**I.** **GUIDELINE PUBLIC COMPANY METHOD**

The ideal methodology to value an asset is to observe the prices paid for that asset in the open market. However, when valuing shares of a privately held company, no such marketplace exists. The market approach is a valuation technique whereby the value of a company is estimated based on pricing relationships associated with market transactions involving similar companies. These observations make it possible to estimate the value of shares that have no active market.

The Guideline Public Company Method is one of the primary market approaches. It requires the availability of data from companies that are reasonably comparable to the company being valued. The criteria for comparability in the selection of publicly traded guideline companies include business and operational characteristics, growth patterns, relative size, earnings trends, markets served, and risk characteristics.

The first step in employing the Guideline Public Company Method is to seek and identify potential guideline companies. The initial criteria in selecting a guideline company is that the company is publicly traded, financially solvent, and has a threshold trading price and volume suggesting it is not traded at a speculative price. Once these criteria are met, companies in the same or similar line of business as the subject company are considered. Ideally, the selected guideline companies would compete in the same industry as the company being valued; however, exact comparability is not required under this method of valuation. If there are insufficient companies in the same or similar line of business that have securities traded on public markets, it may be necessary to consider companies with an underlying similarity of relevant investment characteristics, such as markets, products, growth, cyclical variability, risks, or other pertinent factors.

**Qualitative Assessment**

[ABC Company’s] competitors are [industry description e.g., “metal manufacturers”] serving the [region e.g., “North American”] market. Due to the nature of the industry, there are few public companies directly comparable to [ABC Company] in terms of size, products, and markets served. In the absence of directly comparable public companies, we selected, from a review of public markets primarily in [industry e.g., “SIC #XXXX, Metal Manufacturers”], a group of [number of comps e.g., “seven”] guideline companies that are engaged in [operations e.g., “the manufacture of metal ballasts”]. While these companies differ from [ABC Company] [differences e.g., “in the products they manufacture”], they have similar financial risks and operating performance and reflect economic conditions for the [industry e.g., “metal manufacturing”] industry in general. A brief business description of each of these companies is presented in [exhibit identifier e.g., “Exhibit E”]. Summary financial information for each company is included in [exhibit identifier e.g., “Exhibit C”].

The guideline companies are not necessarily selected for direct comparability to [ABC Company]. Rather, they are chosen as a guideline group that shares similar characteristics and reflects conditions and financial performance of [industry description e.g., “metal manufacturers”]. Specifically, they demonstrate industry cycles, provide representative quantitative indicators, and reflect current stock market pricing in the industry. Thus, the comparative analysis to the [ABC Company] is based on the performance and characteristics of the sample as a whole rather than on any individual company selected.

**Quantitative Assessment**

In applying the Guideline Public Company Method, we analyzed the guideline companies’ financial statements to determine if any extraordinary or nonrecurring items were present. As warranted, we made adjustments to remove items that would diminish the comparability of each company to [ABC Company]. Next, we reviewed and considered various pricing relationships among the guideline companies based upon their [pricing relationships considered e.g., “current (LTM) and historical (three-year weighted average) performance and their closing stock prices and enterprise value (market value of equity plus debt minus cash and equivalents)”] as of [valuation date e.g., “December 31, 2020”]. Relationships considered include the following:

[List of relationships e.g.,

* Price to earnings
* Price to gross cash flow
* Enterprise value to EBIT
* Enterprise value to EBITDA
* Price to book value
* Enterprise value to sales

]

To determine appropriate multiples to apply to [ABC Company], we considered (a) any discernible trends in the pricing multiples of the guideline companies, and (b) [ABC Company’s] risk and return characteristics relative to the guideline companies. Characteristics studied include size, growth, cost structures, profitability, return on investment, liquidity, and leverage. These characteristics, which are presented in [exhibit identifier e.g., “Exhibit E”] for each of the guideline companies, are outlined in detail below.

