

Insights

Economic Obsolescence in the Fair Valuation of Property, Plant & Equipment



Concept, measurement, and application
across the asset lifecycle



WHAT IS ECONOMIC OBSOLESCENCE

and Why Does It Matter?

The fair valuation of property, plant, and equipment (PP&E) under IFRS 13 and ASC 820 most commonly applies the cost approach, which estimates value as the cost to reproduce or replace an asset at current prices, adjusted for all forms of value diminution. Physical deterioration and functional obsolescence are well-understood adjustments, grounded in observable asset condition and engineering benchmarks. Economic obsolescence is the third and often most consequential adjustment — and it is also the least standardized, the most judgment-intensive, and the most frequently contested by auditors and counterparties.

Economic obsolescence — sometimes called external obsolescence — is the loss in value attributable to forces entirely outside the asset itself. It is not caused by wear and tear, and it cannot be remedied by maintenance or redesign. It arises because the environment in which the asset operates has changed: demand has fallen, the industry has contracted, regulation has shifted, input costs have risen, or the business generating returns from the asset is no longer able to do so adequately. The market-participant buyer of the asset would demand a discount to compensate for bearing these external conditions — and estimating that discount with rigor, and defending it with evidence, is one of the most technically demanding aspects of a PP&E valuation.

Economic obsolescence is often the largest single adjustment in a PP&E fair valuation, yet it receives the least standardized treatment. Getting it right — in concept and in measurement — is one of the most technically demanding tasks a valuer faces.

This paper sets out the conceptual foundation of economic obsolescence, explains the principal measurement techniques, identifies the common pitfalls, and works through a detailed case study illustrating how these principles apply.



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UNDERSTANDING ECONOMIC OBSOLESCENCE

The Three Forms of Value Diminution

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When the cost approach is applied, the gross replacement or reproduction cost of an asset is reduced by three categories of diminution, applied in sequence:

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Physical Deterioration

The reduction in value arising from wear, age, and the physical condition of the asset. Estimated through inspection, remaining useful life analysis, and condition scoring. This is the most observable form of diminution and is generally the least contested.



Functional Obsolescence

The loss in value arising from the asset's design, capacity, or technology being inferior to what would be built or installed today. Over-engineering, inefficient layouts, and superseded technology are common sources. Estimated by reference to cost-to-cure or the capitalized operating cost differential.



Economic Obsolescence

The loss in value arising from forces external to the asset — demand decline, industry overcapacity, regulatory change, or the inability of the employing business to generate an adequate return. Unlike the other two forms, economic obsolescence is incurable by the asset owner and is shared across all assets of the affected operation.

What Makes Economic Obsolescence Distinct

Two features of economic obsolescence distinguish it from the other forms of diminution and have direct implications for how it is measured.

1

First, it is external and incurable. Physical deterioration can be addressed through maintenance; functional obsolescence can be resolved through replacement. Economic obsolescence cannot be resolved by the asset owner acting alone. It is a product of market conditions, competitive dynamics, or regulatory forces that no individual asset owner controls. This has an important practical consequence: the same economic obsolescence adjustment applies proportionately across all assets of the affected operation — it is not asset-specific.

2

Second, it is measured at the enterprise level before being attributed to assets.

Economic obsolescence is not observable at the level of a single machine or building. It is estimated by reference to the performance of the business or operation that employs the assets, specifically, the gap between what that business earns and what a market-participant investor would require it to earn. The quantum is then attributed back to the individual assets through the inutility method, the income-based extraction, or a market-derived benchmark.

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ESTIMATING ECONOMIC OBSOLESCENCE

The Three Methods

There is no single prescribed method for estimating economic obsolescence. Three principal approaches are applied in practice, each grounded in different observable inputs and each carrying different strengths and limitations. More than one method is typically applied, with the results used to triangulate the concluded adjustment.

