



Intangible Assets and Finance

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Pickwick

- An Italian businessman buys unmarked t-shirts from manufacturers of generic clothing, attaches his trademark (**Pickwick®**, which pictures a rebellious-looking teenager) and begins to sell them to retail stores
- Started in a garage in the periphery of Rome
- Today the **Pickwick®** trademark is perceived by Italian teenagers as a synonym of style and quality
- **Pickwick®** has begun to export its products across Europe
- Its trademark is its most valuable asset



Presentation Outline

- Background – New Economy and rise in importance of intangible assets
- Focus - Emergence of enterprises that are intellectual asset based (more particularly IP based)
- Issue - Raising start up funds
 - Can IP assets be used for raising finance
 - Available sources of financing
 - Obstacles to using IP - Valuation of IP assets
 - Due diligence

New Economy

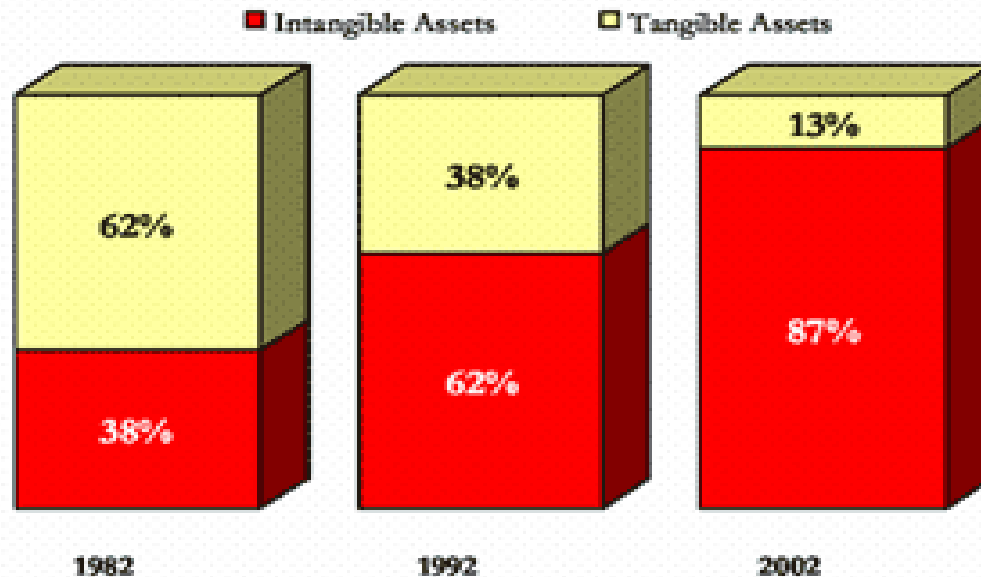
- The capability of companies to create economic value, i.e. customer value, shareholder value, and stakeholder value, is increasingly dependent on intangible assets.

New Economy

- New economy or the knowledge economy – Greater reliance on know-how, knowledge, human creativity and innovation (infinite)
 - *“It is estimated that, as much as 90% of the value of the world’s top 2000 enterprises will consist of intellectual property”* Price Waterhouse Coopers

The amount of market value that cannot be traced to tangible assets on the corporate books.

