Peercomps: One of the Most Reliable Guideline Company Transaction Databases

By Jim Turner, CPA, CVA

According to the principle of substitution, the value of a thing tends to be determined by the cost of acquiring an equally desirable substitute. The guideline company transaction method was developed to define the market for businesses that are equally desirable substitutes for the target business. This method can provide an accurate means to ensure that a valuation is reasonable. After all, who can refute a conclusion of value whose foundation is built on multiples from real-world transactions of similar companies? But historically, the valuation community has been limited to guideline company databases that contain transactions that do not always meet the fair market value standard or the going concern premise. Thus, relying on the guideline company transaction method can leave a valuation analyst's work product vulnerable to challenge in litigation or a governmental audit.

The challenges by critics of the guideline company transaction method go something like this:

- "You do not know whether the comparable sales you relied on sold at fair market value, do you?"
- "How many of the companies in your population were under financial duress?"
- "How many were purchased by a competitor that gained synergies with the acquisition?"

In many cases, these criticisms appear plausible. This spurs me to shed light on Peercomps, a guideline company database that contains only comparable sales of going concern companies at the fair market value standard of value.

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The Peercomps Database is Unique

Unlike other transaction databases, under government guidelines, the Peercomps database generally excludes distressed sales or transactions at the investment standard of value. That is because Peercomps only sources transactions from banks that comply with the Small Business Administration (SBA) Standard Operating Procedure (SOP).[1] The SOP states, "if the Lender's financial analysis demonstrates that the Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined."[2] Because the SOP requires the lender to ascertain whether the business's cash flow can support the repayment of the loan (sustainable cash flows must yield a minimum debt service coverage ratio of 1.15), this effectively eliminates distressed sales. In addition, by adopting the fair market value standard, the SOP discourages lenders from considering synergies that a buyer might recognize if it purchases a particular target. And lenders have much to lose if they do not strictly adhere to the SOP; namely, the 75 percent government guarantee of the loan. Lenders are not willing to take that risk.

The SOP and Business Valuation

The term "fair market value" appears in the SOP 15 times. A business valuation is required when there is a change in ownership and the amount being financed minus the appraised value of real estate and/or equipment is greater than $250,000, or if there is a close relationship between the buyer and seller (for example, transactions between existing owners or family members). Lenders must obtain a copy of the financial information relied upon by the individual who performs a business valuation and verify that information against the seller's IRS transcripts to ensure its accuracy.[3] The business valuation must be prepared by a "qualified source," defined as "an individual who regularly receives compensation for business valuations" and has received a business valuation credential (e.g., CVA, ASA, ABV) from a recognized certifying organization. In addition, the individual must be independent of the loan production function, must not be involved in the approval of the transaction, and must not have the appearance of a conflict of interest.[4]

The SBA loan amount is capped at the business valuation amount and seller earnouts are prohibited; however, buyer rebates based on business performance are allowed because this is a benefit to the borrower.[5]

Consistent Comparable Sales Data

The SOP rules eliminate liquidation and investment level transactions from the Peercomps database. Lenders are judicious in meeting the SOP's lending guidelines, which leads to congruent comparable sales. This is evidenced by comparable sales populations consistently yielding low coefficients of variation with respect to cash flow multiples, such as price-to-earnings before interest, taxes, depreciation, and amortization (P/EBITDA) and price-to-seller's discretionary earnings (P/SDE).

As a result, the Peercomps database is perhaps the most comprehensive database of guideline company transactions consummated at fair market value. This author has successfully argued its merits in trial on several occasions. Of course, litigators continue to argue that the transactions are too old or that they did not occur within the state where the subject business is located. But it usually does not take long to enlighten them that the mantra, "location, location, location," often invoked in real estate appraisals, generally is not relevant to business valuation. These arguments and many more were repudiated by a business valuation pioneer (and developer of the direct data market method) years ago.[6] In addition, a series of studies conducted by Raymond Miles demonstrated that age and geographic location of comparable sales do not

1 Small Business Administration, SOP 50 10 7.1, effective November 15, 2023, https://www.sba.gov/document/sop-50-10-lender-development-company-loan-programs.
2 Ibid., 108 (previous versions of the SOP contain the same or similar language).
3 Ibid., 117–119.
4 Ibid., 362–363.
5 Ibid., 96.
6 James R. Hitchner, *Financial Valuation: Applications and Models,* 4th ed. (Hoboken, NJ: John Wiley & Sons, 2017), 303.

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materially affect the price multiples for which those businesses sell.[7,8] Regarding the timing of transactions, Gary Trugman notes the following:

> Empirical data for all business categories, in aggregate, does not show any significant change in business value as a function of time. This is contrary to conventional wisdom that only recent sales should be considered when choosing guideline (comparable) companies.[9]

Finally, the curator of the database ensures that each transaction is depicted as an asset structure. This leads to consistency among comparable sales in every sample extracted from the database. It saves the valuation analyst time because no adjustments are necessary to the comparable sales as they are already adjusted. For example, equity-structured sales are adjusted to an asset structure to uniformly depict each transaction. Peercomps adjusts each transaction so that the multiples reflect only the market value of invested capital (MVIC) paid for inventory, machinery and equipment, and intangibles. The MVIC is reduced if any cash, accounts receivable, or other assets were included in the transaction. Likewise, any liabilities that were assumed increase the MVIC so that each transaction multiple is derived from consistent parameters. Since the vast majority of SBA deals are already structured as asset sales, very few transactions need adjustment. But each transaction is examined, ensuring an apples-to-apples comparison.

