Excess Assets in Valuation

By: Russell T. Glazer

An important part of the valuation of a business is a review of its balance sheet and the makeup of its assets. Some companies pay out as much as possible in distributions, leaving the company with a weak balance sheet; that is, one with too few assets in relation to its liabilities, or with the wrong kind of assets (current or long term) in relation to its liabilities. Conversely, some companies retain more profit than is necessary to support the business, creating a balance sheet that is too strong. A balance sheet is too strong when a company can distribute profits without impairing its ability to meet its short term and long term obligations. In the middle, of course, are those companies that distribute or retain an amount that results in a balance sheet that is neither too weak nor too strong.

But what determines the strength of the balance sheet? There is no definitive answer or formula; the assessment is derived from a proper analysis of the balance sheet. This includes computing a variety of financial ratios (liquidity ratios, activity ratios, etc.) for the company over time, as well as in comparison to industry benchmarks.

A balance sheet that is considered to be strong may contain excess assets that are not required to remain in the business; the value of these assets can be distributed to the owners without impacting the company's ability to operate smoothly and efficiently. For example, a company may have invested undistributed earnings in marketable securities; these securities can be converted to cash and distributed, or distributed in kind.

Such excess assets represent value that can be unlocked immediately. This represents another element of value in addition to the value to be achieved by operating the company as a going concern into the long term.

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