

Intangible Asset Valuation Due Diligence



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Before the quantitative analysis comes the due diligence.

ATTORNEYS ASK valuation analysts to value an owner/operator's intangible assets for a variety of reasons. These reasons could include: fair value financial accounting, tax compliance and controversy, sale and license transaction opinions, financing collateralization, bankruptcy solvency and reasonably equivalent value analysis, not-for-profit entity private inurement opinions, and litigation damages analysis. These valuation requests may come from the lawyer's prosecution of, or defense of, such legal claims as financial statement fraud and misrepresentation, gift and estate audits, income tax audits, property tax assessments, family law transaction fairness or solvency, lender liability, bankruptcy fraudulent transfers and preference claims, not-for-profit entity excess benefit or private inurement allegations, breach of contract (including licenses, joint ventures, joint development/commercialization agreements, nondisclosure/confidentiality agreements, etc.), and infringement and other tort claims.

Before retaining the valuation analyst, the lawyer should ensure that the analyst understands the intangible asset and the bundle of legal rights subject to analysis. Also, before starting the assignment, the analyst should

understand the purpose and objective of the valuation. Before selecting and performing any quantitative procedures, the analyst performs due diligence procedures. Data gathering is one procedure in the analyst's valuation due diligence process.

There are several ways to categorize the intangible asset documents that the valuation analyst may gather. First, this discussion considers these documents from a time period perspective. That is, if such data are available, the analyst considers documents related to:

- The historical operations of the subject intangible asset;
- The current operations of the subject intangible asset;
- The expected future operations of the subject intangible asset.

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

- The development of the subject intangible asset;
- The owner/operator's current use of the intangible asset;
- A 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 intangible asset. This competitive assessment includes the intangible asset strategic strengths, weaknesses, opportunities, and threats (SWOT), including:

- The intangible asset SWOT compared to the owner/operator's resources and limitations;
- The intangible asset SWOT compared to guideline company benchmarks;
- The intangible asset SWOT compared to industry benchmarks.

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

- Historical data regarding the intangible asset operations;
- Historical data regarding the owner/operator operations;
- Current resources or constraints regarding the owner/operator;
- Publicly available (and presumably objective) data regarding comparable intangible assets;
- Publicly available (and presumably objective) data regarding comparable companies;
- Publicly available (and presumably objective) data regarding the subject industry.

As discussed below, the analyst may ask the owner/operator to provide information regarding the economic benefits associated with the intangible asset. The analyst may perform reasonable due diligence procedures related to such economic benefit information. This caveat does not imply that the owner/operator will attempt to improperly influence the analyst's valuation opinion or to inflate or deflate the intangible asset economic benefits. Rather, this caveat recognizes that the owner/operator is not a valuation analyst.

Therefore, the valuation analyst should be careful to ask the owner/operator well-defined questions. That way, the owner/operator can understand the specific types of specific information that the analyst needs. And, the analyst should be careful to understand the data and documents provided by the owner/operator. That way, the analyst can be assured that he or she has received the specific information needed to proceed with the valuation.

This discussion summarizes what the lawyer should know about this valuation due diligence process. This due diligence process is important

to ensure that the intangible asset valuation stands up to a tax audit, regulatory challenge, or litigation contrarian review.

Types Of Client Intangible Assets

Below is a list of identifiable intangible assets that valuation analysts often refer to. Table 1 presents the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) topic 805-10-55 list of identifiable intangible assets.

It is noteworthy that this ASC topic only presents identifiable intangible assets that are valued at fair value for acquisition accounting purposes. So, this Table 1 does not present an exhaustive list of all intangible assets. For example, this list does not include such common intangible assets as a trained and assembled workforce or goodwill (which are not accounted for as identifiable intangible assets for fair value accounting purposes). And, this list does not include any number of industry-specific intangible assets (e.g., a hospital CON, an FCC spectrum license, etc.).

