



VALUATIONS SURVEY 2021

Assessing the impact of COVID-19
related lockdown restrictions on
Valuations

MARCH 2022



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Introduction

The COVID-19 pandemic is an unprecedented global crisis, affecting human health and economic welfare across the globe. In response to COVID-19, the Government of South Africa implemented one of the most severe lockdowns on the continent otherwise, the human costs of the pandemic could have been even higher.

The government also enacted a significant relief package to counter the adverse impacts of the lockdown on economic activity, especially for low-wage workers and poorer households (Bhorat and Kohler, 2020¹).

7%

Despite these measures, the economy shrank by 7% in 2020, a decline which is amongst the highest recorded in Emerging economies.

4%

For 2021, the World Bank projects growth in the gross domestic product (GDP) of 4%²,

2.1%

followed by 2.1% in 2022

1.5%

and 1.5% in 2023.³

The global recovery is expected to help South Africa, especially given strong performance from its two key trading partners being, China and United States.

The severe economic impact caused by COVID-19 is not equally distributed across sectors and businesses. We observed a reduction in the volatility between different sectors around the total real GDP growth in 2021 compared to 2020. It is our observation, based on the outcomes of the survey, that valuations for these businesses have been impacted. (See Figure 1).

Sources:

¹ <https://www.brookings.edu/blog/africa-in-focus/2020/11/20/lockdown-economics-in-south-africa-social-assistance-and-the-ramaphosa-stimulus-package/>

² <https://www.worldbank.org/en/news/press-release/2022/01/11/global-recovery-economics-debt-commodity-inequality>

³ Building back better from COVID-19, with a special focus on jobs. Available at: <https://documents1.worldbank.org/curated/en/161431626102808095/pdf/Building-Back-Better-from-COVID-19-with-a-Special-Focus-on-Jobs.pdf> (Downloaded: 24 February 2022)

It is against this backdrop that our survey seeks to understand how business valuations have been impacted by COVID-19 related economic effects emanating from lockdown restrictions, new variants, anticipated global economy recoveries and, how these have been incorporated in valuations and whether conventional metrics and models needed to be adjusted.

The survey should be read as the views of only the

20 participants



that took part in the survey and should not be construed as the views of the entire sectors represented.

The participants are all from South Africa and are summarised by sector (See Figure 2).

“ 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 also to our Johannesburg based Valuations team that compiled the survey results. We look forward to your feedback.”

FTI CONSULTING

Corporate Finance
Valuations
Feb 2022

Figure 1. Real GDP growth rates

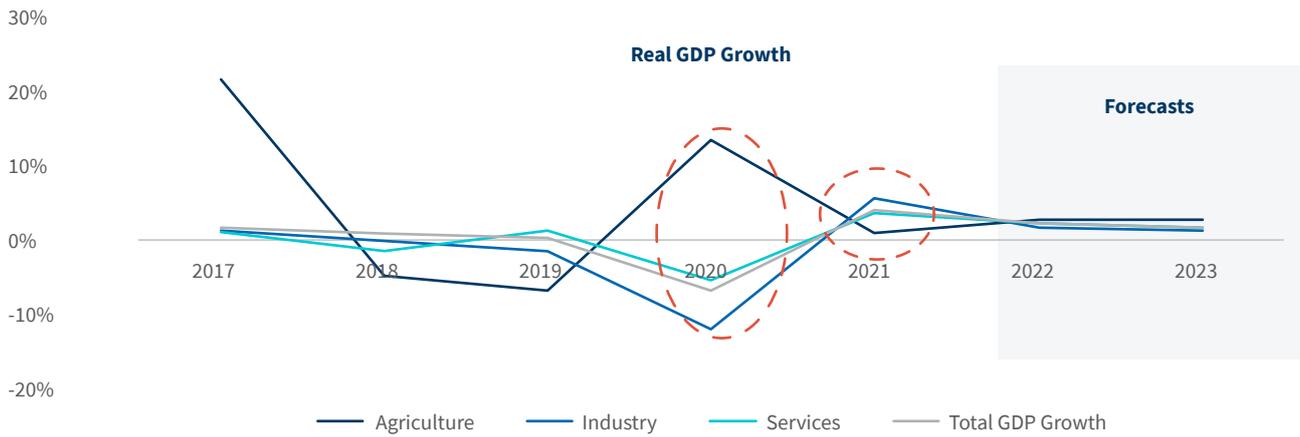
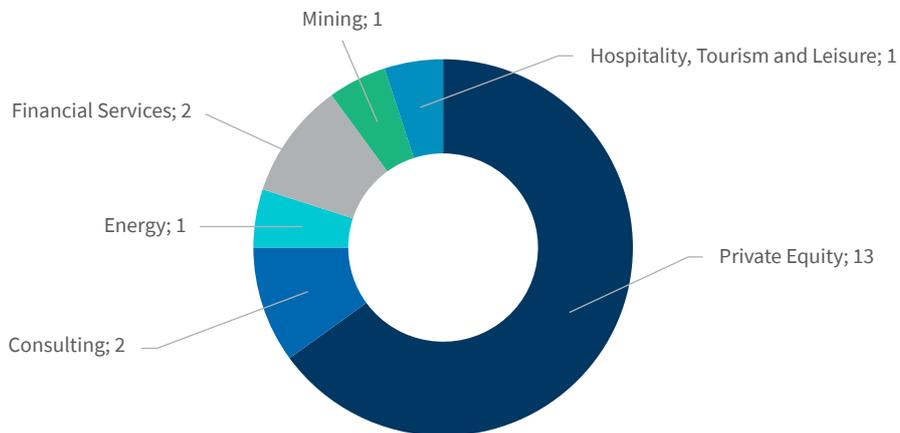


