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SPECIAL REPORT

Q&A: Valuing distressed assets

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Q&A

Valuing distressed assets

FW speaks with James Dimech-DeBono at Grant Thornton, Tom Greco at Hilco Valuation Services, Cindy Ma at Houlihan Lokey, Doug McPhee at KPMG, and Thomas B. Burton at Liquidity Services, about the valuation of distressed assets.

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FW: How would you describe demand for distressed asset valuations over the last 12 months? What levels of activity are you seeing?

Dimech-DeBono: Demand for the valuation of distressed assets had been fairly stable as institutions looked at their distressed portfolios as part of their balance sheet management. Now, entities that previously were happy to sit with distressed loans and leases are actively terminating these contracts – for instance, starting the foreclosure and repossession process. The mix of activity is also changing. From a distressed M&A perspective, there has been more activity from US investors in Europe because pricing has been very attractive. That trend looks set to continue, dependent on the relative pace of economic recovery in different countries. Similarly, if the economic slowdown in emerging markets continues, we would expect a shift towards seeking distressed assets in those markets. In an environment of low interest rates, investors continue to seek opportunities, but the geographic mix of activity will shift to reflect differing economic fundamentals across countries.

Greco: Demand for distressed asset valuation activity has increased measurably, but not dramatically, over the last 12 months. Much of this demand is coming from incumbent lenders and owners who are looking deeper into the balance sheet to meet the company's needs for liquidity. We are also seeing more credits move from lower-yield lenders to higher-yield capital providers as the borrower's financial performance declines. Demand appears to have increased at a greater rate in Europe vs. North America. Demand for intellectual property valuations has significantly increased. Based on current capital markets aggressiveness, demand for valuation of distressed assets will likely increase dramatically in the not-too-distant future.

Ma: We are seeing an increased demand for valuations of illiquid securities as investors, regulators, auditors and others push for increased transparency. Distressed assets are often illiquid, so demand for valuations has likewise increased. Valuations of distressed assets are performed for many purposes – in the context of a transaction, for litigation or dispute purposes, or for financial reporting purposes. Because of a desire to have an independent view in these situations, many market participants will engage a third-party adviser to prepare a valuation of these assets.

McPhee: As you would expect, demand for valuations in this space has increased in recent years as a result of the financial downturn. While this may have eased to some extent in certain markets and geographies, there is certainly still a lot of work to be done, particularly as restructuring deals such as those agreed in 2007-09 are revisited and the balance sheets of European banks come under increasing pressure. In the current environment, investors, lenders and other stakeholders have sought increased comfort over valuations through robust and defendable commercial analysis, particularly for distressed assets which often have an uncertain outlook and value recovery profile. We have also seen investors putting increasing pressure on management teams to unlock shareholder value from non-core assets that are distressed or underperforming, be it through fixing these businesses or exiting them, in order to improve portfolio quality, reduce complexity and deploy capital more effectively.

Burton: While the market has been relatively level from a global and macro perspective, this past year we are seeing signs of increased demand for distressed asset valuations and disposals, especially in industries such as construction. There has also been a trend in the UK of larger companies, known as 'zombie companies', barely able to service their debts, choosing to subsist on low interest rates and bank forbearance. According to The Adam Smith Institute, there are approximately 100,000 such companies in the UK which they would recommend to be restructured or liquidated. By doing so, additional capital and resources can be made available which might be used for other growing or new companies.

FW: Is it rare to see valuations in today's market meet the expectations of buyers and sellers? How wide is the gap? How would you characterise general valuation trends overall?

Greco: Today, there is a material dichotomy between buyer and seller expectations – as in most markets – but deals are getting done so mutual valuation expectations are ultimately being met. M&A transaction volume is below its historic peak overall, but distressed M&A seems to be a relatively active market. This suggests that valuations are in line with both buyer and seller expectations, and in some cases valuations have been exceeding expectations. This is certainly true in both high technology and in the brand management industry. Manufacturers and retailers, on the other hand, are not seeing elevated valuations, and are also not seeing substantial M&A volume.

