

Convenience translation from German into English – German version is prevailing

Technical Guidelines

of the **Austrian Chamber of Tax Advisors and Public Accountants**

regarding the effects of the spread of the coronavirus (COVID-19) on business valuations

(adopted by the Austrian Chamber of Tax Advisors and Public Accountants on 15 April 2020)

Table of contents	Page
1. Preamble	2
2. Introduction.....	2
3. Valuation date principle.....	2
3.1. General.....	2
3.2. Valuation dates up to 31 December 2019.....	3
3.3. Valuation dates after 31 December 2019.....	3
4. Future cash flows	3
5. Cost of capital	4
6. Multiplier methods	5
Appendix: Explanations and practical application	6

Convenience translation from German into English – German version is prevailing

1. Preamble

- (1) The present guidelines were prepared by the Working Group on Business Valuation of the Expert Committee on Business Administration. Due to the urgency and the exceptional situation, it was not possible to refer the matter to the entire expert committee and apply the associated procedures for proper decision-making. The information is therefore to be understood as an elaboration of a group of experts on the state of knowledge as of April 15, 2020 and does not represent a professional guideline or a recommendation of the Expert Committee.
- (2) For the sake of clarification, it should be noted, that these guidelines can only be of a general nature and cases are to be assessed individually on the basis of concrete facts and circumstances by the public accountant.

2. Introduction

- (3) The outbreak of the pandemic ("COVID-19") triggered by the corona virus (SARS-CoV-2) has led to unprecedented effects on social life worldwide. Due to the restrictions on public life imposed by numerous countries to contain the further spread of the virus, entire sectors of the economy and thus numerous companies, are facing fundamentally changed economic conditions. The resulting major economic uncertainty has been reflected, among other things, in a drastic slump in stock market prices and stock market indices.
- (4) In view of the above, the subject matter of these technical guidelines are questions about the effects of COVID-19 on business valuations.

3. Valuation date principle

3.1. General

- (5) In connection with the valuation date principle, it must first be determined for which valuation dates the effects of COVID-19 are generally to be considered in the business valuation. It should be noted that enterprise values according to ref (23) KFS/BW 1 are time-related and are always determined at a particular point in time. The amount of the enterprise value therefore depends largely on the circumstances on the valuation date.
- (6) In this sense, according to ref (24) KFS/BW 1, all relevant information that could have been obtained with reasonable care on the valuation date must be taken into account when determining the value. According to ref (24) KFS/BW 1, changes in the value-determining factors that occur between the valuation date and the (later) conclusion of the valuation are only to be taken into account, if their cause is rooted before the valuation date. In the opinion of the working group, however, it is not sufficient to be able to take developments after the valuation date into account, if a causal chain of any kind can be traced back to a date before the valuation date. Developments occurring at a later date should only be taken into account if they were already present at the root of the causal chain on the valuation date and could have been recognized with reasonable care. Developments are considered as recognizable, if it appears at least more likely than not that these developments were already expected on the valuation date.

Convenience translation from German into English – German version is prevailing

3.2. Valuation dates up to 31 December 2019

- (7) In the opinion of the working group, the global effects of COVID-19 could not have been expected with sufficient probability for valuation dates up to 31 December 2019. Therefore, due to the lack of recognizability of the later global spread of the coronavirus and its consequences, a recognition of these developments in valuations up to 31 December 2019 is not possible due to the valuation date principle.
- (8) If a valuation with a valuation date up to 31 December 2019 is concluded after the publication of these technical guidelines, the valuation report shall indicate that effects of COVID-19 have not been taken into account due to the valuation date principle.

3.3. Valuation dates after 31 December 2019

- (9) For valuation dates after 31 December 2019, it must be assessed on a country- and case-specific basis, whether the effects of COVID-19 could have been recognized on the respective date. In doing so, the specific business model and the geographical activities of the company must be taken into account.
- (10) Within the scope of this assessment, among other things, publications by (health) authorities, restrictions on public life and commercial traffic due to official requirements and their specific effects on the valuation object as well as general economic developments must be taken into account. These include in particular the change in the expectations of capital market participants resulting from the outbreak of COVID-19 and the increased economic uncertainty which contributed to the worldwide slump in stock market prices from 24 February 2020.
- (11) If the economic effects of COVID-19 could have been recognized in valuations with valuation dates after 31 December 2019, the effects on the future cash flows of the valuation object are to be taken into account to the extent that these effects could have been recognized with reasonable care and with sufficient probability on the basis of the information available at the valuation date. The report must address the available information and the circumstances which led to the assessment that the economic effects of COVID-19 were recognizable as of the valuation date.

