



## Impact of COVID19 on Business Valuations

### Background

Globally all businesses are impacted one way or the other due to the recent Covid-19 outbreak and subsequent lockdowns. This has led to increase volatility of markets and also business disruption. While doing a business valuation of a company, concerns have been raised as to what is the fair value of company at times of this pandemic.

The exact economic impact of this pandemic on companies is very hard to predict as there were various theories if the market recovery will be immediate, medium term or long lasting. Further all eyes were on the various actions taken by Governments worldwide to control this pandemic while also ensuring economic activity takes place. The purpose of this report is to assess the various areas where impact of this pandemic has happened. The business valuer has to go through different considerations while deriving a fair value.

### Top 5 recommendations while performing a valuation

As the conditions continue to change, various theories came under discussion such as if the recovery will be U shaped or V shaped or even W shaped. Another important point to note is the recovery pattern seem to differ from one country to another so the role of the valuer has become even more difficult in such a situation.

It is very hard to create a formula for this but some of the recommendation in such situation are as below,

- **Impact on discount rate or weighted average cost of capital**  
The comparative company analysis has become very unrealistic due to greater market volatility and high levels of uncertainty. A valuer needs to assess the correct betas and debt margins. Even the covid19 impact on valuation could be an added factor on the discount rate used.
- **Assessing going concern of the company**  
Certain companies were highly impacted due to the pandemic with severe impact on its cash flows and revenue generating capacity. So, a company which had a smooth track record of performance might be in severe going concern issue. The impact could be due to covenant breaches, financial liquidity risks, order cancellations and higher counterparty risks. So valuer has a difficult job in hand as to which route should be taken, whether to depend on company projections as the basis of going concern or to look it on liquidation basis.
- **Developing market adjusted scenarios**  
While considering the business plans prepared by the management, a valuer also needs to test if it really represents the current market conditions. Basically, if all the known and knowable factors have been considered at the valuation date.

- **Review of management developed projections**

The conditions continue to change due to lockdowns, government action, ability of the customers to pay in time, company expenses etc, so the assumptions need to be evaluated regularly especially on the valuation date. Robust documentation reviews are required for contracts in progress, ability to produce goods etc since the assumptions taken by management may no longer be valid in the future.

- **Selecting the correct valuation date**

In normal conditions it is easier to choose a date which most realistically represent the business cycle of the company but during the pandemic estimating the correct date of valuation could be a challenge as conditions continue to change so the business cycle that was carried out previously might not be the same. In such situations a valuer needs to disclose the gravity of the uncertainty due to the pandemic with recommendation to reassess.

### What process can be followed for valuation adjustments?

#### **Under Income Approach:**

We know that fair value of a company is based on what is known and what is knowable as on the valuation date. In such situations, potential impact quarter wise needs to be assessed or as per the various phases in the business cycle.

Try adjusting the performance shortfalls that could result due to supply chain disruption, volatility in commodity prices, workforce restrictions, temporary curtailment of operations, mothballed assets or delays in payments by customers.

Projections need to consider any government incentives and short-term measures applicable.

In times of uncertainty, investors become more risk averse, thus adjustments to discount rates in the form of additional risk premiums may become necessary.

The adjustment to risk premiums may cover risk factors that were missed out in the projections. However, there is a possibility of overdoing it as well since some risk factors may get doubly counted in the discount rate and also in the projections, thus a holistic view to be considered.

#### **Under Market Approach:**

When applying market approach, ongoing metrics and earnings should be looked at on a market participant basis and therefore one-off impacts can be excluded. However, a valuer will still need to consider expected adverse performance when the pandemic is still underway. Thus, having an adjustment on the enterprise value may be required for estimating a fair value.

Identifying the current multiple can also be another challenge. Thus, more updated information should be used to assess the change in market capitalization of comparable companies

It may no longer be appropriate to consider application of recent transaction prices

There is a high chance of double counting the downward adjustments so care should be taken that values taken fairly represent the realistic value of the company.

### Other adjustments

Impact on liquidity needs to be assessed very closely especially due to debt covenant breaches, impact of the extended reduced cash flow, funding of working capital required etc

Also, a valuer needs to assess credit quality and repayment risks.

It is highly recommendable to include scenario analysis.

### How can Premier Brains assist?

Premier Brains is highly specialized in performing valuations and have spend extensive time in understanding the impact of Covid19 on the valuations.

*If you would like to discuss any ESR matters, please drop us an email at [info@premier-brains.com](mailto:info@premier-brains.com) or call us at + 971 4 3542959.*

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- Tax Agency with FTA
- Tax Advisory
- Business valuations
- Feasibility Studies
- Business Accounts Outsourcing Services

- Fund raising and restructuring
- JAFZA Offshore agents
- Company incorporations (under group entities)

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