

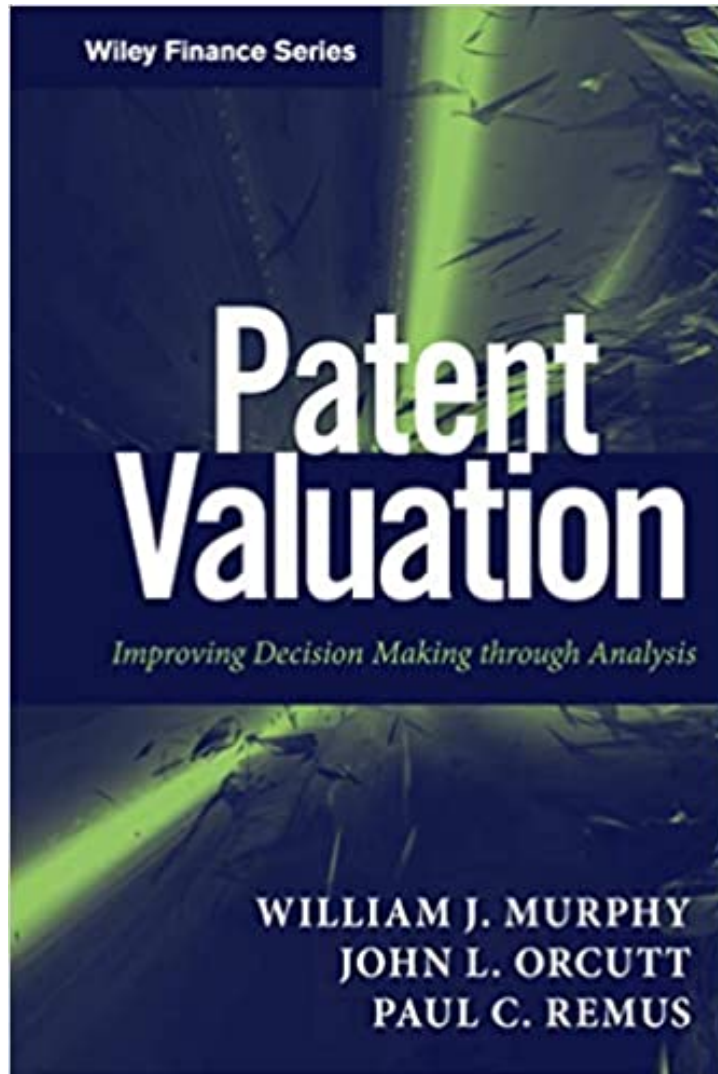
M&A, IP Valuation, and IP Lawyers

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John Orcutt is the author of . . .



Available at:

https://www.amazon.com/Patent-Valuation-Improving-Decision-Analysis-ebook/dp/B007SR648K/ref=sr_1_1?crid=I UJLK6RV7ZM3&keywords=patent+valuation+orcutt&qid=1650861497&s=books&prefix=patent+valuation+orcutt%2Cstripbooks%2C58&sr=1-1

AGENDA

- ✓ **1. Why is IP valuation important for M&A transactions?**
2. What is IP valuation? How can IP lawyers help?
3. IP due diligence
4. One closing thought





Why do companies
acquire other
companies and their
assets?

Answer

To generate future profits (or, more accurately, future cash flows*).

* The distinction between “profits” and “cash flows” is not important for this talk. They are similar concepts. Cash flows is just a more accurate, refined number.

