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Promoting Intellectual Property Rights in the ASEAN Region

IP Valuation: What, When, How

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Overview

- When it is advisable to conduct an IP valuation
- Some key considerations about IP valuation
- IP valuation methodologies: what, pros and cons
  - Historic Cost
  - Comparables or transactional
  - Discounted Cash Flow
- How to use them: practical exercises

When it is needed (or advisable)?

- **Acquisition, transfer or license** of IPRs
- **Internal or external audits**: proactive IP management, due diligences for M&A, bankruptcy
- **Taxes and accounting** purposes
- Seek for **funding** using IP as a collateral
- Prior to any **infringement lawsuit**: Go/No go, litigation strategy, calculation of damages

Some key ideas

IP is a tool to convert intangibles into assets

- Measuring the relevance of assets for the companies' value chain
- Closely linked to IP at policy and strategic levels
  - If no strategic/economic value → difficult to justify the existence of IP
  - Decision on:
    - ♦ Whether registering/maintaining registration
    - ♦ Licensing and at which price
    - ♦ Litigate and the damages to claim

IP valuation methodologies

As easy as applying common sense or a simple formula

As difficult as obtaining the right data

Hence reliance on assumptions and adjustments

As easy as applying common sense or a simple formula…

- Some of the methods used are quite intuitive
- Most maths can be done by anybody with a basic level of excel

…as difficult as obtaining the right data

- Intangible assets present specificities vis-à-vis tangible assets
  - Tangible assets valuation conventions cannot be applied to IA
  - They can "vanish": cancelled, expired etc
- Markets for IP assets are less efficient than those of tangible assets and even other intangible assets (eg stock market)
  - Price formation: most are confidential
  - Asymmetries of information

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Hence reliance on assumptions and adjustments

- **No ”right” valuation** – more an issue of a “convincing” valuation
- There is a second layer of more advanced valuation methodologies
  - Aimed at **defining proxies** or **justifying assumptions/adjustments**
  - Based on econometrics and more specific data: eg SSMM engagement for trademarks; patent families or patent citations
  - Field for even bigger asymmetries of information –affecting less knowledgeable players (eg SMEs)
- **Promising developments** on fields such as semantic searches or Artificial Intelligence
  - Moment A: At first, bigger gap between those that have the technology, the processing capability and the data
  - Moment B: Later, widespread tools at reasonable price – Moore´s Law
  - The (policy) challenge ahead is to help SMEs to transition from moment A to moment B

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Types of methodologies

- **Qualitative:** aimed at measuring the relevance and/or the strength of the IP asset
- **Quantitative:** aimed at calculating in monetary terms the value of the asset

  - Cost-based
    - ♦ Historic cost
  - Market-based
    - ♦ Comparables or transactional
  - Income-based
    - ♦ Discounted Cash Flows

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Historic cost (cost-based)

- Consists in valuing the IPR according to the costs incurred for its creation and protection
- It is commonly used for formal accounting and taxes purposes

PROS	CONS
- Data is widely available within the company - Calculations are simple - Objective method	- According to this valuation method, Apple´s trademark worth is some thousands $

Comparables or transactional method (market-based)

- The price of an IPR is the market price of a comparable asset (transaction)
- Requires 1) screening of comparable assets 2) adjustments

PROS	CONS
- Market value virtually equals real value (not always) - Useful in markets where there is public info available (eg franchises) - Prima facie objective	- IPR markets are not transparent - Is not always possible to find comparables - Adjustments and assumptions can be really complex - Some IPRs are unique (eg blockbuster drugs)

Discounted Cash Flow - DCF (income-based)

- Calculating the current value of the expected cash flow at a discount rate
- Treats IPRs as any other investment

PROS	CONS
- Allows to compare IPRs with other IPRs but also with other investments - If there is data available it is pretty accurate	- Adjustments and assumptions can be really complex - Does not allow to calculate strategic value (eg Tesla´s or Google´s strategies)

Practical exercise I

- ECO–fi is a company whose core business is coffee bars.
- Taking advantage of its reputation they want to create a branch to operate in the well-being sector by means of franchises

How much should ECO-fi ask for each franchise?

- Some data
  - ECO-fi is knowleadgeable in franchises but its their first step into well-being services
  - According to franchising portals, average franchising canon in the well-being sector is ca €2500 a month
  - Coffeebucks, a competitor which made the same movement 5 years ago is charging €2800 a month

Comparable´s method: assumptions& adjustments

Criteria	How to quantify – or assume	Adjust ment
Brand strength	ECO-fi brand is more powerful for well-being than Coffeebucks. **Rely on studies on economic impact of cross-sectorial branding**	+5%
Know-how	Franchise=brand + know how. Know how and services provided to franchisees are likely to be poorer. **Evaluate (eg by means of a questionnaire) which features or services are more valuable for potential franchisees and assign a value**	-3%
Reputation	ECO-fi is better perceived than Coffeebucks in aspects such as healthy or eco responsible, which are key for well-being sector. **Rely on market studies on impact of reputation on income**	+4%
Trademark strength	FR trademark is undergoing through a partial cancellation (for well-being services) proceeding due to lack of use. IP attorneys estimate that there is a 20% chance that the trademark will be cancelled. Attorneys have applied for a new trademark which have not received any opposition for the time being. **Risk assessment by IP attorneys** (different case if cancellation for conflicting trademark)	-1%
Early franchisees premium	A recently launched franchise needs to attract franchisees at a fast pace, hence it is customary to offer better terms in early moments. **Sector's business practices**	-5%

Practical exercise II

- An investors´ group specialised on setting up franchises has showed interest in obtaining a 4-years licence to directly exploit the franchises' business under the ECO-fi trademark
- The comparable study done by ECO-fi has allowed them to estimate that each franchise would generate €30k a year (23k attributable to brand and the rest to know-how and services)

How much does the 4-years licence worth?

Calculating DCF

$$\sum_{1}^{n} \frac{Cash\ flow}{(1+r)^n}$$

Where:

Cash flow: expected income for each year

n: number of years

r: interest rate (usually the interest rate defined by central bank)

Value of licence at DCF = $\frac{23000*15}{(1+0,04)} + \frac{23000*40}{(1+0,04)^2} + \frac{23000*80}{(1+0,04)^3} + \frac{23000*110}{(1+0,04)^4}$ **= 4.980.730,39 €**

This is not the end of the story…

Take away lessons

- **Having the right data** is paramount
- **IPR transactions are not public –** IPRs market is not transparent nor efficient in many cases
- **Informed assumptions can be more efficient** than obtaining and processing all data
- At the end it is a **matter of being convincing**

We will see examples of real assumptions in the case study on Unwired Planet v Huawei

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THANK YOU

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