Ratio of Intangible to Tangible Assets

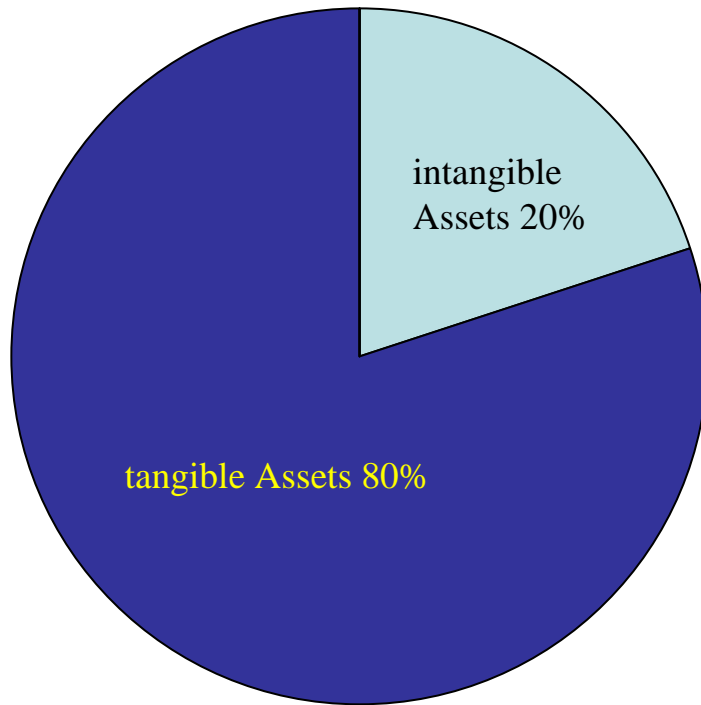


COMPONENTS OF S&P MARKET VALUE

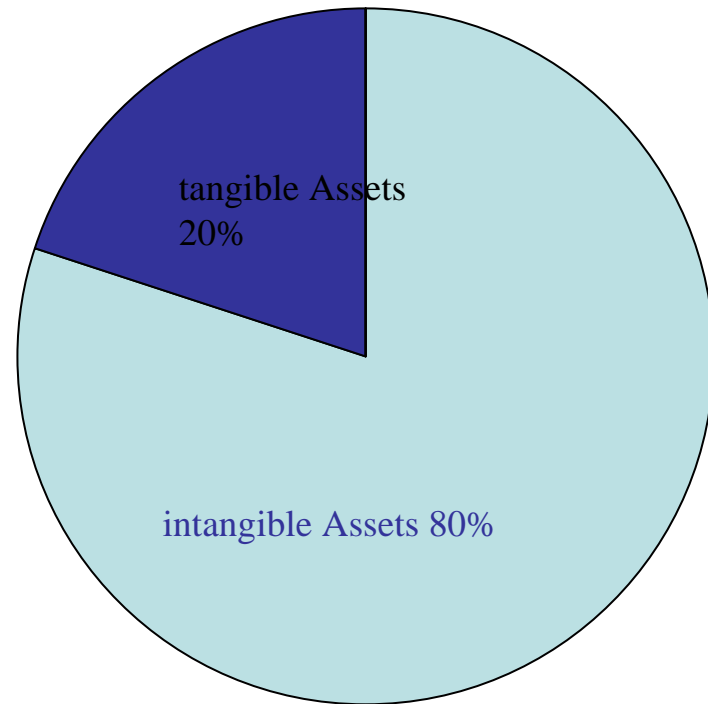
- When Netscape went public in 1995, it was a \$17 million company with fifty employees. Yet after only the first day of trading, the stock market valued Netscape at \$3 billion. What were investors buying? Certainly not fifty telephones and the company's inventory of software.
- In fact, what investors “bought” were the people who had built Netscape — their knowledge, skills, ideas and talent. They were also investing in the company's demonstrated ability to innovate, create, and bring to market a product that makes the Internet accessible to the public at large.

Intellectual Capital: Tomorrow's Asset, Today's Challenge
by Barry Brinker, CPA

Knowledge Economy



Before –
manufacturing
based economy



Now – technology and
innovation driven
economy

Intangible Assets

Marketing-related intangible assets

- (1) Trademarks, trade names, collective marks, certification marks
- (3) Trade dress (unique color, shape, or package design)
- (4) Newspaper mastheads
- (5) Internet domain names
- (6) Noncompetition agreements.

Customer-related intangible assets

- (1) Customer lists
- (2) Order or production backlog
- (3) Customer contracts and related customer relationships
- (4) Non contractual customer relationships.