1. Marketing-Related Intangible Assets

- a. Trademarks, trade names, service marks, collective marks, certification marks
- b. Trade dress (unique color, shape, package design)
- c. Newspaper mastheads
- d. Internet domain names
- e. Noncompetition agreements

2. Customer-Related Intangible Assets

- a. Customer lists
- b. Order or production backlog
- c. Customer contracts and related customer relationships
- d. Noncontractual customer relationships

3. Artistic-Related Intangible Assets

- a. Plays, operas, ballets

- b. Books, magazines, newspapers, other literary works
- c. Musical works such as compositions, song lyrics, and advertising jingles
- d. Pictures, photographs
- e. Video and audiovisual material, including motion pictures or films, music videos, television programs

4. Contract-Based Intangible Assets

- a. Licensing, royalty, standstill agreements
- b. Advertising, construction, management, service or supply contracts
- c. Lease agreements (whether the acquire is the lessee or the lessor)
- d. Construction permits
- e. Franchise agreements
- f. Operating and broadcast rights
- g. Servicing contracts such as mortgage servicing contracts
- h. Employment contracts
- i. Use rights such as drilling, water, air, timber cutting, and route authorities

5. Technology-Based Intangible Assets

- a. Patented technology
- b. Computer software and mask works
- c. Unpatented technology
- d. Databases including title plants
- e. Trade secrets, such as secret formulas, processes, recipes

Owner/Operator Data Gathering

If such information is available and relevant, the analyst typically requests information from the owner/operator with respect to:

- The intangible asset development and maintenance;
- The owner/operator business operations (with the intangible asset);
- The operations of the individual intangible asset.

Sometimes, such information is simply not available. It is common for an owner/operator to create (or maintain) very few documents or data regarding the intangible asset. Of course, the analyst may be performing the valuation within litigation or other contrarian environment. If the analyst is working for an opposing litigant, regulatory authority, taxing agency, etc. (and not for the owner/operator), it may be difficult for the analyst to obtain all of the information he or she would like.

Also, 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, operator manuals and engineering drawings, internal-use computer software) that may be valued using a cost approach method, information regarding the 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 subject intangible asset development process may be less relevant.

Typically, the analyst inquires of the owner/operator regarding the intangible asset development process. In these inquiries, the analyst may request descriptions of:

- When the intangible asset was created;
- Why the intangible asset was created; that is, how did the owner/operator function before the subject intangible asset was developed?
- How the intangible asset was created; that is, what parties (inside and outside the owner/operator entity) were involved in the development;
- The length of time associated with the intangible asset initial development and subsequent evolution (through the valuation date);
- 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. This information may be used in the analyst's assessment of the intangible asset remaining useful life (RUL).

The analyst may inquire about the owner/operator's general business operations. These general business operations are the environment in which the intangible asset actually operates. In these inquiries, the analyst may request descriptions of:

- How the intangible asset functions within the owner/operator;
- How the intangible asset contributes to the success of the owner/operator;
- How the subject intangible asset functions with respect to other intangible assets;
- How the subject intangible asset functions with respect to other tangible assets;
- What owner/operator employees use, maintain, protect, or commercialize the intangible asset?

The analyst may inquire about the operation of the intangible asset within the owner/operator entity. In these inquiries, the analyst may consider the following questions:

- Does the intangible asset contribute to the generation of entity operating income?
- Does the intangible asset contribute to the generation of entity ownership (i.e., royalty) income?
- Has the owner/operator ever considered the inbound or outbound license of the intangible asset?
- If it is not currently licensed, could the intangible asset be licensed?
- Has the owner/operator ever been approached with a sale, license, or other commercialization offer regarding the intangible asset?

Intangible Asset Data-Gathering

In any valuation, the analyst typically considers the economic benefits related to the intangible asset. These economic benefits could be considered from the perspective of the current owner/operator, another individual owner/operator, or “the market” in general (i.e., the population of hypothetical owner/operators). These intangible asset economic benefits could include any or all of the following:

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

The analyst may inquire as to how the owner/operator perceives the economic benefits associated with the intangible asset. This inquiry may include:

- The intangible asset historical benefits to the owner/operator;
- The intangible asset current benefits to the owner/operator;
- The intangible asset prospective benefits to the owner/operator.

The owner/operator is often in a knowledgeable position to identify and quantify these economic benefits. However, the owner/operator is not a valuation analyst. With respect to intangible asset benefits, the owner/operator 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 owner/operator.

Due Diligence Procedures for Owner/Operator Data

With regard to the historical benefits from the intangible asset ownership, the analyst may compare such statements with the owner/operator historical financial statements. Presumably, the claimed revenue increase, expense decrease, or other intangible asset economic benefit may be evident in the owner/operator’s historical results of operations.

