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Review of an article by Carl Sheeler discussing the merits of using market data in valuations:

"A Misunderstood Aspect of Business Value: The Market Approach"

Carl Sheeler PhD, CBA, AVA, is a highly regarded exponent in the field of business valuation in the USA. He manages to combine an active business valuation practice with his role as adjunct professor at Bryant University. In a recent article he questioned some objections to the use of market based valuation approaches.

Sale prices for businesses tend to aggregate around fair market value. Businesses are frequently valued using a multiple of earnings, (a multiple of 3 is equal to a 33.3% ROI). The multiple selected by a valuer may be arrived at by risk analysis based on publicly traded stocks, with an arbitrary adjustment for privately held stocks, in order to simulate the price a reasonable and informed investor would be willing to pay.

However Sheeler considers that the market approach is more objective as it tends to capture what actual investors pay for businesses in many industries. He comments on the subjectivity that exists in determining what is comparable and what adjustments should be made.

He notes that any out-of-hand dismissal of market data by a valuer needs to be carefully questioned. The explanation is often:

> *"Insufficient comparable data were identified; therefore the market approach was not applied."*

Sheeler raises two questions in this situation:

- What is insufficient data and why?
- If transactional data was insufficient, how was there <u>adequate information to express an opinion</u> on the risk rate when arriving at a multiple of earnings or ROI?

Another response may be characterised by statements such as: *"A multiple of three times was selected."*

- This statement lacks an objective basis.
- Valuers may claim to base such statements on their experience or professional opinion, with <u>no concrete proof</u> of actual transactions

Sheeler also challenges "rules-of-thumb".

- Inherent in the use of such rules-of-thumb is the assumption that the business being valued <u>operates within the norm</u> on which the rules are based.
- Businesses which exhibit differing levels of revenue and profitability frequently cannot be valued by use of the same "rule-of-thumb".

Sheeler expresses the view that there is a general consensus that a minimum of five market transactions is required to support an opinion using the market approach. It is pleasing to note that his arguments are entirely consistent with the manner in which the Bizstats data is applied in the NZ context

For those who would like to read Sheeler's article in more detail, it appears in the October 2004 issue of "The CPA Journal"