Attorney
CLE Series

The Market Approach to Business Valuation

UNDERSTANDING THE METHODS AND THEIR BASIC APPLICATION

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Presented by the Business Valuation Services Group

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Certified Public Accountants and Consultants

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Bob brings extensive experience in tax and valuation issues that affect privately held businesses and their owners. The breadth of his involvement encompasses the development and implementation of innovative business and financial strategies designed to minimize taxation and maximize owner wealth.

As his career has progressed, Bob has risen to a level of national prominence in the business valuation arena. His expertise in specific purpose valuations is well known, and he is a frequent speaker, regionally and nationally, on tax and valuation matters.

After graduating from Saint Vincent College in 1979 with Highest Honors in Accounting, Bob earned a Masters of Science degree in Taxation with Honors from Robert Morris University. He is a CPA in Pennsylvania and Ohio and is accredited in Business Valuation by the American Institute of Certified Public Accountants. Bob also carries the well-recognized credentials of Accredited Senior Appraiser, Certified Valuation Analyst and Certified Business Appraiser.

Bob has written numerous articles for several area business publications and professional trade journals. He is a national instructor for both the American Institute of Certified Public Accountants and the National Association of Certified Valuation Analysts and has served as an adjunct professor for Duquesne University's MBA program.

A member of the American and Pennsylvania Institutes of Certified Public Accountants, Bob previously chaired the Pittsburgh Committee on Taxation. He is also the past chair of the Education Board of the National Association of Certified Valuation Analysts as well as a former member of the organization's Executive Advisory Board, its highest Board.

He is a member of the Allegheny Tax Society, the Estate Planning Council of Pittsburgh and the Pittsburgh Chapter of the American Society of Appraisers. Bob has held numerous offices and directorships in various regional not-for-profit organizations. He received the 2003 Distinguished Public Service Award from the Pennsylvania Institute of Certified Public Accountants and the 2004 Distinguished Alumnus Award from Saint Vincent College.

Bob and his wife, Susie, live in Westmoreland County. They have two children, Matthew and Alyssa.

Melissa A. Bizyak, CPA/ABV/CFF, CVA

Melissa has practiced in public accounting for over 16 years. She has significant experience in business valuation and tax-related issues for privately-held concerns and their owners. Melissa's business valuation experience is very diverse, including valuations of professional practices, as well as companies in the manufacturing, oil and gas and technology industries.

These valuations have been performed for a variety of purposes such as Employee Stock Ownership Plans (ESOPs), marital dissolutions, buy/sell transactions, dissenting shareholder disputes, value enhancement and gift and estate tax purposes.

After graduating from the University of Pittsburgh in 1994 with a B.S. in Business/Accounting, Melissa spent more than two years with a local accounting firm in Pittsburgh. She joined Grossman Yanak & Ford LLP in 1997.

Melissa is a certified public accountant. She is accredited in business valuation and certified in financial forensics by the American Institute of Certified Public Accountants (AICPA). She has also earned the AICPA Certificate of Achievement in business valuation. Additionally, Melissa carries the credentials of Certified Valuation Analyst.

Her professional affiliations include membership in the National Association of Certified Valuation Analysts (NACVA) as well as the AICPA and the Pennsylvania Institute of Certified Public Accountants (PICPA). She serves on the Board of Directors of the Estate Planning Council of Pittsburgh as President and is a member of the Robert Morris University Professional Advisor Council.

Melissa has authored articles appearing in professional publications and has written business valuation course-related materials for NACVA and the AICPA. She serves as a national instructor for NACVA.

Melissa is a graduate of the Leadership Development Initiative, a Leadership Pittsburgh, Inc. program. She serves on the Executive Leadership Team for the American Heart Association's "Go Red for Women" initiative.

Melissa resides in the South Hills of Pittsburgh with her husband and their two sons.

Sara L. Bergman, AVA

Sara provides industry, economic and corporate research as well as performing calculations required for the preparation of business valuation reports and other consulting projects. She primarily provides services to privately held concerns and their owners.

During her time at Grossman Yanak & Ford LLP, Sara has played a significant role in preparing business valuations for a variety of purposes including marital dissolutions, gift and estate tax purposes, dissenting shareholder disputes, and buy/sell transactions. She is also a frequent speaker at firm-sponsored events and seminars.

Sara graduated cum laude from Mount Union College in 2006. She earned Bachelor of Arts degrees in two majors – business administration and sport management, with a concentration in finance and a minor in accounting.

After graduation, Sara joined the Business Valuation Services Group at Grossman Yanak & Ford LLP. She has completed the training, certification and examination requirements to earn the Accredited Valuation Analyst (AVA) designation as conferred by the National Association of Certified Valuation Analysts (NACVA).

She continues to pursue additional training and expertise, frequently attending seminars and classes sponsored by NACVA, the American Institute of Certified Public Accountants (AICPA), and the Pennsylvania Institute of Certified Public Accountants (PICPA).

In her spare time, Sara is active in her church and enjoys golfing with family and friends. Sara currently resides in the North Hills with her husband, Josh.

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The Market Approach to Business Valuation

Chapter I – *Introduction*

The market approach to valuation is based on the economic principle of substitution. Under this principle, an investor is presumed to pay no more for a business interest than what he or she would pay for an equally desirable alternative. Thus, under this approach, indicators of value are developed from the prices of companies that are similar and have sold in the marketplace.

The market approach is often perceived as the best way to value a business or an ownership interest in that business. Certainly, it is an approach that offers ease of understanding to users of business valuation reports. Most commonly applied to the appraisal of real estate, a recent sale of a property and building in similar condition and size to another in the same proximate geographic location would seem to easily confirm the market value of that other property.

Such an approach has equal applicability to business valuation. However, in the valuation of business interests, the valuator has far fewer comparable guideline companies from which to choose his or her indicators of value. While real estate appraisers often have tens or even hundreds of completed transactions from which to choose their comparables, business valuators, primarily by virtue of limited availability of information, as well as far fewer transactions, generally will have far fewer comparable companies. Very often, the number of comparables used in business valuation is five or fewer.

In comparing the use of the market approach to the income approach, it is important to understand that those elements key to the determination of value are incorporated (albeit, somewhat differently) in both. Most predominant among these key features is that value is forward-looking. While the income approach is often held by practitioners to more closely align with the forward-looking aspect of business valuation, proper application of the market approach confirms consideration of future expected performance. Valuation multiples developed through this approach, such as price or value to earnings, or some variation thereof, contemplate a multiplier applied to some base variable expected to continue into the future. Thus, it is future-expected performance, and not past performance that dictates value.

