

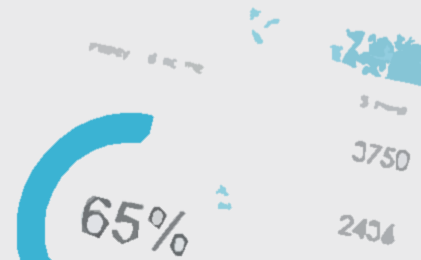


Art'o'val Advisors

True Art of Valuation

Valuation Series 1 - Intangible Assets

Jan 2023



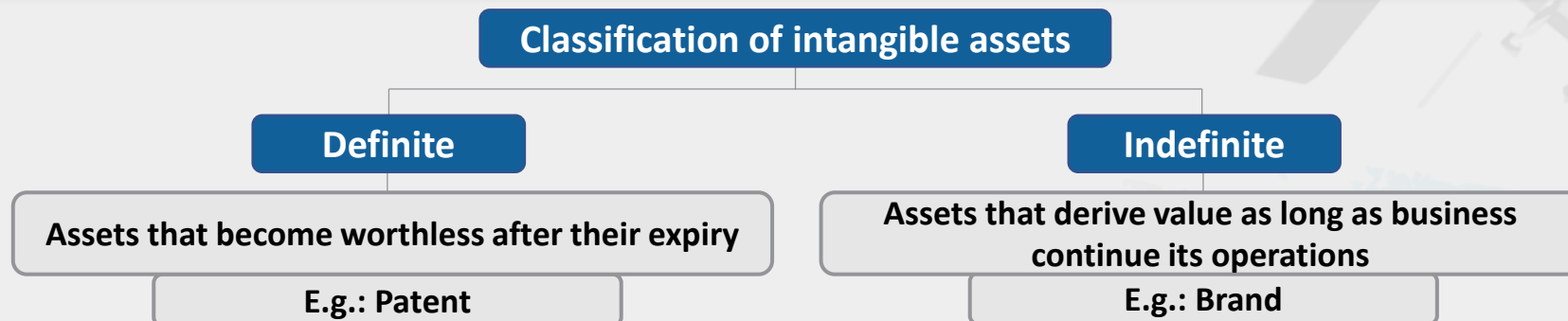
What are Intangible Assets?

Value of intangible assets in new age companies

- Wealth and growth in today's economy are primarily driven by intangible (intellectual) assets
- Physical and financial assets are rapidly becoming commodities, yielding at best an average return on investment
- Abnormal profits, dominant competitive positions, and sometimes even temporary monopolies are achieved by the sound deployment of intangibles, along with other types of assets
- Intangible assets play an important role in valuation of companies in today's economy. Due to increase in economic competitiveness and innovation, large number of new age companies primarily derive value from their intangible assets such as Technology, knowhow, software, etc.
- However, there are certain challenges in recording fair value of intangible assets into books of accounts, which may distort true value of the firm

As per Ind AS-38 – intangible assets

- An intangible asset is an identifiable non-monetary asset without physical substance. It also includes Financial assets (as defined under Ind AS 32) that derive value from a contractual right/claim
- Intangible assets are recognized as follows:
 - **Identifiability** - they are separable or may arise from contractual or other legal rights;
 - **Future economic benefits** – their existence depends on the expectation of future benefits such as revenue or cost savings or other benefits resulting from their use; and
 - **Control** - the owner can control the use or restrict the access to the future economic benefits



Categories of Intangible Assets

Raconteur Publishing has classified intangible assets into eight different categories:



Intellectual Property



B2B Rights



Brand



Hard Intangibles



Data



Non-Revenue Rights



Public Rights



Relationships

The value of the intellectual capital derived from specialized knowledge and experience that employees of an acquiree bring to their jobs may be captured in the value of other intangible assets in certain circumstances

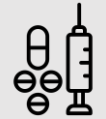
Intangible Assets across Industries

Following are the examples of intangible assets in respective industries:



IT Industry

- Patent
- Technical Know-how
- Internet Domain Names
- Technology or Software Codes



Pharmaceutical Industry

- Product Molecules
- In-process Research & Development
- Licensing Agreements
- Trade Names and Trademarks



Oil & Gas

- Software
- Exploration and Evaluation for Oil
- License
- Patent, Trademark etc.



