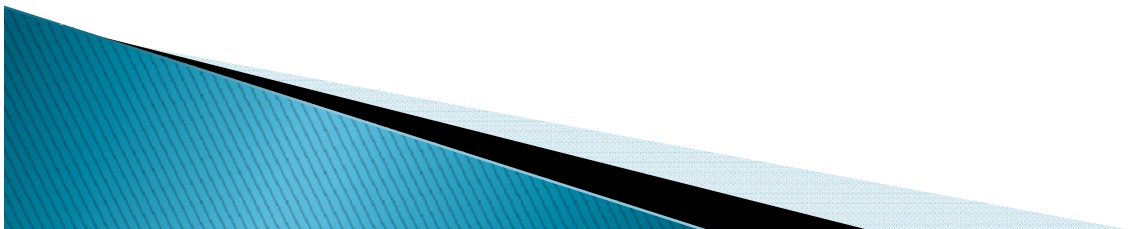


Overlapping Cash Flows for Intangible Assets (Dual Primary Assets)

March 17, 2010



Definitions

Primary Asset

- ▶ The asset that enables the entity to generate the cash flows

Dual Primary Assets

- ▶ When there are multiple enabling assets (typically intangible) that generate the subject cash flows, with no single primary asset.

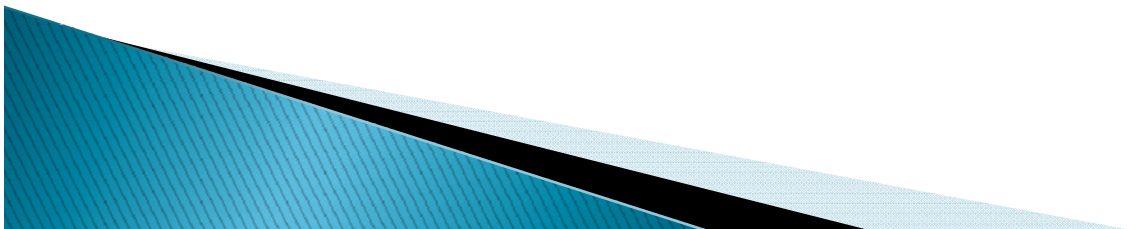
Multi-Period Excess Earnings Method – MPEEM

- ▶ A cash flow analysis estimating the value of the asset over time utilizing a CAC

Contributory Asset Charge – CAC

Relief from Royalty – RFR

Prospective Financial Information – PFI



Sources

The Appraisal Foundation

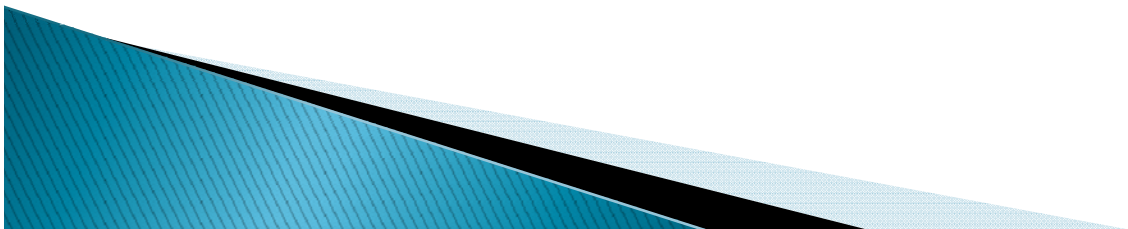
- ▶ The Identification of Contributory Assets and the Calculation of Economic Rents – Exposure Draft / February 25, 2009

Dual Primary Asset Valuation – ASA Advanced BV Conference

- ▶ October 20, 2009 – Presented by Renton Squires – PwC

Dual Primary Asset Valuation – ASA BV 302 (vetting session)

- ▶ September 2009 – Essentially the same as above



The Appraisal Foundation

423 3.5.06 The Working Group strongly believes that the use of simultaneous application of the MPEEM to
424 two intangible assets should be avoided when possible. The best method for avoiding overlapping
425 revenues/cash flows would be to “revenue/cash flow split” the PFI related to the two subject intangible
426 assets such that their analyses are mutually exclusive. In such a case neither subject intangible asset
427 should be charged for the other.

