CVP news
Corporate Finance Insights

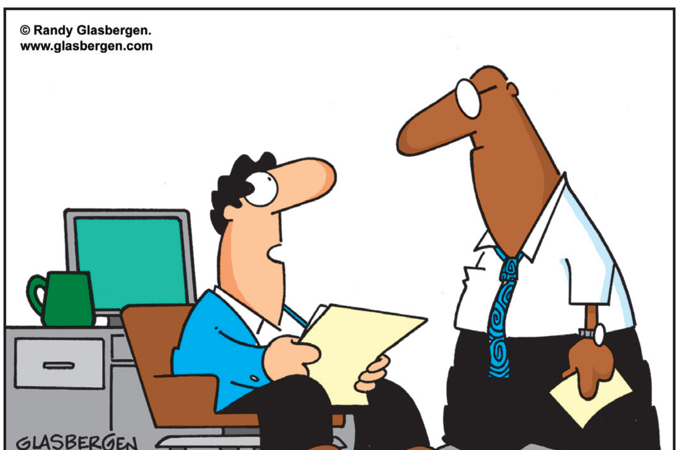
Bubbles

When I talked with my friend Mike about topics for this newsletter, I told him I wasn't happy with any of the ones I listed. He told me to write about something that was current and topical; something that is affecting valuations of businesses today. I thought about it for a little while and came back with, "Bubbles." Before I get into an explanation of what I mean, a little background might help.

What is he talking about?

The past five years have been quite unusual times if you're preparing valuations of privately-held companies. We've had severe swings in public equity, debt, real estate and commodity markets. There have also been fundamental changes in public policy, notably health care and taxes. Most importantly we've had an unusual level of government involvement in our economy. From takeovers of AIG, General Motors and Chrysler to heavy stimulus spending and to an unprecedented financial program known as Quantitative Easing, the US government is present in many facets of the economy.

My point is not to debate the political aspects of these events. I have been well-trained to take the world as it is and to try to determine how any event affects the value of my client's business regardless of politics. That is what I am all about. When valuing a private business any analyst must consider developments in the public markets to decipher what signals about value may be present. Needless to say, events of the past five years have presented a number of unique considerations.



"If you convert the numbers from Celsius to Fahrenheit, adjust for inflation, score on a curve, and factor dog years into the equation, my sales are up 850 percent this quarter!"

Corporate Value Partners, Inc.

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- Assisting with the acquisition or sale of a business, business unit or product line;
- Assisting with the placement of debt financing;
- Preparing business valuations;
- Assisting creditors in corporate bankruptcies;
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Back to bubbles

Attempts to repair the US economy are starting to show results, but some of them are worrisome. Most troubling is the apparent rise of asset bubbles. It sounds odd, but asset bubbles do happen on occasion in the world economy. They develop when money pours into a certain type of investment (as an example real estate) from a large number of investors. If the price of the investment gets too high relative to the income it generates, people start to worry that a bubble has developed – that the price has gone too high. Japan experienced a severe real estate bubble in the early 1990's (they're still struggling with it) and the trouble we had in the US starting in 2008 was also due to a real estate asset bubble.

When reading business news, you've probably noticed that asset bubbles or questionably high prices are becoming a more common topic. The reason they're being discussed more frequently is because the goal of Quantitative Easing is to increase the amount of cash in our economy. The hope is that it will spur more activity such as people building more houses and businesses investing more in machinery and equipment. But once the cash is in the economy the government can't tell everyone what to do with it. Many people have chosen to invest this extra cash which has, apparently, pushed up the price of many assets such as stocks, bonds and commodities.

When prices of companies in public markets are strong, we generally expect prices of companies in private markets to be strong as well. That's where the problem comes in. All that extra cash affects the public and private markets differently. It also causes public markets to be more volatile. So it is very difficult to tell if the prices of assets in the public markets (stock, bonds and commodities) are high because of solid fundamentals or if it is due to Quantitative Easing; and it is difficult to interpret that data in the valuation of a privately-held company. The effect on privately-held companies has been that they tend to be valued in a more cautious light than are companies in public markets.

When valuing a privately-held company be careful about how information from the public markets is used. In general public market data is very useful in valuing a private company, but conditions of the last few years should make all of us wary about just how applicable the information is; and it's all because of bubbles.

Please contact Ronald DiMattia at Corporate Value Partners at (440) 333-1910 or ron@corporatevaluepartners.com with any questions or to discover how CVP can help you get the most out of your assets.

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