

Best Practices

Transaction Structuring: Intangible Asset Due Diligence and Valuation

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Valuation analysts are often called on to value intangible assets for various transaction pricing and structuring reasons. One important part of the transaction-related analysis is the intangible asset due diligence process. In this process, before performing any quantitative analysis, the analyst confirms the condition and the existence of the target company intangible assets. There is a generally accepted process that most analysts follow during the intangible asset due diligence process. This process is usually the first step in the transaction-related valuation analysis. This discussion summarizes the transaction-related intangible asset due diligence and valuation process.

INTRODUCTION

Valuation analysts are often called on to value intangible assets for any number of transaction-related reasons. Those reasons may include the following:

1. Pricing the various alternative transaction structures (e.g., purchase of target company assets, purchase of target company stock, purchase of target company stock followed by a tax liquidation)
2. Assessing the asset collateral value for acquisition financing purposes
3. Assessing and structuring intangible asset sale/license back acquisitions financing opportunities
4. Estimating the post-transaction fair value accounting opening balance sheet
5. Considering income-tax-related planning opportunities (such as the transfer of the acquired intangible assets to off-shore subsidiaries)

One of the most important pre-transaction procedures is the intangible asset due diligence process.

In the intangible asset due diligence process, the analyst assesses the existence, ownership, condition,

and protection of the target company's intangible assets. The due diligence process typically leads to the analyst's preliminary estimate of both of the following:

1. Intangible asset value
2. Intangible asset remaining useful life (RUL)

For purposes of this discussion, the target company intangible assets considered in this due diligence process include all of the intangible assets listed in the FASB Accounting Standards Codification (ASC) topic 805—along with (1) goodwill and (2) going concern value.

The due diligence and valuation process represents a systematic framework for the analyst to answer a set of specific questions about the target company's intangible assets. Those specific questions can originate from the potential acquirer or from the acquirer's legal counsel.

Although there are generally accepted components of the transaction valuation and due diligence process, each intangible asset transaction analysis has unique elements. For example, many different standards of value may be estimated for the target company's intangible assets. Even considering these unique elements, the valuation and due diligence

process provides an overall analytical framework for assessing the target company's intangible assets.

The transaction-related intangible asset analysis process provides a systematic framework for the following procedures:

1. Performing market research, due diligence, and data analysis
2. Selecting and applying the generally accepted valuation approaches, methods, and procedures
3. Synthesizing the value indications derived from each selected method into a final value conclusion
4. Reporting the due diligence process and the value conclusion.

The first half of this discussion summarizes the typical procedures in the transaction intangible asset due diligence process. The second half of this discussion summarizes the elements of the transaction intangible asset valuation process.

INTANGIBLE ASSET DATA GATHERING AND DUE DILIGENCE ANALYSIS

There are several ways to categorize the intangible asset documents that the analyst may gather in the transaction due diligence process.

First, this discussion considers intangible-asset-related documents from a time period perspective. If such documents are available, the analyst considers documents related to the following:

1. The historical operations of the target company intangible asset
2. The current operations of the intangible asset
3. The expected future operations of the intangible asset

Second, if such documents are available, the analyst considers documents from a functional perspective, including the following:

1. The development of the target company intangible asset
2. The target company's current use of the intangible asset
3. The new owner/operator's potential use of the intangible asset

Third, if possible, the analyst collects and assesses data related to different competitive and/or strategic

perspectives of the target company's intangible asset. This competitive assessment considers the intangible asset strategic strengths, weaknesses, opportunities, and threats (SWOT), including the following:

1. The intangible asset SWOT compared to the target company's resources and limitations
2. The intangible asset SWOT compared to guideline company benchmarks
3. The intangible asset SWOT compared to industry benchmarks

The analyst performs reasonable due diligence efforts with regard to the intangible asset documents and data. In this due diligence, the analyst typically compares any intangible asset documents and data (particularly any prospective financial information) to the following:

1. Historical data regarding the target company's intangible asset operations
2. Historical data regarding the target company operations
3. Current resources or constraints regarding the target company
4. Publicly available (and presumably objective) data regarding guideline intangible assets
5. Publicly available (and presumably objective) data regarding guideline companies
6. Publicly available (and presumably objective) data regarding the subject industry

The analyst may ask the target company management to provide information regarding the economic benefits associated with the intangible asset. The analyst performs reasonable due diligence procedures related to such economic benefit information.

This caveat should not imply that the target company will attempt to perform any of the following procedures:

1. Improperly influence the analyst's valuation opinion
2. Inflate or deflate the intangible asset economic benefits

Rather, this caveat recognizes that the target company management is not the experienced valuation analyst.

Therefore, the analyst should be careful to ask the target company management well-defined questions. That way, the target company management

can understand the specific types of information that the analyst needs.

