CLAIRENT ADVISORS
VALUATION AND TRANSACTION SPECIALISTS

The Importance and Value of “Squishy” Intangible Assets

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Josette Ferrer, Managing Director
Clairent Advisors LLC

- **"Squishy" intangible assets comprise large portions of corporate value … *and not just for high technology companies***

Company	(a) Enterprise Value	(b) "Squishy" / Intangible Value
Facebook	$152.0 billion	$138.0 billion 91% of Enterprise Value
The Coca-Cola Company	$217.5 billion	$193.6 billion 89% of Enterprise Value
Navigant Consulting	$938.8 million	$910.8 million 97% of Enterprise Value
Caterpillar Inc.	$103.2 billion	$66.2 billion 64% of Enterprise Value
Schlumberger Limited	$144.1 billion	$114.2 billion 79% of Enterprise Value
Chevron Corporation	$250.8 billion	$84.9 billion 34% Enterprise Value

(a) Source: S&P Capital IQ; market capitalization as of April 15, 2014 + debt

(b) Enterprise Value less working capital, fixed assets, and net other long-term assets / liabilities

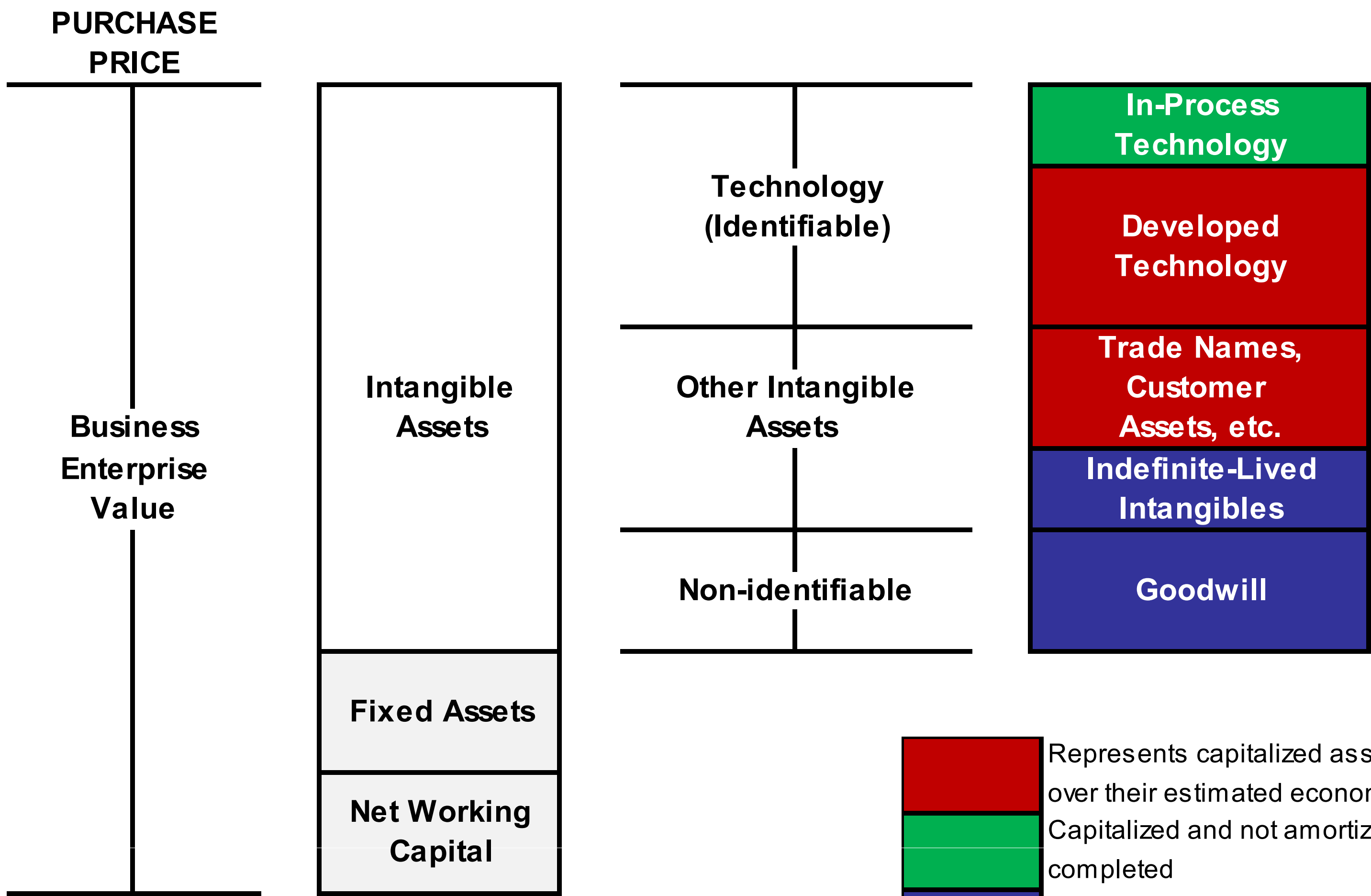
- **Our Perspective**
- **Background and Reference Slides (Purchase Price Allocation Principles)**
- **Valuation Methodology Overview**
- **Case Study #1 – Wireless Telecom Company**
- **Case Study #2 – Sporting Event Trade Name & Trademarks**
- ***Appendix:***
  - *Speaker Background / Contact Information*