428 3.5.07 When it is not possible to revenue/cash flow split the PFI, the Working Group believes that the
429 next best alternative is to value one subject intangible asset using the MPEEM and the other asset using
430 an alternative method (e.g., relief from royalty, cost approach, Greenfield method). In this case, the
431 asset valued using the MPEEM would be charged for the other asset to the extent that the other asset is
432 contributory or to the extent that the other asset’s value is derived from overlapping revenues/cash
433 flows.

443 3.5.09 The Working Group believes that application of simultaneous cross charges results in more than
444 one solution to MPEEM calculations, rendering them inappropriate for use in estimating fair value.



The Appraisal Foundation, Best Practices for Valuations in Financial Reporting
The Identification of Contributory Assets and the Calculation of Economic Rents
EXPOSURE DRAFT – February 25, 2009

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Valuation Methodology

MPEEM

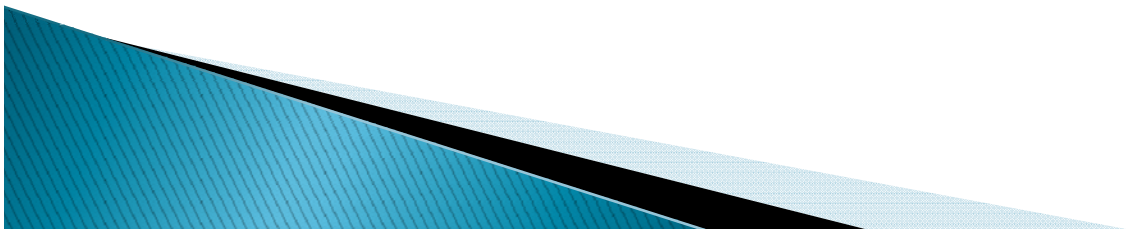
- ▶ This is the primary valuation method for a primary asset.

Assets that are often valued using MPEEM

- ▶ Technology
- ▶ Customer Relationships
- ▶ Distributor Relationships

If not possible to split the PFI – alternative methods are:

- ▶ RFR
- ▶ With and without – also referred to as the Greenfield Method
- ▶ Cost Approach

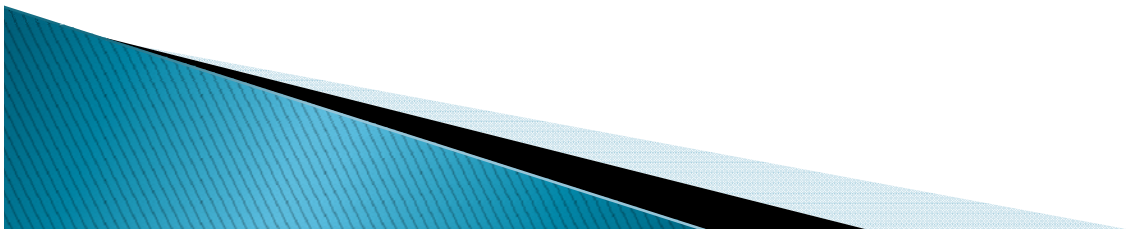


Simultaneous MPEEM

If possible, the preferred method is to split the PFI so that the cash flows used to value the primary assets do not overlap

If unable to split the PFI – valuation professionals typically use one for the following Dual Excess Earnings Methods

- ▶ Hierarchy Method
- ▶ Cross-Charge Method
- ▶ Partial Separation Method
- ▶ Separation Method



