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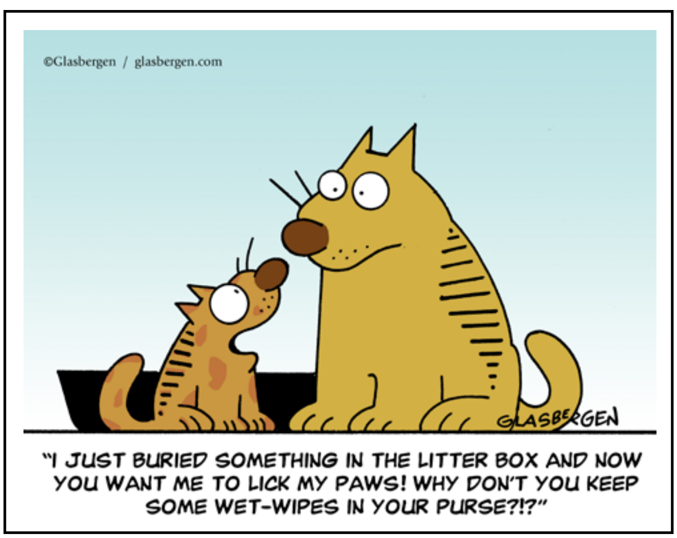
Coronavirus and Valuation

The coronavirus pandemic has had a significant impact on the process of valuing businesses, to say the least. Uncertainty associated with the pandemic has caused M&A activity to plummet, while a number of buyers have tried to back-out of previously agreed-to deals. It seems that many buyers and sellers are holding off and are trying to sort out how the pandemic will affect the value of businesses.

The way the pandemic revealed itself reminds me of how the crash in 2008 played-out, which was similar to watching a train wreck happen in slow motion. In late December 2019 I started noticing reports about an unusual, pneumonia-like illness that was affecting people in central China. By late January 2020 one newsletter I subscribe to was warning that the illness could become a black swan (meaning a highly disruptive and destructive event). It wasn't until March 2020 that it became clear we were witnessing a global outbreak.

It is difficult to tell how the future will unfold. Each company is likely to be affected by the pandemic in different ways, which complicates the task of valuing a business. As an example, many technology companies seem to be thriving in the current environment while many businesses associated with travel, hospitality or food & beverage may never recover.



How the Coronavirus Pandemic Affects Valuations

Although the current market environment makes it difficult to value a business, preparing sound valuations is still necessary. My view of the primary concerns in the current environment follows:

What was known and when was it known: Conclusions of value are specific to the particular date for which the analyses were prepared. As an example, if you are preparing a valuation for compliance purposes (such as estate or gift taxes), being careful about what was generally known at the valuation date is quite important. When preparing compliance-related valuations, be careful not to ignore information that was generally known, or to take into consideration information that didn't come to light until after the valuation date.

Split between financial markets and the economy at large: Even though financial markets seemed to recover quickly, it is important to keep in mind that the financial markets are not an accurate indicator of the economy at large. This has been particularly true since 2008. The effects of the pandemic are comprehensive, so it is important to analyze economic conditions thoroughly and consider how they impact the particular company being analyzed.

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Long and slow vs. "V" shaped recovery: This is the million-dollar question. Since valuation is a forward-looking process, we need to consider how the future will look. This single issue can have a large impact on the conclusion of value for a company. As I write this (late June 2020), there are conflicting signs pointing to competing versions of the future, so the type of recovery expected needs to be carefully considered.

How valuation analyses should be adjusted: It is important to remember that every company is unique. There is no single way to adjust valuation analyses to capture the pandemic's impact for all businesses. Cost of capital, market multiples and forecasts should all be analyzed in detail. Carefully consider the company being valued and how it fits into the broader economy – this will tell you how to build your analyses.

The important thing to remember is that we've been here before. The current time frame is an unstable environment, just like in 2008, 2001 and the early 1990's. Our best response to valuations in an unstable environment is to carefully consider the company and the economy, and build valuation assumptions that are appropriate to the situation. That's all we can do.

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