Our Perspective

- **Unique insight from working on hundreds of accounting-related engagements involving the valuation of intangible assets**
- **Experience also includes intangible asset / IP valuations for strategic planning purposes as well as for tax reporting and planning**

Our Perspective

Overview of Purchase Price Allocation Principles (ASC 805)



Represents capitalized assets that are amortized over their estimated economic lives

Capitalized and not amortized until projects completed

Represents excess of purchase price over assets acquired (not amortized)

New rule -- option for private companies to amortize goodwill over 10 years or a shorter period

Overview of Purchase Price Allocation Principles

- **Primary Standards References**
  - ASC 805, *Business Combinations* (formerly SFAS 141R)
  - ASC 820, *Fair Value Measurements and Disclosures* (formerly SFAS 157)

- **Related Standards** – *which cover post-deal impairment testing*
  - ASC 350, *Goodwill and Other Intangible Assets*
  - ASC 360, *Accounting for the Impairment or Disposal of Long-Lived Assets*

- **Other Published Guidance**
  - Appraisal Foundation Monographs
    - *Identification of Contributory Assets and Calculation of Economic Rents* (issued in 2010)
    - *Valuation of Customer-Related Assets* (draft issued in 6/12)
  - AICPA IPR&D Practice Aid (update issued in 2013)

Typically Recognized Intangible Assets

Technology-Based Intangible Assets
- Patented Technology
- Unpatented Technology
(Patented and Unpatented Technology: *Developed Technology*)
- In-Process Research and Development
- Databases

Customer-Related Intangible Assets
- Backlog
- Customer Contracts
- Customer Relationships (Non-Contractual)
- Customer Lists

Marketing-Related Intangible Assets
- Trademarks, Trade Names
- Trade Dress (Unique Color, Shape, Package Design)
- Internet Domain Names
- Non-Competition Agreements

Contract-Based Intangible Assets
- Licensing, Royalty Agreements
- Franchise Agreements
- Operating and Broadcast Rights

Artistic-Related Intangible Assets
- Pictures, Photographs
- Video and Audiovisual Material (Motion Pictures, TV Programs)
- Musical Works (Compositions, Song Lyrics)

Valuation Methodology Overview

- **Three traditional valuation methods for any asset**
  - ***Cost Approach***
  - ***Market Approach***
  - ***Income Approach***

- **Cost Approach**
  - ***What would it cost to recreate the intangible and its present market position?***
  - Rarely applicable – cost does not equal value
    - Millions were spent by RJR on developing a smokeless cigarette or by Coca Cola on the development and marketing of “New Coke.”
  - Considered for intangible assets and embryonic technology where market potential exists but is impossible to estimate at the early stage
  - Often used as a “reasonableness check” for certain intangible assets
    - Customer assets (cost to replace based on necessary sales and marketing resources)
    - Technology (cost multiples)

