

The Property Tax Valuation of Customer Intangible Assets

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Most industrial or commercial taxpayers own some type of customer-related intangible asset. This intangible asset could be a customer list, recurring customer relationships, customer contracts and expected contract renewals, or a customer base. This discussion summarizes the generally accepted approaches and methods related to the valuation of a taxpayer's customer-related intangible assets. And, this discussion presents an illustrative example of a customer intangible asset valuation prepared for property tax purposes.

INTRODUCTION

Corporate taxpayers, taxing authorities, and the legal counsel for both often have to consider the valuation of commercial intangible assets for property tax compliance, appeal, and litigation purposes. Some taxing jurisdictions tax commercial intangible assets. Many taxing jurisdictions exempt intangible assets (specifically intangible personal property) from property taxation. In such situations, the assessment of the industrial or commercial taxpayer's property often implicitly includes the value of (at least some) commercial intangible assets.

In taxing jurisdictions that exempt intangible personal property, both the taxpayer and the assessor have to ensure that the value of any intangible asset is excluded from the industrial or commercial property assessment.

Corporate taxpayers and taxing authorities (and their legal counsel) often retain specialist valuation analysts ("analysts") to identify and value any identifiable intangible assets that may be impounded in the total property assessment. These analysts (and their corporate or government clients) typically recognize that the customer-related intangible asset is the most common type of intangible personal property.

This is because just about every industrial or commercial taxpayer has recurring customer relationships. And, depending on the valuation

approach used, it is easy to capture some or all of this customer intangible asset value within the assessment of the corporate taxpayer's industrial or commercial property.

This discussion describes the components or attributes of the customer intangible asset. And, it summarizes the generally accepted valuation approaches and methods related to the customer intangible asset. The discussion lists the factors that analysts typically consider in the customer intangible asset valuation and outlines the more important elements of the customer valuation. Finally, this discussion presents an illustrative example of a customer intangible asset valuation.

For purposes of this discussion, the terms "intangible asset" and "intangible personal property" are considered to be synonymous.

Before discussing the mechanics of the intangible asset valuation, let's consider the common elements of a customer relationship. In other words, when analysts consider whether a customer intangible asset exists, what elements are they looking for? Typically, for a customer relationship to exist (and, therefore, for a customer intangible asset to exist), there is both an informational element and an expectational element to the relationship.

The informational element includes factual information about the customer. That information may include name, address, telephone number,

e-mail address, social security number, customer account number, credit card account number, Dunn and Bradstreet credit rating, insurance plan or other third-party payer information, and so forth.

The informational element may also include account information such as when the customer first purchased from the corporate taxpayer, the date of the last purchase, a current accounts receivable balance, the greatest (high credit) account receivable balance, the amount purchased last year, the greatest amount purchased in any year, the greatest amount purchased at any one time, the customer's payment record, and other account information.

It may include data related to the customer's purchase preferences, such as purchase frequency, purchase seasonality, purchase response to sales or promotions, purchase response to solicitations, purchase response to price changes, and purchase response to the introduction of new products or services.

All of this information is important and useful to the corporate taxpayer. There is a time and expense cost associated with assembling, maintaining, and using this customer account information. The taxpayer maintains this information to manage the customer relationship. That is, the information is typically used by the taxpayer to motivate the customer to continue to purchase goods or services.

The expectational element includes the taxpayer's expectation that the customer will continue to purchase consumer goods or services from the provider. Based on the customer's historical purchase activity, the taxpayer expects that the customer will continue to do business with the provider of the goods or services.

That continued business expectation translates into the taxpayer's expectation of future revenue, future income (however measured), and future cash flow. If the taxpayer continues to provide acceptable goods or services and effectively uses the customer information, then the owner/operator can expect the customer's continued patronage for some time in the future.

COMPONENTS OF THE CUSTOMER INTANGIBLE ASSET

There are numerous components to the typical customer intangible asset.

The first component is the tangible component: the actual list of customers. The customer list component may include the customer name, some type of customer identification number, and the customer contract information. Typically, this list can be printed. And, the actual customer list may represent the physical manifestation of this intangible asset.

The second component is the customer account information. These data could include the date the customer first transacted with the taxpayer, the customer's historical purchases of goods and services, the customer's current purchases of goods and services, customer credit and payment information, and information about customer preferences or proclivities.

These last data may include whether the customer responds to sales, solicitations, or other promotions. They may indicate if the customer is a preferred account (for example, the taxpayer may define such an account as a customer who purchases more than \$100,000 of goods or services per year). This component of the customer intangible asset allows the taxpayer to maintain and develop the customer relationship.

The third component is the expected future business that the taxpayer management anticipates with the customer. This expected future business is a function of the age, expected total life, and expected remaining useful life (RUL) of the customer relationship.

