
INTELLECTUAL PROPERTY VALUATIONS

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AGENDA

- Intangible asset categories
- When is a valuation required?
- Components of “fair market value”
- “Fair value” for financial reporting
- Valuation approaches (market, income, cost)

FAIR VALUE FOR FINANCIAL REPORTING CATEGORIES OF INTANGIBLE ASSETS

Canada U.S.A.
CICA 1581 SFAS 141

Appendix Section References

Marketing-related	A20 – A22	A15 – A17
Customer-related	A23 – A28	A18 – A21
Artistic-related	A29 – A30	A22
Contract-based	A31 – A33	A23 – A24
Technology-based	A34 – A38	A25 – A28

INTANGIBLE ASSET CATEGORIES

1. *Marketing-related, including:*

- Trademarks, trade names, brands, logos
- Foreign trademark rights
- Service marks, collective marks, certification marks
- Product distribution channels
- Delivery systems
- Internet domain names
- Trade dress (unique colour, shape or package design)
- Non-competition agreements

INTANGIBLE ASSET CATEGORIES (cont'd)

2. *Customer-related — customer structure of the business, including:*

- Customer lists
- Order backlog
- Customer contracts and the related customer relationships
- Non-contractual customer relationships

INTANGIBLE ASSET CATEGORIES (cont'd)

3. *Artistic-related — artistic works (to which the business has title), including:*

- **Books, magazines**
- **Musical works, including advertising jingles**
- **Literary**
- **Video and audiovisual material, motion pictures, music videos**
- **Pictures, photographs**

INTANGIBLE ASSET CATEGORIES (cont'd)

4. *Contract-based — with fixed or definite term, including:*

- **Licenses**
- **Facility leases and others**
- **Franchise agreements**
- **Permits**
- **Royalties**
- **Advertising, construction, management and service or supply contracts**
- **Employment contracts/collective agreements**
- **Financing agreements**
- **Insurance contracts**

INTANGIBLE ASSET CATEGORIES (cont'd)

5. *Technology based — relate to innovations or technological advances within the business, including:*

- Patents
- Non-patented technology
- Computer software (operational software) and licenses
- Databases
- Technical drawings
- Research and development
- Trade secrets
- Know-how

WHEN ARE THEY REQUIRED?

- Transaction support
- Bankruptcy
- License fees & royalties
- Strategic alliances
- Income taxation
- Marital dissolution
- Infringement damages
- Inter-company transactions & transfer pricing
- Collateral-based financing
- Accounting requirements
- Regulatory requirements
- Purchase price allocation