Artistic-related intangible assets

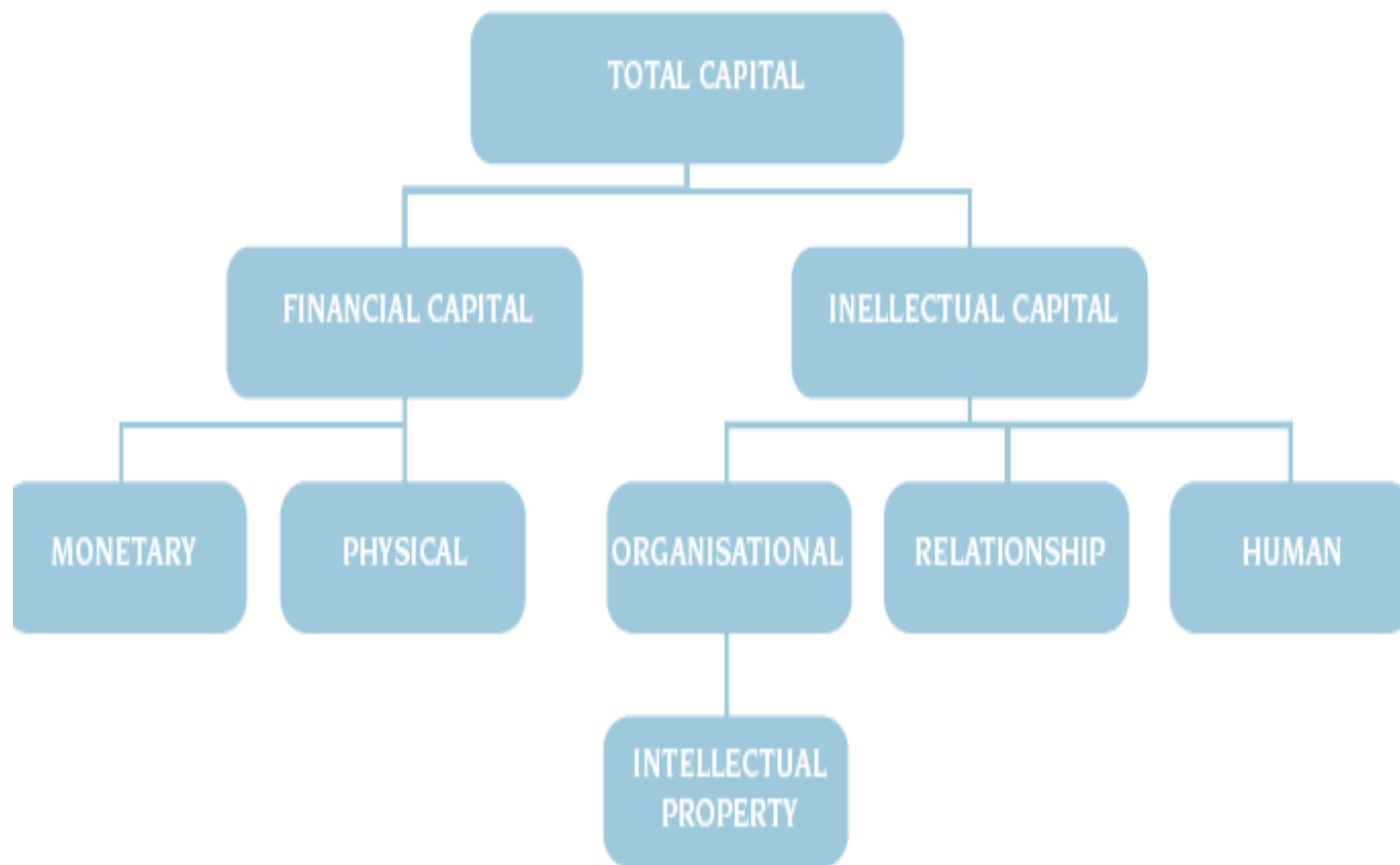
- (1) Plays, operas, ballets
- (2) Books, magazines, newspapers, other literary works
- (3) Musical works; compositions, song lyrics, jingles
- (4) Pictures, photographs
- (5) Video and audiovisual material, including motion pictures, music videos, television programs.

Contract-based intangible assets

- (1) Licensing, royalty, standstill agreements
- (2) Advertising, construction, management, service or supply contracts
- (3) Lease agreements
- (4) Construction permits
- (5) Franchise agreements
- (6) Operating and broadcast rights
- (7) Use rights such as drilling, water, air, mineral, timber cutting, and route authorities
- (8) Servicing contracts such as mortgage servicing contracts
- (9) Employment contracts.

Technology-based intangible assets

- (1) Patented technology
- (2) Computer software and mask works
- (3) Unpatented technology
- (4) Databases, including title plants
- (5) Trade secrets, such as secret formulas, processes, recipes.