This expected future business is also a function of:

1. the customer's historical purchase of goods and services and
2. the taxpayer's ability to influence the customer's future purchases of goods and services.

The income (however measured) that the taxpayer management expects to generate from this future business often influences the customer relationship value.

The fourth component is called the customer base. The customer base is often considered to be the sum of the preceding three components. That is, the customer base includes the customer list, the customer information and data, and the expected future business relationships with the customers.

The customer base is usually all of the taxpayer's current customers in place as of a specified point in time. These current customer relationships are typically expected to retire (or expire) over time.

For some purposes, analysts sometimes define the customer base to include both all current customer relationships (which have a finite RUL) and

“[C]ontinued business expectation translates into the taxpayer's expectation of future revenue, future income . . . , and future cash flow.”

all expected future customer relationships (new customers that replace current customers as the current customers retire). This latter definition includes both current customer relationships and the goodwill component of future customer relationships.

TYPES OF CUSTOMER INTANGIBLE ASSETS

There are different types of customer-related intangible assets. One intangible asset is the customer list itself, which usually lists customer names, identification numbers, and addresses. Corporate taxpayers often rent or license their customer lists for noncompeting uses.

For example, a securities firm may license its client list to a publisher of magazines that target high net worth individuals, an airline may license its frequent flyer list to a car rental company, and a public television station may license its donor member list to a public radio station.

Another intangible asset is the customer database. This intangible asset includes all of the purchase, preference, credit, and payment information discussed in the preceding section. This intangible asset typically has a greater value in use than a value in exchange to the taxpayer. The taxpayer will invest in maintaining and expanding this database because it may be possible to use the database to generate future business from the customer.

Another intangible asset is the open purchase orders from the current customers: customer orders that are already placed for the taxpayer's goods or services. The taxpayer simply has to deliver the good or provide the service.

Once the taxpayer provides the good or service, the open purchase order becomes an account receivable. And, once the customer pays the account receivable, the intangible asset is converted to cash.

Another intangible asset is a customer contract. In this case, the customer has signed a contract with the taxpayer. The customer commits to purchase certain goods or services from the taxpayer over a time period, and the owner/operator commits to provide the goods or services to the customer. The time period could be less than one year, more than one year, or an unspecified (open-ended) time period.

After the current contract expires, the taxpayer management may expect the customer to renew the contract (or enter into a new contract). For example, insurance companies (both underwriters and agents) expect their insured customers to renew their insurance contracts when the current

contracts expire. This intangible asset represents the expectation of future contract renewals by the customer after the term of the current customer contract expires.

Many types of customers don't enter into contracts (or they enter into cancellable month-to-month contracts) with the taxpayer. Nonetheless, as long as the customer is satisfied, the customer continues to do business with the taxpayer. The taxpayer management expects the satisfied customer to continue to purchase goods or services from the taxpayer.

For example, primary care physicians and dentists may not have contracts with their patients, but the physicians and dentists expect the patients to continue to return to their offices whenever the patients need medical or dental care. This intangible asset is typically called the customer relationship asset.

As an aside, physicians and dentists typically also maintain a customer (patient) database intangible asset as well as a customer (patient) relationship intangible asset: patient charts and records. These records may be manual or electronic. In either case, patients typically return for their care to the physician or dentist who maintains their patient charts and records.

In the valuation of customer relationships, it may be important for the analyst to understand if the valuation subject is either a single customer or the sum of all individual customers or the assembled collection of all customer relationships. The analyst may apply different variables in the valuation of the summation of numerous individual customers versus the valuation of a mass asset of all customer relationships.

For example, revenue growth rates, profit margins, RUL, and discount rate (that is, commensurate with risk) may differ in the valuation of, for example, 1,000 individual customers compared to the single assemblage of 1,000 customer accounts.

TYPES OF CUSTOMERS

Analysts commonly categorize customers by the taxpayer's industry or profession. That is, customers are often categorized by the type of product or service they buy. Customers within the same industry or profession category show more similarities than differences.

For example, customers within the same industry or profession typically:

1. generate about the same reasonable range of profit margins for the taxpayer,

2. have the same payment terms,
3. have similar customer relationships total life estimates,
4. have (or not have) similar contractual relationships,
5. have (or not have) personal service elements to the relationship, and
6. have about the same periodic nature of purchases.

Customers of the same type are generally influenced by the same factors, generally exhibit the same consumption patterns, and are affected by the same competitive influences.

CUSTOMER INTANGIBLE ASSET VALUATION METHODS

All three generally accepted valuation approaches may be applicable to the valuation of the customer intangible asset. Both the type of customer asset and the purpose of the valuation influence which approach (or approaches) are more applicable to the subject valuation.

