

# IMPACT OF COVID-19 ON BUSINESS VALUE AND BUSINESS LOSS ASSESSMENTS



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**cohen hamilton steger**

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# Agenda

1. Brief refresher on compensation for businesses under the Expropriations Act
2. Impact of COVID-19 on business valuations
3. Impact of COVID-19 on business loss quantification



# Compensation for Businesses under the Expropriations Act

- Depending on the circumstances, an expropriation and the related impacts may result in a business ceasing to operate or in a business experiencing business losses
- These losses (among others) are compensable under the Expropriations Act provided they are directly attributable to the Expropriation





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# **IMPACT OF COVID-19 ON BUSINESS VALUATIONS**

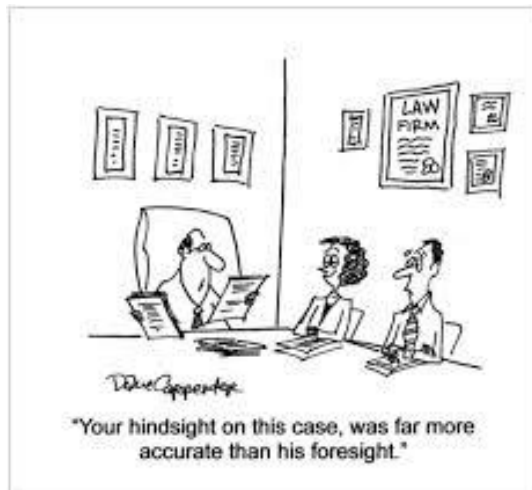


# Value is at a Specific Point in Time – no Hindsight

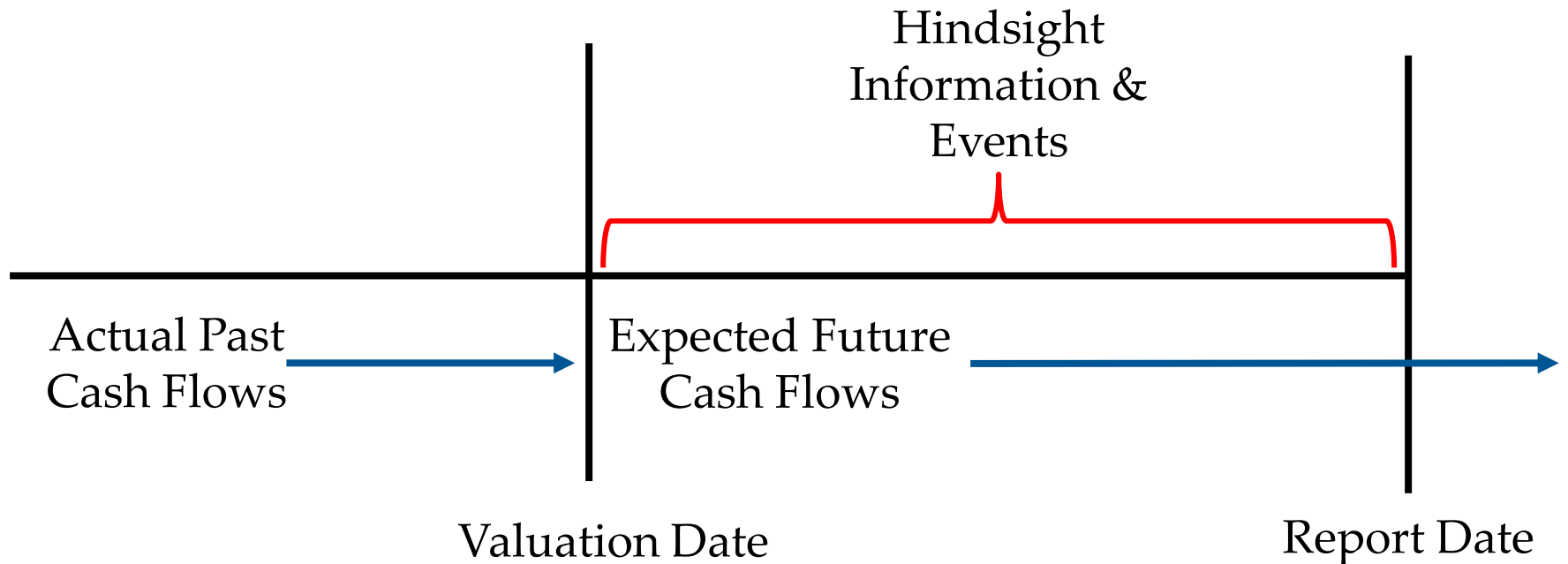
- Value is determined at a specific point in time. It is a function of facts known and expectations at that point in time



