

INTANGIBLE ASSETS

INMACS

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NATURE OF INTANGIBLE ASSETS

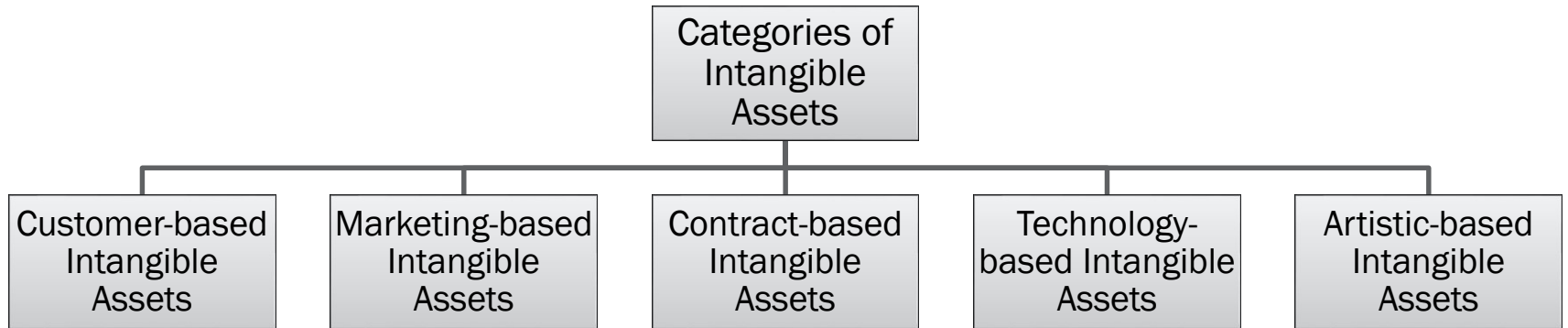
What are Intangible Assets?

- ❖ Valuation Standards – 302, Intangible Assets defines it as:

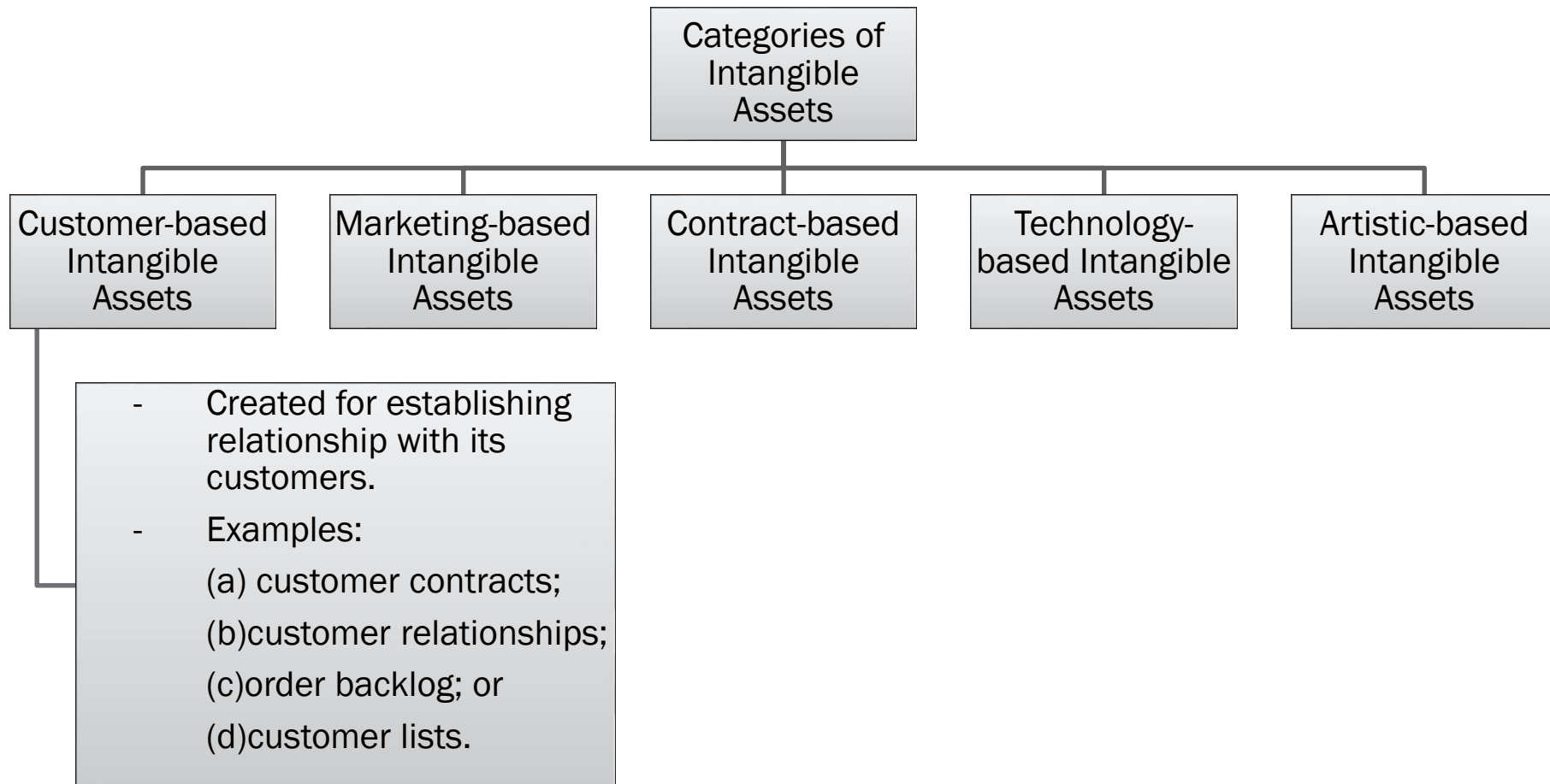
“An intangible asset is an identifiable non-monetary asset without physical substance.”

