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November/December 2016

Price Volatility – Public vs Private Companies

Merry Christmas!

The value of publicly traded companies, at least those that are actively traded, usually changes all day long on each and every day in which the market is open. The price paid for the stock at any given moment is based on a number of factors – but a key point to remember is that each trade requires an able and willing buyer as well as a willing seller; the essential definition of fair market value. I find it fascinating to watch various indications of the stock market as reported on the news. When something horrible happens in the world, the stock market as a whole tends to drop immediately by a significant amount. Conversely, when something that is considered good news occurs, the market tends to immediately jump upwards by a significant amount.

Underlying stock market movement is the investing public's perception of the future. It should be remembered that the key concept is future companies' earnings – future earnings is what drives value. Generally the ratio of price to earnings is a key indicator of the investing public's view regarding a specific stock. The higher the ratio, the more positive the perception regarding that stock. The investing public watches for various events that tend to indicate whether or not future earnings are expected to increase or decrease. This view is shown each day the market is open and usually all during the day.

There is a tremendous amount of information that is available for each actively traded public company. Quarterly financial statements are public record. Historical trading information can be accessed online from a variety of sources at any moment in time. Comments, including recommendations to buy or sell, are available to the investing public at all times.

It is not surprising that the price of publicly traded companies changes rapidly and often. Some companies and some industries experience much more volatility in price than others.

Another key point to remember is that publicly traded companies focus on earnings after income taxes.

Privately owned companies are very different. Information about them is not publicly disclosed and they are often not for sale. When a privately owned company comes up for sale, the financial information available is almost always much less detailed than that generated for public companies. A key point to remember is that privately held companies generally focus on ways to minimize taxable income – they generally do whatever is possible to avoid income taxes as much as possible and it is not uncommon for privately held companies to expense many assets that probably should have been capitalized and sometimes actually deduct expenses that should be personal to the owners' as a business expense.

The financial information available for many privately owned companies is seriously lacking in detail and may have any of a number of accuracy related problems that requires a knowledgeable professional to decipher after interviews with management, the accountant, and others.

The value of privately held companies, similarly to that of publicly traded companies, is based on future earnings and the likelihood of what is expected actually occurring. Economic factors, industry factors, as well as past historical performance all influence the price or value of both privately held and publicly traded companies. However, while the price of actively traded public companies is readily available to see virtually at all times, the price or value of privately held companies is determined infrequently and requires considerable time and effort by a professional. Generally, the expected earnings of a privately held company and the risks associated with achieving those expected earnings do not change as often or as rapidly as do thoughts about public companies. I believe that this is due largely to the illiquidity associated with privately held companies versus actively traded public companies and the fact that generally a purchaser buys the entire privately held company as there is not much of a market for minority or non-controlling interests in privately held companies. It generally takes a considerable amount of time and expense to sell a privately held company whereas selling stock in a publicly traded company is easy, quick, and relatively inexpensive. The acquisition of an entire publicly traded company often occurs generally at a price higher than the current trading price of the shares. These sales or acquisitions can also take some time and expense.

There is a considerable amount of data available regarding acquisitions of publicly traded companies by other publicly traded companies. Some data is available regarding the purchase of privately held businesses, however, much of that data is summary in nature.

Clearly the price or value of active publicly traded stock is much more volatile than that of privately held companies largely because of the market and the ability to convert actively traded public stock to cash quickly whereas equity tied up in privately held companies can take a considerable amount of time and effort as well as expense to be realized.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**

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