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HOW TO PROPERLY USE ASSET TRANSACTIONS IN THE GUIDELINE MERGED AND ACQUIRED COMPANY METHOD

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In utilizing the guideline merged and acquired company method to estimate a value for a closely held company, particularly a smaller business, the valuation analyst typically will find more transactions of private guideline companies than publicly traded companies. Most transactions of small, private companies are structured as asset sales. Although both asset sales and stock sales can be used to develop a value indication for a subject company, it is inappropriate to combine the transactions without making proper adjustments. Assets sales and stock sales are different transaction structures, and the transaction price often reflects the transfer of different assets and liabilities, which will have a direct effect on the pricing multiples used to value the subject company.

Introduction

The market approach is a widely used and generally accepted valuation approach when valuing a closely held company. It is commonly used because it considers real-world market data, providing a meaningful benchmark for the valuation of a subject company.

The market approach analyzes the security prices of companies in the same or similar lines of business as the subject company. It uses a comparison between a sample population of guideline security prices and selected financial or operating fundamentals to create a range of relevant pricing multiples. These pricing multiples are applied to the subject company's

corresponding fundamentals to estimate the value of the subject company.

Two market approach methods are commonly used: (1) the guideline publicly traded company method, and (2) the guideline merged and acquired company ("GMAC") method (sometimes referred to as the transaction method). This article focuses on the GMAC method.

The GMAC method is based on a comparison of the subject company with similar or "guideline" companies (either publicly traded or closely held) that were acquired in a merger or acquisition transaction. The GMAC method analyzes the prices paid to acquire ownership interests in the selected guideline companies.



Valuation pricing multiples are developed based on a relational analysis between the selected guideline companies' financial fundamentals and the transaction prices. The selected valuation pricing multiples are then applied to the subject company's financial fundamentals to estimate the value of the subject company.

Transactions usually are structured as an asset sale, a stock sale, or a merger. Asset sales are transactions in which specific assets are transferred to the acquirer. It is common that only the assets used to conduct the business operations, such as inventory, fixed assets, and intangible assets/goodwill, are transferred. In typical asset sales, no (or few) liabilities are assumed. Typically, the seller keeps the cash and accounts receivable to pay off debt.

Stock sales are transactions in which a business transfers its entire equity interest to the acquirer. In a stock sale, the buyer purchases the entire business—all assets and liabilities—rather than specific assets. Stock sale structures are typical of larger business acquisitions.

A transaction involving a merger often shares many characteristics with a stock sale: The buyer acquires the entire business, including all assets and liabilities. In a merger, the target company either ceases to exist upon the transaction's close, or it becomes the surviving entity. Hereinafter, the term "stock sale" is described as the alternative to an asset sale and includes mergers.

Both asset sales and stock sales can be used to develop a value indication for a subject company. However, the valuation analyst should understand the differences between the two transaction types. In addition, the valuation analyst should understand what was transacted so the pricing multiples applied to the subject company reflect the same assets.¹

The valuation analyst may mix asset sales and stock sales to determine pricing multiples. However, an inexperienced analyst may do so without making proper adjustments. Without the proper adjustments, mixing transaction types will skew the pricing multiple statistics (i.e., mean, median, etc.).

Although there are various ways of using asset sale and stock sale transactions when applying the GMAC method (e.g., separating asset sale transactions from stock sale transactions or separating the transactions by transaction database service), having sufficient transaction details in order to make the relevant

adjustments will help the valuation analyst decide what course of action to pursue. Making the proper adjustments requires the analyst to obtain sufficient transaction details to understand the terms of the transaction (i.e., what assets and liabilities were transferred).

ASSET SALES AND STOCK SALES CAN BE USED TO DEVELOP A VALUE INDICATION FOR A SUBJECT COMPANY.

Oftentimes, separating asset sales from stock sales is the only option. In this process, the valuation analyst groups transactions by asset sales or stock sales and separately applies the pricing multiples to the relevant subject company fundamentals for each group. Then, to estimate the indicated value of the subject company using the asset sale pricing multiples, the valuation analyst will make adjustments.

When valuing a company, particularly a smaller one, the valuation analyst typically will find more transactions of private guideline companies than publicly traded companies. Most transactions of small private companies are structured as asset sales.