The analyst should be careful to understand the data and documents provided by the target company management. That way, the analyst can be assured that he or she has received the specific information needed to proceed with the intangible asset valuation analysis.

OWNER/OPERATOR DATA GATHERING

If this information is available and relevant, the analyst typically requests information from the target company management with respect to the following topics:

1. The target company's intangible asset development and maintenance
2. The target company's business operations (including the intangible asset)
3. The operations of the individual intangible asset

Sometimes, such target company information is simply not available. It is not uncommon for the target company to have created (or maintained) very few documents or data regarding the intangible asset. The analyst may be performing the transaction valuation within a confidential environment. If the analyst is working in a confidential environment, it may be difficult for the analyst to obtain all of the intangible asset information he or she would like.

Depending on the type of intangible asset and on the valuation approach selected, certain information may be more or less relevant. For a contributory intangible asset (e.g., assembled workforce, training manuals and engineering drawings, internal-use computer software), which may be valued using a cost approach method, information regarding the target company's intangible asset development process may be particularly relevant.

For a marketing-related or technology-related intangible asset (e.g., customer relationships, trademarks, patents), that may be valued using an income approach method, information regarding the target company's intangible asset development process may be less relevant.

Typically, the analyst inquires of the target company management regarding the target company's intangible asset development process. The analyst may request descriptions of the following topics:

1. When the intangible asset was created
2. Why the intangible asset was created—that is, how did the target company function before the subject intangible asset was developed
3. How the intangible asset was created—that is, what parties (inside and outside the target company) were involved in the development
4. The length of time associated with the intangible asset (a) initial development and (b) subsequent evolution (through the valuation date)
5. How the intangible asset evolved throughout its life cycle (e.g., due to investments, competition, obsolescence, or any other factors)

The analyst may also inquire about the maintenance of the intangible asset. This discussion may involve both maintenance expenditures and maintenance efforts. These expenditures and efforts may be both historical and planned. This information may be used in the assessment of the intangible asset's RUL.

The analyst may inquire about the target company's general business operations. These general business operations are the environment in which the target company's intangible asset actually operates. The analyst may request descriptions of the following topics:

1. How the intangible asset functions within the target company
2. How the intangible asset contributes to the success of the target company
3. How the subject intangible asset functions with respect to other intangible assets
4. How the subject intangible asset functions with respect to other tangible assets
5. What target company employees use, maintain, protect, or commercialize the intangible asset

The analyst may inquire about the operation of the intangible asset within the target company. The analyst may request responses to the following questions:

1. Does the intangible asset contribute to the generation of target company operating income?
2. Does the intangible asset contribute to the generation of target company ownership (i.e., royalty) income?

3. Has the target company management ever considered the inbound or outbound license of the intangible asset?
4. If it is not currently licensed, could the intangible asset be licensed?
5. Has the target company ever been approached by a third party about an intangible asset sale, license, or other commercialization offer?

INTANGIBLE ASSET DATA GATHERING

In the due diligence, the analyst may consider the economic benefits related to the intangible asset. These economic benefits may be considered from the perspective of the target company, another individual owner/operator, or “the market” in general (i.e., the population of hypothetical owner/operators).

These economic benefits could include any or all of the following:

1. Some measure of operating income
2. Some measure of license income
3. Some protection of alternative income sources (e.g., through forbearance)
4. Some measure of risk reduction (e.g., through licenses, contracts, or other competitive advantages)
5. Some deferral or reduction of expenses, capital costs, or other investments

The analyst may inquire as to how the target company management perceives the economic benefits of the intangible asset. This inquiry may include the following topics:

1. The intangible asset historical benefits to the target company
2. The intangible asset current benefits to the target company
3. The intangible asset prospective benefits to the target company

The target company management is often in a knowledgeable position to identify and quantify these economic benefits. The analyst should be mindful that the target company management is not a valuation analyst.

With respect to intangible asset benefits, the target company typically does not prepare such documents and assemble such data in the normal course of business. Therefore, the analyst should

perform reasonable due diligence procedures with regard to the intangible asset data provided by the target company.

DUE DILIGENCE PROCEDURES FOR TARGET COMPANY DATA

With regard to the historical benefits from the intangible asset ownership, the analyst typically compares such statements with the target company’s historical financial statements. The claimed revenue increase, expense decrease, or other intangible asset economic benefit may be evident in the target company’s historical results of operations.

Likewise, the impact of the intangible asset is encompassed in the target company’s current financial statements. Whatever economic benefit that is identified by the target company (e.g., increased product selling price, decreased operating expense, etc.) may be encompassed in the target company’s results of operations.