Ma: In the context of a transaction, disagreements between buyers and sellers over value are nothing new. As with any assets, the gap with distressed assets is situation-specific. For example, right after a default there can be a burst of trading activity in a company's bonds as investors who were not expecting a default sell. With a significant influx of liquidity, the bid-ask spread on such bonds can be relatively small. However, as the situation unfolds over time, the liquidity can shrink, thus widening the bid-ask spread considerably. Additionally, today's low-rate environment has led many investors to search for yield, thus narrowing the bid-ask spread.

McPhee: There is often a value expectation gap between buyers and sellers, and this hasn't necessarily widened as a result of the current market backdrop. What we have seen are buyers coming under increasing pressure from their investors to not overpay for assets, while sellers are faced with a decision between exiting today and redeploying capital, or holding their nerve, riding the storm until a more opportune time in terms of value realisation. As a result there has been an increased focus on potential value recovery and future realisation through the cycle, with holders relying on robust and independent valuation advice both to support their strategy and decision making processes, and also to use as a negotiation tool to help bridge the expectation gap and minimise value leakage.

Burton: A key role of the valuer is managing expectations – and those expectations will vary based on the client and the specific case. When distressed assets are being valued for restructuring professionals, there is typically a general awareness of the market in which distressed assets trade. A properly researched valuation is seen as a valuable tool by these professionals and will usually be relied upon. When the valuation firm properly sets expectations and explains all the factors that went into the conclusion, buyers and sellers better understand the value. It's important for parties to understand that many buyers have a psychological predisposition to expect a bargain because it is a distressed asset. Typically, the gap is not so big that it cannot be bridged with transparency and a partnership approach, which a trusted vendor will offer its client. In terms of other trends, there can be seasonality to the market which can ebb and flow with buyer and client budgeting.

Dimech-DeBono: As with any valuation, there is a question of perspective. Even on liquidly traded assets, gaps in pricing always exist, as represented by the bid-offer spread. Obviously, for illiquid assets the spread is usually wider and with good reason. While spreads are not as wide as they were at the height of the crisis in 2008-09, they can be significant in a fire sale situation and I have been involved in situations where the width of the gap ended up being a deal breaker. In current market conditions, with no shortage of alternative acquisition targets, this should not come as a surprise – it simply boils down to fundamental economics. Overall, valuation trends remain fairly consistent and are a function of perspective, economics, geography, funding, strategic factors and a degree of subjectivity. At the end of the day, valuation is not a science.

FW: Could you outline some of the latest techniques and metrics used to value distressed assets?

Ma: Distressed assets encompass a wide variety of different asset classes and situations. The techniques used to value distressed assets often involve estimating a range of

possible outcomes or an expected outcome, understanding the extent to which the investor can influence those outcomes, and evaluating the risks and uncertainties around those outcomes. Different asset classes may have different valuation techniques. As an example, assume you are evaluating a financially distressed company. To estimate future cash flows from the company, you would consider the likely scenarios for the company – each of the very different scenarios has different implications for the holders of the various securities in the company's capital structure. In a restructuring scenario, senior creditors may be repaid in full, junior debt securities may receive a fraction of their stated amount, and equity may be wiped out or significantly diluted. In a scenario where new equity comes into the company, debt holders may receive partial repayment, but may have to reduce interest rates or extend the term of the debt. Existing equity may be significantly diluted. Each of these scenarios has implications on the amount and timing of cash flows received by the various capital providers and may result in different rate of return requirements for the same security.