The second key feature of the market approach is the assessment of risk. The risk assessment process that is considered within the income approach is inherently considered within the multiples developed under the market approach. Alternative risk-free investment returns, as well as industry, economic and company-specific risk are all indirectly manifested in valuation multiples developed under the market approach.

The final key feature considered under the market approach is long-term growth. Growth in the future is paramount to a proper determination of value. Implicit in the multiples developed under this approach is the "market's" growth expectations.

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The greatest benefit of the market approach is that it relies on actual "third-party" data from which inferences might be made by the valuator as to the subject company under valuation. Unfortunately, improper assessment and application of this third-party data, as well as the limited availability of quality data often leads to incorrect conclusions of value under the market approach.

Even with these limitations, and those discussed throughout these materials, it is incumbent upon the valuator to consider this approach in every valuation and to utilize the approach where appropriate.

Revenue Ruling 59-60, 1959-1 C.B. 237, section 4.01(h), which provides the primary authoritative guidance for business valuators working before the Internal Revenue Service, states that one of the factors that must be considered in an analysis of value is: "the market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter." Section 4.01(g) of the same ruling dictates that "sales of stock" must be considered as well.

While directly applicable to preparing business valuations for income as well as gift tax purposes, Rev. Rul. 59-60 and its fundamental precepts have come to be broadly accepted by a wide number of courts in resolving matters of value. Moreover, most treatises addressing business valuation, as well as numerous appraisal organizations' professional standards, require consideration of the market approach.

This program is intended to familiarize today's attendees with the market approach, both theoretically and mechanically. General issues related to a valuation conclusion calculated under this approach will be discussed as will how best to identify assumptions and errors in valuation reports.

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Chapter II – *Methods Under the Market Approach*

To best understand the market approach, it is first necessary to understand the different methodologies that are available to the business valuator under the approach. As with the income approach and the cost asset approach, there are multiple methods under the market approach by which a value conclusion can be ascertained. Those methods most commonly employed include:

- Guideline Public Company Method
- Guideline Transaction (Merged and Acquired) Method
- Past Completed Transactions Method
- Rules of Thumb

Guideline Public Company Method

Under the guideline public company method, the value multiples selected by the valuator for application to the subject company under valuation are developed from identification and analysis of companies that are traded freely on an open stock exchange in the public markets. Interest in this method is high within the business valuation community and with users of business valuations for numerous reasons.

First, the sheer number of publicly-traded companies offers the valuator an opportunity to draw comparable guideline companies from a broad pool of potential candidates. The Wall Street Journal estimates that there are approximately 15,000 publicly-traded companies as of the date of these materials. Other commentary notes that there may be an equal amount that do not file with the SEC due to low asset value thresholds or low shareholder counts.

It is noteworthy that many of these registered and reporting companies represent smaller and medium-size businesses, thus expanding the use of this method from only large companies in the past to many smaller and medium-size privately-held businesses in today's current valuation environment. Thus, it is clear that, more than ever before, the guideline public company method is a useful and necessary undertaking in these valuations.

Second, the guideline public companies offer a significant amount of quality financial, industry and economic data by which to determine the degree of comparability. The financial reporting requirements mandated by the Securities and Exchange Commission (SEC) as well as severe scrutiny applied to publicly-traded companies by virtue of investment analysts and other interested parties, serves to ensure that the affected companies present a great deal of information to ensure compliance. This information, properly applied, allows for more direct analysis, better selected comparables and ultimately, a better valuation conclusion.

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Finally, the guideline public company method incorporates, by its mechanics, observations of actively-traded stocks that are price-driven by independent third-party investors. Those risks-vs-return considerations contemplated by these investors, in effect, mirror those that would be considered by a hypothetical buyer or seller of the subject company under valuation. Thus, use of this method directly correlates value to market investor expectations.

Guideline Transaction (Merger and Acquired) Method

The guideline transaction method, often referred to as the merger and acquired method, offers an alternative to the guideline public company method in incorporating market value observations. Under this method, rather than looking to trading prices of publicly-traded stocks, focus is turned to observances of value indicators produced through closed and completed acquisition transactions.

The guideline transaction method has taken on wider appeal over the last 16 years due to substantially greater availability of transaction data. The number of transaction databases and transaction source data available to business valuators and users of business valuation reports has grown from zero at the inception of Revenue Ruling 59-60 to well over 100 as of the date of this presentation.

Transactions providing financial data useful to business valuators under this method are generally classified into one of four categories:

- Public company sale
- Private company sale to public company requiring an SEC 8-K filing
- Private company sale to public company with no SEC 8-K filing
- Private company sale to private company[1]

In most instances, valuation assignments requiring market transaction observances related to medium-size and smaller privately-held companies default to databases setting forth information on private company sales to private companies.

Those databases capturing private-company transactions and most often used by business valuators in the application of the guideline transaction method have added information from nearly 3,000 transactions per year over the last decade. While the current economic crisis has slowed merger and acquisition activity worldwide, including in the continental United States, there is reason to think that the market will improve, and transaction activity will resume. As the databases grow, the validity of this method will garner even more acceptance.

[1] *The Market Approach to Valuing Business*, 2nd Edition, Shannon P. Pratt, John Wiley & Sons, Inc. 2005, p. 35

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The most significant challenge to business valuators in using the guideline transaction method is availability of detail information sufficient to interpret deal structure and to draw inferences of comparability. A number of the databases contain incomplete information that, ultimately, is inadequate for such assessments. Given this very serious limitation, the guideline transaction method is seldom used as a primary valuation method. However, it is still very important to consider the method as confirming indications of value produced under other valuation methods. As such, its usefulness should not be dismissed out-of-hand.

Past Completed Transactions Method

Perhaps the most common method of incorporating "actual" transaction data into the business valuation process is to review and consider past transactions involving the subject companies' equity interests. Generally, these types of transactions are either classified as control or minority transactions. In the case of either a past control or a past minority transaction, the independent, objective and arm's-length nature of the deal must be ascertained before the financial and valuation relevance can be determined.

Very often, dealings in private enterprises work to circumvent good faith and independence where motivations of the parties invoke self-interest. In such cases, it is necessary for the valuator to "identify" and "unwind" those elements of the deal that are not arm's-length. If this cannot be accomplished, the usefulness of past transaction data is at a minimum, questionable, and in a worst-case scenario, useless in determining value at the current date.

If the company under valuation was recently acquired in total in an arm's-length transaction, the value indicators resulting from that deal will be critically important in assessing current value. If it was acquired at arm's-length, the "transaction" would serve as an excellent guideline company under the guideline transaction method. Minority transactions from the past in the subject company's equity interests are much more likely to lack the "arm's-length" character necessary to prove useful in the business valuation context.

Also, in many instances, one or more parties to the past transaction may be found to lack the financial sophistication to properly assess the transaction in which they were a participant. Even if the past transaction was found to be conducted at arm's-length, this lack of participant sophistication could easily void the usefulness of those transactions.