For a newer intangible asset, the analyst may be able to compare current (i.e., with the intangible asset) financial statements to historical (i.e., without the intangible asset) financial statements. The economic benefit of the recently developed intangible asset may be demonstrated by increased revenue growth, decreased expense ratios, and so forth, between the two periods.

The target company management may express the benefits in terms of financial or operational projections. Whether the subject is old or recently developed, the target company management indicates that the intangible asset will contribute to the target company’s operating results in the future. This economic contribution is converted into a value indication when the analyst performs a profit split, multi-period excess earnings, capitalized excess earnings, or similar type of valuation analysis.

Before performing such valuation analyses, the analyst can subject these financial projections to various due diligence procedures, including the following:

1. Compare the target company historically prepared financial projections to historical results of operations; whether the previous projections relate to the intangible asset or to the overall target company, the analyst may be interested in the target company management’s ability to accurately predict future results of operations.
2. Compare the target company’s current financial projections to any current

capacity (or other) constraints; the analyst may consider if the intangible asset-related projections exceed the target company's current plant capacity (without additional capital expenditures), assume new product/service introductions (without additional R&D expenditures), or exceed current regulatory requirements (e.g., the number of CON patient beds for a hospital or the environmental discharge limitations for an oil refinery).

3. Compare the target company's financial projections to guideline company financial projections; many publicly traded guideline companies provide multi-year financial projections to "the market" of security analysts; security analysts also provide multi-year financial projections for the publicly traded guideline companies that they follow.

The analyst may consider if the target company's projection variables (e.g., growth rates, profit margins) are (or are not) in line with guideline public company financial projections.

4. Compare the target company's financial projections to published industry benchmark projections. Trade associations, financial reporting agencies, industry consultants, and others publish both (a) compilations of industry financial ratios and (b) outlook projections for various industries.

The analyst may consider if the target company's projection variables (e.g., growth rates, profit margins) are (or are not) in line with published industry benchmarks.

INFORMATION SOURCES REGARDING GUIDELINE COMPANIES

There are numerous sources of information about the guideline publicly traded companies that operate in the target company's industry. The first two procedures that the analyst typically performs as part of such a due diligence investigation are the following:

1. Select the appropriate industry segment
2. Select the appropriate guideline companies

The analyst may consider these guideline company data in his or her assessment of the subject intangible asset economic benefits.

INFORMATION SOURCES REGARDING TARGET COMPANY INDUSTRY

There are numerous sources of information about industry segments. These sources of information range from periodic special reports (often prepared by industry trade associations) to published industry reporting services to automated data sources.

Most of these data sources provide similar categories of information, including the following:

1. Historical trends and developments
2. Recent milestone events in the industry
3. Projections of future industry growth
4. Discussion of the industry regulatory environment
5. Discussion of the major players in the industry
6. Current and expected industry consolidation trends
7. Analysis of competitive threats to the industry
8. Summary of industry expense ratios or other operational statistics

The analyst may consider these industry data during the due diligence consideration of the target company management's claimed economic benefits related to the intangible asset.

STRATEGIC AND COMPETITIVE ANALYSIS

Before selecting or performing the valuation methods, the analyst typically considers the competitive position of the intangible asset. This due diligence procedure often involves an assessment of the intangible asset SWOT.

This SWOT assessment is often performed by comparing the subject intangible asset to the corresponding intangible assets of the target company's competitors. Typically, the analyst considers the SWOT position of the intangible asset within the SWOT position of the target company.

At this stage of the transaction due diligence, the analyst can only consider general aspects of the intangible asset SWOT. This is because those considerations are different for customer-related assets versus technology-related assets versus engineering related assets, and so on.

As part of data gathering and due diligence procedures, the analyst may consider the following questions with regard to the intangible asset SWOT:

1. How important is the intangible asset to the target company?
2. What would the target company do if the intangible asset did not exist?
3. Does the intangible asset protect the target company from competition?
4. Is the intangible asset susceptible to infringement or other wrongful use?
5. Does the target company adequately protect, improve, and commercialize the intangible asset?
6. Is the intangible asset used primarily used to defend other assets or income sources?
7. Could the intangible asset be further commercialized (e.g., through licensing)?
8. Do the target company's customers, stockholders, and other stakeholders perceive the value of the entity's intangible assets?
9. When practical, are the intangible assets safeguarded through contracts, nondisclosure agreements, noncompetition agreements, and documentation safekeeping practices?
10. Is the existence of the intangible asset sufficiently documented?
11. Is the intangible asset subject to obsolescence influences of any type?
12. What is being done to prolong the intangible asset RUL?

