

### Executive Summary

What is a private company worth? And why would anybody want to know? Valuing a company could have a major impact on whom a development officer decides to solicit for a gift. A prospect's ownership of a company is a strong indication of wealth, and, in extension, his or her capacity to give. But valuing a private company makes even the most experienced development officers and prospect researchers balk. However, with the right techniques and resources, it can *and should* be done.

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## Private Company Valuation and the Prospect Researcher

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Private company owners are hard to research, and nearly every prospect researcher would agree. Give researchers a choice between profiling a private company owner or a public company insider, and they'll take the insider almost every time.

But those researchers are making a couple of big mistakes by favoring the insiders. First, most nonprofit donor databases contain very few, if any, public company insiders. Second, there is often more company wealth held by private company owners considered as a group than by public company insiders considered as a group.

The researcher's problem lies in the fact that private company wealth is hidden, while stock owned by public company insiders is out in the open for anyone to see. Thus, the common preferences among researchers when selecting individuals to review are top officers, directors, or major shareholders of public companies because they're easier to research.

Prospect researchers want to know about company ownership — public or private — because it can be a major component of a family's wealth. If you demonstrate that a prospect has lots of company ownership, you've got a strong indication of significant wealth in other categories as well, and by extension, the prospect's philanthropic capacity.

It may be difficult to research private companies, but it's not impossible. There are tools and guides that are available to help you make some reasonable estimates of a company's value. With that in hand and a good guess at what percentage of the company your prospect owns, you can arrive at a reasonable estimate of the value of that asset in your prospect's financial portfolio.

### Motivation Matters

I've already explained the reason why prospect researchers try to determine a company's value. But most people trying to estimate a company's value have other motivations. Surprisingly, the value

assigned to a private company is heavily influenced by the reason you're asking the question. So why would someone ask? A person might need to value his or her company...

The key issue is that a private company's value is not entirely objective. The value is at least partly subjective.

- ♦ To sell it
- ♦ To raise capital from investors
- ♦ As part of a divorce settlement
- ♦ For a management buyout
- ♦ For estate planning
- ♦ For an employee stock ownership plan
- ♦ For taxation

Change the question, and you change the value of the company. If the data allows for any interpretation (and it almost always does), the owner will certainly interpret a lower value if the purpose is to determine the company's taxable value or if the company itself is part of a divorce settlement. On the other hand, the owner will interpret a higher value if he or she is going to sell the company or is trying to raise additional capital from investors. The key issue is that a private company's value is not entirely objective. The value is at least partly subjective.

You could make the same analogy to the value of real estate. Certainly the land and the building materials have some salvage value, but the total cost of the bricks and boards is not equivalent to the value of the house made from them. The only way to really know what the house is worth is to put it on the market and find a buyer. The amount of money that the buyer is willing to exchange for the house is its market value. Intangibles like nearness to services, schools, and places of employment, or the scenic quality of the surroundings, can heavily influence the value. Two identical houses in different locations or sold at different times can have quite different values.

Likewise, the value of a private company is influenced by many things that have nothing to do with the cost of the buildings, equipment, furnishings, or inventory. Ultimately, if the owners of a company want to know what it is worth, they will have to sell it. Since you, as a development officer or prospect researcher, are not in a position to do that, you'll need to resort to some indirect measures of value. To understand what we're doing, we need to go back to Business 101.

## Business 101

When a company files incorporation papers with the proper government office, it is then issued a certain number of shares. These are known as outstanding stock or outstanding shares. The value of the company is evenly divided among these shares. If the company issued 1,000 shares, and the whole company is worth \$1000, then each share is worth one dollar. Specify any value for the company and do the math. That's what a share is worth. At the point of the company's founding, however, you could truthfully say that the value of the company or a share is irrelevant.

Shares of a company are not so much an item of value as a claim of ownership and control. The more shares you own, the more control you exercise over the company. This is true of both public and private companies, though in the case of a public company, a share does have a specific value. You can look it up on any financial Web site or in certain newspapers. You multiply the

value of one share times the number of outstanding shares, and that's what the public company is worth — more or less. The product of this calculation is known as the "market capitalization" or, simply, "market cap."

We call public companies "public" because any member of the public with enough money is free to buy stock in them. Since most private companies have just a few owners whose shares are not offered to the public, their stock is called "closely held."

