GENERALLY ACCEPTED MARKET APPROACH METHODS ARE PARTICULARLY APPLICABLE TO CERTAIN TYPES OF INTANGIBLE ASSETS, AND CAN BE USED TO ARRIVE AT MEANINGFUL CONCLUSIONS **WHEN ANALYSTS APPLY PROFESSIONAL JUDGMENT IN DATA SELECTION AND ADJUSTMENT.**

ROBERT F. REILLY

THE MARKET APPROACH TO VALUING INTANGIBLE ASSETS

Although the income approach is often considered in intangible asset analysis, actual market transaction data can provide compelling empirical evidence of value, damages, or transfer price. Analysts who routinely apply income approach methods to estimate intangible asset value, damages, or transfer price may be ignoring important market approach information.

The market approach is applicable to all types of intangible assets when there are sufficient *comparable uncontrolled transaction* (CUT) data to estimate value, damages, or transfer price indications. When sufficient CUT data are available, market approach methods provide a direct and systematic analysis.

For example, licenses granted by the FCC, such as television or radio broadcast licenses, can provide meaningful pricing guidance. Similarly, with regard to franchise operations, credit card portfolios, trademarks, insurance policy expirations, and professional sports player contracts, market-derived CUT data is often meaningful.

In applying the market approach, first the analyst performs rigorous due diligence to understand the strengths, weaknesses, opportunities, and threats (SWOT) related to the subject intangible asset. Second, the analyst searches for and selects intangible asset CUT sale or license data. After confirming the CUT data, the analyst converts the transactional prices to pricing metrics that can be applied to the subject intangible asset. Such pricing metrics could include price per revenue, price per income (however defined), price per customer, price per intangible asset unit (for example, per engineering drawing or per line of code), price per population, and price per account balance. Third, the analyst compares the CUT intangible assets to the subject intangible asset. In this comparison, the analyst considers factors such as relative growth rates, profit margins, return on investment, market size, position in market, and position in life cycle. Fourth, based on this comparative analysis, the analyst selects subject-specific pricing metrics derived from the CUT intangible assets. Finally, the analyst applies the selected pricing metric to the subject intangible asset to indicate a value, damages, or transfer price estimate.

Use of Market Data

There is no single efficient marketplace where standalone intangible assets are sold between willing buyers and willing sellers, or where they are licensed between willing licensors and willing licensees. Nonetheless, intangible asset CUTs do take place between willing buyers and willing sellers and between willing licensors and willing licensees. After careful research and analysis, such CUT data can provide meaningful information for the value, damages, or transfer price analysis.

Market conditions influence what the expected sale or license price will be for an intangible asset. In assessing such market influences, the analyst considers all relevant factors regarding the CUT data. In particular, the analyst considers the timing (that is, the age) of the transactions and any participant-specific influences that may affect the comparability of the CUT intangible assets to the subject intangible asset.

Empirical CUT data have to be selected, arranged, analyzed, and adjusted (normalized) before they can be applied in the valuation, damages, or transfer price analysis. The application of market approach methods often involves a significant research effort. Nonetheless, only an inexperienced analyst will dismiss the market approach out of hand. While the market approach is not applicable to every intangible asset analysis, due to the fact that there are often CUT data constraints, experienced analysts should still consider the application of the market approach in each valuation, damages, or transfer price analysis.

When applying the market approach to valuation assignments, analysts follow a systematic process. This discussion summarizes the quan-

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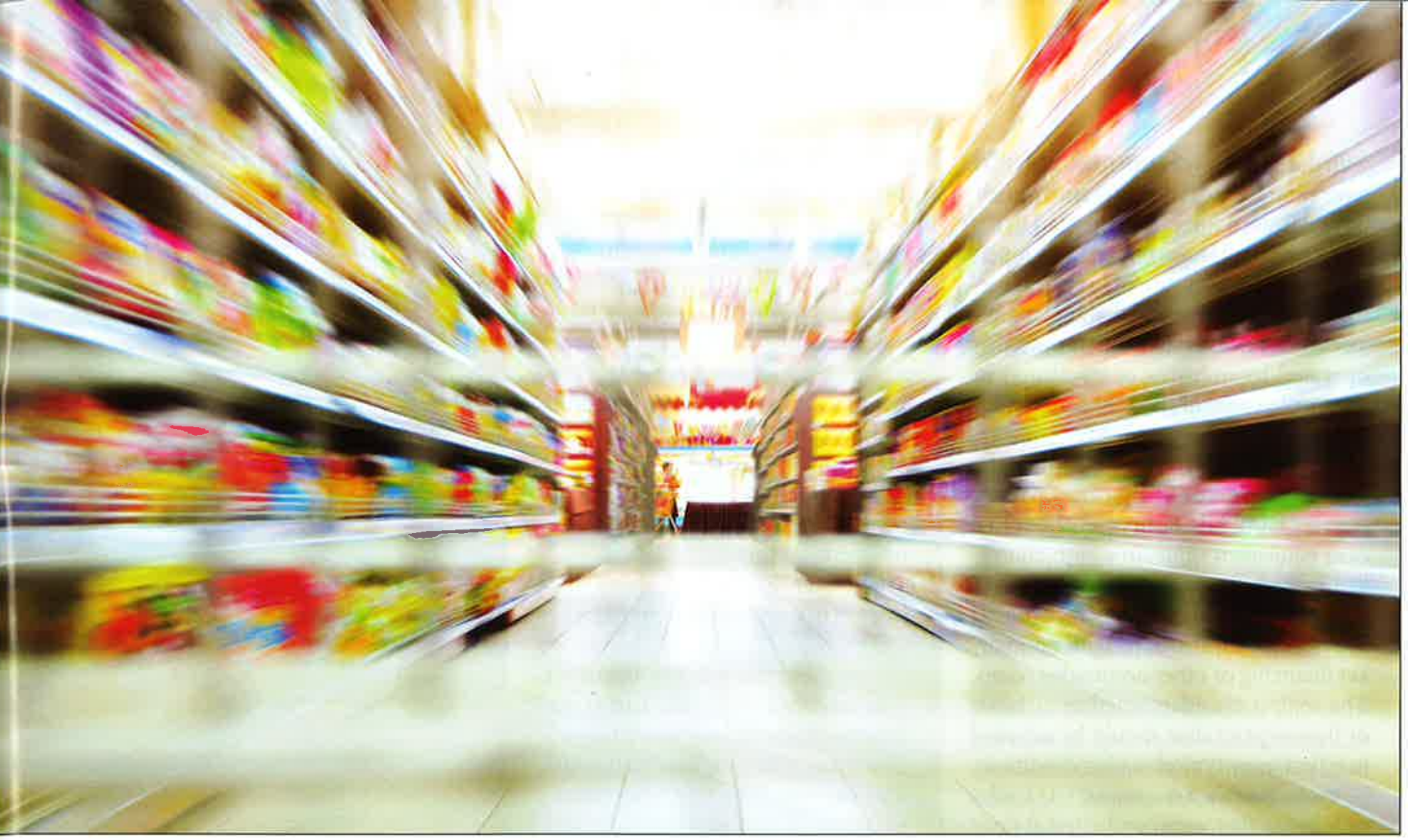


titative and qualitative procedures of this general systematic process, summarizes and illustrates the common market approach valuation methods, and describes some of the common errors that analysts make when applying market approach methods in any type of intangible asset analysis.

Collecting, Classifying, and Verifying Data

One reason why some analysts are reluctant to apply the market approach is the challenge of collecting and selecting relevant CUT data. The analysis of intangible asset CUT data is difficult because information about the economic factors that influenced the buyer or licensee and the seller or licensor decisions are often not available from public records.

CUT data often involve complex sale or license transactions. Such a complex arm's-length transaction does not involve the sale or license of a single (sometimes called *naked*) intangible asset. Rather, the complex arm's-length transaction involves the sale or license of a bundle of tangible assets and intangible assets. With regard to intangible asset sale transactions, the transaction may involve the sale of a going concern business enterprise. In such instances, the analyst has to extract intangible asset-specific pricing metrics from the analysis of a complex transaction.

To apply the market approach, the analyst gathers data on sales, licenses, sale or license contracts, offers, options, and listings of intangible assets that provide meaningful pricing guidance with regard to the subject intangible asset. The selected transactions should be sufficiently similar to the valuation subject to provide meaningful pricing guidance to the analyst. However, the CUT intangible assets may not be perfectly comparable to the subject intangible asset. Often, the CUT intangible assets are considered to be guideline (and not comparable) intangible assets. Guideline intangible assets may not be perfectly comparable to the subject intangible asset, but they are similar enough to the subject asset (from a risk and expected return perspective) to provide meaningful pricing guidance.