The analyst may consider these general competitive factors when they do the following:

1. Assess the reasonableness of the intangible asset economic benefits (and other data) provided by the target company
2. Select the appropriate valuation approach or approaches

INFORMATION SOURCES REGARDING INTANGIBLE ASSET SALE AND LICENSE TRANSACTIONS

Before considering the application of the market approach, the analyst often performs due diligence procedures related to guideline intangible asset sale or license transactions. In this due diligence

process, the analyst is assessing the existence of, and the volume of, such sale or license transactions.

At this stage of the transaction due diligence process, the analyst typically does not examine these data in order to select a comparable uncontrolled transaction (CUT). Rather, the analyst typically considers these data simply to see if there are any sale or license transactions:

1. of a type of intangible asset that may provide meaningful valuation guidance for the subject intangible asset or
2. in the same (or similar) industry as the target company.

In one respect, this assessment is related to the analyst's strategic assessment of the intangible asset. If there are a fair amount of sale or license transactional data, that fact may mean that there is market interest in the intangible asset type. If there are little or no transactional data, that fact may mean that there is limited market interest in the intangible asset type.

As with all transaction due diligence procedures, the analyst should apply professional judgment. The fact that there are little or no transactional data may mean that the intangible asset:

1. is an internal use only type of intangible asset or
2. is the type of intangible asset that typically transacts with other tangible or intangible assets.

The due diligence procedures regarding sale or license transactional data may inform the analyst as to whether it is even possible to perform a market approach valuation analysis. If the market approach is practical, the analyst still has to select and analyze CUT data. Such valuation analysis procedures are typically beyond the scope of the analyst's transaction due diligence.

VALUATION ANALYST DUE DILIGENCE INQUIRIES

If these data are available and relevant, the analyst may investigate the following lines of inquiry:

1. The target company operations before the development of the intangible asset
2. The target company operations without the existence of the intangible asset
3. The competitors' operations without the intangible asset

4. How the subject intangible asset is different from the competitors' intangible assets
5. The intangible asset life cycle, at the target company specifically or in the industry generally

The analyst's transaction due diligence questions may be affected by whether the intangible asset is one of the following:

1. An internal-use only intangible asset
2. An intangible asset that does (or could) generate operating and/or license income

If such access is available, the analyst may inquire as to how the target company functioned before the development of the current version of the intangible asset. The analyst may consider the following questions:

1. Were there previous versions of the intangible asset?
2. When and how were the previous intangible asset versions created?
3. Did the intangible asset naturally evolve over time (e.g., an assembled workforce) or are there discrete generations of the intangible asset (e.g., a patent or license)?
4. Was there a time when the target company did not have any version of the intangible asset?
5. What was the impact on the target company of developing (or buying) the intangible asset?

The analyst may also inquire as to how the target company would hypothetically function if it did not have access to the subject intangible asset.

The analyst may consider the following questions:

1. Would the target company buy or build a replacement intangible asset?
2. Could the target company buy or build a replacement intangible asset?
3. How would the target company replace the intangible asset?
4. Could the target company function with the current version of the intangible asset?
5. Could the target company function with any current version of the intangible asset?

The analyst may also inquire as to how the industry competitors function without the intangible

asset. The target company enjoys the use of the intangible asset. The competitors do not enjoy the use of the intangible asset. The competitors may or may not have intangible assets that are comparable (or, at least, corresponding) to the subject intangible asset.

The analyst may consider the following issues:

1. Do industry competitors have intangible assets that correspond to the subject intangible asset (or, is the subject intangible asset unique in the industry)?
2. Did the competitors build or buy their corresponding intangible assets?
3. Are there discernible generations of the corresponding intangible assets in the industry?
4. Have any competitors been acquired recently and, if so, do the acquirers report the fair value of the corresponding intangible assets in any public financial statements?
5. Are there any competitors who operate without a corresponding intangible asset and, if so, how (e.g., a contract manufacturer that does not manufacture its own product brands)?

The analyst may inquire as to how the competitors' corresponding intangible assets (if any) compare to the subject intangible asset. The analyst may consider the following questions:

1. Is there any objective measure of relative intangible asset effectiveness (e.g., a consumer brand awareness study regarding product trademarks)?
2. Is there any objective measure of the relative size of intangible assets between the competitors (e.g., the number of patents owned by the competitors)?
3. Is there any way to compare relative age or RUL of intangible assets among the competitors?
4. Is there a reported market for the intangible asset in the industry (e.g., such as for FCC spectrum licenses)?
5. Is there a verifiable industry benchmark or rule-of-thumb regarding the intangible asset in the industry (e.g., price per customer, subscriber, patient, etc.)?

