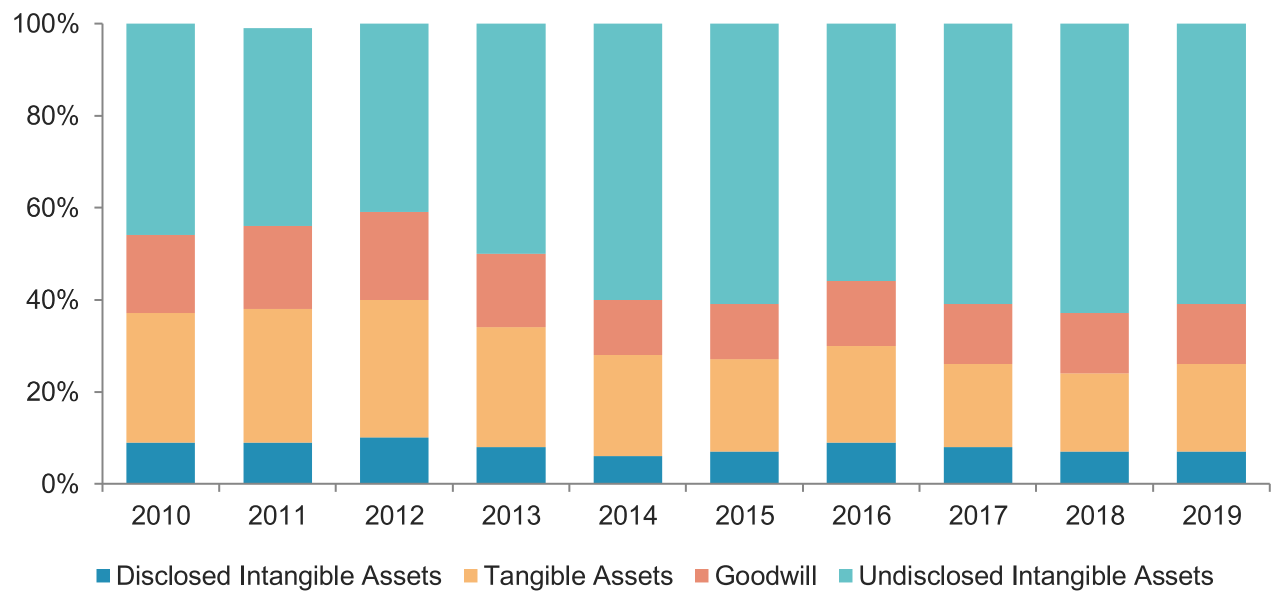
Do you know the value of your technology assets?

Valuation Advisory

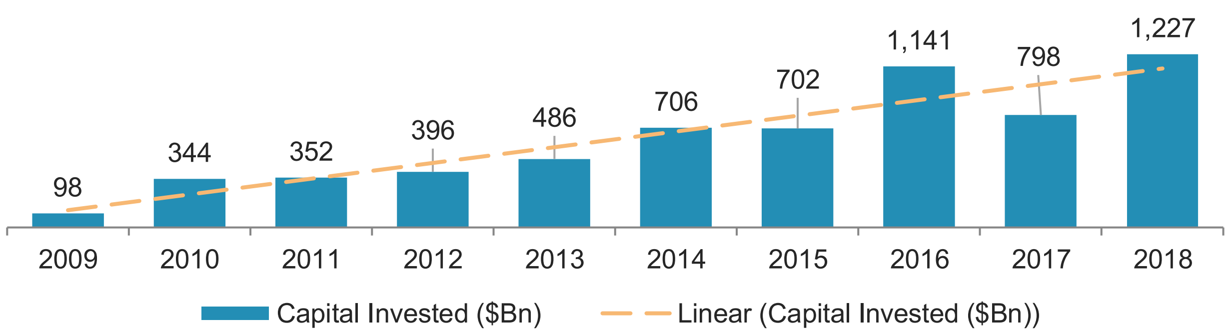
Technology assets: A critical pillar for businesses

Technology companies command a dominant share in terms of capitalization in financial markets globally. Technological advancements and a simplified transaction structure have made the online medium a major component of the lifestyle of an average consumer. From simple conversations (chat) to ordering items (stationery to DIY home), technology dominates almost every aspect of life. Social networking, online retail, banking solutions and other technology-based business models are thriving, altering the traditional brick and mortar way of life. With the new business models, the perception of business assets has also changed. Intrinsic resources such as software solutions, customer relationships and other intangibles are considered invaluable assets vis-à-vis the traditional tangible assets on the balance sheet.



