Greenfield Method for Valuing Intangible Assets

The Greenfield method is a modified form of discounted cash flow analysis and an acceptable method used to value certain intangible assets. By way of background, the Greenfield method assumes the subject asset is the only asset owned by the entity as of the valuation date. Assumptions are made regarding the start-up costs and capital investment required to utilize the subject asset. These assumptions are made with a view to developing an operation comparable to the one in which the subject asset is actually utilized. Thus, the Greenfield method forecasts the cash flows attributable to the subject asset by subtracting necessary investments. In this regard, the Greenfield method is sometimes referred to as the Build-Out method. The projected cash flows are then discounted back to the present value using a discount rate commensurate with the subject asset's risk.

By effectively constructing a start-up scenario, the Greenfield method excludes goodwill and going concern value. To this end, the fair value of the asset is determined directly via an income-based valuation approach.

The Greenfield method is commonly used to value assets in industries that require a government license or permit to operate. The primary example is telecommunications, namely the television and radio-broadcasting industries wherein the method is utilized to value FCC licenses. Additional examples where the application may be appropriate include other subsets of telecommunications (i.e., wireless, satellite, etc.), power generation, and franchising.

Take, for example, the valuation of an FCC license for a broadcasting company. The application of the Greenfield method involves a top down approach. The starting point for such a valuation analysis involves first projecting market revenues (i.e., in the case of an FCC license, total advertising dollars allocated to broadcasters in a particular geographic area). Second, the analyst must estimate the market share available to the owner of the FCC license.

Following a determination of market revenue and market share, the build-out of an operating infrastructure must be considered. In this regard, the company may first have to purchase or lease land. Next, fixed assets such as towers, antennae, transmitters, building and improvements, and others must be designed and constructed. The analyst must consider both the cost to acquire and construct, as well as the associated timeframe to completion.

Separate and apart from capital expenditures, it must be remembered that direct operating expenses will be incurred during the construction period. Such expenses include, but are not limited to, permits, utilities, professional fees, salaries and wages, and other fringe benefits. Such expenses will likely increase throughout the construction period as the company prepares for the initial operating phase. In addition, as the operating phase approaches, new expenses, such as selling and business development expenses, will be incurred. The analyst must use judgment and give careful consideration to guidance obtained from financial managers regarding the build-out of expenses.

As the cash flows are finalized, the analyst must carefully consider projected revenue and expense growth, as well as normalized operating margins. These variables are not static; rather, they rather vary by market influences in any given geographic area.

Given the level of subjectivity associated with the Greenfield method, an increased level of diligence is necessary. Support is required for start-up levels of income and capital charges as well as the ramp-up time to full revenue generation. Analysts should not only discuss these factors with management, but should also look to corroborate data with independent reports.

Upon determining an appropriate cash flow scenario, the discount rate to be used in the present value analysis is another area involving an increased level of subjectivity. In addition to measuring start-up related risk, it must be remembered that the Greenfield method is being used to value an asset --- not a company. Therefore, the discount rate associated with an intangible asset is often higher than that applicable to the company itself.

In summary, the Greenfield method is a viable approach for valuing license-based intangible assets. Key advantages and disadvantages of the Greenfield method are summarized below:

Key Advantages:

- Provides a theoretical model for isolating the value of a particular asset independent of the other assets utilized in the operation of a business.

- Is a widely accepted and utilized method for valuing intangible assets when business operations are dependent on owning the subject asset; in such cases, the subject asset is often referred to as an "enabling" asset.
- The method results in compliance with SEC Topic D-108, which suggests that a direct valuation method be used to value various types of license assets.[1]

Key Disadvantages:

- The inputs and assumptions required to develop cash flow forecasts are often difficult to quantify and highly subjective.
- The resultant value may not represent value in-use (i.e., the value of the asset in use as part of an ongoing business as opposed to the value of a start-up business).

MPI has significant experience valuing license-based intangible assets. Our professionals have utilized the Greenfield method in connection with the valuation of intangible assets for purchase price allocations and impairment tests, among other assignments. Please contact us if you have questions or require assistance.

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[1] A key criticism levied by SEC Topic D-108 is that the residual method should only be used to measure the value of goodwill. Correspondingly, it is suggested that direct valuation methods be used to value identifiable intangible assets.

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