McPhee: When it comes to the valuation of distressed businesses, the real questions are what is the actual market value of the business today, and is there a potential for value evolution at a given future date – that is, is it more effective to trade through the downturn in the cycle or to foreclose on the debt? The valuation process is less theoretical and focuses more on who the potential buyers or investors are today, the depth of that buyer pool and their availability of funds and what those potential buyers would pay for this business or asset in the current situation. Business-specific discounts and assessment of the potential buyer audience and their appetite for the particular type of asset become much more important in a distressed situation, particularly when earnings are falling and multiple erosions can accelerate disproportionately quickly.

Burton: Valuation is a process that continues to be based upon market evidence where it is available. There is no direct substitute for reliable market evidence and this data can be reliably found by an expert valuer, who will have access to the right resources and possess the capability to properly interpret the data. In terms of metrics, recent evidence of similar assets traded in the marketplace is still the strongest indicator of value, though a valuer would need to apply their own knowledge when interpreting this data, as allowances need to be made for dealer mark ups, value of warranties, condition of assets, and so on. With inventory valuation for products on-hand or held in warehouses by retailers or consumer products manufacturers, historical sales, profitability, open orders, and other data points for physical items can aid the valuer in producing a reliable valuation, but there is no replacement for experience.

Dimech-DeBono: For distressed assets we would usually look at asset-based and income-based techniques. Depending on the liquidity of the assets in question, we may also look at a market approach. For structured assets and portfolios of structured assets, and in highly illiquid situations, my approach tends to be based on an income approach. Being able to calibrate to the market is always key, otherwise the valuation becomes a theoretical exercise and possibly of less value to the client. From a portfolio perspective – and this is quite critical as institutions dispose of portfolios of assets – concentration risk or correlation should not to be ignored, as overall returns can be binary in an extreme situation.

Greco: A greater emphasis is being placed on understanding strategic value in an acquisition, which may partially explain the values being realised in the M&A market. However, from a credit and underwriting perspective, traditional valuation techniques – market, income and asset – are still being relied upon for issuance of new capital.

FW: To what extent is the valuation process made more difficult in the absence of market parameters, or comparable benchmarks? What alternative factors does a valuer need to rely on in these circumstances?

McPhee: Given the distressed nature of the business and, often, the existence of significant additional business and forecast specific risks, a number of methodologies should be considered when triangulating the value range and assessing an appropriate risk-adequate adjustment. In-depth understanding of the key business drivers is essential to select appropriate comparable companies and derive a level of market multiples for a similar non-distressed business. However, a potential buyer might not be prepared to pay a full market multiple for the business today given current uncertainty around company specific issues, particularly for a distressed business. It is therefore important to assess the business specific issues and non-systematic risks to arrive at risk-adequate considerations for multiple discounts. These risks include operational reorganisation including new management initiatives to be implemented to stabilise the business, integration of new management, performance deterioration and significant growth forecast, refinancing risks and risk of formal breach of financial covenants.

Burton: In the absence of strong or trustworthy market evidence, the valuer needs to rely on other dependable methods. In short, he or she can take a cost approach, accessing company data to determine the cost of the asset and applying depreciation factors to arrive at a value. Another tool is to determine if there is investment value in the asset and value on a multiple of income or profits derived from the asset over recent times. Even where market evidence is scarce, wider market knowledge can be essential and a good valuer will turn to their rolodex of contacts in a particular industry to corroborate the ▸▸

value of a distressed asset through similar asset values and market trends. Additionally, a valuer with online marketplace platforms and a strong buyer base can provide a basis of comparison for pricing, especially in real-time. Ultimately, experience will aid and inform a valuation; there is no better partner for a distressed asset scenario than a valuer with market expertise and relevant experience.

Dimech-DeBono: The absence of market data always makes a valuation more trying. Typically, in any valuation we use a primary and secondary method. Both approaches require calibration to the market. A distinction should also be drawn between asset classes. With corporate securities, information is generally available from comparable companies or transactions, but with asset-backed securities, for example, the assets may not have traded for a considerable time and you end up marking-to-model rather than marking-to-market. This is recognised even from an accounting perspective as both under US GAAP and IFRS, assets are classified into three categories – ranging from Level One assets which have directly observable prices to Level Three assets, where these are marked-to-model using a set of assumptions. The assumptions used may be either market implied or based on management estimates. In the latter case, these may be susceptible to an element of subjectivity, making the valuer's task more challenging.