For the purpose of this discussion, we will focus on the application of the GMAC method using asset sale transactions. In addition, we will discuss how to determine what is included in the transaction price—a key consideration in knowing how to properly use asset sale transactions in the GMAC method.

Understanding What Is Included in the Transaction Price

To apply the GMAC method, the valuation analyst will search for transactions of guideline merged and acquired companies that are similar to the subject company, using databases containing information on transactions typically involving publicly traded and privately held companies. Commonly used databases are Standard and Poor's ("S&P") Capital IQ, PitchBook, DealStats (formerly known as Pratt's Stats), BIZCOMPS, and FactSet.

To understand what assets and liabilities (if any) were



transferred in a transaction, the valuation analyst should first determine whether the transaction was a stock sale or an asset sale. S&P Capital IQ, PitchBook, and FactSet primarily report stock sales. However, these databases occasionally report asset sales. DealStats reports asset sales and stock sales and distinguishes between the transaction types in its data. BIZCOMPS reports only asset sales (or stock sales converted to equivalent asset sale values).

The same transaction may have different transaction prices among the databases. As such, it is important for the valuation analyst to be familiar with the definition of the transaction price within each database.

For example, the market value of invested capital (“MVIC”) price reported by DealStats includes the noncompete value and the assumption of interest-bearing liabilities but excludes: (1) the real estate value, (2) any earnouts, and (3) the employment/consulting agreement values. In contrast, BIZCOMPS only excludes the value relating to earnouts from its reported transaction price.

IT IS IMPORTANT FOR THE VALUATION ANALYST TO BE FAMILIAR WITH THE DEFINITION OF THE TRANSACTION PRICE WITHIN EACH DATABASE.

If critical data, such as assets and liabilities, are not available for a specific transaction, that transaction would need to be rejected as a potential guideline

Table 1
Comparison of Asset Sale and Stock Sale
Purchase Price Allocation
Company XYZ

	Asset Sale PPA (\$000)	Stock Sale PPA (\$000)
Assets Acquired:		
Cash	-	
Accounts Receivable	-	19
Inventory	15	15
Other Current Assets	-	5
Fixed Assets	250	250
Goodwill	10	10
Other Intangible Assets	340	340
Total Assets Acquired	615	639
Liabilities Assumed:		
Accounts Payable	-	(20)
Accrued Expenses	-	(10)
Other Current Liabilities	-	(2)
Long-Term Debt	-	(50)
Total Liabilities Assumed	-	(82)
Net Assets Acquired	\$615	\$557

company due to a lack of information.

A purchase price allocation (“PPA”) can provide definitive information regarding what assets were transferred and what liabilities (if any) were assumed. Without a PPA, an accurate reconciliation to the asset sale price may not be possible.

According to DealStats, “If no purchase price allocation is available for the transaction, the appraiser will need to use his or her experience and knowledge in the field and the buyer’s/seller’s knowledge and experience with his or her business to determine what is customarily transferred in an asset sale in that industry.”²

Table 1, above, provides a comparison of the PPA of a stock sale and an asset sale. As illustrated, the price of a company will differ depending on what was acquired.

In the asset sale transaction, the buyer acquired only certain assets (i.e., inventory, fixed assets, and intangible assets) of Company XYZ and assumed no liabilities for a price of \$615,000. In a stock sale transaction, the buyer acquired 100 percent of the equity of Company XYZ for \$557,000.



The GMAC Method Using Asset Sale Transactions

When applying the GMAC method using asset sale transactions, the valuation analyst first must determine what assets and liabilities (if any) were transferred and reflected in the transaction prices of the guideline merged and acquired companies. After applying the selected multiple(s) derived from the asset transactions to the fundamentals of the subject company, the valuation analyst can reconcile the indicated value of the subject company by considering the assets and non-interest-bearing liabilities that were not included in the guideline multiples. Determining which assets or liabilities should be added or subtracted from the estimated value of the subject company is based on whether they were transferred in the transaction.

Table 2, right, presents an example of adjusting for the assets and liabilities of the subject company that were excluded in the pricing multiples of the guideline companies.

