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Certified Public Accountants and Consultants

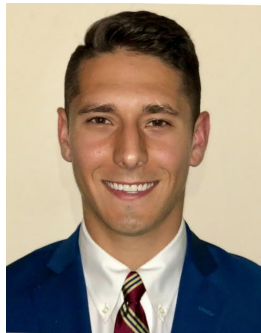
*Valuation in the Current Environment:
The COVID-19 Saga Continues*

WELCOME! OUR PROGRAM WILL BEGIN SHORTLY



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WELCOME TO THE TEAM, ETHAN!





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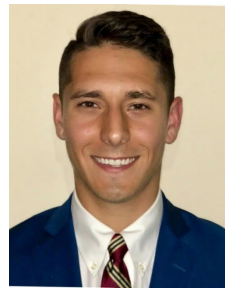


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Valuation in the Current Environment: The COVID-19 Saga Continues

INTRODUCTION



Valuation in the Current Environment

INTRODUCTION

- ***Continued Impact of COVID-19***
 - Today's overriding topic of discussion and the primary driver of the economy's current economic woes
 - Valuators must understand the impact on value of
 - Government stimulus
 - Current administration and potential tax law changes



Valuation in the Current Environment

INTRODUCTION

- ***A Brief Refresher on Value and Valuation***
 - All value is “forward looking”
 - Valuators must focus on what is “known or knowable” at the date of valuation
 - Care should be taken to ensure that procedures and processes are in conformity with professional standards to ensure an appropriate outcome



Valuation in the Current Environment

INTRODUCTION

- ***A Brief Refresher on Value and Valuation***
 - Valuation is fundamentally risk assessment and measurement
 - Risk in business valuation is contemplated and considered in three primary elements of the business valuation process:
 - Expected future economic benefits (free cash flows)
 - The risk rate associated with the expected receipt and timing of future economic benefits
 - Specific equity interest attribute discounts/premiums



Valuation in the Current Environment

INTRODUCTION

- ***Impact of COVID-19***
 - Three-steps to assessing value in the COVID-19 world
 1. Develop an intimate understanding of the economic effects of the pandemic on the subject company in 2020
 2. Develop an understanding of the economic effects of the pandemic on the subject company in the recovery period, which can vary
 3. Develop an understanding of that period in the future when constant growth and normalcy returns for the subject company's operations (terminal year)



Valuation in the Current Environment

INTRODUCTION

- ***Impact of COVID-19***
 - Applying the three-step approach will require some careful prognostication on the part of business valuers
 - Understanding recovery in conjunction with the outlook for both industry and economy
 - The challenge will be to develop a strong understanding of the economic effects of the pandemic currently and into the future
 - Ultimate roll out of the vaccine or the potential of a second wave of the virus in 2021 or later



Valuation in the Current Environment

TOPICS TO BE COVERED IN THIS PRESENTATION

- *Industry Update*
- *Economic Outlook and Impact on Valuation*
- *Public Market Performance and Impact on Valuation*
- *Date of Valuation Considerations*
- *Valuation Methodologies*
- *Opportunities*



Valuation in the Current Environment: The COVID-19 Saga Continues

INDUSTRY UPDATE





Valuation in the Current Environment

INDUSTRY UPDATE

- *In some industry sectors, more than a quarter of small businesses may close permanently*
 - High financial risk, less resilience
- *Both public health regulations and consumer behavior shape the vulnerability of subsectors in the same broader industry*
 - Disparity reflects differences in which businesses were classified as essential



Valuation in the Current Environment

INDUSTRY UPDATE

- *COVID-19 has crushed certain industries*
 - Those depending on movement of people
- *Some industries have remained unscathed*
 - Those depending on movement of information
- *Performance of core industries consequently impacts supporting industries*



Valuation in the Current Environment

INDUSTRY UPDATE

- ***Industries most vulnerable to COVID-19***
 - Leisure (arts, entertainment and recreation)
 - Hospitality (accommodation and food service)
 - Labor-intensive health care and social assistance
 - Educational services
 - Retail



Valuation in the Current Environment

INDUSTRY UPDATE

- ***Industries most resilient during COVID-19***
 - Technology
 - Non-store retailers (online shopping)
 - Government



Valuation in the Current Environment

INDUSTRY UPDATE

- *Focus of prudent business owners*
 - Stabilization
 - Reconfiguration
 - Recovery

- *As the crisis unfolds, businesses are preparing for what is coming next – the “new normal”*