Figure 2. Participants by Industry breakdown



Sector Analysis

The global economic outlook offers an opportunity for South Africa. Favourable commodity prices and the global recovery support the recovery of the South African economy in 2021. The external sector could be a driver of growth after the pandemic at a time when domestic drivers remain weak. This would also support public finances and might smooth the adjustment needed to achieve the government’s fiscal targets.⁴ We asked participants for their views on the likely effects of the lockdown measures to the business sectors in which they operate and whether these effects are permanent or temporary in nature.

6 of the participants indicated that the impact of the COVID-19 pandemic would have an adverse impact on the business sectors in which they operate, while 6 of the participants indicated that the pandemic would have a favourable impact with the remaining 7 of the participants believing that the pandemic would have no impact on their respective business sectors.

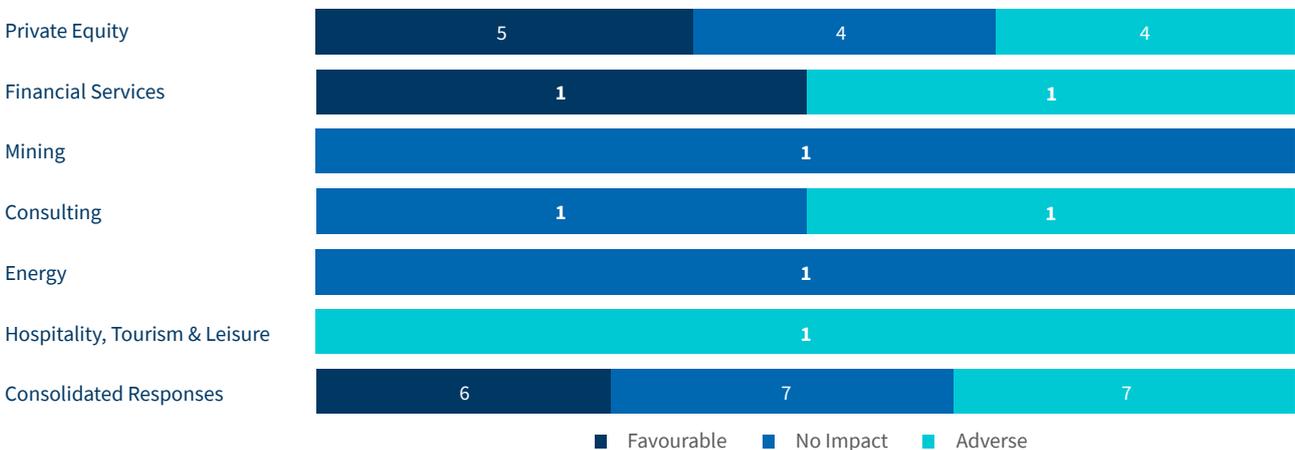
We further noted that participants who indicated that they had no impact of the COVID-19 pandemic, operate or have exposure in the following business sectors:

- Energy;
- Mining;
- Consulting; and
- some private equity participants.

