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IP VALUATION AND M&A INTANGIBLES – THE CURRENT BIG ISSUES IN M&A

- Accounting Standards
- Fairness Opinions
- IPRD

A M&A FAIRNESS OPINION IS NOT REQUIRED BY STATUTE OR REGULATION

A Delaware case Smith v Van Gorkum created the fuss in 1985. It was found that a Board breached its fiduciary duty of care by approving a merger without adequate information, including information on the value of the company and the fairness of the offering price.

Thus these opinions are typically used in conjunction with such activities as merger and acquisitions.

Why is IP valuation expertise crucial in FO's.

FAIRNESS OPINION AND IP

- A fairness opinion states whether or not the financial terms or consideration of a proposed transaction are fair. FO's are expressed from a financial point of view to specific parties of the proposed transaction.

A Fairness Opinion is not

- an opinion that a transaction is fair legally
- a recommendation for the proposed transaction

In practice it is therefore

- an independent opinion that the consideration to be paid is within a range of fairness.

MUCH OF THIS DEPENDS ON IP

"If you can find something everyone agrees on, it's wrong"
Mo Udall, American Politician (1922-1998)

FAIR VALUE IS NOT THE SAME AS FAIR MARKET VALUE WHICH CONCEPT HAS NOTHING TO DO WITH FAIRNESS

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- Fair market value ignores intent, history and employment, preferences or prejudices of any particular buyer or seller and assumes there is always a buyer at a price.

- *"fair value can be reliably determined by a skilled business appraiser if the steps…(all of which require large doses of judgment based on logic, experience and training) are followed"* Alex Howard, HFBE, ASA National Business Valuation Conference, Nov 05

VALUATION METHODOLOGIES

- Either or any combination of income, market or asset.

"A fairness opinion is not a guarantee that the deal is truly fair or good. It is simply a document that reviews a deal's valuation, compares it with the valuation of similar deals and says it is within the parameters"
Andrew Sorkin of the New York Times, July 2005

THE M&A PURCHASER & VENDOR

Four Calculations or Steps – ‘can Kelvin count’

1. Intrinsic value of Vendor
2. Intrinsic value of Purchaser

PLUS

1. Intrinsic value of Vendor
2. Intrinsic value of Purchaser

The capital values calculated are an essential step to calculate deal parameters

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M&A: ONE OF MANY OCCASIONS FOR VALUING INTELLECTUAL PROPERTY

- Mergers and acquisitions
- Portfolio review and risk assessments
- Arrange a loan – securitisation
- Tax purposes
- Licensing
- Balance sheet purposes
- Joint ventures
- Selling your company
- Selling your IP
- Insurance
- Implication

WHY IS THIS IMPORTANT

CONCEPTS OF VALUATION DRIVEN BY M&A

- Tax Valuation and Open Market Value
- Fair Value
- Fair Market Value
- Commercial Value
- Investment Value

COMPARABLE MARKET TRANSACTIONS

- Few sales
- Lack of information
- Separate values
- Special purchasers
- Different negotiating skills
- Distorting effects of varying values
- Assets not always comparable

M&A AND HISTORICAL OR REPLACEMENT COST

- Economic benefits excluded.
- Duration of benefit-economic life
- Obsolescence difficult to quantify
- Maintenance
- Time value of money

INCOME METHODS OF VALUATION

- Capitalisation of historical profits
- Future economic benefits

IN M&A MODERN VALUATION ANALYSIS IS EFFECTIVELY DCF APPLIED TO THE BUSINESS ENTERPRISE UNDER CONSIDERATION

- **The Net Present Value (NPV) of a strategy or business is the sum of its expected free cash flows to a horizon (H) discounted by its cost of capital (r)**

$$NPV = \frac{\text{Year 1 Cash Flow}}{(1 + r)} + \frac{\text{Year 2 Cash Flow}}{(1 + r)^2} \ldots \text{ to } \frac{\text{say Year 5 Cash Flow}}{(1 + r)H}$$

PLUS

The terminal value which is the value of the business at a horizon (HV)

$$HV = \frac{\text{Cash Flow}}{(r - \text{growth})}$$

Also discounted back to present value

IN DCF ANALYSIS SOLVING THE HOW MUCH PROBLEM IN M&A?

- **GROSS PROFIT DIFFERENTIAL METHOD – PREMIUM PRICES/ PREMIUM PROFITS**

- **EXCESS PROFITS METHOD**

- **RELIEF FROM ROYALTY METHOD**

SOLVING HOW LONG IN M&A?

USEFUL LIFE

- Physical life
- Functional life
- Technological life
- Economic life
- Legal life

AT WHAT RISK?

(COST OF CAPITAL)

THE LICENSEE/PURCHASER & LICENSOR/VENDOR

Four Calculations or Steps – 'can Kelvin count'

1. Intrinsic value of Vendor
2. Intrinsic value of Purchaser

PLUS

1. Intrinsic value of Vendor
2. Intrinsic value of Purchaser

The capital values calculated are an essential step to calculate a royalty rate or valuation – discuss