Likewise, the impact of any intangible asset benefits may be included in the current owner/operator’s financial statements. That is, whatever economic benefit that is identified by the owner/operator (e.g., increased product selling price, decreased operating expense, etc.) may be encompassed in the owner/operator’s results of operations.

In particular, 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 benefit of the recently developed intangible asset may be demonstrated by increased revenue growth, decreased expense ratios, etc. between these two time periods.

The owner/operator may express the intangible asset benefits in terms of financial or operational projections. Whether the subject is old or recently developed, the owner/operator indicates that the intangible asset will contribute to the entity’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 valuation method analysis.

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

- Compare the owner/operator historically prepared financial projections to historical results of operations; whether the previous projections

relate to the subject intangible asset or to the overall entity, the analyst may be interested in the owner/operator's ability to accurately predict future results of operations;

- Compare the owner/operator current financial projections to any current capacity (or other) constraints; the analyst may consider if the intangible asset-related projections exceed the owner/operator'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);
- Compare the owner/operator 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 owner/operator projection variables (e.g., growth rates, profit margins) are in line with guideline public company financial projections;
- Compare the owner/operator financial projections to published industry benchmark projections; trade associations, financial reporting agencies, industry consultants, and others publish both compilations of industry financial ratios and outlook projections for various industries; the analyst may consider the reasons why the owner/operator projection variables (e.g., growth rates, profit margins) are not in line with published industry benchmarks.

Information Sources Regarding Owner/Operator Guideline Companies

There are numerous sources of information about the guideline publicly traded companies that operate in the owner/operator's industry. The first

two procedures the analyst performs as part of such a due diligence investigation are select the appropriate industry segment and select the appropriate guideline companies. The analyst can consider these guideline company data in his or her assessment of the intangible asset economic benefits.

Assuming the analyst has exercised professional judgment and selected appropriate guideline companies, here is a list of the automated data sources the analyst can use to research those selected companies.

- **Bloomberg.** Bloomberg is a fully searchable online database that provides financial information on nearly all active and inactive U.S. publicly traded companies and active and inactive international companies. Companies may be searched by industry sectors or by SIC codes. Detailed financial information is available. The information is updated frequently. More information is available at www.bloomberg.com/professional/
- **MergentOnline.** MergentOnline is a fully searchable online database that provides financial information on over 15,000 active and inactive U.S. publicly traded companies and approximately 20,000 active and inactive international companies. Companies are listed by SIC codes and by NAICS codes. More information is available at www.mergentonline.com
- **S&P Capital IQ.** S&P Capital IQ contains detailed financial and textual information on approximately 79,000 publicly traded companies (both domestic and foreign). The information is derived from documents filed with the Securities and Exchange Commission (SEC) and similar global stock regulators (as well as proprietary research). The database may be searched by SIC code or by Standard & Poor's industry classifications. Detailed financial information is available. The information is updated frequently. More information is available at www.capitaliq.com

- **Thompson ONE.** Thompson ONE is a fully searchable online database that provides financial information on approximately 52,000 public companies and over 1 million private companies. Companies may be searched by GICS codes or SIC codes. Detailed financial information is available. The information is updated frequently. More information is available at www.thomsonreuters.com.

Information Sources Regarding Owner/Operator Industries

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:

- Historical trends and developments;
- Recent milestone events in the industry;
- Projections of future industry growth;
- Discussion of the industry regulatory environment;
- Discussion of the “major players” in the industry;
- Current and expected industry consolidation trends;
- Analysis of competitive threats to the industry;
- Summary of industry expense ratios or other operational statistics.

The analyst can consider these industry data during the due diligence consideration of the owner/operator’s claimed economic benefits related to the subject intangible asset.

The following list provides a summary of the print and automated data sources the analyst can use to research the selected industry segment.