Business Services Industry

- Customer/ Vendor Relationships
- Order Backlogs
- Non-compete Agreements
- Database



Telecommunication Industry

- Spectrum Licenses
- Software
- Customer
- Tower Rights

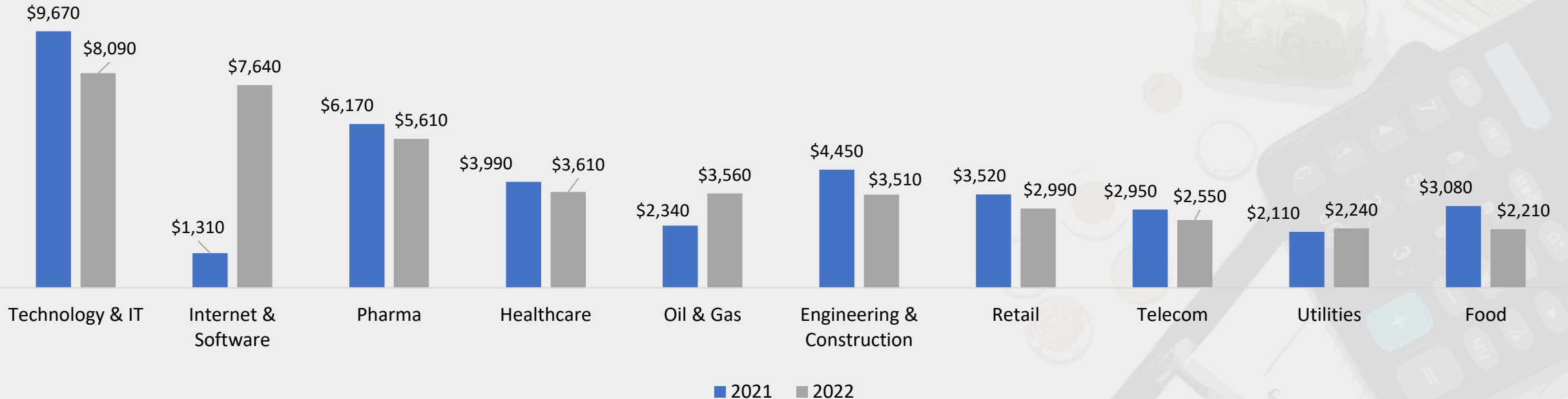


Aerospace & Defence

- Patent
- Airport Operating Rights
- License
- Services

Sector wise Intangible Assets

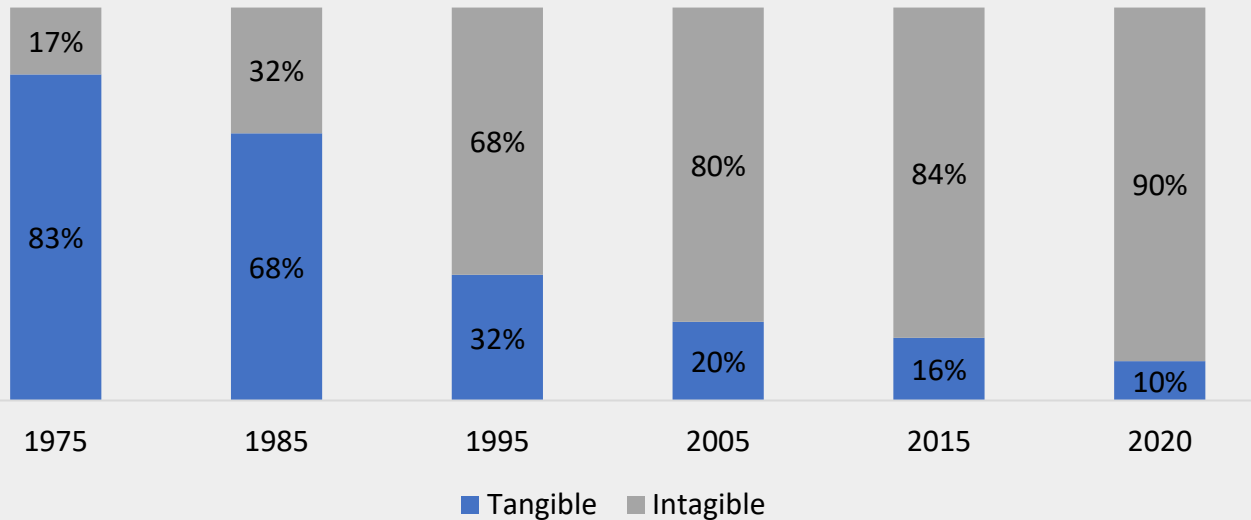
Total intangible assets value by sector (\$ Bn)



