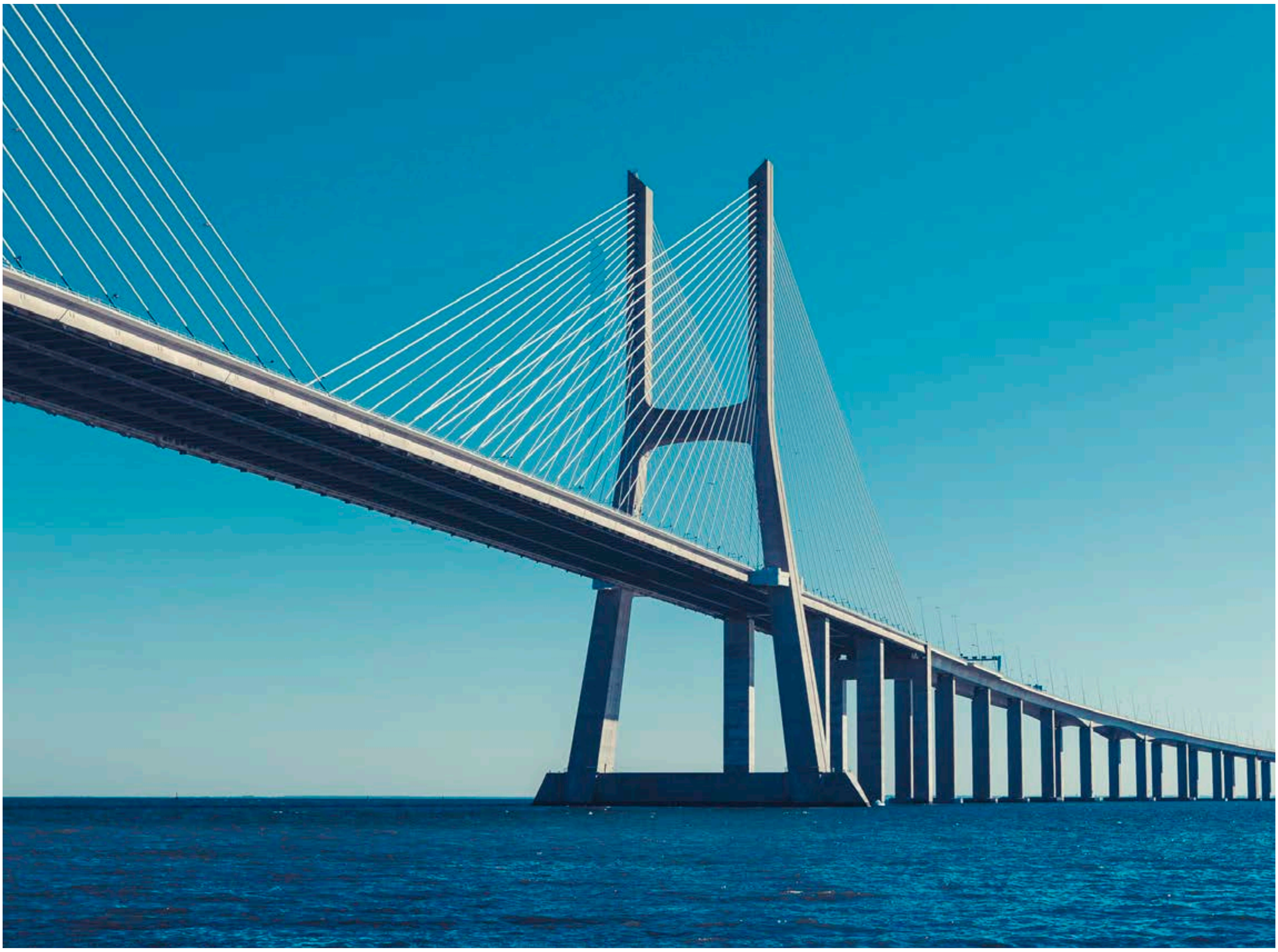
AN FTI CONSULTING REPORT – PUBLISHED 02/02/2023