* ***Size.*** [Size comparison e.g., “Six of the seven guideline companies are larger than ABC Company”]. The guideline companies have annual sales ranging from [sales range e.g., “$75 to $900 million”] with a median of [median e.g., “$325 million”] compared to [ABC Company] with sales of [target company sales e.g., “$90 million”]. [ABC Company’s] smaller size may suggest increased perceived investment risk (and a lower pricing multiple) in relation to the guideline companies. Specifically, larger companies typically have greater financial resources to capitalize on market opportunities or survive an economic downturn. Additionally, larger companies are likely to have more levels of management, and accordingly, greater management depth. [if using size adjustment: “We explicitly adjust for differences in risk attributable to size by applying an adjustment to the pricing multiples directly (see section on Size Adjustment)”].
* ***Growth*.** Everything else held constant, the higher the expected growth rate for a company, the higher the applicable multiple. [Growth summary e.g., “The majority of the guideline companies are experiencing positive growth in sales and EBITDA over the prior five year period. The median five-year compound annual growth rates (“CAGR”s) of sales and EBITDA were 10.6% and 5.4%, respectively, while the current year guideline medians are higher, at 13.2% and 12.3%”]. [ABC Company’s] long-term growth is fairly consistent with industry growth levels, with [target company growth e.g., “five‑year CAGRs of sales and EBITDA of 14.1% and 7.1%, or slightly above/below the guideline medians”]. Overall, [ABC Company’s] growth trends are relatively comparable to the guideline group.
* ***Cost Structure*.** The five-year average gross profit margins of the guideline companies range from [gross margin comparison e.g., “20.2% to 36.5%, with a median of 30.4%, which is consistent with that of ABC Company’s five‑year average gross profit margin of 29.5%”]. Comparable gross margins suggest similar cost structures and confirm our judgment that the guideline companies provide a reasonable basis for comparison to [ABC Company].
* ***Profitability and Return on Investment*.** The guideline companies have median five-year average EBITDA and net profit margins of [margin comparison e.g., “16.8% and 4.8%, respectively, which is slightly higher/lower than ABC Company’s adjusted margins of 10.8% and 3.8%. However, ABC Company’s five-year average return on assets and equity of 6.9% and 28.8% are above/below the guideline median returns on assets and equity of 5.9% and 11.5%, respectively”]. Overall, [ABC Company’s] profitability levels are relatively comparable to the guideline group.
* ***Liquidity*.** [Liquidity comparison e.g., “ABC Company’s five-year average current ratio of 1.2 is below the guideline median of 2.1”]. A current ratio below industry levels suggests more aggressive working capital management and greater liquidity risk relative to the guideline group. A current ratio above industry levels suggests low liquidity risk in relation to the guideline companies, as well as the potential for improvements in working capital management. Lower liquidity and aggressive working capital management may indicate incremental risk, suggesting lower relative pricing multiples may be appropriate.
* ***Leverage*.** [Leverage comparison e.g., “ABC Company’s five‑year average percentage of debt to debt plus the book value of equity is 68.2%, which is higher than the 49.3% median of the guideline companies. ABC Company has historically been highly leveraged, and is expected to remain so for the foreseeable future. In addition, ABC’s five-year average interest coverage ratio is 3.9, below the guideline medians of 5.2 and 2.4”]. Higher leverage and lower coverage ratios suggest a higher level of financial risk than the guideline companies, while lower leverage and higher coverage ratios suggest lower financial risk. Greater financial risk directly increases a company’s cost of capital, indicating a lower relative pricing multiple may be appropriate. [if using beta adjustment: “We explicitly adjust for differences in risk attributable to capital structure by applying an adjustment to the pricing multiples directly (see section on Beta Adjustment)”].

**Size Adjustment**

###### Investments in small companies are empirically riskier than investments in large companies, everything else held constant. Greater risk to small companies may arise from a number of sources, including but not limited to a) lower liquidity due to higher transaction costs, b) more difficulty diversifying away idiosyncratic risk, c) reduced access to capital markets, d) less resources available for entering new markets, surviving cyclical downturns, and hiring talented employees, e) less management depth, f) less diversified customer base, and g) investment data is less available, necessitating more analysis per dollar invested. As such, it is appropriate to explicitly adjust the resulting guideline company pricing multiples to account for differences in size.

Using the Adjusted Capital Asset Pricing Model (“Adjusted CAPM”) methodology, wherein the cost of equity is a function of the risk-free rate, concurrent and lagged systematic risk, and company size, a size premium is measured for each guideline company. This size premium is then replaced with the size premium applicable to [ABC Company]. As a result, the effect of size on the pricing multiple is explicitly accounted for. The methodology for this adjustment is consistent with the approaches described in Zweig & Luke (2022), Quackenbush (2019), and Mattson & Drysdale (2001).[[1]](#footnote-1)

**Capitalization Adjustment**

Within the Modified CAPM methodology, a company’s beta captures its exposure to systematic risk i.e., risk to the market as a whole rather than any single stock or industry. There are two risk factors associated with systematic risk: a) business risk, representing risk stemming from a company’s operations and b) financial risk, representing risk attributable to a company’s capital structure. When calculating a firm’s beta using historical total returns, observed volatility is necessarily attributable to both business and financial risk. Ceteris paribus, the more debt a company has in its capital structure, the riskier is its equity.