- Hindsight information and events (i.e. become known after the valuation date) should not be considered



# Value is at a Specific Point in Time – no Hindsight



# Valuation Date and COVID-19

- Critical to know what was known with respect to COVID-19 and its expected impacts as at the specific valuation date
- What was the expected impact of COVID-19 on the specific business being valued of COVID-19 as at the valuation date?
- Key to consider the timelines associated with the progression of COVID-19 in Ontario/Canada/World and its impact on the economy and businesses over time



# Value is Future Looking

- Value is the present value of expected future earnings/cash flows of a business as at the valuation date

Present Value of Discounted Cash Flows

$$PV = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \frac{CF_3}{(1+r)^3} \dots \frac{CF_n}{(1+r)^n}$$

CF equals cash flow for a period,

r equals the discount rate, and

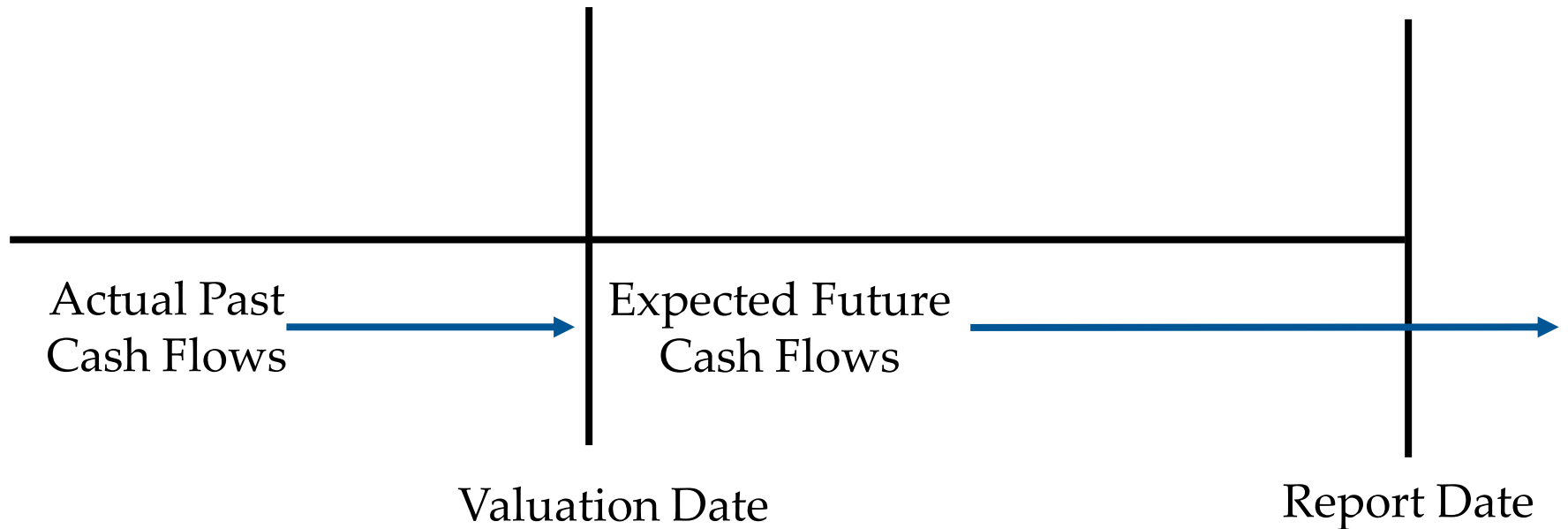
n equals the number of periods.

