

# Chapter 6: Gas Station Asset Valuation (Equipment)

**Knowing how much the gas station's fixtures and equipment are worth will determine the amount of goodwill that is being paid as part of the overall purchase price. Valuing these assets is different from valuing other types of assets, such as real estate and intangibles, because the values can differ depending upon the specific circumstances, such as liquidation value, going concern value, etc.**

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## Introduction

This is a critical chapter to review in particular for gas stations, since in most cases equipment values are lower than that normally represented by gas station owners. A seller may state that the equipment is worth \$600,000, but the liquidation value may only be \$100,000 or less. We will carefully describe the differences in equipment types and their functionality and provide the three valuation methods for gas station equipment.

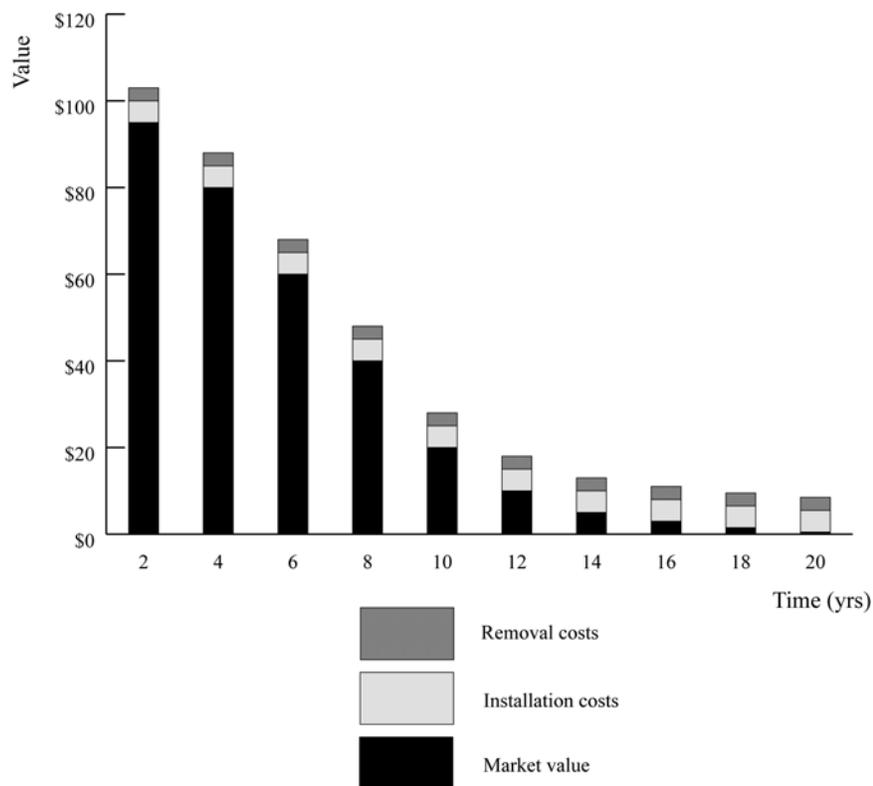
Over the past three decades, the technology used throughout the gasoline industry, especially at gas stations, has been subject to massive improvements and re-developments. This in turn, has vastly improved the level of service provided at gas stations and enhanced the gas station "experience". The range of gas station equipment available for owners to purchase and install at their stations is endless. These equipment developments have made it even simpler and more convenient for customers to fill their cars and purchase their fuel. In addition to all of this, many oil companies now offer loyalty schemes and credit cards, to entice customers and offer them discounts on their fuel purchases.

The value of a gas station's equipment can differ depending upon technology, manufacturer, age and selling circumstances. Obviously the pieces of an operation will be worth less individually, than if they were part of a "turn key" operation where each piece is an integral part of the overall business. Similarly, the duration before the sale of any equipment until the sale is also a factor. The longer you can wait to sell your equipment, the higher the probability of obtaining a wholesale or retail value. Installation must also come into play when valuing a gas station's equipment. There is a fair amount of specialized installation knowledge required for proper installation of the fuel pumps and POS 'Pay at Pump' technology.

