VALUATIONCONSULTINGCO

INDEPENDENCE
INNOVATION AND
TRANSPARENCY

VALUATION CONSULTING CO LTD

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VALUATIONCONSULTINGCO

WHO ARE VALUATION CONSUTING CO

- Many years experience within Government, investment banks and the accountancy profession
- Members of the Society of Share and Business Valuers, authors, lecturers
- RICS Registered Business Valuers
- Law Society Registered Expert Witness accreditation/membership of the Expert Witness Institute
- Experience in presenting testimony
- Dedicated valuers – we value shares, businesses, intangibles and IPR
- Worldwide clients from multi-nationals to small private companies

MANAGING IPR'S IN THE ADVERTISING INDUSTRY AND THEIR VALUATION – THE CURRENT BIG ISSUES

- Accounting Standards
- Corporate Governance
- Fairness Opinions
- Valuation methods and concepts (RICS, IVSC)

STARTING AT THE TOP AND TRYING TO BUILD DOWN

THE LAWS OF PHYSICS

AND VALUATION

SUGGEST THAT THIS IS NOT POSSIBLE

DUE DILIGENCE AND THE VALUER

Attributes relating to intellectual capital in a business context

- Legal protection – barriers to competitors
- Coverage, products, 'the boundaries of the plot of land you call yours'

Regulation often defines required due diligence

- FRS 141/142, IFRS 3 and IAS 38/39

Governance and Fiduciary Capacities often define the due diligence

- Directors
- Bankers and Financiers
- Regulators
- Auditors
- Tax authorities

YOU NEED TO KNOW THE VALUE OF THE CROWN JEWELS

Risk and liability affects all companies. Risk effects valuation analysis, corporate valuation must reflect risk and importantly risk assessment should reflect economic Valuations

- What are the intellectual property rights used in the business
- What is their value and hence level of risk
- Identify under-utilisation – how can IP be transferred or exploited for increased shareholder value
- Licensing in and out
- Create stronger barriers for example IP holding companies
- Create better exploitation strategies (securitisation, pension deficits and tax)

THE LICENSEE/PURCHASER & LICENSOR/VENDOR

Four Calculations or Steps – 'can Kelvin count'

1. Intrinsic value of Vendor
2. Intrinsic value of Purchaser

PLUS

1. Intrinsic value of Vendor
2. Intrinsic value of Purchaser

The capital values calculated are an essential step to calculate royalty rate or valuation – discuss from a Pension Trustees' perspective

DEFINITION

&

IDENTIFICATION

INTELLECTUAL PROPERTY

Those assets whose essential characteristics are derived from the Legal System, in this case the UK

Registered Rights

- Patents – UK, EP(UK) (PA 1977, EPC 2000)
- Trade Marks – UK, CTM (TMA 1994)
- Registered Designs – UK, CDR (RDA 1949)

Unregistered Rights

- Confidential Information (equitable and contract)
- Passing-off (common law)
- Design Right (CDPA 1988)
- Copyright (CDPA 1988 and Copyright Computer Software Amendment Act 1985)
- Miscellaneous: Performance Rights, Image Rights, Moral Rights, Database Rights, Malicious Falsehood (common law), Plant Variety Rights

INTANGIBLE ASSETS – JUST A FEW EXAMPLES

Rights

- Contracts

Relationships

- Workforce
- Customers

Group Intangibles

- Brands
- Goodwill

Characteristics of Economic Advantage

- The spectrum of creative thought
- Formulae, Recipes
- Experience
- Negative Knowledge
- R&D and Information

ACCOUNTING STANDARDS

The US FASB has created a list of what it considers to be a firms intangibles:

Market-related

- Trademarks, trade names, service marks, trade dress, newspaper mastheads, internet domain names.

Customer-related

- Customer lists, customer contracts, customer relationships, customer agreements.

Artistic related

- Ballets, books, plays, articles, other literary works, musical words, opera, pictures, photographs, video and audiovisual material.

ACCOUNTING STANDARDS CONT…

Contract-based

- Licensing agreements, advertising or service contracts, lease agreements, construction permits, operating and broadcast rights, employment contracts.

Technology-based

- Patented technology, computer software, unpatented technology, databases, trade secrets, secret formulae

BUNDLE OF RIGHTS

Privileges of ownership are the same as for any other asset

- Use
- Sale
- Merge
- Mortgage
- Gift
- Transfer Part of the Rights

If managers do not know the 'true' returns that are being generated on their investment somebody else may be better informed. Often millions of pounds are spent on gaining market share, developing, launching, protecting and nurturing these assets.

OCCASIONS FOR VALUING INTELLECTUAL PROPERTY

- Mergers & Acquisitions
- Portfolio review and risk assessment
- Arrange a loan – securitisation
- Tax purposes
- Licensing
- Balance Sheet
- Joint Ventures and Technology Transfer
- Pension deficits
- Selling your IP
- Distress

CONCEPTS OF VALUATION?