- In estimating future earnings/cash flows:
  - the past operations of a business adjusted for revenues and/or expenses that aren't expected to recur are usually considered
  - forecasts of the future operating results of the business as at the valuation date are also considered





# Value is Future Looking



# Impact of COVID-19 on Estimate of Future Earnings/ Cash Flows

- Is the business even a going-concern now?
- Past operating results most likely won't be representative of future operating results anymore (at least over the next year or two)
- Will the business recover fully to its pre-COVID-19 operating results?
- Will there be permanent changes to the businesses operations that need to be considered?
- Difficult to forecast future earnings/cash flows of a business when there is so much uncertainty as to how long the impacts of the COVID-19 pandemic will last



# Impact of COVID-19 on Discount Rates/ Capitalization Rates for Business Valuations

- Lots of questions and uncertainty regarding the future of the economy and businesses in general
- Layer on top of that the specific uncertainty related to the business being valued due to COVID-19



- Increased uncertainty = increased risk associated with the estimated future earnings/cash flows of the business
- Higher risk results in higher discount rates/capitalization rates, leading to lower values



# Impact of COVID-19 on Valuation Methodology

- Use of Discounted Cash Flow technique over Capitalized Cash flow technique

		Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Terminal
Cashflow after debt service	A	150	100	200	250	350	
Equity investment	B		(750)				
Terminal value *	C						2,500
Discount rate	D	15%	15%	15%	15%	15%	15%
Discount factor	$E = 1/(1+D)^n$	0.87	0.76	0.66	0.57	0.50	0.50
PV of annual cash flow	$F = (A+B) \times E$	130.43	(491.49)	131.50	142.94	174.01	
PV of terminal value	$G = C \times E$						1,242.94
Total PV	$G + \text{sum of } F$	1,330.34					
<b>PV rounded to</b>		<b>\$ 1,330</b>					

<sup>^</sup> = to the power of (number of years)  
 \* found using capitalized cashflow method

- Less reliance on the market approach
- More prevalent use of liquidation approach?
- Possibly more scenarios considered and some sort of probability assessment for each scenario
- Discount/capitalization rates should be consistent with the cash flows and risk of each scenario