The analyst identifies the property rights conveyed in each selected CUT sale or license as completely as possible. The sale or license transaction price often depends on the bundle of rights that are conveyed. With sufficient information, the analyst can make any necessary adjustments to reflect the difference between intangible assets sold or licensed at market rates and intangible assets sold or licensed at above or below market rates. The term of a license and the other conditions of the license agreement typically influence the license royalty rate. The license royalty rate influences the license income generated by the CUT intangible assets. And the pricing metrics extracted from the CUT licenses influence the subject intangible asset value, damages, or intercompany transfer price.

Differing Financial Arrangements. The price of one intangible asset sale/license may differ from the price of an otherwise identical intangible asset sale/license due to different financial arrangements. For example, a trademark licensor may commit to provide advertising, promotion, legal protection, or product development expenditures to maintain or expand the income-producing capacity of a trademark. In a different license for the same trademark, the licensee may accept financial responsibility for all of these marketing, legal, and technological activities.

Royalty Rate Data. It is difficult to obtain arm's-length license royalty rate data for certain types of intangible assets. Before searching commercial databases for CUT royalty rate data, the analyst considers primary sources of royalty rate information. The analyst may consult

with the actual owner/operator, who may have entered into either inbound or outbound license agreements related to the subject intangible asset. The owner/operator may also be aware of license agreements of directly competitive intangible assets (that is, intangible assets owned or operated by industry competitors) or sales or licenses of directly competitive intangible assets.

For many value, damages, or transfer price analyses, the analyst may have to convert CUT sale or license prices to a cash equivalent value. In a cash equivalent analysis, the analyst investigates CUT sales or licenses where the intangible asset appears to be transferred with nonmarket financing or other nonmarket terms. The analyst considers whether such sale or license price data should be adjusted to reflect more typical market conditions.

Normalization Adjustment. CUT sales or licenses that were conducted at nonmarket conditions may have to be normalized to current market conditions as of the analysis date. A normalization adjustment for market conditions may be necessary if intangible asset prices have increased or decreased since the time of the CUT sale or license. Such price changes could occur because market participant perceptions of the economy or the industry have changed.

Normalization adjustments for the conditions surrounding the CUT sale or license may be appropriate to properly reflect market participant motivations. For example, a buyer may pay more than market value for an intangible asset if that asset is needed for the buyer to capitalize on a unique market condition. An intangible asset sale may be transacted at a below-market price if the seller needs cash in a hurry. Affiliated corporate entities may record a sale at a nonmarket price to serve specific business purposes. And, family members may buy or sell an intangible asset at a nonmarket price to protect a legacy. For these reasons, the analyst typically confirms that the selected CUT sales or licenses were transacted at an arm's-length price between unrelated parties.

To the extent possible, the analyst investigates the circumstances surrounding the CUT sale or licenses before such transactions are used in a market approach analysis.

Establishing and Applying Pricing Metrics

In selecting and analyzing CUT sales and licenses, the analyst typically considers the elements of comparison, which generally include all attributes of the intangible asset. Analysts often consider the following ten basic elements of comparison when selecting and analyzing CUT sales or licenses transactions:

1. The legal rights of intangible asset ownership conveyed in the guideline transaction.
2. The existence of any special financing terms or arrangements (for example, between the buyer or licensee and the seller or licensor).
3. The existence, or absence, of arm's-length sale or license conditions.
4. The economic (especially the risk and expected returns) conditions existing in the appropriate secondary market at the time of the guideline sale or license transaction.
5. The industry in which the guideline intangible asset was—or will be—used.
6. The geographic or territorial characteristics of the sale or license CUTs compared to the actual intangible asset.
7. The term or duration characteristics of the sale or license CUTs compared to the subject intangible asset.
8. The use, exploitation, or obsolescence characteristics of the sale or license CUTs compared to the actual intangible asset.
9. The economic characteristics of the sale or license CUTs compared to the subject intangible asset (for example, who is responsible for continued development, commercialization, or legal protection of the intangible asset).
10. The inclusion of other assets in the sale or license CUT (this element may include the sale or license of a bundle or a portfolio of assets and could include tangible real or personal property, marketing assistance, trademarks, product development, or other contractual rights).

The comparative analysis focuses on similarities and differences between the CUT intangible assets

and the subject intangible asset. These factors may include differences in the property rights conveyed, the motivations of buyers and sellers, financing terms, market conditions at the time of sale (the comparative numbers of buyers, sellers, and lenders), size, attributes, and economic characteristics.

One pricing metric is a pricing multiple computed by dividing the CUT price by some relevant financial or operational variable. For example, the selected pricing metric could be price per customer, price per dollar of revenue generated, price per units produced, price per dollar of earnings before interest and taxes (EBIT) generated, price per drawing, or price per line of code. Other pricing metrics are based on projections of expected income or market potential. For example, the selected pricing metric could be price per expected future revenue, future customers, future market share, future population served, future EBIT, or future cash flow.

CUT owner/operator income statement variables are sometimes considered in the calculation of pricing metrics. Such variables that may be used to calculate pricing metrics include:

- Price per average selling price.
- Price per average unit volume.
- Price per net sales.
- Price per net income.
- Price per gross cash flow.
- Price per net cash flow.

Occasionally, CUT owner/operator balance sheet data can be used to develop pricing metrics. Such pricing metrics are developed by dividing the CUT price by the CUT owner/operator's balance sheet account balances. The balance sheet variables that may be used to calculate pricing metrics from CUT prices include:

- Price to depreciated original cost of CUT company assets;
- Price to book value of CUT company assets;
- Price to adjusted book value of CUT company assets.

Other market approach procedures for calculating CUT-derived pricing metrics are described below.

Frequency of Use. Certain intangible asset value depends on the subject asset being an integral part of a process that could not be completed without the intangible asset. For example, an engineering drawing may be used repetitively in the process of designing or operating a manufacturing process. The engineering drawing value may depend more on the frequency of its use rather than on its replacement cost new. In this example, the engineering drawing value may be measured in terms of a price per use.

Market Potential. Cable television franchise transactions, cellular telephone franchise transactions, and similar services-based intangible assets are sometimes described in terms of price per subscriber, price per home passed, or price per population. In these situations, the CUT prices may be expressed in terms of the existing customer base, the number of potential customers who could subscribe to the service (like cable TV) without additional cost to reach those customers, and the number of potential customers living within the franchise territory.

The number of potential patients living within the geographic area of a hospital or similar health care facility may also provide a pricing metric related to market potential. These pricing metrics indicate that the CUT prices are a function of both the seller's experience in penetrating the available market and the buyer's potential for market share growth.

Market Approach Valuation Methods

There are three primary intangible asset market approach valuation methods:

1. Sales comparison.
2. Relief from royalty.
3. Comparable profit margin.

Each method is discussed below. Although these methods are primarily valuation methods, they can also be used, with appropriate modification, to measure intangible asset damages, transfer price, or other analysis conclusions. As the three methods are described, the direct conclusion of each method is an indication of intangible asset value.

Sales Comparison Method. The comparison of two value indications can provide an estimate of intangible asset damages. For example, the difference between a before damages event value, and an after damages event value, can provide an indication of the damages. Assume that the fair value of the Kappa intangible asset before suffering a damages event was $12 million, and the owner/operator experienced a tortious interference of a business opportunity due to the actions of a damaging party. The fair value of the Kappa intangible asset after the damages event was $2 million. One indication of damages suffered by the Kappa owner/operator is $10 million (or the decrease in the $12 million before damages value).

Likewise, a transfer price can be estimated as an intangible asset value indication multiplied by a fair rate of return of and on the asset to provide an indication of a reasonable transfer payment. When the transfer payment is divided by the revenue (or unit volume) of the business entity using the intangible asset, the result is an indicated transfer price.