As presented in Table 2, the transaction prices of the selected guideline companies reflect primarily the transfer of inventory, fixed assets, and intangible assets. To adjust for other assets and liabilities not included in the transaction price, the valuation analyst should add the reported assets and subtract the reported liabilities of the subject company from the indicated value. In this example, to arrive at the MVIC of the subject company, cash and accounts receivable were added, and non-interest-bearing liabilities (i.e., accounts payable, accrued expenses, and other) were subtracted.

The example in Table 2 illustrates how different the indicated value of the subject company would be if the valuation analyst did not make the appropriate adjustments. Further, without the adjustments, the indicated value from applying the pricing multiple would not reflect the MVIC or equity value (based on a 100 percent ownership level) of the subject company

Table 2
Asset Sales
Guideline Company Transactions

Target Company	Assets Included in Price			Price / Revenue
	Inventory	Fixed Asset	Intangible Assets	
Target Company #1	X	X	X	0.49
Target Company #2	X	X		0.55
Target Company #3	X	X	X	0.50
Target Company #4	X	X	X	0.54
Target Company #5		X	X	0.39
Target Company #6	X	X		0.63
Target Company #7	X	X	X	0.74
Target Company #8		X	X	0.89
Target Company #9	X	X	X	1.14
Target Company #10	X	X	X	1.02

Low	0.39
Median	0.59
Average	0.69
High	1.14

	(\$000)
Subject Company Revenue	4,000
Selected Multiple	0.69
Indicated Value (asset value)	\$2,751
Adjusted for Assets and Liabilities Not Included in the Pricing Multiples:	
Cash	400
Accounts Receivable	105
Accounts Payable	(75)
Accrued Expenses	(25)
Other Non-Interest-Bearing Liabilities	(5)
Total Adjustments for Assets and Liabilities Not Included in the Pricing Multiple	400
Indicated Subject Company MVIC	3,151
Less: Interest-Bearing Debt	(55)
Indicated Subject Company Market Value of Equity	\$3,096

because the transaction prices of the guideline companies were based on the acquisition of only certain assets.

The example in Table 2 provides a simplified method of reconciling the transaction prices of assets sales by adjusting the subject company fundamentals. As previously discussed, each transaction database may define transaction price differently. Although outside the scope of this discussion, to properly use asset sales in the GMAC method, the valuation analyst also can (1) separate the guideline transactions by databases and by asset sale and stock sale transactions, or (2) adjust the prices of the transactions individually to make them equivalent to one another if combining asset and equity transactions.



Conclusion

The primary objective of the GMAC method is to derive meaningful guidance from transactions in order to value a company. The GMAC method is particularly useful in valuing small businesses because transactional data for thousands of guideline companies are available.

However, most transactions of small, private companies are structured as asset sales. Although asset sales and stock sales can be used to develop a value indication for a subject company, mixing asset sales and stock sales without appropriate adjustments can result in skewed pricing multiples, thereby affecting the meaningfulness of the indication of value derived from the GMAC method.

Assets sales and stock sales are two different transaction structures, and the transaction price of each reflects the transfer of different assets and liabilities. The price from an asset sale may not reflect the price of a 100 percent ownership interest in a business. The resulting pricing

multiple if applied to value a subject company then may not represent the entire value of the business.

Using asset sale transactions for the GMAC method requires an understanding of what was transacted. If available, a PPA is helpful in determining what assets and liabilities the buyer acquired. Transaction details also may be provided by the transactional database.

After the valuation analyst understands what was transacted, he or she can appropriately add assets and subtract liabilities that were not included in the transaction price to derive an indicated value for the subject company.

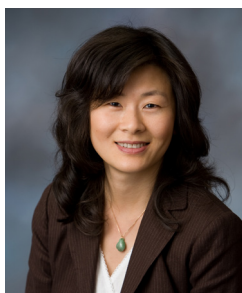
References:

- 1 Shannon P. Pratt, *The Market Approach to Valuing Businesses*, Second Edition (Hoboken, NJ: John Wiley & Sons, Inc., 2005): 37.
- 2 *DealStats Companion Guide, 2022 Edition*, Business Valuation Resources, LLC (2022): 16.

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