Valuation Considerations Involving Intangible Assets

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Some of the most complex litigation is related to damages associated with intangible assets. This litigation involves the necessity to establish the damage first and then to quantify the amount of the loss. Add to that the element of assets that cannot be seen or touched and the task for the jury is daunting.

A key element of the litigation is retaining valuation experts who understand the nature of intangible assets and are qualified to value the assets. Generally the assets must be valued just prior to the damage event and again subsequent to the damage event. Generally, the difference is the loss in value caused by the damage event. Loss of value is often the most significant element of total damages.

Valuation Methods

There are several methods of valuing intangible assets. Some are highly complex and others are basic and easy to understand. As in all litigation matters, the ultimate user of the information is either a jury or a judge. Selection of the appropriate methodology is driven to some degree by the ability of the trier of fact to understand the methodology. Methodology is also limited to available information. For example, one method that is generally used to value intangible assets is essentially a market approach whereby transactions for similar assets are reviewed to determine appropriate multiples. However, in a damages case the asset has been impaired and it is nearly impossible to find similar transactions for impaired assets.

The primary approach to valuing intangibles is an earnings-based approach that involves reviewing historic and projected cash flows generated by the intangible asset. Projected cash flows are prepared in this context under two scenarios. The first scenario is under the assumption that the damage event did not take place. Usually historic trends are used to project future performance but for the damage event taking place. The result is compared to projections of cash flow given that the damaging event has taken place. The present value of the difference between the two projections is the amount of the damages as it easily translates into a loss of cash flow and a loss of value. The cash flow difference is used to quantify the damages if it is a temporary loss. If the damage is permanent, then the cash flow difference is converted to a single value as a loss in value. Either way, the basis of the damage calculation is cash flow.

A similar approach is the royalty avoidance calculation. This approach contemplates what the cost to the business would be if they had to acquire the intellectual property from an outsider. To determine the value of the intellectual property for damage calculations under this method the appraiser must project future sales directly and indirectly associated and dependent on the asset, determine an appropriate royalty rate, and determine an appropriate present value discount factor.

Regardless of the methodology, an expert will be needed that understands the importance of assumptions that are made, the need to develop a reasonable and rational conclusion, and ultimately has the ability to explain complex concepts in a way that a trier of fact can understand and even replicate the calculations.

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