Introduction to valuation

Beneluxvereniging voor merken- en modellenrecht | Association Benelux pour le droit des marques et modèles

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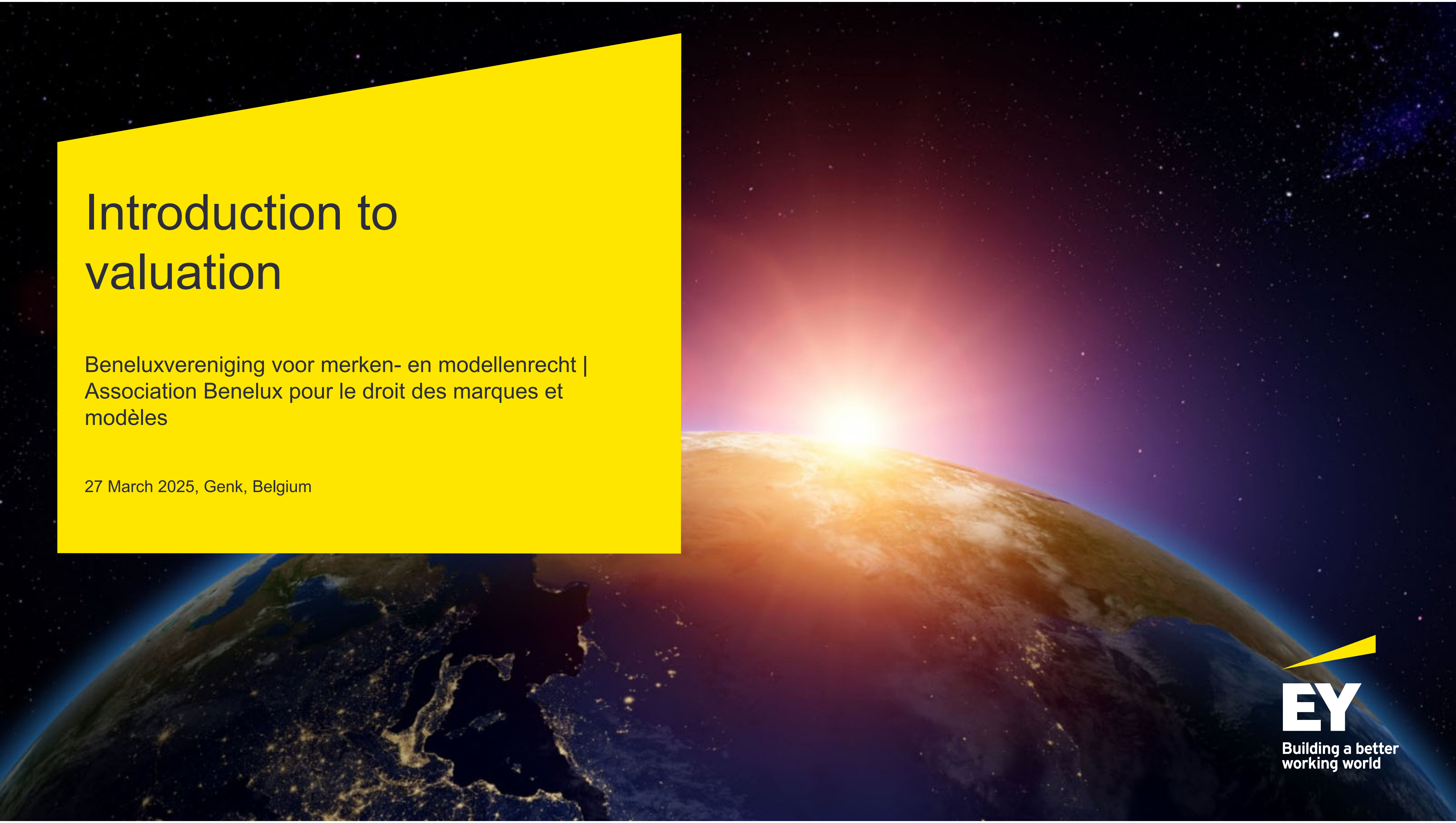

