Constructing the “Price” of the Technology in IP Licensing Negotiations

Topics

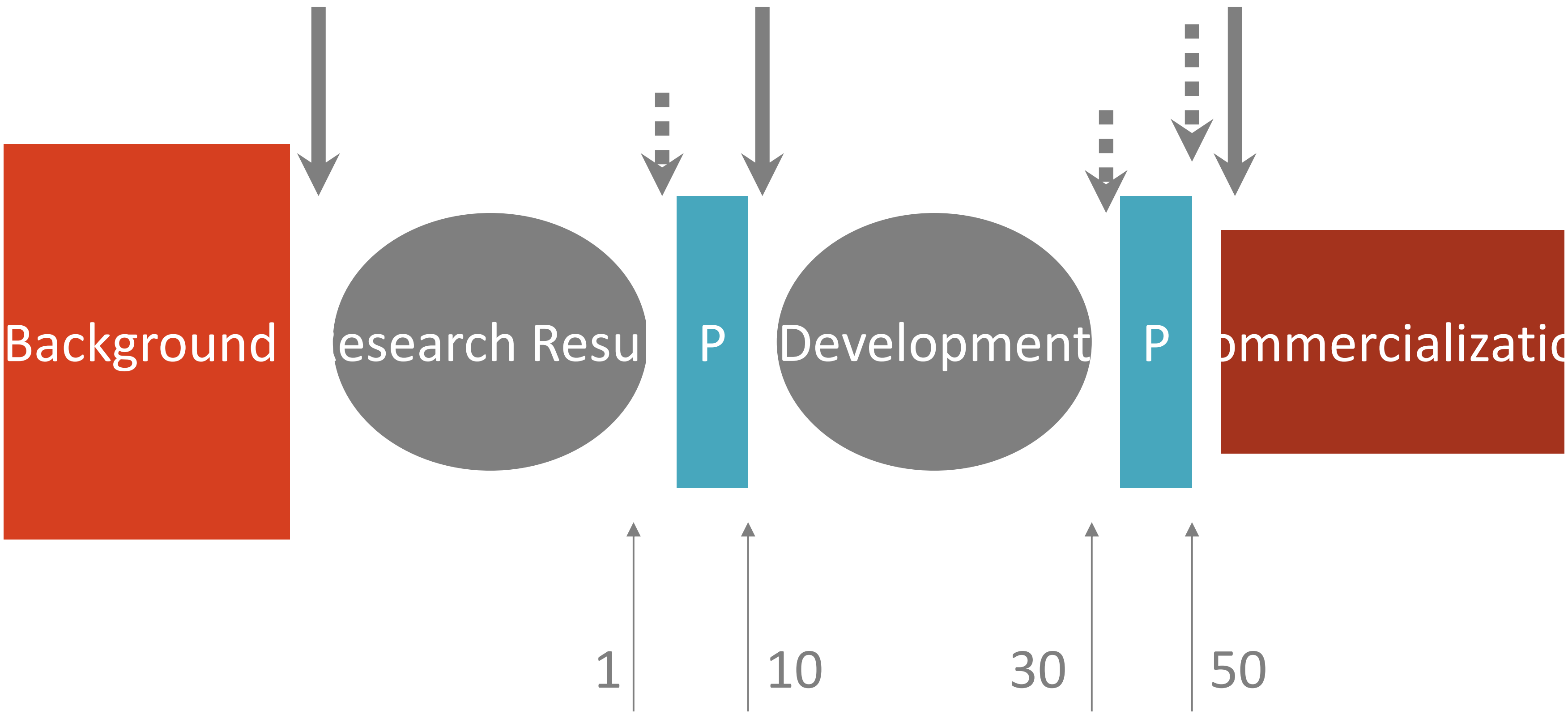
- What is Valuation
- Value and Price
- Key Terms of a Licensing Agreement
- Constructing the "Price"

IP Valuation

- Valuation – The process of identifying and measuring financial benefit of an asset.
- Valuation of Intangibles – The process of identifying and measuring financial benefit and risk of an asset, in a particular context.
- Risk
  - Time – What is the time needed to bring technology on the market? Sometimes even breakthrough technology can be « too early » for the market.
  - Money – How much more do we need to invest?
- Risk is a particularly important element in the valuation of early stage technologies – more time and money needed to bring technology on the market – less value.