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# **IMPACT OF COVID-19 ON BUSINESS LOSS QUANTIFICATION**

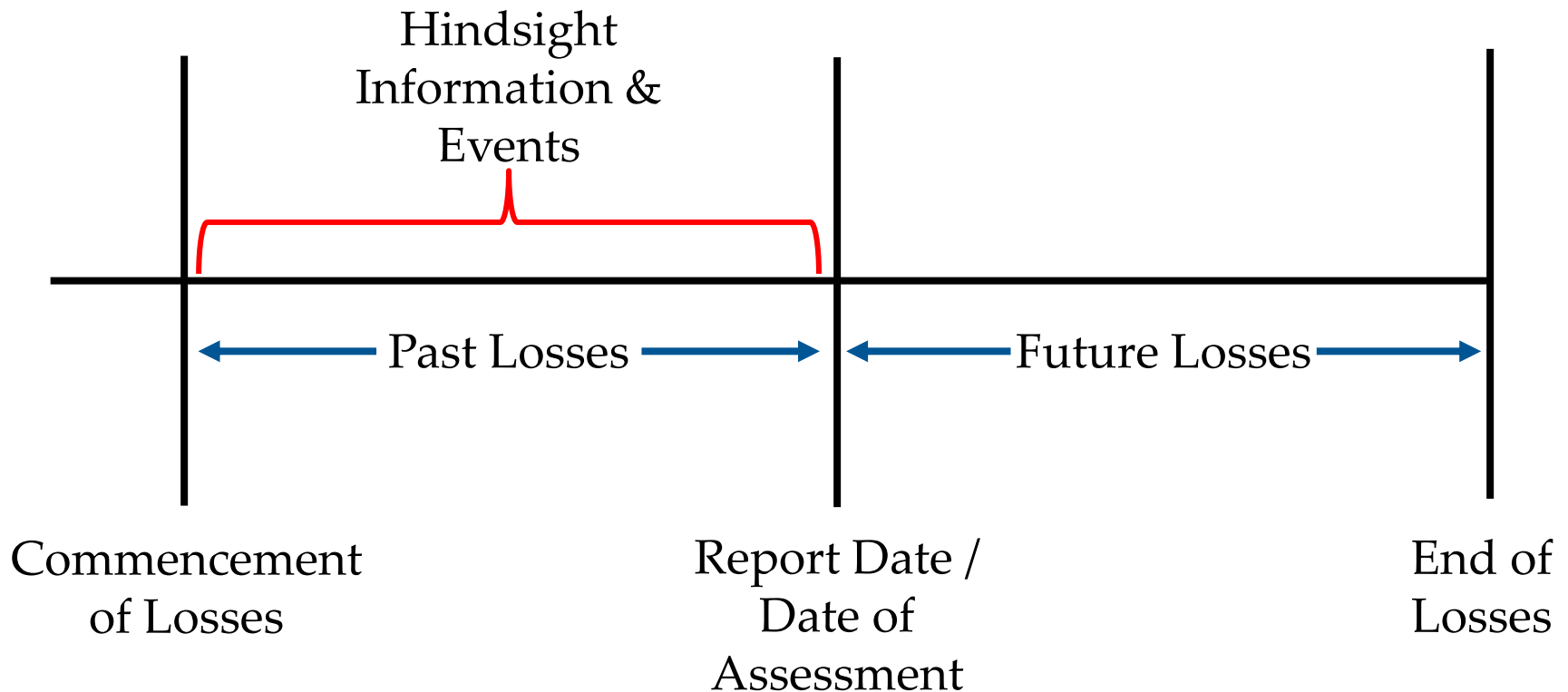


# Key Business Loss Quantification Principles

- Damages (i.e. business losses) are meant to put the claimant back in the same position they would have been in had the expropriation not occurred
- Business losses are equal to the estimated profits of the business had the expropriation not occurred (i.e. the but-for profits), less the actual profits of the business
- While losses are assessed at a point in time - hindsight information and events should be considered
- Losses can be backward and forward looking (i.e. past losses and future losses)



# Assessment of Business Losses – Use Hindsight



# Impact of COVID-19 on Estimating Business Losses

- Harder to determine the causation of the business losses (i.e. are the losses due to the expropriation, due to COVID-19, other factors?)
- Harder to estimate the profits of the business had the expropriation not occurred
  - Still must take into consideration the impact of COVID-19 and other factors
  - Historical operating results prior to the expropriation may not be a good guide
  - Lots of uncertainty as to the future due to COVID-19 and how long the impacts of it will last





# Impact of COVID-19 on Discount Rates for Business Losses

- Lots of questions and uncertainty regarding the future of the economy and businesses in general
- Layer on top of that the specific uncertainty related to the business for which losses are being estimated due to COVID-19



- Increased uncertainty = increased risk associated with the estimated future business losses
- Higher risk results in higher discount rates



# Impact of COVID-19 on Business Loss Methodology

- May need to consider more scenarios - discount rates should be consistent with risk of the estimated business losses under each scenario
- Much more industry and economic research will be required to determine how the business was impacted by COVID-19 and economic conditions separate and apart from the impacts of the expropriation/construction



- Review of the performance of “comparable” companies or the rest of the industry not impacted by the expropriation/construction during the loss period



# Concluding Thoughts

- Critical to understand the timeline of COVID-19 in assessing business value
- Critical to consider hindsight in assessing past business losses
- Additional industry/economic research and due diligence with respect to the business will be key
- Lots of uncertainty created by COVID-19 – which will impact the discount rates/capitalization rates used



# Contact Information

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