Greco: Valuation practitioners frequently rely on time-tested modelling structures which typically rely on market data available as of the valuation date. Where there has historically been a challenge is during brief periods of severe dislocation, such as the last quarter of 2008. Much of the valuation work conducted during that period reflected tremendous uncertainty, and the transactions which took place during that period were priced with the same uncertainty in mind. The valuation practitioner needs to understand how to interpret market data to understand what is anomalous, and what represents longer term trends. The parameters are always present, the key is having the ability to understanding and read them. Subject matter expertise and experience are invaluable in unpredictable markets. Having a global perspective and reach is also important.

Ma: Valuation is increasingly difficult as the uncertainty involved increases, and distressed assets often have a high level of uncertainty. Comparable benchmarks may not be reliable in the valuation of a distressed asset: for example, applying multiples based on healthy comparable companies may not be appropriate when valuing a distressed company with depressed cash flows. In such cases, analytical techniques can sometimes be used that can lessen the need for such data – for example, decision trees, real options analysis, and Monte Carlo simulations can help in the estimation of future cash flows. The facts and circumstances of the asset must also be considered, such as whether the resolution of the distress is likely to involve an in-court or out-of-court restructuring, a liquidation, or a potential turnaround in the business. These factors all influence the estimate of the likely cash flows received in the future.

FW: Could you describe the complexities of identifying and valuing intangible assets? What does this process entail, and what pitfalls does it present?

Burton: Intangible assets can encompass a range of categories including marketing-related assets, such as trademarks, brands, web domains; customer or supplier-related assets, like customer lists; technology-related assets – for example, patented technology; and goodwill, among others. Given the range of possibilities, there are a number of approaches which can be utilised in silo or in tandem to develop a proper valuation. A traditional market approach can be difficult due to lack of sales history for identical assets. Typically, the information to enable an income or cash flow valuation approach is often more readily available. This income method looks at marginal cash flow and ascertains the present value of the future economic benefits of the asset through the use of discounted cash flow (DCF) methods.

Dimech-DeBono: In general, accounting standards require an intangible asset to be recognised if there is certainty on the future economic benefits arising from the asset, the corporate entity has legal control over it, and if the asset is separable from the business itself. Intangible assets can be valued using a cost approach, income approach or a market approach, depending on the economic utility, transferability and stage of the asset's life. Since each class of intangible assets possesses unique characteristics they pose significant valuation challenges. Assets, such as patents, with limited utility may have a discrete period of life for economic exploitation, however assets such as franchise and licence agreements have characteristics of transferability and non-specific utility that could enhance or diminish value. Since intangible assets are generally illiquid and hard to transact there are no readily available market prices, which poses the greatest challenge to their valuation.

Greco: Intangibles are mostly unique, but at the end of the day, everything has a substitute. The strength of an intangible is the extent to which it can create economic value for its owner based on the notion that substitutes are less valuable. In the case of brands, this may be purely based on market perception. In the case of patents, the value can be determined by monopoly rents that accrue to the patent holder. When these assets are actively being commercialised, either through direct product or licensing, valuation requires understanding how to disentangle the intangibles from the other assets of the enterprise, and also understanding how the market pays for similar assets under licensing arrangements. For non-commercialised intangibles, the exercise is much more difficult, and this relates to both the risk associated with commercialisation and market risks.