Risk and Money?

Closer to the market, with and without financial partner –
the value of IP will be different for the same asset.



Intangibles
What is so Different than Valuating Tangibles?

- Most intangibles are capable to generate more than one value stream simultaneously.
- In certain contexts the value is determinate by the authority, relevant laws (tax laws) or empirical experiences.
- It is important to define approach to value:
  - Understand actual value of an asset in use for actor,
  - Potential value in use,
  - Value construction – for negotiation purposes.

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Intangibles
Value and Price

- The value of an intangible is the financial benefit that an asset can generate in a particular context, taking fully into account the risk that the investment in the development of the asset may be higher than realized value.
- The potential value of intangibles depends on the context in which that value will be realized.
- The price is not the value of an intangible asset, while the price of a tangible asset is usually the expression of the real value.
- The price is what is proposed to the other side of the deal and it depends on how « thirsty » is the other side for that particular technology.

Challenge 1. - Identifying Potential Asset

- **Potential Asset**
  - IP that can generate a value in particular context;
    - Collaboration – non exclusive license providing access to other parties;
    - Sponsored research – usually providing access and right for non – profit use;
    - Licensing to industrial partner to commertialize technology ;
    - Spin – off , Start up.
  - Entity has a control over the future generated benefits – ownership or legal contract providing control – licensing.

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R&D Context - Examples of Scoring Criteria

- Internally developed ranking criteria, such as “8 leading factors”:
  - Suitability for Suggested Application
  - Cost
  - Development Status
  - Exploitation Rights
  - Degree of Novelty
  - Marketing Interest of Partner
  - Quality of Technology Information
  - Sociability of Technology Provider

- Or
  - Patentability
  - Patent Strength
  - Status of Invention
  - Market Situation
  - Inventor’s History – Supportive or not in the process of transfer?
  - Additional Services for the Partner (potential for continuation of collaboration)
  - To whom shall invention be licensed

Elements of Ranking – IP Valuation, Wroclaw 2013, Team I

Each element has fixed weight, from 0,6 to 1,4

Element	Weight
Ease of collection	1
Market potential	1,4
Barriers of entry	1,2
Technology development	0,8
Competitors	1,2
Legal protectability	1,2
Relative technical experience	1,2
Communication skills of researches	1
Experience with business and industry	1
Interdisciplinary potential of technology	0,8

Challenge 2. Potential Value of IP for Licensee

- Context is essential
  - Collaboration – value for project result;
  - Spin off – attracting venture capitalist;
  - Licensing
- Does this IP correspond to licensee business objectives and business plan?
  - 1. Reduce the investment needed to access the marketplace;
    2. Accelerate market introduction;
    3. Minimize potential liability;
    5. Limit time commitment;
    6. Access markets otherwise inaccessible due to shipping restrictions or lack of a distribution system; or
    7. Acquire specific capabilities such as manufacturing, sales and distribution or business management
- Technical characteristics
- IP quality
  - scope of protection – "freedom of operation";
  - can patents and trade secrets be easily circumvented; and
  - the projected cost to enforce patents and trade secrets
- Market potential

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Challenge 3: Measuring the Value

- Quantitative methods attempt to calculate the monetary value of the IP and include:
  - Cost
  - Market
  - Income
  - “Rule of Thumb”
  - Monte Carlo
  - Industrial Standard
  - Real Option
  - Other Methods.

Income Method
Discounted Cash Flow Approach (DCF)

- DCF is the most frequently used approach of the Income Method;
- A projection of a **future net cash flow** expected from the commercial use of an intangible asset under review;
- Over a **period of the economic life of the IP**;
- "Discounted" by the time value of the money and **risk** ("discounted rate");
- Objective: determination of the **Net Present Value** of the IP asset.

How DCF Works
Basic Elements

- Potential Market
- Growth of the Market in the Future
- Time under Review – Economic Life of an Asset
- Penetration Rate of the New Technology
- Expected Cash Flow from the Exploitation of the New Technology
- Determination of the Net Cash Flow – as a base for discounting and calculation of the Net Present Value
- Discounting Rate
- NPV – Sum of calculated discounted Net Cash Flow for each year under review !

