

AN FTI CONSULTING REPORT - PUBLISHED NOVEMBER 2020

# Valuations Survey 2020

Assessing Impact of COVID-19 Related  
Lockdown Restrictions on Valuations



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# Introduction

The COVID-19 pandemic has disrupted businesses, caused market volatility and triggered asset devaluations across the globe.

## + -5%

The World Trade Organisation estimates that world trade in 2020 could fall sharply - between 13% and 32%, with estimated global losses in GDP growth of approximately 5%<sup>1</sup>.

Bill Conerly, a Forbes economist, states that the pandemic hurts economies in four ways:

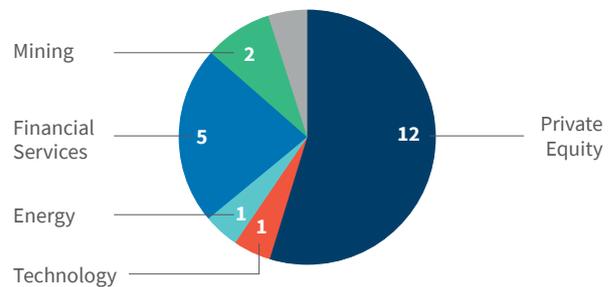
- Supply chains failures;
- Direct effects of illness in terms of lost work by those who are sick or tending to the sick (currently insignificant impact in South Africa);
- Indirect effect of quarantines, travel restrictions, restaurant and company closures, and so forth; and
- Demand shocks as people’s incomes are limited by job loss and, in the case of small business owners, profit and loss.<sup>2</sup>

In addition, were participants considering using impairments to account for the impact of the pandemic in current and future financial reporting?

Amongst other questions, the survey investigated whether various stimulus packages put in place by the South African government had been utilised by local businesses to alleviate the impact of COVID-19 and how these were accounted for.

The results of the survey reflect the views of 22 participants, and while these should not be generalised to entire sectors, they provide fascinating insights into the challenges currently faced by businesses.

The participants surveyed are South African entities operating in various sectors as summarised in the diagram below:



We would like to thank all participants for their valued contribution and the time and effort taken to participate in the survey. Our gratitude extends to our Johannesburg based Valuations team that compiled the survey results.

We look forward to your feedback.

FTI Consulting  
Corporate Finance  
Valuations

**“While the full economic impact of the pandemic has not yet been felt in South Africa, it is clear that the volatility has created much uncertainty around how the fair value of a business is determined.”**

Our team of valuation and deal advisory professionals sought the views of local participants from various sectors to assess their views on how lockdown restrictions had impacted their businesses and value drivers.

We also looked to determine whether valuation metrics and models had been adjusted to incorporate the effects of this unprecedented crisis.

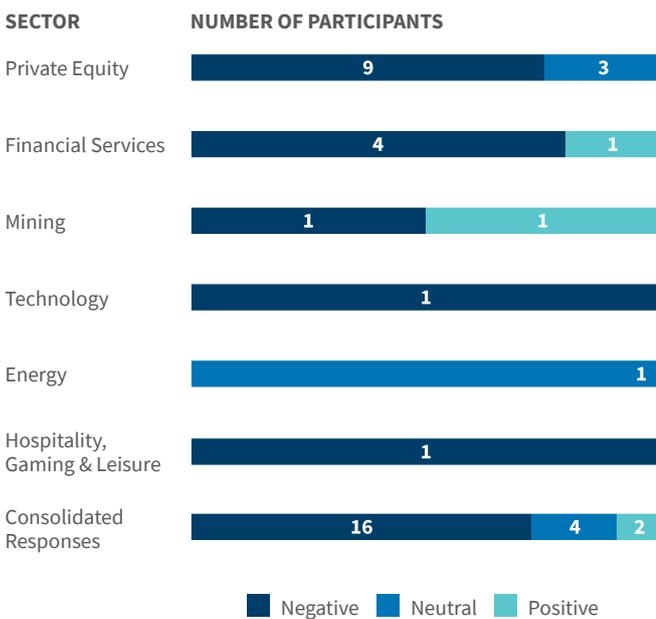
<sup>1</sup> Source : World Trade Organisation, (8 APRIL 2020) . Trade set to plunge as COVID-19 pandemic upends global economy. Available at [https://www.wto.org/english/news\\_e/pres20\\_e/pr855\\_e.htm](https://www.wto.org/english/news_e/pres20_e/pr855_e.htm) (Downloaded: 15 October 2020)

