



# VALUING INTELLECTUAL PROPERTY

## ISSUES FOR MERGERS AND ACQUISITIONS

### A Valuation Primer for Transactions

#### Tips to Consider in M&A transactions

By Mike Pellegrino

#### What Is Intellectual Property?

There are four generally accepted forms of intellectual property (IP). They include trademarks, copyrights, patents, and trade secrets. The first three IP forms come with formal and explicit government protections. Trade secrets, which may encompass organizational or personal expertise or knowledge, such as formulas, processes, devices, or other proprietary information, are not subject to traditional government protection. All IP forms may have economic value.

**Tip:** In mergers and acquisitions (M&A), it is important to value the acquisition candidate's IP in order to verify that the acquiring company pays a fair price for the acquired company. Knowing the value of IP is also important for allocation and tax reporting purposes in accordance with generally accepted accounting practices (GAAP) as described in Statements of Financial Accounting Standards (SFAS) 141, *Business Combinations* and SFAS 142, *Goodwill and Other Intangibles*.

#### Why Value IP

There are many reasons to value IP. Some of these reasons include equity financing, loan collateralization, bankruptcy, taxation and transfer pricing, controversies (e.g., quantifying damages), and internal reporting needs such as company metrics and management accounting. The value of IP can be huge. For example, IBM generates over \$1 billion in annual revenues from IP licensing; Texas Instruments generates hundreds of millions in annual revenues from IP licensing.<sup>1</sup>

**Tip:** When reviewing an M&A deal, always be sure to investigate the potential for IP sitting on a shelf that the acquired company does not recognize currently on the balance sheet or income statement thoroughly. Failure to recognize and value this IP at the time of acquisition may understate the value of the company for the acquisition target. Acquirers should be keen about searching for such unrecognized valuable IP as it may provide hidden value for the acquirer and reduce the size of post-merger goodwill.

#### About IP Valuations

IP valuation is part art, part science. IP valuation is science in that the valuation analyst will use well-defined and tested financial formulas and models to capture the quantitative aspects of the IP and combine them to arrive at a value conclusion.

#### About This Article

The article appears in the 2005 Indiana Continuing Legal Education Forum (ICLEF) "Business Valuations and Preparations for Sale" seminar proceedings.

Pellegrino & Associates LLC specializes in the valuation of intellectual property for investment and tax purposes.

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<sup>1</sup> Parr, Russell L. and Patrick H. Sullivan, *Technology Licensing: Corporate Strategies for Maximizing Value*, John Wiles & Sons Inc., New Jersey, 1996, p. 83.

IP valuation is art in the ways that the valuation analyst applies these financial formulas and models. The valuation analyst will apply these in meaningful ways based on the qualitative aspects of the IP, the amount of independent research that the valuation analyst performs, and the relative background of the valuation analyst. All of these drive the value opinion quality.

**Tip:** Never expect a valuation opinion to be a guarantee of value for a transaction. Valuation opinions are merely reasoned estimates for what the value could be in a given situation within probabilities within the valuation industry.

### IP's Value Sources

The value for IP can come from many sources. These include through the direct IP exploitation, through IP ownership, through IP licensing, and through not exploiting the IP. An IP owner may use the IP in a product they make and market directly, such as developing a product described by a patent. An IP owner may generate economic value by owning a patent or trademark, which keeps a competitor from exploiting the IP in its own products, thereby putting the competitor at a market disadvantage. An IP owner may generate value through IP licensing to a third party for development and marketing. Lastly, an IP owner may generate economic value from not exploiting IP, like in the case where a third party may pay the IP owner a reasonable rate of return for not exploiting the IP if it would affect the third party's business adversely.

**Tip:** When considering the IP portfolio in a transaction, always verify the IP portfolio's value sources. Acquiring companies should study the target company's IP portfolio to determine which IP has value components the target company is exploiting, and question the target company on IP components that have no clear value source.