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Speaker

1 – Valuation for financial reporting purposes

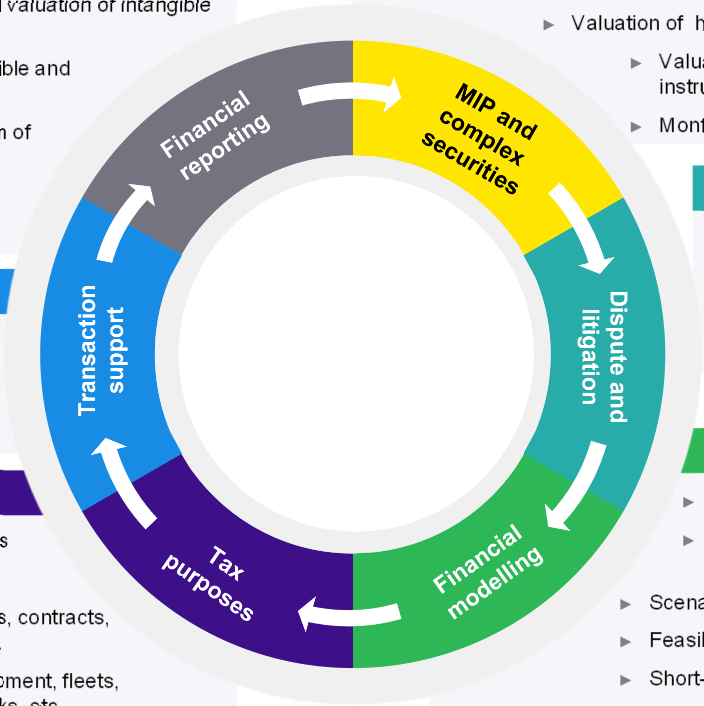
- IFRS 13 Fair Value Measurement
- Purchase price allocation (‘PPA’) under IFRS 3 Business Combinations including identification and valuation of intangible assets
- Impairment testing or revaluation of tangible and intangible assets under IAS 36
- IFRS 2 Share-based Payments, valuation of equity instruments
- IFRS 9 Financial instruments
- IFRS 16 Leases and right-of-use assets

2 –Transaction support

- Alternative scenario valuations
- Deal synergy valuation
- IRR and NPV simulations

3 – Valuation for tax purposes

- Intra-group sales / restructuring of entities
- Contribution-in-kind of
  - Intangible assets: brands, tradenames, contracts, IP rights, customer relationships, etc.
  - Tangible assets: machinery and equipment, fleets, distribution networks, telecom networks, etc.
- Employee stock option plans and management incentive plans



4 – Management incentive plans and complex securities

- Valuation of long-term / management incentive plans
- Valuation of share classes (preference, ordinary and sweet equity)
- Valuation of hurdles, warrants and option instruments
- Valuation of (callable) subordinated debt instruments
- Monte Carlo simulations

5 – Dispute and litigation

- Enterprise valuations for contractual disputes, shareholder conflicts, purchase price disputes, etc.
- Solvency analysis (pro- and retrospective)

6 – Financial modelling

- Dynamic integrated financial models
- Transaction and deal models, synergy analysis
- Scenario analysis
- Feasibility studies
- Short-term cash flow modelling
- Tax modelling
- Model review

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Stijn is skilled in dealing with detailed valuation topics like equity valuation, management incentive plan valuation, intangible asset and IP valuation, as well as financial modelling. He has more than 10 years of experience in giving advice on corporate finance, working with small and medium businesses, family-owned companies, private equity funds, and institutional investors.