McPhee: Management teams often have strong views regarding which intangible assets are the most valuable to their business, and the challenge lies in quantifying the value of these and determining what other, less obvious intangibles might exist. This is key not only to securing the right price, but also to protecting shareholder returns; failing to recognise and value intangibles correctly at the outset can lead to future accounting impairments, impacting distributable profits. When valuing distressed intangibles, such as brands or technology, their useful life needs to be considered carefully. For a company with an established longer term track record that is now distressed, it can be difficult to quantify the impact of this distress on the ability of the brand and customer relationships to generate future earnings or super returns. In such cases it is vital to understand the reasons for the business's underperformance, the potential impact on individual intangibles, and the likelihood of resolving the issues going forward.

FW: If a distressed entity has licensing agreements in place, such as software and IT assets, what specific issues need to be considered?

Dimech-DeBono: Maximising the value of intangible assets in distressed situations ▸▸

is not easy as it is hard to sell such assets piecemeal. Historically, it was unusual for insolvency practitioners to look at software licence agreements as assets that could generate value, but this trend is changing. The transferability criteria for licensing agreements and technological advances that may have rendered the asset partially obsolete are key. As many software licences have standard utility and are available 'off-the-shelf', pricing can be less of a challenge. Non-standard IT assets, which may have been internally developed, may need more rigorous valuation analysis as their utility outside the business may be questionable. Income-based methods of valuation can be employed if the IT asset is generating revenues. If it is being used for internal purposes, a comparable 'off-the-shelf' asset can be used as a benchmark for pricing after taking the age and utility of the asset into consideration.

Greco: These issues are largely addressed in the scope of the valuation exercise and the assumptions the valuation professional is utilising. Typically, valuations of enterprises in distress which have going concern value will rely on the assumption that non-core licences, which are typically non-exclusive, would remain in place. When the subject has exclusive licensing deals, either inbound or outbound, the valuation professional needs to understand how those rights and the terms and conditions of those licences, and applicable local insolvency law, would impact values.

McPhee: This depends on the distressed entity's perspective. As licensor – the entity has an intangible asset which has been licensed, from which it generates a revenue stream – the key concerns arise around the impact of distress on the licensor's ability to continue to derive the relevant income stream. For example, is there a risk that the licensee will terminate the agreement? As licensee, presumably the distressed entity has licensed a technology which enables it to generate an income stream. So the question is then whether the distress has resulted in a breach of covenants that could cause the licensor to terminate the agreement? Either way, concerns arise around the contractual position, the counterparty risk and the security of the distressed entity's cash flows.

Burton: This is an area where special attention certainly makes a difference. The key issue for licensing agreements is whether or not the licences are transferable to a new owner. If they are not transferable, then the purchaser will need to investigate their ability to secure the licence from the licensor before they purchase the asset. In the case of non-transferrable licensing for software or IT assets, difficulties can arise if the software is proprietary and central to the operation of an asset. If it is an M&A transaction, valuers will typically adjust for the licensing fees under a distress situation. Beyond licensing, there can be more practical issues, such as access to assets used in specific industries. For instance, if IT or computer aided design employees have left the company and a dongle cannot be located for a critical IT asset – the equivalent of a key to a car – that can affect the valuation.

FW: Time can be a rare commodity in distressed deals. How do compressed timelines impact the valuation process, particularly in fire sale situations?

Greco: The valuation professional needs to make the time element a central component of the assumptions underlying a report. With respect to process, valuation professionals need to assemble as much information from the subject as quickly as possible and may ultimately find themselves without an optimal, comprehensive data set. All of these limitations need to be outlined in both the scope document and the report. As time relates to value, in 'fire sale' situations the stakeholders are frequently faced with a combination of falling asset values and a smaller pool of willing buyers, both of which have an adverse impact on value. Additionally, buyers acting very quickly may be forced to pay cash if they cannot arrange debt financing fast enough, which also reduces value even if there are recapitalisation options available to them in the following weeks or months.