Valuation Methodology Overview *(continued)*

- **Market Approach**
  - ***Comparison of subject property to recently priced property (sale, license, transactions, etc.) that is similar and for which price information is available***
  - Characteristics of ideal transaction:
    - Transaction should be between unrelated parties
    - Neither party compelled to complete transaction
    - Involves similar property for use in the same industry as the subject property
    - Relevant date of transaction
  - Market transactions or identifiable comps are rare for individual intangible assets
    - Few transactions of similar property
    - Financial details often not disclosed
- **Income Approach** – most common approach
  - ***Present value of future economic benefits***
    - Project net cash flows
    - Determine appropriate discount rate
  - ***Specific variations of the Income Approach will be covered in Case Studies #1 & #2***

Case Study #1 – Wireless Telecom Company
Overview

$000's	**Fair Values**
Wireless Licenses	**$200,000**
Subscriber Base	**150,000**
Trade Names	**10,000**
Goodwill	600,000
Fixed Assets	110,000
Working Capital	4,000
Other LT Assets	3,000
	$1,077,000

"Squishy" Assets

Purchase price premium
$960,000

89.1%
of purchase price

Identified intangibles
37.5%
of purchase price premium

Goodwill
62.5%
of purchase price premium

Case Study #1 – Wireless Telecom Company
Overall Valuation Framework

Business Enterprise Model

Starting economics for acquired assets

Key assumptions and support for:
- Revenue growth
- Margins
- Discount rate
etc.

Enterprise Value Ties to Purchase Price

Certain assumptions feed into intangible asset models

Intangible Asset Models

- **Subscriber Base**
- **Wireless Licenses**
- **Trade Name**

Asset-specific assumptions

"Gut" checks:
- *Do relative asset values make sense?*
- *Intangibles / goodwill values as % of purchase price premium vs. similar deals*
- *Weighted average return on assets*

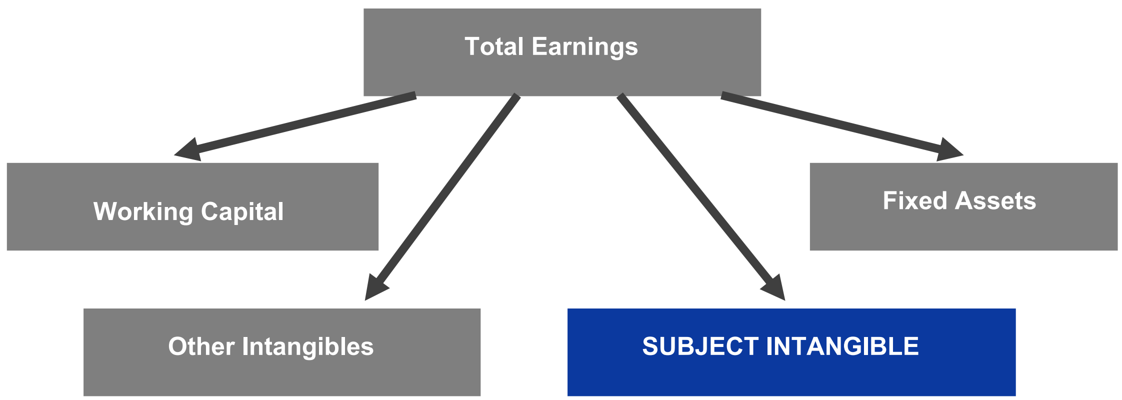
Incorporate understanding of "THE STORY" behind company / assets / deal

Case Study #1 – Wireless Telecom Company
Subscriber Base Valuation

- **Subscriber Base**
  - Value associated with a predictable revenue stream / repeat business
  - **Excess Earnings Method**
    - Variation of the Income Approach
    - Intangible assets are used in combination with other assets to generate income
    - Fundamental principle: *isolate* net earnings attributable to the asset being valued

Total earnings for asset group

Less returns related to contributory assets:
Working capital
Fixed assets
Intangible assets
Equals:
Excess earnings
(calculate present value)



Case Study #1 – Wireless Telecom Company
Subscriber Base Valuation (continued)

Selected Components of Excess Earnings Method Model

Subscriber revenue	*Considered historical and expected churn / attrition; declining revenue over time*
Operating expenses	*Based on overall business model projections*
Earnings before taxes	
plus: Sales and marketing adjustment	*Mitigated sales and marketing costs -- which the acquiring company does not need to spend*
Adjusted earnings before taxes	
Income tax expense	*Based on rate utilized in overall business model*
Net income	
less: Charges for the use of contributory assets	
Working capital charge	*Based on estimated returns associated with each asset (lowest for working capital; highest for other intangible assets) and asset values*
Fixed asset charge	
Other intangible asset charge	
After-tax cash flows	*Cash flows discounted to the present utilizing intangible-specific discount rate*

