

Valuing a "bundle of rights" to use assets – a special class of intangible asset

by Alan Edwards

Agreements-based investment involves a buyer and seller entering into contracts which confer rights and obligations in the buyer's use of the seller's assets – be they tangible assets such as land and infrastructure or intangible assets such as intellectual property.

Over the last few years, Value Adviser Associates has been engaged to provide expert advice in a wide range of valuation disputes related to agreements, including:

- » Core technology licences in over 20 R&D syndicates valued around \$400M
- » 8 PPPs with a total enterprise value over \$10B
- » A non-PPP infrastructure transaction exceeding \$5B
- » More than 10 securitisation and financing agreements and managed investment schemes involving more than \$1B
- » Providing expert evidence in the Victorian Supreme Court in respect to the valuation of 'bundles of rights'

In our experience, there are some recurring characteristics of agreements-based investments which make them a different valuation proposition. For example:

- » Lack of asset ownership rights – agreements typically constitute a financial interest including rights to occupy, use, lease and manage assets. Oftentimes, the investor takes on a custodial role and is obliged to fund further development of the asset, operating costs, maintenance costs and so on over the term of the agreement. Critically, ownership rights are not transferred to the investor.

- » The use is prescribed – agreements typically prescribe the uses to which the underlying assets may be put. For example, a licence to use medical technology may limit the conditions for which drugs may be developed; or an agribusiness investment scheme may prescribe the type of crop which is to be cultivated; or an airport management agreement may stipulate that the land and infrastructure assets must only be used as an airport.
- » The only beneficial right of investors is a prescribed share of income proceeds
- » The term of agreements is medium to long term; oftentimes between 10–20 years (sometimes longer)
- » A set of agreements is substantially unique
- » In some instances, agreements-based investments confer prescribed tax benefits in the early years

What are the implications for valuation?

- » While the 'basis for valuation' may be 'market value', it is our experience that 'income capitalisation' approaches are most suitable, because:
 - » There is rarely a 'spot market' and the unique nature of the agreements (including prescribed use) make it difficult to find comparables – rendering 'sales comparison' approaches unsuitable;
 - » The intangible nature of the asset renders 'cost' approaches unsuitable
- » Discounted cash flow (DCF) analysis is likely to be preferable to direct capitalisation of income, given:
 - » Cash flows are often able to be forecast over the term of the agreements
 - » Variations over time in the cash flows makes it difficult to assess a reliable 'future maintainable earnings' figure

- » Using DCF analysis over 10-20 year timeframes gives the analyst the flexibility to model variations and uncertainties, for example:
 - » Using probabilistic modelling tools (such as Monte Carlo analysis) enables different assumptions to be applied over specific time periods, e.g. changes to the inflation or cost-of-money outlook
 - » It is possible to risk-adjust the cash flows for specific technical or commercial risks rather than building all risk factors into a discount rate, e.g. the probability of failing to pass a phase of clinical drug trials
 - » The impact on value of initial tax benefits can be isolated. This enables assessment of value in the after-market – after the tax benefit has been realised. In our experience, many agreement-based investments which include initial tax benefits become significantly less attractive (if at all) to secondary buyers. Fundamental weaknesses in the cash flow outlook can result in a relatively 'illiquid' investment.

In conclusion, it is our experience that valuing agreements-based investments demands rigorous attention to:

- » The nature of the rights and obligations of the investor to share in the income proceeds – this underpins the DCF analysis
- » The degree to which use of the asset is limited can be critical in identifying reliable comparables
- » Uncertainties in longer term cash flows increase and should be modelled appropriately
- » Investment risk which changes materially before and after the realisation of any tax benefit and impacts on discount rate over time

VAA has significant experience and capability in valuing agreements-based investments. For more information contact Alan Edwards on 03 9626 4300.

Value Adviser Associates is a specialist, independent business and securities valuation practice with offices in Melbourne, Brisbane, Adelaide and operating in Tasmania.

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