Chapter III

Nature and scope of Intangible Asset and Intellectual Property valuation

Definition and types of intangible valuation

An intangible is defined as something not tangible, something that has no physical existence and incapable of being perceived by the sense of touch, as an incorporeal immaterial and impalpable thing.

Definition and types of intangible valuation.

1) **Patents** – patents provide exclusive rights to produce or sell new inventions when patent is purchased from another company, the cost of the patent is the purchase price. If the company invests a new product and receives a patent for it, the cost includes only registration, documentation, and legal fees associated with acquiring the patent and defending it against unlawful use by other companies. Research and development costs which are spent to improve existing products or create new ones, are never included in the cost of a patent, such costs are recorded as operating expenses when they are incurred because of the uncertainty surrounding the benefits they will provide. The legal life of a patent is seventeen years, which obtain exceeds the patent’s useful life.
2) **Copyrights** :-

Companies amortize a variety of intangible assists, depending on the nature of the business. Copyrights provide their owner with the exclusive right to reproduce and sell artistic works such as books, songs, or monies. The cost of copyrights includes a nominal registration fee and any expenditures associated with defending the copyright. If a copyright is purchased, the purchase price determines the amortizable cost. Although the legal life of a copyright is extensive, copyrights are often fully amortized within a relatively short period of time. The amortizable life of a copyright, like other intangible assets, may never exceed forty years.

3) **Trade mark and Trade names** :-

Trade marks and trade names include corporate logos, advertising jingles and product names that have been registered with the government and serve to identify specific companies and products. All expenditures associated with securing and defending trade marks and trade names are amortizable.

4) **Franchise Licenses** :-

The purchaser of a franchise license receives the right to sell certain products or services and to use certain trade marks or trade names. These
rights are valuable because they provide the purchaser with immediate customer recognition. Many fast food restaurants, hotels, gas stations, and automobile dealerships are owned by individuals who have paid a company for a franchise license. The cost of a franchise license is amortized over its useful life, often its contractual life which is not to exceed forty years.

5) **Government Licenses** :-

The purchaser of a government license receives the right to engage in regulated business activities. For example, government licenses are required to broadcast on specific frequencies and to transport certain materials. The cost of government licenses is amortizable in the same way as franchise licenses.

6) **Good Will** :-

Goodwill equals the amount paid to acquire a company in excess of its net assets at fair market value. The excess payment may result from the value of the company’s reputation, location, customer list, management team, or other intangible factors. Goodwill may be recorded only after the purchase of a company occurs because such a transaction provides an objective measure of a goodwill as recognized by the purchaser. The value of a goodwill is calculated by first subtracting the purchased company’s liabilities.
from the fair market value not the et book value of its assets and then subtracting this result from the purchase price of the company.

Intangibles are all around the business world what in tangible assets are, have been under a lot of study for more than forty years and still there is no generally accepted approach on how to measure their value or what makes them to increase or decrease in the need of a known reference to build the theory for intangibles, the according theory analogies are still being made even through the intangible asset concept has evolved to broader one, intellectual capital. Intellectual capital still uses an accounting terminology but is studied by a managerial approaches.

The presence of an accounting terminology confuses sometimes and allows still trying to explain its behavior from a accounting point of view. That is why concepts like in tangible liabilities and intangible capital or equity have appeared trying to explain variations in the intangibles value. It should be considered that intellectual capital might not vary because of the existence of intangible liabilities but due to the context where they interact.

Means of acquiring intangible Assets. It is often critical for one to understand that the transfer of intellectual property rights not a transaction standing alone, but rather an essential aspects of a large transaction. Intellectual property is often the predominant factors driving mergers and acquisitions.
7) **Mergers**:-

Mergers are often classified as horizontal, vertical, or conglomerate. A horizontal merger is the combination of two competitors into one entity. A vertical merger involves two companies who previously had a buyer and seller relationship. A conglomerate merger occurs when two companies who were neither competitors nor engaged in a buyer seller relationship combine. The structure of a merger and the methods of merger financing are widely varied and can be all cash all security, or a combination of both, variations on merger types include short form mergers, leveraged buy outs (including a management buy out)

8) **Purchase Agreement**:-

A purchase agreement is prepared for detailing the terms and conditions under which stock will be purchased or assets will be sold. The purpose of the purchase agreement identifies the specific transactions essential issues, such as the type of stock or assets, purchase price, method of payment date of closing and any conditions precedent that one of the parties is expected to meet before the closing date. When intellectual property is involved, the seller will usually be asked, additionally, to make certain representations and warranties about the intangible assets being sold. The need to list the assets and liabilities is greater an assets purchases than a share purchases because
the asset purchaser will typically acquire the assets covered in the transfer agreement, but the share purchaser will transfer all rights in the intellectual property by the operation of law. Regardless of the nature of the transaction asset schedules for intellectual property are key in determining the representations and warranties to be included in the agreement.

9) **Supplemental Closing Documentation:**

Several other documents, especially involving intellectual property, are generally executed separately from the purchase agreement previously discussed to effect the sale. If the acquisition is structured as a stock purchase, document transferring the assets are generally not necessary any however, document that transfer stock will allow the buyer to indirectly become the owner of the assets or in which the target will become a wholly owned subsidiary often intellectual property assets will be separately transferred to a holding company and then either licensed back to the operating company or become the subject of a subsequent sale to the ultimate purchaser.