Case Study #1 – Wireless Telecom Company
Wireless Licenses Valuation

- **Wireless Licenses**
  - FCC licenses; enable telecom carriers to provide service to certain geographic areas and operate in specific frequencies with varying bandwidths
  - Valuation approaches: **Greenfield Method** and **Market Approach** (transactions; spectrum auctions)

Greenfield Method

- Variation of the Income Approach
- Calculates value of a hypothetical start-up business with no assets except the asset to be valued
- Since the hypothetical business has no other assets, the value of the subject asset equals the value resulting from the Greenfield Method

Market Approach -- Transactions

- Most common multiple: **Price per MHz POP**
  Sales price / (MHz of license x population covered)
- Example: 15 MHz license, covers 1 million POPs, sales price of $12 million

Price per MHz POP = $12 million / (1 million x 15)
= $0.80

Market Approach (spectrum auctions) utilized as a reasonableness check

Case Study #1 – Other Observations
Qualitative *Factors and Impact on Intangible Asset Values*

Comparison of Intangible Assets by Industry

Intangible Asset	**Software Company**	**Services Company**	**Telecom Service Provider**
Technology	High	Low / None	Low / None
Customer Assets	Depends (Low to High)	High	Low / Medium
Trade Name, Trademarks	Low	Depends (Low to High)	Depends (Usually Low)
Licenses	NA	NA	High

Case Study #1 – Other Observations

Qualitative Factors and Impact on Intangible Asset Values *(continued)*

Factors and Considerations	Impact of Factor on Identified Intangible Assets ("IIA") or Goodwill		Notes
General Business and Deal Factors			
- Long company history	↑ IIA	↓ Goodwill	
- High profitability in recent historical periods	↑ IIA	↓ Goodwill	
- High revenue growth and profitability projected in the next several years	↑ IIA	↓ Goodwill	Both aspects add more value to identified intangible assets since these increase economics in early years when present value factors are higher.
- Higher deal multiples paid for the acquired business	↓ IIA	↑ Goodwill	Likely translates into more value in the terminal period (which does not impact the intangible asset valuation models).
- Acquirer plans to make significant changes to the acquired business as part of its integration plans	↓ IIA	↑ Goodwill	Assumes acquirer plans would be similar to market participant likely plans
- Acquirer rationale for the acquisition (e.g., detailed in the deal press release) explicitly references identified intangible assets (like customers or technology)	↑ IIA	↓ Goodwill	

Case Study #1 – Other Observations

Qualitative Factors and Impact on Intangible Asset Values *(continued)*

Factors and Considerations	Impact of Factor on Identified Intangible Assets ("IIA") or Goodwill		Notes
Intangible Asset-Specific Considerations			
Contracts / Customers			
- Significant / material long-term contracts and backlog acquired	↑ IIA	↓ Goodwill	
- High customer retention / contract renewal anticipated	↑ IIA	↓ Goodwill	
- Ability and high expectations to sign new contracts / sell additional products to current customers	↑ IIA	↓ Goodwill	
Developed Technology			
- Significant changes to products expected over the next several years	↓ IIA	↑ Goodwill	
- Company spends significant R&D on new development (vs. maintenance)	↓ IIA	↑ Goodwill	
- Long product / technology lifecycle anticipated	↑ IIA	↓ Goodwill	
- Company has significant patents which are key to its business	↑ IIA	↓ Goodwill	
- Few alternatives exist to the company's technology	↑ IIA	↓ Goodwill	

Case Study #1 – Other Observations
Qualitative Factors and Impact on Intangible Asset Values (continued)

Factors and Considerations	Impact of Factor on Identified Intangible Assets ("IIA") or Goodwill		Notes
Intangible Asset-Specific Considerations (continued)			
Trade Names			
- Business / product trade names are expected to be retained after the acquisition	↑ IIA	↓ Goodwill	
- Strong strength of the trade names in the market / high customer recognition	↑ IIA	↓ Goodwill	
- Trade names attract customers and offer strong pricing or other advantages	↑ IIA	↓ Goodwill	

