



# *Impairment in a COVID World*

Are you ready for a major test of impairment?

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# COVID – making an already difficult job more difficult

Impairment testing can be a **high risk area** at the best of times, this will only **increase** in the current COVID environment.

There are **significant challenges** this audit season for auditors and their clients to accurately assess whether an impairment of intangibles exist.

The key challenge for businesses will be in preparing cash flow forecasts that incorporate the impact of COVID-19. Management will need to consider:



What is **the real impact** of COVID-19 on revenue and earnings, compared with other business specific issues?



**How long** will COVID-19 impact revenue and earnings?



**When** will the business return to 'normal'?



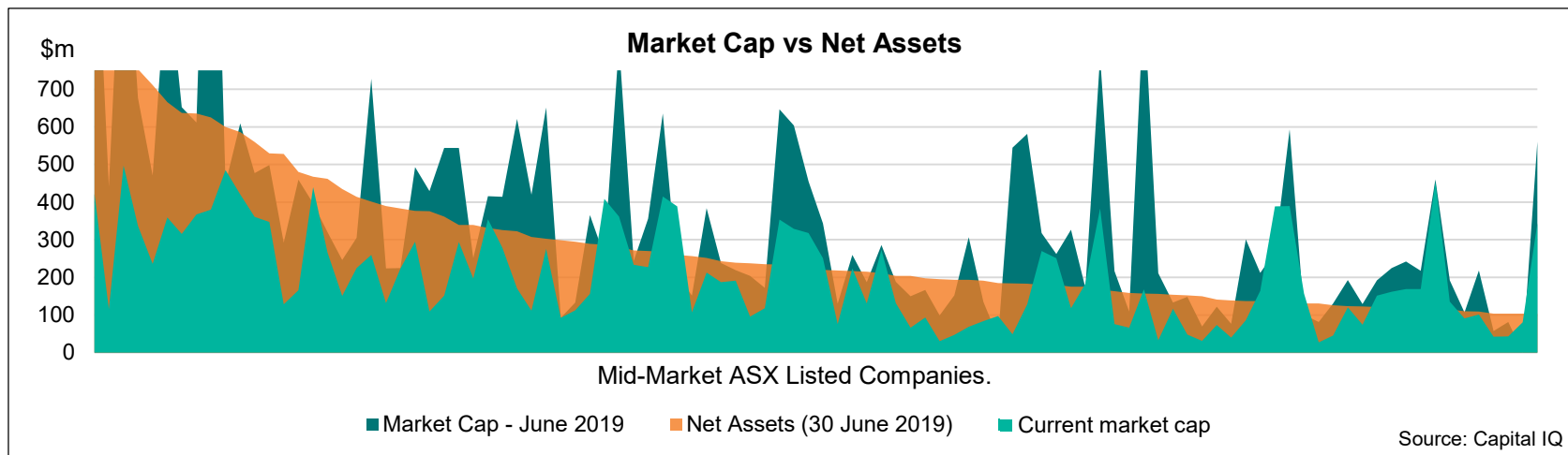
What does **the new normal** look like?

# More intangible asset carrying values 'underwater'

A large number of mid-market companies are being pushed 'underwater' – where market values of equity fall below the **book value of net assets** – which is a key indicator for potential impairment of intangible asset carrying values.

For most ASX listed companies, 30 June 2020 will be the first major test of intangible asset carrying values following the COVID-19 induced carnage in equity markets.

Since the most recent reporting period of 31 December 2019, the market capitalisations of ASX listed companies have been hit hard across the board – from the top end of town to the ASX minnows.



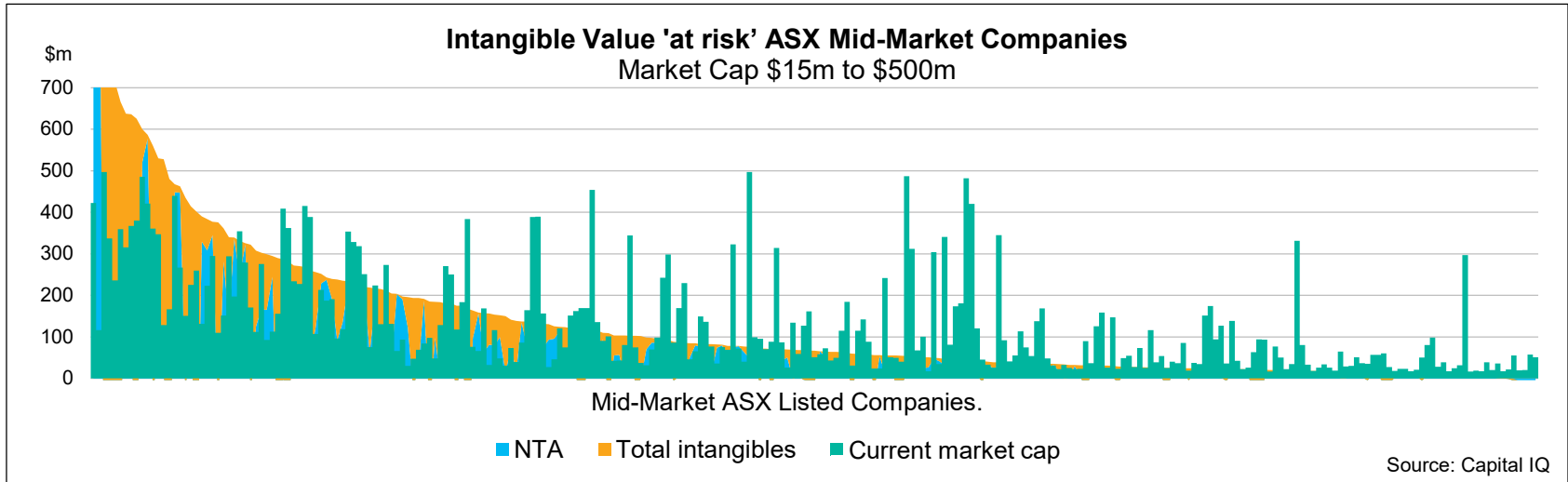
# Intangible value 'at risk' of write-down