Analysts often use the market approach to value customer lists because there are sufficient transactional data regarding the sale or license of similar customer lists. For example, the Alpha professional organization may license its memberships list for a one-time use fee of 10 cents per name. Or, the Beta magazine publisher may sell its subscriber list for unlimited use to a book publisher for 1 dollar per name. Or, the Gamma securities company may sell its list of high net worth customers to a private jet charter firm for 100 dollars per name.

The analyst should note that these examples provide transactional data regarding the rental or sale of the use of the taxpayer's customer list. In each of these instances, the taxpayer continues to own (and commercialize) the customer relationships. That is, Alpha, Beta, and Gamma continue to own the customer relationship. They have simply licensed or sold the use of their customer lists for noncompetitive purposes. Alpha, Beta, and Gamma can continue to sell or license their customer lists over, and over, and over again.

Analysts often use the cost approach to value a customer database or related intangible asset. The analyst could estimate all of the taxpayer's time and effort involved in replacing all of the informational content of a customer database.

In particular, analysts often use the cost approach to value physician or dentist patient charts and

records or to value law firm or accounting firm client files and records. The analyst should note that this analysis estimates the informational content value of the customer, patient, or client database. This analysis does not value the business expectation value of the customer, patient, or client relationships.

Analysts often use the income approach to value customer relationships. Typically, analysts use the discounted cash flow method. That method allows for a projection of the income to be earned from the customer relationships over either the RUL of the customer relationships or the decayed total life of the customer relationships.

These two procedures generally reach about the same value conclusion. But, depending on the income growth rate and the discount rate selected in the valuation, the two value conclusions may not be the same.

To illustrate this effect, let's assume that the analyst is asked to value the client list of Delta Company. Based upon an analysis of the historical placements and retirements of customers, the analyst concluded that Delta customers turnover at the rate of about 5 percent per year.

To simplify our illustration, let's assume that the total expected life of a new client is 20 years, the average life of a new customer is 10 years, and the average age of the Delta current customer relationship is 5 years.

The analyst could estimate the income expected from the Delta customer relationships based on the average expected RUL illustrated in Figure 1.

Alternatively, the analyst could estimate the income expected from the Delta customer relationships based on the expected RUL decay curve illustrated in Figure 2.

In applying the discounted cash flow valuation method, the analyst typically applies the customer relationship income projection period that is best supported by the available data. If the data best support a single RUL life estimate, the analyst may use that estimate in the income approach analysis. If the data support the development of a RUL decay curve estimate, the analyst may use that estimate in the income approach analysis.

Regardless of the RUL estimate used, the analyst has to select an income measure commensurate with the income generated by the customer intangible asset. Some of the common income measures include the following:

1. Excess income. The total income of the taxpayer is reduced by a fair rate of return applied to all of the taxpayer's contributory assets.