<sup>2</sup> Source : Bill Conerly, (20 March 2020) , Economic Forecast Update March 20, 2020 For COVID-19, Coronavirus Impacts. Forbes. Available at <https://www.forbes.com/sites/billconerly/2020/03/20/economic-forecast-update-march-20-2020-for-covid-19-coronavirus-impacts/#237c51c42f07> (Downloaded: 15 October 2020)

# Sector impact analysis

The decline in global equity markets at the beginning stages of the COVID-19 pandemic demonstrated the potential impact of the pandemic on the valuation of investments. Travel restrictions, quarantines, consumer uncertainty, supply chain disruptions and other government directed initiatives translated into world wide stock volatility and asset devaluations. We asked participants for their views on the likely effects of the lockdown measures on the business sectors in which they operate and whether these effects are permanent or temporary in nature.

*Q: What do you expect would be the impact of the COVID-19 related lockdown restrictions on economic growth in your industry for the next 12 to 36 months?*

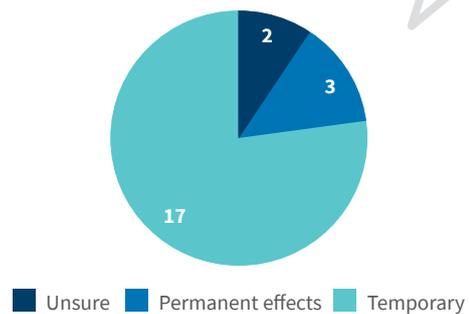


- The majority (16) of participants indicated that the impact of the COVID-19 pandemic would have a negative impact on their industry over the next 12-36 months.
- Only 2 of the respondents reported that it would have positive impact,
- while the remaining 4 believed that the pandemic will have no or little impact on their respective business sectors.

We further noted that participants who indicated that they expect to benefit or have benefited from the impact of the COVID-19 pandemic, operate or have portfolio exposure in the following business sectors: **Private Equity, Financial Services, Energy, and Gold mining.**

The participants who indicated that the COVID-19 pandemic had no impact on the business sectors to which they had exposure were mostly from the Private Equity industry. These respondents were exposed to various business sectors, some of which had not been impacted by the pandemic. They reported that the overall impact of COVID-19 was neutral.

*Q: Do you perceive the current economic disruptions caused by COVID-19 related lockdown restrictions to be permanent in your industry?*

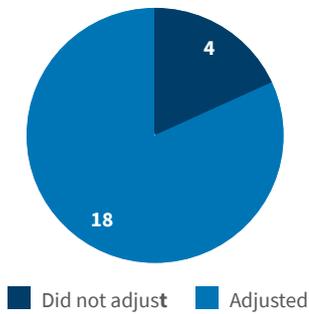


- The majority (17) of participants believed that economic disruptions caused by COVID-19- related restrictions would have a temporary impact in the business sectors in which they operate.
- Only 3 of the participants believed that the impact would be permanent,
- and the remaining 2 indicated that the nature of the impact was uncertain.

## Sector impact analysis *cont.*

We asked the participants to indicate whether they have adjusted their business models to adapt and cope with these challenges and if so, how those adjustments were applied.

**Q: How have you adjusted the business' operating model to adapt and cope with the challenges emanating from the COVID-19 related lockdown restrictions?**



18 Participants that made changes to their business models implemented the following initiatives to reduce the economic impact of COVID-19 related lockdown restrictions:

- Business continuity processes;
- Liquidity management;
- Workforce optimisation;
- Focusing on core business operations;
- Diversification of business activities;
- Process optimisation; and
- Capital structure optimisation.

Only a handful of participants reported not adjusting their business models to reduce the economic impact of COVID-19 related restrictions.