Data Sources For Researching The Owner/Operator’s Industry

This list provides common industry research sources. For some industries, there are also industry-specific sources available from trade associations, independent publishers, and periodicals:

- **FirstResearch.** FirstResearch is an industry research database that was developed to provide information for sales people. It provides an overview, valuation multiples, growth rates, and information on how to analyze a company in a particular industry. Information is updated quarterly. Available at www.firstresearch.com
- **IBISWorld.** IBISWorld is one of the largest independent publishers of U.S. industry research. Research includes information on major companies in the industry, growth rates, key financial data, and outlook for the industries. They cover approximately 700 different market segments. Some international reports are also available. Information is updated quarterly for most industries — less frequently for some. Available at www.ibisworld.com and also through other database aggregators.
- **S&P Industry Surveys.** S&P Industry Surveys are available on approximately 50 industry sectors. The reports provide global industry information as well as information on the U.S. industries. Major companies are discussed, and detailed information on the recent past as well as an outlook for the future is provided. A glossary of specialized terms is provided. Also, comparable financial information on major companies in the industry is provided. The information is updated twice a year. These surveys are available from various sources, including S&P NetAdvantage and Alacra.com.
- **ABI/Inform.** Articles from U.S. and international general interest and trade publications may be searched. This database is available at most libraries and through database aggregators such as Alacra.com.

- **Bloomberg Industries.** This component of the Bloomberg database provides industry data, interactive charting, and written analysis from a team of industry experts. Contact information for each industry expert is provided, so that an analyst can follow up with questions if needed. More information is available at www.bloomberg.com/professional/
- **MarketResearch.com.** This database provides access to industry and market research reports from many different sources. They provide information on products, trends, regions, demographics, industries and companies from their collection of over 700 research publishers. More information is available at www.market-research.com
- **S&P CapitalIQ.** This database provides access to analyst research as well as some market research reports. In addition, comparative ratio information is available. More information is available at www.capitaliq.com
- **ThomsonOne.** This database provides access to analyst research and market research reports. More information is available at www.thomson-reuters.com
- **Westlaw.** Articles from U.S. and international general interest and trade publications may be searched. Westlaw also provides access to the Investext analyst research database. More information is available at www.westlaw.com
- **Almanac of Financial Ratios,** CCH, Inc. This resource is available in print and e-book formats. The book includes 50 comparative performance indicators and covers all of North America using NAICS data. The information is calculated and derived from the latest available IRS data on nearly 5 million companies. It includes companies in nearly 200 industries. The book is issued annually. More information is available at www.cchgroup.com
- **Annual Statement Studies: Financial Ratio Benchmarks and eStatement Studies database, The Risk Management Association.** Both the book and the online database contain financial statement ratios and common-size balance-sheet and income-statement line items, arrayed by asset and sales size. Six different asset and sales size categories are presented. The book and database cover over 700 industries, sorted by NAICS codes. The book is issued annually. More information is available at www.rmahq.org
- **Ibbotson Cost of Capital, Morningstar.** This annual book contains five separate measures of cost of equity, weighted average cost of capital, statistics on sales and profitability, capitalization, beta, equity valuation multiples, enterprise valuation multiples, financial ratios, equity returns, and capital structure. It is organized by SIC code. Quarterly updates are available online at ccrc.morningstar.com
- **IRS Corporate Ratios, Schonfeld & Associates, Inc.** This book includes 76 financial ratios that are based on the most recently available income statement and balance sheet data compiled by the Internal Revenue Service. The data focuses on the comparison of financial ratios for companies with and without net income. The contrast between profitable and unprofitable companies highlights which ratios are critical in the achievement of financial success. The book is issued annually. More information is available at www.saibooks.com.

Strategic And Competitive Analysis

Before selecting or performing 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 intangible asset to the competitors' corresponding intangible assets. Typically, the analyst will consider the SWOT posi-

tion of the intangible asset within the SWOT position of the owner/operator entity.

At this stage of the valuation, 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, etc. In addition, more specific SWOT considerations have different implications for cost approach, income approach, and market approach analyses.

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

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

The analyst may consider these general competitive factors when assessing the reasonableness of the intangible asset economic benefits (and other data) provided by the owner/operator and when selecting the appropriate valuation approach or approaches.

Information Sources Regarding Intangible Asset Sale And License Transactions

The application of the market approach and the associated valuation methods (e.g., the comparable sales method and the relief from royalty method) is beyond the scope of this discussion. However, 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 volume of, such sale or license transactions.

