Glossary of IP Terms/Financial

ABATNA (Best Alternative to a Negotiated Agreement). Any negotiator should determine his or her BATNA before agreeing to any negotiated settlement. If the alternative is better, it should be pursued instead of the negotiated settlement.

Adjusted Book Value. The book value (equity) of a company after adjusting the values of assets and liabilities to reflect estimated market Values rather than depreciated tax values and removing non-operating assets and liabilities from the balance sheet.

Adjusted Earnings. The earnings of a business after adjustment for one-time or extraordinary expenses, excess owner compensation, and discretionary expenses or other expenses that are not essential for the successful ongoing operation of the business.

Amortization. The process of reducing the value of the asset by a predetermined amount each year over a period of time.

Arm's Length. A transaction in which the two parties are unrelated and dealing with each other in a market environment.

Asset Approach. A way of estimating the value of a business ownership interest using one or more methods based on the value of the Adjusted Book Value of the company.

Asset Sale. A form of acquisition whereby a selling entity agrees to sell all or certain assets and liabilities of a company to a purchaser. The corporate entity is not transferred.

Bankruptcy Code. The set of rules and laws covering a troubled company's reorganization, restructuring, or liquidation.

Base Year. The Company's current fiscal year. Since complete financial statements are not available for the current year, sales and income are projected based on the expectations of management.

Beta. Describes and measures the relative volatility of a company or a group of assets.

Blue Sky. Any intangible portion of a price above the maximum goodwill that can be reasonably supported through the application of established valuation methodology.

Book Value. The value at which an asset, whether tangible or intangible, is carried on a company's balance sheet. Book value may or may not reflect any connection with true market value.

Business Enterprise Value. The total value of a business measured as a combination of a company's cash or financial assets, plus its other tangible assets, plus the intangible assets, which in total is the business enterprise value.

Buy-in. An initial payment either in an arm's length transaction or as a term of art when dealing with transfer pricing of intangible assets.

Capital Structure. The mix of invested equity and debt financing of a business enterprise.

Capitalization Factor or Rate. Any multiple or divisor used to convert anticipated economic benefits over time into a present economic value.

Capitalizing Net Income. Determining the value of a Company by dividing annual adjusted income by the capitalization rate (required ROI).

Cash Flow. The amount by which the total cash coming into a business from all sources exceeds the total cash going out.

Cash Flow Statement. An analysis of all the changes that affect the cash account during an accounting period. These changes may be shown as either sources or uses of cash.

CPM (Comparable Profits Method). A method described by the Internal Revenue Service in its Section 482 Regulations.

Cost Sharing. The process by which two companies develop intangible assets and share their costs in proportion to the benefits they receive from those assets—a term used most often in conjunction with IRS-based valuations.

CUT (Comparable Uncontrolled Transaction). Another IRS methodology for valuation that depends on identifying other market sales, licenses, etc.

Deal Structure. The combination of types of payment by which the purchase of a business is accomplished. It can include cash, notes, stock, consulting agreements, earnout provisions, and covenants not to compete. The sale can take the form of an asset sale or a stock sale. See those definitions.

Definition of Value. The process by which a specific term of value (e.g., fair market value) is used as a basis for the valuation project.

Delaware Holding Company (DHC). As the term implies, a company specifically set up in Delaware that owns the intellectual property of a corporation, licenses the use of that intellectual property back to the various operating units within a company, and receives royalties in exchange.

Discount Rate. That percentage by which the value of money declines each year. Critical in valuations and used to arrive at a net present value of a future stream of income.

Discounted Cash Flow (DCF). Results from using the discount rate and applying it to a future steam of income.

Discretionary Earnings. Earnings of a business enterprise prior to these expenses:
• Income taxes
• Non-operating income & expenses
• Non-recurring income & expenses
• Depreciation and amortization
• Interest expense or income
• A single owner's total compensation and
benefits.

Earnout. The portion of the purchase price that is contingent on future performance of the business. It is payable to the sellers after certain predefined levels of sales or income are achieved in the year(s) after acquisition.

Enterprise Value. The total value of the stock of the business, plus the face value of all interest-bearing debt owed by the business.

Fair Market Value. Similar terms include market value, true value, and fair value. The following is the most appropriate definition of fair market value: The value of an asset when two unrelated persons come together for the purpose of exchanging or buying an asset—also known as that value at which an asset changes hands between a willing buyer and a willing seller, with neither of them being under compulsion to act and both having full knowledge of the facts.

FASB 141/142. The new accounting rules under which a company must account for the value of its intangible assets for SEC reporting purposes.

Fixed Interest Rate: An interest rate which does not fluctuate over the term of the loan.

Free Cash Flow: Cash available for distribution to owners after taxes but before the effects of financing. Calculated as net income, plus depreciation and amortization, plus interest expense, less required capital expenditures and changes in working capital.

GAAP. Generally accepted accounting principles.

Going Concern Value. The gross value of a company as an operating business. This value may exceed or be at a discount from the liquidation value. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

Goodwill. The amount by which the price paid for a company exceeds the company's estimated net worth at market value of the underlying tangible assets and liabilities. Goodwill is a result of name, reputation, customer loyalty, location, products, etc.