Valuation in the Current Environment: The COVID-19 Saga Continues

CURRENT ECONOMIC OUTLOOK





Valuation in the Current Environment

ECONOMIC OUTLOOK

▪ *Regional Economic Outlook*

- District economy starting to gain momentum
- Customer demand is up, reflects declining COVID-19 cases and the effects of the stimulus
- Construction, retail, and manufacturing firms reported delays from suppliers and COVID-related employee issues caused setbacks
- Stronger gains in second half of 2021 as vaccine rollout continues



Valuation in the Current Environment

ECONOMIC OUTLOOK

▪ *Federal Reserve – Current Economic Conditions Commentary*

- Most districts reported expansion in business activity from January to mid-February
- Leisure and hospitality sector continues to be hit hard by the pandemic
- Manufacturing saw a slight uptick from the prior period, despite supply chain interruptions
- Low mortgage rates continue to cause an increase in demand for housing



Valuation in the Current Environment

ECONOMIC OUTLOOK

- ***Federal Open Market Committee – Monetary Policy Commentary***
 - Inflation currently sits below 2 percent
 - Virus controls our path to economic recovery
 - Pandemic poses risk to economic outlook, including economic activity, employment, and inflation



Valuation in the Current Environment

ECONOMIC OUTLOOK

- ***Current Employment Conditions***
 - February 2021 unemployment = 6.2 percent
 - Slight drop from January 2021
 - Total nonfarm payroll employment increased by 379,000, with gains occurring in the leisure and hospitality, healthcare and social assistance, retail trade and manufacturing industries



Valuation in the Current Environment

ECONOMIC OUTLOOK

- **Current Employment Conditions, continued**
 - Unemployed persons who were on temporary layoff decreased by 517,000 in February 2021, to 2.2 million
 - 13.3 million persons reported they were unable to work because their employers closed due to the pandemic in February 2021
 - Down from 14.8 million in January 2021



Valuation in the Current Environment

ECONOMIC OUTLOOK

- **Historical Unemployment Rates**

UNITED STATES UNEMPLOYMENT RATE												
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
2017	4.8%	4.7%	4.5%	4.4%	4.3%	4.3%	4.3%	4.4%	4.2%	4.1%	4.1%	4.1%
2018	4.1%	4.1%	4.0%	3.9%	3.8%	4.0%	3.9%	3.8%	3.7%	3.8%	3.7%	3.9%
2019	4.0%	3.8%	3.8%	3.6%	3.6%	3.7%	3.7%	3.7%	3.5%	3.6%	3.5%	3.5%
2020	3.6%	3.5%	4.4%	14.7%	13.3%	11.1%	10.2%	8.4%	7.8%	6.9%	6.7%	6.7%
2021	6.3%	6.2%										

Source: YCharts.com



Valuation in the Current Environment

ECONOMIC OUTLOOK

- **Current Interest Rates and Market Implied Inflation Compensation**

MARKET IMPLIED INFLATION					
	<u>5 Year</u>	<u>7 Year</u>	<u>10 Year</u>	<u>20 Year</u>	<u>30 Year</u>
Nominal Treasuries	0.86%	1.35%	1.71%	2.36%	2.45%
Treasury Inflation Protected Securities	-1.64%	-1.06%	-0.56%	-0.03%	0.21%
Market Implied Inflation (Difference)	<u>2.50%</u>	<u>2.41%</u>	<u>2.27%</u>	<u>2.39%</u>	<u>2.24%</u>

Source: Board of Governors of the Federal Reserve System, Data as of 03/18/2021



Valuation in the Current Environment

ECONOMIC OUTLOOK

- **Gross Domestic Product (GDP) and Inflation**

– BEA projects 4.1% increase in Real GDP, compared to 33.4% increase in previous quarter

FEDERAL RESERVE ECONOMIC PROJECTIONS (MEDIAN)				
	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>Longer-Run</u>
Change in Real GDP	6.5%	3.3%	2.2%	1.8%
Unemployment Rate	4.5%	3.9%	3.5%	4.0%
PCE Inflation	2.4%	2.0%	2.1%	2.0%
Federal Funds	0.1%	0.1%	0.1%	2.5%

Source: Board of Governors of the Federal Reserve System, March 17, 2021



Valuation in the Current Environment

ECONOMIC OUTLOOK

- ***Additional Sources***
 - Industrial Production and Manufacturing
 - Consumer Confidence
 - Housing and Construction



