4. Valuing your Intellectual Property

About this guidance

This section is designed to help businesses conducting transactions involving Intellectual Property Rights (IPRs) arrive at a valuation for the IPRs. It:

- will help you understand the value of your IPRs;
- describes the common methods of valuing IPR;
- provides an easy-to-complete checklist, which you can use to assess the value of IPRs in your transaction.

There is no easy or foolproof way to value IPR and it can become complicated. This section will take a little time to read through, but it will take you a long way towards being able to take an informed decision about the value of IPR.

It will provide you with an overview of the different methods of valuing IP assets and includes a checklist on page 15, for you to undertake a valuation of the IP within your business. This valuation will provide valuable insight into the potential value of your IP assets and provide a basis for an independent, professional valuation of those assets.

In order to effectively value your IP it is recommended that you develop an IP Management and Commercialisation strategy. Guidance for the development of this is available at Section 3.

Information within this section and the IP Management and Commercialisation strategy section has been cross-referenced to help with completion of the IPR Valuation Checklist.

If you are considering finance to grow your business and would like further information regarding the different types of funding available it is recommended that you refer to the Funding available for IP-Rich Businesses at Section 5.

Why place a value on your Intellectual Property?

There are many good reasons why businesses should audit and seek to value their IP assets. IP is vitally important to businesses. Some still do not recognise the fact that their trade marks, designs, and other IP assets are as valuable as their plant, premises or stock. For many businesses, IP constitutes their single most valuable asset and could be used as a lever to secure finance for company growth.

IP valuation improves the accuracy of a business's worth. IP assets form collateral; they can also be bought, licensed and sold. Knowing how much each trade mark, patent or design is worth, alone and as part of the whole, helps businesses with their valuation (funding, transactions, joint ventures, mergers and acquisitions, bankruptcy).

In business transactions, parties must know the value of IP assets if they are to be traded. If bankruptcy or reorganisation occurs, assessment of the business's value is required and this should include the value of IP assets and the assessment of the impact of proposed reorganisation plans.

If IP assets are to be used for raising finance then an accurate valuation will be required to demonstrate to the lender the value, how it is secured and supports the future cash flow of the business.

Valuing the intangible

Discerning the value of IP is not an easy task. How much is a brand name worth after years of marketing? Does a patent protect a high value unique selling point of a product or is it redundant? A well known brand or a vital patent can be the life blood of a business and losing IP protection for these can drastically reduce its value.

Not all IP is valuable, unless they help to create, maintain or increase cash flow they may have no real value. Moreover, intellectual property rights change in value for a variety of reasons. A patent may for example begin its life as a unique solution to a problem, but in time, other solutions to the problem may be found thus reducing its worth. Alternatively, with successful marketing of an effective product a great patent can become a world beater. Trade marks generally gain value as they become better known.

The value of IPRs depends on the circumstances at the given time and place. It is important to look at the nature of the intellectual property right, the purpose for which they will be used, the potential market for them and their competitors.

IP valuation methodologies

There are a number of ways to value IP rights. They all have their limitations and no method is appropriate in every case. The stage of development of the IPRs, the availability of information and the aim of the valuation all have a bearing on the method used. Three useful examples are listed here.

1. The Cost method {ref 9, 10 & 11}

This valuation is based on the costs incurred in developing or creating an IP right, or what it might cost to recreate or develop a similar product or service; it does not take into consideration the current economic value of a product.

Costs usually included are:

- Labour,
- Materials and equipment,
- Research and development,
- Creating a prototype,
- Testing and trials,
- Regulatory approval and certification,
- Registering the IP,
- Overheads for utilities, accommodation and support staff.

This method assumes that a potential buyer can avoid these costs by buying the IPR. Valuable benefits may be:

- **Time:** by purchasing the right from the seller, the buyer will not waste time researching and developing their form of IP;
- **Expenditure:** if attempting to recreate their own IP, the buyer would spend at least this much;
- **Success:** a buyer may not be successful in developing the IP;
- **Protection:** a buyer may not be able to protect their IP, and may well be infringing on others.

This method of valuing intellectual property assets lends itself to an overall assessment when purchasing a business, and the consideration of assets when they are at an early stage in their development. However, the emphasis on costs, rather than profit, can skew the figures so that market potential is not fully recognised. This method does not take account of future value, and therefore misses out on a standard by which value is traditionally calculated.

2. The Market Value method

Understanding the value of a product based on its recent track record in the market place may be a more reliable way of establishing the market value of an intellectual property right. Assessing the sale or licensing of similar products in the market may provide a good litmus test as to the value of a right.

Market valuations of intellectual property rights provide a good estimate. The problem with this method is that it can be very hard to find published data on IP transactions, they are often confidential; moreover IP transactions are hard to generalise, there are sources of data for various sectors, but they tend to provide a wide range of figures for sales and licences which are only broadly comparable.

Few transactions are sufficiently similar to allow a valid comparison. Arrangements may differ in terms of exclusivity, payment structure, any technical/other support provided, territory, economic climate and market conditions. No two deals are the same.

This method is unlikely to be used to value patents. That is because the value of a patent depends on its novelty; and that novelty means there is unlikely to be comparable information.

That said, this method is objective and it can provide a realistic analysis of value based on a right's worth as perceived by both owners and their consumers. This method can be useful for researching the high, low and mean royalty rates paid in any given market sector. In negotiating a licence agreement for example, an agreed industry acceptable range may form the basis of a discussion.