### IP's Value Components

Three primary components drive IP value. They include primary sources, secondary sources, and speculative extensions. By example, consider the Martha Stewart brand. Martha Stewart started her brand with a television show that generated her primary revenue stream. From there, Martha Stewart generated secondary revenue streams by building on the value of her television brand and by expanding into selling private-label house wares through K-mart and other outlets. People bought the products because of the association with the Martha Stewart brand. Martha Stewart received royalties for the use of her brand, and this created revenue streams in addition to her initial television show revenues. A valuation analyst cannot predict speculative extensions up front with much precision. Martha Stewart generates speculative extensions to her initial brand by creating her own version of "The Apprentice" television show, for which she receives additional revenues and royalties. Martha Stewart would not have likely considered building this show earlier in her brand development. "The Apprentice" television show concept did not exist until only recently. Any conjecture in the early 1980's about a follow-on reality television show based on a concept that Donald Trump perfected would have been purely speculative.

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**Tip:** When considering the IP portfolio of an acquisition target, always be sure to consider secondary and speculative extensions to the IP, particularly through synergies with the acquirer's ongoing business lines. Such extensions may create additional hidden value in a deal for the acquirer, or give cause for a higher asking price by the seller.

### IP Valuation Administration Considerations

The first step a valuation analyst should take when looking to value IP, particularly for patents and other forms that require periodic administration is to ensure that the IP owner is current with their maintenance fees with the governmental agencies. Maintenance fees keep the IP registration current and under government protection. Without proper maintenance of government fees, the IP owner irrevocably waives monopoly power and government protections. Thus, the financial value of IP without the monopoly protection provided by the government is effectively nothing.

**Tip:** Trade secrets do not generate value from government registrations and granted monopoly power. Therefore, the value of trade secrets is dependent on the level of confidentiality and non-compete agreements in place with those in a position to know the trade secret's value-creating components. Companies with loose employee agreements, loose security procedures around their trade secrets, and loose IP ownership clauses put the value of their trade secrets at risk.

### Value Standard

An important part of any valuation assignment is the value standard employed for the assignment. Value standards include fair value, fair market value, investment value, liquidation value, and forced liquidation value. The value standard depends on the valuation purpose because each purpose will have a different value measure. For example, if a company owns IP that empowers a next generation consumer electronic device and the owner is looking to sell it to a major consumer electronics manufacturer, then fair market value may be the appropriate value standard to use. However, contrast that with IP used in a declining industry where the company is undergoing involuntary bankruptcy proceedings and needs to sell the IP rights quickly. In this case, the distress of the owner's financial situation and the prospects for future value is likely materially lower than in the prior example. In this case, an appropriate value standard may be forced liquidation value.

**Tip:** When commissioning an IP appraisal, ensure that the value standard matches the deal (e.g., fair market value for going concerns, forced liquidation value for involuntary bankruptcies, and so on). The wrong value standard can generate materially different valuation results in a transaction.

### Value Standard

Many factors drive the value of a particular piece of IP. They include things such as market dynamics, general economic climate, geopolitical issues, and the

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application of IP to the market. Market dynamics plays a tremendous role in the value of IP, particularly for things like brands and trademarks. Consider Phillip Morris on “Marlboro Friday.” On April 2, 1993, Phillip Morris cut the pack of Marlboro brand cigarettes by 20%. The stock took a beating, losing 23% of its value in one day. The market price of the loss in value to the Marlboro brand was staggering: about \$13 billion.<sup>2</sup>

The general economic climate also plays an important role in the IP valuation. Much of this depends on the optimism or pessimism of the market. For example, during the dot-com boom of the late 1990’s and into early 2000, IP in the high-tech sector commanded an investment premium. The market’s optimism of the potential economic returns from high-tech IP drove up prices and licensing royalties. However, by mid 2002, the market viewed with skepticism the economic returns of the high-tech sector after having funded billions of dollars in losses for unrealized IP gains. The market priced high-tech IP lower because of its overall pessimism.

Other factors drive IP value as well. These include the competitive landscape, the IP’s profitability, the amount of capital required to exploit the IP, the timing of cash flows related to the IP, and others. It is imperative that the valuation analyst consider all practical and material IP value factors. Failure to consider these factors in a transaction may materially misrepresent the IP’s value.

