

FACTSHEET

IMPORTANT ISSUES



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1. Why should I perform an IP Valuation?

This Factsheet belongs to the series of Factsheets on IP Management published by the Latin America IPR SME Helpdesk. Please see also our Factsheets on Identification of IP assets and IP Due Diligence.

Many companies merely “own” IPRs (Intellectual Property Rights) with little or no information about their real value, the incomes that they generate or its potential to expand the business. IPRs are part of a company’s assets and can be used to create value for the company.

Therefore, just as for other assets, it is important to know the real value of the company’s IP assets in order to facilitate the decision-making processes where IPRs are involved.

The following are some cases where IP Valuation is really useful:

- When the company is planning to acquire, transfer or license an IPR
- The right valuation process will help the company decide whether to actually go ahead with the operation and what price to pay or offer to third parties.
- When the whole company has to be valued
- Internal or external audits, bankruptcy or reorganization as well as mergers and acquisitions are more or less common situations for companies in which an IP Valuation is of the utmost importance.
- For tax and accounting purposes
- Some Tax regulations aim to boost innovation through tax incentives for IPR. Good tax planning will allow the company to benefit from such incentives.
- In conflict scenarios

- When an IPR is being infringed, the valuation of such IPR is essential. The valuation will provide the basis for a decision to take the case to court or to opt for an Alternative Dispute Resolution System (such as arbitration), to litigate in all jurisdictions or in some only and to determine the level of damages to claim.
- When the company wants to access finance
- Securing and financing IP assets is becoming increasingly frequent (especially for big companies) and it is rather common to find IP as collateral of bank loans. Venture capital investors also evaluate the potential of the company's intangible assets before investing.
- As a strategic management tool
- The company's IPR portfolio should be managed taking into account everything that affects (or may affect) the IPRs. Not renewing a trademark, abandoning an already existing research or patenting an invention are examples of decisions that should be based on an assets profitability analysis.

2. How to perform an IP valuation



TIPS and WATCH-OUTS

Usually, the experts distinguish between quantitative and qualitative methods of evaluation and recommend choosing one or the other depending on the aim of the valuation. In most cases, a combination of both methods will provide you with more accurate and reliable information.

A. Qualitative methods

What are qualitative methods?

In qualitative methods (referred to also as evaluation methods) the approximate value of the IPR is calculated taking into account any factor that may affect the asset valuation. They are very useful when developing internal IP strategies and SWOT analyses.

Qualitative method's main indicators

The evaluation is carried out via a questionnaire where the final result is obtained from the sum of the chosen answers (score on a scale). It is possible to design your own system or to choose any of the qualitative-method based systems that are freely available (see links at the end).



Some of the key aspects when conducting a qualitative valuation are:

IPR FOCUS		
Indicator	IPR concerned	Valuation Impact
(Remaining) Lifetime/duration	All	Direct (more duration/ more value)
Reverse Engineering Feasibility	Trade Secrets, Software, Process Patents	Inverse (more REF/ less value)
Register requirements compliance	All	Lack of one of the requirements makes the IPR potentially void and reduces its value
Complexity	Patents, Utility Models	Direct
Reputation	Trademarks	Direct

Advantages and disadvantages of qualitative valuation methods

Advantages:

- **Simplicity:** the valuation is performed over easily accessible data and does not imply complex figures.
- **Flexibility:** it is possible to adapt the relative weight of different factors to the reality of the company, the market or the asset itself.

Disadvantages:

- **Accuracy:** the accuracy of the final results depends on the indicators chosen and the quality of the information.
- **Subjectivity:** indicators and their relative weight do not depend on objective factors.

STRATEGIC FOCUS	
Indicator	Valuation Impact
Geographical scope	Direct
Previous Licenses	Depending on the purpose of the valuation. If the valuation is aimed at analysing the importance of the IPR for the company, the more licenses the more turnover. On the other hand, if the aim is to grant a new license, a reduced number of previous licenses may imply a higher royalty.
Potential leveraging in other markets/ sectors	Direct
Control on the derivatives	Especially in copyright. If there are derivative works owned by third parties, the copyright value will decrease
Continuation strategy	If there is research addressed at improving the patent or a trademark family that may lead to continuing the exploitation of the IPR, it will have a positive impact on the IPR Value
Opposition/ cancellation/ infringement proceedings	It may negatively affect the value of the patent
Obsolescence risk	In the case of Patents, Utility Models and Software



B. Quantitative methods

The quantitative methods are aimed at calculating the monetary value of the IPR taking into account their costs, the incomes they generate or their market price.

