



Why Private Equity and Venture Capital Firms Should Care About Intellectual Property Assets

September 01, 2012

SHARE

The Value and Importance of Intellectual Property

It is well established that intellectual property (“IP”) assets can generate what economists would refer to as “excess profits”

SERVICES
EXPERIENCE
INSIGHTS
PROFESSIONALS

About
Journal
News & Events
Careers
Locations
Contact
English

to their owners, causing relatively high levels of returns compared to other asset classes. Similarly, it appears that today, more than ever, IP assets are contributing more value to corporations than other assets. In 1975, only 17 percent of the market value of the S&P 500 companies was represented by intangible assets. In contrast, in 2015, intangible assets represented 87 percent of the market value of the S&P 500.¹ We believe that much of this value represents legally protected IP assets, including patents, trademarks, copyright, and trade secrets, among others.

Today, IP is valuable and important in virtually all industries. Any industry in which companies make substantial investments in research and development, technology, and brands typically generates valuable IP. For example, medical device, biotechnology, and pharmaceutical companies in the health care and life sciences industry typically protect most, if not all, of their products with patents and/or trade secrets. These companies also create valuable trademarks as they go to market so that their products are easily recognizable to potential customers. Similarly, most high technology companies in various industries including aerospace, telecommunications, computers, semiconductors, and electronics rely on IP assets to protect hard-won market share and competitive advantage. Patent infringement litigation matters, for which the world's largest companies have played roles of both plaintiff and defendant, have been well documented in the popular press. Approximately 5,600 such suits were filed in the United States in 2015.² Further, it is well known that many consumer product companies that sell food, beverages, clothing, electronics, and other commonly purchased consumables rely on their trademarks and brands to communicate their underlying corporate values and implied product quality promises to their customers. Even traditional industries such as manufacturing, energy, and automotive are led by companies that put particular focus on developing and exploiting their IP assets.

As a result of the high value of IP today, financially significant IP-based transactions are common. For example, RPX Clearinghouse LLC purchased approximately 4,000 patent assets related to telecommunications technologies from Rockstar Consortium LLC in early 2015 for approximately \$900 million. Further, the brokered patent market (i.e., the market for patents for which sellers hire a third-party to broker the deal) accounted for approximately \$1.1 billion in buying opportunities and \$233 million in transacted sales between June 1, 2014 and May, 31, 2015.³ Currently, Yahoo's Excalibur patent portfolio – containing approximately 2,500 patents that are not core to the Yahoo business and which were not included in the acquisition of Yahoo by Verizon – is up for sale and expected to yield hundreds of millions, and possibly more than a billion, dollars.

We believe that private equity and venture capital firms may have opportunities to improve returns on their investments if they are willing to put more focus on IP assets. In particular, we see two specific areas in which private equity and venture capital firms can potentially create significant value related to IP:

- 1) Realizing increased returns from current investments by having portfolio companies focus on identifying and monetizing their IP assets; and
- 2) Improving future investment decisions by performing more effective IP due diligence related to companies that they are considering purchasing.

Realizing Increased Returns From Current Investments

One of the most attractive and potentially profitable aspects of IP assets is that they are highly leverageable and exploitable. Each IP asset or group of related assets has a “spectrum of value” associated with it which is made up of the collection of individual potential internal and external value/monetization opportunities associated with the asset.

“Monetization” of IP assets simply relates to the various strategies and methods an IP asset owner may use to realize and maximize various aspects of the spectrum of value. Each individual opportunity can be considered a slice or channel in the spectrum of value. Individual value/monetization opportunities may include:

- Internal use in support of product/service manufacture and sales
- Sale of the IP
- Licensing-out and/or cross-licensing of the IP to various companies, for various applications, within a single industry or across multiple industries, and in one or many geographies
- Contribution of IP to a joint venture
- Enforcement/litigation against potential infringers
- Use as collateral for financing activities

Defensive uses (i.e., to preclude or at least discourage competition)

- Potentially others.

For example, a certain engine-related patent can be used by the patent owner in the automotive industry to support the manufacture and sale of its cars. The same patent can concurrently be licensed to unrelated airplane, motorcycle, and boat manufacturers for use in their products, providing the patent owner with additional revenue streams resulting from the use of the same asset while not cannibalizing the patent owner's automotive engine sales. At the same time, the patent owner could evaluate the possibility of engaging in litigation with its automotive competitors for patent infringement to the extent they may be using the subject patent without a license. The collection of any relevant litigation damages or settlement revenues can be added to 1) revenues from internal use of the patent and 2) revenues from licensing the patent to companies in non-automotive industries. Clearly, the "spectrum of value" concept is one that is unique to IP assets, as most tangible assets such as plant and equipment are not as versatile (e.g., a machine on the production line can normally only produce one type of product at a time and can't simultaneously be leveraged to other geographies and fields of use).