Figure 1
Delta Customer Relationships
Expected Remaining Useful Life

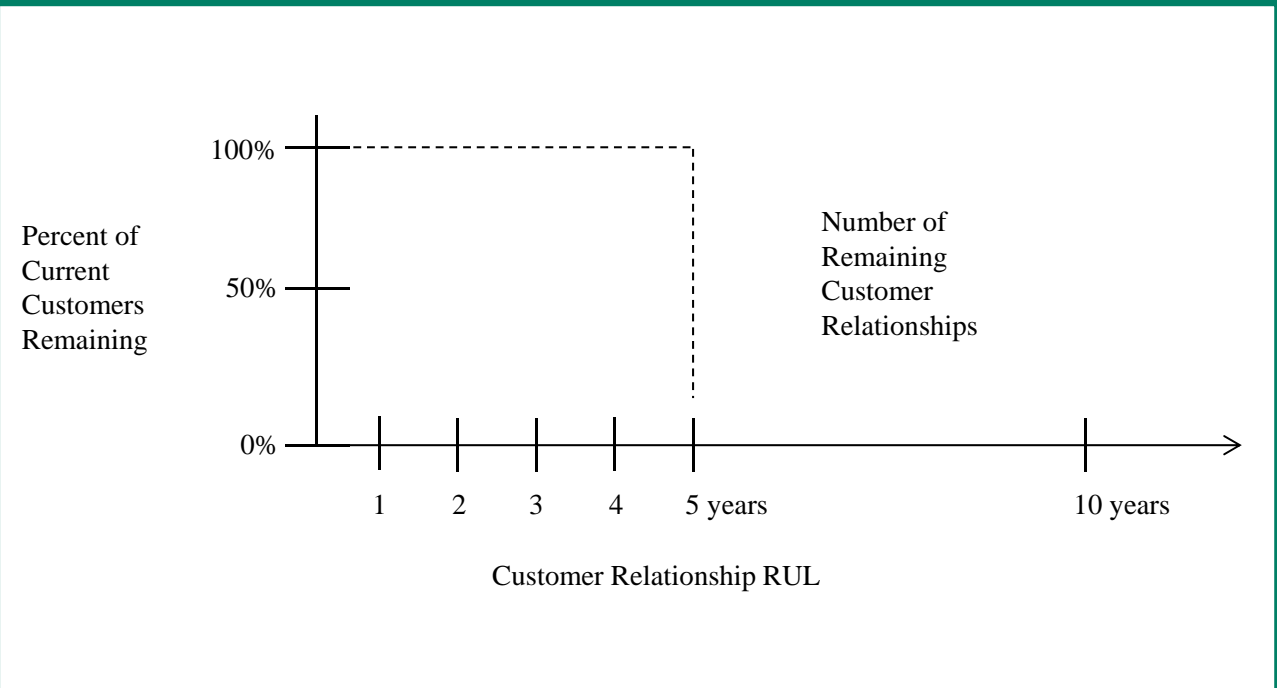
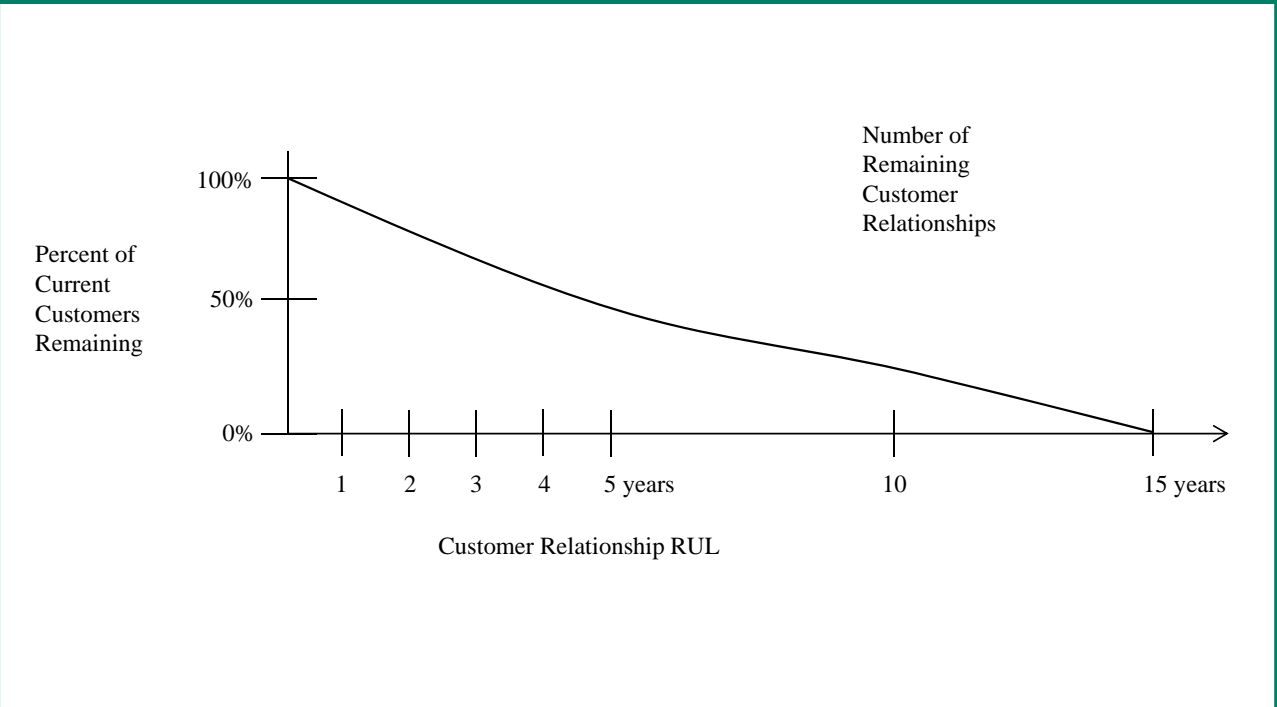


Figure 2
Delta Customer Relationships
Expected Remaining Customer Decay Curve



2. Profit split income. A percentage of the total income of the taxpayer is assigned to the customer relationships. The remaining income (not included in the analysis) is conceptually allocated to the taxpayer's contributory assets.
3. Residual profit split income. The excess income measure and the profit split measure are combined. The analyst assigns a fair return to the identifiable contributory assets. The analyst subtracts this fair return from the taxpayer's total income. The residual income is then split among the remaining intangible assets (for example, current customer relationship and goodwill) to conclude the income allocated solely to the customer intangible asset.