# Treatment of government stimulus packages

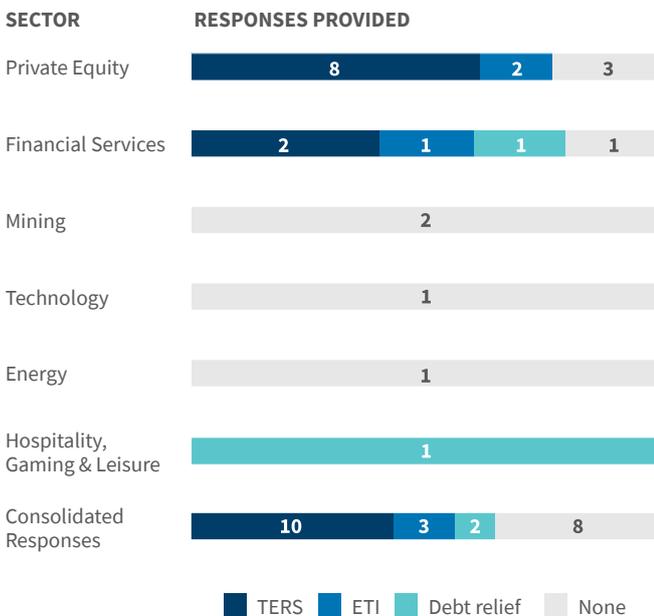
The South African government implemented a range of stimulus packages intended to ease the economic impact of lockdown restrictions on businesses. These aimed to curb the risk of business failures and subsequent adverse socio-economic impacts. We asked participants about the types of stimulus packages available in their industries and whether they had received government assistance.

**Q: What type of economic stimulus packages have the Government provided to the businesses in your sector?**

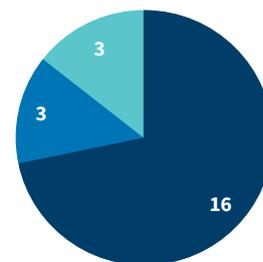
The general indication from participants was that they were aware of COVID-19 Temporary Employee/Employer Relief Scheme, while far fewer knew about the Employees Tax Incentive or the Debt Relief Fund.

Despite a general awareness of these stimulus packages, the majority of participants indicated that they had not received any assistance from government.

An exception was one respondent in the Private Equity sector who indicated that they had utilised both the TERS and the ETI.



**Q: Where economic stimulus packages have been received, how have you treated these in your valuation model?**



Participants highlighted the following types of economic stimulus packages available:

- COVID-19 temporary employee/employer relief scheme (TERS);
- Employees Tax Incentive (ETI);
- Debt relief fund and,
- Not aware of economic stimulus package/ no economic stimulus package received.

- Not applicable
- Non-operational cash flow item
- No adjustments

Where participants had received economic stimulus packages, most did not include them in the recent cycle of valuations performed.

Some of those that did adjust for stimulus packages received, treated them as non-operational cash flow items.

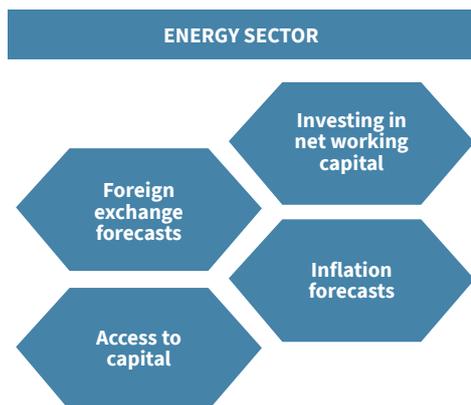
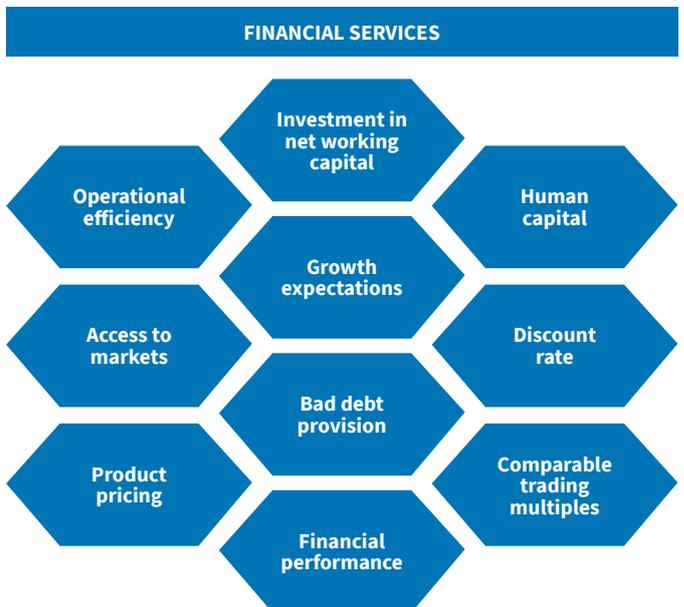
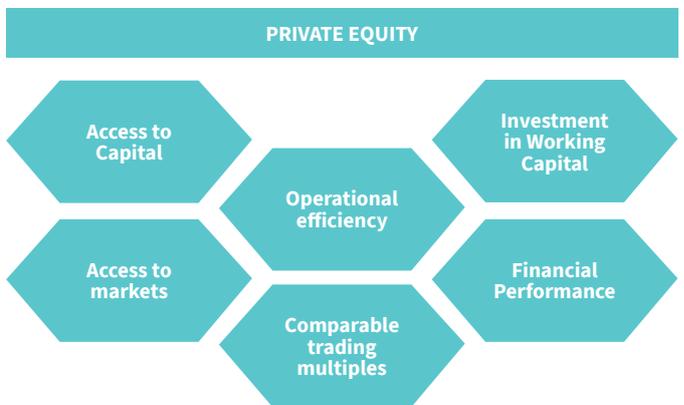
Others - for example in cases where they were in the form of debt - reflected the impact of the package in the net debt balance.