Ma: Fire sales can dramatically reduce the price realised in a distressed situation. The valuation process is impacted as there is typically a corresponding compressed timeline in finalising the valuation. Furthermore, there is greater uncertainty in the values as traditional valuation benchmarks may not be applicable in a fire sale. Reduced timelines impact the time a potential buyer has to analyse the situation, which leads to greater uncertainty for the potential buyer. Also, fire sales often occur when the company is collapsing, and the speed and depth of that decline may dramatically impact value. When there is a highly compressed timeline, buyers know it and will often seek to benefit from the company's desperate situation. As a result of these factors, there is potentially a greater variance around valuation conclusions in the context of a fire sale. Because the universe of distressed investors who can execute quickly and seek to invest in such opportunities is relatively small, prices realised by such quick sale processes can be relatively low.

McPhee: Over the last two years we have seen a number of distressed assets being put into administration, sold as a pre-pack, or sold in a fire sale or accelerated process, which unless carefully run, pose the risk of significant value deterioration or leakage. Often, when a business is being sold under extreme time pressure, there has been a material performance deterioration in the current trading, possibly with no stabilisation in sight, and the stakeholders are not willing or not able to take on – or fund – additional operational and financial risk going forward. In such cases there is limited time to run a detailed diligence process and assess future business potential, and this is reflected in the discounts applied by the market. When valuing such assets consideration of multiple downside sensitivities, particularly given the lack of due diligence, is vital. In addition, the negative pricing impact could be increased by a number of opportunistic buyers in the fire sale market looking for lucrative turnaround candidates. One of the key characteristics when this occurs is the velocity at which trading multiples can fall.

Burton: Restricted timescales are commonplace regarding the sale of distressed assets, and should be factored as a variable into the valuation. Having more time to negotiate deals with current customers and vendors will increase recovery value more so than in a scenario where the time is restricted, and valuers should be well-versed in this relationship of time and value. In certain circumstances – for example, landlord or leasing issues – assets need to be sold with exceptionally restrictive timelines and it's critical to save on storage and transport expenses as much as possible. In this situation, a bulk sale of assets to a buyer familiar with the needs of the situation can provide for the optimal net realisation within the constraints. The exit strategy overview of the valuation is also key in such instances, as is the marketing strategy. Allowances also need to be made to account for the time required to physically remove the asset, as this can take significant time and further limit the marketing timescales. It's important to work with a vendor who is in the market on a continuous basis and has the market knowledge and contacts to work with compressed timelines.

Dimech-DeBono: A normal sales process requires time for collecting and verifying financial information; assembling and distributing information memoranda and eliciting expressions of interest; assessing and approving appropriate deal financing; and, for a full due diligence, marketing and bidding process. Compressed timelines may not impact the valuation exercise significantly, as we can put the necessary resources in place to reasonably value the assets in question. However, if the sales process is condensed, value realisation usually suffers and is reflected by assigning a valuation discount for lack of marketability and liquidity. An accelerated sales process also imposes additional risks and limitations on potential acquirers, such as: limited time available to identify and engage with potential buyers; increased likelihood of limited, incomplete and poorly organised information; a limited or incomplete due diligence process; and a limited period for potential buyers to raise finance. These factors can make the overall discount applied quite significant.

FW: What additional valuation challenges tend to surface in cross-border distressed transactions?

McPhee: Cross-border distressed transactions can be more complex due to the differences in fiscal and legal regimes which may not offer the same optionality in all countries. For example, in some markets it is the stakeholders – including employees and jobs – and not just the shareholders or creditor banks that are protected and this can severely limit value realisation options leading to lower realised prices. A valuation in such circumstances requires all involved parties to hit the ground running. Having access to local expertise and market knowledge around comparable business, trading dynamics and depth of investors is critical as timetables typically do not allow time to build up that knowledge of the foreign jurisdiction from the outside. It is imperative to get a handle on the country by country trading environment for the business, and actions being taken to address any areas of weakness via some sort of independent business review.