Application areas of intangible asset valuation

Accounting purposes

- Purchase price allocations in accordance with IFRS 3
- IP asset capitalisation
- Impairment testing of IP
- Financial reporting of IP assets
- Valuation of IP for internal management
- Contribution-in-kind

Tax purposes

- Transfer pricing for IP rights
- Tax deductions for IP depreciation
- Contribution-in-kind
- Valuing IP for estate/gift tax or charitable contributions
- Tax incentives for R&D
- Determination of taxable gains

Dispute and litigation

- IP valuation for contractual disputes (such as infringement damages, shareholder conflicts, purchase price disputes, etc.)
- Tax disputes: the taxable amount of an intrafirm transaction is disputed by the tax authorities
- Shareholder disputes

M&A, strategy, liquidation and others

- IP assets as collateral to obtain financing;
- Assist investment decision making for VC/M&A/Joint ventures transactions
- Sale of IP assets in a liquidation
- Determining royalty rates or licensing (transfer pricing)

What defines intangible assets from a financial or accounting point of view?

1 Definition of intangible assets

- IAS 38 defines an intangible asset as “**an identifiable non-monetary asset without physical substance”** (IAS 38, paragraphs 8-17 – Definitions);
- In acquisition accounting: Analysis of acquired intangible assets is to be performed in accordance with **IFRS 3 Business Combinations and IAS 38.**

2 Recognition criteria intangible assets

Is the asset **separable** or arising from **contractual or other legal rights?** (IAS 38 paragraphs 11-12)

→ No → The asset cannot be identified

↓ Yes

Does the entity expect **future economic benefits** flowing from the underlying asset? (IAS 38 paragraphs 13)

→ No → The asset cannot be valued

3 Case illustrative balance sheet

Goodwill	Shareholder’s equity
Other intangible assets	
Tangible assets	Net financial debt
Working capital	
Capital employed	**Capital invested**

What is value and how can it be determined?

1 What the "fool" wants to pay for it?

- The "fool" wants to pay what seems economically reasonable to them
- This can be different for every "fool", based on facts and circumstance that are not always clear to the other party
- This might not be what is deemed reasonable from a market participant or at-arm's-length perspective
- What if there is no transaction, but we require a value anyway?

2 Concept of fair (market) value

- Price at which an asset would change hands in an orderly transaction, under normal market conditions as of the measurement date
- 'Intrinsic value' or 'market participant value'
- Applied in reporting standards worldwide such as the International Financial Reporting Standards ('IFRS'), improving transparency and consistency.

