Patent Valuation at IP Bewertungs AG (IPB)

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Abstract

Nowadays, an efficient financed company does not own real estate or machinery any more. So called “sale and lease back” mechanisms are increasingly being used not only to realize off balance sheet (hidden) values but also to optimize taxes. As a result, the staff working in offices or laboratories are housed in rented or leased premises, and work at desks the company does not own and they drive in cars which do not belong to their company, but are rented or leased from another company. Consequently, a number of studies in the recent past have underlined the growing relevance and increasing share of intellectual property (IP) in the total assets of all types of companies and not merely of the high tech enterprises. In fact, for a wide range of companies the contribution of IP to the total value of the company has risen from around 20 percent in 1980 to as much as 80 or 90 percent today.

The growing awareness on IP’s importance has become a major issue for companies of all size, research institutions, universities and also single inventors. Patents are no longer used only as legal rights to keep competitors out of specific markets but also for generating revenue through licensing the patents to others.

For many years patents had only been a topic of interest to scientists, inventors and patent lawyers. Today, a wide range of companies have become aware of the importance of patents as key business assets. They are also beginning to take a closer look at the monetary value and economic use of patents. Today, patents can also be used as collaterals for financial transactions or as assets for alternative investments.

IPB has already initiated two private placements where the investor’s focus is the commercialization of patents. In other words, the investor is not investing in the company but is investing in the patent asset. Their aim is to conclude license-agreements. Apart from the asset management for the actual placements, IPB right now is preparing a public placement for institutional investors.

From a financial perspective, there are two crucial aspects: First, a reliable but cost efficient monetary valuation method for valuation of patents that is accepted by banks or any other investor. Second, a structured transfer process.

Surely, the IPB does not offer what people in Germany call the “Eier-legende-Wollmilch-Sau” (proverb for an animal which gives eggs, wool, milk and meat at the same time) but the IPB-Market-Approach was certified on customers’ request by chartered accountant KPMG in February 2004. The certificate allows banks to use patents as single collaterals for short and medium-term financing. The IPB-Market-Approach delivers also a reliable value for equity financing, purchase price allocations, licensing and all other related questions of patent management concerning valuation.

The structured transfer process of IPB is divided into four steps:

- Patent’s Valuation-Analysis
- Quantitative Analysis which companies own similar IP as key for no. 3
- Qualitative Analysis which is examining all potential licensees
- Contact to licensees and conclusion of license-agreement

The Story of IPB

In the mid-nineties, a small team of product development specialists in the treasury department of a German bank identified knowledge as follow-up investment target after the Internet. The Internet is now providing almost any information to anybody anywhere in the world. Due to this fact, mere information is losing value. Valuable today is the information’s abstract: Knowledge. Through patenting of information pertaining to inventions that meet the requirements of patent law the key requirement for commercializing knowledge is created as a patent enables property like rights over the knowledge concerning that invention. The idea was born to set up an investment trust only investing in companies which own underestimated patent-portfolios. Therefore, there was a need to find a method of valuating patents fast, reliably and competitively priced.

Nearly at the same time, the bank was liquidating a customer’s collateral which was machinery. Unfortunately, the machinery was protected by several patents, which did not belong to the enterprise but to its former owner. Needless to say, the former owner was quite happy when the bank sold the machinery because on the same day he had a licensee that gave him a new income stream.

These two circumstances led to setting up of IPB’s in 2001.

In cooperation with seven German universities and a growing number of IP-specialists, IPB developed a new valuation-method for patents that was certified, on customers’ request, by a firm of chartered accountants, namely, KPMG. This was done in February 2004. Since then it has been possible to use patent-portfolios as collaterals. Especially SMEs can benefit from the alternative financing option which helps to enlarge the companies equity base. In most cases, banks offer similar conditions as if using classical collaterals, such as real estate.

Although nearly all shares of IPB are owned by individual investors, who are expecting profit out of their investment, IPB always tries to increase the awareness of the use and value of patents in general. Patents being a crucial asset in today's emerging markets and economies is well known to scientists and politicians, but most companies -in particular SMEs and especially in Europe- are not aware of the true potential of their patent portfolio. That is why IPB is constantly increasing its effort in marketing the idea of patenting inventions in a knowledge-based economy and using better means for raising finance by owners of patent portfolios.