- Global intangible value has declined by 25% y-o-y, from \$76 Tn in 2021 to \$57 Tn in 2022 primarily due to the impact of COVID-19 pandemic
- On the other hand, sectors such as Internet & Software, Oil & Gas, and Utilities have experienced a y-o-y increase in intangible value
- Internet & Software sector rebounded significantly in 2022 as compared to 2021, recording \$1,310 Bn in 2021 and \$7,640 Bn in 2022 respectively
- Oil and gas sector increased by 52% from \$2,340 Bn in 2021 to \$3,560 Bn in 2022 and utilities by 6% from \$2,110 Bn in 2021 to \$2,240 in 2022

Shift in Companies Assets Investments

Share of Tangible vs Intangible assets of S&P 500 companies (%)



Companies where Intangible assets value represent 100% of Enterprise Value (2022)



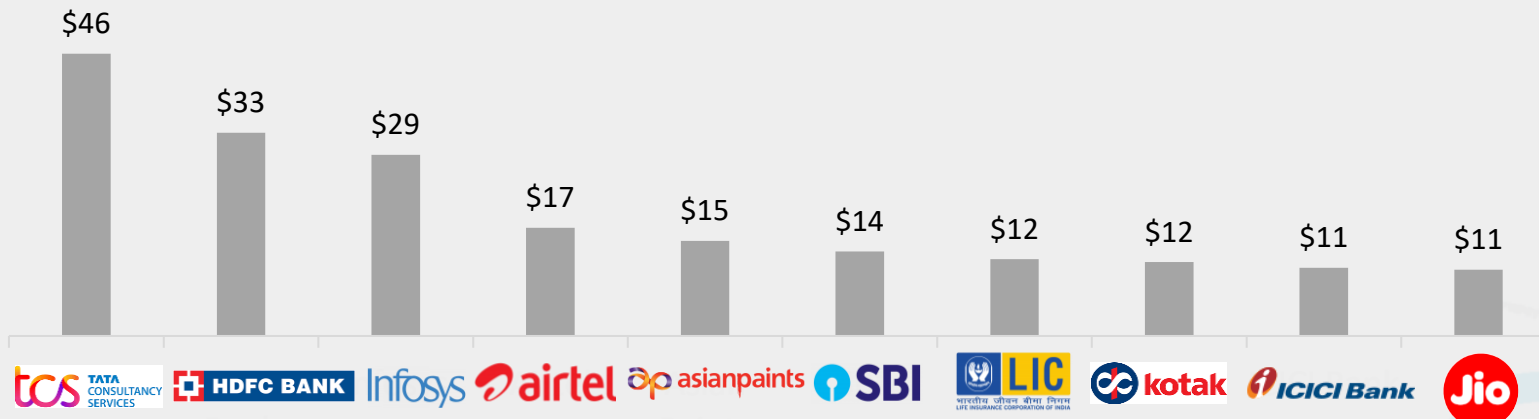
- Intangibles used to play a much smaller role than they do now, with physical assets comprising the majority of value for most companies
- An increase in competition and innovations led to a rise in intellectual property and other intangible assets of the companies
- Intangible assets have evolved as a key component in the valuation of an enterprise
- Over and above the technology & IT companies, pharma and healthcare companies' intangible assets value represents 100% of its business valuation

Valuation of Top Brands

Top 10 global brands value (\$Bn, 2022)