If the transaction structured as an asset purchase, the intellectual property assets will be specifically mentioned in the purchase agreement become the subject of a separate bill of sale or both. However intellectual property assets are often the subject of a separate agreement because they require
recordable of the new owner in the respective jurisdictions in which they are validly owned and used. Further more the forms and requirements for valid transfer differ from country to country and become a matter of public records. The parties of the transaction should anticipate these contingencies and contemplate one, or perhaps several, separate agreements about intellectually property assets.

10) **Sale of Assets**:-

If a party gains intellectual property rights by acquiring a business vis-à-vis a sale of assets, it is not unusual for the transfer agreement to not specifically mention trade mark or other intellectual property rights. If a business is sold as a going concern, the intent to transfer trademarks and the goodwill associated with this intent may be presumed even though not expressly provided for however, it is recommended that such issues be addressed in the supplemental closing documentation. An exception to this concept lies in this context of transitions between parent corporation and their wholly owned subsidiaries. Assets based purchases in this context will not automatically include intellectual property rights; rather ownership of the intangible assets will remain with the parents corporation unless the underlying agreement expressly provides for transfer to the subsidiary.
11) **Stock Purchase** :-

In stock purchase acquisitions ownership of trade marks and other Intellectual property remains with the acquired company share purchases will not affect distinct property rights in intangible assets or other intellectual property to be properly transferred, although a separate agreement is usually recommended to underscore the parties intentions.

The most widely recognized valuation methodologies fall into of three categories: the **Cost Approach, the Market Approach and the Income Approach**. Each of these has strengths and limitations that make more or less appropriate depending on the specific circumstances of each analysis.

The **cost approach** seeks to determine the value of I.P. by aggregating the costs involved in its development. ver, there is more to it than merely adding up all of the receipts for expenditures associated with the R & D. There are two distinct **Cost Approach methods; Reproduction Cost and Replacement Cost**.

**Reproduction Cost** is the level of expenditures needed to reproduce the exact same asset. It is appropriate in situations such as litigation involving the specific intangibles in question. The **Replacement Cost** method measures the expenditures necessary to develop an asset with similar utility and is appropriate in situations such as determining a target
price prior to negotiations or calculating a basis for suitable royalties rates or
transfer pricing.

The cost approach is most useful in cases where there is no economic
activity to review, such as early stage technology. It also is effective at
establishing a maximum price for the asset if the context is proposed
transaction. This situation exists when there are many candidates for
substitution available. The relevant theory is that an investor will pay no
more for an asset than the cost to develop or obtain an asset of similar
utility.

The main drawback associated with the cost approach is that it does
not recognize any economic benefits associated with market place activity.
There is no mechanism to incorporate revenue or profit data and therefore it
ignores an important standard or value by which many assets are measured.

The market approach to Intellectual Property value is determined by
comparing the Intellectual property to comparable assets that have recently
exchanged under similar circumstances. Because the indication of value is
based on comparable transaction and there is high degree of familiarity with
the intrinsic concepts established through other asset valuation experience,
this method is usually preferred by finders of fact, tax authorities and other
third arties. This approach is best if an active market exists that includes
many recent examples of arm’s length transactions for comparable intangible assets.

When using the **Market Approach** accurate and complete data analysis is of vital importance. Once empirical sales and licencing transactions have been selected based on circumstantial comparability such as time frame, type of asset, geographical use and other factors, it must be determined whether the financial characteristics of the underlying operations are comparable. The price information contained in these comparables will frequently have to be adjusted using a common reference point such as sales of branded products or some type of margin analysis.

An advantage of this approach is that it can be applied to a wide variety of intangible assets in a wide variety of circumstances. It is equally valid when applied to an established trade mark or an early stage technology.

**Income Approach**  This approach is based on discounted cash flow theory and defines the value of the subject property as the present value of the anticipated net economic benefits to be achieved over the duration of the property’s useful life. When using the Income Approach to the value intellectual property, future income or cash flow related to the business, business segment or product live under consideration is estimated.
When using the Income Approach, particular attention is paid to five main parameters that determine value: revenue or income associated with the use of the intellectual property, expected growth characteristics of the identified revenue or income, expected duration of the revenue or income, risk associated with generating the estimates of revenue or income, and, the proportion of the revenue or income that is attributable to the subject of Intellectual Property.

The **Relief from Royalty** approach measures value by estimating future revenue associated with the intellectual property over its useful and then applying an appropriate royalty rate to the revenue estimate. It is called relief from royalty because it measures the costs that are avoided the royalty payments that are not made) due to firm’s ownership of the assets. The royalty rate used in this analysis isolates the portion of the value that is attributable to the associated intellectual property. When identifying appropriate royalty rates for this analysis, the license agreements should feature similar attributes. As with the Market Comparables these will include the type of asset, relevant industry, geographical exclusivity, sub-licensing and advertising constraints, payment mechanisms and the appropriate time frame.

The **Technology Factor approach** is designed to measure the portion of a business unit's overall market value that is based on the utilization of the underlying technology. The willing buyer/willing seller aspect of the fair
market value definition is incorporated by scoring a series of attributes as to whether they favour a buyer nor a seller in a hypothetical negotiation.