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Rules of Thumb

Rules of thumb are very simply, multiples set forth by various parties, publications, industry organizations or business brokerage services. Most often these rules of thumb are based on suggested multipliers applied to an easily identifiable variable within the subject company's financial statements. Examples include the following:

- Multiple of sales
- Multiple of Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA)
- Multiple of Earnings before Interest and Taxes (EBIT)
- Multiple of Seller's Discretionary Cash Flow or Owner's Cash Flow

Rules of thumb provide a useful means to confirm the reasonableness of value conclusions developed under more rigorous valuation methods. While it is generally considered improper to dismiss rules of thumb out-of-hand, it is also deemed improper within the business valuation community to accept rules of thumb carte blanche, without further analysis and understanding of how they were developed.

Guidance for the use of rules of thumb is set forth in the American Society of Appraisers Business Valuation Standards, as follows:

> *Rules of thumb may provide insight on the value of a business, business ownership interest, or security. However, value indications derived from the use of rules of thumb should not be given substantial weight unless supported by other valuation methods, and it can be established that knowledgeable buyers and sellers place substantial reliance on them.*[2]

The most glaring challenge when using rules of thumb is the total lack of detail supporting the multiples. Seldom do the promoters of rules of thumb include details such as where (geographically) and when (date of transaction) the underlying transactions occurred. Also, it is uncommon to have detail available describing deal structure, deal terms or the acquired company's profitability. This "missing" detail is critical to the valuation process and often negates the usefulness of rules of thumb.

The four methods discussed above briefly describe the most common methods employed by the business valuation community in applying the market approach. The balance of the program will focus on providing a detailed understanding of the two guideline company methods including those mechanical steps required for proper utilization of the methods, as well as the advantages and disadvantages specific to these methods.

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[2] American Society of Appraisers, Business Valuation Standards, BVS-S

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Chapter III – *Comparability and Similarity of Guideline Companies*

In contrast with real property appraisals, one of the more difficult (and, perhaps, the most significant) tasks in applying the market approach to the valuation of privately-held businesses, and ownership interests within those businesses, is the identification of companies that can serve as legitimate proxies for the attendant company under valuation.

Section 3.03 of Revenue Ruling 59-60, which strongly advocates the guideline public company method within the market approach, states,

> *When a stock is closely held, is traded infrequently, or is traded in an erratic market, some other measure of value [other than public market trading prices] must be used. In many instances, the next best measure may be found in the prices at which the stocks of companies engaged in the same or a similar line of business are selling in a free and open market.*

In addition to this language, Section 4.02(h) adds,

> *Section 2301(b) of the Code states, in effect, that in valuing unlisted securities, the value of stock or securities of corporations engaged in the same or a similar line of business, which are listed on an exchange, should be taken into consideration along with all other factors. An important consideration is that the corporations to be used for comparisons have capital stocks, which are actively traded by the public. In accordance with section 2031(b) of the Code, stocks listed on an exchange are to be considered first. However, if sufficient comparable companies whose stocks are listed on an exchange cannot be found, other comparable companies that have stocks actively traded in the over-the-counter market also may be used. The essential factor is that, whether the stocks are sold on an exchange or over-the-counter, there is evidence of an active, free public market for the stock as of the valuation date. In selecting corporations for comparative purposes, care should be taken to use only comparable companies. Although the only restrictive requirement as to comparable corporations specified in the statute is that their lines of business be the same or similar, yet it is obvious that consideration must be given to other relevant factors in order that the most valid comparison possible will be obtained. For illustration,...a company with a declining business and decreasing markets is not comparable to one with a record of current progress and market expansion.*

The language in this ruling has driven much of the current thinking in the business valuation community as to selection of valid comparison companies.

At one time, the "guideline" methods were described as "comparable" methods. Over time, the "comparable" title evolved to "guideline" to better define what was happening within the market approach and how the selected companies were being used within the business valuation process.

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No two assets are identical. However, certain assets, including collectibles and real estate, can often be valued with comparisons to nearly identical characteristics. Such is not the case with privately-held businesses and ownership interests in those businesses.

Of course, no two businesses are likely to be found identically comparable. The process, then, becomes one of finding sufficient comparability to allow for the provision of meaningful guidance as to value. Thus, those companies selected by the valuator as sufficiently comparable will then lend guideline criteria in determining value.

What makes comparability sufficient to be used as guideline indicators of values? By virtue of Revenue Ruling 59-60, the selected companies must be in the same or a similar line of business. However, the ruling notes, (as do most business valuation treaties) "that consideration must be given to other relevant factors in order that the most valid comparison possible will be obtained."

These other relevant factors are determined judgmentally by business valuators on a case-by-case basis. However, such determinations often turn first to an assessment of the subject company under valuation to fully understand its business. This necessary understanding includes the company's main products and/or services; its customers and clients; those markets currently served and expected to be served in the future; its product distribution capabilities; competition, supplier and employee relationships; and financial performance (past and expected), including expected future growth, profitability, asset utilization, debt relationships and structure, etc.

Again, as noted in earlier programs, the ability to opine on value requires an intimate understanding of all aspects of the subject company. Nowhere in the business valuation process is that necessity greater than in the selection of guideline companies.

Note that any financial analysis procedures, including ratio analysis, trend analysis, and common sizing analysis may require economic "normalization" adjustments. Normalization was discussed in an earlier presentation and is beyond the scope of this program.

Once the subject company analysis is complete, the valuator can begin to search for guideline companies that offer sufficient comparability to provide valid indicators of value. Invariably, the process begins with a search of Standard Industrial Classification (SIC) and, in some search services, the North American Industrial Classification Systems (NAICS). Beyond simple code classification, further research must be undertaken to establish that the identified companies are in the same or a similar line of business.

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Size and Growth

Size and expected growth are two critical elements of comparability requiring assessment by the valuator. Size can be expressed in terms of gross revenue or sales, total assets or some component thereof, and/or market capitalization. Most often, size seems to be evaluated in terms of revenue or sales.

Size becomes important in that trading or pricing multiples are historically less for smaller companies due to greater perceived risk. More risk means investors will require a higher rate of return on their investments. Such higher returns generally equate to lower multiples leading to lower values.

While no hard and fast rules apply, in the search of sufficiently comparable guideline companies, a commonly-accepted practice in the business valuation community is to exclude those identified companies with more than 10 times the measurement variables. In other words, a company with $300,000,000 in revenue might be deemed sufficiently comparable for consideration in the valuation of a company with $30,000,000 in revenue. Ultimately, such decisions are judgmental and at the prerogative of the business valuator.