4. Future cash flows

- (12) If effects of COVID-19 are to be taken into account in the planning of future cash flows in accordance with the valuation date principle, both negative and positive effects of COVID-19 must be taken into account. In addition to negative effects such as loss of sales and collapse of earnings, any government support to compensate for economic disadvantages must therefore also be taken into account.
- (13) The consideration of consequences of COVID-19 for the valuation object is often accompanied by a considerable increase in planning uncertainty. This increased uncertainty should be countered within the meaning of ref (66) KFS/BW 1, by deriving expected values for future cash flows based on scenarios where each scenario has a specific probability.
- (14) To illustrate the effects of COVID-19 on the business plan, a distinction can be made between the effects of a short- to medium-term pandemic phase including a subsequent recovery phase and the long-term consequences of the pandemic.

Convenience translation from German into English – German version is prevailing

- (15) The duration of the pandemic phase is currently difficult to estimate. If the extent of its effects on future cash flows is also difficult to estimate, different scenarios must be analyzed. The extent to which the pandemic will have an impact on earnings depends to a large extent on the industry and the individual business model of the valuation object. The duration of short- to medium-term effects is determined by the length of the immediate threat from the virus on the relevant markets of the company and the duration of the subsequent recovery phase.
- (16) When assessing the long-term consequences of the pandemic, the business model of the valuation object must be analyzed in order to determine whether there are indications that the economic conditions after the crisis will differ from those before the crisis. In doing so, possible changes in consumer behavior, communication, logistics or supply chains are to be taken into account. In particular, it must be analyzed to what extent disruptive developments for business areas of the company being valued, which already started before the crisis, are likely to be intensified by the crisis. When determining objectified enterprise values, it should be noted that according to ref (79) KFS/BW 1, measures that are intended to lead to structural changes in the company may only be taken into account if they have already been initiated or sufficiently specified on the valuation date.
- (17) The assessment of the plausibility of the business plan in times of a crisis poses particular challenges for the public accountant. The adequate consideration of the increased uncertainty caused by COVID-19 in the business plan is of crucial importance when deriving the expected values of the future cash flows. If the business plan proves to be insufficient in this respect, the public accountant must proceed in accordance with the provisions in ref (75) to (78) KFS/BW 1 and make adjustments if necessary. In this context, it should be noted that according to ref (78) KFS/BW 1, uncertainties resulting from insufficiencies in the business plan may not be taken into account by making lump-sum deductions from the future cash flows nor by adding surcharges to the discount rate.

5. Cost of capital

- (18) When determining the cost of capital, it is necessary to assess the extent to which the increased uncertainty due to COVID-19 has also been reflected in an increase in the expected rate of return by equity and debt investors.
- (19) The stock markets showed a jump in implied market returns with the decline of stock market prices from 24 February 2020 onwards, followed by a clear decrease until the end of March 2020 when implied market returns almost returned to the level before the beginning of the crises. However, the short-term increase in implied market returns is also caused by a delayed adjustment of expected earnings to the changes in the economic conditions by market analysts. In the opinion of the working group, there are no indications in the observed development of the implied market returns that would suggest a lasting significant increase in the yield level for periods after the end of March 2020.

It should be noted however, that volatility on the stock markets is currently still significantly above the pre-crisis level. In light of the aforementioned, the working group considers it appropriate to continue in basing the expected market risk premium (before personal taxes) on a range for the expected nominal market return of 7.5% to 9.0% in accordance with the recommendation KFS/BW 1 E 7.

Convenience translation from German into English – German version is prevailing

- (20) When estimating future beta factors on the basis of historical data, the decline in stock market prices from 24 February 2020 onwards will often lead to distorting effects. This can be avoided by excluding the relevant period from the analysis or by determining rolling beta factors over a longer period of time. Nevertheless, the extent to which the beta factor adequately reflects the future systematic risk of the company has to be assessed separately in the context of the economic changes caused by COVID-19.

6. Multiplier methods

- (21) When using multiplier methods as a plausibility assessment, effects by COVID-19 on the level of the selected reference values (earnings numbers) and on market multiples should be taken into account. In particular, it has to be assessed to which extent market multiples based on data which were obtained before the crisis are still significant and conclusive.