Burton: A number of issues may affect a purchaser in a cross-border scenario and, consequently, impact the strength of offer from a purchaser. More often, the day-to-day factors include logistics and transportation, export and import, VAT and duty – including zero-rating of VAT – payment issues, proof of export for VAT purposes, engineers' reports, and certificates of origin and knowledge of commodity codes. In addition, certain rules may apply to a specific country or region, which can affect whether or not an asset can be sold – components which might be used to build weapons in a country where restrictions might apply. Though the scenario is rare, dual-use applies in this circumstance, and it is important to work with a valuer who can provide additional compliance around this area, helping to protect the client and even the purchaser, who may not be as informed on the relevant regulations. There can also be cultural and legal issues that need to be addressed early on, so an awareness of local jurisdiction and driving forces can be added value from an expert vendor.

Dimech-DeBono: The importance of a robust due diligence process increases in cross-border distressed transactions as the need to obtain sound and reasonable information for the valuation takes on an extra degree of significance. Interviews with management and verification of their projections, despite language barriers, become a more pertinent exercise and key to the valuation. In conjunction with this approach, to reach reasonable conclusions on value the analyst also needs to consider a range of issues raised by the cross-border nature of the transaction, such as: foreign exchange fluctuations and volatility; reconciliation of corporate and value added taxes between the two countries; legal differences regarding the ownership and control of different types of distressed entities, portfolios, or assets; and different accounting treatments and policies. Analysts must also consider geopolitical risk and possible political pressures depending on the national importance of the asset or assets, for example, when dealing with power plants; and the quality of the assets and their location.

Greco: Money is still the ultimate fungible commodity, even when changing currency. Where valuation professionals need to demonstrate their skills in these cases is both with respect to local insolvency law and understand how to interpret comparable transactions, as well as the tax implications that arise from these transactions. In many cases, buyers domiciled in the same locale as the seller will benefit from local market knowledge, speed, and structure. Overseas buyers may be slower to respond and to the extent that time is an issue, these limitations will show up in value. Other considerations include local perfection laws, access to assets, differing preferred or secured creditor issues, differing local licensing requirements, and language barriers. Having access to global markets can enhance value, but cross-border considerations must be fully understood and factored in. One significant challenge comes from the limited number of cross-border events that have been 'tested' in a distressed situation.

FW: How important is it for the valuer to maintain transparency and accountability throughout the process?

McPhee: Transparency and accountability – in appearance and in fact – is absolutely vital when issuing independent valuation opinions to banks other creditors and possibly the courts in a restructuring situation. This should be at the heart of any good valuer's approach. A fully transparent valuation process helps our clients and the users of our valuation opinions understand how the conclusion was arrived at and to understand the key cash flow drivers and risks, and importantly their impact on value under different strategic and operational scenarios. This can help bridge the expectation gap between buyer and seller or borrower and lender, by helping each party understand how the other's view on particular upsides or risks translates into their view on value and to narrow any gap in a negotiation situation. Being open and accountable for ones views also brings credibility and trust to the process. These are all important considerations when seeking to achieve a successful outcome for all stakeholders.

Burton: For all valuers, and especially those professionally qualified and affiliated with organisations such as the Royal Institution of Chartered Surveyors' (RICS) and the American Society of Appraisers (ASA), professional standards and ethics are paramount. It is important to treat all parties in a specific valuation case with respect and demonstrate openness and candour. This is an area where a valuation team with a marketplace platform capability can add value by providing a transparent marketing and bidding process. Raising red flags – such as troubled credit or high reliance to the advance rate – early in the process with clients not only helps to avoid any surprises further down the line, but emboldens a more interactive process with the client and company being appraised. In this industry, a valuer's reputation is built on transparency and accountability. Therefore, it is unlikely that a major client will contract with valuers and firms with questionable ethics.

Dimech-DeBono: In our experience, this is one of the critical success factors in actively managing the resolution and ultimate disposal of an asset. The valuer must be completely independent and objective about the asset's condition, status and present value in a marketplace, which may be subtly changing, dependent on both global and local factors, such as foreign exchange, interest rates and EU or government intervention.