Growth is inextricably woven into the fabric of value. Future expected growth is implicitly included in the pricing of all stocks and equities that are publicly traded. As such, it is absolutely critical that guideline companies selected under the market approach have consistent and comparable growth rates.

From a valuation perspective, the price of publicly-traded securities must be analyzed and researched to ensure that the growth rate inherent in that pricing is consistent with that of the subject company. In most cases, public company analysts and industry analysts project rates of growth for publicly-traded enterprises.

Though beyond the scope of this program, it is noteworthy that very often, the analysts project only single-year or short-term growth, while valuation of privately-held businesses contemplate long-term sustainable growth. The market approach allows for consideration of these differences and their adjustment, if necessary.

Sample Size Considerations

To properly apply the market approach, it is necessary for business valuators to identify a sufficient number of guideline companies to reduce the risk of erroneous results arising from specific anomalies. The question that must be addressed in each application of the market approach is, "How many guideline companies are required to draw meaningful and accurate conclusions?"

Unfortunately, there is no definitive answer to this question. It is an obvious statistical reality that the greater the number of guideline companies, the less influence any single company anomaly will carry.

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Courts have ruled that a single comparable guideline company is insufficient to define an adequate sample. However, given the limitations in identifying quality comparable guideline companies, the valuator may be left with little alternative than to use a limited number of guideline companies in his or her sample or use a larger group of less desirable guideline companies that are, perhaps, less similar.

Financial Analysis of Guideline Companies

Once an adequate number of guideline companies has been identified (via SIC code, NAICS code and/or size and growth), further refinement of the comparability assessment is conducted by the business valuator through detailed financial and operational analysis of those companies. To allow for direct and specific comparisons to the subject company under valuation, it is necessary that the same financial and analytical procedures applied to the subject company be applied to each of the guideline companies. These include ratio analysis, trend analysis and common sizing analysis.

It is also relevant and critical that the historical financial data of each of the guideline companies aligns properly with the "date of valuation" applicable to the engagement at hand. In all cases, analysis of financial data through the date of valuation is proper, while analysis of data beyond the date of valuation is not as useful for purposes of determining comparability.

Common financial performance measures developed for both the guideline companies and the subject company include activity ratios, balance sheet ratios, liquidity ratios, capital structure ratios, profitability and cash flow and industry specific analysis, if applicable.

Other Comparability Issues

With particular applicability to the guideline transaction (merger and acquired) method under the market approach, sufficient comparability is more difficult to determine. The key dynamic fueling this problem is a severe limitation in the availability of detailed financial information for transactions involving privately-held business enterprises in the transaction databases.

In many instances, this limitation is so difficult to overcome that the guideline transaction method is only useful for confirming or reconciling conclusions of value developed under alternative approaches and/or methods. As can be seen from these materials, identification and selection of guideline companies with sufficient comparability to the subject company is a complex process, often requiring a great deal of professional judgment.

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Chapter IV – *Basic Concepts Under the Market Approach*

Fundamental concepts equally applicable to all methods under the market approach must be understood to fully appreciate the procedures applied throughout the valuator's use of this approach. In addition, an understanding of these fundamental concepts will allow users of business valuations to properly discern the quality and propriety of the conclusions set forth under this approach.

Standard of Value

Discussed in detail in earlier programs, suffice to say that the standard of value is most often driven by the purpose of the valuation. For most valuations, including those performed for income, estate and gift tax purposes, as well as Pennsylvania family law, the applicable standard of value is fair market value.

Fair market value is defined as:

> *the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.*[3]

The definition requires that the valuation result be driven by a hypothetical sale transaction. Given that the definition requires consideration of a hypothetical sale, it stands to reason, then, that focus and attention must be given by a valuator to those hypothetical buyers and sellers and to the concerns and issues that a potential hypothetical buyer and seller might consider prior to entering into a transaction.

A key component of this definition is that a value determination based on special motivations of either a specific buyer or a specific seller would not be considered fair market value. Fair market value also anticipates that both the hypothetical buyer and seller have the ability, as well as the willingness, to enter into the hypothetical transaction.

The definition of fair market value anticipates a value determination under prevalent economic and market conditions at a particular date of valuation. To assume an economic or market turnaround at a point in time beyond the date of valuation will result in a value other than fair market value.

[3] U.S. Treasury regs. (20.2031-1(b)) and Rev. Rul. 59-60, 59-1 CB 237

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Finally, fair market value, by definition, must allow a reasonable time for exposure in the open market. For equity ownership interests requiring longer periods of exposure, marketability, or rather the lack of marketability, presents a greater investment risk, and, therefore, a value detriment. Often this value detriment is addressed in the business valuation process as a discount.

It should be noted that fair market value is a financial measure of value as opposed to a strategic or synergistic measure. The latter is generally referred to as investment value. Investment value is generally defined as the specific value of an investment to a particular class of investors based on individual investment requirements and/or motivations. In consideration of valuing an equity ownership interest, investment value differs from fair market value, which is not buyer- or seller-specific.

Often, investment value is also referred to as synergistic or strategic value. This reference reflects the impact of those synergistic or strategic benefits one particular buyer may bring to the negotiating table in determining investment value. Such buyer-specific benefits might include:

- An ability to enhance future operating performance,
- An ability to mitigate certain risk inherent in the subject company,
- An ability to more efficiently finance the acquisition of the subject company, and
- An ability to assimilate current operations synergistically with the subject company.

In most instances, investment value will exceed fair market value. This phenomenon is primarily the result of the supply and demand continuum for target companies. Simply put, demand for acquisition targets far exceeds available supply. As competitive bidding progresses in the negotiation process, the marketplace reveals that prospective specific buyers are generally willing to pay a premium beyond fair market value to close the deal. Additionally, anticipated post-acquisition cost reductions due to operational synergies may allow for the payment of a premium.

It is commonly-accepted among the business valuation community that a conclusion developed under the guideline public company method is a fair market value conclusion. That consensus opinion has developed because the public markets with active and freely-traded shares best incorporates no synergistic investor perceptions about value of those equities.

The answer is not as clear when considering the guideline transaction method. The market transactions that have closed and are included in various transaction databases generally represent acquisitions of 100% of the target company, or at least a very large controlling block. As the transaction has closed, there was a single specific buyer with potential strategic or synergistic attributes and specific buyer motivations. Since this is the case, many valuators interpret the result under the guideline transaction method as an investment standard of value.