Assume that the fair market value of the Lambda intangible asset is $100 million. The Lambda's remaining useful life (RUL) is ten years. The Alpha subsidiary of Gamma Corporation owns Lambda. The Beta subsidiary of Gamma Corporation will use Lambda in the production of its products. Beta subsidiary will pay an arm's-length price (ALP) to Alpha for an intercompany license to use Lambda over the next ten years. Assume the analyst con-

EXHIBIT 1
Intercompany Transfer Price Illustration

Total Royalty Payment	
Lambda intangible asset fair market value	$100,000,000
× Fair rate of return of and on the Lambda intangible asset	20%
= Annual royalty payment Alpha expects from Beta	$2,000,000
Intercompany Transfer Price Estimate	
Annual royalty payment from Beta to Alpha	$2,000,000
÷ Beta expected revenue (from products that use the Lambda intangible asset)	$200,000,000
= ALP for the use of Lambda (as a % of revenue)	1%

EXHIBIT 2
Public Sources of Information on Guideline Sale or License Transactions

Securities and Exchange Commission Filings
Various Securities and Exchange Commission (SEC) filings, such as 10-Ks, 8-Ks, and proxy statements, contain information on intangible asset sale and license transactions. This information can include the price or royalty paid in such transactions. SEC filings can be accessed through various subscription databases, such as Morningstar, S&P Capital IQ, Bloomberg, and others. These filings can also be accessed through the free public Electronic Data-Gathering, Analysis, and Retrieval website at www.sec.gov/edgar/searchedgar/companysearch.htm.

Company Press Releases
Intangible asset sale and license agreements are sometimes announced in company press releases. These press releases can be searched through the SEC sources mentioned previously and through news article databases, such as Westlaw. An Internet search (Google, Bing, and the like) can also find company press releases, although it is common for many releases to not appear in a simple Internet search for various reasons.

Analyst Reports
Intangible asset sale and license agreements are sometimes discussed in analyst reports. Analyst reports can be accessed through various subscription databases, such as ThomsonOne and S&P Capital IQ.

Articles
Intangible asset sale and license agreements are sometimes discussed in news or trade journal articles. These articles can be found through searching an article database, such as ABI/INFORM (ProQuest) (available through many public libraries), LexisNexis, or Westlaw. Articles can sometimes be found in an Internet search, but this will not give thorough or comprehensive results.

Scholarly or Academic Publications
From time to time, intangible asset sale and license transactions are studied and discussed in academic journal articles, white papers, presentations, and so forth. Usually there is not a lot of detail on specific transactions, but overall trends and statistics are presented. These publications can sometimes be found through a general Internet search, in particular Google Scholar. The Social Science Research Network is also a good source for this type of information.

Court Decisions
When intangible asset sale or licensing transactions become involved in litigation, the details of these transactions are sometimes presented in the written court documents. Legal databases such as Westlaw or LexisNexis are the best source for finding this information.

cluded that a combined fair rate of return of and on the value of Lambda is 20% per year for the next ten years.

One indication of an intercompany transfer price for the Lambda use license is illustrated in Exhibit 1.

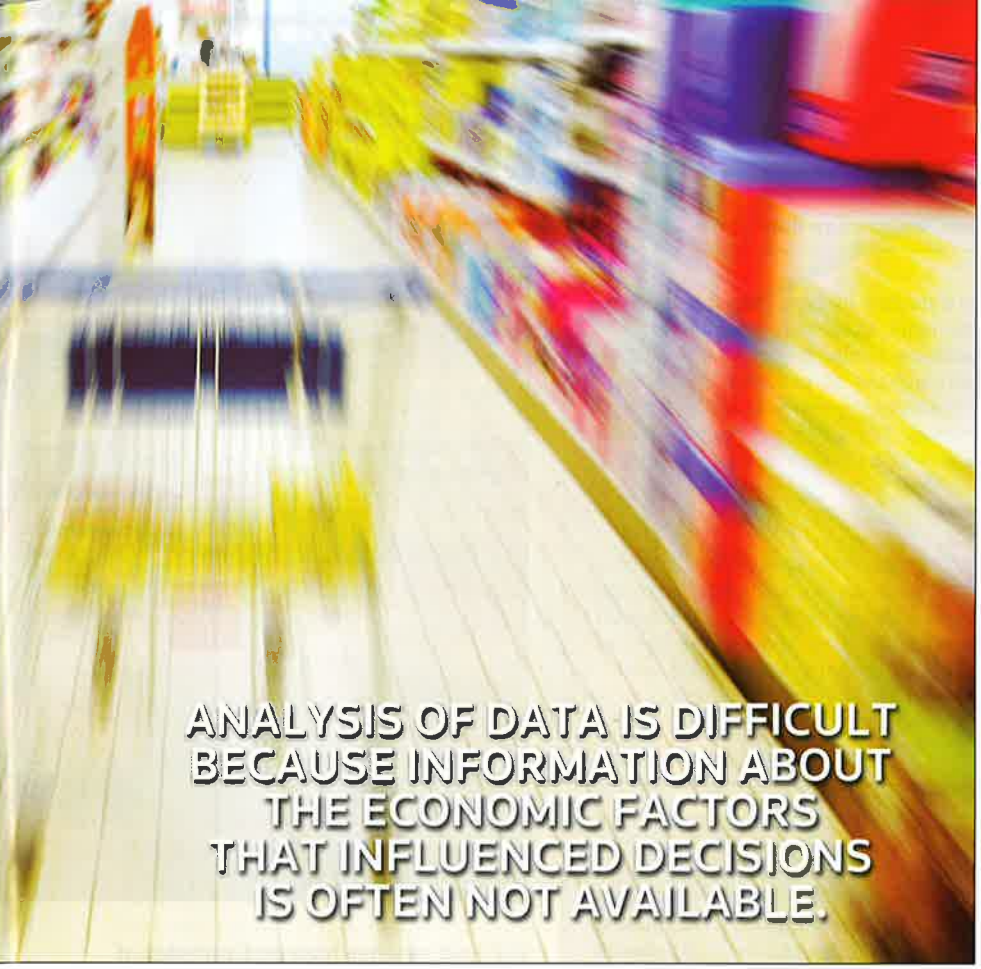
Based on these illustrative facts, Alpha (the intangible asset owner) will charge its sister corporation Beta (the intangible asset operator) a 1% of revenue royalty rate as the transfer price for intercompany license to use the Lambda intangible asset.

All three market approach methods are based on empirical data:

1. The sales comparison method is based on actual sales.
2. The relief from royalty method is based on actual licenses.
3. The comparable profit margin method is based on actual comparable companies.

All three market approach methods are also based on a measure of comparability:

1. The sales comparison method is based on comparable sales.
2. The relief from royalty method is based on comparable licenses.
3. The comparable profit margin method is based on comparable companies.



The first two market approach methods rely on transaction data—the sales comparison method is based on intangible asset sale transactions, and the relief from royalty method is based on intangible asset license transactions, making both methods CUT methods.

Although these methods rely on CUT data, the analyst understands that the transactional intangible assets and the subject intangible asset may not be perfectly comparable. The analyst does not expect that each sold intangible asset or each licensed intangible asset is perfectly comparable to the subject asset. And the analyst applies professional judgment in the selection of CUT data in order to assemble sufficient empirical data to provide meaningful valuation guidance.

The CUT intangible assets should be reasonably similar to the actual asset. They should be used in a reasonably similar industry to the owner/operator's, and for reasonably similar purposes to the purpose for which the actual asset is used. However, the analyst can account for any reasonable differences between the CUT intangible assets and the actual asset by the following procedures:

- Adjusting the CUT sale or license pricing data for any differences in comparability.
- Selecting a subject-specific pricing metric from the range of CUT sale or license prices.

When CUT data are analyzed for use in the market approach, the sale or license transactions are selected and adjusted for comparability. The CUT intangible assets are not expected to be perfectly comparable to the actual intangible asset. The CUT data are not comparable uncontrolled intangible assets. In a CUT, it is the transaction (not the intangible asset) that is comparable. However, the transactional assets have to be similar enough to the actual asset to provide meaningful valuation guidance.

The Sales Comparison Method

The first method described in detail below is the sales comparison method. The analyst uses this method to analyze comparable intangible asset sales and to extract relevant pricing metrics from the sales. This method is typically not called the comparable sales method, because because the analyst does not expect that the transferred intangible assets are perfectly comparable to the subject intangible asset. The discussion below describes when this method is most applicable, the quantitative procedures of the method, the data sources used, and the strengths and weaknesses of the method. The discussion concludes with an illustrative example.

Method Application. This method is most applicable when the subject asset is the type of intangible asset that sells in the marketplace as a separate intangible asset. In other words, such assets transact as naked intangible assets (without any other tangible or intangible assets). Examples of some intangible assets that sell independently in the marketplace include credit card customer portfolios, bank core depositors, mortgage servicing rights, and mortgage and other loan portfolios. Other examples include FCC spectrum and other licenses. Such licenses are first sold by the government to broadcast and communications companies, then seasoned licenses are sold between owners/operators.

