

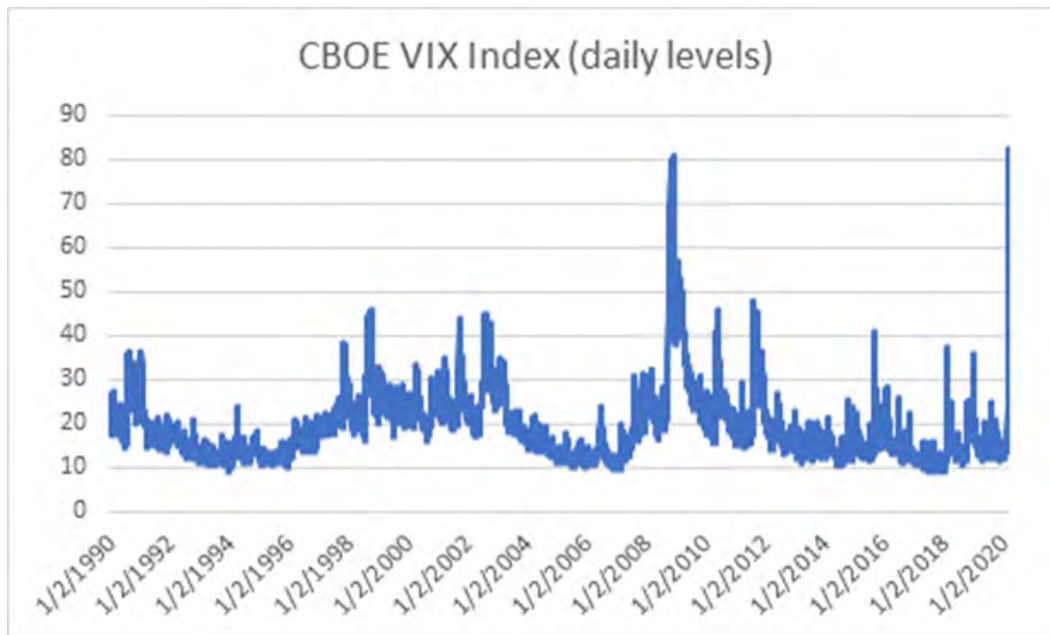


## AXIOM VALUATION UPDATE<sup>1\*</sup>

# THE COVID-19 PANDEMIC SIGNALS THE SUSPENSION OF THE FAIR MARKET VALUE STANDARD FOR NOW

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*Several of our clients are in the middle of a capital raise. The values established are fair market value at year end and well before the collapse of the financial markets related to both the pandemic- a black swan event- and the crash in oil prices- a systematic predictable event. Our advice to them is that while year-end values would ordinarily be within the fair market value range, these values no longer meet the fair market value standard. The reason is that fair market value requires that buyers and sellers are fully informed about the risks. When asset prices are in a virtual free fall and*



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<sup>1</sup> Axiom Valuation Solutions ([www.axiomvaluation.com](http://www.axiomvaluation.com)) is a nationally recognized firm that specializes in the valuation of private firms and works with investors to establish transaction values when they are acquiring and divesting businesses and financial assets. Given the firm's mission, it is expert in analyzing financial market conditions and offers this insight to its client.



*the VIX- the volatility index- is rapidly increasing, indicating rising levels of uncertainty, it is not possible for market participants to price investment risk.*

*Put differently, asset values reflect the probability of cash flows reaching a certain level by a certain time. When investor uncertainty is increasing, this means that the probabilities of cash flows emerging cannot be determined. When this happens, investors sell assets and increase cash holdings. When the proverbial smoke clears, and cash flow probabilities can be established once again, risk can be priced, and fair market value can be determined.*

*One could argue that the current crisis will end in the next several months and that values will return to previous levels. However, this assumes that global market participants will return to their former relationships and will continue to act as if previous events had not happened. But this is never the case because the pandemic black swan event is now something possible and market participants will change their behavior in an effort to mitigate this and related risks. Government policies will also change and probably change in unpredictable ways. Hence, the world has changed, and previous fair market values will be reassessed and pandemic risks, which were previously thought to be inconsequential, will now be thought of as another systematic risk that must be priced.*

*In October of last year, I reached out and argued there was risk building in the fixed income market that was not priced into equity values (*Risk Building in the Financial Markets is Not Being Priced Properly*). I would like to say that our view at the time was prescient and suggestive of what has since transpired. My point then was that the cost of capital- both investment grade debt and equity- was generally too low and there was some evidence that there were parts of the financial market that appeared to reflect this fact. But nobody, certainly not Axiom, had any idea that a black swan event was in the offing. Anybody that tells you that they had some idea about a pandemic is simply blowing proverbial smoke. Moreover, the fact that oil prices crashed, and the pandemic occurred virtually simultaneously is pure coincidence and any argument to the contrary is unfounded and should be fully discounted.*

*As we have told our clients before, the U.S. is now the world's marginal oil producer, and we, not the Saudi's or Russians, set the world oil price. Saudi Arabia and Russia need oil revenue to survive and this has been the case for some time. So, it is no surprise that when oligopolies break up because of new entrants- in this case, U.S. oil fracking- at some point there will be a price war, which is exactly what we are witnessing in the oil markets now. The U.S. may step in to prevent a full oil price collapse, but this will only be a temporary solution. The implications of the secular oil*



*price collapse are too numerous to review here, but it has serious economic and foreign policy implications.*

*When will we return to some level of normalcy? Will there be a recession and, if so, how deep and for how long? The sooner economic policies that reduce uncertainty are put in place, the less the decline in real GDP, and for a shorter duration of time. We are in uncharted waters here. Any model or metrics used to assess the economic consequences are not relevant and are subject to a very large degree of error, since both are based on data outside of any pandemic event and the government's subsequent reaction to it.*

*I am not picking on President Trump's economic team, but they are not philosophically aligned with the fiscal stimulus policies necessary to address the heightened level of uncertainty now driving the economic decisions made by Americans. Tax cuts etc. have no impact and giving away money has little effect, because neither lift the veil of uncertainty. Job security is the number one concern. If people believe that their jobs are not at risk, their spending patterns will be normalized, as they will not be afraid to spend. There are two central ways to do this.*

*First, President Trump should ask all public firms to impose a progressive wage cut on all full-time workers in lieu of firing employees. These wage cuts should be treated as wage deferrals that will be made up when the economy returns to some level of normalcy. This will reduce economic uncertainty and encourage people to spend rather than hoard. An equity buffer will also be created by these actions, so firms in distress will not have to turn to the bankruptcy laws to protect themselves. Secondly, 1099 employees should be able to receive unemployment benefits and these benefits should be doubled for the short-term. In addition to Fed. actions, this response will end the free fall in equity values.*

*Axiom Valuation Solutions will be here throughout this crisis to help with any of your valuation needs. Feel free to call us with any questions or issues you may have.*