Distressed Sale Discounts

Developing a Thoughtful Approach to Selecting a Discount To Apply



EXPERTS WITH IMPACT™

FTI™ CONSULTING

Abstract

In restructuring contexts, particularly in relation to Restructuring Plan relevant alternatives and Scheme comparators, it is common to see discounts applied to valuation estimates derived on the basis of the conditions of an orderly sales process. These discounts are often material and consequently can have a significant impact on the valuation conclusions. It is therefore essential that the valuer is able to clearly articulate the circumstances of the sales process envisaged and how it deviates from the conditions of an orderly sales process.

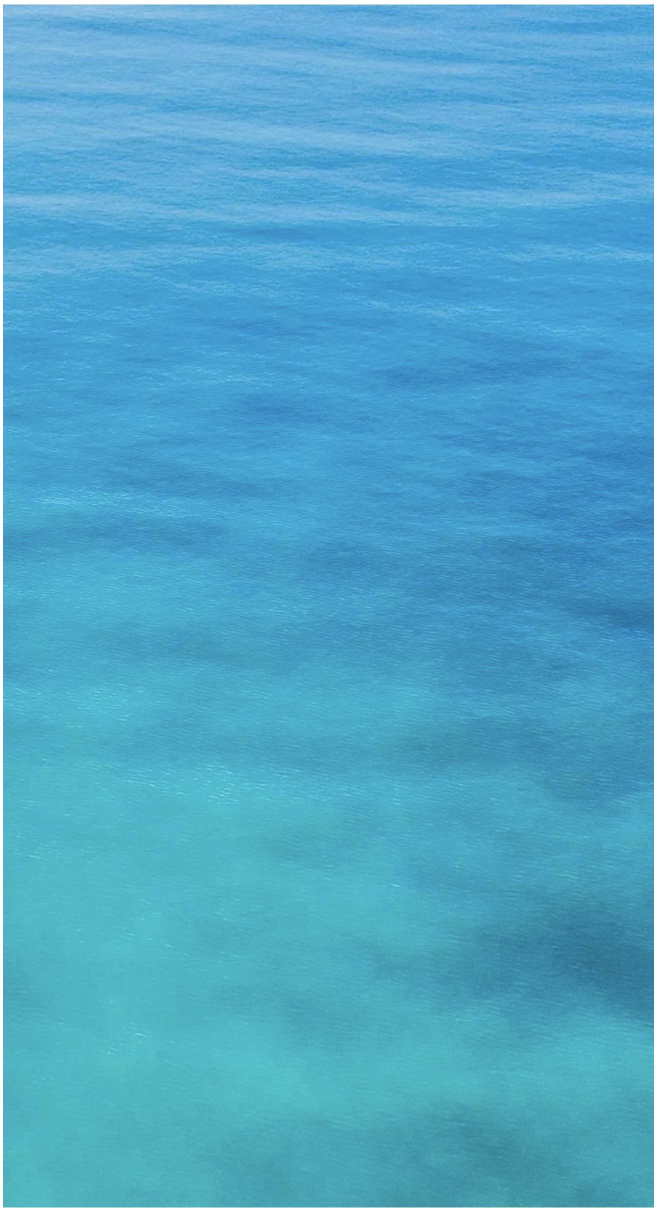
In this context, we set out a summary of the key factors to consider when forming a view on an appropriate discount, examine a selection of discounts previously used by valuers, and summarise the skills and experience of relevant FTI Consulting experts.

Authors

ALEXIS ANAMAN
Senior Managing Director
Restructuring valuation specialist

BEN HUGHES
Senior Managing Director
Distressed M&A expert

JONATHAN DYER
Senior Director
Restructuring valuation specialist



Selection of a distressed sale ("DS") discount

DS discounts are difficult to substantiate empirically, although valuers typically assume a range of 20%-40%. The selected discount should be justified by the valuer based on how the sales process and contract considerations are expected to differ from those in an orderly sales process.