Convenience translation from German into English – German version is prevailing

Appendix: Explanations and practical application

Regarding ref (3):

With regard to the factors influencing stock market prices in crisis situations, reference is made to the technical note of the Technical Committee for Business Valuation (FAUB) of the German Institute of Public Accountants (IDW) on the effects of the spread of the coronavirus on company valuations, dated March 25, 2020.

Regarding ref (7):

On December 31, 2019, the spread of the corona virus (SARS-CoV-2) was limited to the city of Wuhan in China and it was still unclear whether the virus will be transmitted from person to person. Substantial information about the threats associated with this virus only became known in the weeks that followed. The opinion expressed herein is consistent with the expert information on accounting issues as of December 31, 2019, provided by the Austrian Financial Reporting and Auditing Committee (AFRAC technical information COVID-19, April 2020), the German Institute of Public Accountants (Technical guidelines of the IDW regarding the effects of the Coronavirus outbreak on accounting practices and their audit for 31 December 2019, 4 March 2020) and Accountancy Europe (Coronavirus crisis: Implications on reporting and auditing, March 20, 2020), which classify the outbreak of COVID-19 as a value-determining event from the point of view of accounting law.

Regarding ref (8):

If 31 December 2019 is only used as the so-called "technical" valuation date in the context of a valuation which is actually carried out on a valuation date after 31 December 2019, the effects of COVID-19 are to be taken into account on the basis of their recognizability on the effective valuation date in accordance with the provisions of ref (9).

Regarding ref (10):

Internationally, the following events, among others, are significant:

- 30 January 2020: WHO declares an international health emergency
- 24 February 2020: Start of the price decline on the international capital markets
- 8 March 2020: Italy is the first European country to introduce exit restrictions in Northern Italy
- 10 March 2020: The whole of Italy is declared a restricted zone
- 11 March 2020: WHO declares the existence of a pandemic
- From mid-March 2020: Imposition of exit restrictions in many countries, restrictions on air traffic and travel warnings
- From the end of March 2020: Correction of the economic forecasts 2020 for the euro zone countries from positive to negative (-2 to -3%)
- 14 April 2020: IMF forecasts a global recession (real GDP loss of 3% globally and of 7.5% in the euro zone)

In Austria, the following events, among others, are significant:

- 10 March 2020: Announcement of the first restriction measures (e.g. for events)
- 11 March 2020: Ban on events exceeding a certain number of participants, entry from risk areas only with medical certificate
- 13 March 2020: Announcement of the restriction of public life to a minimum from 16 March 2020 (see there)

Convenience translation from German into English – German version is prevailing

- 14 March 2020: Announcement of a Corona crisis fund in the amount of EUR 4 billion
- 16 March 2020: Initial restrictions with a few exceptions (e.g. occupation and necessary errands), closure of shops not required for the basic service, total ban on events
- 17 March 2020: closure of all restaurants and bars
- 18 March 2020: Increase of the government aid package to EUR 38 bn
- 20 March 2020: Extension of initial restrictions until 13 April 2020
- 30 March 2020: Announcement of the ban on the use of tourist accommodation
- 4 April 2020: Ban on the use of tourist accommodation establishments for tourism
- 6 April 2020: Extension of the initial restrictions until the end of April 2020, announcement of the gradual opening of businesses after Easter
- 9 April 2020: Highest travel warning level for a large number of countries
- 14 April 2020: Opening of DIY superstores, garden centres and small retailers
- Planned: Opening of all shops and shopping centres from 1 May 2020
- Planned: Opening of restaurants and hotels mid to end of May 2020

Regarding ref (11):

It should be noted that the accounting principle to which circumstances that affect the financial statements but become known only between the balance sheet date and the date of their preparation, must be taken into account is not valid for the valuation of companies. In business valuation only changes resulting from factors originating from before the valuation date are to be taken into account in company valuations if the information could have been obtained with due care. The standard of due care in the valuation of companies is therefore based on taking into account only the information available on the valuation date, whereas annual financial statements are bound to consider all enlightening events in the period up to the preparation.

Regarding ref (14):

The principles laid down in ref (59) ff. KFS/BW 1 for planning the future cash flows in a detailed planning phase, a simplified planning phase, and a terminal value must also be considered when illustrating the effects of COVID-19 on the business plan.

Regarding ref (15) f.:

With regards to the possible negative effects of the pandemic, reference is made to the technical note of the Technical Committee for Business Valuation (FAUB) of the German Institute of Auditors (IDW) on the effects of the spread of the corona virus on company valuations dated 25 March 2020.