Inutility Method

The Excess Capacity Approach

The inutility or excess capacity method estimates economic obsolescence as the value of the productive capacity that cannot be sustainably utilized at the measurement date. It is conceptually straightforward: an asset operating below its economic capacity is worth less to a market-participant buyer than an equivalent asset operating at full capacity, because the buyer would not pay for the right to generate returns from capacity that the market cannot absorb.

The adjustment is typically calculated as:

$$\text{Economic Obsolescence\%} = 1 - (\text{Utilized Capacity} / \text{Installed Capacity}) ^ \text{Cost-Capacity Factor}$$

The cost-capacity factor (commonly 0.6 to 0.7 for process-type plant, reflecting economies of scale) moderates the adjustment for the non-linear relationship between capacity and cost. A simple linear inutility calculation — applying the idle capacity percentage directly — will overstate the economic obsolescence for most categories of PP&E.

Key limitation:

The inutility method is a point-in-time snapshot. It reflects utilization at the measurement date but does not capture whether that utilization is likely to recover, deteriorate further, or has reached a permanent structural level. In rapidly changing conditions, the relevant assessment is whether the current utilization rate is representative of a sustainable long-run level or a temporary trough.

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Income-Based Extraction

The Return-on-Assets Cross-Check

The income-based extraction method estimates economic obsolescence as the capitalized value of the gap between the return an asset base is actually generating and the return a market-participant investor would require. It anchors economic obsolescence to the profitability of the employing business rather than to physical capacity, making it particularly useful as a cross-check where the inutility method is the primary approach.

The mechanics, simplified:

- Estimate the normalized earnings before interest and tax (EBIT) of the operation employing the assets
- Determine the required pre-tax return on assets (typically derived from WACC adjusted for asset-specific risk)
- Apply the required return to the reproduction cost of the asset base to derive the required earnings
- The shortfall between required and actual earnings, capitalized at the required return rate, represents the combined obsolescence quantum attributable to economic and any residual functional factors

Key limitation:

This method conflates economic obsolescence with entity-specific operational performance. If the business is a sub-optimal operator — underperforming not because of external market conditions but because of internal inefficiencies — the extraction method will overstate economic obsolescence. Earnings must therefore be normalized for entity-specific factors before the method is applied.

Market-Derived Method

Observable Market Benchmarks

Where a secondary market exists for the assets being valued, the market-derived method infers total obsolescence — including the economic component — as the gap between observed transaction prices and the replacement cost of equivalent new assets. This is the most empirically grounded approach when data are available, as it directly captures market participants' pricing rather than requiring a model of the economic conditions that drive it.

In practice, this method is constrained by data availability. Comparable sales of large, specialized, or industry-specific plant are infrequent. Where observable data exists — auction results, broker listings, published price guides for second-hand equipment — it should be used, at a minimum, as a floor or cross-check. For highly specialized assets with no secondary market, the method cannot be applied directly but can be approximated through reference to orderly liquidation value estimates from equipment specialists.

Key limitation:

Market prices for second-hand assets embed all forms of obsolescence — physical, functional, and economic — without disaggregation. Care must therefore be exercised when isolating the economic component, particularly where the physical and functional condition of the reference assets differs materially from that of the subject asset.

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A CRITICAL CONCEPT

The Liquidation Value Floor

One of the most important — and most frequently overlooked — constraints in the fair valuation of PP&E under severe economic obsolescence is the relationship between the depreciated replacement cost (DRC) conclusion and the asset's realizable value in an orderly liquidation.

The cost approach, even after aggressive economic obsolescence adjustments, can in theory produce a value below what the assets would realize in a hypothetical orderly liquidation — that is, a sale of the assets on a standalone basis to a willing buyer in the secondary market, without the distress of a forced or time-constrained disposal. **This is a logical impossibility from the perspective of a market participant.**

A rational market-participant buyer acquiring the CGU as a going concern would never pay less than they could realize by simply purchasing the assets and liquidating them in an orderly manner. The orderly liquidation value (OLV), therefore, represents an economic floor beneath which the fair value of the PP&E cannot fall, regardless of how severe the economic obsolescence adjustment under the cost approach appears to be.