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Levels of Value

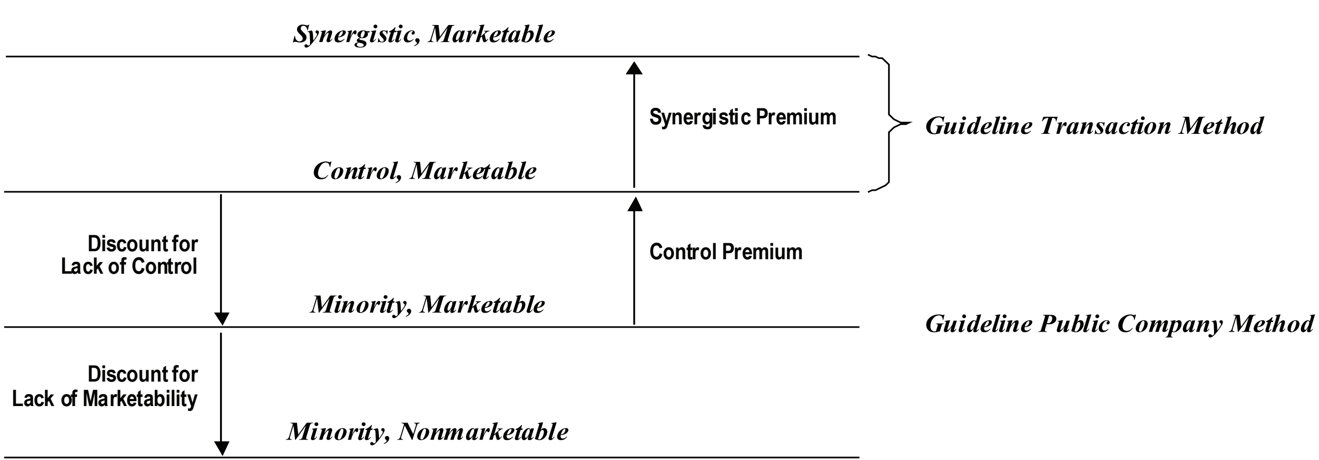
Level of value generally refers to ownership attributes of control and marketability. Under the guideline public company method the result is generally considered a noncontrolling, minority value that is marketable. This conclusion is based on the fact that the public companies used as guideline companies under this method are freely-traded, and the pricing is based on a per-share amount. Thus, the value is deemed to be a minority value.

Note that there is an opposing position within the business valuation profession that would argue that the guideline public company method produces neither a control nor a minority value. Though not yet commonly accepted, it is important to understand that this viewpoint exists.

In almost every case, the result obtained under the guideline transaction method is deemed to be a control, marketable value. The consensus opinion within the business valuation community is based on the fact that the transaction databases contemplate control interest or entire business sales that have been completed.

Understanding levels of value is critical to reconciling the conclusion of value developed under these market approach methods. For instance, if the valuator is engaged to value a minority interest in a privately-held enterprise, which is often the case, the result produced under the guideline public company method would require a discount for lack of marketability. Alternatively, if the valuator were determining value under the guideline transaction method, the adjustments required might include a discount reflective of the strategic premium included in that conclusion. Thereafter, the valuator would likely apply a discount for lack of control as well as a discount for lack of marketability.

Market Approach Methods – Levels of Value



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Assets Under Valuation

The guideline public company method and the guideline transaction method under the market approach both produce enterprise value. That is to say that the valuation results obtained under both of these methods are inclusive of all tangible as well as intangible assets. This also includes both recorded and unrecorded intangible assets.

These key fundamental concepts will prove useful in the remainder of the program as the mechanics of both methods are illustrated.

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Chapter V – *Common Databases and Information Sources*

This chapter will present a brief discussion of some of the databases and sources that are available to valuators for use in applying the guideline public company and guideline transaction methods under the market approach. The next chapter will provide an example of both methods under this approach.

When using guideline publicly-traded companies to value a subject company, different data sources are used. FetchXL and Morningstar Document Research are two options valuators use for comparables.

FetchXL is a program compatible with Microsoft Excel spreadsheets. FetchXL datasets are very extensive and are available for over 13,000 publicly-traded companies. Through the database, analysts have access to more than 750 annual and quarterly fundamental data points from over 9,000 U.S. companies and 3,000 Canadian companies. The data can date back up to 20 years.

Through the FetchXL database, valuation analysts can obtain valuation multiples to apply to their subject companies. Custom spreadsheets can be made to pull specific information given a company's ticker symbol. Additionally, the program has a formula builder and screen builder function to aid the user in obtaining additional company information when necessary.

Morningstar Document Research, formerly named 10-K Wizard, is a database that provides a valuation analyst with the ability to search SEC EDGAR filings. The database includes all 418 electronically filed forms and archives dating back through 1994. There are over 20 search criteria that an analyst can use to find company filings including, but not limited to, ticker symbol, company name, industry or SIC codes, form group/type, geographic location and company profiles.

There are numerous other resources from which a valuation analyst can obtain market multiples including Alacra, Compustat, Disclosure, Hoovers, Reuters, Mergent Company Data Direct and OneSource. Each source contains data for currently-operating U.S. companies. They allow an analyst to search the companies using descriptive and financial variables.

Adjustments may need to be made to the publicly-traded companies to make them comparable to the subject company. These adjustments are subject to the valuation analyst's professional judgment.

Another method under the market approach that is commonly used is the guideline transaction method. When using this approach a valuator relies on finding guideline company transactions as comparables.

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There are a number of databases that gather information on transactions of businesses. The most commonly used sources are:

- BIZCOMPS®
- Pratt's Stats™
- Public Stats
- Done Deals
- The Institute of Business Appraisers (IBA) database
- Mergerstat

The BIZCOMPS® database includes transactions listed dating back to 1996 and has over 11,623 transactions with a median selling price of approximately $165,000. These transactions are searchable by four-digit SIC code, six-digit NAICS code, keyword, annual gross revenue, sale date and sale price ranges, and location of the transaction.

Pratt's Stats™ includes over 16,554 transactions, roughly half of which are below $1,000,000 in value. The transactions have an approximate median revenue of $860,000 and a median selling price of $450,000. Pratt's Stats™ reports up to 88 data points for each transaction. The transactions are updated monthly, with an average of 100 transactions added each month.

Public Stats is a database of public company sales (approximately 2,768) where the entire entity is sold. The database compiles information on up to 64 data points. The data comes from SEC filings submitted by the business buyer. This database is updated monthly, with several transactions added each month. Each transaction has nine valuation multiples from which the valuator can choose.

The Done Deals database contains a number of transactions in which one of the companies is or was publicly traded. As a result, additional information can be obtained in the public company's 10-K (annual filing) or 8-K, which is used to inform investors of a current event. This database includes roughly 8,600 transactions as of December 2008. The majority (75%) of the companies whose transactions are reported in Done Deals are privately-held, and the deal prices range from $1 million to $1 billion. The data primarily comes from SEC filings.

The IBA database contains over 30,000 transactions in 725 different SIC codes. This database contains the smallest number of data points per transaction. The data is obtained primarily from business brokers.