Source: Thompson Reuters, Financial Statements for S&P 500

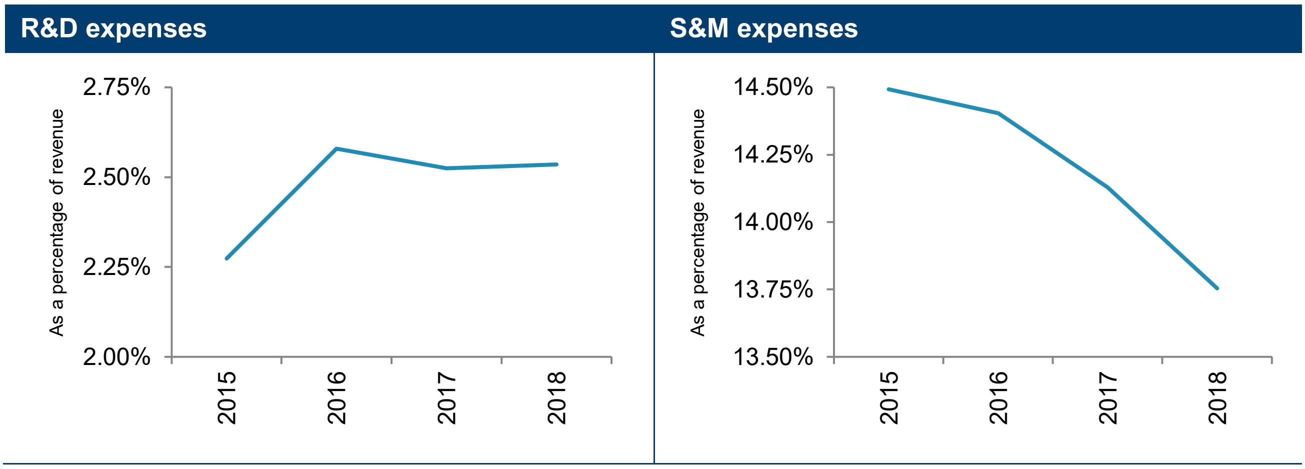
Technology startups are disrupting almost every industry. Investment in these businesses has increased significantly worldwide over the last decade. Venture capital and private equity firms alike are investing in new tech-based platforms.



Source: Pitchbook. Investments in Information Technology vertical over the last 10 years

Companies investing heavily in R&D as part of growth strategies

Businesses across the globe are cognizant of the importance of technology in ensuring efficiency of systems and processes. Expenditure on R&D has increased notably over the last few years. In most new-age businesses, technology related Research and Development (R&D) expenses outweigh Sales and Marketing (S&M) expenses, which have been the primary revenue driver in traditional business models.



Source: Thompson Reuters, Financial Statements for S&P 500, Operating expenses as a percentage of revenue

Valuation of technology assets: Critical and challenging

Business valuation plays an important role in optimal allocation of capital as well as in maintaining investor confidence capital markets (Public and Private). Valuation should yield the correct value of both, tangible and intangible assets. It is important to note that over the years, the proportion of tangible assets in market value has declined from more than 28% to below 20%. This is indicative of the growing significance of intangible assets (such as patents and technological assets) as credible sources of revenue.

Technology assets can easily be over or undervalued; therefore, it is critical to get the analysis right. Assessing the true potential of technology and other intellectual property (IP) assets provides the company superior long-term ability to compete in the market place.

Technology assets are the key drivers in investment and M&A deals. However, at times, estimating their value poses a significant challenge. Knowledge of valuation concepts supplemented with a strong understanding of the technology' monetization plan is crucial to estimate the intrinsic value of tech-based assets accurately.

