



FON Advisors, LLC
1775 Tysons Blvd, 5th Floor
McLean, Virginia 22102
Phone: +1.202.780.3820

Valuation in the Midst of a Pandemic

In a year dominated by the novel coronavirus, most aspects of everyday life have had to be reimagined. Figuring out the “new normal” in a constantly shifting landscape is part of the daily routine. During the global pause, as countries around the world instituted quarantine measures, deal making activity fell predictably in the first half. Numerous studies have documented the drop in global M&A activity, including a July 2020 alert from White & Case which cited a 53% and 32% decline in total value of and volume of deals announced in 1H 2020 compared to the prior year, respectively.¹

More recently, however, encouraging signs have begun to emerge. Flexibility and adaptability seem to be the key to the improved conditions for M&A. The Wall Street Journal noted that in the months since the onset of the pandemic, executives have learned to overcome initial fears that “due diligence, especially reviewing a target company’s books and assets, wouldn’t be doable in a remote world and that negotiations via Zoom and other virtual platforms wouldn’t succeed. Months later, global companies have overcome those concerns to strike deals worth more than \$1 trillion in the third quarter of this year, compared with \$762.67 billion in the prior-year period, Dealogic Ltd. said.”²

At FON, we have noticed similar trends in the Aerospace, Defense, & Government Services (ADG) market. As our Corporate Finance colleagues reported in the Q3 Market Insight newsletter, “ADG M&A deal volume in Q3 2020 decreased by 39% compared to Q3 2019; however, deal volume increased slightly, by 9% relative to Q2 2020, as the global economy continues to show gradual signs of a recovery. The aerospace sector has seen the most significant uptick in deal activity, seeing a 75% increase over Q2 2020 and only a 18% decline from Q3 2019. Social distancing measures and contact restrictions continue to add new complexities to the M&A process, from preparation through due diligence, and are extending process timelines.”³

The challenges of deal making does not necessarily end with the signing of the legal documents. Arguably, the real work begins post-closing and integration teams must complete their tasks while balancing the health and safety of its personnel. One post-closing task is the financial reporting process that often involves valuation professionals.

The valuation profession has adapted quickly to meet the challenging environment posed by COVID-19. The lessons of the 2007 financial crisis are still fresh in our minds and the best practices arising from that period continue to serve the profession well. Seasoned valuers, like

¹ Reiss, J. and Pryor, G. July 13, 2020, *Global M&A value collapses to record lows in Q2 2020*, White & Case
<<https://mergers.whitecase.com/highlights/global-ma-value-collapses-to-record-lows-in-q2-2020#!>>

² Trentmann, N. 2020, *CFOs Adjust to Remote Due Diligence as Deal Making Soars*, WSJ.com CFO Journal,
<<https://www.wsj.com/articles/cfos-adjust-to-remote-due-diligence-as-deal-making-soars-11606127401?page=1>>

³ FON Advisors November 5, 2020, *Corporate Finance Q3 2020 Newsletter*,
<<https://fonadvisors.com/news/insights/fon-corporate-finance-releases-q3-newsletter/>>



those at FON Valuation Services, are intimately familiar with the resources, techniques, and processes that must be undertaken to develop robust analyses that will meet the expectations of market participants and withstand the rigor of independent reviews.

Below are some observations from our team - based on learnings from the financial crisis, take-aways from recent engagements, and regular interactions with the global valuation, accounting, regulatory, and standard setting communities - that outline the challenges one should expect with valuation assignments during the pandemic-era.

Valuation Due Diligence

On-site management interviews have long been an integral part of the work programs of valuation professionals and are considered a best practice. These in-person discussions with representatives from the acquirer and the acquiree can often uncover information easily overlooked in less involved data exchanges. COVID-19 has greatly impacted on-site meetings in the valuation due diligence process, given travel restrictions, quarantines, and safety protocols. Valuers have increased usage of technology to successfully work around these issues, often conducting site inspections of real and personal property via interactive video feeds; thereby, helping clients reduce operational and financial risks, while meeting health and safety protocols and still realizing time and costs savings from reduced travel.