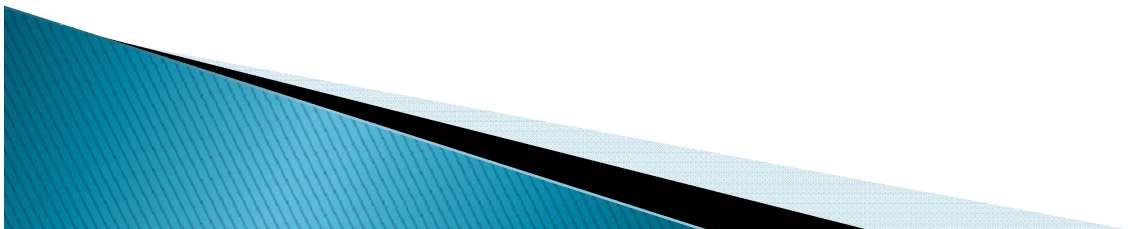
Hierarchy Method

Based on the assumption there is a hierarchy between the two primary assets and the valuation professional must determine which is the first primary asset and which is the second primary asset

- ▶ Calculate your CAC
- ▶ The first primary asset is not charged for use of the second primary asset
- ▶ The second primary asset is charged for the use of the first primary asset
- ▶ Perform MPEEM for each asset

Primary Disadvantage

- ▶ Does not split the PFI and thus, high chance of double counting PFI
- ▶ Does not include a CAC for the primary asset (but does include a CAC for the secondary primary asset)
- ▶ Harder to audit cash flows



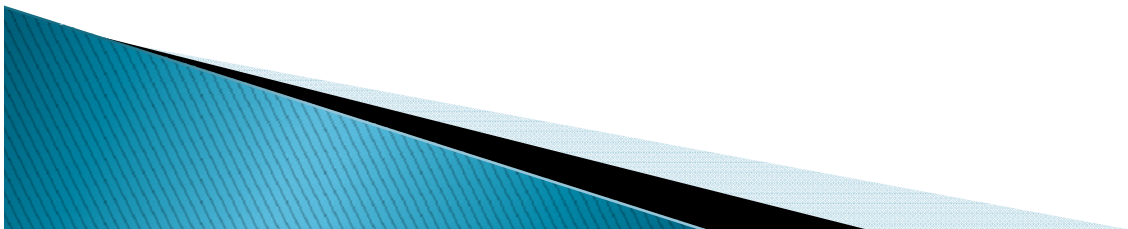
Cross Charge Method

Does not distinguish between the dual primary intangible assets

- ▶ Calculate your CAC
- ▶ The first primary asset is charged for use of the second primary asset
- ▶ The second primary asset is charged for use of the first primary asset
- ▶ Perform MPEEM for each asset

Primary Disadvantage

- ▶ Requires circular calculations to yield CAC on the two primary assets
- ▶ There is complete overlap of the PFI
- ▶ More challenging to use with primary assets with different useful lives
- ▶ Harder to audit cash flows

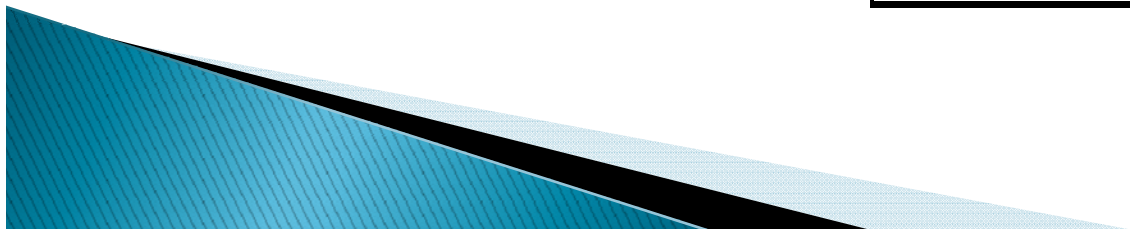


Partial Separation Method

This method separates some of the profits and cash flows of the dual primary assets

- ▶ Separate the PFI into applicable segments
- ▶ Value each segment separately
- ▶ Allocate and sum the various values to the applicable asset

