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Intangible insolvencies

During the good times, brands, patents, copyrights, software and other intellectual property rights get valued for transactions, legal disputes and assisting management in their development. That's all changing and businesses need to know their IP value.

Key Points

- ▶ The value of IPR
- ▶ The difficulties of valuation
- ▶ The risks of Dutch auctions

Recent events have triggered a new class of professional to consider the value of IPR; business recovery and insolvency practitioners (IPs). We talk to Richard Yoxon, Director of Intangible Business, the brand valuation consultancy who says that while valuers have had to adapt, the step-change has perhaps been even greater for some IPs who have had get to grips with new-fangled IPR-driven businesses.

Talking the lingo

"Language has been the first challenge," says Yoxon. "A surprising number of insolvency practitioners, SME owners and their finance directors often talk about goodwill as if on a pre-FRS 3 basis (effective from December 31, 1998) whereby goodwill is defined as the enterprise value less the net tangible asset value."

The modern definition includes separately identifiable intangible assets in the net asset value when deriving goodwill. This difference does not stem from a lack of understanding of accounting standards but from the lack of expertise to value individual intangibles and cost constraints which necessitate a simplified approach. However, this leads to some confusion and some ingrained misconceptions regarding goodwill and intangible assets.

Some believe that if a business is bust then the IPRs can not be worth anything. This same spurious logic doesn't apply to plant, property and machinery. This view in part stems from a dated understanding of goodwill. Even under the old definition, the goodwill value of a distressed business is often zero but this does not mean that the IPRs have no material value. Yoxon says that most practitioners are somewhat more enlightened.

Like selling on eBay without a minimum bid

"A more common view amongst IPs is that the IPRs are only worth what someone will pay for them – market value, a discount on fair market value (FMV) due to timescale, distressed sale and limited available information. This may be valid with regards to fixed assets and IPRs in CVLs (Creditors Voluntary Liquidations) and compulsory liquidations.

The ongoing maintenance, storage and depreciation costs of stock, property and machinery assets justifies this fire-sale approach. In comparison, the ongoing costs and value decay are not as elevated for many IPRs, providing scope to carry out a more comprehensive sales process to maximise recoverable value. Furthermore, because an auction-type process is used, bidders tend to make low offers which are likely to be accepted unless the insolvency practitioner has a full appreciation of FMV."

Extra cost of a specialist valuer

When selling a fixed asset, the IPs, asset disposal specialists and potential acquirers can reference active markets for such assets, the price new, technical specifications and the remaining useful life on which to base the minimum bid or offer. "Often sold as seen, the lack of knowledge regarding the condition of the asset results in a reduction on FMV. In the case of IPRs which are unique and not actively traded, even less information is readily available resulting in bigger discounts on FMV. By taking a considered approach to understanding and explaining the contribution that the IPR can make to prospective purchasers, a higher disposal value can be realised," says Yoxon.

Market driven valuations of IPRs less clear cut

Many viable businesses become insolvent through no fault of their own, perhaps due to withdrawal of finance or loss of a significant customer. In such situations a pre-pack may be recommended as value is preserved by maintaining business continuity and negating the damage to reputation from a public administration process while maximising the amount recovered.

"This motivation for carrying out a pre-pack by default means that there has to be some intangible value. If there isn't any value attributable to intangibles, the only benefit of the pre-pack over liquidation is to safe-guard jobs while undermining the purchase consideration and the IP's integrity.

The introduction of SIP 16 and the threat of litigation helps ensure that pre-packs are carried out in a transparent manner but a market driven approach to valuing goodwill and IPRs still creates a window for errors and potential abuse," says Yoxon.