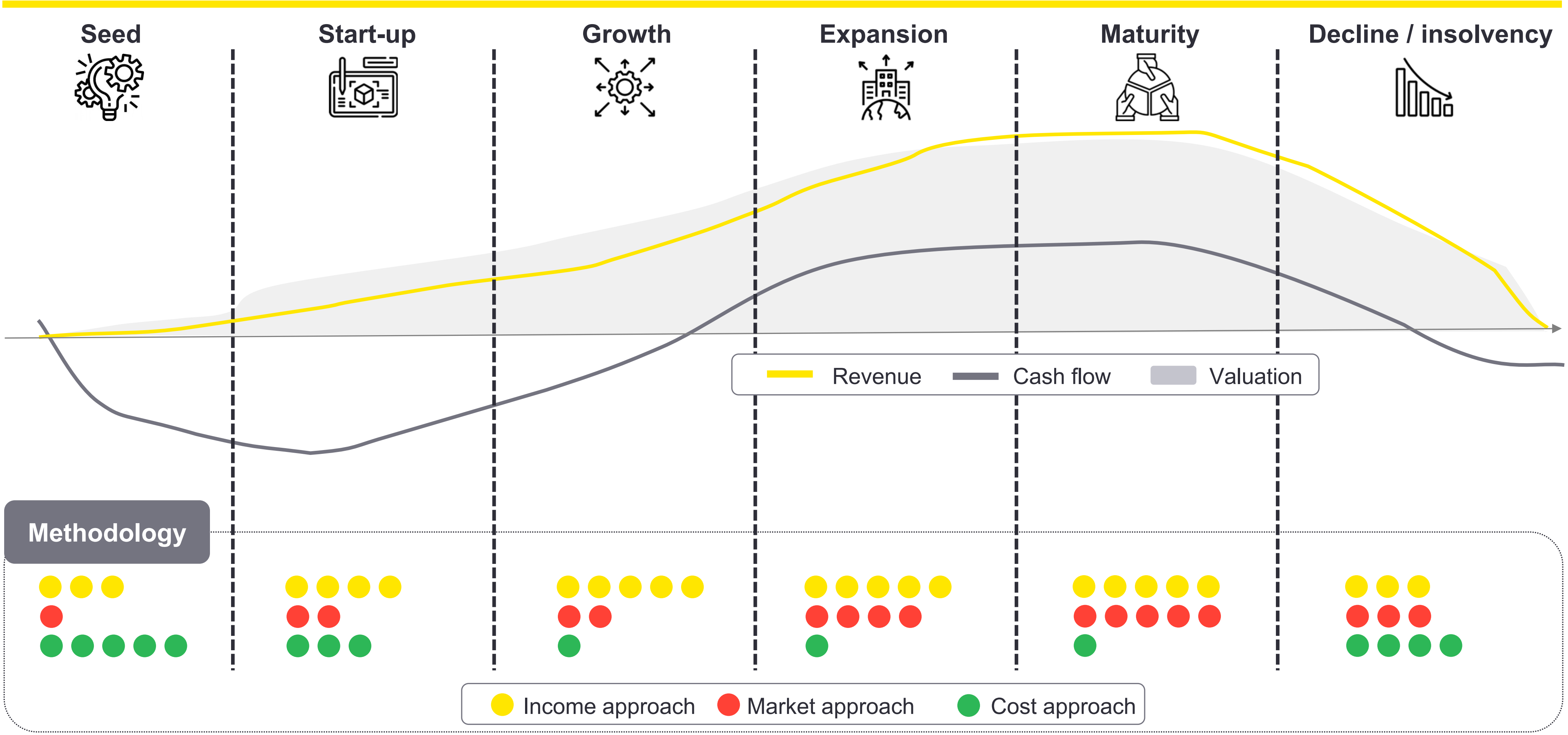
3 How to determine value? There are models! Basically: "Value is the sum of future cash flows, adjusted for risk and uncertainty"

Income approach (discounted cash flow)
- Excess earnings cash flows
- Royalty rate cash flows

Market approach or comparable approach
- Comparable transactions
- Market rates

Cost approach
- Reconstitution costs
- Replacement costs

Valuation methodologies are not arbitrarily chosen but in function of maturity, subject type, etc.

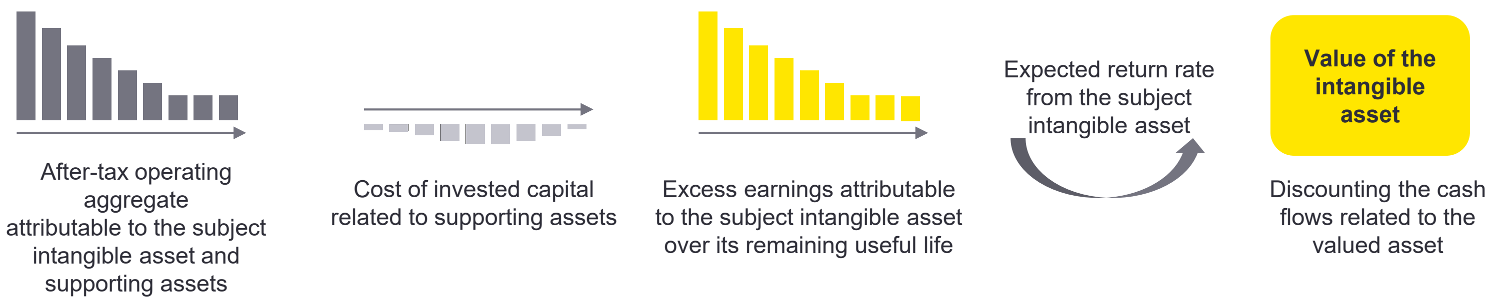


Specific direct approaches to value intangible assets

Multi-Period Excess Earnings Method

Key parameters

- Revenue attributable to the intangible asset
- Attrition rate / obsolescence curve
- Operating margin
- Add back of certain expenses
- Contributory asset charges (CAC)
- Appropriate discount rate