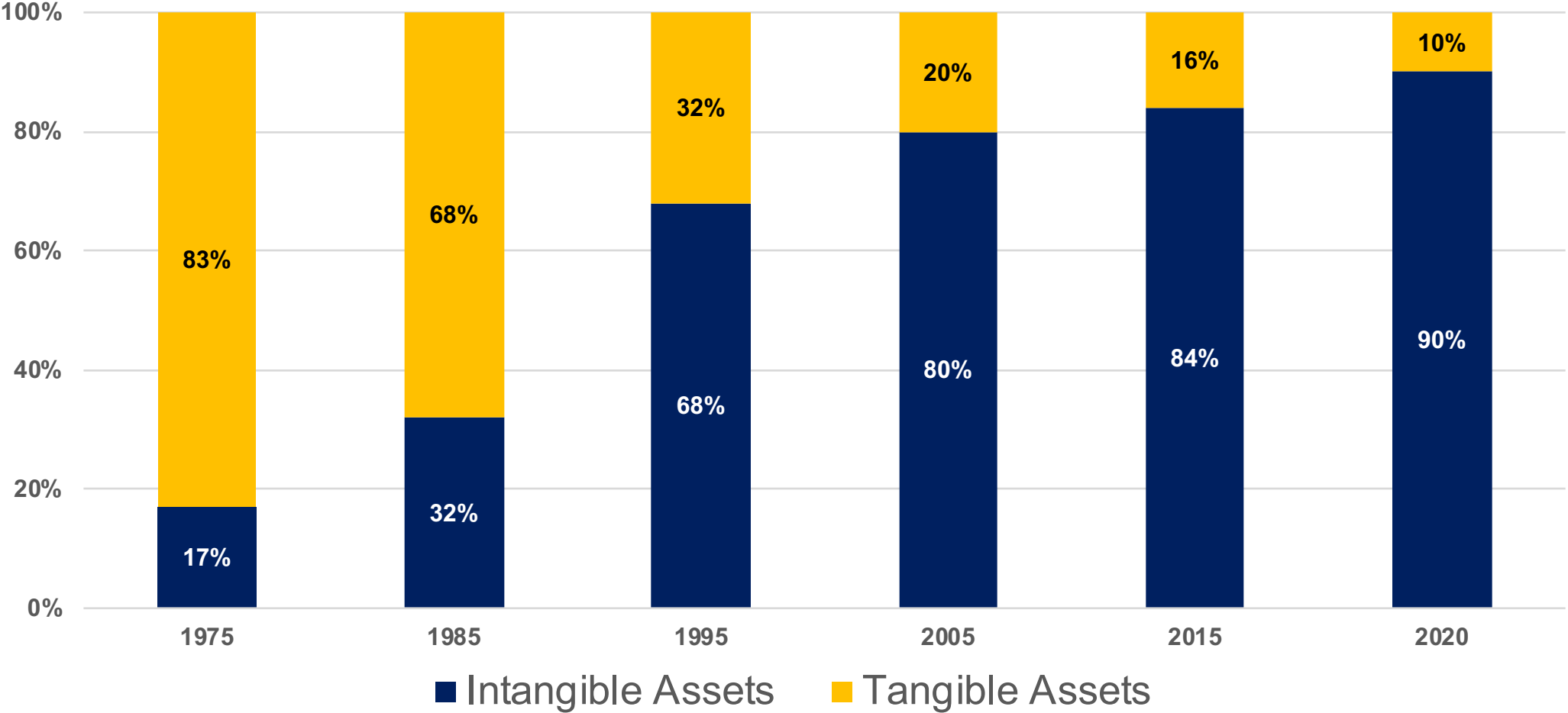
IDEAS

IDEAS

IDEAS

More and more,
innovations and their
IP protections are the
source for those cash
flows.

COMPONENTS OF S&P 500 MARKET VALUE



Source: Ocean Tomo, LLC Intangible Asset Market Value Study, 2022



What about Latin
America?

Excerpt from Oct. 2022 White & Case article* . . .

Is Latin America the next frontier for technology M&A?

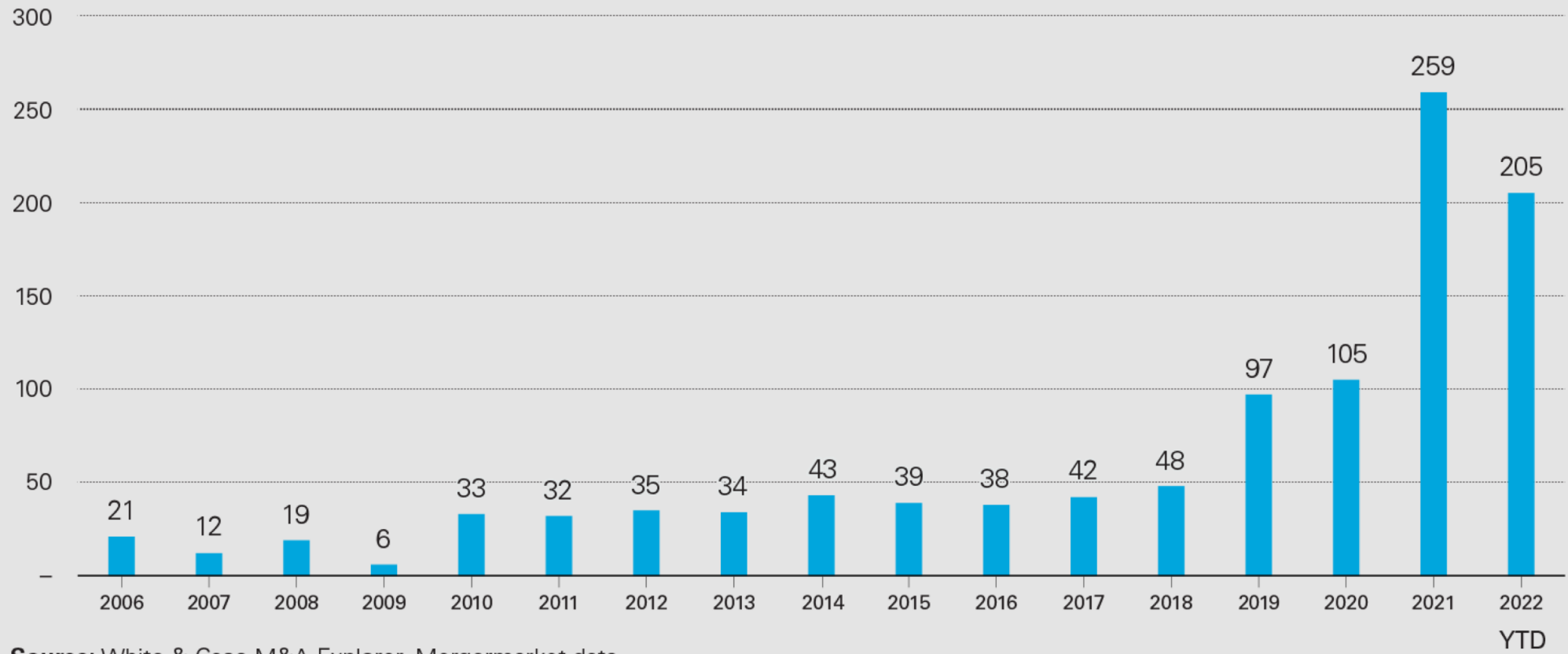
. . . Fast-forward to the 2020s, opportunities appear to be broader than energy and infrastructure, with technology becoming a critical part of economic growth in the region. . . . Fueled by a rapidly expanding middle class and an influx of foreign investment, the region saw a boom in new businesses specializing in everything from e-commerce to digital media. . . . This surge of entrepreneurial activity was particularly evident in countries like Brazil, Chile, Colombia, and Mexico, where the number of tech startups has nearly tripled in the last five years.

