Hilco Appraisal Services
Business Asset Valuation Services

Newsletter
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Intangible Assets and Valuation Issues in the Current Market

Recently, Financier Worldwide Magazine interviewed Jason Frank, Managing Director at Hilco Enterprise Valuation Services, and Gabe Fried, CEO of HilcoStreambank, about valuation of intangible assets and issues in the current market.

FW: In your view, how important is intellectual property (IP) to companies around the world? To what extent can a strong IP portfolio boost the value of a potential investment or acquisition?

Frank: IP plays an increasingly significant role in corporate transactions, both on the buy and sell side. While there have been very significant transactions recently, such as the acquisition of Motorola Mobility by Google and the structure by which GM divested itself of the Saab assets, there are hundreds of smaller deals in which IP plays a significant role. Beyond legally protected intangibles, such as patents and trademarks, the value of an assembled workforce is evident in recent Silicon Valley transactions known by the term 'acqu-hire', where the buyer has no intention of commercializing the target's product but just wants to redeploy the engineering team. Additionally, global free trade has made global patent protection extremely valuable, and we are seeing the value of that in the current multijurisdictional litigation between Apple and Samsung over patents and trade dress. A strong IP portfolio is a clear differentiator because the assets are, by definition, unique. With respect to value in particular, there are numerous companies currently losing market share in the smart phone market with very little hope of a turnaround and whose stock values are being propped up by the market's belief that they will be acquired for their IP.

FW: What is the current market for IP being sold in the context of a going concern healthy or distressed company? Who is selling? Who is buying? And why?

Fried: Because IP tends to play a core strategic role, there are very few 'healthy' company sales of the IP on a standalone basis. Usually, 'healthy' companies look to monetize their IP through licensing strategies to third parties versus straight out sales. However, there have been a few exceptions including the recent sale from AOL to Microsoft and Facebook of a portfolio of patents that were deemed non-core. In instances where industries have very rapid innovation cycles, these transactions are more likely. We would expect the consumer electronics and personal computing sectors to start engaging in more patent dispositions of non-core assets because they are increasingly under pressure to reduce costs, streamline their product base and improve their balance sheets. Polaroid sold significant non-core IP assets during its transition away from an operating company. Kodak is currently engaged in the same process as part of a reorganization. HP is continuously marketing non-core IP as well. Buyers in these cases are either looking for an enhanced defense, a trading card for a future cross-licensing deal or litigation settlement, and occasionally a new commercial opportunity.

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Hilco Serves Grocers' Real Estate Needs

Hilco provides a broad range of services covering grocer-related real estate, including valuation, advisory, lease mitigation and leased & owned property disposition. Grocers typically lease their retail real estate, and, as a result, significant leasehold assets and/or liabilities may exist.

From a pure real estate perspective, a leasehold is considered an asset when the contract rent under the lease is measurably lower than the current market rent for that location. Conversely, a leasehold is a liability if the contract rent is comparably greater than the current market rent. The valuation of the asset or liability is calculated by discounting the difference between contact and market rent during the remaining lease term, and potentially option terms, to a present value. Hilco's vast expertise includes developing strategies to maximize leasehold value or minimize leasehold liability through restructuring/renegotiation, termination, subleasing or assignment efforts. The goal being to minimize occupancy costs, while optimizing potential lendable value among a portfolio of leaseholds.

HIlco's real estate professionals have unmatched valuation, advisory, restructuring and disposition experience in the supermarket arena. We have successfully completed engagements on behalf of A&P, Tops Markets (Ahold), Stop & Shop (Ahold) , BI-LO/ Bruno's, Bashas', Raley's, Planet Organic/Mrs. Green's, Balducci's, Kroger, Food Lion (Delhaize), Penn Traffic (Tops Markets LLC), Winn-Dixie and Kings Supermarkets, among others. Over the years, we have restructured or disposed of close to 35,000 leases.

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How might an East Coast port strike impact my borrower and collateral?

The longshoremen's contract originally set to expire at the end of September has been extended for 90 days and is now set to expire December 29th. There has been recent progress in negotiations regarding the dispute between shipping companies and dock workers at ports from Maine to Texas. A key issue in the dispute is overtime rules and royalty payments to longshoremen based on container weight. Those representing the shippers say the longshoremen are taking advantage of overtime rules. The longshoremen's union disputes this and counter by saying a small percentage of their membership are being singled out.

If the union were to go on strike it would force cargo to be re-routed and could cause economic pain across the country. Some retailers have already begun re-routing ships in anticipation of a possible strike.