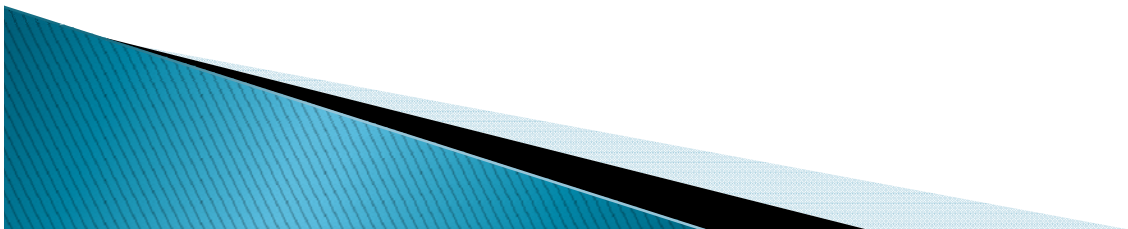
		Technology	
		Existing	Future
Customers	Existing	MEEM on Existing Technology on both Existing and Future Customers, Take CAC for CR	MEEM on Customer, add back CR CAC from Technology MEEM
	Future		



Separation Method

Valuation of each segment

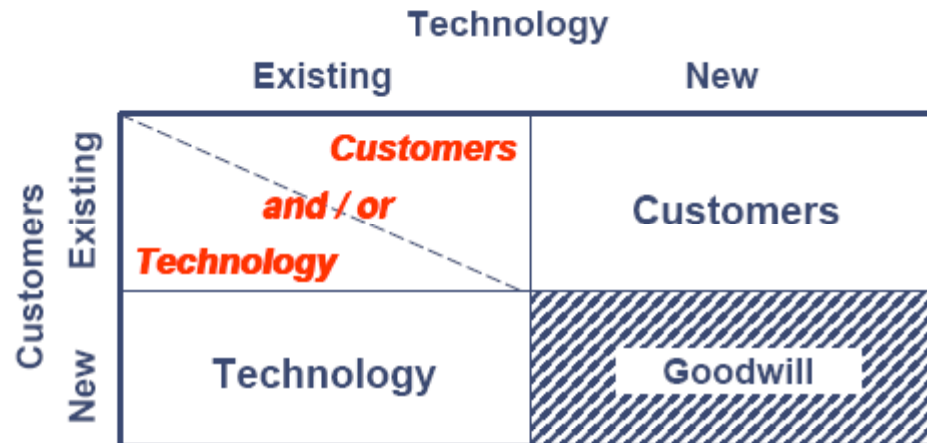
- ▶ Apply a MPEEP to the Existing Technology to Existing and Future Customers PFI
 - ▶ Uses a CAC for the use of the Customer Relationships
 - ▶ This value is attributed to Technology Value
- ▶ Apply a MPEEP to the Future Technology to Existing Customers PFI
 - ▶ This value is attributed to Customer Relations Value
- ▶ Add to the PV of the CAC taken form the Technology valuation
 - ▶ This value is attributed to Customer Relations Value



Separation Method

Separates profits and cash flows of the dual primary assets and avoids double counting of cash flows

- ▶ Separate the PFI into applicable segments
- ▶ Value each segment separately
- ▶ Allocate and sum the various values to the applicable asset



Separation Method

Valuation of each segment

- ▶ Apply a MPEEP to the Existing Technology to Future Customers PFI
 - ▶ Apply a RFR method but back solve to yield the implied royalty rate to yield the above MPEEP result
 - ▶ This value is attributed to Technology Value
- ▶ Apply a MPEEP to the Future Technology to Existing Customers PFI
 - ▶ This value is attributed to Customer Relations Value
- ▶ Apply a MPEEM on the Existing Technology to Existing Customers PFI
 - ▶ Uses a CAC based on the implied technology RFR rate
 - ▶ This value is attributed to Customer Relations Value
- ▶ Use a RFR on the Existing Technology to Existing Customers PFI
 - ▶ This value is attributed to Technology Value