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The Liquidation Floor Principle

If $DRC \text{ (after all obsolescence adjustments)} < \text{Orderly Liquidation Value}$, then the concluded fair value should be the Orderly Liquidation Value. The cost approach result in this scenario does not represent a market participant price—it reflects an over-adjustment of economic obsolescence that produces a value below what the secondary market would actually pay for the physical assets.

Practically, this means the DRC conclusion must always be tested against available secondary market evidence — broker appraisals, auction data, equipment dealer estimates — as a mandatory step in the valuation process for any asset subject to a material economic obsolescence adjustment.

Ford India — Sanand and Chennai Plants (2019–2023)

Ford India invested more than USD 2.0 billion across two state-of-the-art manufacturing facilities — Sanand in Gujarat and Maraimalai Nagar near Chennai — with a combined annual installed capacity of 440,000 vehicles. At the time of exit in 2021, actual production had fallen to around 80,000 units, representing approximately 20% utilization of capacity, with no new model launches planned for either facility.

Ford had already recorded a USD 800 million non-operating write-down of assets in 2019. Following the September 2021 restructuring announcement, it recognized further pre-tax special item charges of approximately USD 2 billion, including non-cash charges for accelerated depreciation. The Sanand vehicle assembly plant was ultimately sold to Tata Motors in January 2023 for Rs 725.7 crore (approximately USD 88 million) — a recovery of less than 10% of the original investment in that facility.

Relevance: The Ford India situation illustrates both the scale of the investment-to-realizable-value gap that can emerge in severely underutilized, model-specific manufacturing facilities and the practical difficulty of establishing OLV when the pool of willing buyers for a purpose-built automotive plant is thin. The Chennai plant remained unsold for over two years despite multiple expressions of interest — itself a market signal about realizable value for a facility with no confirmed production program.

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AUTOMOTIVE MANUFACTURING PLANT

Severe Demand Contraction and End-of-Model-Life

Background

A global automotive manufacturer operates a state-of-the-art passenger car manufacturing facility with a large installed production capacity. The facility was built and equipped to support specific current models of passenger vehicles. At the measurement date, actual production utilization has fallen to approximately 15% of installed capacity, driven by a structural decline in demand for the models produced. The current model range is 4–5 years into its lifecycle, with end-of-production expected within 1–2 years. No new model launches have been confirmed for this facility, and management has no visibility of future programs that would re-purpose or utilize the installed capacity.

The auditors are asserting impairment of the PP&E. A DCF-based value in use returns a value close to nil on account of operating losses and the absence of confirmed future programs. An initial cost approach analysis — applying economic obsolescence for the 85% idle capacity — is producing a DRC lower than what secondary market evidence suggests the assets would realize in an orderly liquidation.

Step 1:

Framing the Valuation Problem

Before any methodology is applied, the valuation problem must be correctly framed. The starting question is not ‘how much should we write this down?’ — it is ‘what would a market-participant buyer pay for this asset on this date, and under what premise?’

This framing immediately raises a central premise question in the case. The facility is a specialized, purpose-built manufacturing plant. A market participant acquiring it would likely consider two distinct scenarios:

Scenario A

Continued use as a manufacturing facility — potentially for different models, different customers, or as a contract manufacturing operation — in which case the buyer is paying for the facility’s productive capacity and its adaptability.

Scenario B

Acquisition for the purpose of asset realization — stripping and selling the equipment and redeveloping or repurposing the building, in which case the buyer is paying the liquidation value of the components.

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The higher of the two scenarios represents the market participant's price and, therefore, the fair value. Both must be estimated; the higher governs.

