Helpful Hints in Using the IBA Market Database

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The IBA Market Data Base contains over 23,000 transactions of closely-held businesses, which is a wealth of data to use in applying the Direct Market Data Method ("DMDM"). The DMDM can be one of the most direct and easily applied methods in business valuation, as well as one of the easiest to explain. The IBA Market Data Base has all of this data to strengthen your transaction analysis, but you must use the data correctly to be able to really take advantage of this resource. Good data and poor DMDM execution makes for a bad appraisal report.

I have compiled a list of helpful hints to consider when applying the DMDM, which are based on common errors and misunderstandings of the IBA Market Data Base. They are as follows:

1. Know what the price reflects - IBA Market Data Base transactions are *asset sales* as opposed to *stock sales*. An asset sale is a transaction where only certain assets are transferred to a new owner who will effectively become the new owner of the business. More often than not, only the operating assets of the business are transferred to the buyer. The price reflects the value of the tangible and intangible operating assets if the business.

2. Assets not included in the sale - transaction sale prices reflect the price of operating tangible and intangible assets transferred in a transaction. The prices typically do not include cash, accounts receivables or any liabilities. Other assets that may be retained by the seller include security deposits and non-operating assets that appraisers are typically instructed to remove from the balance sheet (e.g. real estate, company jet...). These other assets and liabilities that are expected to be retained by the seller should be added back to the value concluded using a transaction multiple. The value indicated by the transaction multiple plus the retained assets and liabilities equals the value of the subject's equity.

3. Know the definition of earnings - the IBA Market Data Base defines earnings as earnings before owner's compensation, interest expense and income taxes. When you apply an earnings multiple to your subject company, you should be applying it to the same level of earnings for your subject company. This is also important when you consider using other databases. For instance, Bizcomps defines earnings as seller's discretionary cash flow which is

defined as net profit before taxes plus all owners compensation plus amortization, depreciation, interest, other non-cash expenses, and non-business related expenses. The price to earnings multiples from these two data bases may not be compared since the definitions of earnings are different.

4. Terms of sale - the terms of sale are not disclosed in the IBA Market Data Base. Transaction price reflects total consideration paid, and it includes cash, notes, liabilities assumed by the buyer and any other considerations such as non-compete agreements.

5. Indication of value - the value indicated when applying a multiple derived from transactions of entire businesses in on a Control, Non-Marketable level. The control part is pretty straight forward. If a controlling interest is sold, then the resulting price multiple reflects a control value. The marketability part is where most of the confusion arises. Since selling a privately held company takes more than a couple of days, it is considered to be nonmarketable. This means that it lacks the liquidity of shares of publicly traded stock (which is considered marketable). Each of the transactions in the IBA Market Data Base are closely-held businesses and therefore their prices are non-marketable. So, if your valuing a controlling interest in a closely-held business, you probably will not need to apply discounts or premiums to your conclusion of value.

A common metaphor used when the DMDM is discussed is "Apples to Apples, Oranges to Oranges," which really does sum up all of these pitfalls in the method's application. If you know what your data reflects, compare it on the same level as that for your subject company. Compare apples to apples and you'll never go wrong (well hardly ever). If you have not seen it yet, IBA has a great online tutorial on how to use the IBA Market Data Base (http://www.go-iba.com/tutorial.asp). Included in the tutorial is a full description of the data contained in the IBA Market Data Base.

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