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

- Of a type of intangible asset that may provide meaningful valuation guidance for the subject intangible asset;
- In the same (or similar) industry as the owner/operator entity.

This assessment is related to the analyst's strategic assessment of the intangible asset. If there are fair amounts 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 due diligence procedures, the analyst should apply professional judgment. The fact that there are little or no transactional data may mean that the subject asset:

- Is an internal use only type of intangible asset; or
- 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 due diligence investigation.

Below is a summary of the print and automated data sources the analyst can use to research intangible asset CUT data (a detailed description of data sources is beyond the scope of this article):

- **ktMINE.** ktMINE is an interactive intellectual property database that provides direct access to license royalty rates, actual license agreements, and detailed agreement summaries. The database contains over 12,000 intellectual property license agreements. The intellectual property license database is updated frequently. License agreements are searchable by industry, keyword, and various other parameters. The full text of each intellectual property license agreement is available. Available at www.bvmarketdata.com
- **Royalty Connection.** Royalty Connection™ provides online access to intellectual property license royalty rate and other license information on all types of technology, patents, trade secrets, and know-how. The data are aggregated from arm's-length sale/license transactions, litigation settlements, and court-awarded royalty order from 1990 to the present. The intellectual property license database is frequently updated. Users can search by industry, product category, or keyword. The information provided includes the consideration paid for the intellectual property license and any restrictions (such as geographic or exclusivity). Available at www.royaltyconnection.com
- **RoyaltySource.** AUS Consultants produces a database that provides intellectual property license transaction royalty rates. The database can be searched by industry, technology, and/or keyword. The information provided includes the license royalty rates, name of the licensee and the licensor, a description of the intellectual property licensed (or sold, if applicable), the transaction terms, and the original sources of the information provided. Preliminary results are available online and a final report is sent to the subscriber via e-mail. Available at www.royaltysource.com
- **RoyaltyStat, LLC.** RoyaltyStat is a subscription-based database of intellectual property license royalty rates and license agreements, compiled from Securities and Exchange Commission documents. It is searchable by SIC code or by full text. The results can be viewed online or archived. The intellectual property transaction database is updated daily. The full text of each intellectual property license agreement in the database is available. Available at www.royaltystat.com
- **Licensing Economics Review.** AUS Consultants publishes this monthly newsletter, which contains license royalty rates on selected recent intellectual property transactions. The December issue each year also contains an annual summary of intellectual property license royalty rates by industry.
- **License Royalty Rates.** Gregory J. Battersby and Charles W. Grimes annually author this book, which is published by Aspen Publishers. This reference tool provides intellectual property license royalty rates for 1,500 products and services in 10 different licensed product categories: art, celebrity, character/entertainment, collegiate, corporate, designer event, music, nonprofit, and sports.

- **Intellectual Property Research Associates.** Intellectual Property Research Associates produces three books that contain information on license royalty rates for patents, trademarks, and copyrights. The books are *Royalty Rates for Trademarks & Copyrights*, *Royalty Rates for Technology*, and *Royalty Rates for Pharmaceuticals & Biotechnology*. These books are updated periodically.

Due Diligence Inquiries

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

- The owner/operator operations before the development of the intangible asset;
- The owner/operator operations without the existence of the intangible asset;
- The competitors' operations without the subject intangible asset;
- How the subject intangible asset is different from the competitors' intangible assets;
- The intangible asset life cycle, at the owner/operator specifically or in the industry generally.

Depending on what party he or she is working for in the engagement, the analyst may not have access to due diligence data sources related to the above inquiries. Also, the analyst's due diligence questions will be affected by whether the intangible asset is:

- An internal-use only intangible asset;
- 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 owner/operator entity functioned before the development of the current version of the intangible asset. The analyst may consider:

- Were there previous versions of the intangible asset?
- When and how were the previous intangible asset versions created?

- 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)?
- Was there a time when the owner/operator did not have any version of the intangible asset?
- What was the impact on the owner/operator entity of developing (or buying) the intangible asset?

The analyst may also inquire as to how the owner/operator entity would hypothetically function if it did not have access to the intangible asset.

The analyst may consider:

- Would the owner/operator buy or build a replacement intangible asset?
- Could the owner/operator buy or build a replacement intangible asset?
- How would the owner/operator replace the intangible asset?
- Could the owner/operator function with the current version of the intangible asset?
- Could the owner/operator function with any current version of the intangible asset?