Within the gas station industry, operators have standard equipment that make up the majority of their assets. Most of the differences in equipment value are attributed to the type of fuel pumps installed and types of tanks. For example, Pay at Pump fuel pumps are installed at more advanced premium stations to increase the ease of payments. Older fuel pumps without this technology are much less valuable.

When valuing gas station equipment, it is important to specify *exactly* what value is being used. When valuing real estate, personal property or businesses, the importance and definition of value to each of these disciplines is different. Real estate values rarely have to explain installation costs, since land is stationary. Personal property is typically valued based upon continued use and rarely uses the cost approach like with machinery and equipment. Also, business valuations grapple with the fair market value of the business which is either a control or minority interest.

**Figure 6-1: Installation Costs Relative to Age Life of Equipment**

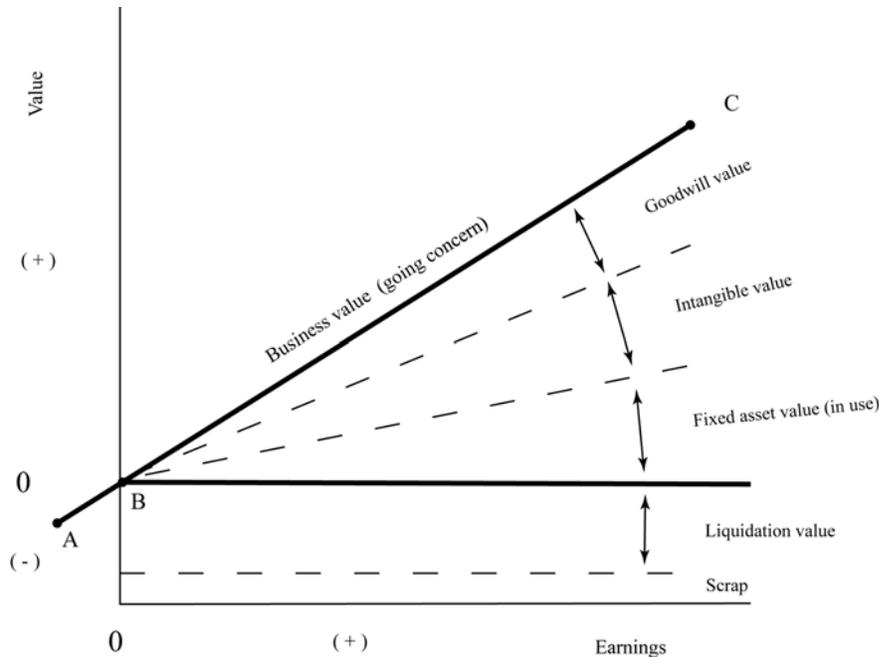


In many cases appraisers use “fair market retail values” for a purchase price allocation of equipment where the owner purchased the equipment at liquidation prices. Obviously if you are starting a business from scratch, then you are going to get the least expensive equipment that is still usable. When valuing a business and potentially purchasing the operation, the buyer must identify the downside of selling the equipment, or more importantly, finance the transaction. Bankers will only lend on a forced or orderly liquidation value, since they assume that they will have to unload the equipment at auction prices.

## Value Definitions

As a result from all of the differences mentioned above, many value definitions are available and the right one is needed to be agreed upon before a value can be given. The American Society of Appraisers has definitions which apply to the valuation of machinery and equipment. These value concepts can best be seen visually in Figure 6-2, and are defined in Table 6-1 on page 160.

**Figure 6-2: Valuation Definitions Relative to One Another**



## Purposes of Valuation Relative to Definitions of Value

One must first know the valuation purpose. This purpose usually goes hand in hand with the use of the valuation. For example, if the purpose of the valuation is for the allocation of a purchase price, or for an ongoing business, then the proper valuation concept would be the "Fair Market Value in Continued Use." This definition means the value of the assets to the ongoing business. If the valuation is to be used for financing purposes, then the proper value to be used would be "Orderly Liquidation Value," "Forced Liquidation Value," "Liquidation Value in Place," or "Fair Market Removal."

A short description of the different values and purposes can be seen in Table 6-2 on page 161.

## Approaches to Valuation

Like real property and business valuation, machinery and equipment are valued through the cost, market, and income approaches. Value is almost exclusively derived through the cost and market approaches with the income approach being rarely used.