Finally, the Mergerstat database is similar to Done Deals in that the data generally includes transactions where one of the companies is or was publicly-traded. However, the data is not very comprehensive and is listed by industry.

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The majority of the deals (51%) in the database have net sales less than $100 million. The transactions contain equity value greater than $1 million and represent at least a 10% interest. Additionally, one of the parties is a U.S. entity.

Clearly, there are numerous source choices available when a valuation analyst decides to rely upon a market approach. A valuation analyst who performs his/her due diligence will check each source for the best and most reliable data upon which to base his/her conclusion. However, it is also important to note that the sources can at times be duplicative, and it is critical that an analyst not double count a transaction.

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Chapter VI – *The Valuation Process: Examples of the Guideline Public Company & Guideline Transaction Methods*

This chapter provides examples of both the guideline public company method and the guideline transaction method in practice. Readers of this material should note that the examples are intended for illustrative purposes only and that each valuation study has its own set of facts and circumstances that drive the project.

Consideration of the theory set forth in Revenue Ruling 59-60, 1959-1 C.C. 237, is advocated by all commonly-accepted business valuation treatises for determination of value for a broad array of business valuation and economic purposes. In addition, use of the market approach has been widely accepted by the U.S. Tax Court, U.S. District Court in bankruptcy proceedings, various family and appellate courts in divorce and marital dissolution and, finally, in various other state and federal courts.

While no two companies are exactly identical, proponents of the market approach advocate the identification of market transaction companies that are sufficiently similar to provide users with "guideline" indicators of value. A valuator accesses the databases presented in the prior chapter to obtain a valuation multiple to apply to the subject company being valued.

In the most general sense, the following equation is used:

$$\text{Value} = [(\text{Price/Parameter})_{comp} * \ \text{Parameter}_{subject}] - \text{Debt}_{subject}$$

The Parameter could be sales, net income, book value, etc. The Price/Parameter multiple is the applicable multiple based on the parameter used. Only when using an invested capital multiple does the debt need to be subtracted in the calculation.

Examples of the application of the guideline transaction method and the guideline publicly traded method are included on the following pages and in the attached appendices. Our example case encompasses ABC Chemical, Inc., which operates in the coatings manufacturing industry. The Company's last twelve months (LTM) revenue was approximately $32 million, and had EBITDA of $4.5 million. ABC Chemical, Inc. competes with both small and very large (including publicly-traded) companies. Analysts project growth in the public companies that exceeds the expectations of ABC Chemical, Inc.

Example: Guideline Transaction Method

Guideline company transactions refer to acquisitions and sales of entire companies, divisions or large blocks of stock of either private or publicly traded firms.

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In assessing the propriety of the guideline company transaction method in the example case, a number of databases, which are considered to be broadly-accepted sources of transaction data used in the valuation of privately-held business interests, were utilized. The research was conducted utilizing Pratt's Stats™, BIZCOMPS®, Public Stats, International Business Appraisers (IBA) and Done Deals, based on search criteria that included the following selections:

- Standard Industrial Classification (SIC) codes 2800 and 2810;
- Business Descriptions sufficiently similar to ABC Chemical, Inc.; and
- Gross revenue between $3.2 and $320 million

Based on searches of the previously-noted databases utilizing the search criteria above, the following results were obtained. There were no transactions adhering to the criteria in BIZCOMPS® and IBA. The Public Stats database resulted in two transactions; however, this was deemed insufficient for a population from which to draw any meaningful conclusions. The Pratt's Stats™ and Done Deals databases provided three and six transactions, respectively.

The r-squared, which is a statistical measure of how well a regression line approximates real data points, was calculated for each of the market value of invested capital (MVIC) to revenue multiples. The invested capital multiple with the highest r-squared (closest to one, with one being the highest) was selected as the most accurate indicator of comparability and, along with specific company factors, was applied to a regression line analysis. The smaller the variability of the residual values around the regression line, relative to the overall variability (i.e. the closer the r-squared value is to one), the better the model fits the data and more variability is accounted for.

In this case, the multiple of MVIC/Revenue multiple from Pratt's Stats™ produced an r-squared of .99, and Done Deals resulted in .87. Consequently, it was deemed appropriate to apply the multiple derived from Pratt's Stats™. Appendix A presents the multiples and regression analysis used herein. The resulting multiple is applied to ABC Chemicals, Inc.'s last twelve months (LTM) revenue as follows:

Application of Market Approach – Guideline Transaction Method

ABC CHEMICAL, INC.
(in thousands)

LTM Revenue	$ 32,000
MVIC/Revenue Multiple	.99
Market Value of Invested Capital	31,680
Less: Long-Term Debt	(4,550)
Controlling, Marketable Strategic Value of Equity	$ 27,130

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The market value of equity derived from application of the guideline company transaction method is $27,130,000, which is deemed to be a control, marketable value.

It is commonly held by the valuation community that the multiples based on private-company transactions derived from the databases include a strategic premium, implying that some transactions consummated under a standard other than fair market value. This standard of value is an investment or strategic value. In such cases, the value would be something over and above a control value, reflecting an acquisition premium or synergistic premium consisting of the value of perceived synergies included in the transaction exceeding the control value of the seller (or acquiree) on a stand-alone basis.

Due to the inability to quantify this premium and limitations on the information provided by the databases, this method was not used as a primary method in this study but rather as a confirming methodology after consideration of a judgmentally-determined strategic premium of 25%. Reduction for the strategic premium produces a value of $20,347,500 ($27,130,000 * .75).

Example: Guideline Public Company Method

The guideline public company method provides an alternative method to the guideline company transaction method under the market approach. Publicly-traded companies are those whose securities are traded on any of the major public stock exchanges including:

- New York Stock Exchange (NYSE)
- American Stock Exchange (AMEX)
- National Association of Securities Dealers Automated Quotation System (NASDAQ)

There are currently in excess of 15,000 companies registered within the exchanges. Numerous databases exist that include a compilation of an extensive amount of operational and financial information about the registered companies which can be used to provide indicators of value.

Those steps that were undertaken with respect to developing an indication of value under the guideline publicly-traded company method including the following:

1. An initial search of relevant databases was undertaken to identify publicly-traded companies that are "the same or similar" to ABC Chemical, Inc. by SIC code.

2. Once identified, detailed operational information on companies in the initial sample was reviewed to develop an understanding of each company's operating activities and to ensure the activities conducted in the sample

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companies in the initial search are sufficiently similar for use under this method. All companies in the initial search sample that are not deemed sufficiently similar by business description were eliminated.

