MAXIMIZING THE FINANCIAL VALUE OF IP ASSETS

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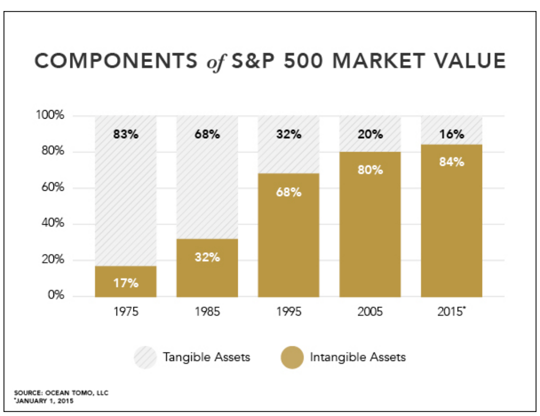
INTELLECTUAL PROPERTY IN THE INFORMATION AGE

How vital can intellectual property (IP) be to a company's balance sheet? Just ask Limelight Networks. The company's shares fell 18 percent after it lost a patent infringement case to Akamai Technologies in August 2015. The announcement of this news alone erased more than $18 million from Limelight's market value in a matter of hours.[1]

As we transition from an industrial economy (based primarily on the exchange of physical assets) to an information-based economy, IP has increasingly been viewed as a fundamental economic resource for many businesses, universities, and institutional investors. As illustrated below, in 1975, intangible assets including IP comprised only 17 percent of the market capitalization of S&P 500 companies. Over the past four decades, this ratio has grown so that approximately 84 percent of the market capitalization of S&P 500 comprises intangible assets and IP.



(http://www.oceantomo.com/intellectual-capital-equity)

In spite of the wave of businesses adding IP to their balance sheets, all companies should make a thoughtful inquiry as to whether an IP portfolio should be considered a financial asset, and if so, how they can efficiently extract real value and drive economic performance from that portfolio.

IP PORTFOLIOS: THE NEW FINANCIAL ASSET

As global IP transactions rise, companies are adding IP assets to their balance sheet at an unprecedented rate. IP portfolios are intrinsically packaged with a company's other intangible and tangible assets to be traded on securities exchanges as a traditional financial asset (i.e., stocks). However, the expectation of future economic benefits derived from these IP assets, and in particular patents, may not be as apparent in comparison.

Substantial differences exist between transactions involving traditional financial assets and IP assets. Financial assets are governed by securities regulations and have been structured to reduce risk by enabling safe, dependable securities transactions. These safeguards, together with established financial exchanges, have led to an increase in financial asset transactions, which allow companies to more competently exchange market information and determine the value of available financial assets. IP markets typically do not share these same characteristics. The lack of transparency and information surrounding IP has made it increasingly difficult to conduct IP transactions at a frequency that generates economic value for most market participants.

1. "Akamai Wins Appeal in $45.5 Million Limelight Patent Case," *Bloomberg Business*, August 13, 2015.

In many instances, prospective IP transactions do not occur simply because it is too challenging for buyers and sellers to find each other.

Additionally, unlike most financial assets, it has become increasingly difficult for companies to value the worth of their IP portfolios, much less the individual components that comprise a portfolio. Determining a valuation for an IP portfolio is an evolving science that varies between businesses and evaluators. Moreover, the value of an IP portfolio can be significantly altered based on future litigation, estoppel, or changes in patent law — does *Alice* ring a bell? Likewise, with the rise of post-issuance proceedings, in particular *inter partes* reviews (IPRs), serving as a more amenable defense to patent litigation, patent owners must remain vigilant in assessing how such events may affect the estimated value of their IP portfolio.

For many businesses, IP is an undervalued and underexploited asset. Companies seeking to stay competitive in the marketplace invest in research and development that may lead to valuable IP assets. However, often times, companies are quickly swayed by the winds of time, expense, or change, and fail to tap the full potential of internally-generated IP. They ultimately allow unexploited technology to lay dormant, instead of utilizing various other means to generate value from these IP assets (e.g., securitizing IP assets, licensing, sale, acquiring debt funding, etc.).

Still, IP portfolios are increasingly recognized as a financial asset. As market transparency improves in relation to the frequency of IP transactions, companies may begin to invest more resources toward gathering and sharing market data. This may eventually lead to a level playing field for market participants and a progression toward treating IP more like financial assets.

> "Using these best practices as a foundation for targeting and developing underutilized IP assets can lead to increased cash flows and maximize the expected value of your portfolio."

PRACTITIONER'S TOOLKIT FOR MAXIMIZING IP PORTFOLIO VALUE

Generally, the goal of every business is to maximize profits and minimize expenses. This principle should apply equally to financial assets and IP assets alike.

Consequently, some tips for maximizing the value of an IP portfolio include:

(1) Treating your IP portfolio like a financial asset.

- Develop a basic fundamental understanding of the various types of IP in your portfolio, as well as the corresponding rights, protections, and subject matter of each IP asset.
- Gather intelligence concerning competitor IP strategies and portfolios.
    - Conduct periodic searches of the competitive IP landscape to gain detailed legal and business information relating to competitor products and IP assets. This information can be used to assess the expected value of your IP portfolio and to determine whether new technologies may impair that value.
- Make calculated and informed decisions to maximize the expected value of your portfolio.

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[IP ASSETS, FROM PAGE 5]

- Many companies evaluate and compare strategic IP decisions in terms of the estimated impact on reported earnings rather than focusing on the expected incremental value of future cash flows for each IP asset in their portfolio.
- To maximize portfolio value, companies should evaluate alternative IP strategies in view of their effect on expected value and susceptibility to shifts in competitive and legal landscapes.

(2) Do not prioritize portfolio quantity over quality.

- Many companies are focused on acquiring or creating large portfolios of IP assets, despite the fact that much of their current portfolio remains unexploited. Periodically monitor or audit your portfolio to determine the status of relevant value-creating IP activities/opportunities, and seek to pursue IP transactions that maximize the expected value of the overall portfolio.
- Track the quality of acquired or internally-generated IP assets using objective criteria, as well as their relationship with and contribution to the total value of the portfolio.
    - Generate detailed performance metrics for each IP asset to determine and monitor value over the life of the asset.
- IP rights cost money to create, and can generate negative cash flows to maintain or assert these rights (e.g., maintenance fees, litigation, etc.). Carry only IP assets that maximize portfolio value, and license/sell IP assets that fail to generate value or returns above your cost of capital.

(3) Adjust your business plan to ensure IP assets are applied profitably across most business activities.

- Adopt IP management procedures that promote the exchange of value-relevant information between business sectors so that you may quickly respond to changing market conditions and leverage potential IP transaction opportunities.
- Periodically conduct detailed portfolio assessments and develop/monitor objective economic performance indicators for your IP portfolio. This data can be utilized to increase the overall transparency of your portfolio's value, thus reducing risk and transaction costs for potential buyers.

(4) Seek out new strategies and opportunities to monetize your IP portfolio by considering estimated value creation during all phases of IP development/implementation.

- Consider new methods of generating revenue from your current IP portfolio by identifying underutilized or undervalued IP assets, determining whether and how best to monetize these assets (e.g., licensing, selling, etc.), and acquiring IP to further both offensive and defensive positions within the competitive marketplace.

Using these best practices as a foundation for targeting and developing underutilized IP assets can lead to increased cash flows and maximize the expected value of your portfolio. While IP may not exhibit all the characteristics of a financial asset, it will continue to be an important measure of a company's market value. Consequently, IP portfolios must be judiciously managed like any other financial asset in order to maximize future growth and economic value. ■