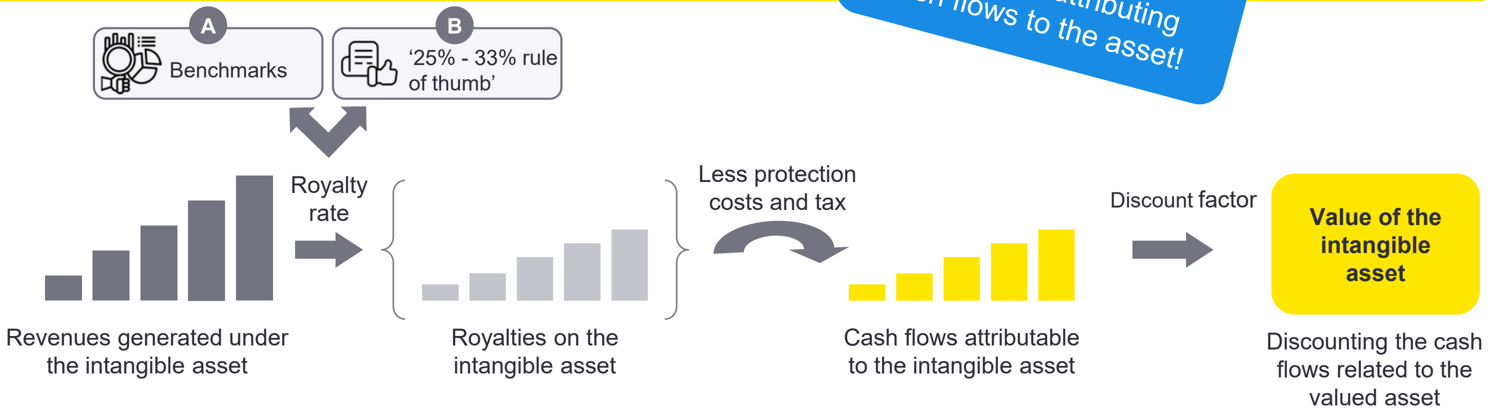


Both methods: Difficulty of attributing cash flows to the asset!

Relief-from-Royalty Method (preferred for trademarks and brands)