Perhaps one of the biggest value drivers is the ability to detect infringement. IP where it is easy to detect infringement is more valuable than IP where it is not easy to detect infringement. This is because it may be less costly to detect infringement and it may be easier to prove under dispute with the infringing party. IP where it is difficult to detect infringement is worth less because there may be excess costs associated with infringement discovery and defense in disputes. For example, it is easier for Nike to sue a shirt-company that makes knock-offs of their best selling golf shirts and win. It is much more difficult for Guidant to reverse-engineer the software code in a competitor’s pacemaker device to detect infringement of their software patents.

## Ways to Value IP

There are three generally accepted ways to value IP. They include the cost approach, the market approach, and the income approach.

### Cost Approach

A valuation analyst who values IP using the cost approach looks at what it cost to produce the IP, or what it would cost to reproduce the IP on a given effective date. These costs include things like labor, materials, applied overhead, and capital charges. Depending on the effective date of the valuation, the valuation analyst may trend costs from a historical reference point to the effective date. For example, if the IP owner has cost data from five years ago and wants the IP value

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<sup>2</sup> Smith, Gordon V. and Russell L. Parr, Intellectual Property: Valuation, Exploitation, and Infringement Damages, John Wiles & Sons Inc., New Jersey, 2005, p. 171.

using the cost approach in today's dollars, the valuation analyst may grow the costs at the rate of inflation over those five years to arrive at the cost as of today. Once the valuation analyst accumulates all costs, the valuation analyst adjusts the final tally for obsolescence to arrive at a final value opinion.

**Tip:** Governments reward companies that invest in IP in the form of income tax credits. These tax credits can increase the value of IP. Thus, during any IP valuation assignment, it is important, particularly for the seller, to review the IP's candidacy for research and development tax credits and account for those tax credits in value as applicable. The cost approach may be appropriate for valuing the basis for these tax credits.

### **Cost Approach Methods**

There are several methods to establish value using the cost approach. The first method is to use the reproduction cost new method of the cost approach. Using this method, the valuation analyst looks to recreate the subject IP using the same or similar development methods and materials as the original effort. The reproduction cost new method does not account for changes in technology, higher utility from other materials, and other factors. Valuation analysts use the reproduction cost new method to value IP such as embedded computer software for tax reporting purposes. The second method is to use the replacement cost new method of the cost approach. Using this method, the valuation analyst considers what it would take to recreate the subject IP, but the valuation analyst can consider the impact of new technology and development methods on the IP recreation effort. Valuation analysts may use the replacement cost new method of the cost approach to value the establishment of a consumer brand from 20 years ago in today's market, which contains many new direct-to-consumer options such as the Internet and Podcasting.

### **Problems with the Cost Approach**

The cost approach rarely provides a credible valuation for IP such as patents or trade secrets. Cost does not equal value and it is a common misconception to relate the value of IP to its investment amount. It is a rare case when the cost and the value are the same. Future economic income potential, market timeliness, and profit potential drives the value of IP. Rumors are that Nike spent \$35 in the 1970's to purchase rights to the "swoosh" emblem now universal to all of Nike's products. That swoosh today is instantly recognizable around the world. In fact, Nike no longer puts the word "Nike" near the swoosh because the public knows the symbol's meaning so well. Thus, the symbol is worth substantially more than what it cost Nike to purchase it. In spite of the issues involved with using the cost approach to establish value, in certain instances, it may work well, such as determining the value of a trademark and the costs to change from one brand to another in an M&A deal.

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## Obsolescence

The obsolescence types used in cost approach valuations include physical deterioration, and functional, technological, and economic obsolescence. Physical deterioration generally does not apply to IP because IP is intangible. Its physical manifestation, on mediums such as paper or electronic media, physically deteriorates, but the IP itself never physically deteriorates. Functional, technological, and economic obsolescence do affect the value of IP. Functional obsolescence occurs when the IP user must incur excess operational costs to use the IP versus current alternatives, which may be state of the art. Technological obsolescence occurs when technological forces render the IP worthless. For example, patents for a next generation computer floppy disk drive are likely worthless because there are better technological options already on the market, such as high capacity flash memory. Economic obsolescence occurs when the use of the IP in its highest and best form cannot provide an adequate return on investment. This can occur in IP easily because IP is generally unique and may have little use outside of a particular function.