COMPONENTS OF THE FAIR MARKET VALUE OF A BUSINESS



COMPOSITION OF A BUSINESS ENTERPRISE



Working Capital



Other Tangible Assets

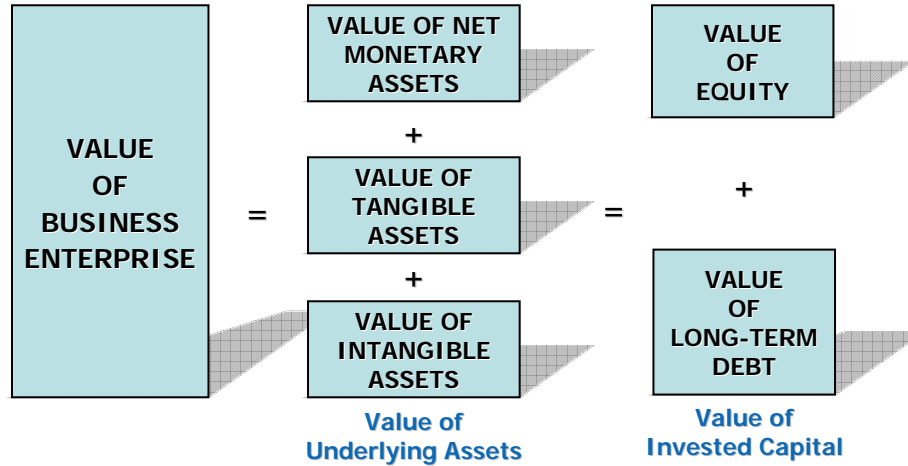


Intangible Assets

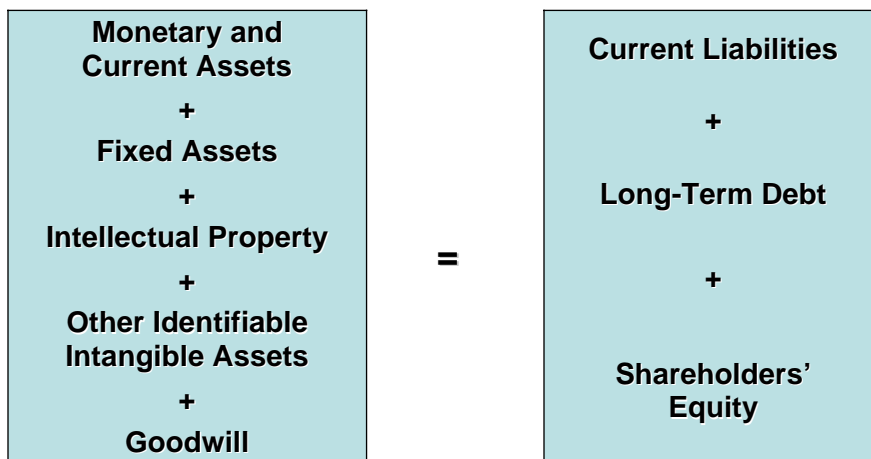


Intellectual Property

THE BUSINESS ENTERPRISE EQUATION



GENERAL ALLOCATION FORMULA



EXAMPLE CONSTITUENT ELEMENTS OF A TRADE MARK

- Trademark ^{TM, MD}
- “Sub-brands”
- Marketing strategy
- Logo
- Website
- Colours
- International public relations
- Label designs
- Etc.





TRADEMARKS vs OTHER ASSETS

Coca-Cola trademark combines following elements:






- Recipes
- Processes
- “Sub-brands” (Classic Coke, Diet Coke, Cherry Coke, Zero, etc.)







EXAMPLES OF TRADEMARKS

Commercial name	Nike
Image	Association with Tiger Woods
Branding	Excellence
Logo	“Swoosh” 
Registered or not	TM
Commercial presentation (colour, form, Unique packaging concept)	  

NINE HIGHEST VALUED TRADEMARKS – 2007 (\$ BILLIONS — SOURCE : INTERBRAND)

Rank	Trademark	Estimated Value of Trademark	Book Value of Intangible Assets (Balance Sheet)	Market Capitalization	Book Value of Shareholders' Equity (Balance Sheet)
9		29.2	8.1	65.7	31.8
8		29.4	0.0	71.1	15.5
7		31.0	1.0	158.0	36.8
6		32.1	0.0	202.0	100.0
5		33.7	0.6	155.6	16.0

NINE HIGHEST VALUED TRADEMARKS – 2007
(\$ BILLIONS — SOURCE: INTERBRAND) (cont'd)

Rank	Trademark	Estimated Value of Trademark	Book Value of Intangible Assets (Balance Sheet)	Market Capitalization	Book Value of Shareholders' Equity (Balance Sheet)
4		51.6	13.1	410.9	112.3
3		57.1	2.2	154.1	28.5
2		58.7	0.9	337.0	31.1
1		65.3	3.7	139.8	16.9

VALUATION APPROACHES

- Income
- Market
- Cost

COST APPROACH

- **Replacement/reproduction cost**
- **Cumulative historical costs**
 - Professional fees
 - Registration fees
 - Design fees
 - Marketing and promotion fees
- **Indexed to inflation**

MARKET APPROACH

- **Reference to actual comparable market transactions (guideline companies or comparable IP)**
- **Compare characteristics of IP and adjust if necessary**
- **Relief-from-Royalty Method**
- **Difficulty: Obtaining royalty rate**

RELIEF-FROM-ROYALTY METHOD

- **Multiply future projected revenues by royalty rate**
- **Discount cash flows using appropriate rate of return reflecting risk**

REASONABLE ROYALTY

- **Established royalty**
- **Notionally (hypothetically) negotiated royalty**
- **Adopting analytical approach (which determines reasonable royalty as excess of anticipated profits over normalized level of industry profit margin)**

RELIEF-FROM-ROYALTY METHOD

Five inputs used in applying method:

1. Remaining life of IP
2. Forecast revenues
3. Royalty rate
4. Tax rate
5. Discount rate

RELIEF-FROM-ROYALTY METHOD

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Projected sales of product	\$50,000	\$52,500	\$55,125	\$57,881	\$60,775
Fair market royalty rate — say	<u>5%</u>	<u>5%</u>	<u>5%</u>	<u>5%</u>	<u>5%</u>
Avoided royalties	2,500	2,625	2,756	2,894	3,309
Less: Income taxes — say 30%	<u>-750</u>	<u>-787</u>	<u>-827</u>	<u>-868</u>	<u>-993</u>
After-tax income	1,750	1,838	1,929	2,026	2,316
Present value (discount) factor	0.889	0.790	0.702	0.624	0.555
Present value	\$1,556	\$1,452	\$1,354	\$1,264	\$1,285

**VALUE OF INTANGIBLE ASSET:
= TOTAL OF PRESENT VALUES = \$6,911**

CASH FLOW METHOD

- **Higher sales price**
- **Additional volume**
- **Economies of scale (production)**
- **Reduction in costs (administration, advertising and promotion)**