METHOD	WHAT	HOW	WHEN	ADVANTAGES	DISADVANTAGES
Historic cost (Cost based)	Under this method the value of an IPR is considered to be the cost of developing it.	Include all the costs incurred to develop the IPR at the time they were incurred such as: - Labour, - Materials, - R&D, - Quality control, - Registration...	At the early stage of the lifespan of the IPR. It is the most common valuation method for accounting purposes.	- Simplicity - Availability of the data	- Does not reflect the real value of the IPR since even very "cheap" IPRs can generate a great income. - Not really useful for valuation purposes (except accounting).
Replacement Cost (Cost based)	This method assumes that the value of an IPR is directly related to the cost of developing a substitute IPR.	Identifying all the relevant costs to develop a substitute. Exclude costs related to unsuccessful attempts or prototypes.	At the first stages of the IPR's life or when the IPR can be easily substituted, patents granted on very common technologies, and "weak" or defensive IPRs. It is also useful to establish a "floor" price when negotiating the transfer or the license of an IPR.	- Simplicity - Availability of the data	- Certain IPRs cannot be easily replaced (e.g. Coca Cola or Apple trademarks or pharmaceutical patents). - Does not take into account the income that IPRs generate.
Real Options Method (Option based)	This approach treats IPRs as a series of financial options. Therefore, it takes into account expected cash-flows (As DCF does) and the information and decisions that may affect the value of the patent by using the Black Scholes pricing model (more about it and a calculator here).	Inputs needed: - Underlying Asset Value: current value of the future cash flows (DCF). - Exercise price: costs associated to the exploitation and defence of the IPR. - Time: Estimated lifespan of the IPR. - Volatility: standard deviation of the IPR expected cash flows. Risk-free rate - Estimated alterations on the IPR's lifetime	In sectors with a high degree of uncertainty.	- More complete: takes into account the cash-flows and the acquired knowledge. - Dynamic: versus other models such as DCF that are static.	- Is based on the assumption of the efficiency of the stock market, where thousands of transactions are (publicly) concluded everyday, contrary to what happens in the case of IPRs. - Some information could be difficult to obtain. - Unlike financial options, IPRs can "disappear" (e.g. be cancelled)

METHOD	WHAT	HOW	WHEN	ADVANTAGES	DISADVANTAGES
Transactional Method (Market based)	This methodology assumes that the value of an IPR is comparable to the price paid in the market for a comparable asset.	<p>1) Screening: Monitor the market in order to find similar or comparable transfers and ensure the comparability factors at legal, business and financial levels.</p> <p>2) Adjustments: in case of explicit differences between the compared IPRs</p>	Transactions, internal valuation. In markets where IPR transfers are common (and public) (e.g. University research)	<ul style="list-style-type: none"> - Market value is one of the most reliable valuation criteria. - Objectivity: This method is not based on subjective assumptions. 	<ul style="list-style-type: none"> - Difficulty to find reliable and suitable data. - Uniqueness of IPRs.
Discounted Cash Flow (DCF) (Income based)	This approach is based on companies' valuation methods. It consists of calculating the current value of the expected cash flow at a discount rate (that can be modified according to the asset's risk).	$C = \sum \frac{Cp}{(1+i)^p}$ <p>Being:</p> <p>Cp: expected cash flow in the period "p"</p> <p>i: discount rate</p> <p>p: period</p>	Funding, financing, security or venture capital investors.	<ul style="list-style-type: none"> - Availability of the relevant data. - Allows to accurately compare IPRs under similar circumstances. 	<ul style="list-style-type: none"> - Cash flows are assumed to be static - Impact of risk over the discount rate is generally based on assumptions and/or very complex statistical models. - Certain IPR-associated risks such as cancellation, dependence or obsolescence cannot be taken into account properly.
Relief-from Royalty (Income based)	The theoretical royalty that the company would pay if it acquires a license on the IPR is used as a basis of the expected cash-flow.	$C = If + \sum \frac{Rp}{(1+i)^p}$ <p>In this case, If refers to the initial fee that is usually paid for a license, whereas Rp refers to the royalty paid in each period "p".</p> <p>One should take into account that royalties are usually calculated over sales figures that should be also forecasted.</p> <p>It is also possible to use comparable royalties as a reference to use this method.</p>	Funding, financing, security or venture capital investors, especially in markets where information about royalties is publicly available (franchising, Essential Patents included within Standards)	<ul style="list-style-type: none"> - Very accurate when comparable transactions information is available. - Intuitive. 	<ul style="list-style-type: none"> - The information is not always accessible. - Certain IPR's royalty value is very low compared to its strategic value (e.g. defensive patents).

3. Related links & additional information

For more information about Intellectual Property in Latin America, please visit the Latin America IPR SME Helpdesk webpage: www.latinamerica-ipr-helpdesk.eu

Free-access IP Valuation Tools

- **IPScore:** is a qualitative method- system developed by the European Patent Office based on Microsoft Access that takes into account more than 40 indicators to evaluate your IP right.
- **IPtradeportal:** is a portal hosted by the Danish Patent and Trademarks Office (DKPTO) focused on the commercialization of IP Rights, with a section dedicated to IP valuation.

More information about valuation

<http://www.wipo.int/sme/en/documents/valuationdocs/index.htm>

http://faculty.darden.virginia.edu/chaplinskys/PEPortal/Documents/IP%20Valuation%20F-1401%20_watermark_.pdf

<http://www.ip4inno.eu/index.php?id=336>

http://ec.europa.eu/research/innovation-union/pdf/Expert_Group_Report_on_Intellectual_Property_Valuation_IP_web_2.pdf



4. Glossary

SWOT analysis: strategic tool allowing a general overview of a project, a product, a market or an asset by showing its Strengths, Weaknesses, Opportunities and Threats.

Source: www.latinamerica-ipr-helpdesk.eu

Volatility: A statistical measure of the dispersion of returns for a given security or market index. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

Source: Investopedia



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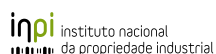
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