For each of these measurement metrics, the analyst typically uses the taxpayer's net cash flow as the starting income measure, but it is possible to use other income measures (such as net income) as the starting income measure. In such cases, the analyst should select a present value discount rate that is calculated on a basis consistent with the measure of income selected.

FACTORS TO CONSIDER IN THE CUSTOMER VALUATION

Exhibit 1 presents many of the factors that analysts typically consider in the customer intangible asset valuation.

Each of these factors has more or less importance depending on the type of customer (such as customer, patient, or client) and the type of customer intangible asset (such as customer list, database, or recurring relationships).

Elements of the Customer Analysis

In addition to the preceding factors, there are several elements of the customer intangible asset valuation that the analyst typically considers before performing any quantitative methods or procedures. For purposes of this discussion, these elements may be considered as decisions that the analyst makes before or during the valuation.

These common elements of the customer valuation are summarized as follows:

1. Does the assignment call for the valuation of the customer relationships as a stand-alone intangible asset or as a part of a going concern business enterprise? This assign-

ment element involves the highest and best use (HABU) of the intangible asset. That is, is the HABU of the intangible asset value in exchange as the transfer of an individual asset or value in use as the transfer of a going concern business entity?

2. Does the assignment call for the valuation of each customer individually? That analysis may require a separate value and RUL estimate for each individual customer. Or does the assignment call for the valuation of all customer relationships collectively? That analysis may involve a single value and RUL conclusion for the total customer relationships intangible asset.
3. Does the assignment call for any income projection to be made over the average RUL of all of the customers or over the total life decay curve of the customer relationships? As mentioned, data constraints (with regard to the customer intangible asset life characteristics) often influence the answer to this question.
4. Can the analyst identify an income measure that is specific to the customer relationships? Or does the analyst have to somehow allocate (for example, as an excess income measure or profit split measure) the taxpayer's total income to the customer intangible asset? If an income allocation is required, what income allocation methods are appropriate?
5. With or without an income allocation, has the analysis appropriately considered the impact of contributory assets in the valuation? Contributory assets are other (non-customer) tangible and intangible assets that are used in the production of the taxpayer's income.
6. If an income approach method is used in the analysis, what is the appropriate present value discount rate? Of course, the discount rate measurement should be consistent with the customer-related income measure. In addition, the discount rate measure should be consistent with the intangible asset HABU and valuation premise assumed in the analysis.
7. If an income approach method is used in the analysis, should a tax amortization benefit (TAB) adjustment be included in the analysis? Does the purpose of the analysis affect this analysis element? Do the tax implications of any assumed customer intangible asset transfer affect this analysis element?

Exhibit 1 Factors That May Influence the Customer Intangible Asset Value

1. The industry or profession in which the customer intangible asset exists
2. The ease or difficulty in the ability to transfer the customer intangible asset between owners/operators
3. The ease or difficulty of the customer to transfer its business between owners/operators
4. Whether the customer relationship is documented in a contract, agreement, or other written document
5. If the customer relationship is documented in a written document, the frequency with which that document is renewed
6. When the customer intangible asset transfers between owners/operators, whether it normally transfers with other intangible assets
7. When the customer intangible asset transfers between owners/operators, whether it normally transfers with other tangible assets
8. When the customer intangible asset transfers between owners/operators, whether it normally transfers with the personal relationship of an individual goods or services provider
9. Whether the customer relationship involves the purchase of goods or services
10. If goods, whether the customer relationship involves the purchase of manufactured goods (like tailored clothing) or processed products (like refined petroleum products)
11. If goods, whether the goods are specialized or differentiated or commodity
12. If services, whether the services are specialized or differentiated or commodity
13. The price elasticity of demand of the goods or services
14. The average price (and purchase size) of the goods or services (for example, many units purchased at low price versus few units purchased at high price)
15. The frequency at which the goods or services are purchased (for example, monthly, annually, or sporadically)
16. Growth rate in the number of customers
17. Growth rate in the customer revenue
18. Profit margin earned from the customer revenue
19. Return on investment earned from the customer revenue
20. Customer historical churn (or turnover) rate
21. The ease or difficulty for the owner/operator to replace retired customers
22. Average customer total life (of expected tenure of relationship)
23. Average customer relationship age
24. Average customer relationship expected remaining life
25. Rate at which new customers enter market (compared to rate of seasoned customers switching between owners/operators)

8. Are the current customer relationships more profitable than the average profitability level of the taxpayer? Are the current customer relationships more profitable than the taxpayer's future customer relationships? The answers to these questions may be "yes." This is because the taxpayer has to incur prospecting, qualifying, credit rating, and marketing expenses to develop a new customer. This is true for a new customer relationship developed tomorrow or a new customer relationship developed 10 years from now. These new customer expenses are not required for the current,

seasoned customer relationships, so the taxpayer's current customers are often more profitable than the taxpayer's potential new customers.