## Market Approach

The valuation analyst who values IP using the market approach looks for comparable transactions in the same industry and of the same relative size that recently occurred in the open market. Value is determined indirectly using the comparable IP transaction as a proxy for value of the target IP. The reasoning is logical: if the market paid \$X for rights to the use or own that IP once, then one would expect that the market would reasonably pay a similar amount again, *ceteris paribus*. There are several approaches to establishing this value, depending on the desired value standard and value purpose. For example, if one desires the fair market value for licensing IP to another company, the valuation analyst would look to other recent licensing transactions in the same industry and use a similar royalty rate. Another way to value IP using the market approach is to use a gross multiplier such as a cash flow factor to arrive at a value. For example, IP generates \$1M of free cash flow in year 5, and the valuation analyst uses a cash flow multiplier of eight, so the IP is worth \$8M. Valuation analysts use other multiplier factors commonly as well and these factors are usually ratio based. Once the valuation analyst arrives at a value, then the valuation analyst adjusts the IP's value to account for identifiable differences, such as the remaining life of IP protections.

The problem is that the market approach may not work well for IP. First, comparable circumstances rarely exist. IP by its very nature is novel and unique. It is generally impossible for the valuation analyst to find a comparable transaction in the market. Therefore, any reference to other IP transactions is at best a crude value approximation. Second, the comparable may have the support and expertise of a proven management team, existing customers, available working capital, and a host of other factors that dictate why the IP sold for the price it did. The candidate IP under valuation would require the same circumstances, or the valuation analyst must make adjustments to account for the change. However, these adjustments are generally arbitrary approximations themselves. Their use can compound valuation

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error. Third, the market is not rational. Investors enter the market routinely with imperfect information and these investors drive prices sky-high. That is why a company like Sonic Wall could have a P/E ratio of 8675 in the dot-com bubble and a market valuation of \$1.2B on earnings of \$147,000. That is beyond irrational—it is insane. Market participants also leave the market irrationally and abnormally depress market transaction prices. Fourth, the value of the IP depends on the application of the IP to the market, and the circumstances need to be similar to serve as a credible value proxy. The trademark for a soft drink may not command near the value applied to a car that it does for fruit flavored, sugar sweetened water. To use a soft drink brand transaction as a basis for establishing the value of a car's brand is not appropriate either—the two are altogether different in their application and industry. Finally, the comparable transaction may represent a portfolio of IP. It is rare to find standalone comparable IP transactions that do not include other bundled tangible or intangible assets.

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***While the market approach works well for things such as licensing royalty rates, be wary of patent valuations or trade secrets valued using the market approach.***

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**Tip:** Be vigilant about the use of IP valuations that rely heavily on the market approach. The market approach is a relative valuation technique, subject to market bias. While the market approach works well for things such as licensing royalty rates, be wary of patent valuations or trade secrets valued using the market approach.

### **Income Approach**

The income approach is the last method that a valuation analyst uses to value IP. This method is the most principled, requires the most discipline and insight into value-creating features of the IP to complete, and is what valuation analysts use commonly for IP valuation assignments. A valuation analyst using the income approach bases their opinion on the IP owner's business plan, marketing and operational inputs, and other external references. Using this method, the valuation analyst projects the economic income generated solely from the IP over a discrete period, known as the remaining useful life (RUL) as well as any residual value after the RUL.

