Challenges in harnessing IP for finance

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ADDING VALUE TO YOUR IP

Interest in utilization of intellectual property and intangible assets is large, and is growing

- Innovative companies grow faster, export more, employ large numbers of people and live longer; most are reliant on IP intangibles and lack “hard” asset collateral
- Internationally, Asian nations have been, and remain, the most active in policy terms

The hurdles to utilization lie in two main areas

- High transaction costs (of IP due diligence, valuation, guarantees, interest premiums)
- Lack of confidence in the realizable value of IP (e.g. disposal routes)

There are a number of ways to approach these issues

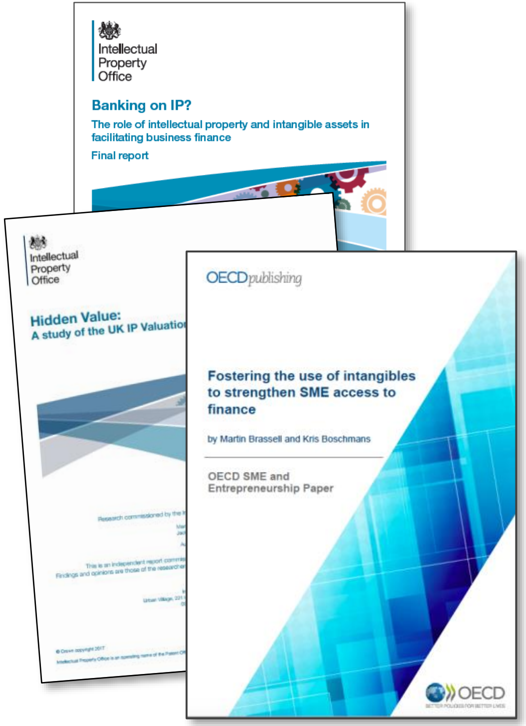
- South Korea has set out a wide range of measures to boost IP finance

It is possible for scale to be achieved

- China’s experience proves this (boosted by a wide range of measures)

Market-based solutions are also emerging

- US developments suggest how scale may be achieved in future



Korea

Korea is recognized as a technology finance innovator

- Very high rate of patenting (around 10x Singapore by number of knowledge workers)
- KIBO (KOTEC) provides recognized technology ratings to assist lender decision-making; KIPA (invention promotion subsidiary of KIPO) offers the 'Smart 3' patent rating tool

Korea's comprehensive review of IP finance in December 2018 highlighted key issues

- The intrinsic risk levels of intangibles; immature trading markets; shortcomings in investment approaches; high cost of IP valuation and lack of objectivity; and legal issues in establishing effective security interests over IP
- Need to support early stages of IP commercialization, and target the 'valley of death' at 3-5 years

Four areas of activity highlighted, targeting three challenges:

- *Extending provision and reducing interest rates;* most Korean banks now participate, offering rates of 2% - 6%; new drive to establish a KRW 500bn IP investment fund
- *Addressing lack of confidence in recoverable value;* increase guarantee levels and reduce cost; treble size of the IP recovery fund run by KDB, and create a specialist recovery institution
- *Reduce the cost, time and complexity of IP valuation;* introduce four 'modular' levels and stimulate more private sector involvement

Korea's Comprehensive Plan for IP Financing (2018) sets targets for increased lending:

- From KRW 450bn in 2018 to **KRW 2tr in value in 2022** *(SGD 520m - SGD 2.3bn)*
- From 741 deals in 2018 to **2,960 in 2022**
- From 1.4% of patents being utilized in 2017 to **8% in 2022**

(source: KIPO/KIPA)

China’s experience

China began its IP finance journey in 2006

- Alongside measures to encourage IP filing by businesses of all sizes, and legal/court system reforms to strengthen enforcement

Patent pledges have been the main focus of activity in IP terms

- Trade marks and copyright materials also leveraged for some deals
- Loan to IP value ratio generally 20% - 40%, but can extend up to 70%
- Loan tenor is normally short - often as little as 1 year