In the first half of 2022, technology transactions in Latin America accounted for approximately 42 percent of regional deal value. . . .

* Rodrigo Dominguez Sotomayor, *Is Latin America the next frontier for technology M&A?* (Oct. 25, 2022), <https://www.whitecase.com/publications/insight/latin-america-focus-fall-2022-latin-america-technology-ma>

From the White and Case article . . .

Technology M&A volume in Latin America



Source: White & Case M&A Explorer, Mergermarket data

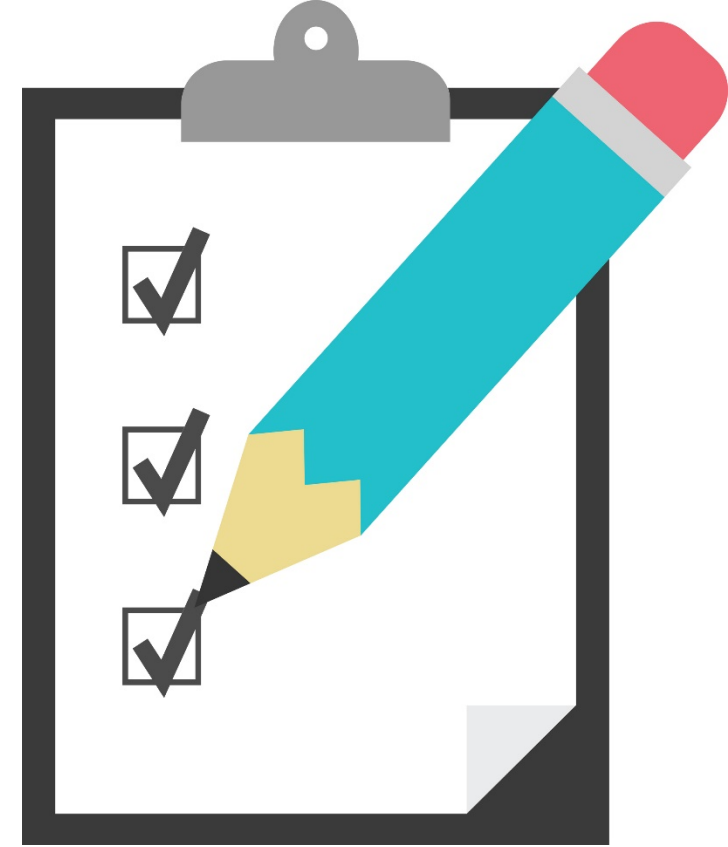


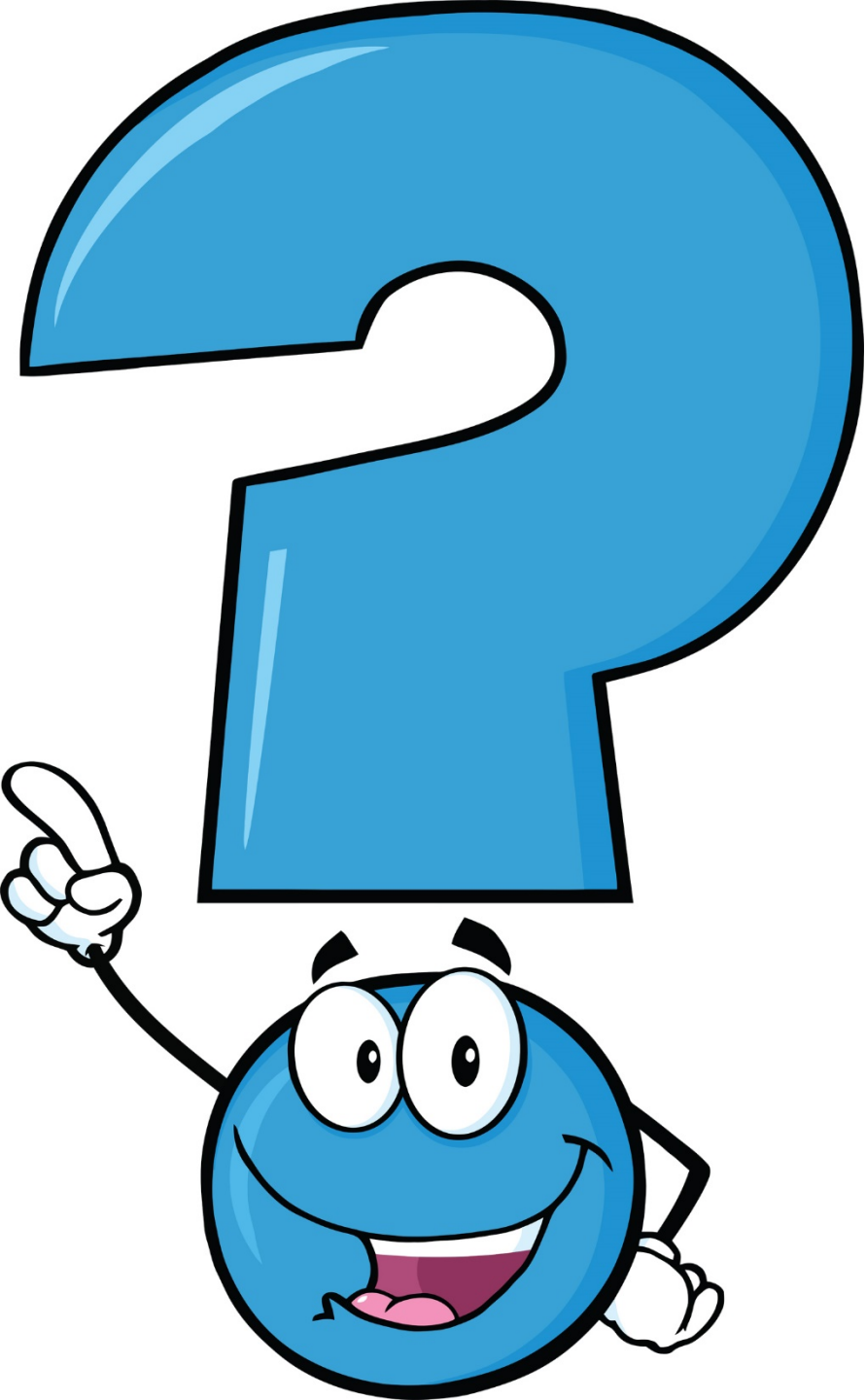
Making thoughtful M&A decisions requires valuing the target and its assets.

More and more, that requires valuing the target's IP.

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Is IP valuation the
same as traditional
valuation?

Answer

Yes and No

Let's start with
the "yes."

YES!!!

There are lots of different types of value . . .



Common types include:

1. Accounting value
 - ✓ Initial book value
 - ✓ Adjusted book value
2. Acquisition value
3. Fair value
4. Fair market value
5. Going-concern value
6. Intrinsic value
7. Liquidation value
8. Option value
9. Replacement value
10. Strategic value
11. Synergy value
12. Transaction value

Let's focus on
intrinsic value (or
real value).



