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## Valuing Your Intangible Assets

Intangible assets are increasingly important in today's service-based economy, but being able to identify and value those assets in order to insure them can be difficult.

**What Are Intangible Assets?**
Intangible assets are, at their most basic level, assets that are not physical in nature. Intangible assets include legally protected intellectual property—patents, trademarks, copyrights and trade secrets—as well as software, databases, customer relationships, workforce, websites and many more. Intellectual property and intangible assets can be used synonymously.

**Five Ways to Value Intangible Assets**
There are five modern approaches to valuing intangible assets. The types of intangible assets differ from business sector to business sector, which can sometimes make it difficult to place a value on an asset that is unique to a particular company. To maximise accuracy, it is wise to use more than one method to determine the value of an intangible asset.

**1. Cost Approach**
The Cost Approach is based on the economic principle of substitution. Basically, an asset is worth no more than it would cost a buyer to develop or obtain that asset or something similar. The cost of replacing or producing an asset may be problematic if the asset is unique. The Cost Approach ignores any future economic benefit the asset may have. For example, the Cost Approach would not be able to determine a value for an unregistered patent since it could lead to future revenue.

There are two Cost Approach methods: Reproduction Cost and Replacement Cost. *Reproduction Cost* measures how much it would cost to reproduce the exact same asset, taking into account its current market value. *Replacement Cost* measures the cost to replace an asset of similar utility.

Example:

| Cost Approach – Reproduction Cost Method | | |
|---|---|---|
| | Historic Cost | Current Cost |
| Data development | £8,000 | £0 |
| Labour/research costs | £5,000 | £7,000 |
| Technology Development | £3,000 | £1,500 |
| Legal fees | £1,000 | £5,000 |
| Other | £6,000 | £12,000 |
| **Totals** | **£23,000** | **£25,500** |

**2. Income Approach**
The Income Approach estimates future income from an intangible asset, minus the asset's current value, to determine a present value.

The asset's owner must predict three things to determine an asset's value:

1. Future income stream
2. Number of years the income stream will continue
3. Risk(s) associated with the income stream, such as obsolescence or market/industry risks

A discount rate is applied to the present value to account for the risks involved in future revenue earned from the asset.

The equation to find out the asset's value is:

Future company revenue x
Portion of the revenue attributable to the asset (%) x
# of years of future use x
Discount rate =
**Asset Value**

Example:

| | |
|---|---|
| Future company revenue | £50M |
| Portion attributable to asset | 15% |
| Years of future use | 5 |
| Discount rate (1 - %) | 15% |
| | **VALUE = £31.9M** |

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### 3. Market Approach

The Market Approach uses an asset's current market value to determine its value. Assets that are unique to a specific company may be difficult to value under this approach since there might not be a market for them. The Market Approach is a preferred method when applicable because of its straightforward methodology.

Example:

| Sale # | Terms |
|---|---|
| 1 | £15M |
| 2 | £12M |
| 3 | £10M (£4M now, £3M over next two years) |
| 4 | £15M |
| 5 | £13.6M |
| 6 | £12M (£3M for four years) |
| | **Market Value: £10M-15M** |

### 4. Relief from Royalty Approach

The Relief from Royalty Approach determines an asset's value by what the owner of the asset would pay in royalties if he or she did not own the asset and had to licence it from a third party. Determining the correct royalty rate for the asset is essential to calculating the most accurate value for the intangible asset. The Relief from Royalty Approach takes market value and potential revenue into consideration, making it a hybrid of the Market Approach and Income Approach.

Example (use the same equation as the Income Approach):

| | |
|---|---|
| Annual sales | £5M |
| Royalty rate | 10% |
| Remaining life | 5 years |
| Discount rate | 18% |
| | **Net Present Value = 2.05M** |

### 5. Technology Factor Approach

The Technology Factor Approach is applicable only to technology, but is becoming more and more popular with the digitalisation of so many intangible assets. This approach measures the contribution of technology to the total revenue of a business, assigning it a "Technology Factor." The Technology Factor is calculated by establishing an upper limit for the utility provided by the technology, and then performing an analysis to determine what competitive advantages or disadvantages the technology provides. Once determined, the utility and competitive results are averaged to arrive at the final Technology Factor. Then, the Technology Factor is multiplied by the projected net present value of the technology to arrive at the technology's current value.

Example:

| Upper Limit for Technology: 70 | | | Calculation formula: |
|---|---|---|---|
| Weight | Attribute | Score | |
| 2 | Stage of the technology | +2 | (Upper limit x (weight x score)) = attribute factor<br>Sum of attribute factors/sum of weights = Technology factor |
| 1 | Similar technologies? | -2 | |
| 1 | Market size | +1 | 70 x (2 x 1) = 140<br>70 x (1 x .0) = 0<br>70 x (1 x .75) = 52.5 |
| **Technology Factor: (140 + 0 + 52.5) / 4 = 48.125** | | | |

### Why Value Intangible Assets?

It is important to value your intangible assets not only if you purchase another company or sell your own, but also to determine how much insurance to buy to protect those assets.

Intellectual property insurance can protect a company from costs associated with copyright, trademark or patent infringement claims and help a company enforce its intellectual property by pursuing infringing third parties.

Your intangible assets should also be protected against various cyber risks. Data that is lost or stolen, including customer credit card numbers, lead lists or personal data could significantly hurt your company's reputation, lead to loss of sales and revenue or potentially destroy your business.

### We Can Help Protect Your Assets

In today's world, intangible assets are an enormous part of nearly every company. Contact **Crendon Insurance Brokers Ltd** today. We have the tools necessary to ensure you have the proper cover to protect your intangible assets against many types of risk.

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