The participants who indicated that the COVID-19 pandemic had favourable impact on the business sectors in which they had exposure were majority of the private equity participants who believe the world seems to be in recovery mode so they could experience growth in their investee companies that had stagnated growth in 2020.

“ Q1. "What do you expect would be the impact of the COVID-19 related lockdown restrictions on economic growth in your industry or in industries in which your portfolio companies operate for the next 12 to 24 months?"

Figure 3. Covid-19 Impact by industry

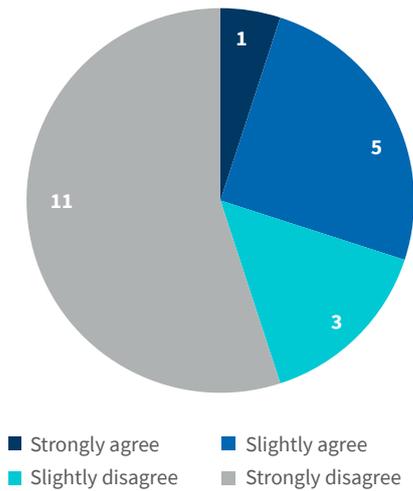


Source:

⁴ <https://www.fitchratings.com/research/sovereigns/south-africas-prospects-for-reaching-fiscal-goals-improve-21-09-2021>

“ Q2. "Do you perceive the current economic disruptions caused by COVID-19 related lockdown restrictions to be permanent in your industry or in industries in which your portfolio companies operate?"

Figure 4. Nature of Covid-19 related disruptions by industry



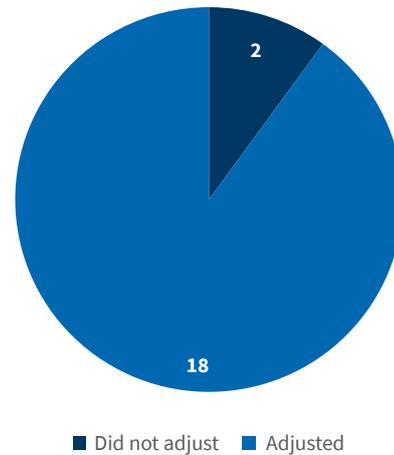
The majority of participants believe that economic disruptions caused by COVID-19 related restrictions would have a temporary impact in the business sectors in which they operate.

11 of the participants strongly believe that COVID-19 would have a temporary impact on the business sectors in which they operate, while 1 of the participants strongly believe that the impact would be permanent, 3 of the participants slightly disagree and remaining 5 slightly agree that the nature of the impact was permanent.

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

“ Q3. "How have you adjusted the business operating model or that of portfolio companies to adapt and cope with the challenges emanating from the COVID-19 related lockdown restrictions?"

Figure 5. Impact on the Business Operating Models



18 of the 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;
- Revenue streams diversification and
- Capital allocation optimisation.

Government Stimulus Packages

Government implemented certain stimulus packages⁵ to help ease the economic impact of lockdown restrictions in businesses facing financial challenges. The aim of these stimulus packages is to curb the risk of business failures which could have adverse social impact in the form of an increase in unemployment levels. We asked the participants about the type of industry wide stimulus packages and whether they received any in their respective companies.