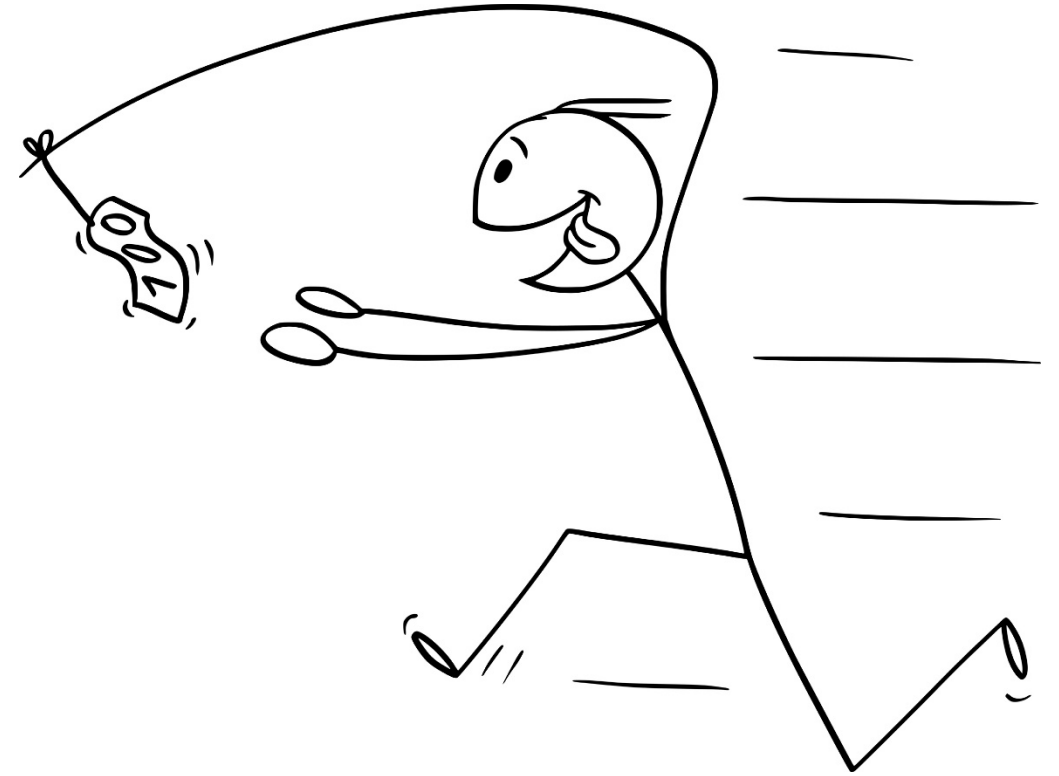
Intrinsic value =

The present value of the future benefits that result from possessing an asset.



Business/financial investors make investments to generate future cash flows.

The fundamental value of any business/financial asset, therefore, is the present value of those future cash flows.



A valuation analysis
(whether a traditional
valuation or an IP
valuation) seeks to
measure the present
value of those future
cash flows.



Typical valuation methods include:

1. A discounted cash flow (“DCF”) analysis
2. Relative value (aka comparative market method)
3. The venture capital method
4. The First Chicago method

Each method requires projecting the future profits (or cash flows) that come from owning assets and assessing their risk.



Basic arithmetic of a DCF calculation

Just to give you a
taste!!!

$$PV = CF_0 + \frac{CF_1}{1 + r_1} + \frac{CF_2}{(1 + r_2)^2} + \frac{CF_3}{(1 + r_3)^3} + \dots + \frac{CF_n}{(1 + r_n)^n}$$

Where:

PV = Present value

CF = Cash flow

$CF_{1,2,3 \text{ etc.}}$ = Cash flow in the first, second, third periods (and so on) of the stream of benefits

CF_n = Cash flow in the last period of the stream of benefits

$r_{1,2,3 \text{ etc.}}$ = Discount rate in the first, second, third periods (and so on)

So, what about
the “no”?

NO!!!

Valuing patents (or any type of IP) is comparable to valuing any other asset.

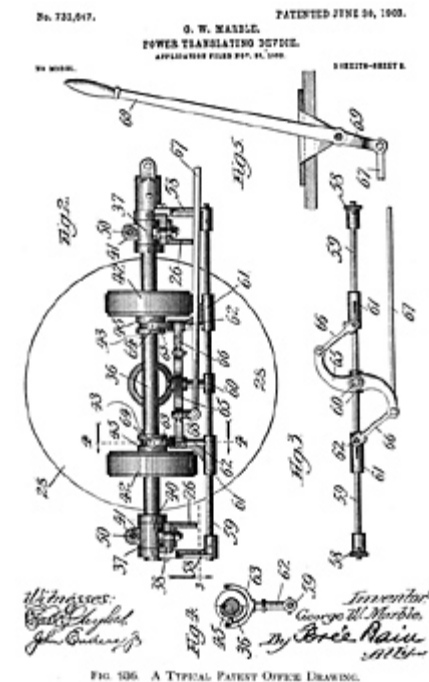
It fundamentally involves measuring the future cash flow the IP rights will generate for their holder.

***SAME AS
VALUING ANY ASSET!!!***

What is different about valuing IP (particularly patents), however, is greater complexity and more uncertainty.

*... BUT SOME
DIFFERENCES.*

A patent's value, for example, depends on various technology, business, and legal factors.



Just a small selection of the three types of factors . . .