There isn't a page in the *Wall Street Journal* — nor is there any Web site — where you can go to look up the value of a share of a private company's stock. Yet, from time to time, the owners of private companies decide to determine the value of their investment, which is a difficult and complex task. Private company owners pay accounting firms big money to determine that value. The chances are low that a prospect researcher could make an accurate assessment of a company's value without access to inside information from the company. But it's not always necessary to be precise about value. Sometimes it's enough just to have a general idea.

## Methods of Valuation

Professionals who practice company valuation have several methods for estimating the value of a particular company. These include calculating the book value of all assets and adding them up, using the price/earnings ratio, and using the discounted cash flow model. For a researcher who does not have access to detailed financial information from inside the company, none of these are an option. A more feasible approach is to find comparable companies whose values are known.

When looking for comparable companies, there are two options: (1) find one or more similar public companies, or (2) find similar private companies with known values. Although there are many metrics we might use to compare your target company\* to these others, you are most likely to find comparable data on sales, industry, and region. Let's first deal with the use of comparable public companies.

## Comparison to a Public Company

Immediately we are faced with the fact that, because of certain accounting realities, a public company will almost always be valued higher than a private company having the same characteristics. Still, it is usually worth the effort to try this method, if only to get a feel for the industry.

**To compare your target company to a similar public company, follow these steps:**

1. First you need some basic information about your target company. If you don't have data from any other source, you should be able to get a basic report from Dun & Bradstreet®, which will provide some key indications such as sales, number of employees, and line of

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\* I'll use the phrase "target company" when referring to the company you are valuing.

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business or a Standard Industrial Classification (SIC) code. Dun & Bradstreet® sells these reports in varying formats and prices. The one called the “Duns Market Identifiers” would be a good compromise of cost and data completeness.

2. Go to the Yahoo!® Stock Screener at <http://screen.yahoo.com/stocks.html>.
3. Among the various metrics available for searching at the Yahoo!® Stock Screener, the only ones usable in comparison to a private company are “sales” and “industry category,” which is based on SIC codes. Enter the relevant information in the form and click “find stocks.”
4. Read through the profiles of the public companies returned. With luck, you’ll find a public company in the same region as your target company.

**Here are some things to consider when using this method:**

- ◆ Public companies tend to be much larger than their private counterparts, so you’ll probably have to use a sales range that is greater than your target’s in order to find some examples.
- ◆ Your target’s industry will not always match those offered by Yahoo!® perfectly. Don’t get stuck on this. Try to find something that is close.
- ◆ Read the profile to see if the comparison company is similar enough to the target’s business.
- ◆ The market capitalization (share price × outstanding shares) is one of the simplest ways of stating the value of the company. If your target company is similar to the public company, it might have a similar, though probably somewhat lower, market cap.
- ◆ Even if a public company has flat or negative earnings, it may still have value. The same may be true of your target private company.

## Comparison to a Private Company

If you wanted to buy a used car, you’d probably start by opening the daily paper to the classifieds section and reviewing the cars for sale. This would give you a good sense for the market price for the kind of car you want to buy. There may be a few businesses for sale in the daily paper as well. But if you wanted to buy a business, you’d probably do better consulting some specialized resources that are designed specifically for business buyers and sellers. One of the best is [www.bizbuysell.com](http://www.bizbuysell.com). On the home page, you’ll see a search form that allows you to select a business category (which you could also describe as “line of business” and is roughly equivalent to SIC) and a location. Location includes all the states in the U.S., as well as other countries and continents. After selecting the appropriate line of business and the correct state, click the search button and a list of businesses will be presented. As you click on each one, you’ll see a description of the business and some financial data, such as asking price, gross sales, and cash flow.

If you’re very lucky, you’ll find a business that closely resembles your target company in description and sales figure. However, even if the companies you found have different sales figures and don’t have quite the same description as yours, reading through these profiles will give you a feel for the buying and selling market in your target’s industry. You may also notice a relatively consistent ratio between the sales figures reported for these businesses and their asking prices. This can be a helpful metric for you. If, for instance, most of the businesses you found are selling for about half of their annual sales, that ratio between annual sales and company value may apply to your target company. It should be clear by now that there is no generalized rule of thumb for the ratio of sales to

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company value that can be applied across the board. Each industry will have specific conditions not shared by other industries that affect value. You could say the same for different parts of the country as well. Using business classifieds like this can help you to establish your own rule for valuing one kind of business in your part of the country.