The bottom line is if the ports close added mileage means added costs and additional time. The biggest risk factor is goods not arriving as planned and the negative impact that would have on sales. In the case of consumer or retail products past experience has shown that in order to "save the season" and ensure the goods are in the warehouse or on the retail shelves at the proper time companies must adjust and begin air freighting more goods or stocking them earlier than usual, but all contingency plans come at the expense of gross margin. The longer any stoppage or slowdown lasted the deeper the impact will be felt. The last major longshoreman port shutdown was in 2002, it last beyond 100 days and estimates are that it cost the US economy $15 billion.

Hilco Profiles

Todd Haney
President, Valuations Services

Todd Haney, MAI, has been President /CEO of Hilco Real Estate's Valuation Group since 1999. Over his career, Todd has managed hundreds of valuation and consulting assignments involving a broad range of property types throughout North America, and in Europe, Asia and Australia. Properties appraised, including some valued at more than $500 million for a single asset, include traditional industrial, retail, office and multi-family residential properties, as well as complex properties evincing environmental concerns, historical status, easements, etc. He has also been involved in proposed project feasibility and economic analysis, portfolio valuation, assessment appeals and litigation.

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John R. Tinnell, Jr.
SVP & Relationship Manager

John Tinnell joined Hilco in 2010 as Senior Vice President and Relationship Manager covering the Southeast and Texas. Prior to joining Hilco, John was Vice President, Business Development, at CIT and was previously with First Factors and Bank of America.

John represents Hilco's broad range of services, including tangible and intangible asset appraisal, enterprise valuation, and specialty practices such as real estate, FAS valuation and litigation support. He also provides existing and prospective clients with access to the entirety of the Hilco global business platform, including acquisition and disposition services, corporate finance, real estate services, debt workout advisory and retail consulting.

In his spare time, John enjoys snowboarding, surfing, and mountain biking. John attended Duke University and is an active member of the CFA, TMA, and ACG.

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FW: Are there any particular industry segments where IP represents a material strategic importance?

Frank: Any sector that has rapid innovation cycles and where patented features and benefits are used as selling points – for instance in technology, telecommunications and consumer electronics – will have material strategic IP value. Additionally, sectors such as pharmaceuticals and medical devices that have enormous fixed and very low marginal cost structures benefit tremendously from patent protection. Beyond patents, in the consumer and retail arena, brand values have increased tremendously over the last several decades as the other operational aspects of the businesses including design, sourcing, and distribution have all become commoditized and outsourcable.

FW: What types of sales approaches are used to sell IP assets? Do they differ from selling companies or other asset classes?

Fried: IP assets are, by definition, unique. There is no 'Blue Book' or other reference for historical valuation, which significantly differs when selling companies or other asset classes. To conduct an IP sales approach, one should first conduct a comprehensive asset review to fully understand the asset, and then analyse the asset value to be able to articulate the strategic value.

Once value is determined, a marketplace reality check should be conducted to identify the target market. Lastly, one should define a pathway to liquidity to determine the ultimate sales structure and to market the IP asset to drive demand. Patents that have litigation value with known or suspected infringers have to market very carefully. Acknowledgement of the existence of a patent by a potential infringer may expose that entity to treble damages in US courts. Patent sales therefore frequently take place through intermediaries such as outside counsel or under the cover of very strong confidentiality agreements.

FW: Could you outline the process of identifying and conducting an assessment of the strategic and monetary value of IP assets?

Frank: Fundamentally, all IP assets entitle the rights holder to exclude others from the market. Therefore the key drivers of value are the size of the market and the profits expected from serving that market. Understanding market size is very important because markets are frequently understood as 'solutions to a problem' and there may be many approaches to take. Other important drivers also include: current use of the IP assets, potential future use as well, customer recognition, global reach, age and timeliness. Finally one should determine if the IP assets have the proper legal protection, as well as if the assets have been, or are currently, infringed upon.

FW: Can you explain some of the strategies that can be used to maximize the value of IP?

Fried: If the IP is going to remain in place, value maximization can come in several forms. Companies can borrow against the value of the IP to make further investments, can license the IP out to third parties to enhance cash flow and market share, and can reorganize around core IP to alter the business model. If the IP is going to be monetized separately, there are a number of mechanisms available to enhance the value. All of these strategies begin with understand the use cases for the IP assets and modeling each of these to understand the highest value. In the case of brands, for example, the use cases can include licensing, access to new markets for an operating company, brand diffusion, and even the use case where a buyer pays to keep the brand on the sidelines. For patents, the infringement litigation/licensing value has become increasingly popular and this has also spawned a cottage industry in idelines. For patents, the infringement litigation/licensing value has become increasingly popular and this has also spawned a cottage industry in defensive patent aggregation. Understanding the use cases for licensing as well as production will help identify the highest and best uses and therefore the path to achieving the highest value. In the case of both patents and brands, as with whole enterprises, the transparency and timing of the sale process will also influence value.