Valuation in the Current Environment

ECONOMIC OUTLOOK

- ***Interest Rates***
 - In September 2020, Federal Reserve pledged to keep interest rates near zero until 2023
 - Prime rate currently sits at 3.25 percent
 - Measured 4.75 percent pre-pandemic



Valuation in the Current Environment

ECONOMIC OUTLOOK

- **Conclusion**
 - Economic activity still below pre-pandemic levels
 - As of today, economy still at the mercy of the virus
 - Vaccine rollout will be crucial in restoring economy



Valuation in the Current Environment: The COVID-19 Saga Continues

PUBLIC MARKET PERFORMANCE

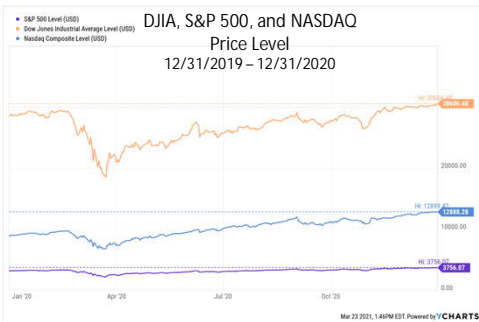




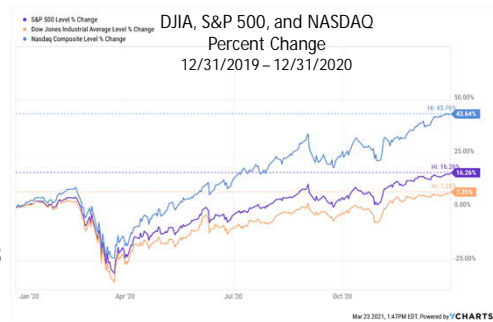
Valuation in the Current Environment

TRANSITIONING TO 2021

- The DJIA, S&P 500, and the Nasdaq all end 2020 at record highs



As of 12/31/2020
 DJIA: \$30,606.48
 +7.25%
 S&P 500: \$3,756.07
 +16.26%
 NASDAQ: \$12,888.28
 +43.64%



Valuation in the Current Environment

YEAR-TO-DATE 2021

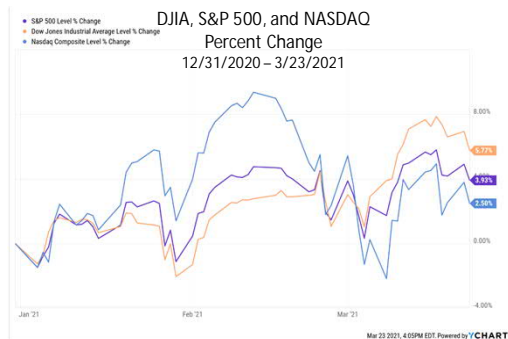
- Market Indices continue to grow from 2020 record highs

As of 12/31/2020

DJIA: \$30,606.48

S&P 500: \$3,756.07

NASDAQ: \$12,888.28



As of 3/23/2021

DJIA: \$32,373.80 +5.77%

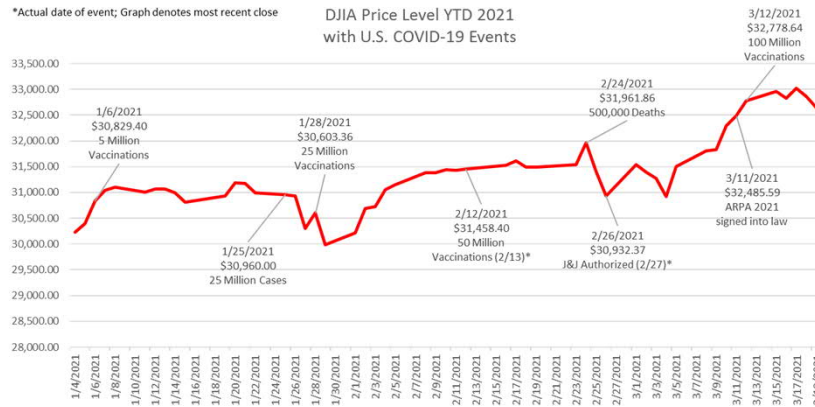
S&P 500: \$3,904.53 +3.93%

NASDAQ: \$13,212.63 +2.50%



Valuation in the Current Environment

KEY COVID-19 EVENTS 2021



Valuation in the Current Environment

MIDDLE MARKET ACTIVITY

- **Significant decrease in # of middle market deals in 2Q20**
 - Dramatic recovery to end 2020
 - TEV/EBITDA multiples have remained between 6.7x and 7.4x from 2019 to 2020