# Value drivers

When valuing businesses during the COVID-19 period, prospective investors need to understand the extent to which lockdown restrictions impacted the key value drivers of the business.

*Q: Which key value drivers have been affected the most by COVID-19 related lockdown restrictions in your business?*

Participants identified the following key value drivers that were impacted by the COVID-19 pandemic in each sector:



The participant from the Technology industry noted inability to identify specific Value Drivers affected as a result of COVID-19 related lockdown.

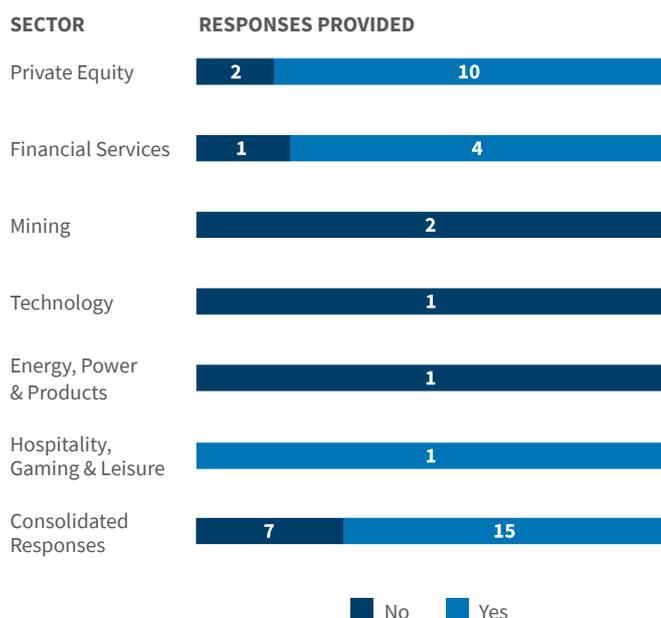
# Impairment considerations

COVID-19 related restrictions resulted in significant business disruptions across different sectors. We asked participants whether they expected this to result in impairments for financial years ending during 2020.

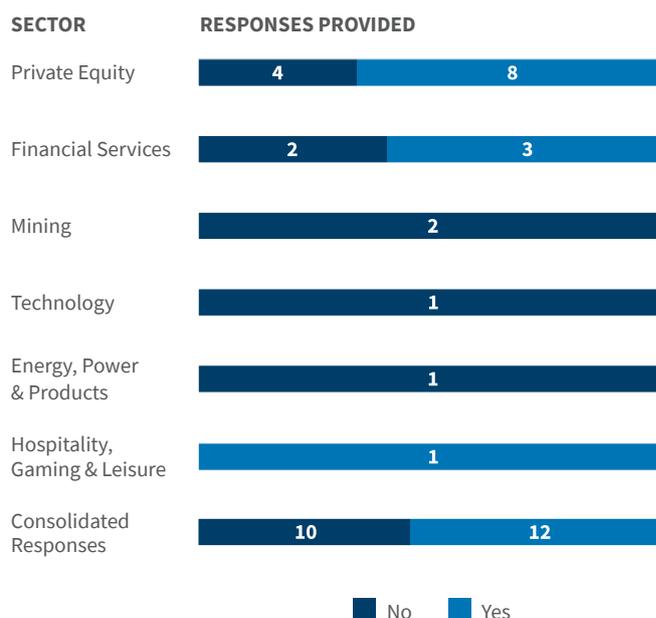
*Q: Has the impact of COVID-19 related lockdown restrictions resulted, or is it expected to result, in impairments for financial year periods ending during 2020?*

