

Ch. 4 Valuation of Select Intangible Assets

What Is an Intangible Asset?

In accounting, an intangible asset is a resource with long-term financial value to a business. It also isn't a material object.

The meaning of intangible is something that can't be touched or physically seen, according to the Cambridge Dictionary. Intangible resources don't exist physically, though they still have value.

Types of intangible assets include a business's reputation, copyrights, trademarks and brand recognition.

PURPOSE OF INTANGIBLE ASSETS IN BUSINESS

Intangible assets improve a small business's long-term worth as opposed to tangible (physical) assets like equipment or computer hardware that are used to calculate a business's *current* worth.

Intangible assets have value thanks to the sole legal or intellectual rights they enjoy. Intangible assets also improve the value of *other* assets.

- For example, Coca Cola may have a vast inventory. But the value of that inventory is greatly increased by intangible assets like brand recognition and a good reputation.

Intangible assets can't be used as a guarantee ("collateral") to get loans, unlike tangible assets that lenders can seize if the loan isn't paid back.

Valuation Approaches to Measure Intangible Assets

1. **Market Approach** Observable (one might say "findable") market based transactions of identical or substantially similar intangible assets recently exchanged in an arm's length transaction are often difficult to obtain. Publicly traded data usually represents a market capitalisation of the enterprise, not singular intangible assets. Market data from market participants is often used in income based models, such as determining reasonable royalty rates and discount rates. Direct market evidence is usually available in the valuation of internet domain names, carbon emission rights and US Federal Communications Committee licenses (for radio stations, for example). Consider the following:
 1. Search for sale/license transactional data
 2. Issue of comparability and timing
 3. Selecting/adjusting price multiples
 4. Selecting/adjusting royalty rates
2. **Income Approach** Income based models are best used when the intangible asset is income producing or when it allows an asset to generate cash flow. Just as in other valuation

assignments, an income approach technique converts future benefits (such as cash flows or earnings) to a single, discounted amount, usually as a result of increased turnover or cost savings. We have the traditional two choices of either capitalising a single period of benefits or discounting a future stream of benefits. One of the primary difficulties within an income approach method is distinguishing the cash flows uniquely related to the intangible asset from the cash flows related to the whole company.

Income models examine a discount rate from either

- (1) a weighted average cost of capital (WACC),
- (2) a weighted average return on assets (WARA), or
- (3) an internal rate of return (IRR) to the investor.

3. **Cost Approach** Cost based analyses are based on the economic principle of substitution and usually ignore the amount, timing and duration of future economic benefits, as well as the risk of performance within a competitive environment. Historical cost reflects only the actual cost that had been incurred to develop the asset. Reproduction cost new implies the current cost of an identical new property. Replacement cost new implies the current cost of a similar new property. Having the nearest equivalent utility to the property being valued. In most cases, replacement cost new is the most direct and meaningful cost based means of estimating the value of an asset. Once replacement cost new is estimated, various forms of obsolescence must be considered, such as functional, technological and economic. Physical deterioration is common for tangible assets, but not for intangibles, although overuse or deterioration of tangible assets could affect value of specific intangibles and the business enterprise.

Valuation of Copyright

Copyright Valuation

Copyright is an important practical component of intellectual property / IP rights, brands and intangible assets. In general, copyright protects work such as:

- Literary, dramatic, musical and artistic work, including illustration and photography.
- Non-literary written work, such as software, web content and databases.
- Sound and music recordings.
- Film and television recordings.
- Broadcasts.
- The layout of published editions of written, dramatic and musical works.

Copyright gives the right to prevent copying, distributing copies, renting or lending copies, performing, showing or playing in public, making an adaptation, and putting it on the internet. In most countries copyright lasts a minimum of life plus 50 years for most types of written, dramatic and artistic works, and at least 25 years for photographs. It can be different for other types of work.

Valuing copyright requires an in-depth understanding of the particular business and industry in which the copyright operates. Copyright valuation is something Intangible Business has carried out for a number of different copyright properties including books, films, plays, TV, music, characters, images and musicals.

Copyright provides for a bundle of exclusive rights to authors of original literary, musical, dramatic and artistic works, the sole right to authorize (or prohibit) the following uses of their copyrighted works:

- To reproduce all or part of the work.
- To make new (derivative) versions.
- To distribute copies by selling, renting, leasing, or lending them.
- To perform (that is, to recite, dance, or act) the work publicly.
- To display the work publicly, directly, or by means of film, TV, slides, or other device or process.