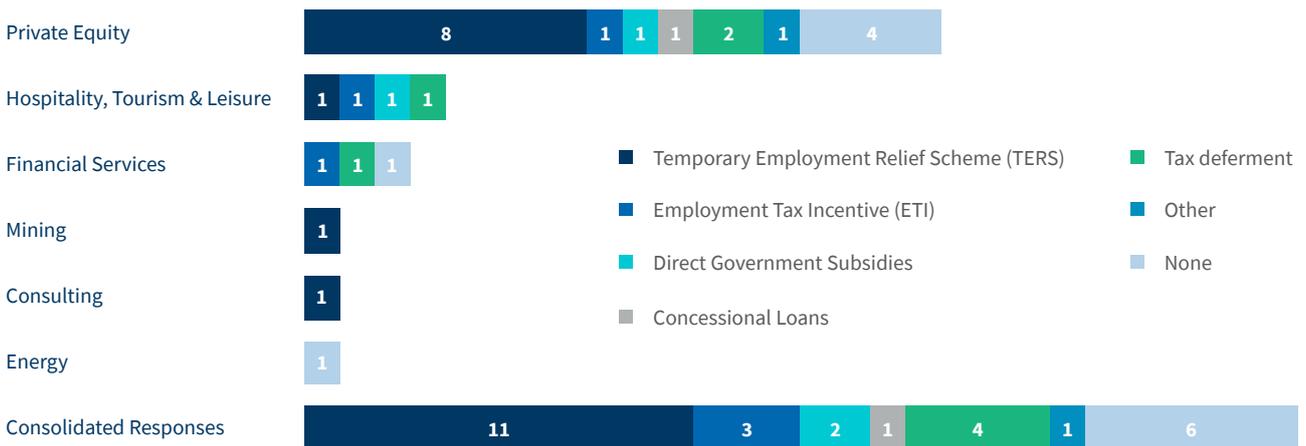
When asked about the type of economic stimulus packages provided by the South African Government to reduce the impact of the COVID-19 related lockdown restrictions⁶ on the South African economy which are available in the business sectors in which they operate, the participants answered as follows:

- Temporary Employment Relief Scheme (TERS);
- Employment Tax Incentive (ETI);
- Concessional loans;
- Tax deferment and;
- Other support.

The general indications from participants is that they were aware of the Temporary Employment Relief Scheme⁷. A considerable number of participants have indicated that they were not aware of economic stimulus package or have not received any economic stimulus package.

“ Q4: "What type of economic stimulus packages have the Government provided to the businesses in your sector?"

Figure 6. Economic stimulus packages received per Industry



Sources:

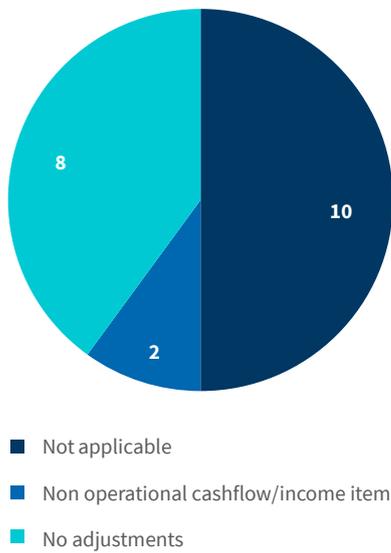
⁵ <https://www.parliament.gov.za/news/r500-billion-stimulus-package-one-largest-economic-response-packages-developing-world-tito-mboweni>

⁶ https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf

⁷ <https://www.gov.za/documents/disaster-management-act-directive-coronavirus-covid19-temporary-employee-employer-relief>

“ Q5: "Where economic stimulus packages have been received, how have you treated these in your valuation model?"

Figure 7. Impact of economic stimulus packages in valuations



A majority of the participants indicated that this question was not applicable as these participants did not have to include these economic stimulus packages⁸ in the recent cycle of valuations performed.

Participants who adjusted for the economic stimulus packages in their valuation treated them as once off items non-operational cash flow items. Other participants did not apply any adjustments with the stimulus packages received.