3. Once the second step was concluded, a detailed review of the financial characteristics of the guideline sample companies was undertaken to provide more comparison points to ABC Chemical, Inc. The "narrowing" of the search parameters increased the quality of the remaining sample companies, thereby enhancing comparability and relevancy of the sample selection.

   Among those parameters closely scrutinized in this process are size in terms of total assets, sales and market capitalization, as well as long-term sustainable growth, which is inextricably related to value.

4. The guideline publicly-traded companies remaining after step three are subjected to a review for extraordinary or nonrecurring items that must necessarily be adjusted out or "normalized" to ensure that any valuation multiples indicative of the present value of future economic benefits are correct and reflect normal future expectations.

5. The fifth step requires detailed analysis of the final sample companies to develop financial and analytic information to provide an overall comparison to ABC Chemical, Inc. Such information includes common sizing the guideline publicly-traded companies, as well as ABC Chemical, Inc., and performing comparative ratio analysis on both.

   This analysis process is intended to identify strengths and weaknesses in ABC Chemical, Inc. at the date of valuation, which will serve as potential adjustments to the valuation multiples developed under this method before applying those multiples to the ABC Chemical, Inc. variables.

6. Once the final guideline publicly-traded companies sample is set, valuation multiples are developed for either equity or the market value of invested capital from those guideline companies.

7. If required, step seven incorporates adjustments to the guideline publicly-traded multiples to facilitate consideration of specific company strengths and weaknesses inherent at ABC Chemical, Inc., but not in the guideline publicly-traded companies.

8. Final valuation multiples are applied to ABC Chemical, Inc. variables in the final step to garner the indications of value under this method.

Note that the level of value produced under this method is a value that is deemed to be minority, marketable.

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After elimination of companies based upon the above-listed steps, a population of seven guideline comparable companies resulted. As described earlier in this section, it is generally-accepted business valuation theory to analyze the population by size, business description, etc. in an effort to determine whether a sufficient population of "similar" companies exists in order to gain enough confidence in the similarities of the guideline companies and the subject company to derive an indication of value. Appendix B includes the population of companies reviewed, including a brief description and key financial data of companies deemed "similar" to our subject company, ABC Chemical, Inc.

It is necessary to keep in mind that a potential investor will make his/her investment decision based on the best available information. Based upon the procedures performed, it is our professional judgment that deriving a multiple from the population of guideline companies would provide an investor with a reasonable indication of the value of ABC Chemical, Inc.

The following example illustrates the value calculated under the guideline public company method under the market approach. Multiples were calculated and analyzed for each of the guideline companies selected. The r-squared was calculated for each of the following multiples.

Application of Market Approach – Guideline Company Method

ABC CHEMICAL, INC.
(in thousands)

	Multiple	
	MVIC/Revenue	MVIC/EBITDA
Revenue / EBITDA	$ 32,000	$ 4,500
Multiple (Median)	.632	4.17
Market Value of Invested Capital	20,224	18,765
Plus: Cash	8,000	8,000
Less: Debt	4,550	4,550
Equity Value	$ 23,674	$ 22,215

Note multiples are rounded

In this case, the multiple of MVIC/Revenue and MVIC/EBITDA produced an r-squared of .77 and .81 respectively. Both multiples provided us with a confidence level sufficient to ascertain an indication of value. The multiples derived under this approach were adjusted based on specific factors that exist at ABC Chemical, Inc. that are not present in the guideline companies, including the risk associated with customer concentration and future growth prospects.

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The multiples will be applied to the last twelve months (LTM) of operating results on a consolidated basis. The calculations are illustrated on the following page. After application of the guideline company multiples, the resulting values derived under the market approach are $23,674,000 and $22,215,000, which are deemed to be on a non-controlling (minority), marketable basis.

In order to convert the value reached under the guideline public company method to a control, marketable value, a control premium must be applied. Empirical data contained in Mergerstat® Review, published by Factset Mergerstat, LLC, assists valuators in quantifying premiums related to control. The annual control premium study provides research on the premiums paid for controlling interests in public companies. The median premium documented for transactions in the chemicals, paints and coatings industry in the most recent study was 27.5%.

Current business valuation theory accepts that an element of the control premiums observed in the Mergerstat® Review studies is attributable to strategic acquisition premiums. While the portion of the overall control premium comprised of a strategic premium is not directly discernible, many commentators conclude that it is between 10-25% of the total control premium. In this case we will assume that 25% of the total control premium is attributed to a strategic premium, resulting in a control premium in the chemicals, paints and coatings industry of 20.6% (27.5% * .75). The following example will illustrate the application of the control premium to the results of the market approach.

Application of Control Premium to Results
Under Application Under Guideline Company Method

ABC CHEMICAL, INC.
(in thousands)

	Multiple	
	MVIC/Revenue	MVIC/EBITDA
Total Equity Value on a Non-controlling, Marketable Basis	$ 23,674	$ 22,215
Control Premium (20.6%)	4,877	4,576
Total Equity Value on a Control, Marketable Basis	$ 28,551	$ 26,791

The values derived under the guideline public company method under the market approach are $28,551,000 and $26,791,000. A typical valuation will then reconcile all of the values obtained under each of the three broad approaches to valuation. The reconciliation will be based on the specific facts and circumstances of the particular case and can provide either a single opinion of value or a range of values.

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Chapter VII – *Acceptance in the Courts*

In a broad range of applications, the market approach has been accepted by the Courts. Most often, the issue at contest is not the validity of the approach itself, but rather, the propriety of the comparable guideline company selection, the size of the comparable company sample, the manner in which the comparable companies were "aligned" with the subject company, and, finally, the propriety of the modeling process itself.

The market approach has garnered its widest and most-pronounced acceptance in the U.S. Tax Court. Through a number of key cases, the utilization of the market approach has evolved over time to address concerns voiced by the judiciary. The most-common issue encountered, and the issue at the core of properly using the market approach, is comparable guideline company selection and the necessary number of comparable guideline companies required to constitute a meaningful sample from which value indicators can be determined. A brief sample of these cases follow.

***Lauder v. Commissioner,* T.C. Memo 1982-736, 64 T.C.M. (CCH) 1643 (December 30, 1982)**

A buy-sell agreement was the central valuation issue in this case and whether the agreement price should hold for estate tax purposes. The agreement provided for a formula value based on book value of the shares of Estee Lauder, Inc. The Court rejected the agreement as setting value, noting that there was no formal appraisal, no evidence that comparable companies were considered, and the formula did not consider intangible value.

***Gallo v. Commissioner,* T.C. Memo 1985-363, 50 T.C.M. (CCH) 470 T.C.M. (RIA) 85363 (July 22, 1985)**

Three experts submitted multiple guideline companies, but only one was in the winery business. All experts identified only one publicly-traded comparable guideline company, and all experts used distilling, malt beverage and soft drink companies as being "the same or similar." Key similarities in their selections were balance sheet considerations, regulatory environments and competitive environments.