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FW: Which factors provide consumer brands with the greatest financial value to lenders and strategic buyers?

Fried: Extensibility into new categories and territories is incredibly important. Companies looking either for growth or access to new customers are increasingly looking to adjacent product brands or retail nameplates to increase market share. In many cases these add-ons are less expensive and provide a higher return on investment than continued reinvestment in existing brands.

FW: Which sectors have seen their IP assets most adversely affected by the global slowdown, and why?

Frank: With the most depressed consumer confidence and spending levels since the Great Recession, IP in the consumer product and retail segments have been adversely affected. Many companies in these segments have experience decreased sales and margin compression. However, these depressed values have created significant opportunity for well positioned strategic and financial acquirers looking to pick up strong brands and other IP assets to facilitate product growth or geographic expansion.

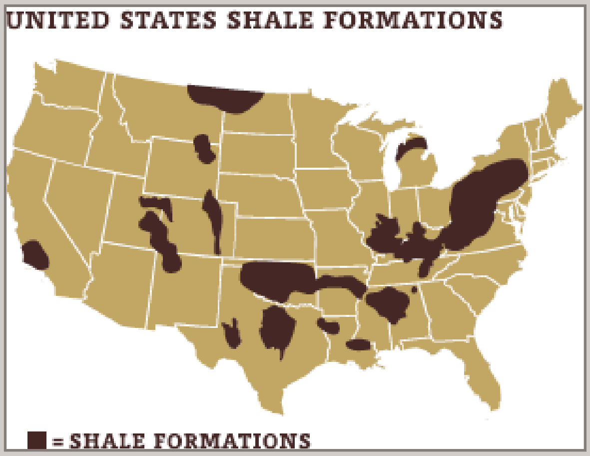
America's Golden Age of Energy

One of the most exciting topics in energy markets over the past several years has been the discovery of immense reserves of natural gas and oil within shale formations in the continental United States. Not only has this significantly driven down the price of natural gas , but also has allowed for potential relocation of energy intensive manufacturing industries to the United States.These industries range from large billion dollar petrochemical concerns to smaller operations such as glass and pottery plants and greenhouses. Additionally suppliers such as steel pipe and tube producers have added significant capacity to meet the needs of exploration and production companies.

Major shale plays are located in the Mountain West, the South and the Northeast Appalachian Basin and are delineated as follows:

- Marcellus – Estimated as the world's largest natural gas field with reserves approximating 410 trillion cubic feet, it spans New York, Pennsylvania, Ohio and Maryland. It's strategic importance lies in its location, which is densely populated and near a concentration of heavy industry that is energy intensive.
- Utica- This play contains both oil and gas reserves and is located underneath the Marcellus. Its geographic footprint partially duplicates the Marcelllus though with extensions into Kentucky and Ontario. Gas reserve estimates are 15 trillion cubic feet and oil estimates are 5. 5 billion barrels. This play as with the Marcelllus is advantaged in its location near a large local customer base.
- Eagle Ford – Located in southwest Texas this combined oil and gas play has an estimated 20.8 trillion cubic feet of gas and 3.3 billion barrels of oil. Situated near large petrochemical, pipeline and refinery complexes makes it very economical due to low transportation costs.
- Haynesville- Located in east Texas, southwest Arkansas and western Louisiana, this gas only play is estimated to contain 251 trillion cubic feet of gas.
- Barnett – Located in north Texas, this gas only play has an estimated 43.4 trillion cubic feet of gas. Like Eagle Ford, its location allows for easy transport to existing pipeline and petrochemical facilities.
- Bakken – Located in Montana and North Dakota, this oil only play contains 4.3 billion barrels of oil, the largest oil find in US history. This find made North Dakota the 4th largest oil producing state in the nation and added almost $1 billion a year to state revenues.

Natural gas prices, which were as high as $13.10 MMBTU in 2008 now hover around $2.75 MMBTU. These new discoveries could provide the US with an estimated 200 year supply of a clean domestic fuel greatly reducing our dependence on foreign oil and lessening the need for coal for power generation.



Upcoming Sales & Auctions

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Eliminate Uncertainty

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