

Consider a solvency analysis on a company that went through a recapitalization in 2019, or as recently as February 2020, and how different that analysis would look today.

SOLVENCY TESTS

There are three common tests used in a solvency opinion.

1. **Balance Sheet Test:** The balance sheet test determines whether, at the time of the transaction the fair value of a company's assets exceed liabilities. Assets are valued at their present fair salable value and compared with current and long-term liabilities and any contingent liabilities effective after the leveraged transaction.
2. **Cash Flow Test:** The cash flow test evaluates whether a company can meet its debt obligations as they become due. The company's projected cash flows are utilized as a basis for this test. Analysis is performed using various scenarios relative to key assumptions, like revenue growth rates (*no growth, inflationary growth, and historical growth*) and profit margins to estimate the impact of the company failing to achieve its projections.
3. **Adequate Capital Test:** The adequate capital test evaluates as to whether or not a company is expected to have adequate capital to pay its 1) operating expenses, 2) capital expenditures, and 3) debt repayment obligations. This analysis evaluates how much surplus capital a company will retain after a leveraged transaction with the goal of determining whether the company can withstand a downturn.

Finally, as the COVID-19 economy evolves, with the current impact on business cash flows and resulting higher leveraged balance sheets, the question of solvency will become a more pressing topic that companies and directors will need to address. A solvency analysis and opinion performed by an independent third-party can provide a level of comfort to the company's or board's internal analysis.

Established in 1932, **Marshall & Stevens** is a nationally recognized independent valuation firm. Our professionals provide Fairness Opinions, Solvency Opinions and valuations of businesses, debt and equity instruments, real estate and equipment for public and private companies.



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