To successfully generate returns from IP assets, the IP assets must first be identified and inventoried. Some types of IP assets are very easy to identify. However, IP is sometimes difficult to identify since, typically, IP assets created in-house are expensed as they are created and, therefore, are not found on a company's balance sheet. Certainly, patents, patent applications, trademarks, and copyrights are often easy to identify as they are either formally registered with governments in various geographic jurisdictions or are less formally tracked to facilitate protection, payment of maintenance fees, and possible use by the IP owner. These assets are also often vital to the owner's business success. Alternatively, trade secrets, know-how, proprietary processes (including business processes), formulas, recipes, and internally created software, among others, may have an equal or even a superior contribution to business success, but are often considerably more challenging to identify. The key to identifying the potentially most valuable IP assets is to systematically interview knowledgeable employees throughout the organization to understand the sources of a company's competitive advantages and to analyze areas of substantial corporate success and/or investment. If properly planned, these interviews can be done surprisingly quickly. Once key IP assets have been identified, they should be documented and grouped together based on their synergy in supporting technologies, products and services, and/or current or anticipated future revenue streams.

Once identified and organized, the IP asset groups should be assessed to identify those that are most valuable and which can be further monetized. The goal of this assessment is not necessarily to compute a dollar value for the relevant assets (although that exercise may be helpful in certain circumstances). Instead, the goal should be to generally identify which groups of IP assets are relatively more valuable than others and likely merit the use of the company's finite resources for purposes of monetization. The assessment process should include enough analysis to indicate the potential revenue opportunity for the IP owner while carefully evaluating the many potential risks that could cause the monetization efforts to fail. The assessment process should consider a variety of issues/questions. For instance if you were evaluating a patent, a patentable technology, or certain technology-based trade secrets, then relevant questions might include, but certainly are not limited to:⁴

Monetization strategy

- Is the IP owner willing to license to its competitors?

Business/Financial

- How is the patent used by the owner today, if at all?
- Which other applications inside or outside of the company could benefit from the use of the technology?
- Which potentially relevant applications/uses for the patents are particularly "hot" and potentially large?
- What is the remaining economic life of the patented technology?

Legal

- Is the patent potentially infringed?
- Do any "chain of title" issues exist?
- Have maintenance fees been paid?
- What is the remaining legal life of the patent protections?
- Are the patents subject to limitations related to standards organizations, other license agreements, etc.?

- Do foreign counterpart rights exist or would they still be available to obtain?

Technical

- Is the patent landscape crowded?
- Which companies' patents exhibit a high degree of interdependency with, and frequently cite, the relevant patents?
- Is design-around potentially easy or difficult?
- Are non-infringing alternatives readily available?
- What is required to incorporate the technology into products and/or processes? What supporting infrastructure is required? Are there any switching costs?
- Where is the technology along the development continuum: concept, working prototype, or ready to go to market without further development? Is the technology obsolete, timely, or too far ahead of the market in the relevant application area(s)? Is the market ready for the technology?

Once assessed, a monetization strategy may be developed and implemented for the IP assets that appear to have the most potential value. A typical licensing strategy will include:

- Method of monetization (i.e., sale, license, litigation, etc.)
- Companies to be approached and relevant personnel to contact
- Preliminary value proposition to each potential monetization target
- Methods for approaching selected companies (i.e., phone calls, emails, letters, etc.)
- Marketing/communications collateral that will be developed for each selected monetization method
- Identification of who will take responsibility for each step in each marketing effort
- Estimated timeline for implementation of the strategy
- Total cost estimates to implement the strategy
- Estimated revenue projections
- Identification and analysis of risks associated with various strategic options

IP monetization can be successfully applied in both high-performing platform companies that could provide value to industries where the IP owner does not operate and also stable, low-growth, or troubled portfolio companies that may be generating sub-par operating results.

As an example of a successful monetization effort, we assisted a large private equity firm to undertake an inventory of the IP assets at several of its portfolio companies. While inventorying the IP assets at one of the portfolio companies, our team identified certain manufacturing processes of substantial value that we recommended should be protected and managed as trade secrets. We worked with the company and its counsel to protect and ultimately license these trade secrets for several million dollars paid over a number of years by unrelated companies in non-competitive industries.