Source:

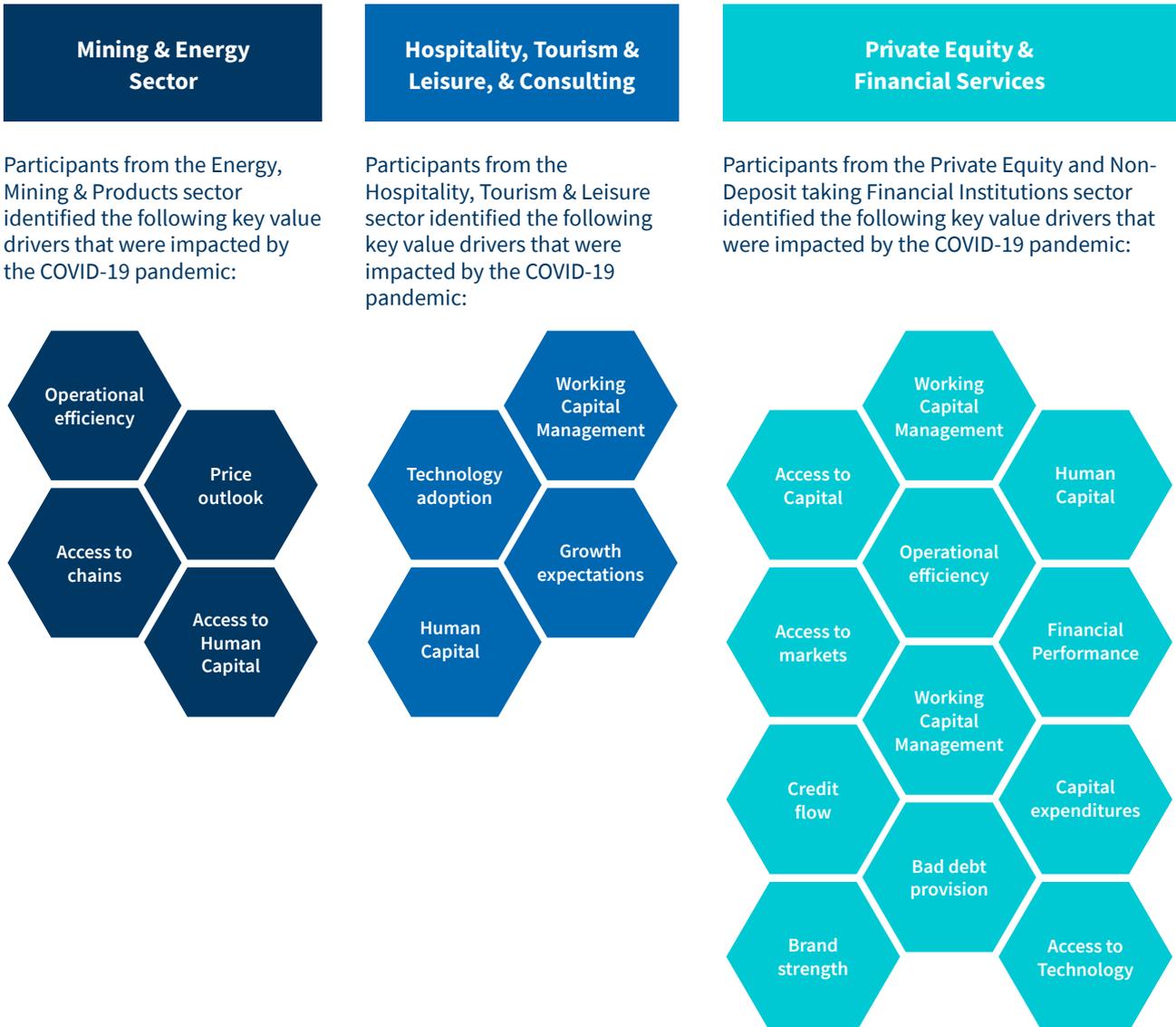
⁸ https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf

Value Drivers

When valuing businesses during this COVID-19 period, a prospective investor needs to understand the extent to which lockdown restrictions have impacted the key value drivers of the business. We solicited the views of the participants to ascertain which key value drivers were affected by COVID-19 related lockdown restrictions.

“ Q7: "Which key value drivers have been affected the most by COVID-19 related lockdown restrictions in your business?"

Figure 9. Covid-19 impacted Key Value Driver per Industry



Impairment Considerations

COVID-19 lockdown restrictions has resulted in significant business disruptions with mixed effects on different sectors and businesses as shown by the responses to the sector analysis section. We wanted to find out if the survey participants expected impairments in the financial years ending in 2021 and what is the likelihood of impairments in the financial years ending in 2022.