The analyst may inquire about the life cycle of the intangible asset—and the relative position of the intangible asset within that life cycle. The analyst may consider the following questions:

1. Is it possible to estimate the intangible asset RUL?
2. Is it possible to estimate the intangible asset total life cycle?
3. Is it possible to estimate the typical life cycle of any corresponding intangible assets in the industry?
4. How does obsolescence (in any form) affect the performance of the intangible asset?
5. What efforts or expenditures have the target company made to extend the RUL of the intangible asset?
4. The analyst may consider available data with regard to the competition in the target company's industry; this consideration may include any available data with respect to the corresponding intangible assets operated by the competitors.
5. The analyst may consider available data related to the risk factors affecting the intangible asset; such risk factors may include the expected impact of obsolescence, potential regulatory changes, competitive weaknesses and threats related to the target company, legal challenges to the intangible asset, and other factors.

VALUATION ANALYST DUE DILIGENCE CAVEATS

When performing these transaction due diligence procedures, the analyst may consider the following:

1. Prior to the subject analysis, the target company management may have never previously considered the valuation of the intangible asset; therefore, the analyst should not be surprised if the target company management does not have the related documents and data immediately available.

Additionally, the analyst should not be surprised if the target company management does not have immediate answers to the analyst's due diligence questions; the target company management may have never before received similar inquiries about the intangible asset.
2. The analyst should not be surprised if the target company does not have data and documents that are specifically related to the intangible asset; the analyst may have to accept information related to this target company or to the business unit that uses the intangible asset; this is because there is typically no financial accounting or other requirement for the target company to maintain intangible-asset-specific information.
3. The analyst may consider available data with regard to intangible asset maintenance expenditures; most intangible assets require some level of maintenance expenditures in order to stay competitive; the analyst may consider if such expenditures are material to the target company; if so, the analyst should somehow consider such expenditures in the valuation analysis.

For example, such consideration could be made in the estimate of the intangible asset's RUL.

6. The analyst may consider available data regarding expenditures or efforts required to legally protect the intangible asset; these expenditures and efforts could be defensive (i.e., to defend against legal or regulatory challenges) or offensive (i.e., to prosecute breach of contract, infringement, or other legal claims) in nature.
7. The analyst may consider the contractual implications of the intangible asset; to the extent that the intangible asset is the creation of a contract or is obligated to perform according to a contract, the analyst may consider these contractual implications.
8. The analyst may consider alternative perspectives regarding the intangible asset from within the target company, if possible; some intangible assets are so user-specific that only a small subset of target company personnel are knowledgeable regarding the asset; in other cases, the analyst may be able to obtain information from various target company personnel in various departments.

THE NATURE OF THE PRE-TRANSACTION VALUATION PROCESS

The intangible asset transaction valuation process has evolved during the past decade. This evolution includes the consensus of professional practitioners as to what constitutes generally accepted intangible asset valuation approaches, methods, and procedures.

And, this evolution includes the development of professional standards, including the American Institute of Certified Public Accountants (AICPA) Statement on Standards for Valuation Services (SSVS), *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*.

As with most types of property, the value of an intangible asset is influenced by the present value of the future income that the intangible asset is expected to generate. Therefore, a common procedure performed in the intangible asset transaction valuation assignment is to analyze projections of future economic events.

Such future economic events may include the following:

1. The generation of intangible asset owner (e.g., license) income
2. The generation of intangible asset operator (e.g., business operations) income
3. The proceeds from an intangible asset transfer

HIGHEST AND BEST USE

Through the highest and best use (HABU) analysis, the analyst interprets the market forces that influence the target company intangible property, and the analyst identifies the use upon which the final value estimate is based. The HABU analysis helps the valuation analyst to do the following:

1. Identify guideline sale or license transactions
2. Identify any obsolescence factors that may affect the intangible asset value and/or RUL

Some of the relevant valuation factors that are identified during the HABU analysis include: systematic and nonsystematic risk, income projection estimates, and income discount rates or capitalization rates.

During the course of the transaction valuation, the analyst may test the sensitivity of the selected valuation variables. Based on this sensitivity analysis, the analyst may conclude a reasonable range of intangible asset values.

The analyst may identify and analyze various target company operating scenarios during the HABU analysis. The analyst may consider the procedure in the valuation process interrelationships between the selected valuation variable factors—and their probability of occurrence in the future. This consideration may also help the analyst to conclude a reasonable range of pre-transaction intangible asset values.

DATA COLLECTION AND DUE DILIGENCE

The analyst gathers, confirms, analyzes, and adjusts empirical data, as appropriate, when performing the

pre-transaction valuation.

Such empirical data typically include the following:

1. Characteristics of the intangible asset: subject ownership interest, including rights, privileges, conditions, and factors affecting the intangible asset ownership or operational control
2. Nature, history, and outlook of the target company business and industry
3. Historical financial information related to the intangible asset development, operations, and license
4. Any related tangible or intangible assets required for the efficient operation of the intangible asset
5. The nature and conditions of any relevant industry that may have an impact on the intangible asset
6. Local, national, and international economic factors that affect the intangible asset
7. Available rates of return on alternative investments and a description of any relevant market transactions
8. Prior sale or license (both inbound and outbound) transactions involving the subject intangible asset
9. Any other relevant information

The pre-transaction work plan may include an analysis of the following:

1. The market for the intangible asset
2. The intangible asset's supply and demand relationships

To efficiently complete the intangible asset pre-transaction valuation, the valuation process should be planned and scheduled.