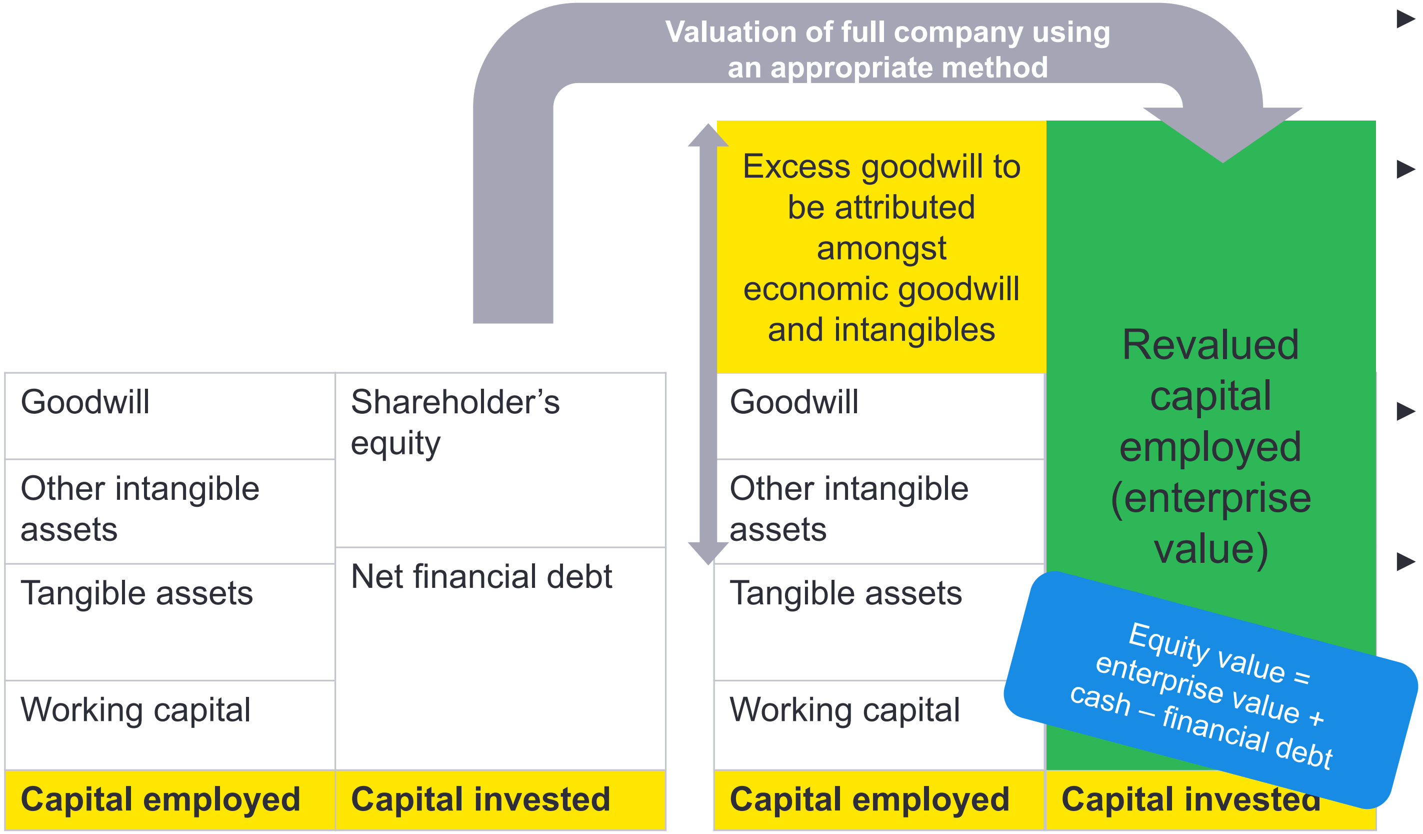
Key parameters

- Revenue attributable to the intangible asset
- Attrition rate / obsolescence curve
- Royalty rate
- Appropriate discount rate



Often intangible assets are valued indirectly

Often indirectly recognized through a full company valuation



Why?

- Often indirectly recognized and in a consolidated manner, laymen's definition of "goodwill"
- Valuing a business as a whole and subtracting the more identifiable, tangible elements leaves the remaining value as intangible assets (or goodwill)
- It is easier to analyse consolidated cash flows rather than to attribute cash flows to specific assets.
- Alternatively, the "with or without" method assesses value by comparing a scenario without the asset, considering its impact on revenue and costs—e.g., a tradename might result in higher revenue and lower marketing expenses.

Can intangible assets really exist on a standalone basis? The concept of contributory asset charges

Contributory Asset Charges (CAC) are used to reflect that some intangible assets require supporting assets. For example:

- A patented drug formula needs manufacturing facilities to be commercially viable.
- A customer list requires a sales team to generate revenue.

If an intangible asset generates standalone cash flows without relying on other assets, then no contributing asset is required.

However, in many business contexts, intangibles work in synergy with other assets, making their valuation dependent on a broader asset base.