6 of the participants have or were expecting significant impairments on their investments. 6 of the participants have or were expecting no more than usual impairments on their investments.

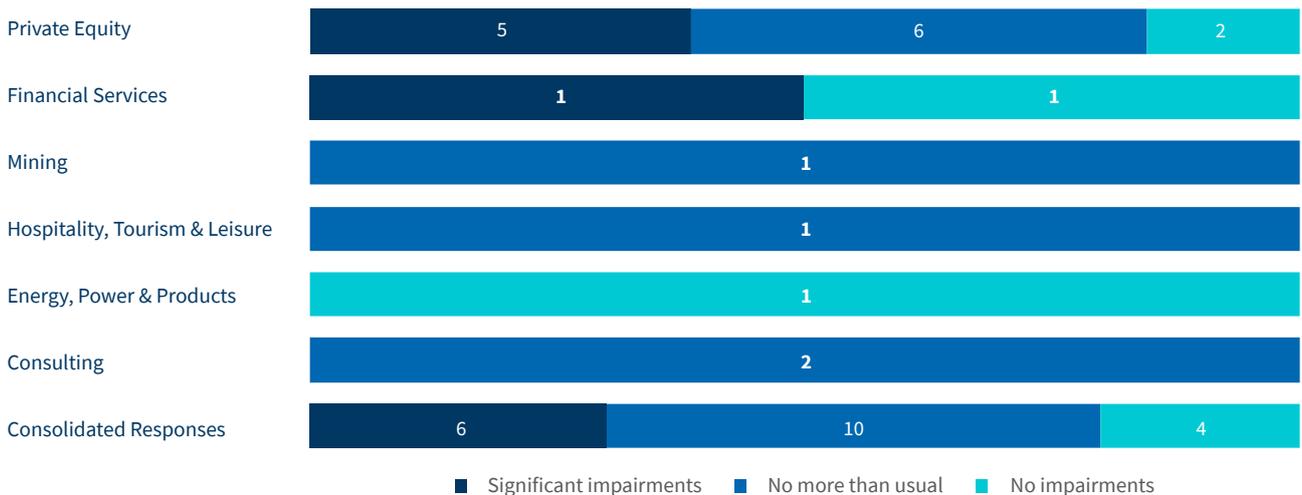
Amongst the participants surveyed, some were not expecting impairments in the following sectors for financial years ending during 2021:

- Private Equity
- Energy



“ Q8: "Has the impact of COVID-19 related lockdown restrictions resulted in impairments for financial year periods ending in the current 2021 calendar year?"

Figure 10. Impairment impacts per level in FY21



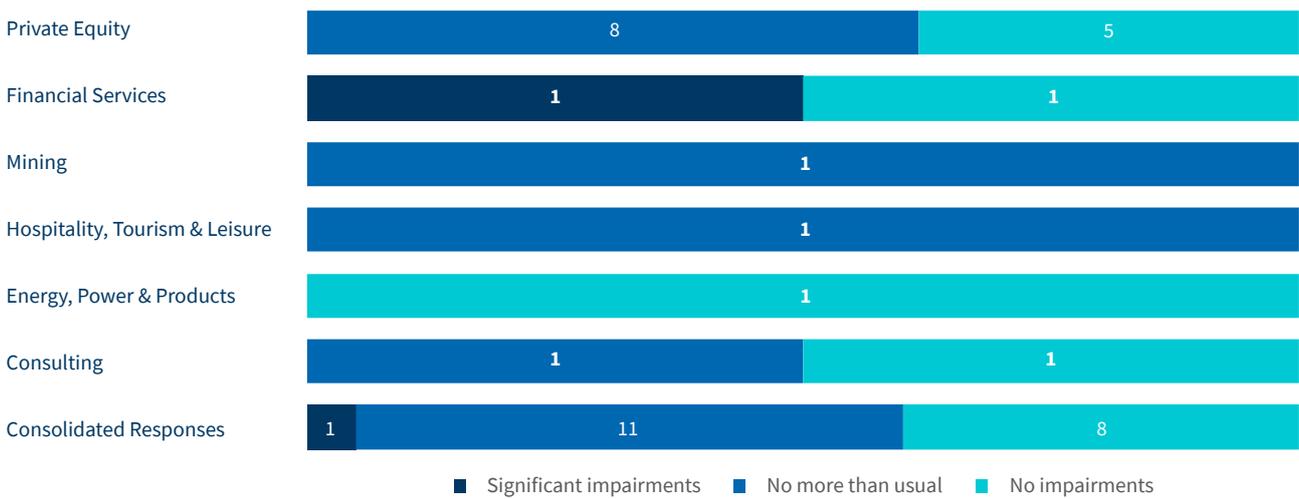
“ Q9: "Do you expect the impact of COVID-19 related lockdown restrictions to result in impairments for financial year periods ending during 2022?"