Engagement time and staffing requirements vary with the complexity of the assignment objective and with the complexity of the available data. Some pre-transaction valuation assignments can be completed in a few days, while other engagements require several months to gather and analyze the relevant data.

“Through the highest and best use (HABU) analysis, the analyst interprets the market forces that influence the target company intangible property. . . .”

“Ultimately, the analyst’s assessment of the quality and quantity of available data will determine the applicability of any valuation approach or approaches.”

On some pre-transaction valuation assignments, the analyst may seek the assistance of specialists with expertise in other fields. For example, the valuation of the contract rights associated with the distribution of a particular entertainer’s work product may benefit from the opinion of an entertainment industry agent.

The principal analyst is ultimately responsible for the value opinion and the valuation work product. Therefore, the principal analyst should have a clear understanding

of the responsibilities of each of the assignment team members. Taking a comprehensive view, the assignment’s principal analyst will recognize the type, volume, and sequence of all of the work to be performed.

The amount and type of empirical data collected may depend on how the pre-transaction valuation assignment is defined. For example, the valuation problem may indicate that one valuation approach be given greater emphasis in the final value estimate.

Ultimately, the analyst’s assessment of the quality and quantity of available data will determine the applicability of any valuation approach or approaches. The empirical data collected and analyzed affect the judgments made in the intangible asset pre-transaction valuation.

Therefore, the intangible asset due diligence and valuation report typically includes a description of all of the information considered by the analyst.

GENERALLY ACCEPTED VALUATION APPROACHES

The transaction valuation process is applied to develop a well-supported estimate of a defined value, based on consideration of all relevant data. The analyst estimates the intangible asset value after considering the three generally accepted valuation approaches: cost, market, and income.

The analyst selects and applies one or more of these generally accepted approaches in all estimates of intangible asset value. Which of the three generally accepted approaches is most applicable in the particular analysis depends on the type of intangible asset, the intended use of the valuation, and the

quality and quantity of empirical data available for analysis.

All three generally accepted valuation approaches are applicable to many intangible asset pre-transaction valuation analyses. Depending on the specific assignment, one or more of the valuation approaches may have greater significance.

Where possible, the analyst selects and applies more than one approach. Alternative value indications can serve as useful benchmarks for assessing the reasonableness of the value indication of the primary valuation approach.

CONTINGENT AND LIMITING CONDITIONS

It is often necessary for the analyst to make general assumptions in order to carry out the pre-transaction valuation assignment in an efficient manner. General assumptions deal with issues such as legal and title considerations, liens and encumbrances, information furnished by other parties (e.g., engineering studies, market research studies), hidden conditions and environmental hazards, and compliance with applicable laws and regulations.

The analyst will make it clear that the possession and use of the valuation report is limited to the specific purpose and to the specific audience for which it was prepared. Unless otherwise agreed to with the client, the analyst typically has no responsibility to update the valuation report or to provide further client consultation or litigation expert testimony services.

The intangible asset pre-transaction valuation report typically indicates that:

1. the analyst personally conducted the valuation and
2. the analyst has no present or prospective interest in the subject intangible asset.

The analyst reports that he or she has no personal interest or bias with respect to the parties involved. With regard to transaction valuations, the report usually specifies that the assignment fee for performing the analysis is not contingent on the value reported or the attainment of a stipulated event.

Depending on the professional qualifications of the analyst, the intangible asset value development and valuation report may be prepared in compliance with a specified set of professional standards. Such professional standards may include SSVS, the Uniform Standards of Professional Appraisal

Practice (USPAP), or some other organization's professional standards.

PRE-TRANSACTION VALUE CONCLUSION

From an overall engagement perspective, the analyst should consider the question: "Did I accomplish what I set out to accomplish in the intangible asset valuation?"

The analyst's final review of the intangible asset pre-transaction valuation assignment should consider the following:

1. Identification of the subject intangible asset
2. The objective of the intangible asset valuation
3. The purpose of the intangible asset valuation
4. The subject intangible asset ownership interest (including the bundle of legal rights)
5. The date of the value estimate
6. Definition of the appropriate standard of value to be estimated
7. Definition of the appropriate premise of value (based on the client's instruction or on the analyst's HABU conclusion)

The intangible asset pre-transaction valuation is performed to answer a question about the intangible asset value. Even within the same valuation approach, different methods will typically conclude different value indications. For example, it is likely that different indicated values would result from two different income approach methods (e.g., from the multiperiod excess income method versus from the discounted incremental income method).