Over 550 ASX listed companies carry intangible assets on their balance sheets.

For the 267 of these we consider 'mid-market', there is around **\$23.5 billion** of intangible assets being carried on the balance sheet – not a trivial number when compared to the combined market cap of around **\$35 billion**.

This is a significant amount of value at risk of being written down – and there's no writing it back.

Impairment also has a direct impact on reported earnings.



# What does this mean for FY20 Impairment Testing Season?

## An indicator is not reality

**Simply being below net assets doesn't automatically mean an impairment is likely.**

It's only one of many indicators – and there are a host of other factors to consider.

But this certainly puts the onus on companies and their auditors to rigorously test these carrying values – not an easy task in these wildly uncertain times.

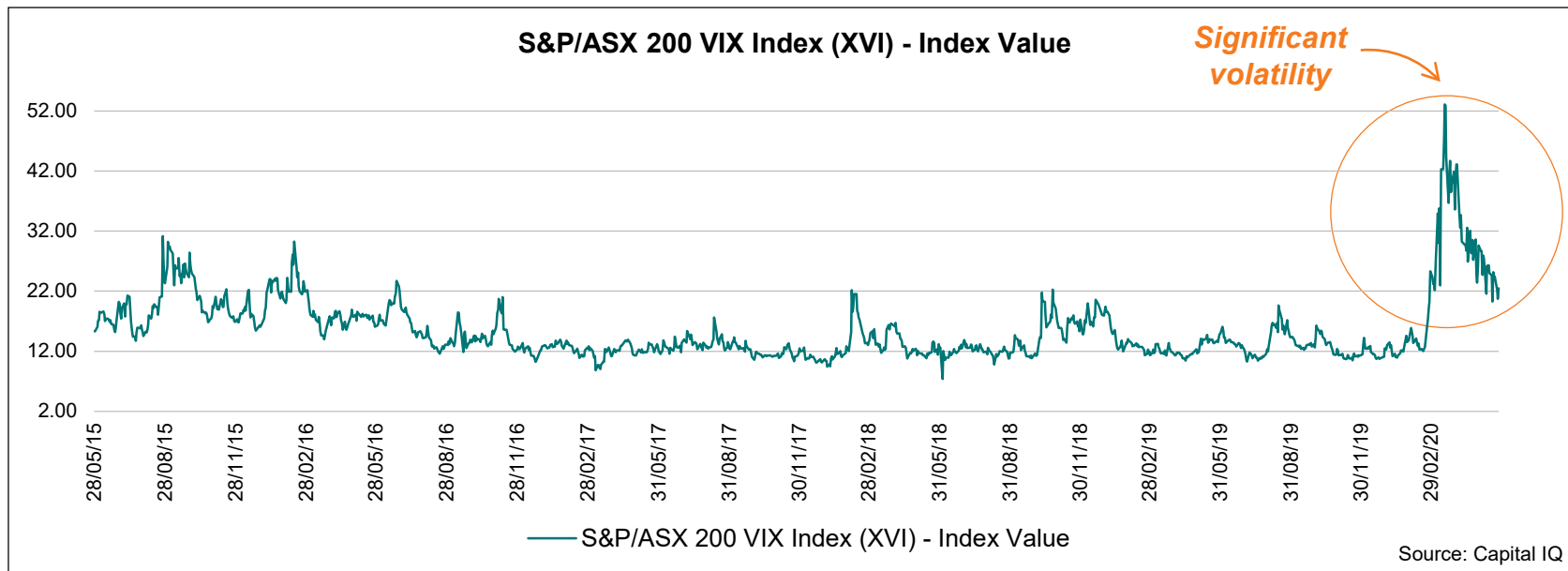


But on the **flip-side**, having a buffer with your market cap doesn't guarantee safety either. The future may look bleaker than the market believes, or the great performance of some business units (CGUs) might be hiding issues in others.

# What does this mean for FY20 Impairment Testing Season?

The ASX 200 VIX, a volatility index providing insight into investor sentiment, demonstrates a significant volatility or risk increase in the current environment.