Basis for a DS discount

Standard valuation methodologies e.g. market multiples and income approach analyses typically derive estimates for the value of a business as a going concern and assume a hypothetical transaction in the business under an orderly sales process ("OSP").

Valuations performed in restructuring contexts often need to consider the value that would be realisable from sales processes that are suboptimal relative to an OSP e.g. where a sale is required to be made on an accelerated basis or where the business is in financial/operational distress ("DS process").

Valuers therefore often derive a value estimate for the business on the basis of an OSP as a starting point, to which an estimate of a DS discount is applied to derive an estimate of the value realisable under a DS process.

Selection of a DS discount

DS discounts are difficult to substantiate empirically and indeed the circumstances surrounding sales processes differ from case to case. However, valuation practitioners typically consider a DS discount range of 20%-40% as a starting point.

In concluding upon a DS discount range to adopt, it is essential that the valuer clearly articulates how the sales process envisaged is expected to differ from an OSP. We set out across page 5 and page 6 a summary of the factors that we consider key to review when making this assessment, although we note that there may be other case-specific considerations to account for.

Key considerations

DS discounts are typically material and often have a significant impact on the valuation conclusions. It is therefore essential to have a well-formed and clearly articulated view as to why and how the sale conditions are expected to differ from an OSP.

In forming such a view, it is helpful for the independent valuer to have detailed discussions with relevant parties (e.g. management and restructuring advisors) upfront, in addition to reviewing the financial position of the business (e.g. liquidity and capital structure considerations), to fully understand the basis of and related circumstances for an assumed sales process.

It is not always the case that the nature of a sales process within a restructuring context needs to reflect conditions materially different from an OSP, in which case a DS discount below the starting point range of 20%-40% may be appropriate (including no discount). Equally it may be the case that the sales process anticipated is so accelerated or lacking in available information that a much higher discount may be appropriate (including a situation where the asset simply attracts no interest). The 20%-40% starting point range should therefore be considered as applicable where the factors set out across page 5 and page 6 lie within a reasonable range, i.e. not at absolute extremes.

Examples of DS discounts applied

The DS discounts available to us span from 10% at the low end to 60% at the high end, with a median of 31%. The materiality of these discounts emphasises the importance of clearly articulating the circumstances of the sales process envisaged.

Summary of DS discount benchmarks

Valuer	Valuation context	DS discount adopted
Valuer firm A	Restructuring Plan relevant alternative valuation – leisure/gym sector	30%
Valuer firm B	Restructuring Plan relevant alternative valuation – commodities sector	10% 30%
Valuer firm B	Valuation to support a restructuring under a Dutch WHOA Scheme	20% 40%
Valuer firm C	Restructuring Plan relevant alternative valuation – infrastructure sector	30%
Valuer firm D	Valuation to support a sale under a pre-pack administration – support services sector	26% 31%
Valuer firm E	Valuation to support a sale under a pre-pack administration – support services sector	25% 50%
Valuer firm E	Various subject matters (including restaurant sector businesses)	25% 50%
Valuer firm F	UK retailer in the context of a sale from administration	30% 40%
Valuer firm G	Valuation to support a Dutch share enforcement – leisure retail sector	40% 60%
Valuer firm H	Various subject matters (including UK leisure sector assets)	25% 40%
Median	N/A	31%

Sales process factors to consider

The sales process factors set out below have a material impact on the realisable value (and associated DS discount) that can be achieved under a DS process relative to an OSP.