The first three rights are violated when anyone copies, excerpts, adapts, or publishes a copyrighted work without permission. Thus, a copyright legally protects the original expression of ideas, NOT the ideas themselves, that means an idea cannot be copyrighted. It is the expression of the idea — the way it is presented — that is copyrighted. The value derived from a copyright is by virtue of using the copyright.

As is true with all intellectual property, a copyright has a special set of legal rights and protections that is afforded to the copyright owner. These legal rights are the basis for the value of a copyright. A copyright can confer monopoly to the owner by creating a barrier to entry and thereby translate to buying power and greater profit margins for the owner.

It brings about a domain of permissibility – where the owner permits a party to use the IP in return for compensation which can be a license or has a sale value. A copyright can be enforced and is often subject of litigation – where the benefits are the litigation award or the owner can sue for damages.

On the face of it, a copyright signals creativity, innovation and uniqueness which may result in additional sales and incremental margins with reduced promotion and marketing efforts. For a copyright to command value it requires other resources like natural resources/tangible resources or people resources or capital when combined by way of a Copyright and exploited in terms of products or services has the capability of yielding profit.

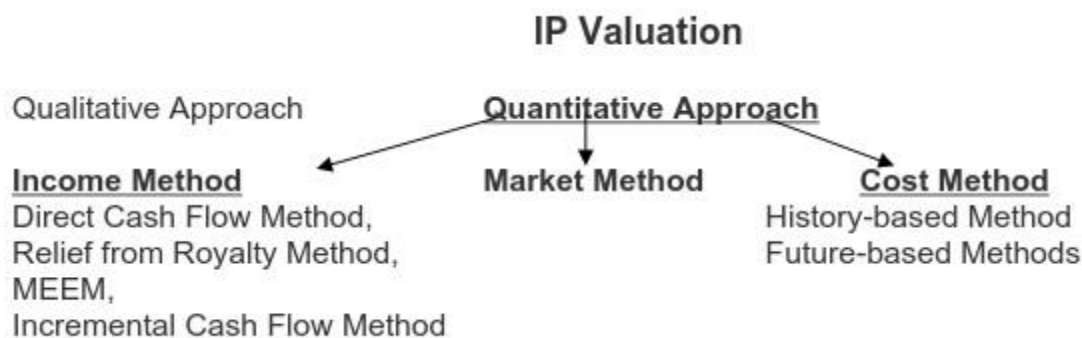
The Value of a Copyright can be broken down to Two Step Process

- Determine the profits.

- And then apportion the profits to the Copyright.

This in turn determines the Value of the Copyright. The value of a copyright that is most commonly enjoyed is the Royalty earnings by licensing the Copyright. The rate of this Royalty is often driven by the earnings of the business of the licensee from the Copyrighted material.

IP Valuation



Qualitative Approach

- Income Method
 - - History – based Method
 - Relief from Royalty Method
 - MEEM
 - Incremental Cash Flow Method

Quantitative Approach

- Market Method
- Cost Method
 - Direct Cash Flow Method
 - Future – based Methods

The 3 generally accepted methods of IP valuation may be applicable to the analysis of copyrights. The Cost method is less commonly used than the Income method or the Market

method. Because the copyright grants monopolistic rights to the owner, the Cost approach is not always applicable to a copyright valuation analysis.

1. Cost Method

This method is based on the intention of establishing the value of an IP asset by calculating the cost of developing same or identical IP asset either internally or externally. The method aims to determine the value of an IP asset at a particular point of time by aggregating the direct expenditures and opportunity costs involved in its development and considering obsolescence of an IP asset. The Cost Method is generally the least used method as, in most cases, it is considered suitable only as a supplement to the income method.

Both creation cost and re-creation cost methods may be used with regard to copyright valuation analysis. In all cost approach valuation analyses of copyrights, the analyst should consider as cost components both, the developer's profit and the entrepreneurial incentive – both of which often represent the largest components of value. The cost approach has certain limitations when analyzing of a corporation-owned copyright and is often considered to provide a minimum estimate of value — as opposed to a maximum estimate of value.

The Cost Approach is based on the economic principle of substitution. This principle suggests that an investor will typically pay no more for a fungible intellectual property asset than the cost to purchase or construct a substitute asset. However, it is not legally possible to purchase or reconstruct a substitute intellectual property with regard to copyrights. Because by definition of Copyrights – they are unique and original work. Therefore, the hypothetical investor who attempts to purchase or construct a substitute intellectual property will be guilty of copyright infringement. Therefore, the “willing buyer” in a copyright market value transaction cannot legally re-create the subject and similarly a willing seller will not sell for less than his cost, which mostly would mean his investment. Hence the cost method is not the most accurate approach to arrive at a ceiling or maximum copyright valuation.