9. Does the assignment call for the analysis of the current customer relationships only, or does the assignment also call for the analysis of new—or replacement—customer relationships? Does the analyst need to provide value or other analysis conclusions for both the current customer relationships and the expected future customer relationships?

10. Do any of the preceding elements change if the customer analysis is a valuation versus other type of analysis? For example, would the analyst select a different life measurement, income allocation, discount rate, TAB adjustment, or other valuation variable depending on the type of customer intangible asset analysis?

The preceding discussion is not a comprehensive list of all elements of the intangible asset analysis. But, it is representative of the types of questions analysts may consider before performing the analysis.

CUSTOMER RELATIONSHIPS VALUATION EXAMPLE

This example illustrates the property tax valuation of the customer relationships of Epsilon Corporation (Epsilon), telecommunications company. The example summarizes:

1. the purpose and objective of the analysis,
2. the illustrative fact set,
3. the valuation analysis, and
4. the value conclusion.

Purpose and Objective of the Analysis

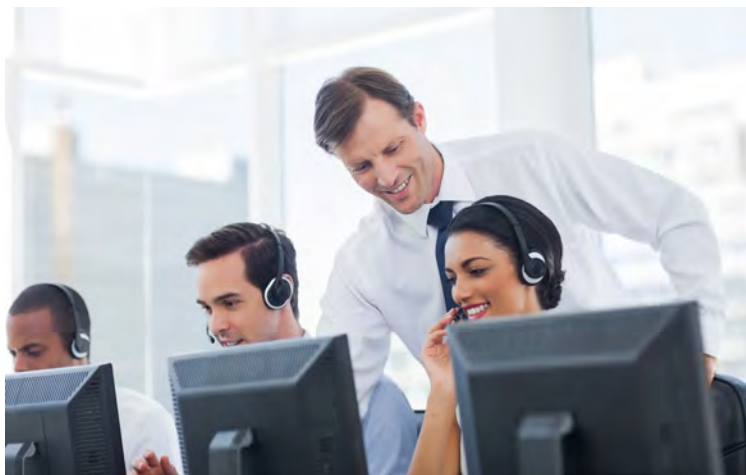
Epsilon conducts business in numerous states and is subject to ad valorem property taxation in most of those states. For property tax purposes, Epsilon is assessed based on the unit value principle. That is, the states estimate the Epsilon overall business enterprise (or unit) value.

Many states, however, exempt intangible assets from property taxation. In those states, Epsilon management has to provide evidence of the fair market value of the exempt intangible assets. Management believes that the customer relationships represent a significant intangible asset.

Accordingly, the analyst is retained to estimate the fair market value of the Epsilon customer relationships as of the January 1, 2013, property tax assessment date. The purpose of the valuation is to assist Epsilon management with its property tax compliance.

Illustrative Fact Set

As of the January 1, 2013, valuation date, Epsilon generated revenue by offering a variety of data, Internet, and voice services to three customer groups: the business market, the mass market,



and the wholesale market. Mass market customers include consumers and small businesses.

Epsilon sells its products and services to mass market customers using a variety of channels, including sales and call centers, website, telemarketing, and retail stores and kiosks. Due to space constraints, this example only illustrates the valuation of the mass market customers.

Valuation Analysis

The analyst considered all generally accepted valuation approaches with regard to the customer relationships valuation. Based on the quantity and quality of available data, the analyst valued the customer relationships using the income approach and, specifically, the multiperiod excess earnings method (MEEM).

Based on the MEEM, the fair market value of the customer relationships is estimated by calculating the present value of the net cash flow attributed to each customer group over its expected RUL.

The valuation variables the analyst used to value the mass market customer relationships include the following:

1. The RUL
2. The revenue attributable to the customers as of the valuation date
3. The expected growth rate in customer revenue
4. The customer operating costs
5. The income tax rate
6. The capital charge or return required on the contributory assets
7. The present value discount rate

The analyst estimated the RUL of the mass market customer relationships based on the historical,

Exhibit 2
Epsilon Corporation
Valuation of Customer Relationships
Churn Rates for the Mass Market Customer
As of January 1, 2013