This method is also applicable when there are sufficient arm's-length sales of the subject type of intangible asset. Such sales are often transfers of the fee simple interest in the intangible asset. Therefore, this method is most applicable when the subject is a fee simple interest in the intangible asset.

Method Procedures. First, the analyst identifies comparability criteria to search for CUT sale data. The criteria may include the following:

1. Type of intangible asset.
2. Industry in which the intangible asset is used.
3. Size of industry or market in which asset is used.
4. How the intangible asset is operated by its owner/operator.
5. Size of the owner/operator (buyer or seller).
6. Growth rate of industry or market.
7. Profitability of industry or market.
8. Growth rate of owner/operator (buyer or seller).
9. Profitability of owner/operator (buyer or seller).
10. Observation window for sale transaction dates.

Second, the analyst searches for arm's-length intangible asset sales that

EXHIBIT 3
Data Sources for Researching Guideline Sale Transaction Data

ktMINE
ktMINE is an interactive intellectual property database that provides direct access to license royalty rates, actual license agreements, asset purchase agreements, and detailed agreement summaries. The database contains over 13,000 intellectual property license agreements and asset purchase agreements. The intellectual property license database is updated frequently. Agreements are searchable by industry or keyword, among other parameters. The full text of each intellectual property license or purchase agreement is available. It is available at http://www.ktmine.com.

RoyaltySource
AUS produces a database that provides intellectual property license transaction royalty rates. The database also contains information on intellectual property sale transactions. The database can be searched by industry, technology, 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. It is available at www.royaltysource.com.

EXHIBIT 4
Epsilon Credit Card Portfolio: CUTs as of 1/1/2013

Seller	Transaction Date	Purchase Price	Receivable Balance	Number of Accounts
Mu	6/12	$1,200,000,000	$1,100,000,000	100,000
Nu	8/12	2,400,000,000	2,100,000,000	200,000
Xi	1/12	600,000,000	550,000,000	60,000
Pi	11/11	800,000,000	700,000,000	72,000
Rho	6/11	1,800,000,000	1,600,000,000	150,000
Mean Price		$1,360,000		
Median Price		$1,200,000		

EXHIBIT 5
Epsilon Credit Card Portfolio: CUT Unit Pricing Metrics as of 1/1/2013

Seller	Transaction Date	Price as a Multiple of Receivable Balance	Price per Account
Mu	6/12	1.09	$12,000
Nu	8/12	1.14	12,000
Xi	1/12	1.09	10,000
Pi	11/11	1.14	11,111
Rho	6/11	1.13	12,000
Mean price		1.12	$11,422
Median price		1.13	$12,000

meet the search criteria. The common data sources that are used to search for sales transactions are described in this section. To the extent possible, the analyst confirms (1) the sales price, (2) that the sales price represents a cash equivalent price, and (3) that the sale transaction was at arm's length. If the transaction sales price is not a cash equivalent price (for instance, there are earn-out provisions or installment payments), the analyst converts the transaction price to a cash equivalency price.

Third, the analyst selects normalized unit pricing metrics. These metrics are used to convert the various sale prices into metrics that can be applied to the subject intangible asset (or the subject owner/operator). In other words, the analyst converts each absolute dollar sale price into a dollar per unit pricing metric. Examples of unit pricing metrics include:

1. Price per revenue generated by the intangible asset.
2. Price per income (however defined) generated by the intangible asset.
3. Price as a multiple of recorded book value of the intangible asset.
4. Price per number of customers or accounts served by the intangible asset.
5. Price per number of population in the intangible asset service area.
6. Price per number of the intangible asset size units (e.g., per lines of code, number of patient beds, or number of files or records).

Fourth, the analyst calculates all of the sale prices in terms of the price per unit metric (price per account). The analyst performs a statistical analysis of the pricing data, which could include price range, price mean, price median, price mode, price quartiles, and so on.

Fifth, the analyst selects a subject-specific pricing metric extracted from the CUT-derived pricing metrics and applies the subject-specific pricing multiple to the owner/operator's corresponding financial or operational data.

Finally, the analyst adjusts the value indication for any differences in

ownership interest between the CUT sales and the actual intangible asset. Such differences in ownership interest could include differences in the level of marketability or ownership control.

Data Sources. First, the analyst investigates if there were any CUT sales involving the subject owner/operator and whether the owner/operator is aware of any CUT sales related to competitor companies.

Second, the analyst considers both public document and private (subscription or other) data sources for information regarding sale transactions of intangible assets. A list of such public data sources is provided in Exhibit 2. A list of private data sources is provided in Exhibit 3.

Strengths and Weaknesses. When a sufficient quantity of sufficiently similar CUT data is available, the sales comparison method provides meaningful valuation guidance. The analyst exercises professional judgment to assess whether there are a sufficient number of CUT transactions and whether the CUT intangible assets are adequately similar to the subject intangible asset to apply this method.

This method is particularly applicable for intangible asset types that regularly sell separately from other assets. Examples of such naked intangible asset sales are more common in the financial services, publishing, and communications industries.

This method is also applicable when the intended standard of value is fair value or fair market value. This is because CUTs often indicate the results of negotiations between market participants dealing at arm's length with each other.

There are also situations in which this method is less applicable. As with any market approach method, the sales comparison method is less applicable when there is not an adequate quantity of CUT data or when the CUT intangible assets are not sufficiently similar to the actual intangible asset. The analyst applies professional judgment in assessing the sufficiency of transactional data and the similarity of the CUT assets to the subject asset.

This method is less applicable when the CUTs involve complex transaction pricing, which may include milestone, contingency, earn-out, progress, or other future payments. Such complex payments should be converted to cash equivalency prices. The method is also less applicable when the analyst cannot confirm the purchase price paid for the CUT intangible asset.

This method is also less applicable when the CUT transactions involve portfolios of multiple intangible assets or of both tangible and intangible assets. In such instances, the analyst performs the additional procedure of allocating the CUT sale price among the bundle of transferred assets. This procedure is necessary for the analyst to compare the market price for an individual CUT asset to the individual subject asset.

Finally, this method is less applicable when the intended standard of value is other than fair value or fair market value. This is true if the CUTs are arm's-length market value transactions. However, if the transactions involve investment value or strategic value price implications, then the CUT data can be used to estimate those other standards of value.

Illustrative Example. Delta bank made an offer to purchase the consumer credit card portfolio of Epsilon bank. The Epsilon credit card portfolio has an outstanding receivable balance of $800 million as of 1/1/2013. The portfolio has 75,000 active customer accounts. The portfolio is growing at about the industry average growth rate, and the portfolio is earning about the industry average profit margin. Epsilon management wants to focus on its depositor business and loan business, and it is willing to sell its consumer credit card portfolio if it receives a fair price. Delta offers $900 million for the credit card portfolio. Epsilon management retains the analyst to answer this question: Is $900 million a fair price for the credit card portfolio?

The analyst decides to use the market approach and the sales comparison method in this analysis. Exhibit 4 presents the CUT data that the analyst assembled. The analyst concludes that these transactions were the most similar to the subject portfolio, confirming all of the CUT data with reliable sources.

According to Exhibit 4, the CUT mean selling price is $1,360,000, and the CUT median selling price is $1,200,000. However, these raw data are not particularly helpful to the analyst; therefore, the analyst converts all of the CUT prices to unit pricing metrics. These unit pricing metrics are presented in Exhibit 5.

EXHIBIT 6
Data Sources for Researching Guideline License Transaction Data

ktMINE
ktMINE is an interactive intellectual property database that provides direct access to license royalty rates, actual license agreements, asset purchase agreements, and detailed agreement summaries. The database contains over 13,000 intellectual property license agreements and asset purchase agreements. The intellectual property license database is updated frequently. Agreements are searchable by industry or keyword, among other parameters. The full text of each intellectual property license or purchase agreement is available. It is available at www.bvmarketdata.com.

RoyaltySource
AUS produces a database that provides intellectual property license transaction royalty rates. The database also contains information on intellectual property sale transactions. The database can be searched by industry, technology, 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. It is available at www.royaltysource.com.

RoyaltyStat, LLC
RoyaltyStat is a subscription-based database of intellectual property license royalty rates and license agreements, compiled from SEC documents. It is searchable by Standard Industrial Classification (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. It is available at www.royaltystat.com.