Reproduction Cost method and Replacement Cost method are the two alternatives of the cost method.

2. Market Method

The Market Method is based on comparison with the actual price paid for a similar IP asset under comparable circumstances. Market approach methods are commonly used in a copyright valuation analysis. The free and simple sale of copyrights is usual practice in the market and is true with regard to all of the types of copyrighted materials like musical, artistic, literary. However, the pricing details related to these copyright sales are not publicly disclosed. Also, it is often difficult for analysts to develop metrics in order to extract market-derived pricing multiples from these transactional data, e.g. it is not easy to convert pricing data regarding the actual sale of a copyright into a logical “per picture”, “per lyric” or “per word” pricing multiple.

Licensing of all types of copyrighted materials is on the other hand a thriving option. Thus, the most common market approach methods involve some form of royalty rate or similar license analysis. Analysts sometimes have the problem of developing units of comparison if the selected empirical license agreements call for fixed periodic dollar payments — for example, \$100,000 per year.

Many copyright license agreements employ either a royalty rate formula or a per-use formula. In the royalty rate formula, the license agreement typically compensates the author by a percentage of the total revenues generated through the use of the copyrighted materials. In the per-use formula, the license agreement typically compensates the author as a dollar amount for each time the copyrighted material is performed, displayed, or otherwise used.

3. Income Methods

They are very commonly used in the valuation and economic analysis of copyright intellectual properties. It focuses on the income generating capability of the property. The Income method values the IP asset based on the amount of economic income that the IP asset – Copyright is expected to generate, adjusted to its present day value.

To determine the Economic Income

1. Project the revenue flow or cost savings generated by the Copyright over the remaining useful life (RUL) of the asset.
2. Offset those revenues/savings by costs related directly to the Copyright. Here, Costs could comprise labor, materials, required capital investment and any appropriate economic rents or capital charges.

3. Take account of the risk to discount the amount of income to a present day value by using the discount rate or the capitalization rate.

The Various Income Approach Methods typically involve some form of the following types of Analysis

1. Incremental Income Analysis

This is the estimation of the difference between the amount of income that the owner/operator would generate with the use of the subject copyright and the amount of income the same owner/operator would generate without the use of the subject copyright.

2. Profit Split Income Analysis

The estimation of the total income that the owner/operator would generate from the use of the copyright where the total income estimate is split between the copyright and all of the other tangible and intangible assets that contribute to the generation of the owner/operator total income estimate.

3. Residual (or Excess) Income Analysis

The estimation of the residual owner/operator income with the ownership/operation of the copyright. This residual income analysis is accomplished by first estimating the total owner/operator income.

The analyst then identifies and values all of the owner/operator tangible and intangible assets. A fair rate of return, which represents a capital charge or an economic rent, is then assigned to each category of the tangible and intangible assets. The analyst would then subtract the capital charge on contributory assets from the total owner/operator income estimate. Finally, the residual or excess income is assigned to the copyright.

For analysis based on an income approach, the copyright income is projected over an estimate of the Remaining Useful Life (RUL) of the copyright income stream. The maximum amount of time that may be considered is the very long legal life remaining in the copyright – typically, the author's life plus 50 years. However, the more practical time span to consider is the expected period of popular acceptance and commercial viability for the copyrighted work.

Some computer games, for example, have a limited lifetime of trendiness and popularity before they are overtaken by the “next big thing”. The determination of remaining useful life of earning potential obviously has a significant effect on the calculation of today’s net present value. The present value of the owner/operator income (defined as excess, incremental or residual income) over this expected RUL is an indication of the value of the copyright.

Valuation of Patent

“Patents are like lotteries, in which there are a few prizes and a great many blanks.”

Introduction

Patent valuation process includes overview of patent and valuation aspects followed by patent valuation approach. Overview of patent covers reviewing patent filing date, patent priority date, countries where patent has been granted, title and abstract of patent, along with scope of granted patent claims.

Patent Valuation Procedure

The patent valuation procedure covers the NPV (Net Present Value), Future Value Forecast, and, Financial Modelling to Estimate Cash Flows. The cash flows are estimated with discounting for patent contribution and discounting for patent risk assessment.

Patent Risk Assessment

The risk assessment of a granted patent is aimed at analyzing the validity of granted patent claims, possibilities of design around patents, and potential risks associated with infringement lawsuits.

Patent Valuation Approach

The patent valuation approach covers different factors, like, the size of market, market share, annual growth rate, per unit price, profit margin, and feasibility of making the patented product.

