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Maximizing the Value of Intangible Assets in Insolvency and Liquidation

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As more and more companies' transition from a business strategy focused on physical assets to a strategy centered on the utilization and exploitation of their intellectual property, it is essential that financial professionals understand the unique nature of these assets and how, with a strategic approach, their value can be maximized as companies head toward insolvency and liquidation.

Lending on intellectual property gained prominence in recent years as world economies evolved from an industrial base focused on physical assets, such as property and equipment, to economies that recognize the value of intangible assets and financial instruments.

Intellectual property includes a wide spectrum of corporate assets and attributes. It can be broken down into five basic categories:

- Marketing-related: Trademarks, trade/brand names, service marks, logos and non-compete agreements
- Customer-related: Customer contracts and relationships, customer lists, databases, open purchase orders, distributors and sales routes
- Contract-based: Franchise and licensing agreements, permits and contracts and supplier contracts
- Technology-based: Process and product patents, patent applications, proprietary processes and technology, engineering drawings, technical documentation, computer software and copyrights, formulas and recipes
- Artistic-related: Musical composition, literary composition and film copyrights

In recent years, there has been heavy reliance on the intrinsic value of intangible assets in conventional loans based on the cash flow and credit quality of the borrower. However, the fear and uncertainty of current global economic conditions has resulted in an irrational rush toward piecemeal liquidation when companies find themselves in financial trouble. Sure, it seems every day we are barraged with bad news about something, but this is an important time to step back and take a deep cleansing breath. Many of those "intangible" assets taken as collateral still have value – sometimes millions – so don't arbitrarily throw them away by making a quick decision to liquidate. Monetizing intangible assets by smartly bundling them with other assets may very well be the key to full recovery. You simply have to have the right strategy to recognize and unlock the full value.

To prepare for the best outcome, start the process by fully understanding what makes or made the company successful, and begin as early as possible. If it is too late to do a detailed examination because the company is already in a fast slide toward insolvency, act quickly to play catch up. What is most important is to fully understand the relationship (or non-relationship, as the case may be) between a company's intangible assets and its investment in specialized real estate, proprietary machinery, product line dedicated inventory and accounts receivables that are otherwise uncollectable without an exit strategy that takes into consideration the needs of the company's customers. The ripple effect of acting impulsively in the face of imminent crisis by going directly to auction to dispose of the tangible assets can cost creditors millions and leave them holding other assets that have little value, no value and sometimes negative value. Sometimes, a thoughtful strategy to bundle the sale of related assets can vastly improve the outcome.

Consider a woodworking company manufacturing a variety of branded products broadly distributed to big box retailers that includes a number of unique and proprietary design features. The woodworking industry has been decimated by lower cost imports and straight liquidations of insolvent companies have been largely disastrous. But, in this example, the results of a thoughtful disposition capitalize on the unique value of all of the assets, both intangible and tangible. By bundling intangible assets such as trade names, trademarks, product drawings, bills of materials, patented and proprietary

manufacturing techniques and expertise, customer lists, customer relationships and shelf space with custom configured machinery, precut and/or product line specific work-in-process inventory, dedicated hardware, preprinted packaging materials and customer-specific accounts receivables, purchasers are not buying distressed assets, they are buying an end-to-end solution that has a projected income stream attached. This could be a solution worth millions verses the alternative of offering a bunch of disparate assets, some of which would likely be unsalable if offered for sale on a piecemeal basis.

Other real-world examples of how the proper bundling of certain tangible and intangible assets produced a significant step up in value includes a well-known distributor of sunglasses. Instead of limiting the investigation of value to simply estimating the worth of the brand value, taking a broader view and examining all of the complementary assets that contribute to brand value, helped the seller achieve maximum value. This included consideration of market recognition, customer loyalty, advertising campaigns and supplier relationships. When these intangible assets were grouped as a salable bundle, the brand was sought after by buyers and competitors. Enhancing the brand's IP value meant that potential buyers could continue to use the brand on subcontractor-manufactured sunglasses, rename lesser-known brands and use the brand for line extensions. Although the company had no manufacturing assets and few tangible assets, the company was able to obtain financing, launch new initiatives and grow sales revenue.

In the case of a global manufacturer of artificial sweetener, the brand was bundled together with its chemical formulas, technical and manufacturing expertise, FDA approvals, and all of the machinery dedicated to the production of the sweetener products. Had these assets been considered independently, their value would have been substantially diminished. By bundling these unique and specialized assets, buyers had the ability to produce products with a predictable remaining economic life and cash flow.

The key to maximizing value is developing a well-conceived and comprehensive exit strategy that explores all potential sale combinations and potential/likely purchasers. The first step in the monetization process is to create an accurate and detailed schedule of all intellectual property such as patents, trademarks, formulas and recipes and obtain copies of the all necessary documentation. Obtain customer lists, purchasing history and information on competitors. Delineate the tangible assets that have incremental value when sold in conjunction with certain intangible assets or vice versa. Familiarize yourself with the company's systems, and determine whether they will help or hurt the sale process. Collect everything needed to effectively communicate to prospects what is being purchased such as photographs and video of the production process, production reports and product samples. Specifically identify the key employees or contractors critical to successfully executing the plan, and estimate the added expense of motivating them to stay with the process until the transaction is consummated and, sometimes, until operations are up and running in foreign countries.

When lenders, equity holders, trustees, receivers and turnaround professionals partner with industry experts that have a broad view of the market potential for businesses, divisions and subsidiaries, operating plants and/or product lines sold together with the related tangible and intangibles assets, they are properly positioned to make the most of a difficult situation. Begin this process as early as possible because that is when it is easiest to obtain the information previously referenced. However, if the crisis is upon you, be prepared to move fast to explore the possibilities quickly or the window of opportunity will close.

There are always those situations where hanging tags and conducting an auction of the assets is unavoidable. But, by preparing a comprehensive exit strategy that considers the interrelationship of all of the tangible and intangible assets, sellers open the door to all the possibilities. This frequently results in substantially improving the net recovery value.

Current economic conditions have caused a lot of distress replacing “irrational exuberance” with irrational fear. With thoughtful preparation and execution, matters that appear bleak on the surface can have very positive outcomes.

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