- Relationship capital - customer relations, relationships with networks of suppliers and strategic partners and stakeholders of the business.
- Human capital - Collective knowledge competency, experience, skills and talents of staff.
- Organisational capital refers to knowledge that has been captured and institutionalized with an organisation's structure, processes and culture. IP is the most tangible form of organizational capital

- “Just as physical assets were used to finance the creation of more physical assets during the industrial age, intangible assets should be used to finance the creation of more intangible assets in the information age”
– Intangible Asset Monetization, Athena Alliance, 2008
- Bears mentioning that intangible assets are not entirely invisible. The value of a company as perceived by the stock market is largely to do with their intangibles

“I have nothing to declare except my genius” – Oscar Wilde

- They need financing, often at a very early stage
- Business is unproven, potential earning potential has not been established
- No collateral as demanded by lending institutions
- They have intangible assets but valuation is difficult, ownership issues, open to challenge, licensing and cross licensing issues
- They have little or no tangible assets

Sources of Finance

- Personal, family, friends and “fools”
- Debt
 - Can IP be accepted as collateral?
 - Perfecting the security right
- Equity
 - Business angels and Venture Capitalists

- Bootstrapping – fund your start up by yourself with your own personal funds.
 - Retain control
 - However less capital
- Friends and Family
 - “...\$100 billion ‘friends and family’ money is used annually to fund 3 million start ups. This compares to only \$25 billion through venture capitalists. The average amount invested by friends and family is between \$20,000 and \$25,000, and further, 58% of the fastest-growing companies in the U.S. started with \$20,000 or less.”

An introductory guide to start up funding

Debt

- When money is lent to a borrower and the latter promises to pay it back within a certain time frame, under certain conditions and usually with interest.
- Lender will require assets of the borrower to be pledged which it will take over if the borrower defaults in its payments

IP Collateral

- IP collateralisation is essentially the use of IP as collateral in a traditional asset-based loan where a lender extends credit to a company based on an assessment of disposal value of the IP that is taken as collateral in the event the borrower defaults

Credit enhancement

- A method whereby a company attempts to improve its debt or credit worthiness. Through credit enhancement, the lender is provided with reassurance that the borrower will honor the obligation through additional collateral, insurance, or a third party guarantee. Credit enhancement reduces credit/default risk of a debt, thereby increasing the overall credit rating and lowering interest rates
- “Credit enhancement firms who specialize in IP transactions give “comfort” to traditional asset based lenders, who generally are still “uncomfortable” with IP as compared to traditional collateral. Credit enhancement firms essentially guarantee the repayment of the loan to the lender. Credit enhancement firms are more sophisticated in valuing the underlying IP than are traditional asset based lenders.”

IP Collateralisation - Example



- A loan made to BCBG Max Azria Group, a manufacturer and retailer of apparel, footwear and accessories, owned by Max Azria, its founder. There, \$12 million of the \$53 million dollar loan transaction was supported by a guarantee issued by a credit enhancement firm based on the collateralization of BCBG's IP, including its current trademarks,

Perfecting a security right

- The lender needs to be assured that his right to take over the pledged asset is prior to and over and above the right of any other creditor
- Perfecting a security right requires the recording of the transaction in a public register. No such public registers exist for IP except those maintained by IP offices for establishing ownership.
 - US – Uniform Commercial Code 1 Financing Statement to be filed with the appropriate state's Secretary of State

Equity Financing

- Finance provided by investors who will provide finance in return for a stake in the company

Business Angels

- Provide their own funds in return for equity and a stake in the management
- Usually have some experience in the area and bring their expertise into the management
- Enters at the early and high risk stages, invest up to US\$1.5m and require quick and high returns

- Strategic angels - A strategic angel is someone with industry or domain expertise in what you're doing. They will also provide expertise, contacts and legitimacy to the fledgling startup.
- Non strategic Angels -wealthy people looking to diversify their portfolios (and perhaps have some fun) by investing in startups. (businesspeople, doctors, entrepreneurs, etc). If they have money and want to part ways with it for a *“piece of the action”* they're potential angel investors. Not so easy to find but they are less scrutinizing and easier to persuade to invest.

Venture Capitalists

- Invest other peoples money. They are usually investment companies
- They usually come after the angels but typically invest more
- They also require equity in exchange of the investment and a place in the board