*Q: Do you expect the impact of COVID-19 related lockdown restrictions to result in impairments for financial year periods ending during 2021?*

## IMPAIRMENT - FY 2020



## EXPECTED IMPAIRMENT - FY 2021



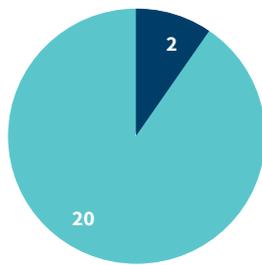
- The majority of participants in the Private Equity and Financial Services sector have or are expected to make impairments for the financial year ending 2020.
- Only those in the Energy, Power & Products; Mining; and Technology sectors did not expect to make impairments for the period.

- The picture with regards to expected impairments was less clear for 2021, with two thirds of respondents in the Private Equity sector expecting COVID-19 related restrictions to result in impairments for financial years ending during 2021.
- As with financial years ending in 2020, those in the Energy, Power & Products, Mining; and Technology sectors reported that they did not expect to make impairments in the coming year either.

# Impact on valuation approach

Valuation practitioners use a range of methodologies to determine the value of a business. Our survey investigated whether their valuation approaches changed as a result of the COVID-19 restrictions. In particular, what determined the preferred valuation approach or adjustments applied?

**Q: Is the valuation approach previously used still relevant to best capture the value of the business?**



No Yes

Of the 22 participants:

- 20 indicated that the valuation approach they previously used remained relevant, despite the impact of COVID-19 restrictions,
- while 2 believed their valuation models no longer applied.

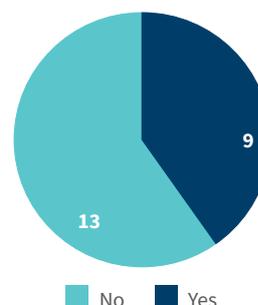
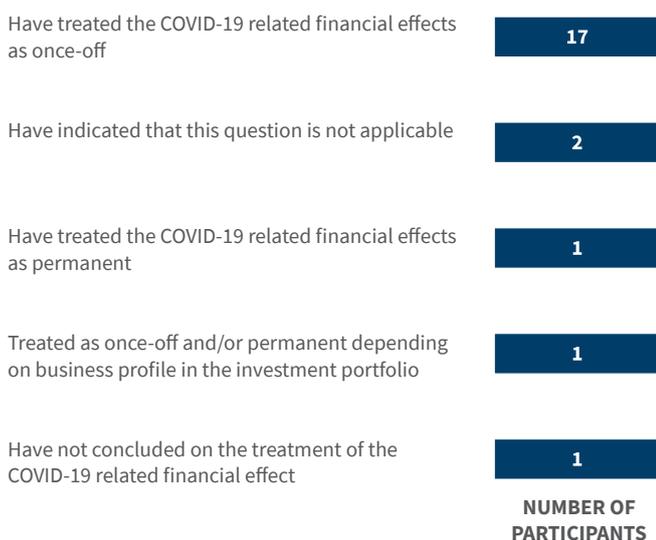


# Valuation adjustments

We asked the participants if they have applied a premium or a discount to capture the risks related to economic impact caused by COVID-19 restrictions. We wanted to understand how these adjustments impacted value and where they have been applied.

*Q: How have you treated financial effects emanating from the COVID-19 related lockdown restrictions when calculating maintainable earnings, are they considered once-off or permanent items?*

*Q: Did you apply a risk premium or discount specific to COVID-19 related lockdown restrictions in valuations performed in the current financial year?*



The consideration of whether the financial effects of COVID-19 were treated as once-off or permanent was a function of the nature of the impact on business activities.

Where the impact was considered to be permanent, the financial effects are treated as part of ongoing operations.

However, where the COVID-19 impact was considered temporary, the resulting financial effects were treated as once-off items.