- ❖ An intangible asset is a non-monetary asset without physical substance, whereas a monetary asset is one where assets to be received are in fixed or determinable amounts of money. An Intangible asset grants economic rights or benefits to its owner and can be identified and differentiated primarily on the basis of its ownership and utility. Intangible assets lack physical properties and represent legal rights developed or acquired by an owner.

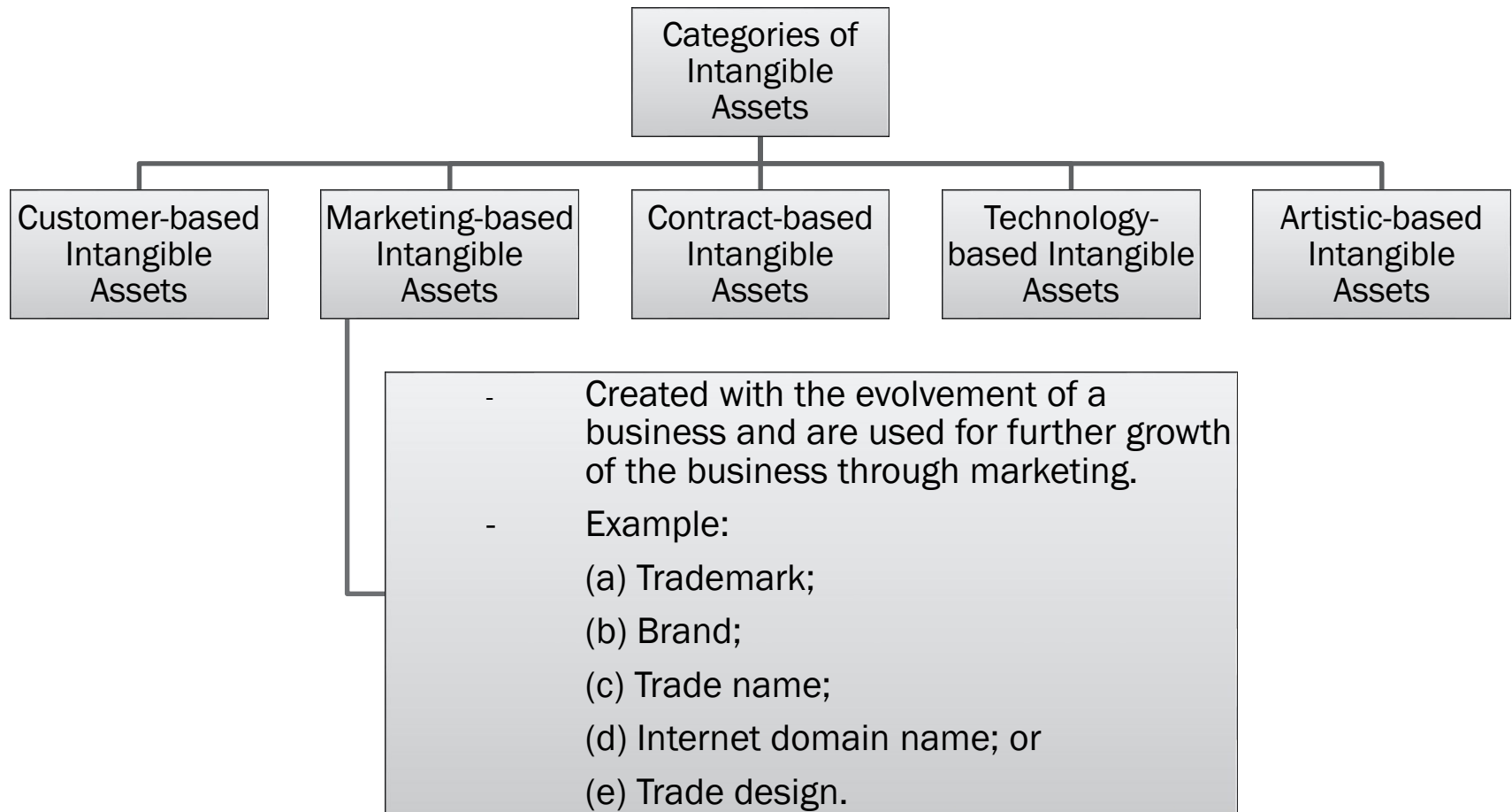
CLASSIFICATION OF INTANGIBLE ASSETS



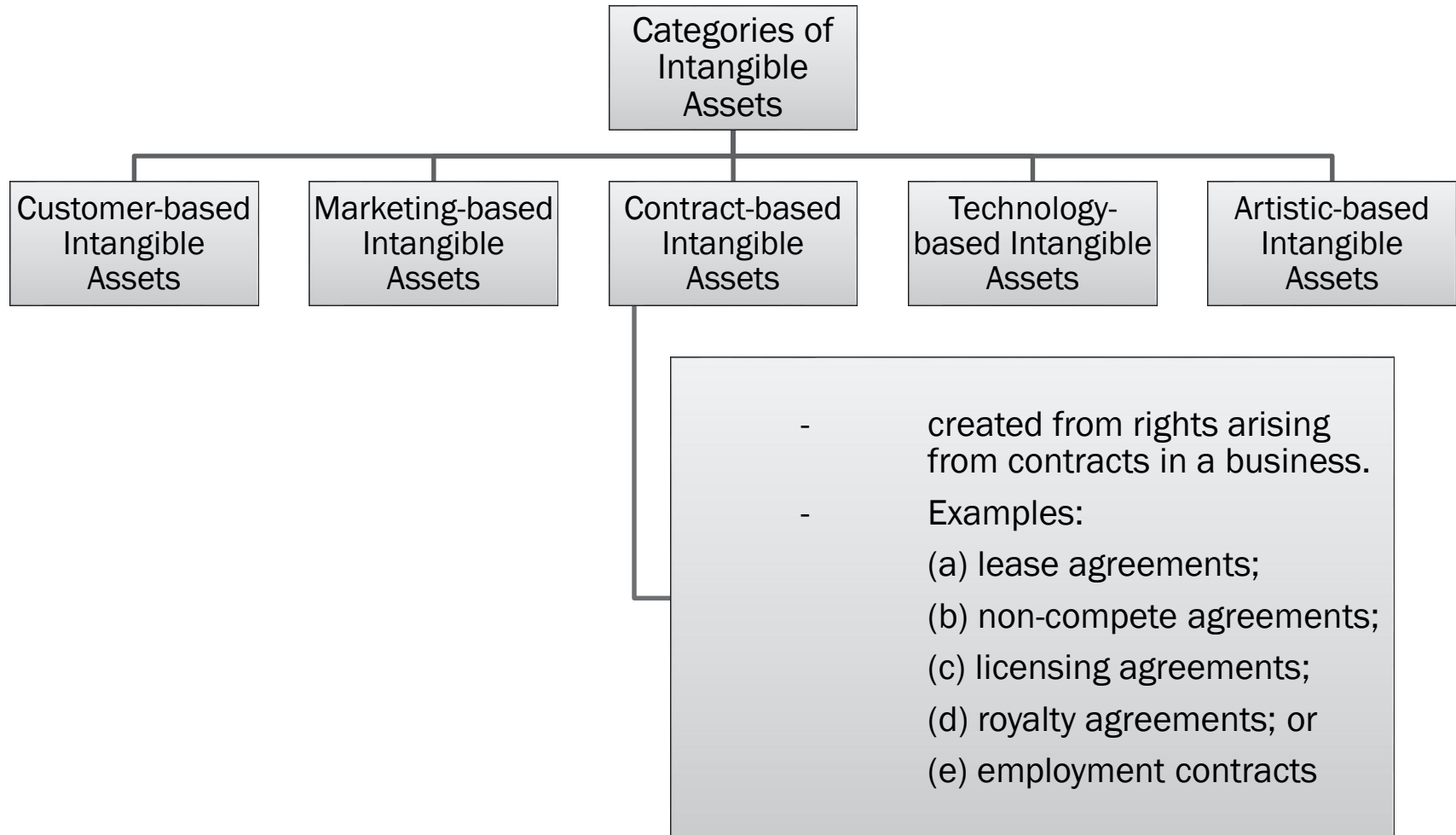
CLASSIFICATION OF INTANGIBLE ASSETS



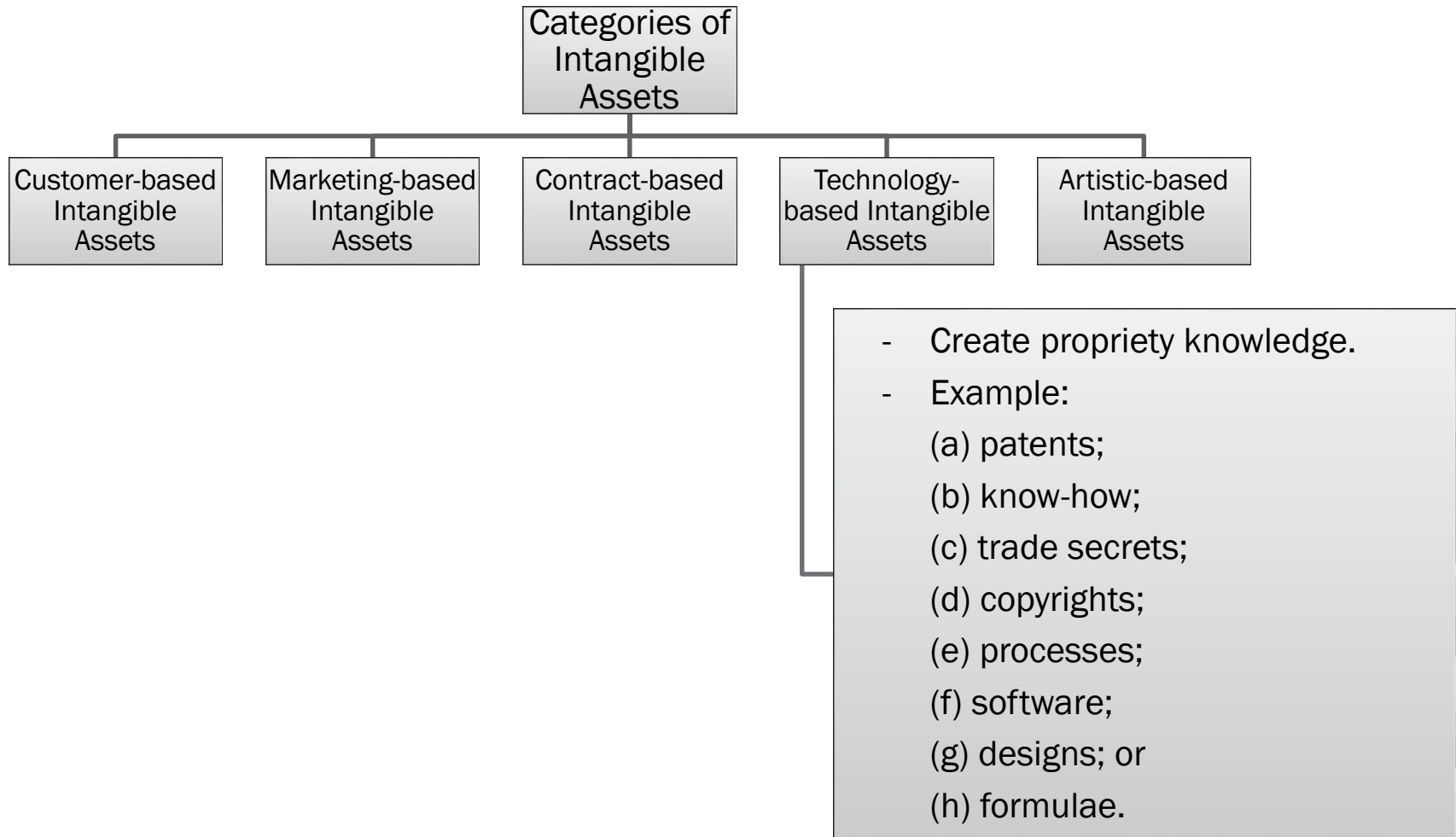
CLASSIFICATION OF INTANGIBLE ASSETS



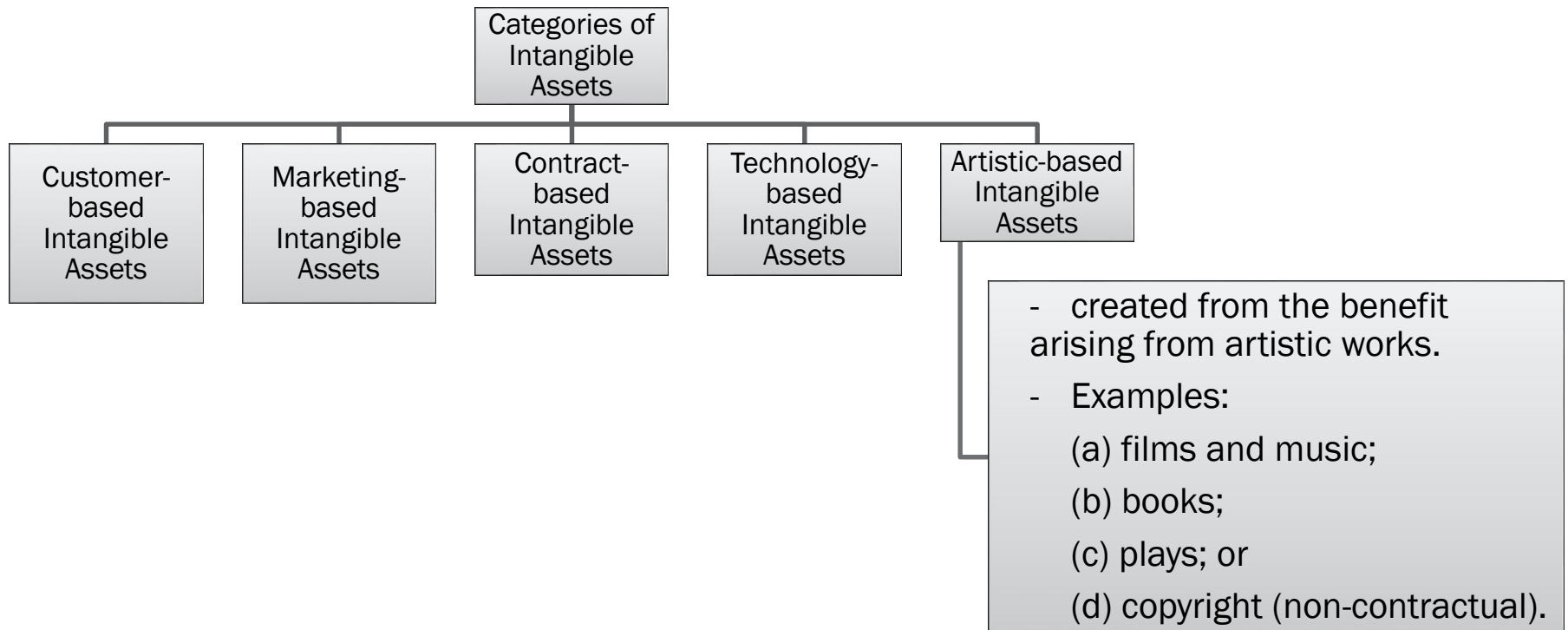
CLASSIFICATION OF INTANGIBLE ASSETS



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IDENTIFICATION OF NATURE OF INTANGIBLE ASSETS