### **Remaining Useful Life**

The RUL is likely one of the most difficult attributes of the IP's value to determine when using the income approach. Unfortunately, it is also one of the most significant drivers for the IP's value. IP with a long RUL will be worth more than IP with a shorter RUL. The RUL will vary based on the IP under review. Utility patents lose their useful life 20 years after the filing date—the point at which the monopoly protection from the government ends. No company would pay royalties in the 21st year, because they can copy the IP owner's design and methods without fear of legal retaliation. Copyrights have a useful life well after an author's death. Trade secrets, such as the formula for Coca Cola, may have an indefinite useful life if they remain confidential. If applicable, the valuation analyst will also consider some residual IP value after the RUL. That is, even after the RUL is over, there may be some residual value to the IP because of market factors. For example, a bankrupt company's trademark may have value even though the company is no

longer in operation.<sup>3</sup> A valuation analyst may determine that the residual value may decrease over five years to \$0. In this case, the valuation analyst would calculate the decreasing cash flows for the five years after the RUL, discount those to the present value, and add those to the value of the cash flows calculated over the RUL.

### Determine Economic Income

To determine economic income, the valuation analyst projects the revenue (or cost savings) generated from the IP over the RUL, and then offsets those revenues with costs related directly to the IP such as labor, and materials, required capital investment, and any appropriate economic rents or capital charges. There are several methods that valuation analysts employ to measure economic income associated with a given IP. Some include the net income method, the relief from royalty method, the profit split method, and others.

Consider an example using the net income method. The valuation analyst can determine the cash flows related solely to the IP, which is the after-tax net income adjusted for net capital investment and interest charges associated with the maintaining the IP. With cash flows for each discrete year in the RUL and a calculated residual value, the valuation analyst discounts these cash flows using an appropriate discount factor to the present value to determine what their value today. This becomes the IP's value before the valuation analyst applies any applicable value adjustments.

One important thing to note is that income may have different meanings based on the context. A valuation for damage analysis may consider income as pre-tax net cash flow whereas a valuation for investment purposes may consider income as after tax net cash flow.

**Tip:** When comparing valuations from differing analysts based on the income approach, always ensure that the two valuations use the same income definition in their valuation development.

### The Income Discount Factor

The income discount factor that the valuation analyst uses is, aside from the RUL, one of the largest value drivers. There is an inverse relationship between the discount rate and IP value. Higher discount factors lead to lower-value IP, and vice versa. This is desirable, as it mirrors classic risk/reward principles when determining an appropriate discount factor. Early stage IP, with little proven market power, commands a higher discount rate than a proven IP because the risk of the early stage IP generating economic income is higher than with proven IP.

To get an example of the impact of the development stage on the discount factor, consider discount factors used by venture capitalists by development stage below:

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<sup>3</sup> The Weyco Group Inc. bought the Florsheim trademark for \$9.8 million in May 2002 following Florsheim's bankruptcy.

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Development Stage	Discount Factor
Start-up/idea	50%
First stage/prototype	40%
Second stage/commercialization	30%
Third stage/expansion	25%

One misconception is to discount the IP's cash flows at the parent company's weighted average cost of capital (WACC). The discount factor should in fact be higher than parent company's WACC, because the parent company typically achieves portfolio diversification through other income sources. The lower discount factor for the parent reflects this diversification. IP typically doesn't have this income portfolio attribute—it is a single-source income model. In certain cases, it may be appropriate to use an increasing discount factor for cash flows in later years of the RUL, particularly if there is a risk that a competitor may design or work around the IP's protections. For example, if a valuation analyst discounts a patent's income at 25% in the early years, it may be appropriate for the valuation analyst to use a 35% discount factor in the later years of the patent's RUL, particularly if the risk or probability of competitors designing around the patent is high.

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***IP that becomes technologically obsolete quickly may command a higher discount rate because the window with which to generate economic income is smaller...***

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The discount factor may also be higher for IP belonging to certain industries. IP that becomes technologically obsolete quickly may command a higher discount rate because the window with which to generate economic income is smaller than IP without this technological obsolescence risk.

#### **Simulation Use**

Once the valuation analyst builds an income valuation model, the analyst should capture the complex value driver interactions in the face of uncertain estimating assumptions using simulation modeling. This is important because by using simulation, the valuation analyst will not constrain the valuation model to any single-value predictions of key value drivers such as the IP's RUL, IP revenues or IP costs. A valuation analyst would program the valuation model to recalculate the valuation model repeatedly to create a distribution of outcomes that the valuation analyst can then analyze and interpret. For example, the valuation analyst performs 10,000 different possible value scenarios using simulation. With a sample size that large, the valuations that the model generates become statistically significant. In complex situations that involve uncertainty, this methodology allows the valuation model to generate meaningful estimates that would otherwise be impossible to model using discrete methods such as best, expected, and worst-case modeling.