Licensing Royalty Rates
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According to Exhibit 5, the CUT mean price multiple (price to receivable balance) is 1.12, and the CUT median price multiple (price to receivable balance) is 1.13. The CUT mean price paid per customer is $11,422, and the CUT median price paid per customer is $12,000.

The proposed Delta purchase indicates a price multiple (price to receivable balance) of 1.13 and a price per customer of $12,000. By comparing the proposed Delta purchase price terms to the CUT unit pricing data presented in Exhibit 5, the analyst concludes that the proposed Delta purchase price of the Epsilon credit card portfolio is fair from a financial perspective. This conclusion is based on the analyst's application of the sales comparison method.

Relief from Royalty Method

Like the sales comparison method, this method relies on CUT data. The sales comparison method analyzes CUT sales of similar intangible assets; the relief from royalty method analyzes CUT licenses of similar intangible assets. This section summarizes the application of this method, the typical quantitative procedures, the common data sources, and the methodological strengths and weaknesses. Finally, it presents an illustrative example of the relief from royalty method.

Method Application. The relief from royalty method is applicable when the analysis objective is a royalty rate. For that reason, this method is applicable when the analysis objective is an intercompany transfer price, a third-party license royalty rate, or a reasonable royalty rate damages measure, as well as a valuation estimate. The method is particularly applicable for the type of intangible assets that are typically licensed between a licensor and a licensee, including patents, proprietary technology, trademarks and trade names, copyrights, franchises, licenses, permits, product designs, and chemical formulas.

In addition, the relief from royalty method is particularly applicable when the subject bundle of rights is for a limited term, is a use (not a fee simple) right, or involves a fractional ownership interest. This is because the typical intangible asset license agreement encompasses a defined (and limited) bundle of rights, in a specific territory, for a specific use, and for a specific period of time. Accordingly, the typical license agreement involves less than a fee simple interest bundle of legal rights.

Method Procedures. Some analysts consider the relief from royalty method to be an income approach method because a projected royalty income is capitalized in order to reach a value indication. Other analysts consider the relief from royalty method to be a cost approach method. This is because the cost of the royalty is avoided because rights associated with the intangible asset are owned by the owner/operator. However, this method is commonly referred to as a *market approach method* because the method relies on market-derived, empirical CUT data.

In this method, the analyst assumes that the actual owner does not own the actual intangible asset. Without this ownership, the actual owner would have to license the intangible asset from a hypothetical licensor. So the actual owner becomes a hypothetical licensee that licenses the intangible asset from a hypothetical third-party licensor. In that scenario, the actual owner or licensee would have to pay a royalty payment to the hypothetical owner or licensor. The royalty payment would be for a use license to use the intangible asset in the actual owner's business operations.

In reality, the actual owner does own the intangible asset. Because of that ownership, the owner avoids the cost of having to pay a use license royalty payment to a licensor. However, the intangible asset can be valued by reference

to this hypothetical royalty payment that the owner is relieved from making.

The hypothetical royalty payment is often calculated as a market-derived royalty rate multiplied by the actual owner/operator's revenue. So the application of this method requires an analysis of CUT license royalty rates and a projection of the owner/operator's revenue related to the use of the actual intangible asset.

In this method, the revenue expected to be generated by the intangible asset (from all sources) during its RUL is multiplied by the selected royalty rate. The product of the multiplication is a projection of the royalty expense that the owner/operator is relieved from paying because of its ownership of that intangible asset. This projected royalty expense is capitalized over the intangible asset's RUL. The result of this capitalization process is the intangible asset value indication.

Although the projected royalty expense stream is most commonly based on a royalty rate multiplied by revenue, it could also be based on a royalty rate multiplied by gross profit, net income, number of units produced, number of units sold, or some other owner/operator metric. The royalty expense stream should be the net royalty stream that the owner/operator is relieved from paying. Therefore, if the owner/licensee would have to pay for intangible asset development, maintenance, promotion, or legal protection expenses (as part of its licenses agreement), then these expenses should be subtracted from the royalty stream projection. The objective of the analysis is to measure the net benefit to the owner/operator from not having to license the intangible asset. So when analyzing the CUT data, the analyst should consider which party would be responsible for these intangible asset maintenance expenses: the actual owner or licensee or the hypothetical owner or licensor.

In the relief from royalty method, the analyst typically performs the following procedures:

1. Select and document the criteria to be used for selecting the CUT license agreements; such criteria could include type of intangible asset, type of owner/operator, type of industry in which the asset is used, size of the market in which the asset is used, and dates and term of the license agreements.
2. Assess the terms of each selected CUT license agreement with consideration of:
   - The description of the bundle of legal rights for the CUT licensed property.
   - The description of any maintenance or other expenditures required for the CUT intangible property (for example, product development, advertising, product promotion, or legal protection).
   - The effective date of the CUT license agreement.
   - The termination date of the CUT license agreement.
   - The degree of exclusivity of the CUT license agreement.
3. Assess the current status of the industry and the associated relevant market and prospective trends.
4. Estimate an appropriate market-derived capitalization rate for the subject royalty expense stream; the capitalization rate considers the risk of the royalty expense projection and the RUL of the intangible asset.
5. Apply the market-derived capitalization rate to the forgone royalty expense projection in order to conclude a value indication.

Data Sources. The analyst surveys a number of public and private data sources to locate CUT license agreement data. Exhibit 6 provides a list and description of the more common intangible asset license agreement data sources.

Strengths and Weaknesses. The relief from royalty method has par-

ticular application for the types of intangible assets that are commonly licensed between licensors and licensees. The method is also applicable when there are a sufficient number of CUT license agreements related to sufficiently similar intangible assets.

The method is especially applicable when the intended standard of value is fair value or fair market value. This is because it is based on actual arm's-length transactions (licenses) between independent parties. It is applicable when the analyst has access to financial projections, especially revenue projections. It is also particularly applicable when the analyst has developed an estimate of the intangible asset's RUL.

This method is less applicable in the following cases:

- In the analysis of intangible assets that are not typically licensed between a licensor and a licensee, such as an assembled workforce;
- When there is not a sufficient quantity of CUT license agreements or if the licensed intangible assets are not sufficiently similar to the actual intangible asset;
- When the analyst does not have access to the financial projections or cannot estimate the intangible asset's RUL; and
- When the analyst does not have sufficient information about which CUT party (licensor or licensee) is responsible for the intangible asset maintenance and protection expenses.

Illustrative Example. Phi Company (Phi) is a designer and manufacturer of high-end women's apparel products. Phi Company acquired Chi Corporation (Chi) on 1/31/2013 in a taxable transaction. Chi is also a designer and manufacturer of high-end women's apparel products, particularly sportswear apparel. Phi management retained the analyst to perform a purchase price allocation according to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805, *Business Combinations*, purchase accounting guidelines.

One of the intangible assets that Phi acquired is the Chi trademark and trade name. As part of the purchase price allocation, the analyst estimates the fair value of this intangible asset. Companies like Phi and Chi regularly license their trademarks to other manufacturers. In fact, Phi has entered into a number of outbound license agreements during the past few years. For that reason, the analyst decided to use the market approach and the relief from royalty method to value the Chi trademarks.

The principle of this method is that the actual owner/operator would be willing to pay a hypothetical third-party owner a license royalty payment for the right to use the intangible asset. Because Phi now actually owns the Chi trademark (as a result of the Chi acquisition), it is relieved from having to make a royalty payment to license the trademark from a third-party licensor.