1 of the participants have or were expecting significant impairments on their investments. 11 of the participants have or were expecting no more than usual impairments on their investments.

Amongst the participants surveyed, some were not expecting impairments in the following sectors for financial years ending during 2022:

- Private Equity
- Energy

Figure 11. Impairment impacts per level in FY22



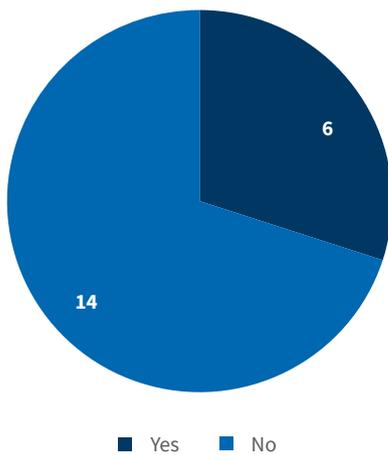
Valuation Approach

There are various valuation methodologies that can be used to value businesses. The aim of this section is to highlight whether there were changes to the valuation approaches used in business enterprise valuations resulting from the effects of COVID-19 restrictions. We were interested in determining the preferred valuation approach or adjustments applied to account for the effects of the COVID-19 lockdown restrictions.

14 of participants indicated that the valuation approach previously used is still relevant to capture the value of the business, whilst 4 believed it is no longer relevant.

“ Q10: "Is the valuation approach previously used still relevant to best capture the value of the business?"

Figure 12. Impact on the previously applied valuation methodology





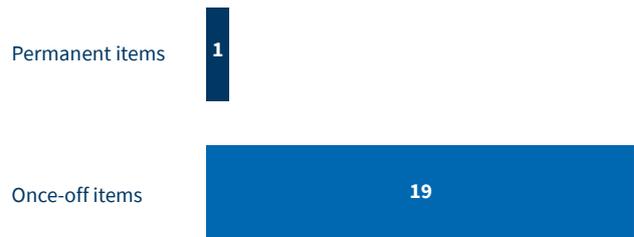
Valuation Adjustments and Disclosures

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 restrictions⁹. We wanted to understand how these adjustments impact value and where they have been applied.



“ Q11: "How have you treated financial effects emanating from the COVID-19 related lockdown restrictions when calculating maintainable earnings; are they considered as once-off or as permanent items?"

Figure 13. : Covid-19 related financial adjustments on maintainable earnings



We noted that the consideration of whether the financial effects of COVID-19 are once-off or permanent is driven by the nature of resulting impact on business activities. Where the impact is considered to be permanent, the financial effects are treated as part of ongoing operations. However, where the COVID-19 impact is considered temporary, the resulting financial effects are treated as once-off items.

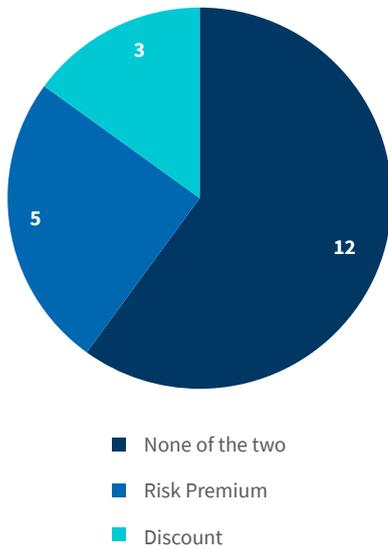
We also noted that for some businesses the COVID-19 related financial effects can be once-off on certain activities but, to the extent it is perceived to be the “new normal” or permanent, the resulting financial effects were treated as permanent. This has particularly been the case for businesses with a portfolio of diverse operations.