Debt v Equity

Debt

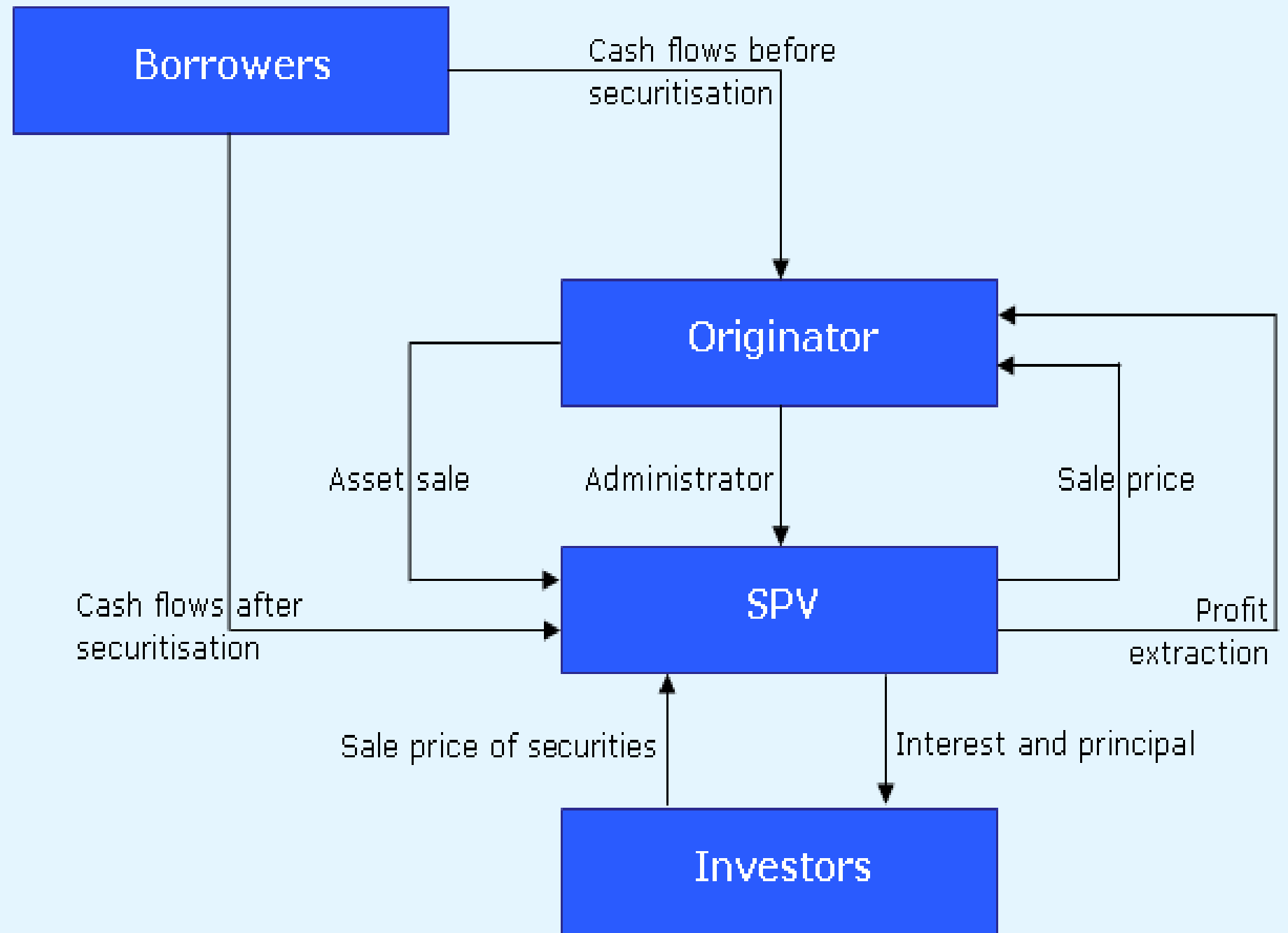
- No ownership
- Regular interest payments
- Can be paid off over time
- Tax deduction
- less complicated

Equity

- Share in ownership
- Share of profits
- No repayment

Securitization of IP Rights

- A company has a steady revenue stream from an IP asset.
- The right to the revenue stream is transferred to a new entity called a "special purpose vehicle; SPV" which holds a pool of such assets.
- The asset holder receives a lump sum representing the present value of the future cash flow of that asset.
- The pool of assets is then converted into bonds which investors buy.
- The cash flowing from the asset now flows into the SPV and is managed by the SPV for the benefit of the investors.
- The asset by being transferred is isolated from the parent company and shielded in case of bankruptcy



