Post-COVID-19 Pandemic: Finding Silver Linings for Businesses

Many articles in 2019 spoke about the impending recession in 2020 but no one had imagined that it would be caused by a microscopic enemy. An enemy so minute and yet deadly that it not only has taken many human lives but has also crippled economies worldwide. The severe acute respiratory syndrome coronavirus 2 (SARS-COV2) or more commonly known as COVID-19 has affected us in more ways than mere travel restrictions. Since the onset of the COVID-19 pandemic, the world has changed in a dramatic way and at a significant pace. The global economy has been severely impacted. The short to medium term seems very uncertain. Stock markets have rapidly declined and the oil price has tumbled to an historical new low.

The world is set to face an economic recession. Throughout history, the impact of each recession is different and vary in severity, with one end of the spectrum where everyone ends up poorer. The current downtown presents an atypical situation where there are no safe havens - it's a worldwide emergency. We are seeing a hit to domestic demand on top of supply chain impacts. Oxford Economics estimate that the global economy will contract marginally this year, before improving by June, this timeline however, is likely to change. In April, the IMF revised its global growth projection to -3% for 2020 from 6.3% in January of the same year.

The Covid-19 recession is slated to be the worst recession since the Great Depression in the 1930s. Post-Covid-19, humans and businesses need to find new ways to survive, to thrive, and seek different opportunities; a new norm. Times are changing, so businesses have to evolve to navigate through this new COVID-19 norm.

This does not mean that there are no opportunities for investors in this time of crisis. There are still silver linings.

For most companies, these tough economic times turn risk into operational and financial stress. Companies may be forced to reduce expenses, which unfortunately means potentially laying off employees. Purchases, acquisitions and capital expenditure will be minimized or put on hold indefinitely. Operational expenses that cannot be eliminated have to be met with limited available cash flows.

As we ride through this Movement Control Order ("MCO") and adjust to life in the new COVID-19 norm, our behaviours and habits are quickly adapting, which directly impacts organizations and industries around us. Broadly, we see businesses falling into three categories moving forward.

The Gainers – sectors that adapt well to this new norm;
The Losers – sectors that will suffer due to this new norm;
The "It Depends" – sectors that could go either way, depending on their response.

The Gainers

These sectors have made huge gains due to the new norm. Companies like those in e-commerce, pharmaceuticals, logistics, video conferencing are suddenly a necessity and not just another option. Astro, for example has recorded a viewership and time-on-platform increase across all their channels during the MCO. Zoom and Microsoft Teams had a boost in their subscription base due to the increase in demand for teleconferencing. E-commerce platforms like Zalora, Fashion Valet and Lazada have managed to continue their operations without much disruption, indirectly boosting logistics companies like Gdex, Citylink, NinjaVan and even Grab. With the right strategy aimed at taking advantage of the current environment, these companies are poised to grow aggressively in the short term with the environment making them especially attractive investments.

The Losers

Sectors such as travel and tourism, oil and gas, and traditional retail, their management will need nothing short of a miracle to pull through this crisis. Travel and tourism have grounded to a complete halt with no clear sight as to when travel restrictions would be lifted. Oil prices have fallen to a multi-year low and the Energy Institute of America foresees that oil prices may remain low for the foreseeable future. Many of these players will be seriously wounded even if they manage to manoeuvre through the recession sludge. Naturally, these companies will cut costs, reduce operational risk and wait for conditions to improve.

The “It Depends”

The survival or success of these companies is dependent on how they react and adapt to the changing tides. If these companies adapt to take advantage of new opportunities, they will thrive. Otherwise, if they chose to soldier on as is, they will likely struggle. The Education sector, for example, will struggle if they do not adapt to the new norm by providing online content and straying from the traditional in-person experience as people remain confined to their homes. Institutions that act and adapt quickly become attractive investments.

Finding that Silver Lining

Prior to the COVID-19 pandemic, buyers seeking acquisitions sat on record amounts of cash reserves, running into intense market competition and high valuations. While the effect of COVID-19 on market valuations is not yet certain, the current situation can present an opportunity to deploy capital in a timeframe with much less competition. For many private equity buyers pushing to continue moving deals ahead, earn-outs (a financing arrangement for purchase of a business in which the seller finances a portion of the purchase price and payment of this amount is contingent on achieving a predetermined level of future earnings), become a key tool to bridge valuation gaps or manage uncertainty.

Meanwhile, companies which are facing difficulty during this pandemic could use this time to restructure itself, rescale, look for alternative investments or perhaps a white knight or investor to provide assistance in terms of cash flow and inject new ideas and opportunities into the company.

