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Unique market shock poses significant challenges in valuation

Unlike 2008, 'you have a situation where revenues have gone to virtually zero overnight'.

Robin Blumenthal

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Southland Royalty may not be a household name, but its unexpected downfall represents a cautionary tale for investors. The oil and gas outfit filed for bankruptcy in late January, just three months after its private equity owner EnCap reported that it valued its investment at \$773.7 million, nearly equal to its total investment in the company since 2015. The demise of Southland came weeks before the coronavirus pandemic and oil shock hit the markets.

While Southland may be an extreme example of the challenges private managers face in marking their illiquid portfolios (and may be anomalous to the typical trajectory toward bankruptcy), when the latest crisis and its economic repercussions and uncertainties are thrown into the mix, the valuation process for managers will undoubtedly be that much more difficult for the first quarter, which just ended...

EXCERPT:

Both the broad economic ramifications and their effect on portfolio companies will pose significant challenges to how managers and their CFOs account for them. "We've never seen a situation where there's such a short-term impact that may either rebound significantly in the short term or may have potential long-lasting effects," said Daniel Roche, national business valuation service line leader at accounting firm Marcum. Beth Wiener, head of Marcum's alternative asset management practice, expects that even those private managers that don't normally mark their books every quarter will have to do so now. Although audits are not even finished for the quarter, "there will probably be drastic changes, not for the methodology but for the inputs", Wiener said.

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