Step 2:

The VIU Problem — Why a Near-Nil DCF Does Not Settle the Question

The auditors' initial position — that impairment is indicated because the DCF-based value in use is near nil — is technically understandable but methodologically incomplete. Value in use under IAS 36 is an entity-specific measure that reflects this entity's cash flow projections from the asset in its current use. Where those cash flows are effectively exhausted — as they are here, given 15% utilization, operating losses, and no confirmed future programs — the VIU will approach nil.

However, fair value is not the same as value in use. IFRS 13 requires the market participant perspective to be adopted, and a market participant would not necessarily operate the facility in the same way, under the same constraints, or with the same product line. A market participant might:

- Negotiate contract manufacturing arrangements with other OEMs seeking additional capacity
- Repurpose part of the facility for adjacent production uses — electric vehicle components, powertrain assemblies, or industrial manufacturing
- Retain the facility in partial operation through the model end-of-life and then redevelop
- Acquire the facility as a platform for entry into the market at a cost below greenfield construction

None of these possibilities is available to the current entity under its existing strategy — but they would be available to a market-participant buyer. This is the essential distinction between VIU and fair value, and it is why a near-nil VIU does not automatically imply a near-nil fair value.

A near-nil value in use under IAS 36 establishes that an impairment exists. It does not establish the recoverable amount. Where the asset has realizable value to a market participant — either in continued use or in orderly liquidation — that value must be recognized as the floor of the impairment calculation.

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Step 3:

Applying Economic Obsolescence — The Inutility Method

With the premise established, the cost approach is applied. After estimating gross replacement cost and adjusting for physical deterioration and functional obsolescence, the economic obsolescence adjustment is estimated.

At 15% utilization, the raw inutility adjustment — before applying the cost-capacity factor — would suggest 85% of capacity is idle. However, a direct application of an 85% economic obsolescence adjustment is not appropriate without further analysis.

The first assessment required is whether 15% is the right utilization rate to apply. In particular:

- 1 Is the 15% figure representative of a sustainable long-run level, or is it a trough that a market participant would expect to partially recover from? If the facility is expected to operate at 15% for 1–2 years and then cease production, the appropriate utilization for the inutility calculation may be the average over the remaining useful life of the asset under its current use, which could be lower than 15% if ramp-down is expected.
- 2 What is the relevant installed capacity denominator? If significant portions of the installed capacity are mothballed or permanently decommissioned, the effective capacity may be lower than the nameplate figure, producing a higher utilization rate on the active base.
- 3 Does the cost-capacity factor appropriately reflect the nature of this facility? Automotive assembly plants have a different scale-cost relationship than, say, a chemical process plant. The chosen factor should be supported by reference to engineering literature or comparable facility data.

Step 4:

The DRC Result and the Liquidation Floor

The DRC conclusion — after adjustments for physical, functional, and economic obsolescence — may indicate a value significantly below the asset's original carrying amount. As discussed above, this conclusion must be tested against secondary market evidence.

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For an automotive manufacturing facility, the relevant evidence includes:

- Broker and auctioneer appraisals of the production equipment — CNC machinery, robotics, assembly line equipment, paint shop infrastructure — on a standalone, orderly liquidation basis
- Published price guides and recent auction results for comparable automotive manufacturing equipment
- Real estate appraisals of the land and buildings at their highest and best use, which may differ materially from their value as an automotive facility
- Opinions from specialized automotive equipment dealers on realizable values for specific asset classes

If the aggregate of these secondary-market values — the OLV — exceeds the DRC conclusion, the OLV becomes the fair-value floor. In the scenario described, this is precisely what occurs: the DRC, after an aggressive but technically supportable economic obsolescence adjustment, falls below what the secondary market evidence suggests the assets would realize in an orderly disposal. The DRC result in this case is internally consistent — the economic obsolescence adjustment is arithmetically correct — but it is not a market-participant price, because no market participant would pay less than the liquidation value.

The concluded fair value is therefore the orderly liquidation value range, not the DRC conclusion. This is the most critical judgment in this case, and one that requires explicit documentation and defense.