On the subject of rules of thumb, you'll find some handy guidelines for valuing businesses in different industries at [www.bizstats.com/rulesofthumb.htm](http://www.bizstats.com/rulesofthumb.htm). It certainly doesn't contain an exhaustive list of industries, but if your target's industry is among them, you'll have a useful guide for estimating value. If you back up to [www.bizstats.com](http://www.bizstats.com), you'll find some other useful information for valuing businesses.

A company called Business Valuation Resources, or BV Resources ([www.bvresources.com](http://www.bvresources.com)), has created some useful tools for estimating the value of a company. This is a resource that is designed for professional business appraisers. However, a researcher with a general understanding of valuation concepts can use several of these tools effectively. In particular, there are two databases at BV Resources that are useful to prospect researchers attempting to value private companies: Pratt's Stats and BizComps.

The idea behind both of these databases is similar to using business classifieds to create a ratio for valuing companies in a specific industry. Except, instead of looking at businesses that are for sale, these tools contain data for companies that have been sold. This eliminates the uncertainty about what the company is actually worth. With BizBuySell, you only know what the asking price is. With BV Resources data, however, you know the actual value of the company. Unarguably, it is worth what someone — or some other company — paid for it.

After the sale of the company, Pratt's Stats and BizComps collect various metrics about the company including those ever-important values: annual sales and selling price. Once they've collected enough examples of companies that sold within a specific industry, they can establish an overall ratio between annual sales and company value. An individual using either Pratt's Stats or BizComps (you can search them separately or together) picks an industry and a sales figure and gets an approximate value for the company based on the appropriate ratios.

Naturally, such powerful tools come at a price, unlike all the other resources I've mentioned thus far. Pratt's Stats, which contains data for companies having a median selling price of \$1.5 million, costs \$595 for an annual subscription. BizComps, which covers companies with a median selling price of \$132,000, costs \$395 per year.

There are two ways you might be able to use these data from BV Resources without actually buying a subscription. You could use Blackbaud Analytics™ to do a WealthPoint™ screening of your database. There is, of course, a fee for this screening, but you'd get information from a number of different sources about assets owned by your prospect, such as real estate, insider stock holdings, and private company ownership. Blackbaud Analytics uses the ratios from BV Resources to estimate the value of private companies. For some prospect researchers, it makes more sense to pay Blackbaud to do the private company valuation and get additional information on the prospect at the same time.



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Mr. Lamb is a frequent speaker at professional conferences, including those sponsored by the Council for Advancement and Support of Education (CASE) and the Association of Professional Researchers for Advancement (APRA). In 1997, he received APRA's Service Award for outstanding service to the profession, and in 2001, he was awarded CASE's Steuben Apple Award for excellence in teaching.

## about Blackbaud

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There is another way a researcher on a shoestring budget can take advantage of the Business Valuation Resources data without actually subscribing. The *Inc. Magazine* "Ultimate Valuation Guide" ([www.inc.com/valuation/index.html](http://www.inc.com/valuation/index.html)) is a free tool built from data provided by BV Resources. The Valuation Guide is a huge interactive chart. It shows where companies in various industries generally fall on two dimensions: median selling price (or company value) and median annual sales. Dots on the chart represent various industries. Click on a dot and you'll see more detailed information about the industries clustered near each other in the chart, including the ratio to use in calculating company value from the annual sales.

This chart is not based on the full data set of companies contained in Pratt's' Stats and BizComps, nor can you see nearly as much information as you would if you were using these databases directly. But it is free and gives you a rational basis for estimating a company's value if you can find its industry on the chart.

## Conclusion

What is your target company worth? It's a simple question with a complex answer. As you've probably gathered from this white paper, you almost certainly won't be able to answer that question with precision unless you have inside information and advanced knowledge of how to interpret all the variables. Most development professionals have neither.

Fortunately, a general idea of the value is almost as good to the development officer as a precise figure. Since you won't be tendering an offer to buy the company, you don't need to know all the details. Instead, you want to know how ownership of the company affects a prospect's philanthropic capacity. It may be sufficient enough to know that the company's value is in a range of \$10-20 million vs. \$1-2 million. This information, then, becomes one factor among many in your ultimate estimate of philanthropic capacity for the private company owner.