The process of reconciliation involves the analysis of the alternative value indications in order to arrive at an intangible asset final value estimate. Before reaching a final value estimate, the analyst reviews the entire intangible asset valuation for appropriateness and accuracy.

It is noteworthy that the definition of value estimated, and its relationship to each procedure in the valuation process, should be carefully considered during the reconciliation process.

REPORTING THE VALUE CONCLUSION

For most pre-transaction assignments, the results of the intangible asset valuation process are typically

presented to the client (or other interested parties) in a valuation report. The intangible asset valuation report may be an oral report or a written report.

Regardless of whether it is prepared in accordance with any specified set of professional standards, the intangible asset valuation report should clearly and accurately set forth the valuation in a manner that is not misleading. The valuation report should contain sufficient information to enable the audience to understand it properly.

And, the valuation report should disclose any extraordinary assumptions or contingent or limiting condition that may impact the intangible asset pre-transaction value conclusion.

The analyst's professional qualifications and experience are typically included in the pre-transaction valuation report. Such disclosures provide evidence of the analyst's competence to perform the pre-transaction valuation assignment.

SUMMARY

The analyst typically obtains most of the transaction valuation information from the target company management. Such information may include financial documents and operational data, summaries of historical development costs and efforts, estimates of economic benefits and other prospective financial information, and so forth.

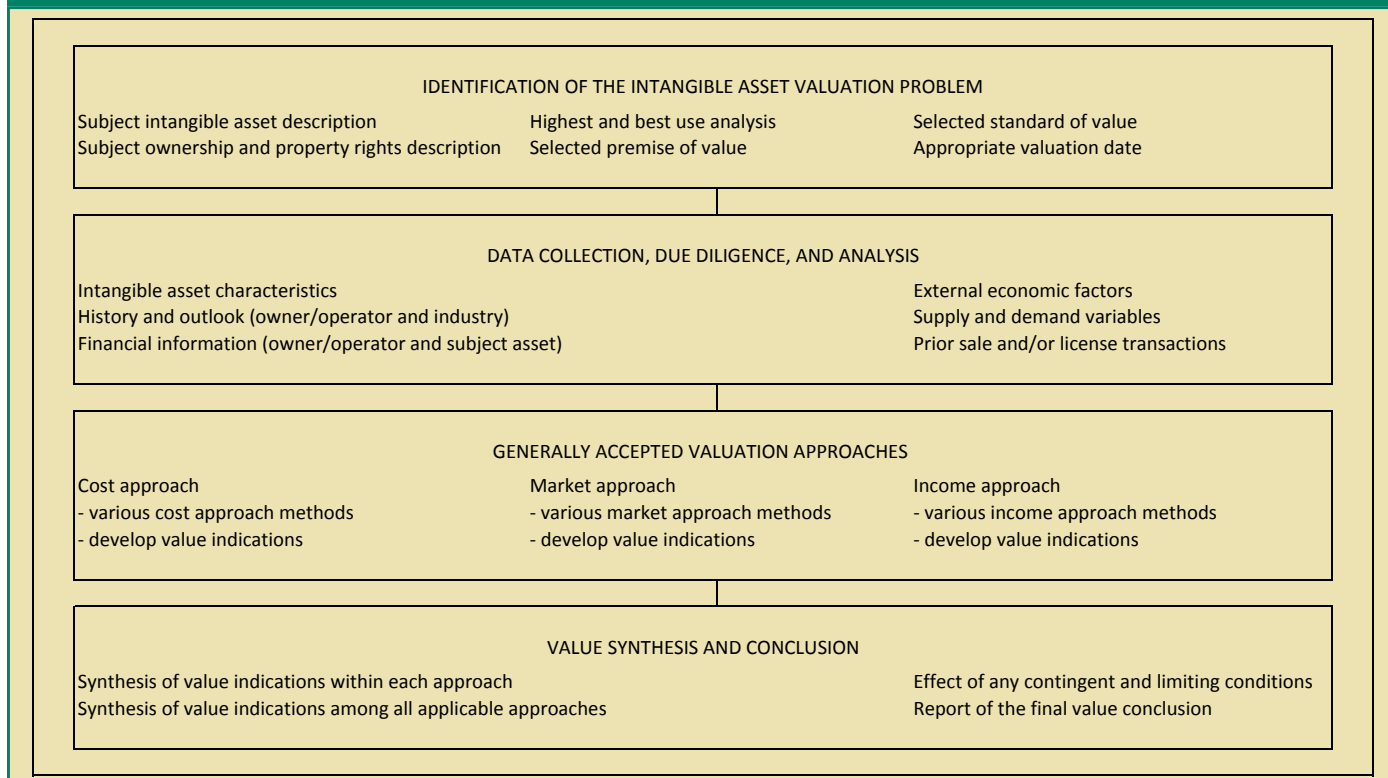
The analyst may consider reasonable due diligence procedures with regard to the intangible-asset-related information. These due diligence procedures could relate to historical, contemporaneous, and prospective information. Many of the due diligence procedures are comparative in nature.