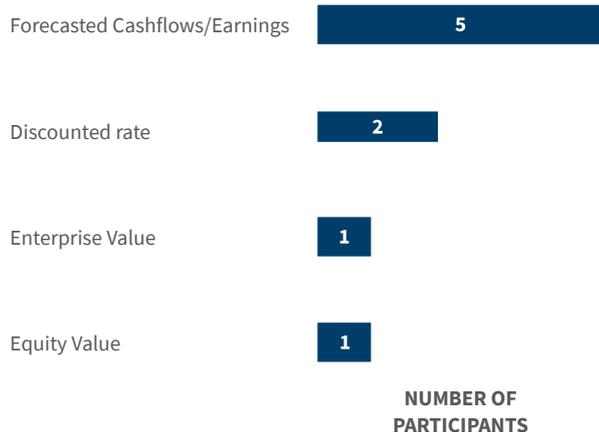
We also noted that for some businesses, the COVID-19 related financial effects could be once-off on certain activities but, to the extent it was perceived to be the “new normal” or permanent, the resulting financial effects were treated as permanent.

This was particularly the case for businesses with a portfolio of diverse operations.

- The majority of the participants did not apply a risk premium or discount specific to COVID-19 related lockdown restrictions,
- with 13 of the participants indicating that no adjustments were made.
- The remaining 9 participants applied specific adjustments to account for the risk associated with financial impact of the COVID-19 pandemic.

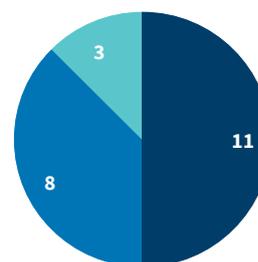
## Valuation adjustments *cont.*

**Q: In instances where a premium or discount has been applied, where was it included in your valuation model?**



The disclosure of COVID-19 impact adjustments in financial statements remains an area of uncertainty. We asked participants if they added specific disclosures relating to the COVID-19 impacts in their current financial statements

**Q: Have you added any additional limitations and/or caveats in your presentations and disclosures to the valuation owing to uncertainty emanating from COVID-19 related lockdown restrictions?**



- Inserted a limitation disclosure
- Not utilised limitation disclosure
- Limitation disclosure irrelevant

The COVID-19 impact adjustments have been the most debated input in a valuation calculation. Did participants apply premiums or discounts to take into account the impact of COVID-19?

**Q: What is the quantum of the premium or discount applied?**

PARTICIPANTS RESPONSES	NUMBER OF PARTICIPANTS	QUANTUM OF PREMIUM/DISCOUNT
Discount applied on cashflows/ earnings forecast	3	2% - 20%
Discount on enterprise value	1	0% - 40%
Discount on equity value	1	15% - 20%
Premium applied on discounted rate	1	10% - 15%
Applied discount/premium- no details provided	3	-
No discount/premium applied	13	-

- Half of the respondents inserted a limitation disclosure in their valuation presentations relating to the uncertainty emanating from the impact of COVID-19.
- Only a small number considered limitation disclosure irrelevant or not applicable.

## Conclusion

It is clear that most sectors of the South African economy have been severely affected by COVID-19 related restrictions. The majority of participants in FTI Consulting's Valuations Survey anticipate that there will be impairments linked to the pandemic in financial years ending during 2020 and possibly 2021.



Divergent and diverse approach in the quantum and nature of adjustments applied...

Participants do not seem to have a standard approach to treating valuation adjustments relating to COVID-19.

On the one hand this could be because most participants are of the view that the set-back in business operations is temporary, rather than permanent.

On the other, this could be driven by a lack of market data that can be used as a reference point for a crisis of this nature.

The result is a divergent and diverse set of approaches in determining the quantum and nature of adjustments applied in recent valuations.

Given the circumstances created by the COVID-19 pandemic, determining the fair value of businesses has become increasingly complex and difficult.

FTI's team of valuation and deal advisory professionals have the experience, local knowledge and technical expertise to support our clients during the valuation process in this uncertain time.