GF Data* Middle Market
2019 - 2020

All Transactions	1Q 19	2Q 19	3Q 19	4Q 19	1Q 20	2Q 20	3Q 20	4Q 20
# of Deals	92	81	63	72	92	35	53	117
TEV/EBITDA	6.8x	7.2x	7.3x	7.1x	7.4x	7.3x	6.7x	7.0x
Total Debt/EBITDA	4.1x	4.0x	3.9x	3.9x	3.9x	3.3x	3.7x	3.8x
Senior Debt/EBITDA	3.5x	3.2x	2.9x	3.2x	3.4x	2.8x	2.7x	3.2x

*GF Data Spring 2021 Report



Valuation in the Current Environment

MARKET PERFORMANCE

- **Conclusion**
 - Although the three major indices are trading at highs, we need to be cautious
 - Need to look at other economic indicators to get the clearest picture
 - Middle Market Activity recovered to end 2020
 - Expect first quarter of 2021 to taper off in terms of number of deals



Valuation in the Current Environment: The COVID-19 Saga Continues

DATE OF VALUATION CONSIDERATIONS





Valuation in the Current Environment

DATE OF VALUATION

- ***Critical element of any valuation project***
 - What is “known or knowable” at effective date
 - Most valuers believe that the impact of COVID-19 must be included in valuations with dates beginning in late February 2020
 - What about subsequent events?
 - How are they considered, if at all?
 - When and how should they be disclosed?



Valuation in the Current Environment

DATE OF VALUATION

- ***Impact of COVID-19 on Date of Valuation***
 - Valuation is a process of risk assessment at any date of valuation
 - Valuation is date (point-in-time) specific
 - A 2020 date of valuation carries with it many complex and difficult judgment(s) by the valuator with respect to what may have been “known or knowable” at a particular date



Valuation in the Current Environment

DATE OF VALUATION

- *Impact of COVID-19 on Date of Valuation*
 - Earlier dates of valuation in 2020 corresponding with specific federal and state mandates shutting down parts of the economy would seem to have the greatest risk
 - A date of valuation after the Presidential election may further impact value due to the effect of the election results on the public markets, economy, and specific industries



Valuation in the Current Environment: The COVID-19 Saga Continues

VALUATION METHODOLOGIES





Valuation in the Current Environment

INCOME APPROACH

- *Based on economic principle of anticipation*
- *Income approach is the simplest way to determine future economic benefit streams as well as to assess associated risk*
- *Past performance has little or no relevance – especially now*
- *How relevant are past results to future expectations*



Valuation in the Current Environment

INCOME APPROACH

- *Primary drivers for calculating value:*
 - Numerator: Future expected economic benefit stream
 - Denominator: Risk associated with realization of future economic benefits
- *Perhaps the most direct means of incorporating forward-looking valuation concepts into the estimation of value*



Valuation in the Current Environment

INCOME APPROACH

- ***Two primary methodologies***
 1. Discounted future economic benefit (cash flow) method (DCF)
 - Series of calculations over a discrete period with terminal value
 2. Capitalized future economic benefit method (CCF)
 - Single calculation with growth presumed to be constant
- ***Both methods are based on forward-looking inputs***



Valuation in the Current Environment

INCOME APPROACH – METHOD SELECTION

- ***DCF versus CCF***
 - Method should be selected based upon growth expectations of the benefit stream
 - Use of a single period CCF poses a variety of issues for the valuator in a COVID-19 environment
 - Subject company's history may have no relevance to the future expectations, at least in the short-term to mid-term time period
 - In such a case, the capitalization rate has to incorporate a growth rate that facilitates a weighted average growth rate over time to get to an appropriate determination of value



Valuation in the Current Environment

INCOME APPROACH – METHOD SELECTION

- ***DCF versus CCF***
 - The best solution, albeit it difficult in application, is to use a multi-period DCF model to allow for the use of a discrete forecast period until operations and financial results return to as somewhat normal level
 - The terminal value, then, can capture growth into the future in a more conventional market
 - DCF more accurately calculates the value of a business which expects to experience non-linear growth in its benefit stream



Valuation in the Current Environment

INCOME APPROACH – NUMERATOR

- ***Future revenue and expenses will, in many cases, experience fluctuations from historical results***
 - Increased emphasis will be placed on Management-prepared forecasts
 - Must assess the impact of the pandemic on both near-term and long-term forecasts
 - It is incumbent upon the valuator to do more than just accept Management's forecasts carte blanche
 - Confidence in Forecasting today vs. Forecasting in 2020