The analyst performed the following procedures to estimate an arm's-length royalty rate associated with the Chi trademark and the fair value of the Chi trademark:

- Discussed the intended use of the Chi trademark with Phi management.
- Searched for guideline arm's-length license transactions to use in the valuation.
- Estimated the appropriate market-based royalty rate for the Chi trademark.
- Estimated the Chi trademark required rate of return.
- Estimated the Chi trademark RUL to apply in the relief from royalty method to conclude an initial value indication.
- Adjusted the initial value indication for a tax amortization benefit adjustment (that is, market participants would expect to benefit from

EXHIBIT 7
Chi Corporation Trademarks and Trade Agreements—Selection of CUT License Agreements as of 1/31/2013

Trademark or Trade Name Licensee	Trademark or Trade Name Licensor	Industry in Which Trademark Is Used	License Agreement Royalty Rate as a % of Revenue	Initial Date of License Agreement	License Agreement Term (Years)
Maxwell Shoe Company, Inc.	Anne Klein, B.D.S., Inc.	Customer nondurables	6.0	July '12	5
Tandy Brands Accessories, Inc.	Hermes	Men's and women's apparel	5.0	August '11	5
Innovo Group, Inc.	Michael Caruso & Co., Inc.	Men's and women's accessories	6.0	February '12	5
Innovo Azteca Apparel, Inc.	Blondie Rockwell, Inc.	Women's apparel	8.0	February '11	5
Wundies Industries	Danskin, Inc.	Women's apparel	4.5	November '10	10
Various	Christian Dior	Women's apparel	7.5	January '11	5
Fashion Mag Apparel, Inc.	Hachette Filipacchi Presse	Women's apparel	6.0	January '10	10
Yes Clothing Co.	Marbel Sportswear, Inc.	Men's and women's apparel	7.0	April '11	5
Miss Erika, Inc.	McNaughton Apparel Holdings, Inc.	Women's apparel	5.0	August '12	5
Ridgeview Inc.	Ellen Tracey, Inc.	Women's apparel	7.0	December '11	5
Designer Holdings, Ltd.	Donna Karan International, Inc.	Women's apparel	7.0	September '10	10
BIB Ltd.	Mark TM, LLC	Young men's and women's apparel	4.0	November '11	5
Gygnes Designs	Kenzo	Women's apparel	8.0	July '12	5
		Average royalty rate	6.2		
		Median royalty rate	6.5		
Phi Company	C&C Laundry	Women's apparel	6.5		
Phi Company	Gotcha/Girl Star	Men's and women's apparel	6.0		
Phi Company	Jantzen	Women's apparel	6.5		
		Average Phi royalty rates	6.3		
		Median Phi royalty rates	6.5		

Selected license royalty rate for Chi trademark (as a percent of revenue) 6.5%

Sources: ktMine and Royalty Source intellectual property license agreement databases.

amortization tax deductions related to the subject intangible asset).
- Concluded a final value indication for the Chi trademark.

The analyst reviewed several databases that report arm's-length intellectual property license agreements, including the ktMine and RoyaltySource databases. Exhibit 7 presents the analyst's selection of arm's-length trademark or trade name license agreements that pertain to the lines of women's apparel products. These license agreements, which relate to high-end women's apparel brands such as Anne Klein, Danskin, Christian Dior, and Donna Karan, indicated an average and a median market-based royalty rate of 6.2% and 6.5%, respectively.

The analyst also reviewed the arm's-length royalty rates that Phi actually earns from outbound licensing of its women's apparel products. As presented in Exhibit 8, these royalty rates ranged from 6.0% to 6.5% for the C&C Laundry, Gotcha/Girl Star, and Jantzen branded products.

Based on the analyst's assessment of the various trademark or trade name arm's-length license agreements in the marketplace and the analyst's consideration of the Phi management plans to showcase the Chi brand within the Phi clothing segment, the analyst concluded a royalty rate of 6.5% for the Chi trademark.

The analyst calculated the fair value of a trademark as the present value of the expected after-tax royalty expense savings attributed to the acquired trademark. Accordingly, the analyst calculated the relieved royalty payment by applying the selected royalty rate to the projected Chi product line revenue. The analyst applied the selected royalty rate of 6.5% to the projected revenue attributed to Chi branded products for the fiscal years ended 1/31/2014 through 1/31/2019. The projected revenue, which was based on Phi management revenue projections (which were determined to be consistent with those of market participants), contemplates a 2% annual growth rate in the dollar volume of Chi branded products.

After the year ended 1/31/2019, Phi management expects (as would market

EXHIBIT 8
Chi Corporation: Fair Value of the Chi Trademark, Relief from Royalty Method as of 1/31/2013

Projected Fiscal Year Ended January 31,	2014	2015	2016	2017	2018	2019
	$000	$000	$000	$000	$000	$000
Projected product line revenue [a]	84,846	86,543	88,274	90,039	91,480	93,677
Revenue growth rate	2%	2%	2%	2%	2%	2%
Arm's-length license royalty rate [b]	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Pretax royalty payment relief	5,515	5,625	5,738	5,853	5,970	6,089
Income taxes at 36% [c]	1,985	2,025	2,066	2,107	2,149	2,192
After-tax royalty payment relief	3,530	3,600	3,672	3,746	3,821	3,897
Present value factor at 14% [d]	0.9366	0.8216	0.7207	0.6322	0.5545	0.4864
Present value of royalty payment relief	3,306	2,958	2,647	2,368	2,118	1,895
Total present value of royalty payment relief	15,292					
Tax amortization benefit factor	1.19					
Indicated fair value of Chi trademark	18,197					
Fair value of Chi trademark (rounded)	18,200					

Footnotes:
[a] Revenue estimates based on Phi management projections.
[b] Royalty rate based on analysis of CUT trademark license agreements.
[c] Based on Phi management estimates.
[d] Estimated Phi cost of capital.

participants) to replace the Chi trademark and trade name with a new trademark and trade name. Therefore, the analyst selected five years as the Chi trademark RUL.

The analyst reviewed the selected CUT license agreements. In these agreements, the licensor was responsible for the intangible asset maintenance and legal expenses. Therefore, the analyst does not need to adjust the relief from royalty payment for any expenses that would be paid by Phi (as the hypothetical licensee).

The analyst adjusted the annual royalty payment for income taxes and discounted the after-tax savings to a present value using a present value discount rate. The present value discount rate reflects the risks inherent in the trademark intangible asset. The analyst used a present value discount rate of 14%, which was the Phi cost of capital (again, consistent with market participants). This analysis is summarized in Exhibit 8.

Based on the relief from royalty method, the indicated fair value of the Chi trademark is approximately $15,292,000 prior to the application of the tax amortization benefit (TAB) factor. The analyst applied a tax amortization benefit factor of 1.19 (based on a 14% present value discount rate, a 36% income tax rate, and a 15-year tax amortization period).

Based on the relief from royalty method analysis in this illustrative example, the fair value of the acquired Chi trademark, including the tax amortization benefit, was $18.2 million (rounded).

Comparable Profit Margin Method

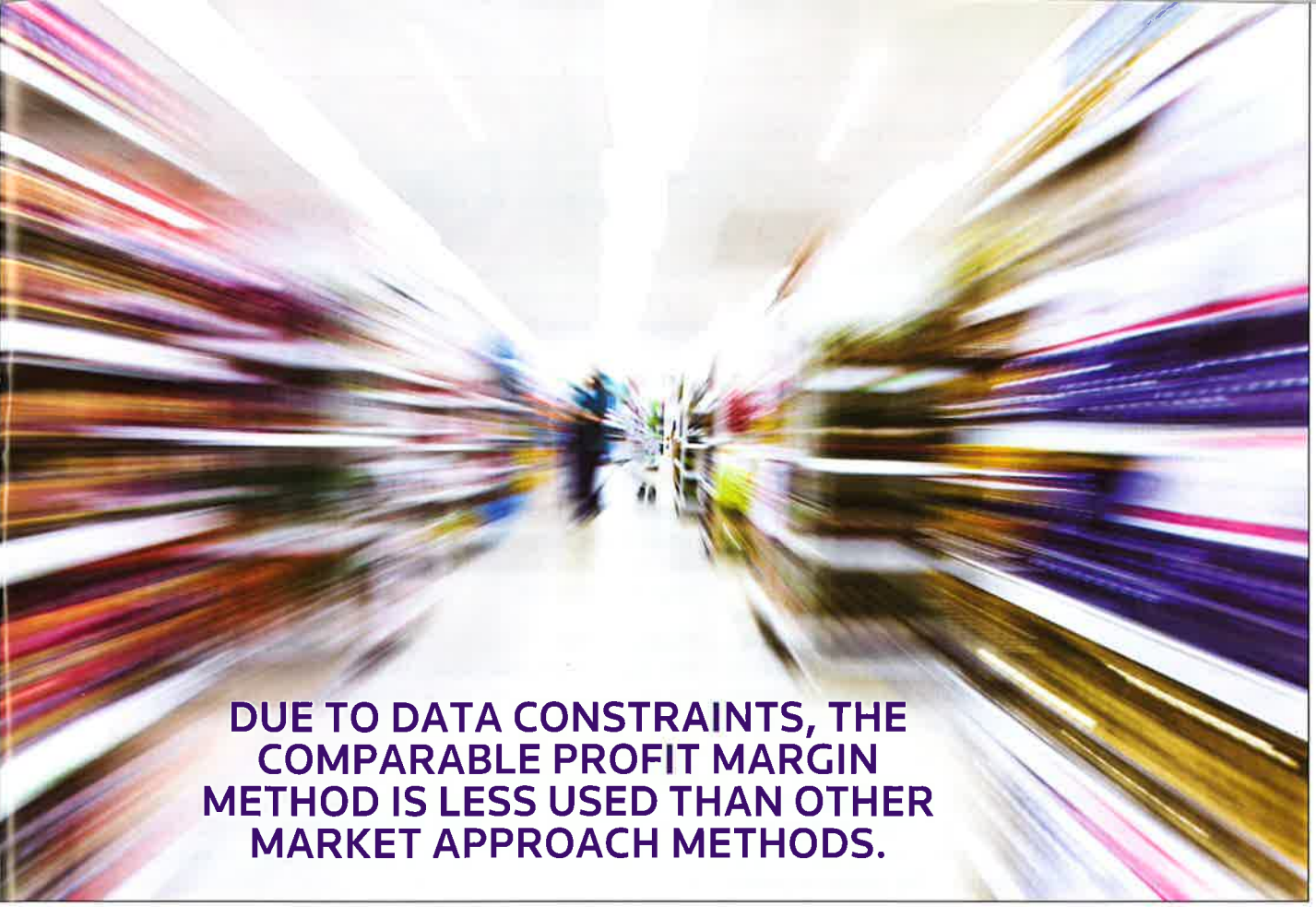
Due to data constraints, the comparable profit margin method is less commonly used than other market approach methods. However, when sufficient data are available, this method provides meaningful valuation guidance. As with other market approach methods, the analyst exercises professional judgment in the selection of the comparability criteria to identify and apply guideline companies.

