

Valuation of Intellectual Property Assets

How to Maximize your Sale Price (or Minimize your Acquisition Cost)

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In recent years intellectual capital, in all its forms, has become of tremendous importance in the business world. Proactive companies and inventors have known this for years, but the leverage that a patent, trademark, trade secret or other know-how can provide has certainly increased. The number of patent applications and issued patents has skyrocketed in the past 15 years, trademark filings are also up and the rate at which intellectual property (IP) assets are being asserted, licensed and even sold is astonishing.

Markets have been created for trading / sales of patents and most of us are aware of the business models of aggregators, non-practicing entities and “trolls” out there. But if you are in the market to buy or sell IP assets how do you know how much to ask for if you’re a seller or where to set your limit if you’re a buyer?

One of the best ways to sell is to put yourself into the mindset of the buyer. How will they make their decision to acquire an IP asset?

The process of divesting IP assets occurs in three phases. First is a market assessment and valuation of the intellectual capital, second is target identification and sales terms negotiation, and last is the sales agreement drafting, deal closure and the transfer of assets.

1) Market Assessment and Valuation

In order to provide a valuation of IP assets there are several methods which can be employed. We have taken some time to list and evaluate the benefits and drawbacks of each one. Certain methods have been employed which I liken to “shortcuts” since there are times when large numbers of patents or trademarks are being evaluated all at once. I believe the best method involves good old fashioned hard work and analysis.

The “historical” method is a simplistic model which takes into account all direct costs incurred to date for technology development and IP protection and attempts to recover these costs plus an additional component for inflation compensation. While this method can improve consistency with historical patent sales price trends, the drawback to the inventor/creator is that there is no correlation between the expenditure on the patent or trademark protection or the revenue generating potential of the eventual commercial product or service and subject IP.

The “market” approach attempts to benchmark the sale price of IP assets against the scope and maturity of your own. Some have likened this to home-buying where you search for “comps” in a neighborhood you are looking to buy to help benchmark what is a reasonable price to pay for your own home. In our case, significant research is

required to determine comparable states of technological maturity as well as the scope of IP protection. The drawback is that prices paid for sales of IP assets are rarely made public, so benchmarking is not always easy. To go back to the home-buying analogy, the house may look the same on the outside, but the condition of the interior and foundation will make all the difference. Real asset value needs to be like for like.

An analytical model utilizing analysis and classification of citations is a newer method resulting from robust tools which were originally developed for patent landscaping. The thought is that the more forward citations your patent has the more valuable it should be, since it is likely to be considered a seminal work in your industry. The problem with this is that there are many reasons a patent is cited as prior art, and unless each forward citation is analyzed one cannot determine the true worth of the patent at hand. I believe analytical tools have a great place in the IP landscaping space, but they wind up being a poor method for determining an appropriate valuation. This approach also is irrelevant for trademarks since it is not possible to use citations in the evaluation of a brand and the marks/logos which go along with it.

Therefore, I would propose the method which is referred to as the “income” approach. This involves quantifying a cash-flow forecast based on future income streams of the IP asset’s commercial use. This approach will necessitate the need for market research and analysis on projected sales and market share, volume production pricing as well as standard profit mark-up, which must all be placed into a cost model.

The reason this method works the best is that savvy potential buyers and corporations will likely construct a similar model and look at the net present value (NPV) of commercializing the IP. One component of their purchase analysis is to investigate whether the acquisition cost of the IP assets makes their NPV calculation zero or negative. If that is the case, then they are unlikely to agree to the purchase.

But, just because you can figure out a positive NPV doesn’t mean you’re home free. The best approach is to select a limit for the valuation price which will not force the NPV calculation to result in an internal rate of return (IRR) which falls below the buyer’s threshold for overall internal project approval. For most companies this IRR is typically on the order of 20 – 25%. Starting with a valuation price which results in a 12 - 15% IRR and working down the price scale from there is highly suggested.

While this method requires adequate market knowledge and cost prediction capability I believe that for most industries there is sufficient market research for a very educated guess at worst.

