

SIGNIFICANCE OF OBSOLESCENCE IN VALUATION OF TANGIBLE ASSETS

by

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Extracts From Preface

Any prudent and willing buyer will certainly take into consideration potential profitability, demand and supply and marketability and therefore the DRC(Depreciated Replacement Cost) is always subject to potential profitability.

DRC computed by only considering the depreciation for wear and tear is not the value.

DRC without taking into consideration potential profitability/demand and supply/marketability/all forms of obsolescence do not satisfy the criteria of ‘willing buyer’ and ‘willing seller’ enshrined in the definition of market value.

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International Recognition

The book has received appreciation and endorsements from distinguished experts and thought leaders from India, Australia, England, Greece, Malaysia, Poland, Romania, Russia, and the United States, including:

- ***Hon'ble Justice Dhaliwal,*** Former Judge, Punjab & Haryana High Court
- ***H. Mundra,*** Former Director, Hindustan Unilever Limited; Visiting Professor, Indian Institute of Management Ahmedabad
- ***Prof. Small,*** Central Queensland University, Sydney
- ***K. Budhbhatti,*** Former Chair, Plant & Equipment Valuation Study Group, Australian Property Institute (API)
- ***C. Derry,*** Former Chair, Plant & Machinery Committee, Royal Institution of Chartered Surveyors (RICS)
- ***K. Pallis,*** Chair, European Plant, Machinery and Equipment Valuation Standards Board, TEGOVA
- ***M. Malmon,*** Member, European Plant, Machinery & Equipment Valuation Standards Board, TEGoVA
- ***Dana Ababei,*** President (2018-19) ANEVAR (National Association of Authorised Romanian Valuers)
- ***Dr. Achu,*** Senior Lecturer in Valuation, University of Technology Malaysia
- ***Prof. Y. Kozyr,*** President, Russian Society of Appraisers
- ***Alexander Kostin,*** Chair- International Committee on Intellectual Property Economics, Eurasian Economic Cooperation Organization (EECO).
- ***T Sexton, ASA,*** Former Member Machinery and Technical Specialties (MTS) Committee, American Society of Appraisers.

What Experts Say

"A comprehensive guide that successfully blends economic, legal, and technical perspectives to improve the accuracy and reliability of asset valuation while highlighting all forms of obsolescence beyond physical depreciation."

"More than a book on machinery valuation, it is a treatise on business valuation in the context of plant and machinery obsolescence, making it invaluable for both students and practitioners."

"A practical reference work reflecting extensive professional experience and advanced valuation methodologies aligned with contemporary market requirements."

"An invaluable resource for students tackling advanced valuation issues and practitioners seeking a deeper understanding of obsolescence."

"The book covers virtually the entire spectrum of business asset appraisal, while appropriately incorporating real estate considerations."

"A well-structured and insightful text for valuers wishing to deepen their understanding of both the art and science of valuation. The value analysis presented in Chapter 2 is especially noteworthy."

"The narrative flows seamlessly and the concepts are presented in an engaging manner, making it suitable for both academic instruction and professional practice."

"An outstanding strength of the book is its integration of obsolescence within the broader framework of machinery and equipment valuation, significantly enhancing readers' understanding of the subject."

"A noteworthy contribution that establishes a strong theoretical and practical foundation for understanding the complexities of tangible asset valuation in today's dynamic economic environment."

"Extremely thorough, exceptionally well-written, and a significant contribution to the valuation profession."

Chapter on Depreciated Replacement Cost Subject to Potential Profitability

This chapter examines the fundamental principle that the value of plant and machinery, when determined using the Depreciated Replacement Cost (DRC) method, must be tested against its potential profitability. Drawing upon the landmark Australian case Symex Holdings Ltd. vs. Commissioner of State Revenue (Victoria), the chapter highlights that a DRC-based valuation cannot represent market value unless the asset is capable of generating adequate economic returns. The discussion explains the rationale behind linking asset values to future cash-generating capacity and demonstrates that physical depreciation alone is insufficient for valuation purposes. The chapter further highlights that the profitability test should not be confined only to DRC valuations but may also be relevant in certain market approach valuations, as prudent buyers ultimately base investment decisions on expected returns. Through practical illustrations, it is shown that market-derived values may require adjustment when anticipated profitability does not support the indicated value. The chapter reviews the relevant provisions of leading valuation standards, including IVS and ANZVGP, which recognize the relationship between economic obsolescence and profitability. It also critically evaluates the reliance on actual earnings, emphasizing that potential profitability is a more appropriate measure because reported profits may be distorted by management inefficiencies or temporary market conditions. Overall, the chapter reinforces the view that valuation must reflect the asset's economic utility and earning potential to satisfy the principles of market value and the willing buyer-willing seller concept.

Chapter on Business Enterprise Value as a Measure of Economic Obsolescence

This chapter outlines how to measure economic obsolescence and estimate economic support when valuing tangible fixed assets, a process requiring collaboration between tangible asset valuers and business valuers. To determine if assets suffer from economic obsolescence, the Business Enterprise Equation (BEE) is rearranged to define economic support for fixed and intangible assets as the Business Enterprise Value (BE) minus Net Working Capital (NWC). Economic obsolescence exists when this economic support (BE – NWC) is less than the individually estimated fractional values of the underlying tangible fixed assets. In such cases, an economic penalty is applied to proportionately reduce the value of all contributing tangible fixed assets, including land. Because profit is generated by the collective contribution of all fixed assets, this calculation is only valid when all fixed assets are valued simultaneously rather than testing a single asset class like plant and machinery. Conversely, any excess economic support indicates the existence of intangible value like goodwill, while the value of open land is noted as generally higher than land encumbered with buildings. Finally, the text distinguishes economic obsolescence from curable business viability, clarifying that obsolescence is generally incurable as it stems from irreversible external shifts in demand.

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