**Risk is heightened**, there is no doubt about it – and despite the flight to ‘safer’ government bonds driving down these bond yields, it’s unlikely that costs of capital have declined with this significant increase in equity market risk and volatility. If anything, this heightened risk may increase required returns.



# Issues to consider

- What **disruption** has the business experienced to date?
- Is COVID masking any **underlying business issues**?
- How are peers and competitors being impacted?
- What does the next 6 to 12 months look like?
- Is the **industry** permanently damaged?  
Can the business get back to where it was, and if so, how long might that take?
- Do you have an **independent valuation report** to substantiate the position on intangibles?

**A single static set of cash flow** is probably less reliable this time around given the significant uncertainty – ideally a range of different cash flow scenarios should be tested, particularly more downside scenarios compared with the ‘base’ forecasts.

## *How Pitcher Partners can help*

Providing independent support for the impairment testing of your intangible assets by providing:



**Assistance**  
in preparing  
any cash flow  
projections and  
undertaking  
detailed sensitivity  
analysis on these



**Access to reliable  
information**  
in the broader  
economic  
community to  
provide insights  
into the impacts  
of COVID-19 and  
the impact on  
discount rates and  
valuations



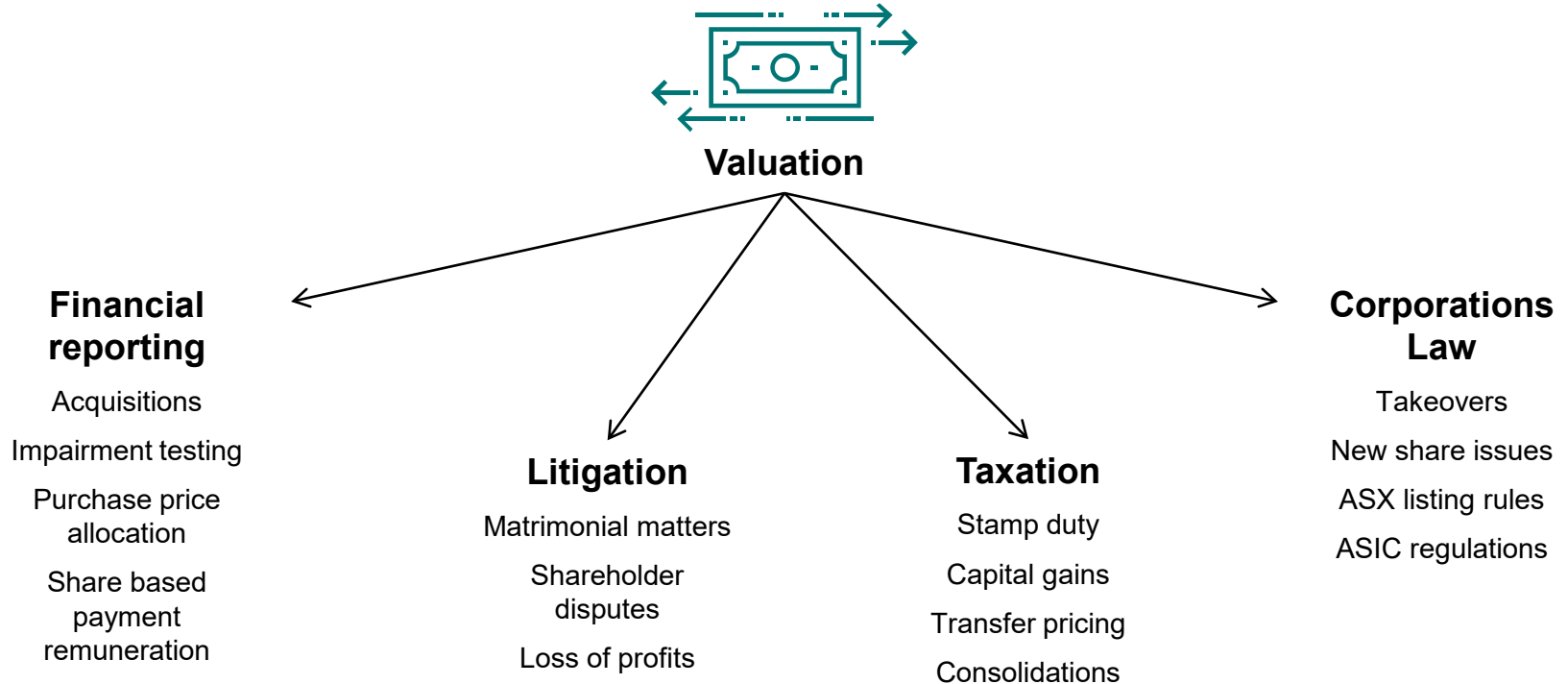
**Our experience  
and sound  
expertise** and  
judgment and  
leveraging the skills  
and experience  
of a full service  
accounting and  
business advisory  
firm.



**Continuous  
discussions**  
with clients about  
the impacts of  
the current  
environment, how  
their business  
is tracking, and  
where they see  
the business in  
the short to  
medium term



# Our valuation services



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