Greco: This is non-negotiable. A valuations firm's greatest asset is its reputation – and the reputations of its professionals. A large part of that reputation is communicating often and clearly throughout the process and providing detailed support for all assumptions and considerations that are the foundation of every valuation report issued.

Ma: Distressed assets represent a small but important asset class in today's market, as market participants continue to resolve situations stemming from the recent financial crisis and prepare for potential future distressed situations. Also, given a lack of transparency with respect to certain distressed situations, the valuation provider should identify key assumptions and limitations underlying the valuation. Finally, the methodologies used to value distressed assets often involve a significant amount of judgment. As such, it is critical for the valuation provider to be fully transparent about the limitations of his or her analysis and the assumptions that were made in its preparation.

FW: In what ways are valuations influenced by the likelihood that whatever values are presented will be contested or disputed by one or more parties down the line? Is this a regular occurrence in today's market?

Burton: While challenges to valuations are not the norm, there is an ever-present risk that the valuation and disposal result may be challenged by one of several possible parties, such as an aggrieved creditor, director, or competitor. The prospect of a challenge is further encouragement for valuers to perform their due diligence to ensure the valuation is accurate and that any sale is completed at the best value achievable within the constraints of the process. More often, there are simply questions from the client or others who may not have been involved in the process who want additional clarification or desire to hear the appraiser's opinion of the value. Valuations tend to be more technical in nature and if data is interpreted and used properly by an expert valuation team, then the value will typically be a fair and accurate representation of the asset. In a distressed asset scenario, this level of trust can make all the difference.

Dimech-DeBono: Valuation opinions are formed on the valuer's independent view. Independence is not just a principle: before we take on any assignment, we ensure that we are free from any conflict of interest. Importantly, any valuation is based on information pertaining at the valuation date and, in most cases, any subsequent information would not be relevant. In forensic assignments our duty as valuation experts is to the courts. In commercial assignments, in our role as valuation advisers, we are required to be independent and, whatever the purpose of the valuation, we form our own view of the value of the assets in question. Litigation appears to be on the increase, especially in an environment where economic conditions are challenging. In the case of asset disposals, demand for fairness opinions has increased as boards, in addition to the generally greater prominence of governance issues, recognise the need for independence regarding valuation.

Greco: Valuation disputes are more frequent in distressed situations. Most of these disputes result from mismanaged expectations, but they also can result from poorly run processes. Only occasionally are these disputes centred solely on an understanding of underlying asset values. Valuation professionals should take care to outline the assumptions regarding a sale process, timing, access to diligence, clarity of rules, and the other parameters that are typically associated with achieving undisputable results. Not only will this set expectations for the client, but will also minimise risk for the valuation professional. To be an independent and reliable valuation professional, it should not matter who your client is. As long as you properly define the scope of the project – standard of value, premise of value, purpose, valuation date, conditions, assumptions, and so on – it is the valuation professionals responsibility to provide an unbiased estimate of value. Every time a valuation professional produces a report, they should be prepared to defend their value conclusion to the client, attorneys, the courts, regulatory and government agencies, as well as other constituents involved in the situation. If they are not prepared to do so, it brings into question the credibility of the valuation and the valuation professional.

McPhee: In the context of distressed business valuations, in particular when it comes to a formal financial restructuring, stakeholders are most concerned about where the 'value break' is and who has the economic ownership of the business. Small changes in value could lead to a change of economic ownership of the business and impact the strategic options available to the economic owner. Distressed valuations are therefore often being scrutinised by a number of parties and their advisers. Robust, thorough analysis and an in-depth understanding of the business and market are critical factors in any the valuation process, but become significantly more so when dealing with substantially different interests and views on the subject business and its prospects. Amongst other things, this may be reflected by the number of sensitivities and scenarios considered, or the level of detail included in the written valuation report. ■