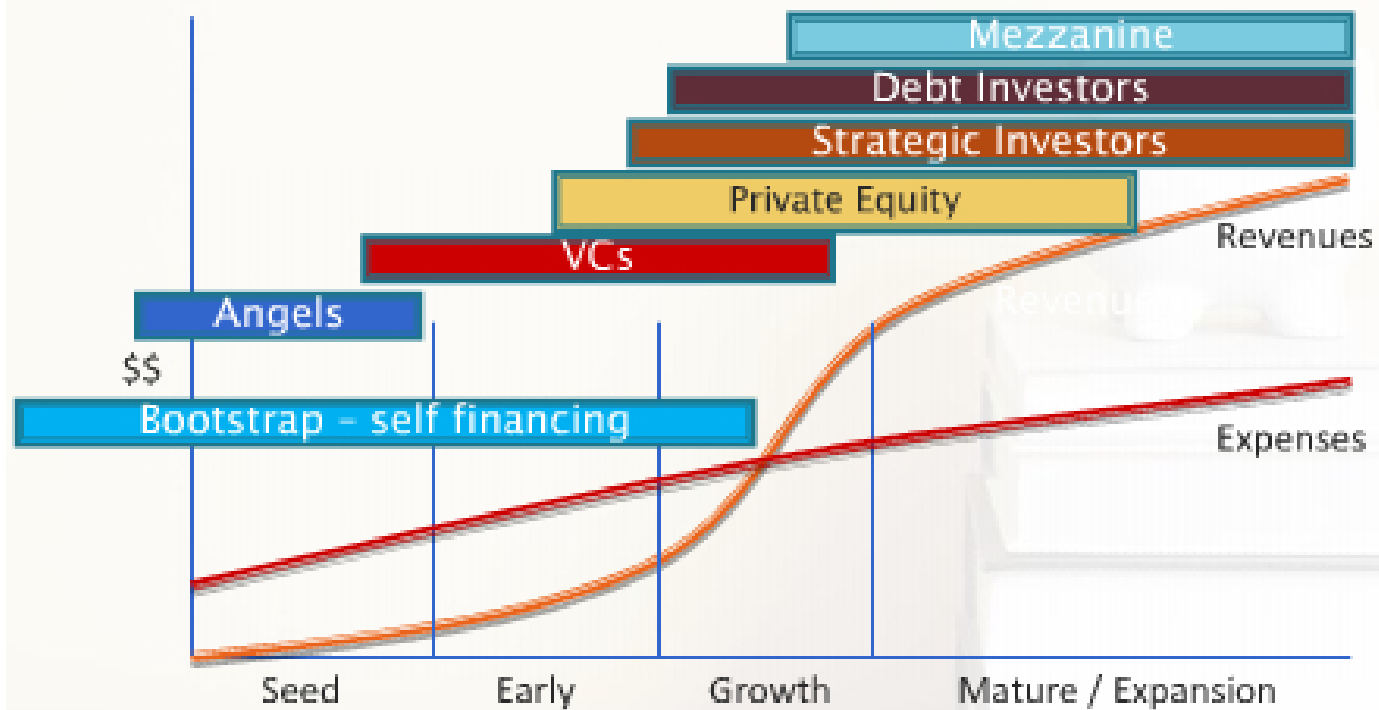
Bowie Bonds

- **Bowie Bonds** are asset backed securities of current and future revenues of the first 25 albums (287 songs) of David Bowie's collection recorded before 1990. Issued by David Bowie in 1997, they were bought for \$55 million by the Prudential Insurance Company. The Bonds were a ten-year issue, after which the royalties of the songs would return to David Bowie. By forfeiting ten years worth of royalties, Bowie was able to receive \$55 million up front, allowing him to buy out the rights to his songs owned by a former manager. David Bowie now owns the rights to all his songs

IP backed Securitization - difficulties

- Difficulty in predicting future cash flows
 - Fashion fads and public opinion
 - Technology becoming obsolete
 - Litigation rendering patents invalid
- Valuation issues
- Problems of enforcement

Financing lifecycle



Other ways of raising money through IP

- Licensing
- Sale
- Auctions
- Donation
- Grants

Methods of Valuing

- Market Approach
- Cost Approach
- Income Approach

Market Approach

- What are others paying for a similar IP? What is the market value?
- Extensive knowledge of comparable data required

Cost Approach

- Economic principle of substitution
- Reproduction cost (Exact replica)
- Replacement cost (Different form or appearance)

Income Approach

- Present value of future income stream
 - Future Income Stream (Economic Income)
 - Duration (Life: Legal, contractual, judicial, physical, technological, functional, analytical, economic)
 - Risk (Uncertainty of receiving expected income; interest rates and investment climate)

Due Diligence

- In order to obtain financing whether debt or equity those who are providing the financing will need to be satisfied as to whether the company is worthy of it.
- Important to be “investor ready”. That is show that you have taken all possible steps to identify, protect and manage your IP assets.