- Plant engineers are provided a detailed list of items to inspect and discuss, and conduct virtual video walk-through of the manufacturing process, from incoming raw materials, the manufacturing process, to shipping finished goods.
- Remote valuation teams will ask questions via text and audio links during these due diligence inspections, regarding verification of material assets, condition, metallurgy, capacity, and utilization.
- For even more remote locations, drone technology, satellite imagery, and database access are used to gather information.
- This process has been helped by the increasing sophistication of video meetings, with increasing bandwidth, breakout rooms, and virtual meeting options providing ever-increasing methods to effectively perform due diligence remotely.

In many respects, the valuation profession has been taking incremental steps towards these solutions over the past decade. Our work programs have been adapting to increased instances where client resources have been limited to accommodate extensive series of in-person meetings and intensive site visits. As a result, we believe it is of paramount importance to engage experienced valuation professionals that are well versed in how in-person visits are done effectively, have been involved in this transformation, understand the limitations of these alternatives, and possess the skills to identify and uncover potential issues to properly conduct virtual site inspections.



Valuation Analysis and the Audit Review Process

Given the uncertainty of the COVID-19 pandemic and its effects on business conditions, timing, and type of recovery, we've noticed that more weight is being placed on indications of value derived from the application of the discounted cash flow (DCF) analysis.

- Particular attention is paid to valuation dates, as the COVID-19 timeline of significant events is frequently measured against what was known or knowable regarding COVID-19 and impacts on operational and financial performance. The World Health Organization declared “a public health emergency of global concern” on January 30, 2020, but the Standard & Poor’s 500 Index Price continued to climb until February 19, 2020.
- Recent financial results are viewed as more of an "anomaly" rather than normal run rates. As such, the DCF analysis is being extended to explicitly model out the recovery period and demonstrate the eventual path to expected normalcy. That is, we are often extending the discrete period projected financial information, or PFI, (8-10+ years) before reaching the normalized period and estimating the terminal value.
- Consequently, there is significant focus on the numerator (PFI) in the DCF analyses. The uncertainties of forecasting cash flows, and often limited client staff availability to do multiple scenario analysis, has resulted in valuers assisting clients with the preparation of best case, likely, and worst-case scenarios. Auditors have been increasingly asking for this multiple-scenario analysis and valuers have been assisting in this process.
- The points of discussion on the denominator (discount rate) are related to the appropriate scaling and capturing of risks. One obvious pitfall is the likely mismatch of market yields (near or at historic lows) to the heightened market risks facing the subject business.
- Audit teams are scrutinizing every assumption employed in the development of the discrete period PFI and taken a concerted review of the terminal value.

Valuation professionals are keyed in on these issues and FON Valuation Services professionals are intimately involved in those conversations and deliberations. Recently, Raymond Moran, Managing Director, co-led the session on Inspection Logistics in a COVID World at the 2020 ASA International Conference with Ryan Kinahan, Managing Director at RK Valuation Advisory LLC, a member firm in the FON Global Valuation Alliance. In many respects, valuation professionals, whilst remaining objective and independent, can be an invaluable extension of the finance and operations integration teams. By tapping their considerable knowledge of industries and assets, experienced valuers can help clients effectively and efficiently navigate the challenges posed by the pandemic and meet the post-closing financial reporting obligations with thorough valuations communicated via thoughtfully written valuation reports.



Get in Touch

Have questions about this article or want to learn more about how FON Valuation Services can help your business? Contact our team:



Jouky Chang

Managing Director and Practice Leader



jchang@fonadvisors.com



+1.571.842.1800



Raymond Moran, ASA, MRICS

Managing Director



rmoran@fonadvisors.com



+1.571.842.1799