



## Approaches and Methods

### ***Market Approach***

There are two generally accepted methods; the Guideline Public Company Method and the Direct Market Data Method.

#### **Guideline Public Company Method (GPCM)**

This is a method that requires a comparison with public companies that are considered similar with our subject (target) private business. What constitutes similarities vary among appraisers and courts. The topic of “what is considered similar” will be covered in a later piece. Factor number eight (8) in RR59-60 states that “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” should be considered. The key term is “considered”. There are three key aspects to the factor. They are similar, public, and traded in a free and open market. Traded in a free and open market, means that the comparable company stock must be actively traded. In other words, penny stock and low volume traded stocks should not be considered.

Once you have found what you would believe to be a similar company, compared financial statements with the subject company, and determined the strength of the subject company in relation to the public companies, you develop a multiple (P/E ratio) to be applied to the subject company revenue stream. Be careful, as this can trip you up if you do not compare the same revenue streams. Example: comparing EBIT to EBITDA. Comparing different revenue streams and applying the multiples to these different streams are a common error in performing the Market Approach methods. Remember, you must be able to support the multiple you arrive at with facts.

#### **Direct Data Market Method (DMDM)**

Do you recall the term “considered”? The (DMDM) is used when there are not enough or zero similar publicly traded companies available to make a comparison. At the very least, you have shown that you “considered” them. This is especially important if the appraisal is done for a tax related issue and fair market value is required. If this is the case, we could use the DMDM in place. In order to perform this method, you would use databases containing private transactions of sold businesses. The three most common are Pratts Stats, Done Deals, and the IBA Database.

There are two major differences between these methods. The GPCM is typically used for larger businesses and provides a minority interest on a marketable basis. The DMDM is used for smaller businesses and provides a controlling interest on a non-marketable basis. As you may have guessed, the GPCM is better suited for a minority interest and the DMDM is better suited for controlling interest. Which ever method is used, leads us to a discussion on premium for control, discount for lack of control, and discount for lack of marketability which will be addressed in later issues.

This is a monthly business appraisal educational piece. The purpose for the educational series is to introduce, educate, and serve as a source of information. The information contained is current with federal laws and regulations at time of printing. Such information is subject to change. This should not be used as evidence or fact in a court of law.