How DCF Calculation Work

$$PV = \sum_{t=1}^{n} \frac{CF(t)}{(1+r)^t}$$

Challenge 4: Constructing the Price

- Once we “projected” the value - question to be asked – what is the percent of potential operational profit of licensee that you think you “deserve” as a generator of technology?
- Rule of Thumb”?
- 25 – 30 % of licensee operational profit?
- 30% of NPV?
- Subjective
- Experience is essential!

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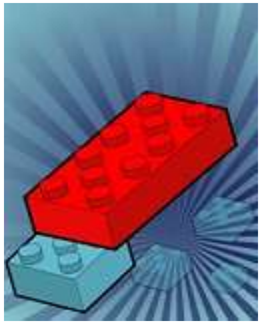
Elements of the Price of License

- Value of Technology
- Benefit and Risk - NPV
- Key Terms of Licensing Agreement
- Premium

Key Terms of a Licensing Agreement



The **key terms of a licensing agreement**

are the vital elements in the structure of the licensing agreement.

Key Terms and Business Objectives of Licensing Parties

- Key Terms are Inter - Related;
- Determined by Business Objectives of Negotiating Parties;
- What do you want to achieve with the licensing agreement will influence your options related to key terms!

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Key Terms

I. Subject Matter: What is licensed?

II. Scope: What can you do with it?

III. Financial: What value is it?

IV. Upgrades and maintenance: What will happen with it in the future?

Subject Matter of the Imaginative “Smart Turbine” Licensing Agreement

Ind. design

Patent 1 (Turbine)	Patent 2 (Integration System)	Patent 3 (Thin Film)
1. Claim	1. Claim	1. Claim
2. Claim	2. Claim	2. Claim
3. Claim	3. Claim	3. Claim
4. Claim	4. Claim	4. Claim
5. Claim	5. Claim	5. Claim
6. Claim	6. Claim	6. Claim
7. Claim	7. Claim	7. Claim

Copyright
(Software, Schematics, Documentation)

Trade Secrets
Know-how

Trademark

I. What the Licensee Wants to License IN

Patent 2 (Integration System)	Patent 3 (Thin Film)
1. Claim	1. Claim
2. Claim	2. Claim
3. Claim	3. Claim
4. Claim	4. Claim
5. Claim	5. Claim
6. Claim	6. Claim
7. Claim	7. Claim

Copyright
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Trade Secrets
Know-how

Key Terms - Scope: What can you do with it?

- Variety of options:
- Exclusive – Non Exclusive (the price will not be the same, even for the same subject matter!!)
- Time – longer legal and economic life, higher price;
- Territory - worldwide is more valuable, if you have an adequate protection;
- Field of Use – specific field or all?
- Right to Sublicense
- Use of Know – How – very valuable.
- **The scope of the rights will influence significantly the price!**

Key Terms – IV. Upgrades and Maintenance: What will happen with it in the future?

- "Grant back" – very important and valuable non – monetary compensation ;
- Additional services – training and other support;
- Responsibilities and Guaranties of Parties – licensor that takes responsibility to enforce the IP, licensee that will monitor potential infringement of IP, guaranties for the quality of the product etc…

Key Terms – III. Financial Terms

- Forms of Payment
  - Lump Sum
  - Upfront payment
  - Installment payment
  - Royalty Rates
  - Combination

Constructing a Price

Objective Elements - influencing the price, measurable

- Value of Technology
- Key Terms Negotiated
- Financial Situation of Licensee – objective, if licensee can afford to pay !

Subjective Element

- How important this technology is for Licensee in the current context? Very Important for Price!

Constructing a Price

- Depends on your business objective
  - Creating a long term research collaboration?
  - Desperately in need for up front payment NOW!
  - Continuing royalty rates flow?

  Structure of the Payment
  - Higher upfront payment – reasonable lower royalties rate;
  - Higher instalment payments – in balance with RR.

Conclusions

- Constructing the price depends on objective and subjective elements;
- The "whole picture" has to be taken into consideration – technology, key terms, context and interest of other party, to create more or less accurate price;
- Experience is essential.

- Thank you

Thank you!

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