Technology Factors	Business Factors	Legal Factors
<ul style="list-style-type: none"> • How strong is the technology? • What are the existing technology alternatives? • How easy will it be for competitors to generate new technology alternatives? • Is the technology disruptive? 	<ul style="list-style-type: none"> • What is the market for the invention? • Does the IP rights holder have a sound business plan to exploit the market opportunity? • Does the IP rights holder have sufficient resources to exploit the market opportunity? • How strong are the IP rights holder's production and distribution capabilities? • How will competitors react to the invention? 	<ul style="list-style-type: none"> • How broad are the IP rights? • How strong are the IP rights? • Does the IP rights holder operate in a highly litigious setting? • When will the IP rights expire? Can the term be extended? • What is the international coverage? Is it the right international coverage? • What tax implications do the IP rights present?

This presents challenges . . .

- **First**, each of these factors requires specific expertise, and one person may not be an expert in all of them.
- **Second**, one must consider a lot of factors to develop an informed valuation analysis.

IP attorneys play a crucial role in the valuation process. One cannot properly value IP without understanding the bundle of legal rights associated with the IP!!!

There is a tendency among valuers to make valuation analyses appear more complicated than necessary.



“Here we have the calculations for this quarter’s EBITDA.”

Any valuation exercise involves three steps:

1. Collect information;
2. Run the information through an economically valid model; and
3. Interpret the results.

When valuing IP, IP attorneys should play a crucial roles when conducting Steps 1 and 3.



Valuation analysis should not be limited to financial experts.

Almost anyone can learn useful valuation skills to help their technology-based clients.

SIMPLIFIED

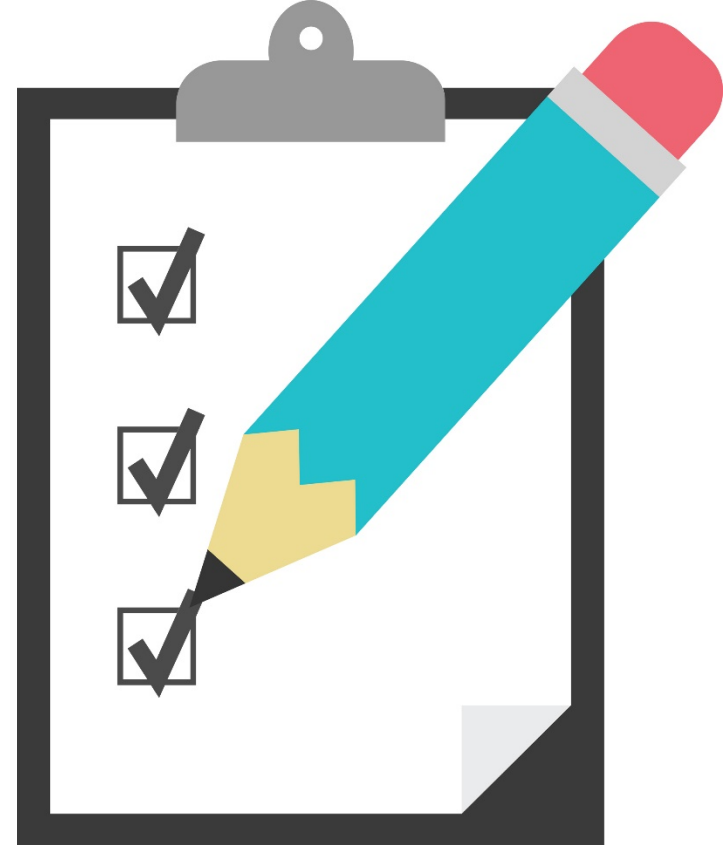
The three biggest challenges for valuing IP:

1. Complexity in how the IP generates cash flows
2. Uncertainty
3. Lack of data

IP attorneys who are willing to become “conversational” in valuation can help substantially reduce these challenges!!!

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I expect everyone uses an IP due diligence checklist when representing buyers in an M&A transaction.

Here is a link to a good example:

<https://www.skadden.com/-/media/files/publications/2014/11/ip-due-diligence-issues-in-ma-transactions-checkli.pdf>).



IP Checklists (cont.)

- Verify that your IP checklist is sufficient.
- **Buyer's counsel:** Make sure everyone on the due diligence team understands how each piece of information requested under the checklist will help your client generate future cash flows.
- **Target's counsel.** Reverse engineer your IP due diligence checklist for a buyer. Clean up legal problems that will prevent the buyer from generating cash flows from target's IP portfolio.