Intangible assets requiring a contributing asset:

- **Goodwill** – It exists only in the context of a business and cannot be separated.
- **Assembled Workforce** – While valuable, it cannot generate value without a functioning business.
- **Customer Relationships** – These require a business operation to monetize.
- **Trade Secrets & Proprietary Processes** – They often need production facilities, technology, or business operations to create value.

Some intangible assets can generate value on their own without requiring a contributing asset:

- **Freestanding IP (Patents, Trademarks, Copyrights)** – These can be licensed or sold independently.
- **Standalone Brands** – Some brands (e.g., "Coca-Cola") have such strong market recognition that they can be monetized without a specific underlying business.
- **Franchises & Licenses** – These can generate revenue independently through licensing agreements.

Relief-from-royalty approach: Finding appropriate royalty rates ('RR') as a valuation basis

Identify comparable license agreements

Using market data to identify observed royalty rates in licensing of similar brands

- Databases such as RoyaltyStat, RoyaltySource, public disclosure of SEC filing, industry reports
- Look for: similar industry and products, brand strength, geography

Screening and adjustments

Because few brands are similar, adjustments are typically needed on observed RR

- Brand strength
- Profitability
- Market position
- Support from licensor, investments in marketing
- Typically, through a scorecard / score matrix

Benchmark with industry norms

Cross-check finding with industry observations

- Higher ranges for luxury goods
- Mid-ranges for consumer products and food & beverages
- Lower ranges for industrial goods

Apply profit split cross-check

Determine the share of total profit that could reasonably be attributed to the brand assessing whether the royalty rate is within bounds

- E.g., if the business has 20% margin and your RR is 10% of sales, that means that 50% of profit is being paid for brand use– maybe too high unless brand is everything

Calibrate using internal data

- Historical license terms
- Profitability uplift analysis
- Internal ROI targets– the rate should be commercially reasonable to justify operations' profitability after royalty deduction (see also profit split analysis)

How to adjust your valuation model?

Screening and adjustments

Because few brands are similar, adjustments are typically needed on observed RR

- Brand strength
- Profitability
- Market position
- Support from licensor, investments in marketing
- Typically, through a scorecard / score matrix

Observed royalty rates can be weighted based on qualitative criteria, e.g. a scorecard:

License feature	Rating
Brand strength	0 - 40%
Market position	0 - 40%
Geography cover	0 - 20%
Total score	**0 - 100%**

Gross versus net royalty rate?

What is included in a royalty agreement? Are many marketing expenses till to be born by the license taker? This would lead to downward adjustments to the RR.

Profit split

Can the business reasonably absorb a royalty payment within its margins?

Appropriate discount rates to the cash flows:

Accounting for prevalent risk-free rates, equity risk premium, specific risk premiums, etc. Typically, the specific risk for one individual assets is higher than for a business.

Common mistakes and fallacies in valuation

Wrong attribution of revenue / cash flow to intangible assets

- Ignoring useful life of the asset: technology assets tend to have a short lifespan, as such the value is impacted
- Post-acquisition brands? Will the brand be absorbed into the acquiring firm?
- Underestimating the role of contributing assets: intangible assets rarely are valuable per se but require “enabling assets”
- Inter-asset relationship

Lack of objectivity

- Common in brands and tradenames. B2B: do customers really care about the brand perception?
- Insufficient internal or market data requires judgements, due diligence of historical performance might give insights
- How much of future growth is attributable to the asset or something else?
- Overestimating future cash flows in general

Financial and economic inconsistency

- Does the company’s margin allow for at-arm’s-length royalty payments?
- Stand-alone intangible asset valuation should be avoided, as the overall consistency with other assets and equity must be pertained. Does the sum of all assets and liabilities match the equity? Does the size of goodwill make sense for the type of business?

Inappropriate financial risk

- Underestimating of asset risk by using too low discount rates
- IRR = WACC = WARA analysis. Do the weighted returns of the assets match with the weighted returns of the company overall?

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