The analyst may compare the intangible asset information to the following:

1. Historical information benchmarks
2. Target company capacity or other constraints
3. Guideline company benchmarks
4. Competitor industry benchmarks
5. Guideline sale or license transaction data

"A competitive (or SWOT) analysis is a common due diligence procedure when the analyst assesses the reasonableness of the intangible asset economic benefits to the target company."

Exhibit 1 The Pre-Transaction Intangible Asset Valuation Process



A competitive (or SWOT) analysis is a common due diligence procedure when the analyst assesses the reasonableness of the intangible asset economic benefits to the target company. As part of the competitive analysis, the analyst may consider the following:

1. How the target company functioned before the development of the intangible asset
2. How the target company would function without the intangible asset
3. How the target company competitors function without the subject intangible asset

When the analyst receives information from the target company, the analyst should be aware that the target company management:

1. may never have assembled this type of information before,
2. may not maintain intangible asset-specific data and documents,
3. may not consider all maintenance and legal expenses in the response, and
4. may not consider all risk factors (including obsolescence considerations) in the response.

Even with these caveats, the analyst typically gathers as much intangible asset development and operations information as possible to use in the pre-transaction valuation analysis.

Understanding the principal procedures in the pre-transaction valuation process—and the reasons for the principal procedures—is helpful to the successful completion of the pre-transaction assignment. The due diligence valuation process provides a general analytical structure that assists the analyst in the collection, assessment, analysis, and interpretation of market-derived valuation evidence.

As summarized in this discussion, Exhibit 1 illustrates the principal procedures in the pre-transaction intangible asset valuation process.

The most complex intangible asset transaction valuation can be more easily understood and more effectively solved if the analyst addresses the problem in terms of the valuation and due diligence process.

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You May Not Need a Business Valuation

Robert P. Schweih

Business transactions have become increasingly more complex over time. Individuals responsible for making the decision whether to accept a complex business transaction will sometimes request that a business valuation be performed. Alternatively, the decision maker may seek the advice of a valuation analyst who will act as the independent financial adviser to that decision maker. The independent financial adviser may conduct an analysis that is consistent with generally accepted business valuation standards and practices. However, such an analysis will focus on the specific information needs of the decision maker.

INTRODUCTION

Individuals are often asked to decide, for themselves or on behalf of others, whether to enter into a transaction as either the buyer or the seller. On many occasions, these decision makers will ask for a business valuation to be performed to help them make their decision. Especially when their decision is going to affect others, they want to be comfortable that they are making the appropriate decision.

While a valuation analyst can provide important services to help support such a decision, it may not be a business valuation that the decision maker needs. It may be a different assignment that the decision maker needs: advice from an independent financial adviser. Valuation analysts are often the appropriate providers of that independent financial advice.

THE ECONOMIC CONFLICT

The buyers want to minimize the consideration they pay in the purchase transaction. The sellers want to maximize the proceeds they receive from the sale transaction. Hence, there is an inherent economic conflict between the buyers and sellers of in purchase transactions.

The final purchase transaction price is typically the result of informed (and intense) negotiations between sophisticated (or, at least, well-advised) parties. During these informed purchase/sale negoti-

ations, both parties seek to achieve their maximum economic self-interests.

When an individual is making a decision on behalf of others, that individual may have a fiduciary duty to those people. A fiduciary has a duty of loyalty to the beneficiary of his or her decisions, and the fiduciary should not put personal interests before that duty.

A fiduciary functions as an agent of the beneficiary. The fiduciary can be, for instance, an individual, a trust, or a board of directors. It seems as though the interpretation of fiduciary duties is ever-changing. Fiduciary duties are based on the continued guidance of law, courts, regulations, and regulators.

The fiduciary's duties typically do not pass through to the advisers that are engaged by the fiduciary. The financial adviser's client is the fiduciary (and not the beneficiary of the fiduciary's duty). The financial adviser takes instructions from and works for the benefit of the fiduciary. Normally, the financial adviser does not have a fiduciary duty to the parties to whom the fiduciary has a duty.

In the purchase/sale transaction, the independent financial adviser typically performs several functions, among them are the following:

1. Conducting the financial analysis of the property that is the target of the proposed transaction
2. Assisting the decision maker in the negotiation of the purchase/sale transaction price