Unlevered beta, also known as asset beta, refers to beta wherein the effect of capital structure has been removed. Unlevered beta can thus be thought of as a firm’s beta should its capital structure consist only of equity capital, no debt. To account for different levels of leverage between the guideline companies and [ABC Company], levered betas are calculated for all guideline companies and then unlevered using the Practitioner’s method. These unlevered betas are then re-levered using [ABC Company’s] capital structure. As a result, the effect of leverage on the pricing multiple is explicitly accounted for. The methodology for this adjustment is consistent with the approaches described in Zweig & Luke (2022).[[2]](#footnote-2)

**Selection of Multiples**

In addition to a similar business description, [ABC Company] is relatively comparable to the guideline group in several respects, including [comparable dimensions e.g., “profitability, historical growth, and cost structure”]. Comparable growth prospects and profitability levels might suggest that [ABC Company] could command pricing multiples near the medians of the ranges established by the guideline companies. However, [differences e.g., “ABC Company’s aggressive working capital management and highly leveraged balance sheet suggests higher financial and liquidity risk (and lower pricing multiples) in relation to the guideline companies”]. In addition, [ABC Company] is significantly smaller than nearly all of the guideline companies. Based on these factors, we estimate that [ABC Company’s] overall risk and return characteristics are sufficient to support pricing multiples [multiple selection e.g., “near the lower quartiles / near the median”] of the ranges established by the guideline companies. [note: If the size adjustment is applied, size should not be considered in selecting the level of the pricing multiple. If the beta adjustment is applied, leverage should not be considered in selecting the level of the pricing multiple]

[if valuing controlling interest, e.g. “In addition to the factors discussed above, we note that the pricing multiples derived through the Guideline Public Company Method result in a value on a marketable, non-controlling-interest basis. Since we are valuing a controlling interest in ABC Company, we select slightly higher pricing multiples to reflect the inherently greater level of control”].

Once selected, the respective pricing multiples were applied to the appropriate measure of performance for [ABC Company]. Net debt (debt net of cash and cash equivalents), the value minority interests, and the value of preferred equity are added to the market capitalization values suggested by the equity-based multiples to derive enterprise value. Based on the pricing relationships utilized and the selected pricing multiples, we derived and considered [number of suggested values e.g., “ three suggested values (see Exhibit F)”]:

[keep only those that apply below:]

* The suggested enterprise values range from [range e.g., “$46.8 million to $59.3 million with a median of $52.9 million and a coefficient of variation near 12%”].
* The values suggested by the five-year weighted average indicators are higher than those suggested by the last-twelve-month (“LTM”) factors. To emphasize [ABC Company’s] performance over a period of time rather than its results for one year, we place primary reliance on the five-year indicators.
* Applying debt-free multiples (EBIT and EBITDA) suggests [“higher/lower”] values than the earnings- and gross cash flow-based multiples. Since [ABC Company’s] current level of debt is significantly different than those of the guideline companies as a whole [exhibit identifier e.g., “see Exhibit B”], it is appropriate to place primary reliance on debt-free indicators.
* Applying depreciation-free multiples (gross cash flow and EBITDA) suggests [“higher/lower”] values than earnings- or EBIT-based multiples. Since [ABC Company] is less asset-intensive than the guideline companies and has substantially different levels of required capital spending and depreciation [exhibit identifier e.g., “see Exhibit B”], it is appropriate to place primary reliance on EBIT-based indicators.

**Conclusion**

Based on the factors discussed above, we select [indicated enterprise value e.g., “$50 million as an appropriate estimate of ABC Company’s enterprise value (see Exhibit F)”]. Since enterprise value is comprised of two components (equity and debt), it is appropriate to subtract the value of [ABC Company’s] debt (net of cash, cash equivalents, and non-operating assets) from enterprise value to estimate the value of [ABC Company’s] equity. Doing so suggests the Fair Market Value of [ABC Company’s] equity, on a marketable, non-controlling-interest basis, based on the Guideline Public Company Method, to be [indicated equity value e.g., “$45 million”].

1. Zweig, Derek, and Adam Luke. “Size and Capitalization  Adjustments for Market-Based  Pricing Multiples.” *The Value Examiner*, July/August 2022, Aug. 2022, pp. 6–17.

   Quackenbush, William C. “Quantitatively Adjusting Guideline Public Company Multiples.” *Financial Valuation and Litigation Expert Journal*, August/September 2019, no. 80, 2019, pp. 8–23.

   Mattson, Michael, and Don M. Drysdale. “Adjusting Guideline Multiples for Size.” *Valuation Strategies*, vol. 5, no. 1, 2001, pp. 24–29. *September/October 2001*. [↑](#footnote-ref-1)
2. Zweig, Derek, and Adam Luke. “Size and Capitalization  Adjustments for Market-Based  Pricing Multiples.” *The Value Examiner*, July/August 2022, Aug. 2022, pp. 6–17. [↑](#footnote-ref-2)