Improving Future Investment Decisions by Performing More Effective IP Due Diligence

A second opportunity related to IP that should be of interest to private equity and venture capital firms relates to their ability to potentially improve future investment decisions and results by performing more effective IP due diligence related to companies that they are considering purchasing. Based upon our experience, many companies do not spend enough time and resources considering IP opportunities (and potential IP-related issues) as part of a potential acquisition. This is especially the case considering the potential importance of such assets as noted previously. By performing more effective IP due diligence, companies can expect to be better informed and, therefore, make better acquisition-related decisions. This due diligence may highlight otherwise unrecognized bargains and likely will allow you to be better positioned to more efficiently and effectively implement monetization efforts once the acquisition transaction has closed. In addition, the due diligence process can also reveal challenging issues associated with the acquisition target's IP portfolio that may negatively affect its value. Additional due diligence and follow-up can then be performed related to such issues until they are resolved or better understood.

An important part of IP due diligence, and a good potential first step, is to simply identify what IP assets the target company owns. As mentioned previously, identifying IP assets is often challenging when one owns and operates a company, but it is even more difficult when trying to do the same for a company for which only limited information and access is available. To

start, an acquirer should consider various high-level issues that may indicate that the target company has important, valuable IP. Some such issues include:

- Does the target company generate consistently superior returns on sales or assets?
- Does the target company have unique competitive advantages, such as superior manufacturing processes, trade secrets, supply chain efficiencies, or distribution advantages?
- Does the target company have identifiable intangibles and goodwill from previous acquisitions and/or are IP assets internally developed?
- Does the target company have a history of relatively significant investments in technology, manufacturing processes, business processes, software, and/or marketing assets?
- Does the target company have internally developed or customized software, machinery and equipment, processes, formulas, or business methods?

Once these and other relevant questions have been addressed, the acquiring company should implement at least some measure of due diligence to not only identify the specific IP assets that are easy to find (e.g., patents, trademarks), but also the IP assets that are more difficult to uncover but which may have substantial value (e.g., trade secrets, know-how, business processes, software, specialized equipment, etc.).

The rest of the IP-focused due diligence process is very similar to the assessment that one might conduct as part of the monetization process as described previously. The acquiring company should, to the best of its ability, try to answer various questions related to important business/financial, legal, and technical issues so as to better understand the potential value of the IP owned by the target and any potential risks that could diminish the value of the potential acquisition.

As an example of a successful due diligence effort, we assisted a client to evaluate the purchase of a Japanese manufacturer and distributor of food additives (the “Target Company”) that was in bankruptcy. In addition to its manufacturing facilities, the Target Company had significant IP assets, including in-process research and development, trademarks, and patents. In particular, our client requested that we estimate the value of the Target Company’s patent portfolio, focusing initially on certain product lines using publicly available information and later relying upon the Target Company’s proprietary data. During the course of this project, we worked closely with our client’s mergers and acquisitions team, which relied upon our analysis in determining the value of the intangible assets which, the client believed, constituted the largest share of the offered purchase price. Ultimately, the client’s competitive bid for the troubled company was beaten by another interested purchaser and the acquisition did not take place. However, the client was very satisfied that, relying on our IP analysis, it made a bid that reflected the value of the Target Company for its own purposes and recognized that the price it would have had to pay to purchase the Target Company would not satisfy its return requirements.

Conclusion

In conclusion, given the significant importance of IP assets to many companies, it is wise for private equity and venture capital firms to consider ways to incorporate IP issues into 1) its management of its portfolio companies through monetization efforts and 2) its consideration of new acquisitions through focused, and perhaps enhanced, IP due diligence. Success in these areas is likely to increase returns on current and future investments.

Also contributing to the article:

Bruce Burton

--

¹ Ocean Tomo, LLC Intangible Asset Market Value Study, 2015.

² PricewaterhouseCoopers 2016 Patent Litigation Study.

³ “The brokered patent market in 2015 – driving off a cliff or just a detour,” Kent Richardson, Erik Oliver and Michael Costa, Intellectual Asset Magazine January/February 2016.

⁴ Note that the illustrative list of assessment questions/issues provided herein specifically focuses on patents. While some of

the assessment questions/issues listed may be relevant to other types of IP assets, each IP asset type has certain unique questions/issues that would be addressed in an assessment for purposes of monetization.

AUTHORS

Scott Weingust

SERVICES

Intellectual Property / Intangible Assets

Intellectual Property Disputes

AUTHORS

Scott Weingust

SERVICES

Intellectual Property / Intangible Assets

Intellectual Property Disputes



SITEMAP

LOCATIONS

CONTACT

TERMS

DISCLAIMER

