Determining a Private Company's Market Value

by Stephen Watkins For NewsUSA

Q: I understand that Entrex has created a market for private companies by applying public market standards and disciplines. I know this could help me raise money for my company, but how do I determine what my company is worth today? - Jean Redman, business owner, Chicago.

A: Jean, this is a great question. Today you may be the only shareholder, but this valuation exercise differentiates between being an owner of a company and being an employee. After all, there is no reason to accept the liabilities and responsibilities that come with ownership if all you really own is a job.

Your job as president/owner of the company is to increase the value of the company for shareholders - again, this might be just you. But by continually understanding the value of your business, you can understand the value that your time and energy bring to the company.

As a colleague of mine once said, "You can't manage what you can't measure."

One methodology for understanding the value of your business is to compare it to similar public companies. Simply select five public companies which most closely compare to yours - the more similar in sales and earnings the better. Take all five price-to-earnings ratios and determine the industry average. Take the price-to-sales ratio of the same companies to determine the industry average.

Then, use these ratios and compare them to your company by multiplying your earnings by the average you determined (your earnings, times the price-to-earnings average) and doing the same with your sales (your sales, times the price-to-sales average). This will give you a starting point.

Being a private company, you will have to discount these numbers for the lack of exposure, credibility and liquidity your organization has, compared to a public company. This can range from a 5 percent discount if you are a few days from going public to a 99 percent discount if you are just starting up.

The above methodology only provides a quick glance, but it does provide an "Investment Valuation" of your company. It doesn't take into account balance sheets, opportunities or management that various "Accounting Valuations" would do.

But if you consider yourself an acquisition candidate or an IPO candidate, it does offer a basis for discussion.

Stephen Watkins is the chief executive officer of Entrex. He can be contacted at swatkins@ entrex.net.