**Tip:** Do not rely on single-point valuation models to establish the value of IP using the income approach. Such practices may materially overstate or understate the IP's value and do not account properly for variability in the many value drivers.

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## Valuation Discounts

Once the valuation analyst determines a value opinion, generally other discount factors may apply. These discount factors reduce the IP's value. These discounts include the minority interest discount, the lack of marketability discount, key-person discounts, and contractual discounts. These discounts are cumulative.

### Minority Interest Discount

The minority discount applies when one sells a partial interest of the IP to another party. Unless the seller provides the buyer 51% ownership, the buyer generally does not have the power to change the direction or use of the IP. Therefore, those with majority control have more power to effect change in direction. Their ownership is thus worth more. Minority interests are generally worth only 65-80% of a majority owner's interests.

Valuation analysts derive minority interest discounts for business valuations from the M&A market by studying the premium that acquiring companies pay for acquisition targets to achieve full-control of the stock. Valuation analysts use these discounts as a proxy for minority interests in IP because there is not an active market in standalone IP sales that provide the data necessary to determine a minority interest discount. One interesting side effect of these studies is that companies that overpay for an acquisition (i.e., the winner's curse), may upwardly bias the control premium, which also increases the minority interest discount, thereby understating the IP's value.

### Illiquidity Discount

Unlike public companies, where it is easy to sell a share of stock on the open market, IP owners that purchase an interest in some IP are buying an interest that is very difficult to sell, particularly if it is a minority interest. This discount compensates the owner for purchasing an interest that is hard to sell to another party when the original owner no longer wants it. An illiquid interest is generally worth only 50-65% of a liquid share's value.

Valuation analysts derive lack of marketability interest discounts for businesses from the IPO market by studying the increase in share price on the opening days of trading for a new issue stock versus the share price some weeks or months before public trading begins. Like the minority interest discount, these discounts for businesses serve as a proxy for the discounts as applied to IP. Also like the minority interest discount, there is a potential for an upward bias in this discount because investment-banking firms may intentionally under-price IPO stocks to generate a bigger first-day jump for their primary-offering subscribers.

### Key Person Discount

Key person discounts are discounts to IP value to account for the risks of relying on any one person or set of people who are the primary value drivers for a given piece of IP. It's simple to determine if a key person discount applies. If IP degradation, delays in commercialization, or other operational interruptions occur if a truck hits

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a person working with the IP, then a key person discount may be applicable. Such discounts may not apply given the IP type. For example, the use of a key person discount for a patent may be inappropriate because the patent describes the design and implementation entirely. There is no mystery for how to complete a product based on a patent. However, a key-person discount may apply to a trade secret if only a few individuals know a trade secret's details and exploitation strategies. The key person discount is a subjective measure and a valuation analyst will look to different organizational attributes to determine a reasonable discount factor, generally using the replacement method of the cost approach to establish such a discount. Such organizational attributes include the business' adaptability to change, the IP's complexity, company training/succession plans, capitalized key person insurance premiums, the industry expertise of the staff, rehiring costs, company reputation, and the centralized nature of the organization's decision-making process.

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### **Contractual Discounts**

Deal negotiators will forever think of creative ways to structure M&A transactions. Each transaction's structure may have an impact on the IP's value. For example, if a company licenses the rights to use IP in a given geographic region, that IP may be worth \$X. However, if there is a contractual restriction that forbids the licensee to use the IP in a certain industry, then this contractual restriction has a discounting value on the IP. The IP would be worth more if it were not for this restriction.

In addition, there may also be cases where there are IP value premiums are appropriate to the licensee due to a contractual clause. Such cases may include clauses that grant the licensee additional profit rights or call or put options.

