IMPACT OF COVID-19 ON VALUATION FROM VALUERS PERSPECTIVE

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VALUATION IMPACT

- Stock markets around the world have fallen with the SENSEX falling by over 40% since the beginning of March
- Volatility: In valuation, volatility is risk and is a key parameter in pricing an asset. However, quantifying such a risk is challenging.
  - Different sectors are differently affected
  - Uncertainty of timing to subside
- Reasons for Impact:
  - Actual and expected revenues and earnings may have decreased due to forced COVID-19-related closures or decreases in customer/client demand.
  - Interest-bearing debt may have increased to pay employees and other fixed continuing expenses.
  - For an asset holding company, such as a real estate holding company or a company holding investments in private and publicly traded equity, decreases in asset values may have reduced the value of the holding company. This is particularly evident when the holdings include publicly traded equity. This can also affect real estate assets due to COVID-19-related changes resulting from lower rental and occupancy rates.
  - For minority interests in privately held companies, discounts for lack of control and lack of marketability may have increased due to liquidity issues in the market.

EFFECTS ON VALUATION APPROACH

Income Approach

- Cash Flow Projections: Re forecasting & Modeling, Reduced cash flow assumptions due to uncertainty of risk
- Sensitivity and Scenario Analysis
- Assessing whether there will be a V shape recovery or a U shape
- 2020 revenue and expenses may reflect significant fluctuations from historical trends and may not reflect a normalized level of operations for the basis of forecasting a subject entity's cash flow.
- Increase in cost of capital- a risk premium for COVID-19 may be worth considering.

Therefore, valuators may have to be acutely aware of the need to make normalizing adjustments to both revenue and expenses as part of their forecast models &

In case the cash flows are already adjusted with the effects of **COVID 19**, no further adjustments would be required in the discounted rate.

INCOME APPROACH…CONTD

- Some of the issues that the company may face and adjustment would be required to be made in forecast are following:
  - Changing customer behavior
  - Short-term and long-term impact on revenue
  - Labour shortages
  - Increased cost of production
  - Increase in working capital days
  - Impact on short term liquidity
  - Difficulty in meeting debt obligation
- Adjustment to Discount for Lack of Marketability
- Valuations using DCF will be given more weightage in the current scenario as this can capture a limited downside period more accurately, albeit with a lot more diligence on business projections.

MARKET APPROACH

- Evaluation of maintainable revenue and earnings, keeping in view the market participants perspective
- Assessing whether recent transactions are still comparable- A multiple reported even a month ago might materially misrepresent the risk associated with a comparable transaction today.
- Assessing whether current market multiples reflecting long term fair value - “unaffected” metrics vs. “affected” market prices, it is important to **document the nature of the selected multiples** (actual vs. normalized) and how they align against the subject company’s financial metrics.
- Forward Multiples
- Transaction Multiples could gain more traction but in the current scenario will still need to be adjusted downwards; degree of this adjustment will need to be assessed on a case to case basis depending upon the industry, level of stress.

Thus, the valuation professional need to carefully use the multiples associated with the transactions that occurred during this crisis

USE OF RANGES

- Valuation ranges will need to be wider than normal, and these ranges may well be subject to volatility as valuations are updated over time.
- In terms of financial reporting valuations, **disclosures may need to be more detailed** and make clear that valuations could change quickly over a relatively short time frame, particularly if the businesses are highly leveraged.

COVID DISCLOSURE CLAUSE

Below note compiled, might be relevant for reports:

- The outbreak of the COVID-19, declared by the World Health Organization as a global pandemic on March 11, 2020, has impacted financial markets and economy across the globe. As at the valuation date, I consider that I can attach less weight to previous market evidence for comparison purposes, to inform opinions of value.
- Indeed, the current response to COVID-19 means that there are an unprecedented set of circumstances on which to base a judgement. My valuation is therefore reported on the basis of ‘material valuation uncertainty’ prevailing as on the date of this Report. Consequently, less certainty – and a higher degree of caution – should be attached to my valuation than would normally be the case.
- Values may change more rapidly and significantly than during standard market conditions. Except above there were no unusual/abnormal events occurred in the business operations between March 31, 2020 and the Report Date which materially impact the operating/financial performance of the business undertaking.
- For the avoidance of doubt, the inclusion of the ‘material valuation uncertainty’ declaration above does not mean that the valuation cannot be relied upon. Rather, the declaration has been included to ensure transparency of the fact that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case. The material uncertainty clause is to serve as a precaution and does not invalidate the valuation.

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