

SPOTLIGHT ON COVID-19



HOULIHAN LOKEY

Corporate Valuations and Goodwill Impairment

The Impact of COVID-19 on Corporate Valuations and Goodwill Impairment

With the quarterly earnings season upon us, many companies face the prospect of goodwill impairment due to COVID-19. In preparing for this and subsequent quarters' potential impairment testing, there are a number of key considerations we've learned through our discussions with various market participants:

Market Multiples

- Public market multiples might not be entirely relevant, either now or before COVID-19 (when the market was at an all-time high).
- LTM multiples calculated off historical earnings may no longer be relevant, as those earnings levels might not be achievable now.
- Forward multiples may be difficult to determine, given that earnings estimates might not yet be revised by filers.

Discount Rates

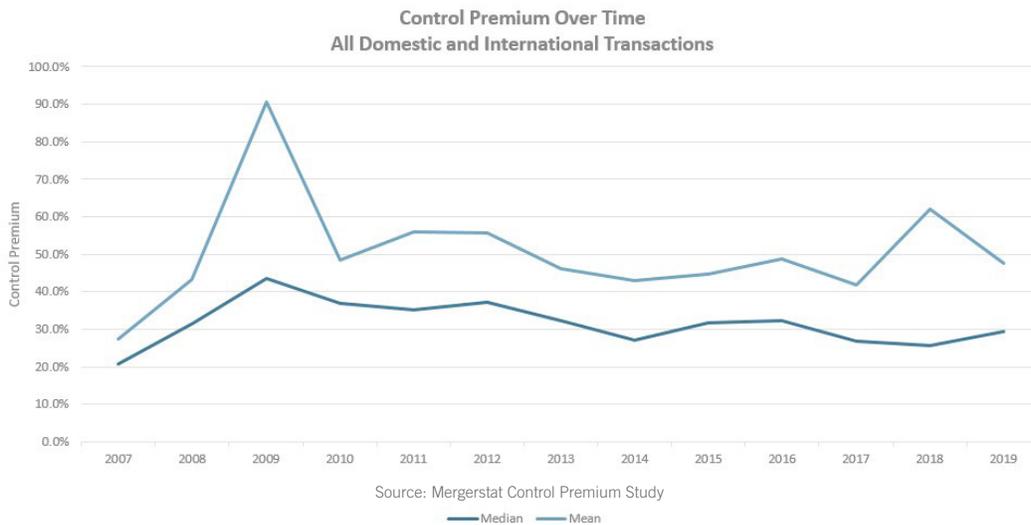
- Historical capital structures may no longer be reasonable in light of depressed equity prices overweighting the value of debt and thus understating the discount rate.
- Cost of debt needs to consider increasing incidence of downgrades and is thus likely to be understated.
- Risk-free rates have decreased, but uncertainty and volatility have increased; companies should consider the additional risk and not just the mechanics of a lower risk-free rate.
- The equity risk premium used in many calculations should trend higher, given the increasing volatility in the markets.

Market Capitalization Reconciliation

- Reconciliation of reporting unit values to the market capitalization generally includes the application of an implied control premium.
- The size of the implied control premium needs to be considered; in the current environment, premiums have likely increased, but by how much?
- Previous bear markets and financial crises can lend support to how one considers the current level of control premiums (please see graphic below).
- In 2008–2009, the SEC commented that a premium is dependent on facts and circumstances, which will presumably hold true in this environment as well.
- The higher the control premium applied, the more supporting evidence generally required.
- Recent trends in market capitalization may be more applicable than a single day's pricing.

Houlihan Lokey is committed to helping companies navigate the uncertainties inherent in financial reporting and valuations during this time.

Mergerstat Control Premium Study Data Over Time



Please let us know if we can be helpful in anyway. We would be happy to discuss what we are learning every day from market participants. We can also give you our specific view on market multiples, discount rates, and control premiums for your particular industry, as well as help you frame your disclosures.

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