



The Market Approach

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Advantages

- ▶ Easy to understand / User friendly
- ▶ Actual Data – “no estimates or assumptions” (or not...)
- ▶ Easy to apply (until today...)

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Myths and Misunderstandings

- ▶ It's quick and easy
- ▶ It's less work for the same pay
- ▶ I don't have to deal with capitalization and discount rates

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Disadvantages

- ▶ “Good” guideline company data does not exist
- ▶ Most of the important assumptions are hidden
- ▶ Not as flexible as other methods



“The Only Formula You Need To Know”

$$\text{Value} = \frac{\text{Income}}{\text{Risk}}$$



The Income Approach

$$PV = \frac{CF}{(1+r)^1} + \frac{CF}{(1+r)^2} + \frac{CF}{(1+r)^3} + \dots + \dots + \dots$$



‣ $P/E = 8$

‣ $\text{Cap Rate} = 1 \div 8 = 12.5\%$

‣ $P/E = 1 \div .125 = 8$

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The Market Approach

A capitalization rate of 20% equates to a multiple of _____?

◦ Proof: $\$1,000,000 \div 0.20 = \$5,000,000$

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What is the "Correct" Rate?

- The rate of return required to attract capital to a similar firm
- Attributes of the rate are consistent with the attributes of the benefit stream:
 - Pre-tax vs. After-tax
 - Equity vs. Invested Capital
 - Income vs. Cash Flow

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Multiples

- ▶ “4 to 6 times EBITDA”
- ▶ “3 times Sellers Discretionary Income”
- ▶ “MVIC to EBITDA is 5”
- ▶ “MVIC to EBIT is 5.5”



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What is EBITDA?

- ▶ The most common multiple used
- ▶ What is the resulting Multiple?
- ▶ Is it right?



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Adjusting Multiples

- ▶ Growth
 - ▶ Size
 - ▶ CSR
- ▶ Other?



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Adjusting the Multiple



- ▶ It's a problem if you do...
- ▶ It's a problem if you don't...

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BizComps

- ▶ Exploring the FAQ's
- ▶ Exploring the User Guide
- ▶ What is an expert to do?

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Pratt's Stats

- ▶ Exploring the FAQ's
- ▶ Exploring the User Guide
- ▶ What's the expert to do?

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All is NOT Lost

- ▶ Tax Valuations
- ▶ Litigation
- ▶ Merger & Acquisition
- ▶ Intangible Asset Valuation

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