Month	2009 Customer Attrition	2010 Customer Attrition	2011 Customer Attrition	2012 Customer Attrition
January	1.46%	2.64%	1.81%	2.22%
February	2.21%	2.36%	1.74%	2.24%
March	1.41%	2.42%	1.80%	2.42%
April	2.31%	2.53%	1.62%	2.25%
May	2.35%	2.44%	2.37%	2.05%
June	2.26%	2.34%	1.70%	1.70%
July	2.30%	1.62%	1.63%	1.54%
August	2.39%	1.52%	1.53%	1.38%
September	2.16%	1.69%	2.41%	1.23%
October	1.51%	1.98%	2.45%	1.13%
November	2.27%	1.54%	2.16%	2.02%
December	2.10%	1.76%	2.39%	1.93%
Mass Market Customer Annual Churn Rate	24.7%	24.8%	23.6%	22.1%
Average Annual Customer Churn Rate	<u>23.8%</u>			
Selected Customer Churn Rate (rounded)	<u>24%</u>			

monthly product churn rates for these customers from 2009 through 2012, as presented in Exhibit 2.

As presented in Exhibit 2, based on the annual churn data, the mass market experienced an average attrition rate of approximately 24 percent from 2009 through 2012.

As presented in Exhibit 3, Epsilon management projects the mass market to generate revenue of approximately \$4.1 billion in 2013, representing a decrease of 2.4 percent compared to 2012 revenue. Based on an annual attrition rate of 24 percent, the analyst projects the existing customer relationships to generate revenue of \$3.1 billion in 2013. After 2013, the analyst projects revenue attributable to the customer relationships to decrease annually at the 24 percent attrition rate and the projected annual growth rate.

The analyst estimated the operating costs required to generate the revenue attributable to the existing mass market customer relationships. The analyst applied the management-projected EBITDA margins and depreciation and amortization expense margins to the projected customer relationships revenue.

The analyst maintained the 2016 EBITDA margin and depreciation expense margin (as a percent of revenue) in the customer relationships valuation.

The financial projection for the mass market was based on a total market demand forecast prepared by Epsilon management and the historical income statements for the mass market business segment.

The analyst estimated a provision for income taxes at 41 percent. The analyst added depreciation and amortization expense to net income. This calculation resulted in projected net cash flow.

The analyst reduced net cash flow for contributory asset charges. To account for the taxpayer's investment in working capital, tangible assets, and other intangible assets—which are assumed to be in place and used throughout the projection period—the analyst reduced the net cash flow attributable to the customer relationships by the required return on these contributory assets.

After adjusting the cash flow projections to reflect the contributory asset charges, the analyst

Exhibit 3 Epsilon Corporation Valuation of Mass Market Customer Relationships Income Approach As of January 1, 2013

	Pro Forma Years										
	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	
	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	
Management Revenue Projection	4,088,018	4,035,750	4,014,850	4,012,963	3,972,833	3,933,105	3,893,774	3,854,836	3,816,288	3,778,125	
Annual Revenue Growth Rate Percent	-2.4%	-1.3%	-0.5%	0.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	
Estimated Customer Attrition Rate	24% [a]										
Revenue Attributable to Existing Customers	3,106,894	2,321,515	1,752,330	1,330,947	998,210	748,657	561,493	421,120	315,840	236,880	
Annual Revenue Growth Rate Percent	NA	-25.3%	-24.5%	-24.0%	-25.0%	-25.0%	-25.0%	-25.0%	-25.0%	-25.0%	
EBITDA	1,553,447	1,160,758	876,165	665,473	499,105	374,329	280,747	210,560	157,920	118,440	
EBITDA Margin	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	
Less: Depreciation/Amortization Expense	670,160	473,104	333,195	233,819	175,364	131,523	98,643	73,982	55,486	41,615	
% of Revenue	21.6%	20.4%	19.0%	17.6%	17.6%	17.6%	17.6%	17.6%	17.6%	17.6%	
EBIT	883,287	687,654	542,970	431,654	323,740	242,805	182,104	136,578	102,434	76,825	
EBIT Margin	28.4%	29.6%	31.0%	32.4%	32.4%	32.4%	32.4%	32.4%	32.4%	32.4%	
Less: Income Taxes @ 41 Percent	362,148	281,938	222,618	176,978	132,734	99,550	74,663	55,997	41,998	31,498	
Net Income	521,139	405,716	320,352	254,676	191,007	143,255	107,441	80,581	60,436	45,327	
Net Margin	16.8%	17.5%	18.3%	19.1%	19.1%	19.1%	19.1%	19.1%	19.1%	19.1%	
Plus: Depreciation/Amortization Expense	670,160	473,104	333,195	233,819	175,364	131,523	98,643	73,982	55,486	41,615	
Less: Charges for the Use of Contributory Assets:											
Working Capital Charge	30,758	22,983	17,348	13,176	9,882	7,412	5,559	4,169	3,127	2,345	
Tangible Assets Capital Charge	(747,773)	(558,205)	(420,987)	(319,494)	(239,621)	(179,715)	(134,787)	(101,090)	(75,817)	(56,863)	
Other Intangible Assets Capital Charge	(154,299)	(117,180)	(89,302)	(68,248)	(51,186)	(38,390)	(28,792)	(21,594)	(16,196)	(12,147)	
Equals: Cash Flow to Customer Relationships	319,986	226,418	160,606	113,929	85,447	64,085	48,064	36,048	27,036	20,277	
Discounting Periods	0.5000	1.5000	2.5000	3.5000	4.5000	5.5000	6.5000	7.5000	8.5000	9.5000	
Present Value Factor @ 11%	0.9492	0.8551	0.7704	0.6940	0.6252	0.5633	0.5075	0.4572	0.4119	0.3710	
Present Value of Cash Flow to Customer Relationships	303,717	193,609	123,724	79,069	53,425	36,098	24,390	16,480	11,135	7,524	
Present Value of Cash Flow to Customer Relationships	849,171										
Fair Market Value of Mass Market Customer Relationships (rounded)	<u>850,000</u>										