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FIVE PRINCIPLES FOR ECONOMIC OBSOLESCENCE ASSESSMENTS

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Distilling the conceptual and case study material above, five principles should underpin every economic obsolescence assessment for PP&E:

01

Always establish the valuation premise first.

Continued use and liquidation produce different values. The fair value is the higher of the two. Do not apply the cost approach without first determining whether a market participant would operate, repurpose, or liquidate.

02

Apply the cost-capacity factor — never use a linear inutility adjustment.

A linear application of idle capacity percentage as economic obsolescence overstates the adjustment for all process and manufacturing-type assets. The cost-capacity factor must be applied and supported with reference to engineering literature or comparable data.

03

Use the income-based extraction as a cross-check, not a primary method.

The extraction method conflates external obsolescence with entity-specific performance. It is most useful as a cross-check on the inutility conclusion, after normalizing earnings for entity-specific factors. In severely distressed operations, normalization may be required to reflect a market participant operator.

04

Always test DRC against orderly liquidation value.

The OLV is a mandatory floor check, not an optional step. Where DRC falls below OLV — as it can in cases of severe economic obsolescence — the OLV governs. Engage specialist equipment appraisers and real estate valuers to provide OLV evidence for major asset classes.

05

Document every judgment with explicit support.

Economic obsolescence is the most judgment-intensive element of a PP&E valuation and the most frequently challenged. Every input — utilization rate, cost-capacity factor, capitalization rate, OLV evidence — must be documented with a clear rationale. The valuation report should enable an informed reader to understand, test, and replicate the conclusion.

FROM ANALYSIS TO ACTION

What makes economic obsolescence genuinely difficult — and consequential — is that it sits at the intersection of two disciplines rarely combined in a single team. Estimating the inutility adjustment requires deep expertise in the asset class's physical characteristics and market dynamics. Estimating the return deficiency that drives economic obsolescence requires enterprise valuation skills: normalized earnings analysis, cost of capital derivation, and DCF modelling. Without both, neither the quantum of obsolescence nor the reliability of the concluded fair value can be adequately supported.

Economic obsolescence is not a residual or a plug. It is a substantive valuation adjustment that requires the same rigor of analysis, the same quality of evidence, and the same depth of documentation as any other element of a fair value conclusion. When it is large — as it was in the automotive case study — it is the adjustment most likely to be challenged, most difficult to defend without structured support, and most consequential for the impairment recognized in the financial statements.

The case study illustrates principles that apply broadly to any PP&E valuation in a distressed or contracting environment. The near-nil value in use establishes that impairment exists but does not determine its quantum. The cost approach, applied with a technically supportable inutility adjustment, provides the primary estimate of fair value for the tangible asset base. The orderly liquidation value provides the essential floor. And the market-participant premise — asking what a knowledgeable buyer would pay, and for what purpose — anchors the entire exercise in economic reality rather than in the entity's own constrained position.

The case illustrated above also highlights the substantial impact that external economic factors can have on asset valuation. Depending on the extent and nature of economic obsolescence, different valuation outcomes may arise, including scenarios such as forced liquidation, distress sale, etc. Therefore, careful consideration of economic obsolescence is essential when determining an appropriate collateral value under varying market and liquidation conditions.

Economic obsolescence is where tangible asset valuation and business valuation converge. Addressing it credibly requires both — and the discipline to ensure they speak with one voice.

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INTEGRATED VALUATION EXPERTISE ACROSS BOTH DISCIPLINES

Our advisory team brings together specialists in tangible asset valuation and business valuation within a single, integrated practice — structured precisely to address the challenge of economic obsolescence. We do not treat these as separate engagements. We approach every PP&E fair value assignment with the understanding that the asset cannot be correctly valued in isolation from the business that employs it.

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Tangible Asset Valuation

PP&E · Specialized Plant · Infrastructure ·
Real Property

Independent Fair Valuation

Cost approach valuations — including gross replacement cost, physical deterioration, functional and economic obsolescence — for all categories of PP&E across industrial, manufacturing, energy, infrastructure, and real estate sectors. All work performed to IFRS 13 and ASC 820 standards.

