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Why it pays to seek out the true value of intangibles

BUSINESS

Most valuations shine a light on fixed assets but fail to put a realistic price on patents, trademarks, copyright and data.

By Tyler Capson•25 November 2022•6 minute read

The popular reality show Storage Wars is a television twist on the old saying, "One man's trash is another man's treasure."

The premise is straightforward but wonderfully entertaining. A group of bidders stand outside a repossessed storage container, the doors are opened and the bidders compete to guess the value of the contents based only on what they can see – with the help of a torch.

It's a great visual metaphor for our broken modern accounting system. Obviously, the treasure hunters on the show probably know what they're looking for as they peer into the gloom. But the same is not true for the people involved in the typical due diligence process. While they try their best, valuers often lack the right tools to assess a company's intangible assets – which is where the real value lies.

As the television show so aptly displays, you can't simply shine a flashlight into a company. That will only highlight the objects that cast the biggest shadow, things like fixed assets and cash holdings. Correctly valuing a company requires pulling on the rubber gloves, peeling away the dusty covers and systematically picking up every piece on the pile.

Of course, that's easier said than done. Like the abandoned lockers on Storage Wars, many corporations have been cooking in the sun for so long that few even remember how the whole puzzle fits together. Companies get split into different units, knowledgeable people leave, documents are mislabelled and crucial customer data remains unwashed for years.

Nevertheless, unpacking a company's intangible assets is the only way to apply a fair value that represents all the time, effort and imagination. It's important to get this right because roughly 90 per cent of the total value of an average company these days is wrapped up in its intangible assets.

So, how does the Storage Wars problem occur when trying to value a company's assets?

The typical process of due diligence focuses on locating and describing a company's tangible assets (property, plant and equipment) as a starting point. Then the valuers calculate how much revenue the business might reasonably be expected to earn during a given time window. But that's about it. After this process, a sale price is then presented to the business owner and, generally, the sale is made

This is shining a torch from outside the storage locker. Intangible assets can't be felt or touched in the same way as cash and fixed assets, so they are easily overlooked in a valuation. Not counting the intangible assets is like refusing to put price tags on each box inside the container, and instead selling the entire thing as a bundle – just like on Storage Wars.

This discrepancy is magnified when considering the purchase price allocation (PPA), a process used to assign a fair value to all assets and liabilities owned by a company. Even if valuers include intangible assets like patent or trademarks in their estimation, most of the time these figures only land on the tally sheet at cost. The remainder end up in a big bucket called “goodwill”, which must be evaluated every year and checked for impairment.

Of course, every company thinks it is special. But the thing is, that hunch might actually be correct. However, they will only know the exact level of their specialness after picking apart their storage locker by deploying annual audits of their intangible assets and then writing strategies to maximise the value and minimise the risk of those assets.

If they perform this daunting valuation process correctly, identifying intangible assets can be highly lucrative for the buyer, but also for the seller.

For example, an Australian software provider asked us to value their assets during negotiations with a California-based buyer. The Californian firm was hoping to acquire the target company for 3-4x annual revenue.

Yet, after performing a full audit and valuation of the company's intangible assets, there was enough evidence to increase the selling price for our Australian client to almost 8x revenue. The buyer wasn't too happy to see this higher number but after walking their executives through the detailed list of intangibles and their associated values, they agreed to a final price of 7.4x revenue.

All it required was ditching the dim flashlights and getting stuck into the dusty contents of the company's storage box to identify all its intangibles including patents, trademarks, copyright, data, software, trade secrets, know-how and much more. By doing this, we helped uncover just how special the company really was.

Whether you have a fantastic piece of technology or are hoping to pull the trigger on that long-awaited exit, performing a proper due diligence assessment that considers intangible assets could be the difference between setting off a bidding war or selling your storage locker for well under its true value.

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