***Hall v. Commissioner,* 92 T.C. 312 (February 14, 1989)**

Hallmark Cards was the subject of the valuation. At date of the valuation, American Greetings was the only publicly-traded greeting card company. The IRS expert used American Greetings as the single guideline indicator. The Court noted that the IRS use of a single guideline company, "too narrowly construes the concept of comparabilities and ignores the use of similar, as well as 'same' [companies]."

The petitioner's expert utilized American Greetings, and several others, that: "produced brand-name consumer goods, were leaders in their industries, had publicly-traded common stock, had financial characteristics similar to Hallmark, and were highly-regarded by the investment community for their quality management, leading market positions

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and excellent financial conditions." The guideline companies used and accepted by the Court were Anheuser-Busch, Coca-Cola, McDonalds and Avon.

Brookshire v. Commissioner, **T.C. Memo 1998-365, 76 T.C.M. (CCH) 659 (October 8, 1998)**

In a decision refining and contrasting "Hall," the Court found that in a valuation of a company with a chain of grocery stores, two food and merchandise centers, two bakery plants, one milk processing plant and a photo processing center, the guideline companies selected by the IRS expert were not comparable because they had "significant sales in markets other than retail grocery."

Rakow v. Commissioner, **T.C. Memo 1999-177, 77 T.C.M. (CCH) 2066 (RIA) 99177 (May 27, 1999)**

Court rejected both experts' use of the guideline public company method. The petitioner's expert failed to focus on the time period close to the date of valuation, while the IRS expert selected guideline companies that were excessively large when compared to the subject company.

Caracci v. Comm., **118 T.C. 379, No. 25, Nov. 25, 2002, U.S. Tax Court LEXIS 25 (U.S. Tax Court, May 22, 2002)**

At issue was the value of a home healthcare agency and related entities that were transferred to an S corporation. The IRS expert used both the guideline public company method and the guideline merged or acquired method. From this data, the expert estimated market value of invested capital with a price/revenue multiple. The Court found that "the best evidence of value of [the Company] arises from the use of the comparable value method by both experts..."

Court rejected both experts' use of the guideline public company method. The petitioner's expert failed to focus on the time period close to the date of valuation, while the IRS expert selected guideline companies that were excessively large when compared to the subject company.

In re DBSD North America, Inc. **2009 WL 3491060 (Bankr. S.D. N.Y.), September 30, 2009**

DBSD North America is a next-generation mobile satellite service provider that declared Chapter 11 bankruptcy in May 2009 with a plan to restructure $800 million in outstanding liabilities. The debtors and their objecting creditors both retained valuation experts to determine the total enterprise value of DBSD.

The court rejected any use of the DCF approach, but found the comparable company analysis to be reliable. Both experts used the same two companies and came up with similar values. However, of the two experts, the debtors' expert used both book and market approaches, weighting them equally. The court liked this approach and discounted the creditor's expert's sole reliance on the comparable company method.

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***In re Chemtura Corp*, 2010 WL 4272727 (Bkrtcy. S.D. NY.), October 29, 2010**

Chemtura Corporation, a specialty chemical maker, filed for bankruptcy in March 2009. A year later, the debtors provided a plan or reorganization and settlement of claims. The equity shareholders claimed that the plan undervalued the company. Bankruptcy court held an independent valuation hearing to determine value. Debtors' expert conducted a comprehensive analysis of comparable companies and transactions.

The debtors' expert considered 10 domestic and five foreign comparable companies, while the shareholders' expert only included two large multinational chemical corporations in his pool. Both experts also applied the comparable transactions approach with the debtors' expert considering 14 deals, and the shareholders' expert examining 19 deals. The court found that the shareholders' expert's analysis had serious flaws including heavy reliance on specific transaction deemed to be inappropriate. However due to the complete and comprehensive analysis done by debtors' expert, this approach was given some weight in the determination of value.

***Estate of Giustina v. Commissioner*, T.C. Memo. 2011-141, 2011 WL 2516168 (U.S. Tax Court), June 22, 2011**

In Estate of *Giustina v. Commissioner*, Mr. Giustina owned a 41.1% interest in a FLP holding large tracts of local timberland in Oregon. Upon his death, the estate reported his LP interest at $12.67 million. On review, the IRS claimed the value was closer to $36 million.

At trial, the estate obtained a new expert who valued the LP interest at nearly $13 million, and the IRS expert came down to $33.5 million. The Court noted that only the income and cost/asset approaches would be "appropriate" and "helpful" methods to value the LP interest.

Both experts applied the guideline publicly-traded company method to value the partnership. The taxpayer's expert used two comparables and weighted his approach 30%, while the IRS expert used four comparables and assigned an 80% weight to this approach. The court stated that because these other companies had assets other than timberland and earned income from additional sources, not solely timber sales, they were not comparable. Also, since other methods of valuation were available, the court accorded no weight to the market approach.

Note: This brief presentation of cases is meant only to familiarize the reader with the broad findings of the court. Every valuation and court decision applying thereto is fact- and circumstance-driven. Careful research of jurisdictional history and decisions within the applicable venue is always prudent and warranted.

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Chapter VIII – *Conclusion and Practical Considerations*

It goes without saying that side-by-side comparisons of an asset present formidable evidence of value when either has been sold in an arm's-length transaction. Businesses, and interests within those businesses, are certainly no different when sufficient guideline companies can be identified as meaningful to the determination of value.

Of course, therein lies the rub. As has been discussed throughout this presentation, it is only through the careful process of identifying, analyzing and, ultimately, selecting appropriate guideline companies, that a correct result can be attained. With varying limitations associated with the availability of information from all third-party data sources, this process can often prove daunting, if not impossible.

Moreover, the process itself and properly applying the market methods are very time-consuming and expensive to undertake in conjunction with any valuation. Cost-benefit concerns, as always, must be considered. However, it is absolutely required by professional standards that this approach be considered in conjunction with every full business valuation project.

With those limitations identified and considered, it is still safe to say that the logic behind this approach, as well as its direct mechanical tie in to "real-life" transactions, make the market approach very popular among producers and users of business valuation reports.

Further, as noted, professional standards require consideration of all applicable approaches in every assignment, it is incumbent upon the business valuator to focus on this approach and its underlying methodologies in every valuation involving an operating entity.

Understanding of this approach by members of the legal community will allow for greater capabilities in reviewing any number of valuation applications. Suffice to say that the "indirect" nature of using valuation multiples from guideline companies can lead to varying results, and the correct result can only be discerned with a careful and complete understanding of the approach and the procedures applied thereunder.

Grossman Yanak & Ford LLP

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