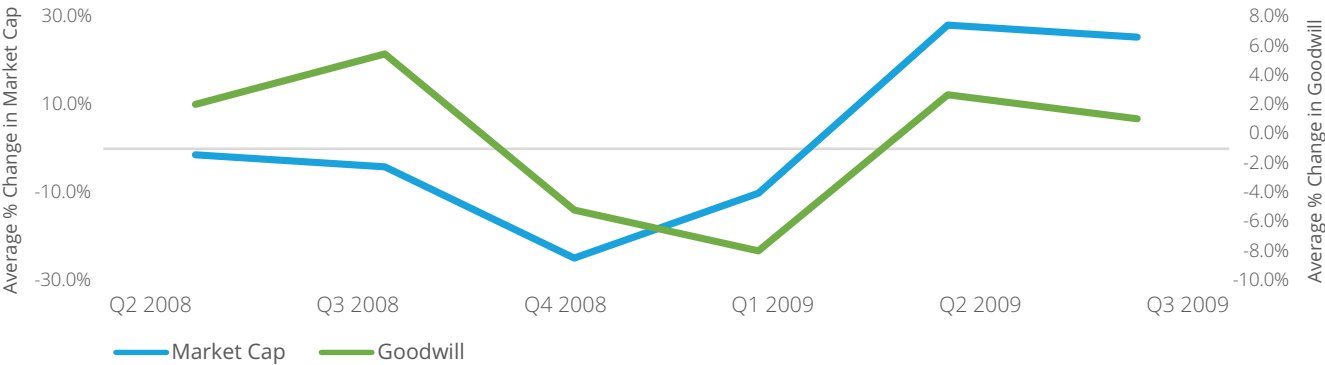


**Will steep declines in capital
markets require testing for
impairment?**

... and how do I reflect this in the valuation?

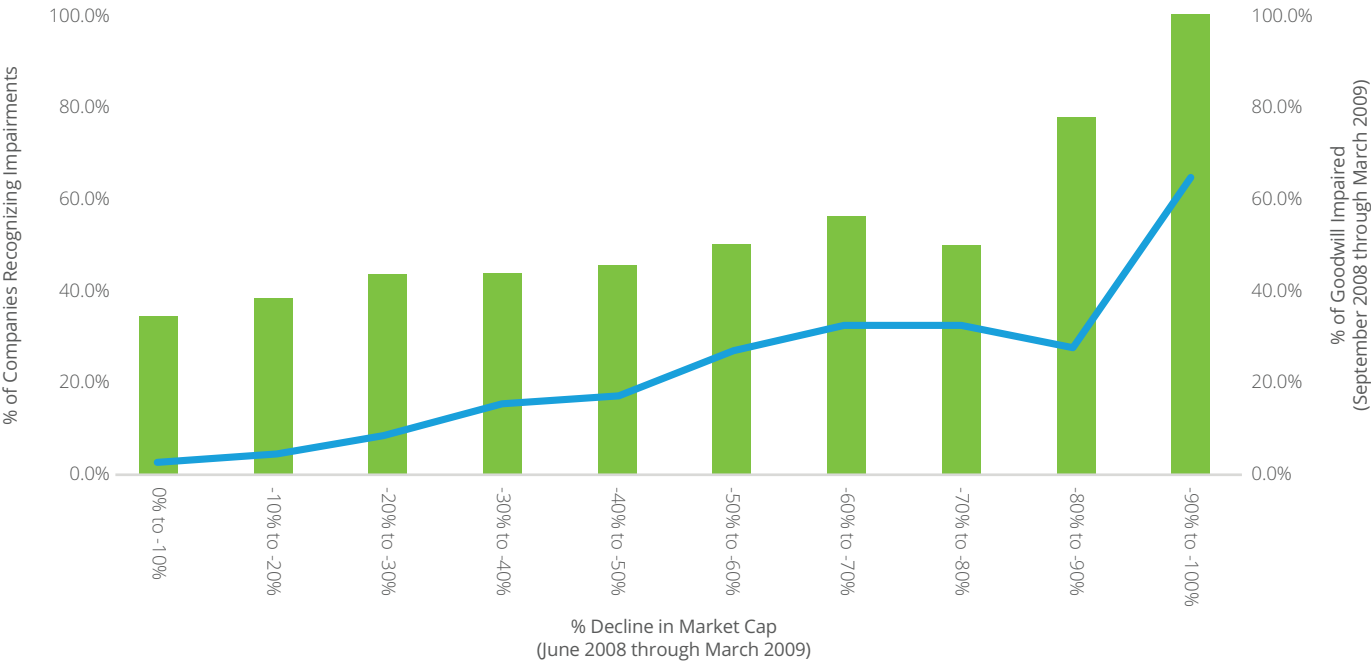
Declines in the stock market can trigger testing of assets, goodwill and other long-lived intangible assets for impairment. However, other factors (triggers) that may accompany stock price declines are typically examined as well. The Financial Crisis of 2008–2009 provides a guidepost to how companies viewed impairment testing during periods of market volatility. Our analysis shows that the impairments recognised by companies in our sample tracked closely with decreases in their stock price.