The analyst may also inquire as to how the industry competitors function without the subject intangible asset. The owner/operator enjoys the use of the subject intangible asset. The competitors do not enjoy the use of the subject 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:

- Do industry competitors have intangible assets that correspond to the subject (or, is the subject intangible asset unique in the industry)?
- Did the competitors build or buy their corresponding intangible assets?
- Are there discernible generations of the corresponding intangible assets in the industry?
- 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?

- 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:

- Is there any objective measure of relative intangible asset effectiveness (e.g., a consumer brand awareness study regarding product trademarks)?
- 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)?
- Is there any way to compare relative age or RUL of intangible assets among the competitors?
- Is there a reported market for the intangible asset in the industry (e.g., such as for FCC spectrum licenses)?
- 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 subject intangible asset within that life cycle. The analyst may consider:

- is it possible to estimate the intangible asset RUL?
- Is it possible to estimate the intangible asset total life cycle?
- Is it possible to estimate the typical life cycle of any corresponding intangible assets in the industry?
- How does obsolescence (in any form) affect the performance of the intangible asset?

- What efforts or expenditures have the owner/operator made to extend the RUL of the intangible asset?

Due Diligence Caveats

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

- Prior to the subject analysis, the owner/operator may have never previously considered the valuation of the intangible asset; therefore, the analyst should not be surprised if the owner/operator does not have the related documents and data immediately available; and, the analyst should not be surprised if the owner/operator does not have immediate answers to the analyst's due diligence questions; the owner/operator may have never before received similar inquiries about the intangible asset;
- The analyst should not be surprised if the owner/operator does not have data and documents that are specifically related to the intangible asset; the analyst may have to accept information related to this owner/operator entity or to the business unit that uses the intangible asset; this is because there is typically no financial accounting or other requirement for the owner/operator to maintain intangible asset-specific information;
- 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 owner/operator entity; 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 RUL;

- The analyst may consider available data with regard to the competition in the owner/operator industry; this consideration may include any available data with respect to the corresponding intangible assets operated by the competitors;
- 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 owner/operator, legal challenges to the intangible asset, and other factors;
- 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;
- 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;
- The analyst may consider alternative perspectives regarding the intangible asset from within the owner/operator entity, if possible; some intangible assets are so user-specific that only a small subset of owner/operator personnel are knowledgeable regarding the asset; in other cases, the analyst may be able to obtain information from various owner/operator personnel in various departments.

CONCLUSION • Legal counsel may retain a valuation analyst to value an owner/operator's intangible asset for any number of reasons. These reasons could include counseling clients related to transactions, financings, regulatory compliance,

taxation issues, family law matters, and a variety of breach of contract or tort claims. The lawyer should be aware that, prior to performing any quantitative analyses, the analyst will perform reasonable due diligence procedures. This discussion is intended to serve as a checklist, to allow the counsel to ensure that the analyst performed appropriate due diligence procedures during the intangible asset valuation.

The analyst typically obtains most of the intangible asset information from the owner/operator. 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, etc. However, depending on what party the analyst is working for in the engagement, he or she may not have direct access to the owner/operator.

In all cases, the analyst will consider reasonable due diligence procedures with regard to the intangible asset information. These due diligence procedures could relate to historical, contemporaneous, and prospective information. Many of the due diligence procedures are comparative in nature. That is, the analyst may compare the intangible asset information to:

- Historical information benchmarks;
- Owner/operator capacity or other constraints;
- Guideline company benchmarks;
- Competitor industry benchmarks;
- 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 owner/operator. As part of the competitive analysis, the analyst may consider:

- How the owner/operator functioned before the development of the intangible asset;
- How the owner/operator would function without the intangible asset;

- How the owner/operator competitors function without the subject intangible asset.

When the analyst receives the requested information, he or she should be aware that the owner/operator:

- May never have assembled this type of information before;
- May not maintain intangible asset-specific data and documents;

- May not consider all maintenance and legal expenses in the response;
- May not consider all risk factors (including obsolescence considerations) in the response.

Even with these caveats, the analyst will typically gather as much intangible asset development and operations information as possible to use in the valuation analysis.

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