

Covid-19: Impact on Valuations

KPMG Deal Advisory

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COVID-19: Impact and Government measures

COVID-19: Impact

- The unparalleled and fast-evolving nature of the crisis has made it challenging for us to estimate the overall impact of COVID-19. With major economies on standstill, the outbreak has impacted our lives, economies and societies with growing risks of a global recession.
- Estimates indicate that most major economies may lose over 2% of the value of their GDP in 2020.
- The first quarter of 2020 witnessed one of the worst global equity collapses since the Great Depression, exacerbated by a 60% oil price slump.
- Lost revenue, disrupted supply chains as shutdowns and quarantine measures along with restricted movement and business activity are some major issues which are impacting businesses. This high levels of uncertainty and risk has caused major cash flow adjustments and tedious monitoring by management.

Measures taken by Kuwait Government

- The Government has responded with certain measures and announced stimulus packages that are aimed to assist various categories of businesses (individual owners, SMEs and private companies).
- Kuwait Banking Association (KBA) announced a moratorium period up to 6 months on bank loans including waiver of interest and charges.
- Additional financial support to individual owners, SMEs and private companies:
 - Providing loans for 2 to 3 years on concessional basis through joint financing from local banks and the Kuwait National Fund, including sharing of interest; and
- KBA agreed to offer a moratorium period up to 6 months on bank loans including waiver of interest and charges to alleviate financial stress of affected entities including retail clients (citizens and expats) and SMEs.
- The Central Bank of Kuwait announced various monetary adjustments including:
 - cut down of the discount rate to a historic low of 1.50%;
 - lowering of capital adequacy ratio from 13% to 10.5%;
 - lowering of risk weight for SMEs from 75% to 25%; and
 - Increasing limit of financing from 90% to 100%.



Sources:

1. Impact of the coronavirus pandemic on the global economy - Statistics & Facts – Erin Duffin, 28 April 2020
2. World Economic Forum: <https://www.weforum.org/agenda/2020/03/take-five-quarter-life-crisis/>
3. <https://www.kuna.net.kw/ArticleDetails.aspx?id=2881126&language=en>
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6. <https://www.cbk.gov.kw/en/cbk-news/announcements-and-press-releases/press-releases/2020/03/202003161122-cbk-cuts-its-discount-rate-by-1-from-250-to-150>

Valuation considerations

- Most companies/investors looking to value their investments now or later during the year might be in a predicament due to the unprecedented social, economic and business disruption.
- For many assets and liabilities, fair values may have changed significantly, reflecting changes in cash flow forecasts, higher uncertainty and elevated risks. Attention must be given to appropriately adjust inputs and assumptions to reflect changes in the underlying business outlook as well as market-driven assumptions. Changes to assumptions should be well documented with sound logical underpinnings.
- As one looks to measure fair value during these volatile times, KPMG is here to help and provide market insights.



01

Evaluate the subject business

Consider how the recent economic developments impact the business and how the company is positioned. Few factors to evaluate include:

- Business model, nature of revenue and product/service offerings;
- Ability to operate amidst lockdown, control costs and cash flows;
- Creditworthiness of customers;
- Inventory levels and exposure to impacted supply chains;
- Special strengths/weaknesses during pandemic/recession and ability to rebound;
- Liquidity, solvency and/or covenant concerns including access to additional capital; and
- Correlation to macroeconomic factors.

03

Adjust the discount rate

Discount rates should be adjusted for additional idiosyncratic risk to factor in the company's ability to achieve the updated forecasts. Some risk factors to consider:

- Measures taken to contain the effect of pandemic may lead to a significant reduction in risk free rates, while the market participants might expect a higher return for the underlying risk;
- **Commodity price risk.** Companies in extractive industries may be significantly affected by decreases in commodity prices;
- The uncertain economic environment has resulted in increasing **the credit risk and liquidity risk** for many companies; and
- Entities may face exacerbated or new risks that may not have previously existed.

02

Update the forecasted cash flows

- It is crucial to consider the specific drivers and assumptions to arrive at the adjusted cash flows.
- Businesses will have to assess if the disruption could result in permanent growth loss and/or the potential shape and tenor of recovery.

- In these unprecedented times, there are several unknowns and thus greater challenges in forecasting relative to a stable market.
- It would be appropriate to carry out scenario analysis and model adjustments to the cash flows to understand the value impact.

04

Consider investment time horizon

- Investment in private equity is typically characterized by a time horizon focused on long-term planning and return expectations.
- Need to assess how current markets could change the investment horizon, return requirements, exit valuation and assumptions.

- The time period is of great importance. Assessment should be done over a consistent time period, as a relative assessment of equity market performance may be flawed.

05

Use multiples with caution

- Adjusting equity values for unlisted stocks based on the market performance of listed comparable companies may underestimate the values of these companies.

- One should be prudent not to "double dip" with respect to valuation inputs – if performance metrics have been adjusted to take into account lower expected performance, an appropriate multiple should be applied rather than a multiple derived from comparable public companies whose results have not yet included lower expected performance.

Key takeaways

Frequency of valuations

- As new information and market situations pertaining to current crisis unfolds, a greater access to information will progressively enable more informed assessment.
- For investors who do not participate ordinarily in quarterly valuation cycles it will become important to take a more frequent approach to valuations until markets stabilize. We also advise all investors to initiate reforecasting and valuation processes earlier than usual.

Valuation range where necessary

- Valuation is usually presented as a range rather than a point estimate. Given current uncertainties and limited information, we consider that risk is currently skewed to the downside.
- One should consider where in the valuation range the point-estimate of value should sit, with the lower end perhaps better reflecting market participants' increased risk aversion.

Financial reporting and impairment consideration

- Impairment assessments will come under scrutiny in forthcoming audit/review processes. Evidence that the underlying financial information is prepared on a reasonable basis will be critical.
- Auditors will expect investors to demonstrate an appropriate balance of risk assessment between the discount rate and cash flows.

KPMG is here to help

In current times of increased market volatility, choosing an advisor requires a firm that has the technical skills and practical experience to provide sound and objective advice. KPMG's professionals provide that experience and knowledge along with a trusted name, and help market participants meet their valuation needs through this challenging time.

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