An Intangible Asset is identifiable if it satisfies either of the following two criteria:

(A) *Is separable*, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so;

or

(B) *Arises from contractual or other legal rights*, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

PURPOSE OF INTANGIBLES VALUATION

Financial Reporting

- Purchase price allocation
- Fair valuation of intangible assets acquired in course of an acquisition
- Impairment testing

Taxation Support

- Transfer of intangible asset to related party (Transfer pricing)
- Estate or gift planning

Financing Support

- For the purpose of providing the asset as collateral

Transaction Support

- Determination of fair value for purpose of sale or purchase of such asset.
- Determining the licensing terms with respect to such asset.

Dispute Resolution

- Infringement
- Bankruptcy/ Insolvency and Bankruptcy code
- Marital and family dissolution

VALUATION APPROACHES

Three Broad
Approaches

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graph TD; A[Three Broad Approaches] --> B[Market Approach]; A --> C[Cost Approach]; A --> D[Income Approach];
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Market
Approach

Cost
Approach

Income
Approach

MARKET APPROACH

- ❖ Market Approach is an approach that uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities or a group of assets and liabilities, such as a business.
- ❖ Methodologies for the market approach is as under:
 - (A) Price/valuation multiples/capitalization rates;
 - (B) Guideline pricing method.
- ❖ **Price/valuation multiple/capitalization rates:**