Intellectual Property Assets

Intellectual Property (IP) is a crucial portion of a company’s assets. Today, a great portion of the assets of fortune 500 companies consists of intangible assets including intellectual property. A strong IP portfolio is instrumental for fundraising, leverage in business transactions, exit strategy (e.g. for startups), and business transactions such as mergers and acquisitions (M&A), to name a few. Intellectual property may consist of patents, trademarks, copyright, and trades secrets.

Patents are in many cases the most important portion, especially in the high tech and biotech industries. Since there are a large number of transactions in these areas, it is important to assess and estimate the value of a patent portfolio.

Market Potential of Patents

Patents have grown from more fancy and honorary pendants to all-out financial assets and they have created their own market. This is partly due to increasing abstraction of business moving from more tangible businesses and assets to more intangible ones. Abstraction of business started a long time ago. The more abstract a line of business, the more sophisticated the methods used to conduct that line of business, and the more profitable and scalable. However, this abstraction of value comes with some risk.

Application of Patent Valuation

1. Valuation of the company's intangible assets in cases of taking tax planning decisions. A company does not have to show their tangible assets, but also the intangible assets in the form of intellectual property for paying taxes.
2. Valuation of a company is often done in cases of mergers, joint ventures, and acquisition. A company invests more in the intangible assets, research and development activities, than the tangible assets. Therefore measuring the economic value of the intangible assets can determine the value of assets.
3. For the licensing and selling of the intellectual property and negotiating deals with the parties, the price of the patent or the intellectual property should be known.
4. In cases of patent infringement, quantification of the damages is done. The correct valuation of the patent would help a patentee to recover the damages from the other party.
5. The valuation of the patent is used as security for bank loans. Patent valuation is also used to attract venture capitalists and investors.
6. The patent valuation helps in making patent protection strategies. It helps an organization identify its weakness, like ownership issues, which can have an impact on the value of the intellectual property.

Patent Valuation Methods

The patent valuation is done by different approaches. Two methods are basically used for patent valuation

- 1) Quantitative Approach – which uses numerical and economic data to measure the value of the intellectual property.
- 2) Qualitative Approach – where the analysis of the potential uses of the intellectual property is done. It deals with the opportunities and risk associated with the intellectual property of the company.

The methods used in qualitative approach are:

Cost Method

This approach indicates that the patent's value is the replacement cost, which is the amount that it would cost to replace the item. Simply put, it would be the amount it would cost to replace the invention.

Income Method

The patent's value will be the present value of the cash flow or cost savings that it will help provide. For example, let's say a company patents a product. The reason for patenting the product is because the company is expecting to increase its capital based on the sale of that product, or may expect to save money based on the invention.

Therefore, that expected amount will be the value of the patent when using the income method. This method can be further divided into 'profit contribution' and 'royalty.' The profit contribution is the profit credited to a patent. The royalty is the income stream expected if a licensing agreement is entered into.

Market Method

Using this method, you'll need to determine what a potential buyer would pay for a similar product or service. Therefore, you can value your patent by looking at similar patents.

What is patent valuation?

In general there are 2 meanings for patent valuation:

1. The qualitative (comparing) valuation of patents – here the result is a qualitative score or a direct competitive result patent A is better than patent B or portfolio A has a better technical score than portfolio B. For qualitative valuation in general certain indicators can be used. Simple manual scoring methods for assigning a qualitative score to a patent are widely spread, these are returning an individual and difficult to verify picture of a patent/family/portfolio. Better approaches are automated or semi-automated methods using multiple-choice answers that are more tamper proof and more transparent. The qualitative valuation is limited to internal usage, like benchmarking, R&D controlling or decision-support.
2. The quantitative/monetary valuation. This valuation can more complex, depending of the method used, it also can be combined within indicator models. For the monetary valuation there are different norms and standards available. Using indicator based market analogy valuation approaches delivers a qualitatively as well and monetary value, is reasonable, fast and offers most opportunities for usage like also in accounting, trading, securities and offers a better understanding in benchmarking, R&D Controlling, strategy management.

Why does a company need to know the value of its patents?

Valuation offers a huge set of controlling, strategy and marketing instruments. Example: Why not having the potential of measuring the outcome of IP activities and the RnD effect and compare it with competitors? Why not knowing the assets of a company? Why not having a higher company value? Why not benefitting from additional assets in terms of i.e. better creditworthiness? So the correct question is “why not?”

Companies with (good) patents have a much higher value than known from their balance as long as their patent value is not activated in the balance. So hiding this value from your shareholders may cause problems.