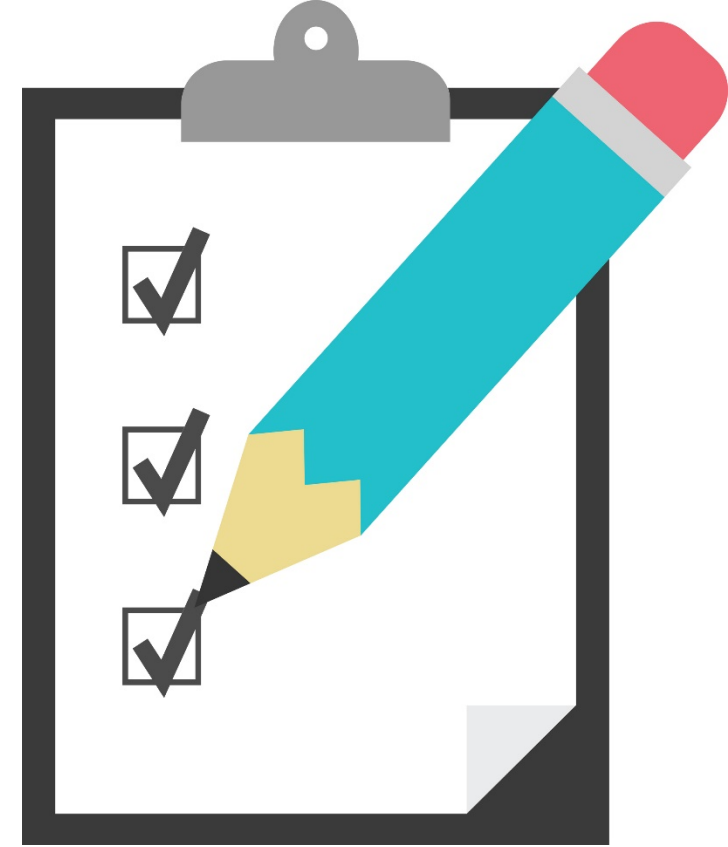
Lawyers should build their checklists in tandem with financial professionals!

Build the valuation knowledge directly into your checklists!

Lots of issues will be missed if the junior attorneys who may be doing the diligence don't understand "why" they are doing it.

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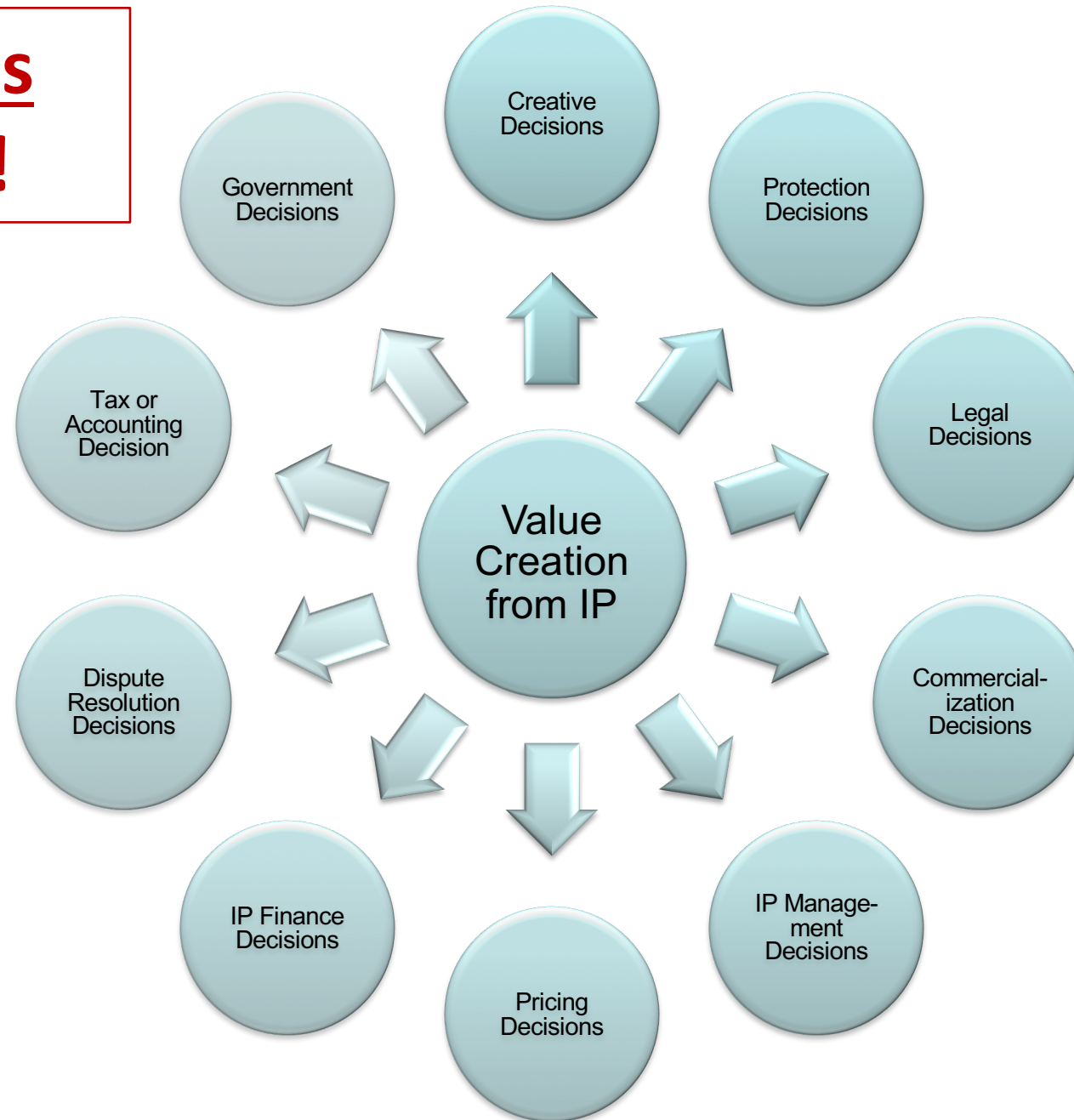
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Insight