Patent Valuation

In general, the first question before starting patent valuation should be the question about the type of value: Do I need a cost-value ("I spent two millions for my invention."), an income-value ("We are going to earn about 50 millions with this patent in the next 15 years.") or do I need a market-value ("I am able to sell this patent for five millions, if I want to.")? Due to these three different values there are three different valuation-approaches known as classical enterprise-valuation: Cost-, income- and market-approach. IPB is offering all of these types as patent valuation methods.

Cost-approach: Regarding the cost-approach the patents' value is equal to the costs for the patent-related R&D costs. This fundamental idea is the core element of all cost-approaches. There are several variations of cost-approaches like discounting the amount of costs by using e.g. the rate of inflation or taking a look at the replacement costs.

The main disadvantage of this approach is that it is not really useful for financial transactions, because either the a mount of cost is too high so that the patents' value is overestimated or the amount of cost is too low so that the patents' value is underestimated. That means the average valuation always fails. Anyhow a cost-approach can be very useful for operation management and controlling.

Income-approach: Regarding the income-approach the patent's value is equal to the amount of the future revenues the patent-holder is going to earn by using his patent. By discounting these patent-related revenues on the valuation date the present value can be calculated. The resulting present value is considered as the patent's value.

The use of the income-approach has two challenges: First the need to have a large database for a reliable outlook on the future revenues for the patent's lifetime. The second major problem is that there is a need to know exactly which part of the products' revenue is related to the monopoly right of a specific patent. In some industries like the pharmaceutical sector this might be easy: There is one active ingredient of a product having one certain market protected by one patent. But when it comes to automotive industries things look pretty different: To find a "one-to-one"-relationship between a patent, a product and a certain value in most cases is impossible.

The need for reliable data makes an income-approach-patent-valuation in most cases quite expensive and -depending on the data's source- subjective. Therefore the income-approach is not that useful for financial transactions especially the valuation of collaterals. But e.g. for equity investors who are interested in their (future) return on investment (ROI) an income-approach might deliver the information needed and therefore the "right" value.

There are several variations of income-approaches like the real-options- approach. But in general problems and benefits delivered are the same as discussed above for the "simple" discounted-cash-flow-approach.

Market-approach: In the economic society it is well known that a market-value is always the most reliable and robust value for every kind of asset. It shows what the buyer is willing to pay for the asset and what the seller wants to receive at the same time. So the general idea is to find a similar patent that has already been priced and traded. The actual value/price is differentiated out of historical transactions. But with this approach there are two major problems: First it is not that easy to gather data of patents which are already priced and traded. Second every Patent is unique and only a few are at least a little similar.

In order to solve the first problem IPB has gathered numerous data of patents that are already priced and traded e.g. from expired license-agreements, remunerations of employees' inventions, patent sales (e.g. out of liquidations), etc. With this number of data the IPB-specialists located value-indicators hidden in nearly every patent-document. With the help of regression analysis significant correlations between indicators and values were identified. Today these parameters are fed into a multivariate-regression-model in which each parameter is supplemented with a 'personal' beta-indicator. The beta measures the impact of each parameter on the patent-value.

IPB's valuation result is not a single-price-calculation. It is a value-distribution which shows the probability of realization on the y-axis and the respective value-interval on the x-axis.

One of the advantages of this valuation-method is that IPB is able to collect at least 95% of the relevant data out of public data-bases. So IPB is able to valuate any patent-portfolio without involving the owner. The advantage of objectivity is not only interesting in order to convince any investor or bank but also to collect information about e.g. M&A-targets.

Another advantage is the value-distribution which shows the investor his whole chance-risk-profile and which puts banks in the position that they are able to calculate the value-at-risk which is essential for the credit-calculation.

The IPB-model has been audited by chartered accountant KPMG at the beginning of 2004. The auditors certified the applicability to validate patent-portfolios as collaterals in the financial sector.

Conclusion

The growing awareness on IP's importance has become a major issue especially for SME.

Due to the increasing replacement of classical assets by IP-assets, investors and banks will have to take a closer look at the intangibles.

Valuation of patents has become a central issue in strategic decision-making. Proper valuation could contribute to increasing the value of the business for shareholders.

Beyond providing adequate financial inputs, using the patent system after understanding the true monetary and business value of patents, will make a big contribution in realizing the fruits of implementation of the Lisbon Strategy of the European Union, which aims to make the European Union “the most dynamic and competitive knowledge-based economy in the world” by boosting investment in research and innovation.

For further German and English information please see: http://www.IPB-AG.com or contact info@IPB-AG.com

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