Valuation in the Current Environment

INCOME APPROACH – NUMERATOR

- ***The preference of many commentators, including a number of judicial decisions, is that risk is best handled in the development of the future expected economic benefit streams***
 - The consideration of risk in the forecasts generally requires more careful consideration by the valuers and future expected economic benefit stream (generally projected free cash flows)
 - The Courts (in particular) and other government entities (the IRS) are not as confident in subjective discount rate premiums and discounts



Valuation in the Current Environment

INCOME APPROACH – NUMERATOR

- ***Current Issues and Considerations with the Numerator:***
 - How has demand changed and is it temporary or permanent?
 - Has the Company received any assistance from government supplied programs?
 - Does the financial forecast consider all impacts of COVID pandemic?
 - What information should be incorporated – what was known or knowable?
 - What will economic recovery look like and how will it impact the future cash flows?



Valuation in the Current Environment

INCOME APPROACH – DENOMINATOR

- *The discount rate*
 - Selected to align the relative risk associated with an investment in the subject entity compared to alternative investment options and their associated rates of return
 - The discount rate reflects the risk of attaining the forecasted future economic benefit streams in the amount forecasted and at the times expected
 - Must consider the factors included in the forecasts and not “overlap”



Valuation in the Current Environment

INCOME APPROACH – DENOMINATOR

- *Under the Build Up Model*

$$k_e = R_f + ERP + R_s + CSRP$$

where,

k_e = equity cost of capital

R_f = risk-free rate

ERP = equity risk premium

R_s = size premium

CSRP = company-specific risk premium



Valuation in the Current Environment

INCOME APPROACH – DENOMINATOR

- ***Current Issues with the Denominator***
 - Determining level of risk associated with benefit stream
 - Current rates/flight to quality
 - Focus should be on long-term required rate of return
 - How sensitive is 'answer' to changes in discount rate



Valuation in the Current Environment

INCOME APPROACH – DENOMINATOR

- ***Current Issues with the Denominator***
 - Most valuers are adding additional risk into the company-specific risk premium
 - Subjective Input to Discount Rate Calculation
 - During uncertain times, may be more than just company-specific
 - COVID risk premium? Must match benefit stream



Valuation in the Current Environment

INCOME APPROACH

- *Application of the income approach for dates of valuation post-COVID-19 has been, and will continue to be, challenging for some time into the future*
- *Changes occurring regionally, nationally and globally are material and fluid*
- *While valuers may find that adjustments need to be made to both the numerator and denominator in the income approach calculation, care should be taken to avoid duplication*



Valuation in the Current Environment

MARKET APPROACH

- *Predicated on the concept of comparability*
- *Basic equation underlying the market approach*

$$\text{Value} = [(\text{Price/Parameter})_{\text{comp}} * \text{Parameter}_{\text{subject}}] - \text{Debt}_{\text{subject}}$$

- *Primary methods under the market approach:*
 - Guideline public company method (GPCM)
 - Guideline completed transaction method (GCTM)



Valuation in the Current Environment

MARKET APPROACH

- **Primary benefits**
 - Relies on actual, third-party data
 - If properly used, brings market realities into the analysis
- **Can lead to incorrect conclusions of value due to:**
 - Limited availability of quality data
 - Difficulty in properly assessing and applying data
 - Misapplication of indicators of value due to lack of sufficient similarity



Valuation in the Current Environment

MARKET APPROACH

- **Primary issues for valuator consideration using GCTM**
 - Reconciliation of pre- and post-COVID-19 value indications are difficult, at best
 - How best to modify pre-COVID-19 multiples for the effects of COVID-19
- **Primary issues for valuator consideration using GPCM**
 - Interpreting public market response to the economic effects of the COVID-19 pandemic is necessary to assure that the subject company will act similarly



Valuation in the Current Environment

COST/ASSET APPROACH

- *Determination of value predicated upon assessment of each asset and liability on a company's balance sheet*
- *Approach not useful for operating companies with significant unrecorded intangible value*
- *Used most often where value of equity is based on value of underlying assets – holding companies*



Valuation in the Current Environment

COST/ASSET APPROACH

- *May need to consider in situations where income approach values are significantly depressed*
- *Asset holding company values may decline based on value of underlying assets*
 - Real estate based on changes in occupancy rates
 - Commercial property, including both office space and retail space, are expected to suffer long-term