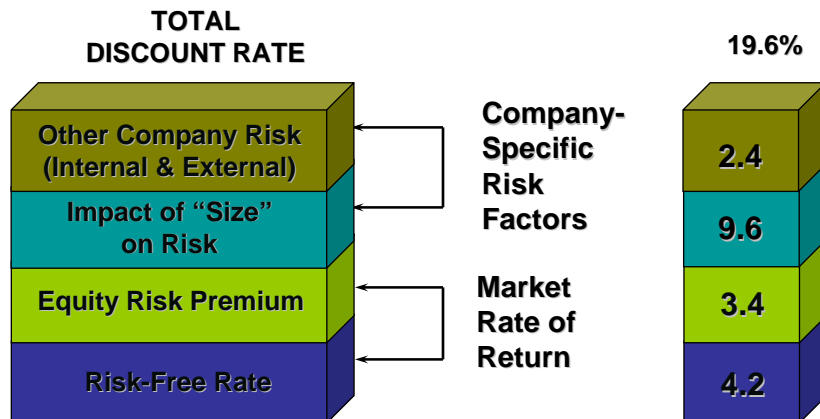
INCOME/CASH FLOW APPROACH

- **Discounting of cash flows**
- **Profit sharing (Rule-of-thumb: 25% - 75%)**
 - **25% of profits to owner of trade name**
 - **75% to user of trade name (higher risk level)**
 - **Depending on characteristics of IP, industry sector, profitability, etc.**

DISCOUNTING OF CASH FLOWS

- **Projection of future benefits:**
 - Revenues
 - Cost of sales
 - Sales and administration costs
 - Taxes
 - Contributory asset charge (working capital, capital assets, other intangible assets)
- **Discount using rate that reflects level of risk**

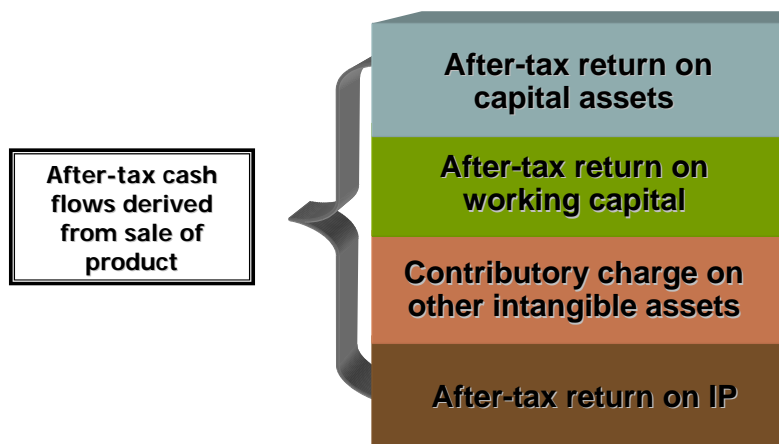
DEVELOPMENT OF DISCOUNT RATE BUILD-UP METHOD



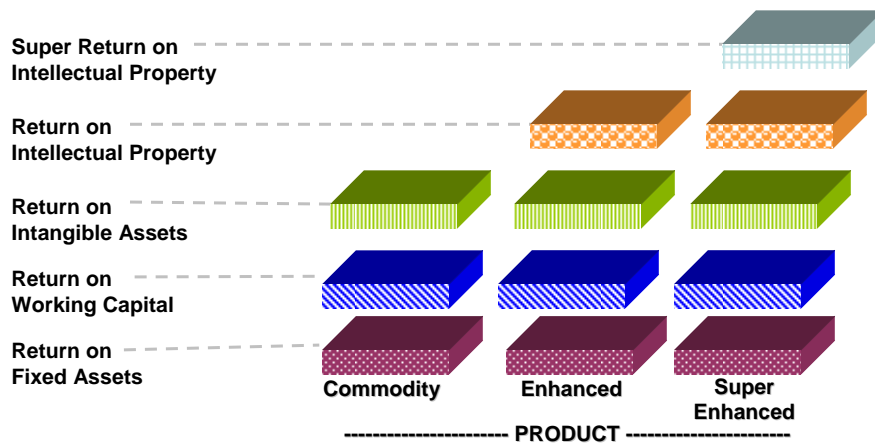
VENTURE CAPITAL RATES OF RETURN

<u>Stage of Development</u>	<u>Required Rate of Return</u>
Start-Up	50%
First Stage	40%
Second Stage	30%
Third Stage	25%

CONTRIBUTORY ASSET CHARGE



EXCESS RETURNS FROM INTELLECTUAL PROPERTY



SUPER RETURNS METHOD

- No-name bread is sold for \$2.50
- Brand-name bread is sold for \$3.25
- Differential of \$0.75 x volume in units = additional revenues attributable to trade name
- Subtract additional advertising and promotion costs



CONSIDERATIONS

- Valuation context (bankruptcy vs. acquisition)
- Management of IP value
- Governance
 - Define oversight and management process
 - Assign responsibility (Board, CTO/COO/CFO)
 - Identify all intellectual property (IP)
 - Value key intangible assets

QUESTIONS?

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