Due diligence is intrinsic to valuation. M&A deals usually face challenges due to time constraints and lack of sufficient focus on technological assets that often create serious issues for the company in terms of post deal write-downs, share price volatility and value destruction. At times, despite following all processes, due diligence may fail to fully address key questions such as how core technology assets will help the company become more competitive in its market; either by increasing market share or reducing costs or mitigating risks.

Key elements of a robust valuation framework for technology assets

Valuation often requires a multi-disciplinary approach to ensure that all key components have been factored in, right from focus on technology strength to fast-evolving market dynamics and the company's business strategy.

Factors Impacting IP Value

Technological	▪ What is the nature of IP? How will protecting it add value to the business? ▪ What is the remaining useful economic life of IP? (rather than its legal life) ▪ What is the quality/ strength of IP? Is IP entirely new, or a refinement over existing IP?
Legal	▪ What are the chances of patents being invalidated? ▪ Is the patent dependent on any other patent/s (Continuation or Continuation-in-Part? ▪ Are maintenance fees and other financial transactions related to the patent executed properly?
Market	▪ What is the anticipated market response for the new technology? ▪ How large is the addressable market and what is the growth outlook? ▪ Are alternative technologies available? If so, what is their cost?
Strategy	▪ How important are the skills and experience of management for successful exploitation of IP? ▪ Which strategic factors can render IP more valuable in the hands of some potential acquirers? ▪ What is the monetization strategy – develop products and services or out-licensing?
Financial	▪ What is the capital investment required to exploit IP? ▪ What percent of market share will business driven by IP capture over the foreseeable future? ▪ What are the projected revenues and costs associated with commercialization?

IP Analysis	Market Analysis	Business Strategy & Financial Review	Valuation
What is the nature of IP? How will protecting it add value to the business?	How attractive is the market opportunity from monetization perspective?	What market share can be expected in the foreseeable future? What risks are involved in monetization plan?	How much excess economic profits can be expected? What is the overall business value and IP value?

- **IP Analysis** – Research must be conducted to understand the application of IP and its involvement in the end product. Apt questions must be asked to get the demand analysis right:
  - *Does the technology provide a viable solution for any major pain point, Does it address an unmet need etc?*
  - *What are the geographical markets that seem most viable targets in the light of overall industry dynamics?*
  - *What is the commercialization life cycle and other market drivers that need to be reviewed to rightly predict the future market scenario?*

  The technological landscape of the IP should be assessed, spanning evolution of the domain, detailed information on market players, level of saturation, and any new disruptive technologies that could also impact the technology value. An IP is robust if it does not have any potent invalidation or infringement risk. It is also critical to understand how it fares vis-à-vis incumbent or other alternative technologies.

- **Market Analysis** – A comprehensive overview of the market ecosystem, its size, demand-supply dynamics, key growth drivers and emerging trends is crucial. Extensive research on players and their market shares helps in analyzing shifting dynamics in the industry. Licensing of the technology and any infringement must also be taken into consideration.
- **Business Strategy and Plan Review** – Analysis under the two parameters mentioned above helps in assessing the technology's monetization potential. Resources needed to implement the business plan and their availability must be reviewed. An analysis and listing of licensees, including a comparison of similar licensing deals, may be required. All these aspects should be prudently analyzed to achieve the primary goal of developing accurate financial projections for the business.

  Valuation Analysis – Expected profitability and cash flows adjusted at an appropriate cost of capital in the light of the target's risk-reward profile must be critically reviewed. This final step would include evaluating various scenarios to assess what is the expected rate of return commensurate with the risks involved including a differentiation of the IP value from overall business value as well as identification of key drivers that have the highest impact on value.

About Aranca

Founded in 2003, Aranca is a global research & advisory services firm working with clients worldwide across financial markets, industry sectors and technology domains. Aranca brings to play the strong combination of best data and best talent to empower decision makers with intelligence and insights, enabling them to reach better business decisions. Our multi-disciplinary expertise is designed to cater to clients of all sizes across a wide spectrum, from Fortune 500 companies and financial institutions to private equity and high potential start-ups. In the MENA region, Aranca works with some of the top family groups, private equity and investment management firms with strong focus on strategic corporate and financial advisory services.

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