Overview of sales process factors to consider

Factor	Orderly sales process (OSP)	Distressed sales process (DS process)
Timeline	OSP typically assumes at least three months from launch to completion, with significant time invested before launch to prepare the business for sale.	Depends on the specific circumstances e.g. liquidity/capacity to support the business through a sales process – however the timeline is often significantly truncated relative to the OSP. A truncated timeline can have a material impact on realisable value via, inter alia, (i) a reduction in a buyer's ability to perform due diligence and gain comfort with respect to the asset; (ii) reduced time for potential buyers to obtain internal approvals, which may limit the pool of potential buyers that can participate in the sales process, reducing competitive tension; and (iii) a shortening of the time available for potential buyers to arrange financing.
Quality of information and management access	OSP will typically provide potential purchasers with (i) well-prepared marketing materials; (ii) comprehensive financial information; and (iii) access to management, enabling bidders to perform detailed due diligence.	Where some or all of these elements are missing, buyers may have less comfort with respect to the nature of the asset being marketed and might consider it riskier; consequently this may negatively impact pricing.
Perception of distress	A business being sold under an OSP will not typically be perceived to be in financial distress.	A DS process, when launched, typically announces to the market that a business is facing financial challenges. This may manifest simply in the potential buyers being aware they are in a stronger negotiating position, but it may also make potential buyers wary of the risk that such financial distress may spill over into operational distress, e.g. supplier withdrawals and terms renegotiation.

Sales contract factors to consider

Under a DS process, the potential buyer will often have limited scope to shape the sale contract (e.g. where the sale is being made by an administrator), with limited representations/ warranties or post-deal support being available, leading to higher post-completion risk.

Overview of sales contract factors to consider

Factor	Orderly sales process (OSP)	Distressed sales process (DS process)
Representations and disclosures/ warranties and indemnities	The extent to which warranties and management representation are provided for in the final agreed terms is always a matter for negotiation. However, a purchaser via an OSP can usually expect a full suite of market representations, disclosures, warranties and indemnities from the seller.	Under a DS process, however, it can often be the case that no representations or highly limited representations are made available, placing enhanced risk post-completion with the buyer which may result in a discount. This is either due to an administrator (acting with personal liability) or a seller with minimal economic interest or detailed knowledge of the asset being the counterparty.
Sale and Purchase Agreement	Every element of the Sale and Purchase Agreement/ Asset Purchase Agreement is subject to negotiation between the buyer and seller.	Under a DS process, there is typically reduced scope for negotiation on key contract terms.

Why FTI Consulting?

With more than 7,500 employees and offices in 31 countries on six continents, FTI Consulting's breadth and depth extends across every major social, political and economic hub around the globe.

Market-leading European restructuring team

Our European restructuring team has been involved in many high-profile restructuring cases and frequently collaborates with our international colleagues to deliver on complex, cross- border cases.

Dedicated restructuring valuations practice

Allied to the European restructuring team is a specialised and highly experienced valuations practice that has deep expertise in advising clients on valuation matters in the context of Schemes, Restructuring Plans, pre-packs, share enforcements and share appropriations.

Significant special situations M&A expertise

Our special situations M&A team combines extensive corporate finance and restructuring skills to advise clients contemplating a sale, acquisition or fundraising, typically in distressed circumstances.

ALEXIS ANAMAN
Senior Managing Director
Restructuring valuation specialist
alexis.anaman@fticonsulting.com

Alexis has provided valuation advice in more than 100 restructuring situations, including valuation opinions in the context of Restructuring Plans, Schemes, pre-packs, share pledge enforcements and share appropriations. He also has significant transaction experience and has led several distressed M&A processes.

BEN HUGHES
Senior Managing Director
Special situations M&A specialist
ben.hughes@fticonsulting.com

Ben leads FTI Consulting's Special Situations M&A team in the UK, where he utilises almost two decades of advisory experience to help clients achieve their goals. He has acted as lead advisor on numerous mainstream and special situations M&A engagements, both on the sell-side and buy-side.

JONATHAN DYER
Senior Director
Restructuring valuation specialist
jonathan.dyer@fticonsulting.com

Jonathan provides valuation advice in restructuring situations, and has almost 10 years of valuation experience gained at both FTI Consulting and PwC. He also spent six years at a private equity-backed retail business, where he fulfilled a range of roles, from managing refinancing and acquisitions to the eventual disposal of the business via solvent liquidation.

F T I CONSULTING™