### **Income Tax Amortization Factor**

When an acquirer purchases IP, the acquirer can amortize the value of the purchased IP ratably over 15 years in accordance with section 197 of the Internal Revenue Code. This allows the acquirer to expense a portion of the purchased IP each year. Because this amortization shows as an expense to the acquirer, the acquirer lowers its net income and defers income taxes to some future time. Because of this, the government in effect subsidizes the IP acquisition. This tax effect lowers the IP acquisition's effective cost; thus, the purchased IP becomes more valuable.

**Tip:** Be sure that the valuation for purchased IP considers the benefits from the income tax amortization, because this increases the value of the IP to the buyer, and the seller should be able to command a higher asking price.

### **USPAP Compliance**

The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989 recognizes that the Uniform Standards of Professional Appraisal Practice (USPAP) is the generally accepted standard for appraisal development and reporting. FIRREA requires USPAP compliance for appraisers in transactions where the federal

government provides guarantees. While not an explicit requirement for valuing IP, it is best to hire valuation analysts that develop their valuation opinions and reports in accordance with USPAP. There are several reasons why.

First, the single largest goal of USPAP is to ensure public trust in the valuation profession and valuation opinions. USPAP standards outline what a credible valuation development effort entails, and what a credible valuation report contains to meet this goal. Next, USPAP compliance requires that each valuation analyst signs and certifies their valuation report with text similar to the following:

*I certify that, to the best of my knowledge and belief:*

- *the statements of fact contained in this report are true and correct.*
- *the reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions and are my personal, impartial, and unbiased professional analyses, opinions, and conclusions.*
- *I have no (or the specified) present or prospective interest in the property that is the subject of this report, and I have no (or the specified) personal interest with respect to the parties involved.*
- *I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.*
- *my engagement in this assignment was not contingent upon developing or reporting predetermined results.*
- *my compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.*
- *my analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice.*
- *no one provided significant business appraisal assistance to the person signing this certification. (If there are exceptions, the name of each individual providing significant business appraisal assistance must be stated.)*

Particularly worth noting is the clause discussing contingent fee arrangements. USPAP compliance requires that the valuation analyst is not paid based on some deal contingency. For example, it is violation of USPAP for an acquiring company to pay a valuation analyst only if a deal closes. This creates a conflict of interest for the valuation analyst and this conflict can bias the valuation analyst's conclusions. Companies that hire valuation analysts should pay them on an hourly or fixed-fee arrangement.

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Finally, courts recognize and accept USPAP standards and USPAP compliance in their proceedings. Parties that contract for value opinions that conform to USPAP are likely in better standing if a deal ever turns sour and lawsuits start flying.

**Tip:** Require USPAP conformance for all valuation opinions you contract and avoid any contingent-fee valuation opinions.

### Valuation Analyst Credentials

One of the most difficult aspects of IP valuation is hiring a valuation analyst with the competence to perform valuation assignment with a reasonable degree of probability within the valuation industry. In fact, the conduct section of the USPAP ethics rule has a specific requirement that the appraiser perform the appraisal effort competently. Furthermore, in litigation matters, the client's counsel will usually treat the valuation analyst as an expert witness and enter the valuation analyst's credentials into the record. It is therefore imperative for the valuation analyst to have proper foundation to complete the valuation assignment, or the valuation analyst's testimony may receive no weight in the matter.

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***A valuation analyst that does not meet the competence requirements of USPAP cannot reasonably expect to generate a credible opinion.***

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A valuation analyst that does not meet the competence requirements of USPAP cannot reasonably expect to generate a credible opinion. It would be like asking a residential home appraiser to perform a cost appraisal for the Sears Tower. For IP valuation assignments, the valuation analyst will either have a relevant background, or will use a subject matter expert (SME) well versed in the art to complete the required valuation development.

When a valuation analyst uses a SME, the valuation analyst must consider the SME's credentials. The valuation analyst must also evaluate how those credentials relate to the valuation effort. For example, if a valuation analyst is valuing embedded software, the valuation analyst is not demonstrating competence if the valuation analyst hires a SME that has spent a career installing and configuring accounting packages or writing business software, because the development considerations for those projects are materially different from embedded software projects. The SME should have relevant and material experience in the valuation assignment IP to perform the valuation competently.