction took place between identified knowledgeable and willing parties and reflects the respective interests of those parties. Note that the parties could have negotiated a price of CU 1,260 (consistent with Market Value) or they could have negotiated a price up to CU 1,590 (consistent with Investment Value to the acquirer). Either of these values or any other price (but likely in that range) could have been considered Fair Value (IVS) if it was negotiated consistent with the requirements for Fair Value (IVS).

Price, Cost and Value

35. Paragraphs 6-8 of the IVS Framework describe the different concepts of price, cost and value. The following scenario provides an illustration of how these concepts are related and how they can differ.

Example 5: Price, Cost and Value

A development company agrees to construct and sell a new building to a manufacturing company following its completion for CU 12. It costs the development company CU 10 to purchase the land and to construct the building.

The price of the new building is CU 12, the figure agreed between the development company and the manufacturing company.

Once completed, the cost of the new building from the perspective of the development

company is CU 10. The cost from the perspective of the manufacturing company is CU 12.

However, due to market price movements, upon completion of the building its Market Value is estimated at CU 13.

This value is not realisable by the development company because it has contracted to sell for CU 12 and is therefore unlikely to be relevant to the development company unless the manufacturing company defaults. It could be realisable by the manufacturing company if it sold the building following its acquisition, although if the economic benefits of owning and operating its business from the building (ie its Investment Value) exceed the Market Value, this is unlikely.

In this example the price and the cost for the manufacturing company coincide, but the estimated value bears no relation to either.

From the perspective of the development company, it is possible to rationalise the difference between the Market Value of CU 13 and the cost incurred of CU 10 by reference to profit and opportunity costs and the impact of various market factors, but the two are not correlated.

In other scenarios the value of an asset may be below its cost of creation or the price agreed in an exchange.

36. Cost and price are factual. They are related but can vary depending on the perspective of different parties. For instance, in Example 5 the cost to the development company may have been CU 10, but in order to make a return on the costs it incurred it would need to include a profit element in calculating the price at which it could sell the completed building to the manufacturing company. Once incurred the agreed price of CU 12 becomes a cost to the manufacturing company.
37. In contrast, value is an opinion. Value is not factual but an estimate based on the hypothesis stipulated by the required basis of value. Market Value is an estimate of the price at which an asset (or liability) should exchange. It therefore follows that that Market Value is a reflection of prices paid in the market. However, as illustrated in Example 5, the price in any particular exchange may differ from Market Value. In this example the difference is due to the price having been determined before construction commenced. This means that the price does not reflect the price that should have been agreed for the completed building on the valuation date.
38. The definition of Market Value contains a number of conditions which are all discussed in detail in paras 30–35 of the IVS Framework. If the terms on which the price in an actual transaction was agreed do not meet these conditions then that price is an unreliable guide to Market Value. Apart from the example given of a price having been determined on a different date to the valuation date, if one or other of the parties was acting under duress, was not acting knowledgeably or was acting imprudently, the price agreed may not be representative of Market Value.

39. Another reason why a price may differ from Market Value is if it contains an element of Special Value, which is specifically excluded from Market Value by para 30(a) of the IVS Framework.
40. Where price information on transactions in a market is abundant it is normally impractical to analyse every transaction to assess its compliance with the definition of Market Value, although such analysis may help explain outliers from the main distribution of price information. However, before reliance is placed on any particular price as evidence of value it is important to investigate the circumstances of the transaction and the parties' motivation.
41. While knowledge of the background to actual prices in a market is of particular importance when determining Market Value, the principle that care must be taken to compare the circumstances under which a price is agreed with the conditions and assumptions on which the required value is founded applies to all bases of value.