See notes in Exhibit 3, Page 2.

Exhibit 3, Page 2
Epsilon Corporation
Valuation of Mass Market Customer Relationships
Income Approach
As of January 1, 2013
Notes

[a] Based on the selected customer churn rates for the mass market presented in Exhibit 2.

[b] Represents 76 percent of revenue in 2012 based on the estimated attrition rate. Thereafter, revenue attributable to existing customer relationships is decreased annually based on (1) the estimated attrition rate and (2) the negative annual growth rate.

[c] The 2016 EBITDA margin is maintained after 2016.

[d] The 2016 depreciation expense as a percent of revenue is maintained after 2016.

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Working capital - % of consolidated revenue	-9%	-9%	-9%	-9%	-9%	-9%	-9%	-9%	-9%	-9%
Working capital requirement (times customer relationship revenue)	(279,620)	(208,936)	(157,710)	(119,785)	(89,839)	(67,379)	(50,534)	(37,901)	(28,426)	(21,319)
Return on working capital	(30,758)	(22,983)	(17,348)	(13,176)	(9,882)	(7,412)	(5,559)	(4,169)	(3,127)	(2,345)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Tangible assets as % of consolidated revenue	104%	104%	104%	104%	104%	104%	104%	104%	104%	104%
Tangible assets requirement (times customer relationship revenue)	3,232,240	2,415,176	1,823,026	1,384,643	1,038,482	778,862	584,146	438,110	328,582	246,437
Return on tangible assets	355,546	265,669	200,533	152,311	114,233	85,675	64,256	48,192	36,144	27,108

[f] Equals the sum of projected capital expenditures allocated to the customer relationships based on (1) % of revenue and (2) the return on tangible assets requirement (estimated based on the Epsilon WACC).

[g] The intangible assets contributory asset charge (or CAC) calculated as percent of consolidated revenue times revenue attributable to the existing customer relationships.

[h] Calculated as if cash flow is received at mid-year.

[i] Excludes the annual net cash flow to the customer relationships expected after 2022. Based on consideration of (1) the discount rate, (2) the expected life of the customer relationships, and (3) the level of annual cash flow expected after 2022, the analyst considered the expected post 2022 cash flow to be immaterial.

discounted the cash flow to present value using an 11 percent discount rate. This 11 percent discount rate is the Epsilon weighted average cost of capital (WACC).

Value Conclusion

Based on the income approach and the MEEM analysis summarized in Exhibit 3, the fair market value of the mass customer relationships as of January 1, 2013, is (rounded): \$850 million.

Management will reduce the company's overall unit value by that amount (and by the value of any other identifiable intangible assets) in order to conclude the value of Epsilon tangible assets subject to property taxation in the relevant taxing jurisdiction.

SUMMARY

Corporate taxpayers and taxing authorities often have to consider the value of industrial and commercial taxpayer intangible assets. Some jurisdictions tax such intangible assets. Many jurisdictions exempt such intangible assets from property taxation.

In either case, valuation specialists are often called on to value such intangible assets. And, for

many industrial or commercial taxpayers, the customer intangible asset is the most common—and most valuable—intangible asset.

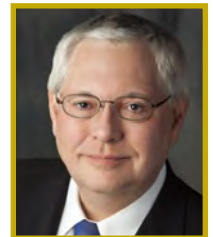
This discussion considered the property tax valuation of the customer-related intangible asset. It considered the attributes that are typically present in the customer intangible asset. It considered the components of the customer intangible asset, the common types of customer intangible assets, and the common types of customers.

This discussion also summarized the valuation methods commonly used to value intangible assets; described the factors and elements that the analyst typically considers in the customer valuation; and presented an illustrative example of a customer relationships valuation.

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