

# VALUATION OF INTANGIBLE ASSETS

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# Overview

- Introduction
- Importance of Intangible Assets
- Requirements for valuation
- Valuation Methods and Examples

# Importance of Intangible Assets

- FTSE 100 company valuations
- Hi-tech companies
- Merck example
- Recent changes in accounting standards

# Intangible Asset Categories under IFRS 3 / IAS 38

## A. Marketing - Related

- Trademarks, trade names, service marks, collective marks and certification marks;
- Internet domain names
- Trade dress
- Newspaper mastheads
- Non-competition agreements

## B. Customer - Related

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

## C. Artistic-Related Intangible Assets

- Plays, operas, ballets
- Books, magazines, newspapers, other literary works
- Musical works such as compositions, song lyrics, advertising jingles
- Pictures, photographs
- Video and audiovisual material, including motion pictures, music videos, television programs

## D. Contract - Based

- Licensing agreements
- Advertising, construction, management, service or supply contracts
- Lease agreements
- Construction permits
- Franchise agreements
- Operating and broadcast rights
- Use rights such as drilling, water, air, mineral, timber cutting, and route authorities
- Servicing contracts such as mortgage servicing contracts
- Employment contracts

## E. Technology - Based

- Patented technology
- Computer software and mask works
- Unpatented technology
- Databases
- Trade secrets, such as secret formulas, processes, recipes

# Valuation Approaches

- **Income Approach:** The Income approach is predicated on the fact that desirability of ownership can be estimated by the expected future economic benefits.
- **Market Approach:** The market/sales comparison approach is predicated on actual sales transaction data. Sales are adjusted for comparability including time, location, size, condition, utility and intangible benefits.
- **Cost Approach:** The cost approach is based on the cost to reproduce or replace the subject asset, less allowances for all causes of depreciation, including physical deterioration and functional and economic/external obsolescence.

# Commonly Used Valuation Methods

- Relief From Royalty
- Excess Earnings (residual)
- Premium Pricing
- Cost Savings

# Relief from Royalty (Royalty Savings)

The value of the IP is calculated based on the present value of the royalty stream that the business is saving by owning the asset, as opposed to in-licensing from third parties.

# Appropriate Royalty Rate

- Existing license agreements
- Market transactions
- Profitability analysis
- Rules of thumb



# Premium Pricing Method

The Premium Pricing Method is often used to value brands in the consumer products sector where it is common for a branded product to be more expensive than an unbranded equivalent.

# Multi-Period Excess Earnings Method (MPEEM)

The Excess Earnings Method determines the value of the IP by capitalising the profits in excess of a normal required return for the use of other contributory assets.

# Cost Savings Method

The value of the IP is determined by the present value of the cost savings that the business expects to make as a result of ownership.

# Case Study I

ABC Cosmetics Ltd manufactures and markets perfumes. It sells the “ABC” branded perfumes, which are advertised heavily in the media. It also generates revenues from fashion design companies through own-label production. ABC Cosmetics also has a license agreement with an unrelated company, which allows the use of the ABC brand on certain beauty products. ABC management observed declining license revenue in recent years, as the licensee is establishing its own brand in the market.

# Case Study I – cont'd

## ABC Cosmetics Limited Brand Valuation

Period	Actual Year 0	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4
Branded Sales	100	105	110	116	122
Own Label Production	100	105	110	116	122
Total Revenue	200	210	221	232	243
<i>% Growth in Sales</i>		5.0%	5.0%	5.0%	5.0%
Branded Gross Profit	50	52.5	55.1	57.9	60.8
<i>Gross Margin</i>	50.0%	50.0%	50.0%	50.0%	50.0%
Own Label Gross Profit	25	26.3	27.6	28.9	30.4
<i>Gross Margin</i>	25.0%	25.0%	25.0%	25.0%	25.0%
Total Gross Profit	75	79	83	87	91
Operating Expenses					
Administrative	20	21	22	23	24
Sales & Marketing (only for branded)	20	21	22	23	24
Total Operating Expenses	40	42	44	46	49
<i>% of Sales</i>	20%	20%	20%	20%	20%
Operating Profit	35	37	39	41	43
<i>% of Sales</i>	18%	18%	18%	18%	18%
Other Income					
License Revenue (5% of 3rd party sales)	5	3	1	0	0
Income Before Tax	40	40	40	41	43

