



Market Approach Methods

Introduction

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When performing a business valuation, the careful selection and use of the appropriate valuation Approaches is key in forming a defensible opinion of value. Within the three valuation Approaches, there are a range of valuation Methodologies. Below we explain the three most frequently used valuation Methodologies when valuing SMEs under the Market Approach.



Comparable Public Company Transaction Method

Comparable Public Company Transaction Method

The Comparable Public Company Transaction Method uses valuation metrics and ratios from publicly traded companies (listed on a public stock exchange) to value a business. Publicly traded company information is often readily available, so comparisons are made with companies that share similar features such as industry, business, size or financial characteristics with the business that is being valued.

Purpose

The main purpose is for users of financial information such as management and investors to value companies, using public company actual transaction data. This Method is highly useful as all public companies must report certain information to regulators, making this information publicly available. Similarly, users of the financial information often need to make adjustments for the fact that private SMEs are smaller in size and have less liquidity, than their publicly traded peers.



Example

Example

A potential investor would like to know the value of a phone manufacturing company using the public transaction method. The company being valued is “Phone Company A” (a private company). The investor only had access to the number of total shares and EBIT of the firm and needs to know the value of the whole firm. The investor found three comparable public companies and used their historical information to compare ratios and find a multiple (EV/EBIT) for the private company. However, the private company’s shares don’t trade on a listed exchange, and as a result they can’t be liquidated easily/quickly. Hence, the investor should apply a discount for lack of liquidity to the average multiple of the public companies, before applying it to the EBIT of the private company.

Company	Type	Share Price	Shares	Market Capitalisation - Equity Value (E)		EBIT	E/EBIT
Phone Company X	Public	\$ 33	100	\$ 3,300	\$ 250		13.20
Phone Company Y	Public	\$ 20	100	\$ 2,000	\$ 200		10.00
Phone Company Z	Public	\$ 25	100	\$ 2,500	\$ 340		7.35
Discount for lack of liquidity		20%	Average Public Multiple - E/EBIT				10.18
			Multiple with Liquidity Discount - E/EBIT				8.15
Phone Company A	Private	\$ 41	100	\$ 4,074	\$ 500		8.15

Comparable Private Company Transaction Method

Comparable Private Company Transaction Method

The Comparable Private Company Transaction Method is similar to the previous method, however, uses transaction data from **privately held** companies to value a business. However, gaining access to private transaction information is difficult to obtain as private companies are not required to publicly report transaction information, unlike their public counterparts. Hence, often to access private company transaction information, access to private databases that house this private information is necessary (they pay business owners to contribute it or give them free access to contribute), which they charge a fee to access.



Purpose

The main purpose is to value certain companies by using comparables from privately traded companies in the market. This is highly useful when access to private transaction and comparable firms is available (remember access to private information could be expensive). It is particularly useful for SME's as they can be compared to other unlisted private SMEs, meaning that fewer adjustments to perform a fair business valuation are required.

Example

Example

The same investor would like to know the value of the same private company using the private transaction method. In comparison with the previous example, the investor had access to financial information of the private firms used as comparables by having a subscription to a private database with classified information of private companies. Hence, the investor came up with the average multiple (E/EBIT) of the three companies. As this is a method comparing the private company with other private companies, the average multiple will be used and unadjusted for company A.

Company	Type	Share Price	Shares	Implied Equity Value (E)	EBIT	E/EBIT
Phone Company X	Private	\$ 10	100	\$ 1,000	\$ 250	4.00
Phone Company Y	Private	\$ 15	100	\$ 1,500	\$ 150	10.00
Phone Company Z	Private	\$ 10	100	\$ 1,000	\$ 200	5.00
Average Multiple - E/EBIT						6.33
Phone Company A	Private	\$ 32	100	\$ 3,167	\$ 500	6.33

Precedent Transaction Method

Precedent transaction Method is used to value companies by analysing past transactions made in the subject company. This method is different from the other Methods as it **does not include a comparison with other companies**, rather analysing the company's prior transactions in its own equity/share holdings, to establish a fair value today.

Purpose

Equally as with the other Methods, the purpose is to provide an estimation of the value of the company. Adjustments to prior transactions may need to be made for things such as discounts/premiums for control, different voting rights and adjustments given how old the prior transactions are.



Example

Example

Finally, the investor wants to value the same firm under the precedent transaction method. The investor had access to the company's own historical equity transactions. For transaction number two, there is a slightly difference on the multiple in comparison with the other transactions. A higher multiple was given during this period because 80 shares (80% of the company) were traded. Hence, a rational investor would normally pay a higher value to acquire a controlling position in that company. As a result, we have weighted this transaction date twice (2) as heavily, as the other two observed transactions, given we are valuing a fully controlled 100% of the company.

Company	Transaction	Share Price	Shares Traded	Total Shares	Implied Equity Value (E)		EBIT	E/EBIT
Phone Company A	1	\$ 30	20	100	\$ 3,000	\$ 500	6.00	
	2	\$ 35	80	100	\$ 3,500	\$ 450	7.78	
	3	\$ 33	30	100	\$ 3,300	\$ 600	5.50	
Average Multiple - E/EBIT								6.76
Phone Company A	Private	\$ 34	N/A	100	\$ 3,382	500	6.76	

Conclusion

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The Private, Public and Precedent Transaction Methods are three Methods under the Market Approach for business valuations. Generally, the Public and Private Transaction Method are the most frequently used and compare ratios and multiples of companies that share similar features that being valued. On the other hand, the Precedent Transaction Method analyses previous transactions one of the shares of the company under valuation. These three Methods will almost always yield different valuations. Hence professional judgement and experience is required to select the most appropriate Methods for each individual business.



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