3. The Income or Economic Benefit method {Ref 12 & 13}

This method focuses on the revenue intellectual property rights may generate in the future. It considers both the future income, which a right may generate during its economic life, and the costs of generating that income. Risk and financial costs are factored into the equation; the end result is described as the 'Net Present Value' or NPV.

This method allows a buyer to consider investment based on whether the NPV is positive or negative.

Although the NPV is a useful, easy-to-use tool, it should be remembered that the income or economic benefit method of valuation is based on an assessment of likely future events rather than past performance.

Difficulties with this method include:

- It is difficult to estimate the economic life of the IPRs;
- It is difficult to estimate the income over several years;
- Factors such as the strength of the IPR, the size of the potential market, the nature of the competition, changes in the economic climate and the cost of registering, enforcing and defending the IPR need to be taken into account.

The way in which the IPR is exploited, the costs involved, the time it will take to get to market and the risks involved along the way will vary from business to business.

Other things to consider are income which may be generated from other factors e.g. the skill of the business' staff.

Uncertainties about the future mean that it is unrealistic to project income for more than 4 or 5 years. Trying to estimate the income for early stage technology is very difficult.

A sub method of the income or economic benefit method is the **relief from royalties method**. This method assesses IP royalties. It is based on an assessment of what royalty costs a company is avoiding by virtue of owning the IP right.

The bottom line:

Valuation of intellectual property rights is incredibly important. It reveals the viability of rights. It enables owners to design coherent strategies and it underpins the purpose of intellectual property: to achieve success in the market.

Valuation Checklist

The following IPR Valuation Checklist sets out some of the factors you need to take into account when valuing IPRs. It has been designed to help you analyse whether you are in a strong or a weak bargaining position and to consider how you might improve your position. To help with completion, the questions in the first column have been cross-referenced back to parts of this section.

Feel free to add more factors to the checklist. You should answer each question in the second column.

Some of the questions may not be relevant to you or to the IPR. Please ignore those.

The final column is for suggestions as to how you might improve your position.

IPR Valuation Checklist

The following table has been devised to help you realise the value of your IP rights ready for any discussions you may have with a potential lender.

The table has been cross-referenced back to the above guidelines to help with completion.

The IPRs: ....

The proposed transaction: ....

The parties:

Business: ....

Bank: ....

QUESTION	ANSWER	Possible steps to be taken to improve the position
What benefits does the IPR bring to your business?		
a) Does the IPR allow your business to: • Generate current revenues? • Generate future revenues? • Create, maintain or increase cash flow? • Increase sales? • Price your products at a premium? • Reduce production costs? • Increase the speed of production? • Improve the quality of your products? • Create customer following? • Avoid or reduce development costs? • Increase or maintain market share by creating a barrier to competition? • Can the IP be enhanced to gain funding? • Is there any other use for the IP to generate income?		

If your business has existing licences, what benefits do they bring?		
• Do they generate revenue? • How much? • Are the terms of those licences commercially sound? • Are they exclusive/non-exclusive? • What are the threats? • Can they support the application for finance?		
The Nature and Strength of the IP		
Is the IP in the early stages of development/close to market/on the market?		
Does the IP give the owner a monopoly, (as with patents, trade marks and registered designs) rather than just a right to prevent copying?		
Does the IPR give the owner a wide monopoly?		
Is the IP new, or a modification of existing IPR?		
If it is a modification, is it vital to the operation of the product?		
Is the IPR dependent on earlier IPR?		
Has the IP been kept confidential?		

Does the business own the IP?		
Does the business have the right to license the IP?		
If the IPR can be registered, has it been registered? (Ask this question for each relevant territory)		
If the IPR is registered, will it expire soon?		
If it is about to expire, can it be renewed?		
Is the IPR likely to be challenged?		
If it is likely to be challenged, can it be easily defended?		
Does the business have sufficient resources to resist any challenge?		
Can competitors design around the IP?		
Is the IPR the subject of a legal dispute?		
If the IPR is infringed, will it be difficult or expensive to stop the infringement?		Example: Consider obtaining insurance cover
The Potential Market		
Is there a market for the products protected by the IPRs?		
What is the products unique selling point?		
What is the nature of the market?		

What is the size of the market?		
What is the value of the market?		
Where is the market?		
How much are customers prepared to pay?		
What is the potential market share?		
Does the business have skills, technology, geographic or market presence or financial resources to get the product to market?		
Will the business have to buy-in expertise or other IPR in order to get the product to market?		
Does the business have access to funding?		
What is the life cycle of the product?		
The Competition		
Does the IPR create a barrier for competitors?		
Can competitors easily work round the IPR?		
How long will it take to work round the IPR?		
How much might it cost to work round the IPR?		
How much interest is there in the product from competitors?		

Further Development and Investment		
How much will the business have to spend before the product is ready for market and attracting customers?		
How long will it take to be ready for market and to attract customers?		
What are the risks of the development not being successful?		
What are the risks of competitors getting to market first?		
The Economic Life of the IPRs		
How likely is technological change which will make the product obsolete?		
How likely are changes in legislation which will make the product obsolete?		
Are production costs likely to increase substantially?		
For how long might market share increase?		
Financial Information		
Can the existing business support the level of lending?		
Where will the money be spent?		