Valuation in the Current Environment

COST/ASSET APPROACH

- *In applying the cost/asset approach, and especially the net asset method thereunder, consideration must given to:*
 - Functional or operational obsolescence
 - Economic obsolescence
 - Value on a going concern basis that is less than the appraised asset values (net of liabilities) but greater than orderly liquidation value



Valuation in the Current Environment: The COVID-19 Saga Continues

VALUATION OPPORTUNITIES





Valuation in the Current Environment

ESTATE PLANNING OPPORTUNITIES

“A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty”

– Winston S. Churchill

- *The global pandemic and current political climate combine to create significant estate planning opportunities resulting in cash preservation for the next generation*



Valuation in the Current Environment

ESTATE AND GIFT PLANNING VALUATIONS

- *Date of Valuation – Gifting*
 - Date is strategically chosen to maximize benefits by transferring appreciated assets at discounted values
 - Impacting factors for date selection:
 - Investment risk is greatly increased
 - Valuation discounts, namely the DLOM, have increased
 - Current tax environment and proposed changes to estate and gift tax laws



Valuation in the Current Environment

EMPLOYEE STOCK OWNERSHIP PLANS (ESOPS)

- *President Biden named economist Jared Bernstein to the White House Council of Economic Advisors*
- *Secure Act 2 likely to extend capital gains deferral benefits to S corporation ESOP sales*
- *ESOPs can provide many benefits including ensuring and controlling business succession, increased cash flow to support growth, and incentive employees*



Valuation in the Current Environment

MERGERS & ACQUISITIONS

- *M&A market expected to be active in 2021*
 - Corporations looking for scale and growth
 - Private equity firms and SPACs looking to invest capital
- *Markets are supportive with historically low cost of capital*
- *Rebound of those sectors impacted by COVID-19*
 - Commercial aerospace, energy, real estate and retail



Valuation in the Current Environment

SHAREHOLDER BUYOUTS

- *Many challenges posed during the pandemic likely exacerbated pre-existing rifts between partners and their vision for the future*
- *Determine how and when a buy-sell agreement is triggered*
- *Understand how payments are structured and other conditions of sale*



Valuation in the Current Environment

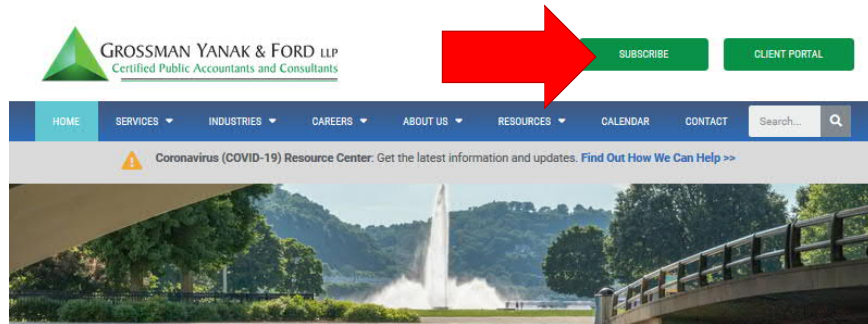
TAKEAWAYS

- *The value of many privately held businesses will continue to be negatively impacted by COVID-19*
- *Valuation is predicated on what is known or knowable as of a specific date, and value will change over time*
- *Seize opportunities!*



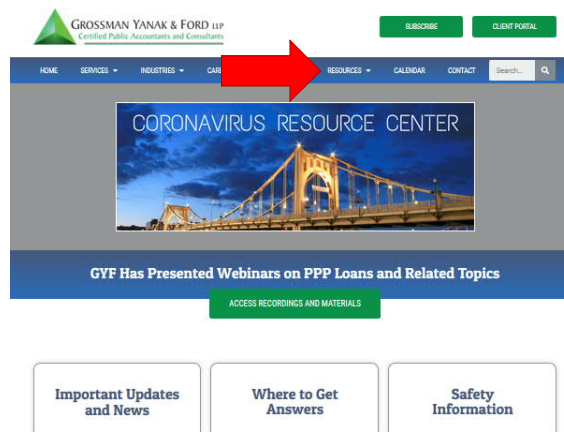
Valuation in the Current Environment

- Please go to www.gyf.com to subscribe to receive timely updates about COVID-19, tax legislation and other issues



Valuation in the Current Environment

- Visit our website's *Coronavirus Resource Center* to access links to webinars, updates and other important information





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THANK YOU FOR ATTENDING!

