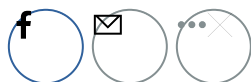
Investors' usual way of valuing companies is under scrutiny— and it could mean the end of the unprofitable unicorns that dominated in the last decade

Bradley Saacks Jun 5, 2020, 12:05 PM



Airbnb CEO Brian Chesky. Airbnb had been pegged as a likely 2020 public debut before the pandemic hit. Richard Drew/AP

Valuing companies — especially money-losing unicorns — was a challenge for investors before the coronavirus

pandemic upended commerce and changed the way the world works.

Now, hedge funds and other investment managers have to determine what kind of world we will be living in the future — and how a certain company will fit in it.

"Companies with negative cash flow will need to prove a path to a sustainable business model in short order," said one hedge-fund manager.

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Weeks after the coronavirus broke out in the US and travel and commerce was halted worldwide, massive asset managers including Hartford Funds and Principal Global Investors arrived at drastically different numbers for what travel-based unicorn Airbnb was worth.

One fund, Macquarie's Optimum Large Cap Growth Fund, even believed the company was worth more at the end of March than last fall, when public equity markets were swollen to all-times highs.

Since those investors made those valuations, markets have only gotten weirder — thanks to a stimulus-fueled bounceback in equity markets despite US unemployment skyrocketing — as the pandemic rages on.

The question now is how investors can determine the worth of a company, private or public, when the world is upended.

"There's a lot of issues with how valuation experts determine the value of a company right now," said Mark Zyla, who runs Zyla Valuation Advisors and is the chairman of the standards review board for the International Valuations Standards Council.

The council put out a report in March with a warning to those tasked with finding out the worth of company: "Valuers should not apply pre-crisis criteria to their valuations as this approach is based on the potentially erroneous assumption that values will return to their pre-crisis levels and there is no way of predicting that this assumption is in fact correct."

Like office real-estate and work-life balance, valuations may never be the same.

Zyla told Business Insider that investors are troubled because two key data points commonly used to estimate a company's worth are either invalid or not

available now. The first is estimates given by companies that investors now can't use because they were made with a pre-pandemic world in mind.

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"The forecasts they made three months ago are no longer valid," he said.

Second, many public companies have delayed reporting financial figures, obfuscating the damage the pandemic has had on their businesses from their investors. It's one of the reasons alternative data providers have jumped in and filled the information void during the pandemic.

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The valuation uncertainty is going to put most pressure on managers that invest private markets, where information on company's financials was

already hard to come by. Mina Faltas, a Tiger Grandcub who started his fund after a stint at Viking Global, foresees "a bifurcation in valuation of privates where certain areas of business will prove to be insulated from the effects mostly. It'll be a haves and have-nots situation."

Businesses that already had a huge digital or "connect-anywhere" presence, like cloud software and esports and certain consumer names like Peloton, will even improve, Faltas predicts. He was an early investor in DraftKings as well as aXiomatic, an esports and video game investment platform, alongside Michael Jordan, Bruce Karsh, Ted Leonsis, and David Rubenstein.

"These are all areas that are now in a stronger position because of COVID-19," said Faltas, who founded Washington Harbour Partners, where he is the CIO, in 2019.

Daniel Ades, the founder and CIO of $1.5 billion Kawa Capital in Miami, believes the pandemic will impact those that eventually make it to a public offering. The pandemic is expected to slow the overall flow of companies filing to go public this year.

But Ades said there'll be a more lasting impact from the pandemic — that the high-flying, but unprofitable, unicorns so many were excited to see go public during the extend bull-market run of the last decade will be forced to start making money for investors.

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"Companies with negative cash flow will need to prove a path to a sustainable business model in short order," he said.

"Yes, I anticipate seeing start-ups rise to unicorn status without making any profits; however, it will be done so much more sparingly. I think valuations will come down to more reasonable levels and growth will be significantly pared back."

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