Market cap declines correlate with goodwill impairment



Source: S&P Capital IQ.
Population: Current S&P 500 companies publicly—traded as of January 2008.

Greater market cap declines correlate with greater impairments



Source: S&P Capital IQ.
Population: Current S&P 500 companies publicly—traded as of January 2008.

Types of Triggering Events¹:



Key Testing Questions:

- How do I define a cash generating unit or reporting unit?
- How do cash flows in value in use (ViU) differ from fair value less costs to sell (FVLCS)?
- Do I need to estimate both ViU and FVLCS under AASB 136? How do cash flows differ for each?
- How do I model alternative scenarios in a time of unprecedented uncertainty?

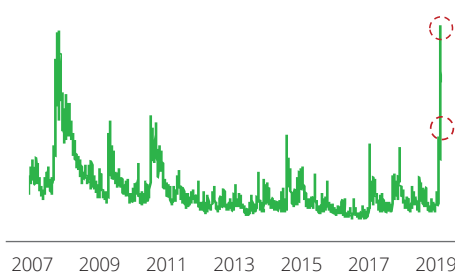
Key Valuation Considerations:

- Is intrinsic value as measured by the DCF weighted more than the market approach in current conditions under FVLCS?
- Are DCF analysis and observable market metrics impacted by recent changes in accounting standards (such as AASB 16)?
- With depressed current multiples, should forward multiples be used to reflect updated market earnings measures?
- Is our estimate of ERP in the discount rate aligned with current market volatility? If impacts to forecast are uncertain, how should I reflect this in the discount rate?
- Should average historical prices be used to smooth the impact of market volatility?
- In sharp market corrections do control premiums expand? Should market capitalization reconciliations imply higher control premiums?

¹ AASB 136 require annual impairment tests for goodwill and assets with an indefinite useful life as well as interim tests for most all long-lived assets, including goodwill, when there is an indicator of impairment.

Impact on valuation measures

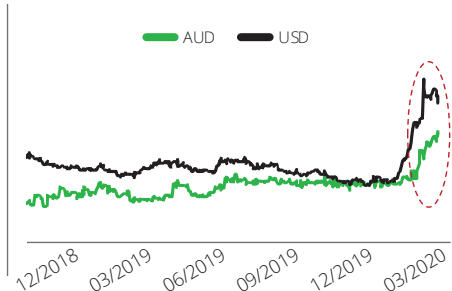
S&P 500 volatility



Australian market (ASX) cost of equity



Debt spreads (BBB)



Unprecedented increase in volatility since the GFC: Forecasts made before the outset of the COVID-19 in Australia may need to be re-evaluated in light of its impacts on the economy and the business in question.

Spike in the market cost of equity: Evaluate whether your discount rates fully reflect the recent considerable increase and subsequent reduction in the implied market rate of return following a partial recovery in markets accompanied by substantial reduction in earnings forecasts. Consider how to best update these parameters for your business in an internally consistent and appropriate fashion, in the face of seemingly erratic market indicators.

Escalating cost of debt: Widening debt spreads signal deteriorating liquidity and reflect both a worsening of company credit risk and a higher returns required by bond market investors.

Other considerations

Reforecasting and modeling: Given the immense uncertainty in the near and medium term, consider alternative scenarios in your forecasting process and performing enhanced modeling.

Long term prospects: huge economic and financial stimulus programs pursued by global authorities may undermine long term inflationary and real growth prospects.

Cash management: Evaluate whether you have cash to cover operations and obligations under alternative scenarios and stay connected with your lenders.

Disclosure and reporting: Consider whether there is a need to update the risk factor to provide more specificity about the potential impact of significant events and current and potential future impact on their operations, financial condition, or liquidity.

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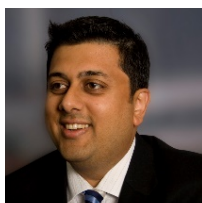
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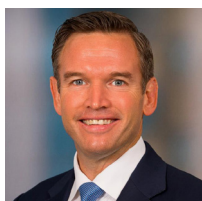
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