As was done above for the sales comparison and relief from royalty methods, the discussion below summarizes the application of the comparable profit margin method, including its procedures, common data sources, and strengths and weaknesses. Finally, the discussion presents an illustrative example of this method.

Method Application. This method is most applicable when the owner/operator has one extraordinary intangible asset and other ordinary intangible assets. In other words, one intangible asset stands out as the reason for the owner/operator's success and excess profitability. That intangible asset may be a patent, copyright, trademark, product design or formula, distribution method, or trade secret.

This method is also applicable when there are a sufficient number of competitors that do not enjoy the benefit of the extraordinary intangible asset. Such competitors generally provide the same products or services as the owner/operator but have a generic (or, at least, not a stand-out) patent, copyright, trademark, product design or formula, distribution method, or trade secret.

In the application of this method, the competitors can be individually identified guideline companies or the group of companies that operate in the same Standard Industrial Classifica-



DUE TO DATA CONSTRAINTS, THE COMPARABLE PROFIT MARGIN METHOD IS LESS USED THAN OTHER MARKET APPROACH METHODS.

tion (SIC) code as the owner/operator. First, the analyst identifies a benchmark group of competitors. Second, the analyst identifies that the owner/operator earns a higher profit margin than the benchmark group. Third, the analyst associates the excess profit margin with the intangible asset. And, finally, the analyst uses the excess profits to derive the indicated value of the subject intangible asset.

Method Procedures. The analyst first performs a functional analysis of the owner/operator. Based on this functional analysis, the analyst identifies the extraordinary intangible asset as the principal reason for the owner/operator's profitability. The owner/operator can operate numerous intangible assets, but one intangible asset should be identified as the extraordinary, or standout, asset.

Second, the analyst identifies a measure of income to use as a comparison between the owner/operator and the benchmark group of companies. Often, EBIT is selected as the comparative income measure. This measure is usually expressed as a profit margin (EBIT divided by revenue). However, other profit margin metrics

EXHIBIT 9
Databases for Researching a Guideline Publicly Traded Company

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 North American Industry Classification System (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 SEC and similar global stock regulators (as well as proprietary research). The database may be searched by SIC code or by Standard & Poor's (S&P's) industry classifications. Detailed financial information is available. The information is updated frequently. More information is available at www.spcapitaliq.com.

Thomson ONE
Thomson ONE is a fully searchable online database that provides financial information on approximately 52,000 public companies and over one 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.

EXHIBIT 10
Data Sources for Researching the Owner/Operator's Industry

The following list provides some commonly used general industry research sources. For some industries, there are also industry-specific sources available from trade associations, independent publishers, and periodicals.

Occupational Safety & Health Administration
The U.S. Department of Labor, Occupational Safety & Health Administration website provides SIC codes. Codes can be searched by keyword, or the SIC code "tree" can be viewed and browsed.

U.S. Census Bureau
The U.S. Census Bureau NAICS website provides a searchable database of NAICS codes. NAICS codes are a more recent classification system than SIC codes. Therefore, they can be better for newer industries, such as some high-tech industries.

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. It is available at www.firstresearch.com.

IBIS*World*
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. The research covers approximately 700 different market segments. Some international reports are also available. Information is updated quarterly for most industries and less frequently for some. It is 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 Capital IQ 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. It provides information on products, trends, regions, demographics, industries, and companies from its collection of over 700 research publishers. More information is available at www.marketresearch.com.

S&P Capital IQ
This database provides access to analyst research as well as some market research reports. Capital IQ uses S&P's industry classifications. These classifications can be helpful in grouping companies in comparable industries. In addition, comparative ratio information is available. More information is available at www.spcapitaliq.com.

Thomson ONE
This database provides access to analyst research and market research reports. More information is available at www.thomsonreuters.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 five million companies. It includes companies in nearly 200 industries. The book is issued annually. More information is available at www.cchgroup.com.

The Risk Management Association
Annual Statement Studies: Financial Ratio Benchmarks and eStatement Studies database; 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.

International Valuation Handbook
Wiley & Sons publishes this annual source for the type of cost of capital data that was previously published by Morningstar/Ibbotson.

***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 IRS. The data focus 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.

are sometimes used (EBIT divided by total assets or EBIT divided by owners' equity). Sometimes comparative income measures are used (for example, comparative revenue, product average selling price, gross or net income, or gross or net cash flow).

Third, the analyst selects the benchmark group of companies. The benchmark group can be individual guideline companies or an industry sector or entire SIC code group of competitors. The benchmark group typically includes companies that compete directly or indirectly with the owner/operator and companies that operate a generic form of the intangible asset compared to the owner/operator's standout intangible asset.

Fourth, the analyst quantifies the excess profits (however measured) that the owner/operator earns compared to the benchmark group. The analyst converts that excess profit measure into an annual excess income stream.

Fifth, the analyst projects that excess income stream over the intangible asset's RUL. That RUL could be a finite period or a perpetuity period. The analyst then applies a discount rate or a direct capitalization rate to that excess income stream. The present value of the excess income stream provides intangible asset value.

Data Sources. Exhibit 9 presents a list of common data sources that analysts use to identify guideline publicly traded companies to serve as the benchmark group. Exhibit 10 is a list of common data sources that analysts use to identify and research industry segments and SIC code categories to serve as the benchmark group.

Strengths and Weaknesses. The comparable profit margin method is more applicable when there is one intangible asset that makes the owner/operator unique. An example of such an intangible asset is a trade secret, a manufacturing process, or a product formulation that is different from what is normally used in the industry.

This method is applicable when there is a well-defined benchmark group of companies that compete with the owner/operator, particularly when the benchmark companies do not own extraordinary intangible assets. Common examples of such benchmark companies include generic food, clothing, or pharmaceutical product manufacturing companies which compete against branded companies.

This method is less applicable when the success of the owner/operator is associated with multiple intangible assets or when the selected benchmark companies also own some degree of extraordinary intangible assets. For example, this situation occurs when the owner/operator owns the most prominent trademark in the industry, and the benchmark companies also own trademarks that are not as prominent as the subject trademark.

This method is also less applicable when there are an insufficient number of benchmark companies or when the benchmark companies are not sufficiently similar to the owner/operator. This situation occurs when there are numerous significant differences between the benchmark companies and the owner/operator and not just a difference in one intangible asset.