- Tax Valuation and Open Market Value
- Fair Value
- Fair Market Value
- Commercial Value
- Investment Value
- Owner Value

LICENSING ECONOMICS & ROYALTY RATES

Why License

- Market penetration
- Increase profits
- Access another's resources
- Synergy with another
- Circumvent infringement situations
- Sell related products

REASON FOR LICENSING IN IP

- Reducing reliance on in-house R & D
- Specialist R & D companies often more innovative and efficient than larger manufacturing/distribution companies
- Reduced product development time and costs
- Cost of acquiring technology may not have to be incurred until revenues commence

REASON FOR LICENSING OUT IP

- Specialist R & D companies can concentrate on what they do best and use others for manufacturing and distribution
- IP may not be of strategic importance for licensor but may be for licensee
- Use of existing production, marketing and distribution facilities can reduce costs
- Effective method of entering foreign markets
- Can accelerate cash flow and/or profits

ROYALTY INCOME

- **Up-front payment**
- **Credits**
- **Earn out link**
- **Running royalty**

ROYALTY INCOME

- Minimum or maximum royalties
- Frequency of payment
- Licensor conditions
- Licensee conditions
- Other considerations
- Currency of payment
- Duration
- Cancellation

CALCULATING THE ROYALTY RATE

Special Factors

- Relative dominance of the brand, patent etc
- Geographical area covered
- Rate of Return acceptable to all parties
- Probable level of continuing sales
- Commercial obligation of licensor(ee)
- Do not always accept ‘market rates’ ‘industry norms’ as gospel
- Royalties often represent mark-ups

METHODS OF VALUATION

Market based

- Comparable market transaction

Caveats

- Few sales
- Lack of information
- Separate values
- Special purchasers
- Different negotiating skills
- Distorting effect of varying values
- Assets not always comparable

METHODS OF VALUATION

Cost based

- Historical or replacement cost

Caveats

- Economic Benefits Excluded
- Duration of benefit and economic life
- Obsolescence difficult to quantify
- Maintenance
- Time Value of Money

METHODS OF VALUATION

Income Approach

- Capitalisation of historical profits

DRAWBACKS

Profitability

- Problems of averaging
- Problems of extrapolating from past performance
- Decline and other key variable
- Net tangible assets not separately assessed

Multiple

- No reference point for price earnings multiple
- Often no regards to established marketplace
- Often no reconciliation with market capitalisation

INCOME APPROACH: DISCOUNTED CASHFLOW MODELS

Modern valuation analysis is effectively DCF applied to the business enterprise under consideration

- The Net Present Value (NPV) of a strategy or business is the sum of its expected free cash flows to a horizon (H) discounted by its cost of capital (r)

NPV = Year 1 Cash Flow + Year 2 Cash Flow …. To say Yea 5 Cash Flow

(1+r) $(1+r)^2$ (1+r)H

PLUS

- The terminal value which is the value of the business at a horizon (HV)

  HV = Cash Flow

  (r – growth)

  Also discounted back to present value

HOW MUCH?

(CASHFLOWS)

TOOLS

- Gross Profit Differential Methods – Premium Prices/Premium Profits
- Excess Profits Method
- Relief from Royalty Method

HOW LONG FOR?

(TIME PERIODS)

USEFUL LIFE

- Physical Life
- Functional Life
- Technological Life
- Economic Life
- Legal Life

AT WHAT RISK?

(COST OF CAPITAL)

VALUATION AND DEFENCE

IP valuation can play an important role in influencing decisions on what kind of IP strategy an enterprise follows e.g. defensive, offensive or competitive

- Assess continuing and future activities
- Infringement by you or others – successful enforcement
- IP defence vs predatory attacks
- Cross licensing

LICENSING AND DUE-DILIGENCE

Many factors effect a valuer's licensing and royalty rate advice

- Deal structure (cash, profit etc)
- Exclusivity
- Relative risks
- Investment rates of return
- Commercial relationship between parties (fair value is not fair market value)

THE DISCOUNT OR CAPITALISATION RATE AND FINANCIAL/MARKET DUE-DILIGENCE

Derive the appropriate cost of capital – for an investment and asset to be worthwhile the expected return on capital (equity and debt) should be greater that the cost of capital

- Risk free profile
- Risk factors

Caveats

- Immense difficulty in forecasting well into the future
- Future distant growth is often significantly discounted in the perpetuity calculation

MARKET AND TECHNOLOGY DUE-DILIGENCE

Examples:

- The legal strength of IP is only a beginning
- Large/small/niche market and where
- State of market and price volatility
- Required investment
- Close to market technology, or not
- Development time and R&D expense
- Economic and technology life
- Market drivers and potential
- Manufacturing depth
- Comparable technologies

MONTE CARLO

- Effectively a DCF multiplier
- Numerous DCF calculations accounting for various scenarios, say of revenue, market share, costs, internationality and other risks
- With just 4 scenario changes of the stated assumptions above this means 256 models!
- That is 4 values for each of income, different market share, costs, international penetration

  i.e. 4 x 4 x 4 x 4 = 256

REAL OPTIONS

- Probability trees = snakes and ladders, develops the Monte Carlo analysis
- Develops terminations (snakes) if a route indentifies problems to suggest failure

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THE MANAGEMENT OF INTELLECTUAL PROPERTY

Principle 1

Make intellectual capital a part of the business strategic thinking and planning. For example risk control, maximising value, being aware of emerging technologies, seek appropriate legal protection etc.

Principle 2

Understanding the role of intellectual capital. Involves assessing the importance of intellectual capital now and in the future to the market position and future success of your business. Part of this is the challenge to identify the intellectual property of others and avoid infringing the associated legal rights.

Principle 3

Be aware of competing intellectual capital.

Principle 4

Know your own intellectual capital. Imply rigorous processes to identify and evaluate the existing intellectual capital in the business, creating a comprehensive record of results and developing a process for identifying future IPR being developed. Positive due-diligence. Success or not is dependent upon a management process to do just the aforementioned.

Principle 5

Know the cost and value of your intellectual capital.

THE MANAGEMENT OF INTELLECTUAL PROPERTY CONT.

Principle 6

Identify required intellectual capital which is a process of forecasting future needs.

Principle 7

Acquire any required intellectual capital.

Principle 8

Think tax and balance sheet.

Principle 9

Be ready to protect your rights.

Principle 10

Measure improvements as an essential part of good intellectual capital management to develop measures of success of the management and evaluation of IPR.

Principle 11

Spread the message because just as important as measuring improvements is communicating a strategy and process, not least via financial PR etc.