PRIVATE COMPANY VALUATION

Private versus Public: Cost of equity

Assume that you are comparing two companies in the same business and with the same financial practices. One is a privately owned business and the other is a publicly traded company. Which one would you expect to have a higher cost of equity?

a. The privately owned business
b. The public company
c. Neither. They should have the same cost of equity

Why?

Cost of illiquidity

When valuing private businesses, it is conventional to reduce the value for illiquidity. That illiquidity discount is often set as a fixed number (20-25%). In which of the following transactions would you expect the discount to be smallest?

a. A profitable, cash flow generating company to a long term buyer
b. A profitable, cash flow generating company to a cash-constrained buyer
c. An unprofitable, negative cash flow company to a long term buyer.
d. An unprofitable, negative cash flow company to a lcash-constrained buyer.

Now assume that you are comparing discounts in different periods: the last quarter of 2008 versus the first quarter of 2013. When would you expect discounts to be higher?

a. In 2008, when the market was in a crisis
b. In 2013, when the market was buoyant
c. No difference

Best potential buyer…

Now assume that the owner of the private business is trying to sell her business. Which of the following buyers is likely to offer the highest price?

a. A private owner
b. A private equity fund
c. A publicly traded company
d. Unclear