 - Certain multiples/capitalization rates are used to arrive at the valuation of a comparable intangible asset. The multiples shall be adjusted appropriately to factor in any differences between the intangible asset to be valued and comparable intangible asset.
- ❖ **Guideline pricing method:**
 - Considers the price paid in an orderly transaction for a comparable intangible asset (called as the guideline intangible asset which is similar to the intangible asset to be valued).

COST APPROACH

- ❖ Approach that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
- ❖ Valuation methods under the Cost approach are:
 - (A) Reproduction cost method;
 - (B) Replacement cost method
- ❖ **Reproduction Cost Method:**
 - Valuing an asset based on the cost that a market participant shall have to incur to recreate a replica of the asset to be valued, adjusted for obsolescence.
- ❖ **Replacement Cost Method:**
 - Valuing an asset based on the cost that a market participant shall have to incur to recreate an asset with substantially the same utility (comparable utility) as that of the asset to be valued, adjusted for obsolescence.

INCOME APPROACH

- ❖ Income approach is the valuation approach that converts maintainable or future amounts (e.g., Cash flows or income and expenses) to a single current (i.e. Discounted or capitalised) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

- ❖ Valuation methods under the Income approach are:
 - (A) Relief-From-Royalty-Method;
 - (B) Multi-Period excess earnings method (MEEM);
 - (C) With-And-Without method or premium profit method;
 - (D) Greenfield method; and
 - (E) Distributor method

CONTD..

