

Component: Consolidation / Goodwill and other intangible assets (IFRS 3)

Short title: Identification and valuing of intangible assets

Issue

The recently issued IFRS 3 "Business Combinations" introduced significant new guidance for the recognition and measurement of intangible assets in a business combination as part of the "purchase price allocation" exercise.

What are the typical intangible assets in a metals business that may need to be recognised in a business combination?

Solution

Intangible assets acquired in a business combination should be recognised separately if they arise from contractual or legal rights, or are separable from the business. The chart below summarises the intangible assets, most likely to be recognised in a business combination in the metals industry. Significant care must be taken in all cases to ensure that all significant intangibles are identified and valued.

The acquiring company should measure the intangible assets at fair value and may very likely require the services of professional valuers to establish the value.

Note, the following list may not be exhaustive and may not be applicable to all cases.

Marketing-related intangible assets	Description / Comments
Tradenames, trademarks and certification marks	<p>Significant value is not usually assigned to the tradenames of commodity producing companies except in cases where the company attracts additional customers, sells additional volumes compared to its competitors or extends the average length of a relationship with a customer as a result of its reputation for the high quality of its products. It may be difficult to separate the additional value created by certification of the company's products from the additional value of the tradename.</p> <p>Certification of commodity products such as ISO often enables a company to obtain premium prices for its products or access to new markets or customer groups. Any increased revenue generated by certification of a company's commodity products should therefore be attributed to a certification intangible.</p> <p>The value attributable to a metal producer's web-site is often not material from a financial reporting perspective except in cases where the entity conducts a significant percentage of its sales via the internet. In such cases a fair value would be expected to be attributed to the company's website or combined with the company's tradename intangible asset.</p>
Technology-based intangible assets	
Core technology (patented and unpatented)	<p>Metal companies often employ patented technology and/or processes at their operations. A frequent valuation issue is whether the value attributable to the patented/unpatented technology is separable from the value of the fixed assets with which it is associated. In such cases it may be better to consider if the company developed the technology itself and then used its own process knowledge to design, purchase and arrange readily available equipment into a patented manufacturing or refining process.</p>

Technology-based intangible assets (continued)	Description / Comments (continued)
Process knowledge and know-how	<p>Certain companies possess enhanced documented knowledge and understanding of how to most efficiently arrange/organize their operations to the point where they obtain significant operating advantages in either operating costs, productivity, quality etc. above and beyond the industry average.</p>
In-process research and development	<p>Many companies have research and development programmes. If such programmes have visible economic benefits at the time the company was acquired then in-process research and development intangible assets may exist.</p>
Customized computer software	<p>Customized software is often employed in various parts of the operations of metal producing companies, particularly in the finance, production, warehousing and distribution parts of the business. The fair value of any customized software used in the business is generally assessed using the cost approach unless the revenues or increased value associated with such owning customized software can be separated from the rest of the business.</p>
Mineral exploration data	<p>The results of any mineral exploration programme may have intangible value if it increases the probability of locating an economic ore body in the area under exploration. Where the results of any exploration programme are available and the company wishes to divest itself of the exploration property any potential acquirer of the property would presumably wish to acquire the results of any previous exploration on the property together with the exploration licence. It may be difficult to separate the value attributable to the exploration data and that attributable to the exploration licence.</p> <p>The ongoing consolidation of the mining industry has enabled certain entities to acquire significant regional or global exploration knowledge often in the form of databases. This enables efficient allocation of funds between their exploration programs or more accurately target prospective areas.</p>
Customer-related intangible assets	
Customer relationships and contracts	<p>One of the principal sources of value of metal producing companies are its contracts with its customers. These contracts often state minimum quantities of metals that will be provided to customers in the future. The relationship with customers is valued on consideration of the time period over which a company has traded with its customers, minimum, average and maximum levels of sales volumes with individual clients as well as prices and any discounts.</p>
Order or production backlog	<p>Metal companies may have order or production backlogs, particularly fabricated product manufacturers. The fair value associated with any order or production backlog should be assessed.</p>

Contract-based intangible assets	Description / Comments
Operating, subsurface mineral extraction and exploration	<p>Metal producing companies often have a collection of licenses/rights, other operating-related permits and use rights, operating licences and permits that enable them to operate legally. The licences and operating permits for a specific site are grouped together.</p> <p>Mineral extraction licences are classified as intangible assets under IFRS 3. Comparable transactions are often used to assign a value to the licence.</p>
Service and/or supply contracts	<p>Metal producing companies often have a collection of materials and service supply contracts that provide the operation(s) with inputs to the production process or technical expertise. The contracts are non-revenue generating, but may be not at fair value i.e. prices that are significantly higher or lower than could readily be obtained on the open market by a competitor.</p>
Lease agreements	<p>Contracts should be reviewed to consider whether the contracts are above or below open market by a competitor prices.</p>
Non-competition employee agreements	<p>The employees or management of certain companies may have highly beneficial relationships or specialist technical knowledge. Employees or management may be required to sign non-competition agreements that restrict their working for competitors. If these contracts are enforceable they are valued as intangible assets.</p>
Non-compete agreements	<p>Non-competition agreements may exist between firms with respect to certain markets or products in order to maximise their revenues or limit competition. Such agreements if written and binding or may have significant value associated with them.</p>