Top 10 Indian brands Value (\$Bn, 2022)


















Commentary

- Among the global brand Apple was the most valuable brand in 2022 with a \$355 Bn brand value followed by Amazon with a \$350 Bn brand value
- Whereas, among Indian brands TCS was the most valuable brand recording \$46 Bn, followed by private financial institution HDFC Bank with a brand value of \$33 Bn in 2022
- Over and above the digital-centric sector, global retail companies are also significantly increasing their brand value
- Major technology and IT company's brand value is driven by increase in intangible assets investment

Intangible Assets Intensive Brands

The following table shows top 15 companies with share of Intangible Assets in Enterprise Value (2021):

Rank	Intangible Assets Intensive Firms	Country	Share of Intangible Assets (%)
1	Microsoft		93
2	Ayden		92
3	LVMH		92
4	Unilever		91
5	Medtronic		87
6	Atlas Copco		86
7	Orsted		85
8	Novartis		82
9	Ferrari		80
10	Volkswagen		80
11	Tencent		78
12	Kindred Group		77
13	Bank Central Asia		75
14	TCS		75
15	QNB Finansbank		73

Need for Valuation of Intangible Assets

As per Ind AS 38, an intangible asset is recognized if the below conditions are met

- It is probable that the expected future economic benefits attributable to the asset will flow to the entity
- The cost of the asset can be measured reliably

Importance of valuation of intangible assets

- Internally generated intangible assets are recognized as expenses, therefore, not recorded in the balance sheet and have no recorded book value, as a result, they are not appropriately recognized as assets in the financial statement. This create a need for appropriate valuation of intangible assets
- Intangible assets play an important role in the valuation of the businesses engaged in pharmaceuticals, technology, luxury, financial services, and consumer industry
- The convergence of Indian Accounting Standards with IFRS has brought the valuation of intangible assets to the fore
- Intangibles comprise a significant asset class in the allocation of the purchase price in case of Business Combinations under Ind AS 103 and Ind AS 38 which deal with the accounting treatment of intangible assets

Intangible asset valuation is critical in the following cases:



Financial Reporting



M&A Decisions



Business Formation & Business Dissolution



Strategic Planning & Corporate Governance



Licensing



Tax Compliance & Planning



Dispute Resolution



Liquidation



Litigations



Fund Raising

Valuation Standard

The ICAI valuation standard 302 deals with the valuation of intangible assets, following considerations, are included in the standard:

- 1** To determine the purpose and objective of the overall valuation assignment
- 2** To consider the legal rights of the intangible asset to be valued. For example, a registered trademark may have a higher value as compared to an unregistered trademark. However, an unpatented technology (as not in the public domain) may have a higher value than a patented technology
- 3** To evaluate the highest and best use considerations
- 4** To assess the history and development of the intangible asset
- 5** To consider any specific laws or regulations guiding the intangible asset valuation in the country. For example, royalty payments in India are regulated

Valuation Methods

IND AS 38 has recommended below valuation methods for valuation of Intangible Assets

Methods	Description
Market	<p><u>Comparable Transaction Method</u></p> <ul style="list-style-type: none">• Transactions occurring in a free and open market between knowledgeable and willing buyers and sellers conducted on an arm's length basis can be used to determine benchmark metrics such as revenue and profitability multiples for valuing comparable intangible assets• While evaluating comparables, factors such as age of the asset, applicability of use, locational / geographical access or use, risk and expected return characteristics, etc. should be considered• An amount or percentage may be deducted from the value to reflect the relative absence of marketability/liquidity in the subject asset to be valued. Also control premium needs to be appropriately reflected
Cost	<p><u>Historical Method</u></p> <ul style="list-style-type: none">• This method considers the historic / sunk cost / purchase price to value the asset• Future benefits arising out of the use of assets are not considered under this method• This method does not reflect the true value of intangible assets as it focuses more on book value rather than intrinsic value of the assets <p><u>Replacement Cost Method</u></p> <ul style="list-style-type: none">• The method considers estimating the costs to recreate/replace an asset with equivalent functionality at current prices and costs, including adjustments for factors like physical deterioration & functional/economic obsolescence• It is based on the premise that a prudent third party would not pay more than the assets' replacement cost• The buyer would be willing to pay more than the replacement cost on account of competition, timing, uniqueness, and other features