Valuation of Brand

Branding is a way of identifying your **business**. It is how your customers recognise and experience your **business**. A strong **brand** is more than just a logo — it's reflected in everything from your customer service style, staff uniforms, **business** cards and premises to your marketing materials and advertising

The Dictionary of **Brand** defines **brand** as “a person's perception of a product, service, experience, or organization.” Marty Neumeier, author and speaker on all things **brand**, defines **brand** by first laying out what a **brand** is not: “A **brand** is not a logo.

Conquering The Three Types Of Branding

In our ongoing talk about “branding,” there are a number of types of branding that must be discussed. The Belford Group is happy to help businesses and organizations develop a corporate identity that is easily recognizable and respected.

Three Types of Branding

Corporate Brand-

The overall parent company must have its own brand that people recognize for quality and its good reputation. This is useful when launching new product brands or product lines. If you can associate the new product brand with the already well-known corporate brand, it has a better chance of being well-received (or poorly received if people don't trust your corporate brand).

Example A: *Coca-Cola Global has many product lines that are individually branded.*

Example B: *The Belford Group offers web design services, marketing services and software development services.*

Example C: *Wallingford Sales Company offers water heaters, plumbing equipment and safety equipment.*

Product Brand-

Individual products or product lines must have their own established brands. This is useful when a corporation or organization has multiple services, including services that at the surface may not seem to have a lot in common.

Example A: *Diet Coke is clearly a part of the dark Coca-Cola soft drinks with similar colors (silver and red vs white and red). Sprite is also owned by Coca-Cola, however, and has a completely different look, taste and target audience.*

Example B: *The Belford Group's teams are separately branded. Our TBG Software team has its own similar yet different branding from the traditional five-color “B” you often see in our*

own

branding.

Example C: *WaterHeaterStore.co* is Wallingford Sales Company's branding for its water heaters, which is one of the company's most popular sales items.

Personal Brand-

Developing a personal brand can be as important for an individual as it is for a company or product line. Personal branding is vital for salesmen, job seekers ... or anyone who wants to deal with the business world. It's your reputation (how others view you) and to some degree, your identity (what people associate you with). Reputation could be good or bad; identity refers to the idea of someone associating you with your given profession, belief system, hobby, etc.

Example A: *Salesman for any kind of product*

Example B: *Angela Belford has launched a consulting and public speaking career. While some of her services coincide with her work at The Belford Group, she has completely different branding for her public speaking career.*

Why brands are valuable

A brand is a promise that lives in the minds of customers and stakeholders (including staff) before, during and after purchase. It sets expectations. The entire product or service experience then determines whether the promise is met, exceeded or broken.

Brands are frequently acknowledged as being amongst the most valuable assets of a business. Brands are valuable for two key, and linked, reasons: for the benefits they give customers; and for the value they generate for the businesses which own them.

Customer benefits: for the customer, brands distil information, ease the decision making process, confirm aspirations and support a sense of belonging. They can be strong symbols of trust and enable customers to associate themselves with the values the brands represent.

Owner benefits: for businesses, brands are frequently their most valuable asset because they are the primary vehicle for their relationships with customers and therefore generate business. Who owns the brand is often irrelevant; it is the brand that is important.

Another reason brands are valuable is because they cost so much to build and maintain. And one of the largest expenses associated with building and maintaining brands is advertising and promotion.

Profit: brands enable businesses to charge a premium and generate volume and growth for their product or service. This is often indicated in licensing arrangements where a royalty can represent a charge for use of a brand.

Market share: brands enable businesses to increase their market share which increases turnover, margin and profitability through economies of scale.

Widely adopted brand valuation approaches

When carrying out a brand valuation, Intangible Business adopts widely accepted approaches based on a combination of the income, market and cost approaches. These approaches have much in common with those used for intangible asset valuation, business valuation, and intellectual property valuation.

- The income approach uses estimates of future estimated economic benefits or cash flows and discounts them, for the associated time and risks involved, to a present value.
- The market approach uses market based indicators of value. For brands this can be transactions involving selling, buying, franchising or licensing brands, which are often in practice bundled with other deals.
- There are two general considerations to the cost approach: 1) the historic cost of creating the brand; and 2) the estimated cost and time that would be required to create an equivalent or replacement brand.

Focus of Intangible Business

The application of these approaches benefits from Intangible Business's specific focus on forecasts, with research and analysis of market transactions for different but comparable assets where relevant information is difficult to obtain. Intangible Business adopts a thorough approach based on good knowledge and experience of how to find, analyse and present information in a way which better informs a brand valuation.

Intangible Business also ensures that the approaches used, and conclusions reached, are commercially balanced, realistic and consistent with analyses required for all the different reasons brand valuations are required and carried out in practice.