Economic Obsolescence Quantification

Application of inutility, income-based extraction, and market-derived methods, with full triangulation and documentation. We apply the cost-capacity factor correctly and support every input with evidence-based assumptions.

Orderly Liquidation Value Assessment

Engagement of specialist equipment appraisers, auctioneers, and real estate valuers to establish secondary market benchmarks — ensuring DRC conclusions are tested against the floor that secondary markets impose.

Impairment Allocation Support

Attribution of recognized impairment losses across individual assets within a CGU, with economic obsolescence revisited where the recoverable amount indicates under-estimation in the original fair value

Normalized Earnings Analysis

Separation of entity-specific operational underperformance from genuine economic obsolescence — the critical normalization step, without which the income-based extraction method produces misleading results. We examine cost structures, management decisions, and market benchmarks to isolate the external component.

Cost of Capital and Discount Rate Derivation

Market-participant WACC estimation using sector betas, capital structure analysis, and risk premium benchmarks. We ensure the cost of capital applied in the obsolescence extraction is consistent with market participant assumptions and reconcilable with any concurrent impairment testing rate.

DCF and Enterprise Valuation

Multi-period cash flow modelling to establish the enterprise value implied by current and projected market conditions. Used as a cross-check on the inutility method and as the primary basis for return-deficiency analysis in the income-based extraction.

Valuation Reconciliation

Where fair value work and impairment testing are conducted by different teams, we review and reconcile the enterprise value assumptions embedded in each exercise, producing a reconciliation memorandum suitable for audit and regulatory review.

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THE EXPERTISE BEHIND THE ANALYSIS



Dual-discipline expertise

Our valuation professionals hold qualifications and experience spanning both tangible asset appraisal and business valuation — the two disciplines that economic obsolescence demands. We do not sub-contract one to the other.

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Sector depth

Deep experience across automotive, heavy manufacturing, energy, chemicals, infrastructure, and real property. We understand the physical asset characteristics, market dynamics, and industry-specific capacity relationships that drive defensible economic obsolescence conclusions.



Audit-ready documentation

Every engagement produces documentation structured to withstand scrutiny from auditors, regulators, and counterparties. We provide reconciliation memoranda, assumption schedules, and methodology notes as standard — not as afterthoughts.



About Uniquis Consultech:

Uniquis Consultech is a global tech-enabled consulting company that specializes in Accounting & Reporting, Governance, Risk & Compliance, Sustainability & Climate, Tech Consulting, and Valuations. The Company is co-founded by consulting veterans Jamil Khatri and Sandip Khetan and backed by marquee investors such as Nexus Venture Partners, Sorin Investments, and UST.

Uniquis has a global team of 800+ professionals led by 100+ Partners & Directors across eleven offices in the USA, the Middle East, and India. The company serves more than 300+ clients, including marquee names in each of the markets it operates in.

Uniquis is committed to leveraging technology and an integrated global delivery model to provide best-in-class consulting services to its clients.

About Our Valuations Services:

Increasingly complex transaction structures, heightened regulatory & governance scrutiny, and the need for transparent financial reporting demand valuations that are both rigorous and reliable.

Our Valuations practice delivers a comprehensive suite of tech-enabled valuation solutions across the breadth of asset classes, supported by deep technical expertise, strong industry knowledge, and a nuanced understanding of accounting and regulatory requirements.

With an experienced team of valuation professionals, we partner with our clients to support them in all their valuation needs, including pre-deal support, dispute resolution, regulatory compliance, financial reporting, and post-acquisition support.

A Team That You Can Trust To Deliver



Jamil Khatri
Co-Founder & CEO



Sandip Khetan
Co-Founder, Global Head
of Accounting & Reporting
Consulting



Kapil Bellubi
Partner, Head of
Valuations



Amit Bora
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Marut Kumar Mishra
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