# FTI corporate finance

## Comprehensive Services: Corporate Finance in EMEA

### EMA KEY SERVICE OFFERING

Transactions Advisory Services

Financial Restructuring	Contingency Planning & Insolvency	Valuation Services	Financial Due Diligence Services	M&A financial advisory Services	Operational Diligence & Transformation	Tax Advisory Services
<ul style="list-style-type: none"> <li>- Lead restructuring advisory</li> <li>- Independent business reviews</li> <li>- Financial modelling including debt capacity &amp; covenants</li> <li>- Stakeholder options analysis</li> <li>- Negotiation with key stakeholders</li> <li>- Review of business strategy &amp; market dynamics</li> <li>- Development of turn-around plans</li> <li>- Short term cash flow management &amp; reporting</li> <li>- CEO, COO, CFO &amp; CRO appointments</li> </ul>	<ul style="list-style-type: none"> <li>- Advising stakeholders on contingency planning to maximise returns</li> <li>- Carve outs of underperforming divisions &amp; business units</li> <li>- Pre-pack insolvencies to facilitate a restructuring</li> <li>- Debt to Equity transactions</li> <li>- Interaction with M&amp;A to facilitate accelerated disposal process</li> <li>- Trading administrations</li> <li>- Assessment of options to mitigate future pension funding obligations or restructuring of entire deficit</li> <li>- Forensic investigations of accounting issues</li> </ul>	<ul style="list-style-type: none"> <li>- Providing valuation analysis and/or opinions:                             <ul style="list-style-type: none"> <li>· Private equity portfolio valuations</li> <li>· M&amp;A transactions &amp; fundraisings</li> <li>· Dispute resolution/litigation support</li> <li>· Fairness opinions</li> <li>· Accounting purposes (e.g. purchase price allocation)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>- Buy &amp; sell side financial due diligence, incorporating:                             <ul style="list-style-type: none"> <li>· Quality of earnings review</li> <li>· Synergy analysis</li> <li>· Evaluation of projections</li> </ul> </li> <li>- Vendor assist services to prepare a business for sale &amp; then once underway assisting management through to conclusion</li> <li>- Financial modelling to support a transaction &amp; debt financing</li> </ul>	<ul style="list-style-type: none"> <li>- Execution &amp; project management of M&amp;A transactions</li> <li>- Ability to provide valuation, structuring &amp; negotiation support and co-ordination of diligence</li> <li>- Expertise in market testing, accelerated &amp; distressed M&amp;A</li> </ul>	<ul style="list-style-type: none"> <li>- Operational restructuring                             <ul style="list-style-type: none"> <li>· Business reorganisations</li> <li>· Cost reduction planning &amp; implementation</li> </ul> </li> <li>- Operational due diligence                             <ul style="list-style-type: none"> <li>· Assessment of operational capability &amp; risks</li> <li>· Synergy &amp; upside identification</li> </ul> </li> <li>- Development &amp; implementation of performance improvement plans - EBIT-DA &amp; cash flow</li> <li>- Post merger integration &amp; carve out services</li> <li>- Interim management</li> </ul>	<ul style="list-style-type: none"> <li>- Transaction advisory                             <ul style="list-style-type: none"> <li>· Sale / purchase advisory &amp; structuring</li> <li>· Tax due diligence</li> <li>· Restructuring plans</li> </ul> </li> <li>- International tax                             <ul style="list-style-type: none"> <li>· Cross border financing</li> <li>· Structuring</li> </ul> </li> <li>- Corporate tax compliance</li> <li>- Corporate tax reporting</li> <li>- Real Estate Advisory                             <ul style="list-style-type: none"> <li>· Fixed asset process improvement</li> <li>· Capex advice</li> <li>· Capital gains tax, SDLT</li> </ul> </li> <li>- Research &amp; development tax solutions</li> <li>- Transfer pricing &amp; tax valuations</li> <li>- Tax policy &amp; strategic communication to stakeholders</li> </ul>

# Our global reach

With offices in every major financial center and every corner of the globe, we successfully serve our clients wherever challenges and opportunities arise.



\* World Map indicates FTI Consulting presence.

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- Canada
- United States of America

## LATIN AMERICA

- Argentina
- Brazil
- Caribbean
- Colombia
- Mexico

## EMEA

- Belgium
- Finland
- France
- Germany
- Ireland
- Israel
- Qatar
- South Africa
- Spain
- United Arab Emirates
- United Kingdom

## ASIA

- China
- India
- Indonesia
- Japan
- Korea
- Malaysia
- Philippines 1
- Singapore

## AUSTRALASIA

- Australia

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