IND AS 38 has recommended below valuation methods for valuation of Intangible Assets

Methods	Description
Income	<u>Relief from Royalty Method (RRM)</u> <ul style="list-style-type: none">• Calculates value based on the hypothetical royalty payments that would be saved by owning the asset rather than licensing it• The RRM is often used to value domain names, trademarks, licensed computer software, and in-progress R&D that can be tied to a specific revenue stream and where data on royalty and license fees from other market transactions are available
	<u>Multiperiod Excess Earnings Method (MEEM)</u> <ul style="list-style-type: none">• The MEEM is a variation of discounted cash-flow analysis• Rather than focusing on the whole entity, the MEEM isolates the cash flows that can be associated with a single intangible asset and measures fair value by discounting them to present value• The MEEM tends to be applied in early-stage enterprises and technology firms
	<u>With and Without Method (WWM)</u> <ul style="list-style-type: none">• WWM measures the economic contribution of the asset by calculating the net present value of the incremental cash flows to be derived from the use of the asset• In this method one needs to calculate two sets of cash flows; one that represents the status quo for the business enterprise with the asset in place, and another without it• The difference could be either in terms of higher pricing that the product/service commands owing to brand or higher volume/units sold as it may have the potential of higher penetration in the target markets• The difference between the cash flows is assumed to be attributed to Intangibles• The WWM is often used to value noncompete agreements

Selection of Intangible Valuation Method

According to AICPA, different valuation methods are preferable for each asset class of Intangible Assets

Intangible Assets	Primary	Secondary	Tertiary
Patent	Income	Market	Cost
Technology	Income	Market	Cost
Copyright	Income	Market	Cost
Assembled Workforce	Cost	Income	Market
Internally developed software	Cost	Market	Income
Brand name	Income	Market	Cost
Customer relationships	Income	Cost	Market

Aspects of Valuing Intangible Assets

Following aspects should be considered for the valuation of Intangible assets

Contributory Asset Charge (CAC)

- Assessing the CAC can be a challenge under MEEM method
- The required returns on CAC must be consistent with an assessment of the risk of individual asset classes and should reconcile overall to the enterprise WACC
- The projection period for the PFI used in the model should reflect the estimated useful life of the subject asset

Tax Amortization Benefit (TAB)

- The present value of tax benefit on intangible assets should be considered in valuation of the assets
- The process is iterative taking into account the amortization period, the discount factor and the applicable marginal tax rate to arrive at the fair value of the asset post TAB

Useful life of an Intangible Assets

- The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights
- The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life
- An intangible asset with an indefinite useful life shall not be amortised

Appendix

ICAI: <https://resource.cdn.icai.org/23721IndAS-38.pdf>

Investopedia: <https://www.investopedia.com/terms/i/intangibleasset.asp>

Wikipedia: https://en.wikipedia.org/wiki/Intangible_asset

Accounting Tools: <https://www.accountingtools.com/articles/what-are-examples-of-intangible-assets.html>

CFA Institute: <https://blogs.cfainstitute.org/investor/2019/01/11/a-renaissance-in-intangible-valuation-five-methods/>

ICAI: <https://resource.cdn.icai.org/56261icaivsbpisr3.pdf>

Statista: <https://www.statista.com/statistics/323944/most-valuable-brands-india/>

Visual Capitalist: <https://www.visualcapitalist.com/intangible-assets-driver-company-value/>

MCA: <https://mca.gov.in/Ministry/pdf/INDAS38.pdf>

Research Gate:

https://www.researchgate.net/publication/228210498_Profitability_and_Royalty_Rates_Across_Industries_Some_Preliminary_Evidence

Brink News: <https://www.brinknews.com/are-intangibles-now-the-most-important-asset-class-in-the-global-economy/>

Brand Finance: <https://brandirectory.com/download-report/brand-finance-gift-2022-full-report.pdf>



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Thank You



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