Application of the Database

The efficacy of this database can be observed in the results of a recent guideline company transaction market method valuation of a financial planning/investment firm. The comparable sales selection criteria were as follows:

- Transactions from NAICS code 523930, “Investment Advice”
- Annual sales between $200,000 and $7.5 million
- Date range of transactions 2016–2020

Statistical Analysis

Eleven transactions met the criteria. The median P/EBITDA was 3.60 and the mean was 3.65.

The sample standard deviation for the P/EBITDA ratio was 0.64, while the standard deviation for the price-to-revenue (P/R) metric was 0.58. Standard deviation measures the spread of data distribution. Thus, it measures the typical distance between each data point and the mean. The standard deviation of P/EBITDA, 0.64, indicates that this ratio is spread around the mean with data points likely above and below the average. The formula for the sample standard deviation is:

$$s=\sqrt{\frac{\sum_{i=1}^{N}(x_i-\overline{x})^2}{N-1}}$$

Where:

s = sample standard deviation
N = the number of observations
x_i = the observed values of a sample item
$\overline{x}$ = the mean value of the observations

The standard deviation of the P/EBITDA ratio (0.64) was higher than the P/R ratio (0.58). But the mean of P/EBITDA (3.65) was more than double the mean of P/R (1.54). The coefficient of variation (CV) is useful for comparing the degree of variation from one data series to another, even if the means are drastically different from one another. The CV shows the extent of variability in relation to the mean of the population. And because it is independent of the unit in which the measurement was taken, it can be used to compare data sets with different units or widely different means. This can be observed when you examine the statistical metrics from the P/EBITDA and P/R ratios from our comparable sales in Figure 1.

Calculating the CV involves a simple ratio of the standard deviation, s, to the mean, $\overline{x}$:

$$CV=\frac{s}{\overline{x}}$$

7 Raymond C. Miles, “In Defense of Stale Comparables,” *IBBA Journal* (September 1992): 17–25, cited in Raymond C. Miles, *Technical Studies of the IBA Transaction Database* (Plantation, FL: Institute of Business Appraisers, 2002), 57.
8 Miles, *Technical Studies of the IBA Transaction Database,* 65.
9 Gary R. Trugman, *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Sized Businesses,* 5th ed. (Hoboken, NJ: John Wiley & Sons, 2017), 398.

Figure 1: Sample Peercomps Data

Description	Bank Source	NAICS Code	State	Sale Price	Year	Revenue	EBITDA	P/R	P/EBITDA
Investment Advice	Wells Fargo	523930	WY	$1,550,000	2016	7,118,899	403,968	0.217730298	3.84
Investment Advice	State Bank & Trust Company	523930	PA	$330,000	2017	193,814	87,496	1.702663378	3.77
Investment Advice	US AmeriBank	523930	FL	$2,000,000	2017	912,840	612,754	2.190964463	3.26
Investment Advice	The Bancorp Bank	523930	NC	$1,113,875	2019	512,208	404,958	2.174653656	2.75
Investment Advice	Live Oak Bank	523930	CT	$450,000	2019	280,254	107,825	1.60568627	4.17
Investment Advice	The Bancorp Bank	523930	TN	$1,300,000	2018	1,202,905	374,044	1.080717097	3.48
Investment Advice	Acclivity Financial, LLC	523930	KS	$750,000	2018	346,711	149,361	2.1631849	5.02
Investment Advice	Achieva Credit Union	523930	FL	$9,250,000	2019	7,225,957	2,703,828	1.280107258	3.42
Investment Advice	Wells Fargo	523930	CA	$4,921,087	2019	2,960,784	1,366,591	1.662089163	3.60
Investment Advice	KeyBank	523930	NV	$585,000	2020	435,072	144,533	1.344605031	4.05
Investment Advice	US Bank	523930	CA	$510,000	2020	326,510	181,635	1.5619736	2.81
Median								1.61	3.60
Mean								1.54	3.65
Standard Deviation								0.58	0.64
Coefficient of Variation								0.37	0.18

The CV for the P/EBITDA ratio was 0.18, while the CV for the P/R ratio was 0.37. This value shows us the relative size of the standard deviation compared to the mean. The CV can be converted to a percentage. In this sample, the standard deviation of P/EBITDA was 18 percent of the size of the mean, but the standard deviation of P/R was 37 percent of the size of the mean. A lower value for the CV is favorable as there is less relative variability compared to the mean. Thus, P/EBITDA had less relative variability than P/R.

Equity Conversion

To convert the asset-structured multiples from Peercomps to an equity value, the user multiplies the selected company measure (e.g., EBITDA, SDE, revenue, etc.) by the appropriate multiple. The product will yield the value indication for inventory, machinery and equipment, and intangibles. Assets not included in the multiple—such as cash, receivables, or real estate—are added to the value indication, while any liabilities are subtracted from the indicated value. The net of this equation equals the value of the equity. In a pure equity sale, it is assumed that all operating assets and liabilities are conveyed to the buyer.

Conclusion

The Peercomps database is a reliable database for identifying comparable sales of privately held businesses that sold at the fair market standard of value. The database does not include distressed sales or investment standard transactions. The curator adjusts the multiples so that all transactions depict an asset structure that only includes the MVIC for the purchase of inventory, machinery and equipment, intangibles (existence and magnitude is quantified by subtracting the value of tangible assets from the MVIC), and no liabilities.

Note that the size of the comparable sales transactions in the Peercomps database is limited because the SBA 7(a) program only allows loans up to $5 million (the transaction can be more than $5 million). As a result, the database may not be as useful when valuing businesses with EBITDA over $10 million or revenues over $100 million, although additional research is needed to address this assertion.

As of this writing, the Peercomps database includes 14,577 transactions, spanning a 25-year period from 1998 to 2023. The data is sourced from participating lenders from across the U.S. The comprehensive median ratios are P/EBITDA of 3.86, P/SDE of 2.79, and P/R of 0.64.

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