For investors, the key is to identify suitable companies in sectors that are in distress - however resilient they may be to a recession - perhaps those that are in need of capital injection to ride out the dire times ahead. During this pandemic, companies that thrive through the MCO period include those in the manufacturing of healthcare products, fast moving consumer goods, logistics and electronics. There are also other companies that are in sectors that may be complimentary depending on investment objectives. By using valuation inputs that sets realistic key drivers, such as risk and internal rates of return, valuation gaps between buyers and sellers can be bridged to a more realistic scenario.

Merger activity could also be an effective means to navigate the crisis period by sharing resources and providing access to capital. However, potential mergers will still present traditional challenges in untraditional times. This includes valuation and integration, along with potential due diligence issues.

Whichever strategic option companies choose, it is important to objectively consider the valuation of the intended acquisition or investment. Be it the income or market approach in valuation techniques, variables in the projections must consider risk factors post-COVID-19 and the long-term effects on the revenue model. Because of the abrupt change in fundamentals and market conditions, using a team of valuation experts helps one in identifying silver linings in distressed companies for the intended merger and acquisition activity.

Whether a company is experiencing performance problems or experiencing liquidity issues, all these factors will have an impact on the valuation of the distressed company. We are in a landscape like no other and these uncertainties should be carefully considered prior to making any investment decisions. Do give our team of valuation experts a call in assisting in your investment decisions.

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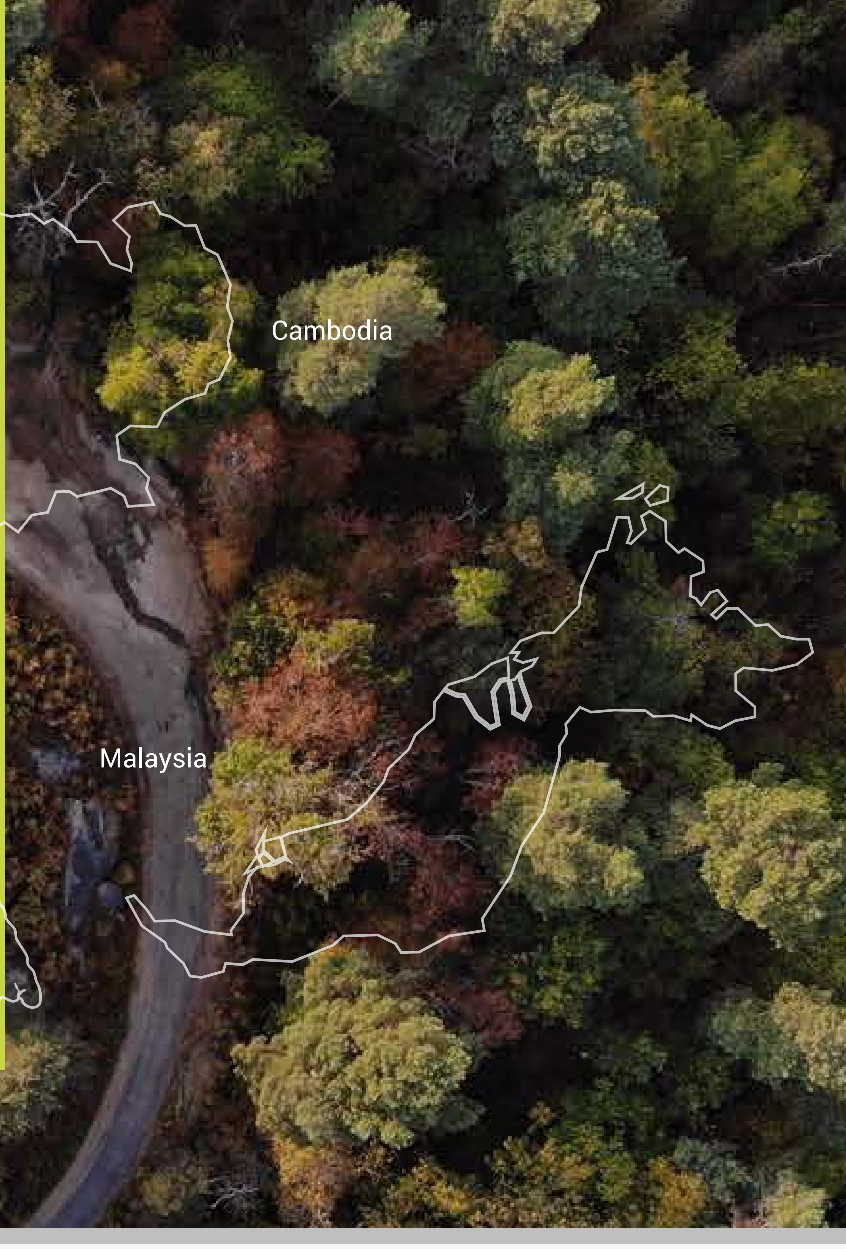

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