Case Study #2 – Sporting Event Trade Name & Trademarks
Overall Valuation Framework

Primary Methodology

Reasonableness Check

	Relief-From-Royalty Method			Excess Earnings Method		
Scenario 1 *Current Ownership - Conservative Case / Minimal Growth*	**$3,800,000**	**to**	**$4,400,000**	$4,200,000	to	$4,600,000
Scenario 2 *Current Ownership - Moderate Growth*	**$4,500,000**	**to**	**$5,100,000**	$5,250,000	to	$5,550,000
Scenario 3 *Market Participant Owner -- Investment Case*	**$5,500,000**	**to**	**$6,400,000**	$6,300,000	to	$6,900,000

Reasonableness Check

	Similar Transaction Indications For Overall Business		
Range of implied full company enterprise values based on transaction multiples	$7,400,000	to	$10,500,000
(of which the trademarks would be a subset / large portion of company value)	Range of trade name values as % of enterprise values		
	51.4%		41.9%
	74.3%		61.0%

Values above modified vs. actual results

Case Study #2 – Sporting Event Trade Name & Trademarks
Valuation Methodology

- **Relief-from-Royalty-Method**
  - Variation of the Income Approach
  - ***If we did not own the asset, how much would we pay to license it?***
  - Estimates a projected stream of hypothetical royalty income generated from the licensing of the subject intangible asset to determine fair value:
    - Estimate royalty base -- revenue from products / services which incorporate the asset
    - Determine appropriate royalty rate
  - Key factors:
    - What are comparable intangibles being licensed for?
    - What is the remaining economic life?
    - What are the relative strengths of the intangibles?
    - Consideration of market potential and competing assets

Case Study #2 – Sporting Event Trade Name & Trademarks
Valuation Methodology *(continued)*

Selected Components of Relief-From-Royalty Method

Revenue	- *Projected revenue related to subject trade name* - *Included participant, sponsorship, and other revenue*
times: Pre-tax royalty rate	*Based on consideration of royalties from similar transactions; profitability of underlying business*
Pre-tax royalties	
Income tax expense	
After-tax royalties	*Cash flows discounted to the present utilizing intangible-specific discount rate*

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Q & A

Appendix: Speaker Background / Contact Information

Josette Ferrer
Managing Director

jferrer@clairent.com
Direct: 415 658 5589
Mobile: 415 272 5191

201 Spear Street, Suite 1100
San Francisco, CA 94105

www.clairent.com

Current Responsibilities

Josette Ferrer is the founder and a Managing Director of Clairent Advisors. Since 1993, Josette has been assisting clients with the valuation of closely held businesses and business interests, intangible assets, intellectual property, stock options, debt instruments, capital equipment / fixed assets, and other assets.

Experience

Prior to founding Clairent Advisors in 2010, Josette was the U.S. Practice Leader of Marsh's Valuation Services Group (formerly Kroll's Valuation Services Practice). Her career includes serving as the Managing Director in charge of the San Francisco Valuation Services Group of WTAS, Inc. ("WTAS"), a former subsidiary of HSBC Group. At WTAS, Josette's responsibilities included developing and overseeing all technical, operational, marketing functions for the SF valuation team. Prior to WTAS, Josette was a director with Huron Consulting Group and a senior manager at Arthur Andersen LLP.

While Josette has extensive experience serving clients in many industries, areas of specialty include telecommunications, high technology, service companies, consumer products, manufacturing, and financial services. Her clients have ranged from small, emerging businesses to Fortune 500 companies. Josette has been a guest speaker for a wide variety of forums, including Financial Executives International (“FEI”), the Institute of Management Accountants (“IMA”), the Practicing Law Institute (“PLI”), the San Francisco Bar Association, Santa Clara University, BIOCOM, and various venture capital roundtables, and has also published an article related to the valuation of intellectual property for the PLI.

Education and Affiliations

- B.S. in Business Administration, University of California, Berkeley
- Board Member, SF Chapter, Financial Executives International
- Membership Committee, Association for Corporate Growth, Silicon Valley
- Member, Fair Value Forum
- Corporate Affiliate, Finance Scholars Group
- Strategic Partner, Strategic Alliances Resources Network
- Member, ProVisors