Whether you realize it or not,
every decision you make
involves a valuation analysis.

**IP involves lots
of decisions!!!**



For IP to achieve its value-generating potential, numerous actors, performing numerous functions must make multiple decisions.

Each such decision requires a valuation analysis to be well informed!!!

Here are a few patent
examples.

EXAMPLES

Some patent **protection** decisions

- Should the firm seek patent protection for an invention?
- How much should the firm invest in the patent's prosecution (e.g., how broadly to draft the claims?)?
- Should the firm pursue a multi-country patent strategy? If yes, which countries?
- How much money should the firm dedicate to its patent protection budgets?

Who makes these decisions for your organization?

- **Patent lawyers.** Do they understand how to conduct a thoughtful valuation analysis?
- **Businesspeople.** Do they understand the technology? Do they understand patent quality?
- **Engineers.** Do they play a role?

Some patent commercialization decisions

- What is the best strategy for monetizing the patent?
 - ✓ What is the optimal strategy for transferring the rights (e.g., assign, exclusive license, sole license, or nonexclusive license)?
 - ✓ Should the company pursue a standard essential patent (SEP) strategy?
- When is the best development stage for transferring the patent rights?

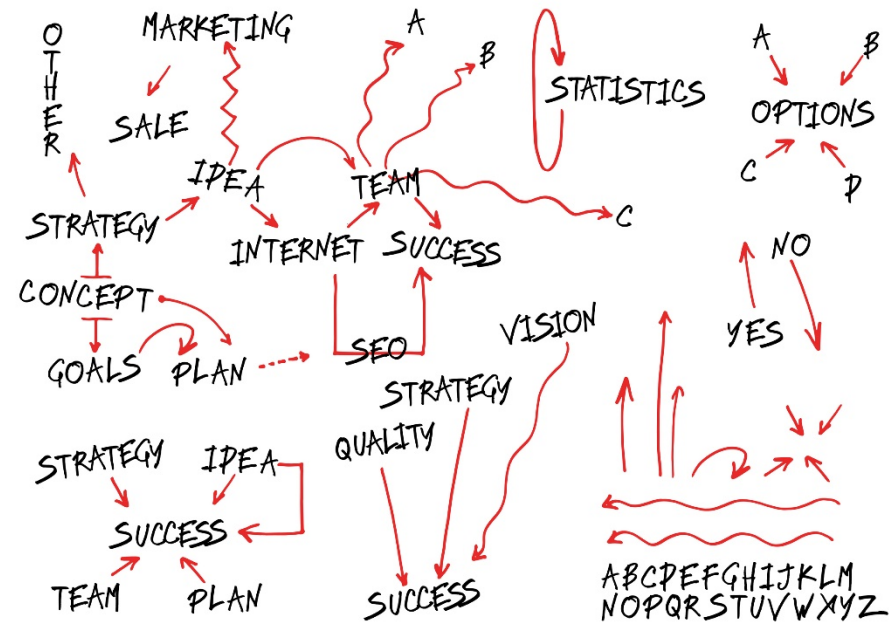
**Who makes
these decisions
for your
organization?
How?**

Some patent pricing decisions

- What price should the firm pay to buy/license-in patent rights?
- What price should the firm demand to sell/license-out patent rights?
- What is the value of licensing restrictions (e.g., exclusive v. non-exclusive, use restrictions) and how should they affect pricing?
- Should payments be in the form of upfront fees, milestone payments, performance royalties, or all three?
- If the firm is participating in an SEP patent pool:
 - ✓ Determining the profit split between parties that contribute patents to the pool
 - ✓ Determining a FRAND licensing rate

. . . and there are many, many more types of patent decisions

- IP finance decisions
- IP management decisions
- IP litigation/dispute resolution decisions
- IP tax decisions
- IP accounting decisions
- Government policy and funding decisions



The End

Thank you for letting me talk with you!!!

The IP valuation world is small. I hope
we cross paths again.

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