2) Target Identification and Negotiation of Sales Terms

This phase should be fairly self-explanatory, but it involves identifying interested buyers and attempting to determine their valuation methods and IRR threshold, so that a price can be set which is equitable to both parties.

Potential buyers may be those who you can infer are infringing on the patent or trademark or even a company who is looking to get into the line of business for the type of IP assets you possess. Doing some homework can usually turn up a reasonably comprehensive list, but looking at the marketplaces for IP asset sale is another approach. Beware that some of these charge fees to list and may also charge a fee for the sale.

The involvement of a law firm representative who has experience in IP asset sales may be necessary at this stage, but it will definitely be required for the sales agreement drafting and review, which occurs next.

3) Sales Agreement Drafting and Transfer of Assets

This step should be self-explanatory as well. Once a buyer has been identified then negotiation of terms will take place. Grant back licenses (if desired), transfer of title as well as payment terms should all be a part of the discussion.

Template agreements exist for this type of transaction, but having a legal expert review and approve draft and final language of such an agreement is strongly suggested. Upon execution of the agreement the transfer of assets will take place in a manner likely to have been negotiated and should be outlined in the agreement.

Considering Working with a Law Firm or Broker?

Most IP asset sellers are inclined to involve a law firm or a broker who specializes in this type of transaction to act on their behalf. Understand that a broker / market maker is likely to ask for 20 – 30% of the take from the asset sale, but law firms might ask for even more, between 35 – 50%. The involvement of a legal professional is not only a good idea, but might be required since someone with very good knowledge of contracts and transfer of ownership is essential to this effort. However, a few caveats exist to this type of arrangement:

- 1) If you do work with either a broker or lawyer it would be highly recommended that the partner selected for this type of effort is willing to accept deferred payment of services rendered until after the asset sale is completed. However, some of them do ask for a retainer up front and some may ask to be compensated even in the event that the asset sale is not completed.
- 2) Additionally, it is recommended that for the involvement of a legal professional, you make payment to the lawyer / firm on a pre-negotiated flat fee basis or on an hourly rate basis for only those specific services rendered in regards to sales agreement drafting and review. Otherwise, the law firm may be inclined to ask for a large percentage of the asset sale as payment for their services rendered, and it is my belief that they would be asking for more than the value they would add to this effort given their limited involvement.

If you want a lawyer handling the negotiation for you, then it might be ok to settle for their terms, but you don't have to give away half your gains if you don't want to.

Don't Have a Trademark or Patent Yet?

Whether you're an individual entrepreneur / inventor or a large corporation you will find it pays to have trademarks registered and patents issued, or at least applications filed. Ideas are intangible assets which cannot be easily valued. Patents and trademarks are a form of tangible asset that has certain capital cost associated with prosecution and the business value the IP creates. The more you have to offer a buyer in tangible IP assets the more it will increase your valuation. Simple as that.

Also, some advice for those individuals out there who "have a great idea that they want to sell to a company." This is a great dream to have, but the more homework and effort you put into presenting a potential buyer with comprehensive analysis the more likely you will be to see success. If you've tried to approach companies before and have been turned away, think about your sales method.

You can cash in on your great ideas if you have the right tools at your disposal. Knowing what you're getting yourself into will prepare you vs. being shocked and feeling taken advantage of later.

About the Author

Mr. Philip Totaro is the Principal at Totaro & Associates, a consulting firm focused on innovation strategy, competitive intelligence, product development and patent search. Mr. Totaro has experience in strategic planning as well as creating and protecting intellectual capital. He has worked for such companies as General Electric, United Technologies Corporation and most recently he oversaw Intellectual Property and Competitive Assessment for Clipper Windpower. He has helped cultivate and disposition over 450 innovations, and his assessment has led to over 250 issued patents. His strategic market analysis has led to the funding justification of over \$500M in R&D investment and the development of multi-million dollar product and service offerings. He has provided legal and technical due-diligence for over \$1B in M&A, including the recent takeover of Clipper Windpower by United Technologies Corporation. To find out more or get in touch please visit www.totaro-associates.com.