Source:

⁹ <https://www.ifpri.org/publication/impact-covid-19-south-african-economy-initial-analysis>

“ Q12: "Did you apply a risk premium or discount specific to COVID-19 related lockdown restrictions in valuations performed in the current financial year?"

Figure 14. Covid-19 related valuation adjustments



The majority of the participants have not applied a risk premium or discount specific to COVID-19 related lockdown restrictions, with 12 of the participants indicating that no adjustments were made, with 5 applying a risk premium and 3 applying a discount to account for the financial impact of the COVID-19 pandemic

“ Q13: "In instances where a premium or discount has been applied, which valuation input was adjusted?"

Figure 15. Adjusted valuation inputs



The participants who have applied a risk premium or discount specific to COVID-19 related lockdown restrictions, applied the risk premium or discount in forecast cash flows, discount rate, and maintainable earnings as set out in the diagram above.

The COVID-19 impact adjustments have been the most debated input in a valuation calculation. We asked participants to indicate the premiums or discounts applied to take into account the impact of COVID-19.

“ Q14: "What is the quantum of the premium or discount applied?"



Figure 16. Valuation inputs adjustment ranges

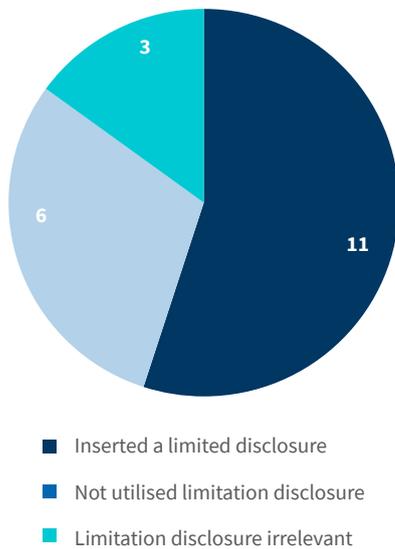
Participants responses		No of Participants	Quantam of premium /discount
Discount applied on cashflows forecast		2	3%-20%
Discount applied on earnings		3	10% -50%
Premium applied on discount rate	$\$/R$	2	10% - 15%
No discount or premium applied	-	12	0%
Applied discount/premium – no details provided	-	1	5% - 15%
Discount on enterprise value		0	-
Discount on the equity value		0	-

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

We noted that 11 of the participants inserted a limitation disclosure in their valuation presentations relating to the uncertainty emanating from the impact of COVID-19, while 6 of the participants have not utilised limitation disclosure and the remaining 3 considered the limitation disclosure irrelevant/not applicable.

“ Q15: "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?"

Figure 17. Covid-19 related disclosures



Conclusion

The economic effects of COVID-19 related lockdown restrictions have been severe to most businesses in various sectors of the economy, thus a number of participants anticipate there will be impairments linked to this pandemic in the immediate financial year ends albeit the increasing trend that these impairments are becoming normalised and no longer COVID-19 related.

Management requires guidance on how best to navigate through uncertainty to ensure the key business drivers are fairly reflected in the value of the business cognisant of the dynamic operating environment affected by government regulations and the volatile economic climate and the potential downside risks that could come with vaccine-resistant strains of the virus.



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

Certain sectors have proved to be more resilient as evidenced by business that have either thrived or maintained their pre-COVID-19 operational capacity with minimal impact.

Our observations of the participants views is that there seem to be no standard approach of treating the valuation adjustments relating to COVID-19 as well as application of similar discount or premium to factor risks associated with COVID-19. This could partly be attributable to the fact that most participant's are of the view that the set-back in business operations is temporary rather than permanent. The fact that there is no recent precedent market data that can be used as a point of reference for an economic and health challenge of this nature could have also added to divergent and diverse approaches in the quantum and nature of adjustments applied for recent valuations performed by the participants. This could also be influenced by the fact that market data has repriced out COVID-19 as shown by strong capital markets rebound, lower risk-free rates and economic recovery.



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