Illustrative Example. Omicron Company (Omicron) owns 80% of a consolidated subsidiary, Upsilon Company (Upsilon). Omicron provides various technical and administrative services to Upsilon. For example, Omicron provides technology and communications infrastructure to Upsilon. In addition, Omicron provides Upsilon with market research, advertising, and product

EXHIBIT 11
Omicron Company—Market-Related Companies Comparable SIC Codes

SIC Code	SIC Description
7311	Advertising Agencies
7319	Advertising, Not Elsewhere Classified
7374	Computer Processing and Data Preparation and Processing Services
7375	Information Retrieval Services
7376	Computer Facilities Management Services
7379	Computer Related Services, Not Elsewhere Classified
7389	Business Services, Not Elsewhere Classified
8111	Legal Services
9741	Management Services
8742	Management Consulting Services
8743	Public Relations Services
8748	Business Consulting Services, Not Elsewhere Classified

EXHIBIT 12
Omicron Company—Technology-Related Services Comparable SIC Codes

SIC Code	Description
7371	Computer Programming Services
7373	Computer Integrated Systems Design
7374	Computer Processing and Data Preparation and Processing Services
7375	Information Retrieval Services
7376	Computer Facilities Management Services
7379	Computer Related Services, Not Elsewhere Classified
7389	Business Services, Not Elsewhere Classified
8748	Business Consulting Services, Not Elsewhere Classified

EXHIBIT 13
Omicron Company: Intercompany Service Agreement Comparable Profit Margin Comparison

Operating Profit to Total Cost Margins:	Average (%)	Median (%)	25% Quartile (%)	75% Quartile (%)
Marketing services benchmark	8.6	8.0	4.6	12.9
Technology services benchmark	9.3	7.1	2.7	15.8

design services. According to the terms of a five-year intercompany services agreement, Upsilon pays Omicron cost plus 8% for the services that Omicron provides.

The Upsilon noncontrolling (that is, 20%) stockholder has questioned the fairness of the pricing of this intercompany services agreement. Omicron management retains the analyst to assess the fairness of the pricing of this intercompany services agreement as of a current date, 1/1/2013.

The analyst decides to use the market approach and the comparable profit margin method to perform this fairness analysis. The analyst searches for guideline publicly traded companies that provide similar services to the intercompany services provided by Omicron. The analyst considers these guideline companies to determine if the cost plus 8% payments received by Omicron are comparable to the operating profit to total cost margins generated by the benchmark companies.

The search for benchmark companies includes companies that performed:

- Outsourced IT services;
- Help desk, call center, or technical support services;
- Outsourced accounting and finance services;
- Outsourced human resources, business processing, employment, and management services; and
- Outsourced communications, advertising, and marketing services.

The analyst determines the most appropriate SIC codes for the intercompany services. The marketing services resemble companies in SIC codes 7311, 7319, 7374, 7375, 7376, 7379, 7389, 8111, 8741, 8742, and 8748. A description of each of these SIC codes is provided in Exhibit 11.

The technology services resemble companies in SIC codes 7371, 7373, 7374, 7375, 7376, 7379, 7389, and 8748. Descriptions of each of these SIC codes are provided in Exhibit 12.

The analyst bases the final determination of comparability to the intercompany marketing services on the following guideline company selection criteria:

1. Companies that provide (*a*) outsourced accounting and financial services; (*b*) outsourced human resources, business processing, employment, and management services; and (*c*) outsourced communications, advertising, and marketing services.
2. Companies with latest fiscal year-end revenue greater than $10 million.
3. Companies with positive operating margin and pretax margin for the latest fiscal year.
4. Companies with positive operating margin and pretax margin for at least three of the last five fiscal years.

5. Companies with an active public market for the company stock.

The analyst bases the final determination of comparability to the intercompany technology services on the following guideline company selection criteria:

1. Companies that perform (*a*) outsourced IT services or (*b*) help desk, call center, or technical support services.
2. Companies are excluded if they were engaged solely in computer systems design or computer programming.
3. Companies with latest fiscal year-end revenue greater than $10 million.
4. Companies with positive operating margin and pretax margin for the latest fiscal year
5. Companies with positive operating margin and pretax margin for at least three of the last five fiscal years.
6. Companies with an active public market for the company stock.

The analyst identifies the following guideline companies that provide services that are sufficiently similar to the Omicron marketing services:

1. Accenture PLC.
2. Manpower, Inc.
3. CBA, Inc.
4. Resources Connection, Inc.
5. Affiliated Computer Services, Inc.
6. Administaff, Inc.
7. MPS Group, Inc.
8. Hewitt Associates, Inc.
9. HP Enterprise Services, LLC
10. EMAK Worldwide, Inc.
11. Interpublic Group of Companies, Inc.
12. Mktg, Inc.
13. Omnicom Group, Inc.
14. Grey Global Group, Inc.

The analyst identifies the following guideline publicly traded companies that provide services sufficiently similar to the Omicron technology services:

1. Accenture PLC.
2. Cognizant Technology Solutions Corporation.
3. CIBER, Inc.
4. Unisys Corporation.
5. Intelligroup, Inc.
6. Computer Task Group, Inc.
7. Affiliated Computer Services, Inc.
8. Computer Sciences Corporation
9. TechTeam Global, Inc.
10. SITEL Corporation.
11. StarTek, Inc.
12. Sykes Enterprises, Inc.
13. Metro One Telecommunications, Inc.

The analyst concludes the average and median operating profit to total cost margins of the selected guideline companies in the latest fiscal year, as presented in the table in Exhibit 13.

The analyst compared the Omicron 8% plus actual costs pricing formula to the comparable profit margin (defined as operating profit to total cost) benchmarks indicated by this analysis. Based on the comparable profit margin method analysis in this illustrative example, the analyst concludes that the subject intercompany services agreement pricing formula was fair to the Upsilon noncontrolling stockholder.

Comment on So-Called Rules of Thumb

Some industries have so-called "rules of thumb" related to the valuation of industry-specific intangible assets. These rules of thumb are often expressed as pricing metrics such as price per owner/operator revenue or price by intangible asset unit (for example, price per customer). Industry participants may describe these pricing metrics to the analyst and may even rely on these pricing metrics when assessing the reasonableness of proposed intangible asset transactions.

Presumably, these industry pricing rules were derived over time from actual intangible asset CUT sales or licenses; however, these rules of thumb do not constitute a generally accepted valuation approach or method. The experienced analyst may compare a value indication to the industry rules of thumb to perform a reasonable assessment of that value indication, but the experienced analyst does not rely on a rule of thumb to provide an actual value conclusion.

There are several application weaknesses associated with relying on rules of thumb. First, the analyst does not always know what bundle of assets is included in the rule of thumb. For example, does the price per customer industry rule really include customers only? Or does the industry rule of thumb include customers, a trademark, a product or service design, a license or permit, and goodwill?

Second, the analyst does not know if the quoted rule of *(Continued on page 47)*

(Continued from page 23) thumb is a current indicator of market value. Even if the rule of thumb was valid in the industry five or ten years ago, it may no longer be valid as of a current analysis date.

Third, the analyst cannot always compare the subject owner/operator to the rule of thumb companies. For example, compared to the rule of thumb transactions, is the actual owner/operator growing at a faster or slower rate, earning a higher or lower return on investment, or earning a higher or lower profit margin? Although the rule of thumb may even apply to the typical transaction, the analyst cannot assess if the subject intangible asset is, in fact, typical.

If industry rules of thumb pricing metrics are meaningful and current, then the analyst should be able to locate CUT sales or licenses that reach the same value indication. However, even in that instance, the analyst relies on actual CUT data to reach the value conclusion and not on the industry rule of thumb.

Consideration of Alternative Standards of Value

The market approach methods described above typically conclude a fair value or a fair market value. The same methods can conclude other standards of value if the income-based valuation variables are adjusted accordingly. The market approach methods usually provide market-derived pricing metrics, such as price per revenue, price per income, price per intangible asset unit, or royalty rate per dollar of revenue. These metrics can indicate owner/operator-specific values if owner/operator-specific income measures are used.

For example, market approach methods can also be used to conclude an acquisition, investment, use, or user value. These values are concluded when the revenue, income, or other pricing metrics are acquirer-specific, investor-specific, use-specific, or user-specific. That is, if the analyst uses acquirer-specific revenue, income, or other valuation variable projections, then the analyses will conclude a value, damages, or transfer price indication appropriate for that owner/operator.

Conclusion

Generally accepted market approach methods are available to indicate value, damages, or transfer price conclusions relating to intangible assets. This discussion summarized the generally accepted market approach methods and considered the analytical strengths and weaknesses of each method. Common data sources for each method were described, and an illustrative example of the application of each method was provided.

These methods are particularly applicable to certain types of intangible assets that are typically sold or licensed separately from other assets. When there is a sufficient quantity of sufficiently similar CUT sales or licensees, the market approach provides meaningful analysis conclusions. The analyst applies professional judgment to conclude CUT selection and adjustment criteria, and to conclude whether the market-derived CUT data are sufficient (and sufficiently similar) to rely on. ■