Wide local/regional variations in how IP finance is facilitated

- Interest rates can be 8-12% and valuers will charge 1-2% of loan amount
- Subsidies therefore important: these can extend to interest payments as well as guarantee and valuation fees; where available, they typically cover 50% - 100% of these costs
- Guarantees provided by a mixture of regional government-backed funds and specialist companies. Usually cover 30% - 40% of the loan, but 100% is offered in some areas

Conservative approach means default rates generally low

- But as a result, recovery experience is limited; hence, confidence remains an issue

Value of patent pledge financing in 2020 increased by 41% to **RMB 156bn (SGD 32bn)**

Scale of this increase is apparent from amount raised in successive Five Year Plan periods:

- Amount of patent pledge finance raised in 2011-2015: **RMB 168bn (SGD 35bn)**
- Amount of patent pledge finance raised in 2016-2020: **RMB 470bn (SGD 98bn)**

(source: CNIPA)

Market solutions in the US

Historically, activity has been strongest in the venture debt market

- Lending against IP value has been used to introduce a non-dilutive element into a pre-existing strong equity financing relationship

Some specialist IP financiers now work alongside commercial lenders

- These lenders generally take a first charge over IP assets as a ‘top-up’ to a proposed loan structure, if company has IP assets of sufficient importance
- Valuations typically delivered by companies operating in the business restructuring and insolvency market (e.g. Hilco, Gordon Brothers)

Collateral protection insurance policies now successfully adapted to cover IP value

- Addresses concerns over recoverable value of IP by providing a guarantee of a minimum residual value if the company defaults on a loan
- May also provide a route to capital relief for lenders, reducing cost of money (further making IP finance more affordable)
- Three brokers active in this space: first deals now being done outside the US

Aon targets IP-backed lending growth with product launch

John Hewitt Jones October 6, 2020

Aon’s IP Solutions group has launched a product to support loans issued to high-growth companies that use intellectual property (IP) as collateral.

The broker says it hopes the novel form of financing will increase the options for IP-rich businesses in early-stage development, when access to funding from equity markets can typically be expensive or hard to obtain.

Aon CEO Greg Case described the launch as a “watershed moment”, and underscored his belief that intangible assets are the foundation of the global economy.

In a press release on Tuesday, Aon said the product had already been used in a deal that provided Boston-based agricultural technology firm Indigo with a $100mn policy and loan.

entrinsic bioscience Secures $49 million in Financing to Accelerate Development and Commercialization of Next Generation Functional Ingredients and Active Pharmaceutical Ingredients

June 7, 2021 · 4 min read

AON +0.32% JEF -1.95%

- Groundbreaking Platform Poised to Disrupt Multiple Consumer Health and Therapeutic Markets

- entrinsic bioscience, Working with Aon, Leverages its IP Portfolio to Secure Insurancebacked Financing from Jefferies Funding LLC with Limited Equity Dilution

NORWOOD, Mass., June 7, 2021 /PRNewswire/ -- entrinsic bioscience (EBS) announced that it has secured $49 million in non-dilutive growth capital from Jefferies Group LLC's subsidiary, Jefferies Funding LLC (Jefferies). The event follows Series A and B raises, including multiple rounds of investment from Johnson & Johnson INNOVATION | JJDC. Aon Plc's Intellectual Property Solutions also played an important role in helping to secure key Collateral Protection Insurance to support the financing.

Observations

Transparent secondary markets for IP are very hard to achieve

- There is a lack of supply - if you take the IP from a company, there's usually no company left!
- Typically, financing issues are addressed via rescheduling/refinancing/restructuring rather than asset sales
- However, China auction sales of *liquidated* IP assets are increasing

Other measures are required to increase financier confidence in IP's recoverable value

- State-backed guarantees have traditionally been the main method
- Private sector insurance has potential to supplement these (and ultimately replace them, if scale can be achieved)
- Some IP-backed deals *have* to go bad (and lead to value recoveries) to prove that IP-backed financing really works

The type of valuation required is very specific

- Most approaches to IP valuation do not directly address the question that is most important to financiers

Creative/disruptive approaches are required to build scale

- IP and innovation are inseparable
- Standards are required - but care is needed not to over-regulate and stifle innovation