### Cost

The cost approach is based upon the assumption that a purchaser would pay no more for an asset than the cost of creating a substitute with the identical utility of the subject asset being valued. This value usually establishes the upper limit of value. Once the replacement cost is established, the condition needs to be accounted for by applying accrued depreciation. As with real property, the depreciation considered is physical curable, physical incurable, functional & economic depreciation.

**Table 6-1: Strengths Versus Weaknesses of Approaches to Value**

| Method | Strengths  | Weaknesses  |
|--------|--|---|
| Cost   | Good for special purpose assets.                                       | Sometimes economic obsolescence can be overstated.  |
|        | Good for new assets.   | Depreciation estimate is subjective.  |
|        | Good for isolation of different items of depreciation.                 | Effective age is difficult to estimate; if a machine was rebuilt, then this complicates analysis; time consuming. |
| Market | Most reliable indicator for individual items with established markets. | Certain items have no comparable sales, and adjusting is subjective.  |
|        | More accurate measure of depreciation.                                 | Sales data is oftentimes questionable and not detailed, and buyer and seller motivation is unknown.               |
| Income | Recognizes income contribution to a business.                          | Poor method if specific assets need to be segregated.   |
|        | Most accurate measurement of total depreciation of all assets.         | Rates of return are subjective and need to be combined with the business value.                                   |

### Sales

The sales comparison approach relies on the assumption that the value of the business assets can be obtained based upon transactions of similar items selling in the secondary or used market. This is easy to see in concept but difficult in reality. Usually the comparable prices of equipment need to be adjusted for differences such as age, condition and capacity of the assets, model, location, date and type of sale (retail sale, auction sale, asking price, etc.). Also, if valuing the business under a continued use, then the value associated with the cost of assembly or installing the assets needs to be adjusted.

### Income

The income approach breaks down the earning capacity of the business assets under investigation. This approach is rarely utilized for individual pieces and is more applicable when analyzing a production line or for a plant which

produces a set product. This approach would not be used in valuing gas station equipment. In summary, the strengths and weaknesses of all three approaches to value can be summarized in Table 6-1. Table 6-2 shows why it is imperative to use the right definition for the valuation of equipment, since each value definition will represent a different percentage of the reproduction or replacement cost new.

**Table 6-2: Value Definitions and Users**

| Term                               | Short Definition   | Users/Purposes   | % of Total New Value |
|------------------------------------|--|--|----------------------|
| Reproduction Cost New              | The cost of reproducing a new replica of a property on the basis of current prices with the same or closely similar materials.   | Feasibility or alternatives for theater expansion, change, modernization or relocation; used for special purpose equipment; insurance purposes.  | 95-100%              |
| Replacement Cost New               | The current cost of a similar new property having the nearest equivalent utility as the property being appraised.  | Feasibility or alternatives for theater expansion, change, modernization or relocation; used for special purpose equipment; insurance purposes. Review any insurance policy for exact definition.                      | 95-100%              |
| Depreciated Reproduction Cost      | Reproduction cost new, less accrued depreciation.  | Insurance purposes. Review insurance policy for exact definition.  | Varies               |
| Insurance Replacement Cost         | The replacement cost new as defined in the insurance policy, less the cost new of the items specifically excluded in the policy, if any.   | Insurance purposes. Review insurance policy for exact definition.  | Varies               |
| Insurable Value Depreciated        | The insurance replacement cost less accrued depreciation for insurance purposes.   | Insurance purposes; review insurance policy for exact definition.  | Varies               |
| Fair Market Value                  | The amount expressed in terms of money, that may reasonably be expected for property in exchange between a willing buyer and a willing seller with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts. This and all fair market values assume that the assets are installed, operating, and are an integral part of the overall business. | Buyers of a business who want a break out for an allocation of purchase price; dissolutions of marriage, partnerships, or corporations to establish an equitable distribution; tax assessors; gift and state taxation. | Varies               |
| Fair Market Value in Continued Use | The amount expressed... all relevant facts; includes installation and assuming that the earnings support the value reported.   | Same as above  | Varies               |
| Fair Market Value-Removal          | The amount expressed....all relevant facts; considers removal of the property to another location.   | Same as above  | Varies               |