# The Guideline Company Transaction Method:
## What Does The Information Really Mean?

*"The question is," said Alice, "whether you can make words mean so many different things."*
*"The question is," said Humpty Dumpty, "which is to be master – that's all."*
*- Lewis Carroll: Through the Looking-Glass*

### INTRODUCTION
The exchange between Alice and Humpty Dumpty regarding the meaning of the words in Lewis Carroll's *Through the Looking Glass* provides a useful lesson to appraisers considering the use of the market approach and more specifically, the guideline company transaction method. Such transaction multiples may be meaningful for purposes of valuing the subject company; however, the appraiser must fully understand what information is or is not reflected in the multiples in order to assess whether or not these multiples are meaningful. The following example illustrates this issue.

### ILLUSTRATIVE EXAMPLE
Our firm recently represented a closely held firm in an assignment to determine the value of a departing shareholder's interest and to also review the valuation performed by another firm (an investment banking firm specializing in mergers and acquisitions in the relevant industry) that represented the departing shareholder. After receiving the investment banker's report, we noted that (surprise!) the value was substantially higher than the value we had determined. After a quick perusal of their report, we determined that the investment banker had solely relied upon the guideline company transaction method for his valuation methodology. Upon further review, we made some interesting observations relating to the transactions selected as comparables for purposes of computing the multiple.

- There was no information provided, other than assets, to: 1) indicate whether or not the investment banker assessed the comparability of the business services and other qualitative characteristics or the financial data for the acquired companies to the subject company or, 2) permit another appraiser to perform his own assessment of the comparability.
- The transactions occurred over a period of years, and there was no information provided to indicate whether or not the investment banker assessed the market and economic conditions during the time period in which the transactions occurred to determine if those conditions were comparable to those as of the valuation date.
- There was no information provided to indicate the level of value (e.g., fair market value, investment value, etc.) represented by the transaction prices.
- There was no information provided to indicate the motivations or perspectives of either the buyers or sellers.
- There was no information provided regarding what was acquired by the purchaser (e.g., assets or stock).
- No information was presented regarding the transaction terms (e.g., cash only, restricted stock, seller financing, employment contracts at below market compensation, earnout provisions, non-compete agreements, etc.)
- There was no indication that the investment banker made any adjustments to the "raw" transaction multiples to reflect differences between the characteristics of the acquired firms and the subject company.

In other words, with the exception of the transaction multiples, there was virtually no other information presented for the acquisitions.

**HAROLD G. MARTIN JR.,**
CPA, ABV, CFF, ASA, CFE

Keiter, Stephens, Hurst,
Gary & Shreaves. P.C.
Richmond, VA
HMartin@KSHGS.com

### GUIDANCE PROVIDED BY PROFESSIONAL STANDARDS
The business valuation standards of the professional appraisal organizations provide useful guidance to their members in applying the market approach and the guideline company transaction method.[1] For example, the American Institute of Certified Public Accountants' (AICPA) Statement on Standards for Valuation Services No. 1 (SSVS) provides the following guidance to CPAs who are members of the AICPA for using the market approach and the guideline company transaction method:

37. In applying the methods listed in paragraph 36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider:

*Continued on next page*

**expert TIP**

**Transaction multiples may be meaningful for purposes of valuing the subject company; however, the appraiser must fully understand what information is or is not reflected in the multiples in order to assess whether or not these multiples are meaningful.**