# Case Study I – cont'd

## ABC Cosmetics Limited Brand Valuation - Royalty Savings Method

Period	Actual Year 0	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4
Branded Sales	100.0	105.0	110.3	115.8	121.6
Relief from Royalty	5.0%	5.3	5.5	5.8	6.1
Royalty Revenue		3.0	1.0	0.0	0.0
Total Revenue Attributable to Brand		8.3	6.5	5.8	6.1
Income Tax Expense	30.0%	(2.5)	(2.0)	(1.7)	(1.8)
After-tax Royalty Savings		5.8	4.6	4.1	4.3
Discount Period		0.50	1.50	2.50	3.50
Discount Factor	20.0%	0.9129	0.7607	0.6339	0.5283
Present Value		5.3	3.5	2.6	2.2
<b>Sum of Present Value Cash Flows</b>		<b>13.6</b>			
<b><i>Terminal Value Calculation</i></b>					
Terminal Value		4.3			
Terminal Value Capitalized (at (k) less (g))		23.6			
Discount Factor		0.5283			
<b>Present Value of Terminal Value</b>		<b>12.5</b>			
<b>Total Present Value</b>		<b>26.0</b>			

# Case Study II

The R&D group at XYZ Chemicals Limited discovered a chemical substance that could be substituted for one of the raw materials used in production. The use of the substitute product will decrease manufacturing costs by 10%. Management does not file a patent due to enforceability issues in developing countries. XYZ estimates it would take approximately 5 years for the competition to discover this trade secret.

# Case Study II – cont'd

## XYZ Chemicals Limited Valuation of Proprietary Technology

Period	Actual Year 0	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4	Projected Year 5
Total Revenue	100.0	105.0	110.3	115.8	121.6	127.6
<i>% Growth</i>		5.0%	5.0%	5.0%	5.0%	5.0%
Cost of Goods Sold	50.0	52.5	55.1	57.9	60.8	63.8
Operating Expenses	30.0	31.5	33.1	34.7	36.5	38.3
Income Before Tax	20.0	21.0	22.1	23.2	24.3	25.5

### Assumptions:

	Fair Value	Required Return
Working Capital	10.0	5%
Tangible Assets	25.0	10%
Assembled Workforce	5.0	20%



# Case Study II – cont'd

## XYZ Chemicals Limited Valuation of Trade Secret - Cost Savings Method

Period	Actual Year 0	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4	Projected Year 5
Total Revenue	100.0	105.0	110.3	115.8	121.6	127.6
<i>% Growth</i>		5.0%	5.0%	5.0%	5.0%	5.0%
COGS without Trade Secret	50.0	52.5	55.1	57.9	60.8	63.8
COGS with Trade Secret		47.3	49.6	52.1	54.7	57.4
Cost Savings Before Tax		5.3	5.5	5.8	6.1	6.4
Less: Estimated Taxes	30%	1.6	1.7	1.7	1.8	1.9
Net Cost Savings		3.7	3.9	4.1	4.3	4.5
Discount Period		0.50	1.50	2.50	3.50	4.50
Present Value Factor	20%	0.9129	0.7607	0.6339	0.5283	0.4402
Present Value		3.4	2.9	2.6	2.2	2.0
<b>Concluded Value</b>		<b>13.1</b>				

# Commonly Used Valuation Methods

	Royalty Savings	Cost Savings	Premium Pricing	Multi-Period Excess Earnings
Brands / Trademarks	•		•	•
Know How		•		•
Patents	•	•		•

# Questions