❖ Relief-From-Royalty-Method:

- Under Relief-From-Royalty-Method, the value of an intangible asset is determined by estimating the value of total costs saved that would have otherwise been paid by the user as royalty payments, if had been taken on lease from another part.
- Alternatively, it could also indicate the value of an intangible asset that could have fetched cash flows in the form of royalty payments, had it been leased to a third party. Any associated costs expected to be incurred by the licensee needs to be adjusted from the forecasted revenues.
- Following are the major steps in the RFR method:
 - (A) Obtain the projected income statement associated with the intangible asset to be valued over the remaining useful life of the said asset.
 - (B) Analyse the projected income statement and its underlying assumptions to assess the reasonableness.
 - (C) Select the appropriate royalty rate based on market-based royalty rates for similar intangible assets.

CONTD. (RFR METHOD)..

(D) Apply the selected royalty rate to the future income attributable to the said asset.

(E) Use the appropriate marginal tax rate or such other appropriate tax rate to arrive at an after-tax royalty savings.

(F) Discount the after-tax royalty savings to arrive at the present value using an appropriate discount rate: the value of the intangible asset to be valued is the present value of the after-tax cash flows so computed by using an appropriate risk-adjusted discount rate.

(G) Tax amortization benefit (TAB), if appropriate considering nature of the asset and purpose of the engagement, should be added to the overall value of the intangible asset.

CONTD. INCOME APPROACH

❖ Multi-Period excess earnings method (MEEM):

- The MEEM is used to value an intangible asset which is the primary intangible asset of the business.
- Under this method, the value of an intangible asset is equal to the present value of the incremental after-tax cash flows ('Excess earnings') attributable to the intangible asset to be valued over its remaining useful life.
- Following are the major steps in deriving a value using the MEEM :
 - (a) Obtain the projections for the entity or the combined as set group over the remaining useful life of the said intangible asset to be valued from the client or the target to determine the future after-tax cash flows expected to be generated;
 - (B) Analyse the projections and its underlying assumptions to assess the reasonableness of the Cash flows;

CONTD. MEEM

(C) Contributory asset charges (CAC) or economic rents to be reduced from the total net after-tax cash flows projected for the entity/combined asset group to obtain the incremental after-tax cash flows attributable to the intangible asset to be valued;

(D) The CAC represent the charges for the use of an asset or group of assets (e.g., Working Capital, fixed assets, assembled workforce, other intangibles) based on their respective fair values and should be considered for all assets, excluding goodwill, that contribute to the realization of cash flows for the intangible asset to be valued;

(E) Discount the incremental after-tax cash flows attributable to the intangible asset to be valued to arrive at the present value using an appropriate discount rate; and

(F) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

CONTD. INCOME APPROACH.

❖ *With-And-Without method or premium profit method:*

- Under this method, the value of the intangible asset to be valued is equal to the present value of the difference between the projected cash flows over the remaining useful life of the asset under the following two scenarios :
 - (a) Business with all assets in place including the intangible asset to be valued; and
 - (b) Business with all assets in place except the intangible asset to be valued.

❖ *Greenfield method:*

The following are the major steps in deriving a value using the Greenfield method:

- (A) Prepare cash flow projections with the premise that the intangible is the only asset in the business;
- (B) Project the related revenues, expenses, working capital and capital;

CONTD. INCOME APPROACH

(C) Project the amount and timing of expenditure relating to acquisition, creation or rentals of other assets required by the intangible asset to be valued;

(D) Compute the present value of the net cash flows using an appropriate discount rate; and

(E) Tax amortisation benefit (TAB) can be appropriately built and added to the overall value of the intangible asset.

❖ *Distributor method:*

This is a variation of MEEM and is adopted for valuation of customer-based intangible assets when MEEM is applied to value another intangible asset.

The following are the major steps in deriving a value using the distributor method:

(A) Prepare revenue and expenses projections of existing customers relationships along with relevant attrition;

(B) Determine profit margins of distributors who are comparable to the subject business and apply the same to the cash flows projected;

CONTD. INCOME APPROACH

- (C) Determine the support of distributor contributory assets like working capital, fixed assets, workforce, etc;
- (D) Determine excess earnings after considering the contributory asset charges;
- (E) Compute the present value of cash flows using an appropriate discount rate; and
- (F) Calculate tax amortisation benefit, if appropriate and applicable, and add it to the value of the intangible asset to be valued.



THANK YOU!

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