

Securitizing and Monetizing IP



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Agenda

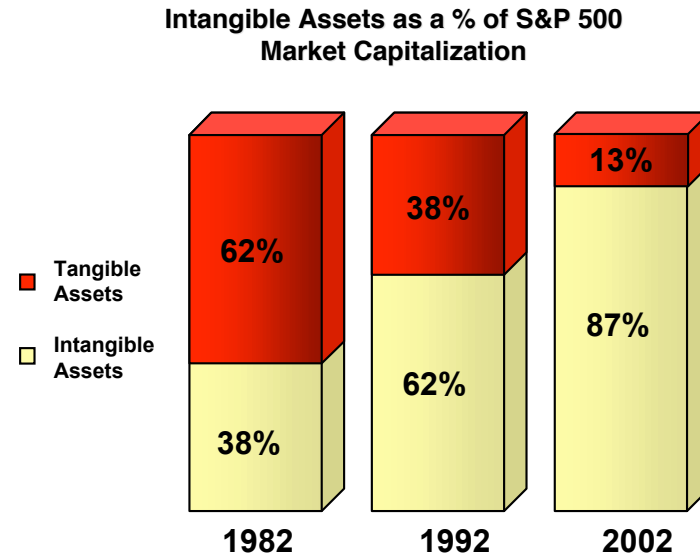
♣ Topics

- Why don't investment bankers care about IP
- InterTrust as the exception to the rule (and the new paradigm)
- Monetization alternatives, including securitization
- Problems with current patent valuation methodologies

Overview

- ♣ Intellectual property (primarily patents, but also trade secrets, trademarks and copyrights, collectively “IP”) is increasingly important to the financial sector and the world economy

- *Still, investment bankers generally view IP as only a risk factor and not a value element, SO*
- *IP underutilized as an asset class in the corporate finance world*



Source: Brookings Institute

Unique Attributes of IP

- ♣ IP usually has a quantifiable value to operations (cost savings, price premium, market share)
- ♣ There may be direct and indirect applications for IP outside of the owner's core business
- ♣ IP tends to maintain value in distressed or turnaround situations
- ♣ IP can be strategically managed to expand its value over time
- ♣ The valuation and management of IP typically requires a high degree of subject matter expertise
- ♣ IP assets are generally intangible, divisible, and non-depletable

InterTrust as the New Paradigm

- ♣ Background
 - DRM software company
 - Public offering in 1999, secondary in 2000
 - Up to nearly 400 employees at the height
 - Filed the “Big Book” in 1995
- ♣ Unfavorable market conditions
 - Market for DRM software slow to develop
 - Microsoft likely to dominate market
- ♣ Board and management decision to reposition the Company as an IP licensing Company and position Company for sale
- ♣ Issues
 - Positioning a company to the public market
 - Selecting appropriate targets
 - Marketing the company
 - Due diligence
 - Structure
 - Execution

Primary Monetization Models

License

- Assertion (Stick) Model -
Patents only - Non-exclusive, Covenant Not to Sue
- Tech Transfer (Carrot) Model -
Patents & Know How - Exclusive FOU option

Divestiture

Sale -

Patents, IP + know how, business unit, company

Retention of use rights (non-exclusive or exclusive F/U)

Spin off/Spin out

Joint Venture -

contractual (license-based) vs. Newco (equity-based)

Donation

Monetization Alternatives

♣ IP-Collateralized Debt

- Mezzanine and/or senior notes
- Incremental commercialization/outlicensing integrated into structure
- Full Borrower obligation to repay, independent of IP outlicensing
- Mitigate risk via risk management structures and products, including residual value insurance
- Lower cost of borrowing through participation in outlicensing revenue

♣ Securitization

- Purchase qualified IP royalty streams
- Creation of SPE for ownership of IP assets
- Purchase price based on discount rate on existing royalty stream

♣ Sale License Back

- Investors seek to purchase fragmented collections of technology-based patent assets primarily from industry diversified, creditworthy companies
- On a field-of-use basis for a fixed term and fixed amount, the manager will license-back those rights needed by the original patent owner to continue to operate
- Once sufficient patents assets have been acquired, the manager will out-license the portfolio to third parties on a non-discriminatory basis, sharing a portion of any royalties collected with contributing patent owners

Valuation Issues

♣ Valuation Contexts – Transaction Based

- M&A – Price Allocation, Exchange Ratio, Premium
- Technology Divestiture – Spin Out (Newco) vs. Spin-Off (sale)
- Joint Venture or Strategic Alliance – In-kind contribution value
- Venture Investment Decisions – Angels, VCs, Private Equity
- Patent Brokerage - Purchase/Sale of IP only (vs. technology)
- License Fees - Paid-up, Upfront payments & royalty rates
- Collateralization and securitization of IP
- Inter-Affiliate Transfers – Transfer pricing issues

♣ Valuation Contexts - Non-Transactional

- Strategic IP Position Enhancement – IP Aggregation
- Purchase vs. Exclusive License vs. Non-exclusive License
- Litigation –
 - Damages - greater of infringers profits or reasonable royalty
 - Settlement value
- R&D Investment – Make vs. buy decisions, Determination of IP-ROI
- Portfolio Management – Foreign filing and prosecution costs, maintenance fees
- Charitable Donations – Tax benefit

Methodology

- ♣ Traditional Valuation Methodologies
 - Cost (to replicate)
 - Market (Comparables)
 - Income (Discounted NPV of projected revenue stream)
- ♣ IP-Specific Valuation Methodologies
 - The Twenty Five Per Cent Rule
 - Industry Standards
 - Rating & Ranking
 - Monte Carlo Analysis
 - Real Options - Black Scholes
- ♣ So, what about the role of validity, scope and infringement analysis?
 - Present quantitative valuation methods are essentially actuarial in nature
 - deal with individual patents, and patent portfolios, on a semi-statistical basis, approximating value based on comparison with past transactions involving similar patents, or using analogies to other kinds of intangible rights (e.g., stock options).
 - In the future, economists and patent lawyers will work together to create a valuation that better reflects the exclusivity domain, i.e., the market, defined by the patent claims...and takes into account the uncertainty factors inherent in all patents.