

# How inflation and rising interest rates affect private business valuation

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The most recent consumer price index rose 8.2% from a year earlier. The last time inflation in the US was this persistent was more than 40 years ago. This has many folks wondering how inflation and its companion—rising interest rates will affect private business valuations. One can look to the publicly traded

stock markets and glean valuable insights. At the end of September, all three major indexes the DOW, S&P 500, and NASDAQ were in bear territory—meaning they have fallen more than 20% from their highs. This year marks the S&P's worst year to date performance in 20 years. The tech-heavy NASDAQ is down more than 30% already this year. The Dow, which fell 9% in September has erased any gains made in the last two years, falling back where it was in November 2020.

But looking to the public stock market to ascertain the affects to private equity value has its limitations--as private stock values tend to fluctuate less than publicly traded stocks. In other words, private company multiples of both earnings and revenue are more stable than their publicly traded counterparts. But this does not mean private companies are immune to the affects of inflation. I recently studied this subject and presented the results to a major US lender. To determine the change in value of private stocks, I examined the results from BizBuySell's insight report--- the largest private market in the US and I found the value of the composite private company has dropped about 3%. In addition, I measured how increased interest rates has affected the income approach

to value—particularly the risk-free rate. The results are similar---rising interest rates have decreased the value of private businesses by approximately 4.5%. This should come as no surprise to anyone because when the cost of capital increases (the denominator) the value of the cash flow stream (the numerator) will decrease. Not all the news is negative though--- there have been some winners like oil and gas—which has popped during this current inflationary environment.

In conclusion, similar to how the ebbs and flows of the tides affect every boat on the water--the current inflationary trend in the broader economy has an affect on every business riding on the waters of the U.S. economy.