Income (Income Based) Approach. General way of determining the value of a business, business ownership interest, security, or intangible asset using one or more methods that calculate the present value of anticipated future income.

Intangible Assets. Those assets that cannot be fixed, touched, measured, seen, or otherwise physically quantified.

Intellectual Capital. A new term that is best described in books by Patrick Sullivan and Thomas Stewart as follows: "Intellectual capital is the measure of the true value of a company like Microsoft. It is more than the tangible assets, the company's value is in its intangible intellectual assets as well as in its ability to convert those assets into revenues." Alternatively used to describe the total of all of a company's intangible asset values and intellectual property values.

Internal Rate of Return (IRR). The rate of profitability or return on a company's investments that it uses as a standard.

Intrinsic Value. An analytical judgment of value based on the perceived characteristics inherent in the investment as distinguished from the current market price.

Investment Value. The value to a particular investor based on individual investment requirements and expectations.

Liquidation or Liquidating Value. The estimated value, net of liabilities, of a company based on the market value of its assets.

Market (Market-Based) Approach. General way of determining a value indication of a business, business ownership interest, security, intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Net Book Value. With respect to a business enterprise, the difference between total assets (net of depreciation, depletion and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flow. Cash available for distribution after taxes and after the effects of financing. Calculated as net income plus depreciation less expenditures required for working capital and capital items.

Net Present Value (NPV). Related to discounted cash flow and the discounting of a stream of income, the net present value of a stream of income is that amount of dollars received today in lieu of a stream of income over a period of, for example, ten years.

Present Value. The value today of a future payment, or stream of payments, discounted at some appropriate compound interest (discount) rate.

Profit Split Method. A valuation methodology that is based on allocating or splitting the profit among different asset classes. Also see the introduction to Part III.

Pro Forma Financial Statements. Hypothetical financial statements. Financial statements as they would appear if some event, such as increased sales or production had occurred or were to occur. Also used to make projections for future years.

Projection. Prospective financial statements which present an entity's expected financial position, results of operation and changes in financial position, based upon one or more hypothetical assumptions.

Recasting. Financial recasting eliminates from the historical financial presentation, items such as excessive and discretionary expenses and nonrecurring revenues and expenses, since they reflect the financing decision of the current owner and may not represent financing preferences of a new owner. Recasting provides an economic view of the company, and allows meaningful comparisons with other investment opportunities.

Recast Book Value. See also Adjusted Book Value. The value of a balance sheet item(s) (asset, liability, or equity) after recasting adjustments have been made.

Residual Value. The estimated market value of an asset at the end of the period being considered.

Return on Investment (ROI): The rate of return at which the sum of the discounted future cash flows plus the discounted future residual value equals the initial cash outlay.

Risk Premium. That amount of implied interest that needs to be added to a company's discount rate to reflect the fact that intangible assets typically have higher risk and more volatility than most classes of tangible assets.

Return on Assets, Return on Income, Return on Assets Employed. These three terms (ROA, ROI, and ROAE, respectively) describe a process that calculates the amount of money that is received each year in return for the use of the assets. In other words, if an asset is worth $1,000, and each year $100 (or 10%) is received for use of that asset, then in simplest terms its return on investment or return on assets is 10%.

Stock Sale. A form of acquisition whereby all or a portion of the stock in a corporation is sold to the purchaser.

Tangible Assets. Those assets that are fixed and can be touched, measured, seen, or otherwise quantified.

Trade Secrets. Include formulas, patents, programs, techniques, etc., that have independent economic value and have been protected and kept secret. Trade secrets cannot be registered or protected under any government regulations; instead, they are protected and gain their value through the owner's diligence.

Transaction Value. Total of all consideration passed at any time between the Buyer and Seller for an ownership interest in a business enterprise and may include but is not limited to all remuneration for tangible and intangible assets such as: furniture, equipment, supplies, inventory, working capital, non-competition agreements, customer lists, employment and/or consultation agreements, franchise fees, assumed liabilities, stock options or redemptions, real estate, leases, royalties, earnouts, and future considerations.

Transfer Pricing. The process of sending an asset or the income from an asset from one related company to another Transfer pricing can occur between a parent company and a subsidiary or between two other separate but related companies.

Useful Remaining Life. In simplest terms, this describes how much longer an asset will be functionally useful in its particular market or competitive environment.

Valuation Approach. A general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods. There are three Approaches generally used to value a business: Asset Approach, Income Approach, and Market Approach.

Variable Interest Rate. An interest rate that adjusts periodically to a predefined margin above or below an index rate. A commonly used index is the bank prime rate.

Valuation Method. Within a Valuation Approach, a specific way to determine value.

Valuation Procedure. The act, manner and technique of performing the steps of an appraisal method.

WACC (Weighted Average Cost Capital). Used in developing the discounted cash flow calculations in connection with arriving at a discount rate. It is a measure of the cost of a company's total capitalization (cost of equity funds and cost of borrowed funds), which in turn becomes its discount rate for valuing future income.

Working Capital. The excess of current assets over current liabilities.