

Money men hedge their bets at LES in New York

At this year's meeting of the LES USA and Canada, the relationship between patents and finance was high on the agenda. And while the mainstream investment community remains wary of placing too much emphasis on any kind of IP right, specialist investors are beginning to emerge

For those interested in the nitty-gritty of making money from intellectual property, the annual meeting of the US and Canada group of the Licensing Executives Society remains a must-attend event. While there are countless other IP-related conferences throughout the year, nothing has yet emerged which rivals the LES's North American get together for range and depth when it comes to IP commercialisation.

Finance was one of the key themes of this year's conference, held in New York from 10th to 14th September. And, more precisely, just where does intellectual property fit in when investors are deciding whether to get involved in a business or not? For many of those attending, the answer probably seemed obvious: it should be right at the centre of things.

Mixed message

But if that was what delegates were hoping to hear, they would have been disappointed. Speaking at the opening day keynote session, Hiram Ewald, managing partner of Virginia-based seed and early stage healthcare and IT venture firm Tall Oaks, and Mary Tanner, a long time managing director of Lehmann Brothers and Bear Sterns, and most recently the founder of Life Sciences Partners, were not so sure of IP's value. Of course, they said, intellectual property is a necessary component of any potential target, but it is very rare

for it actually to trigger an investment decision; it has to be in place, but other factors – such as management and the product being developed – are equally, if not more, significant.

Companies seeking funding need to be at the edge of the wave, said Tanner; clearly it is important not to be behind it but if you are too far ahead of it you will struggle to attract interest because people will not "get" the product you are seeking to commercialise. "There has to be a broad consensus in the scientific and investment community that any IP underpins something whose time has come," she stated.

The later the better

Intellectual property comes into its own, delegates were told, the longer a company is in business. If proprietary rights underpin a product that is on the market or is just about to hit it, they have a value because revenue streams become more certain and, therefore, predictable – vital factors if investors are looking at an IPO or, more likely these days, steering the company towards becoming an acquisition target.

"The later the stage towards commercialisation the more important the IP is. As it begins to form a part of deals or starts to generate royalties, so it becomes more tangible and you can begin to put a value on it," said another panellist, Todd

Davis of New York's Paul Capital Partners. On their own, however, IP rights mean very little.

It may all have been quite obvious stuff, but it was useful for IP professionals to hear it from the lips of those making the decisions and doing the deals. There can be a tendency for those in the IP world to overplay the role IP rights have or should have in deal making; Ewald, Tanner and Davis, as well as their co-panellist Tom Gillespie, of In-Q-Tel, provided the bigger picture. "IP is just one piece of making a product more valuable," said Davis. And whether the IP world likes it or not, that is currently the general view on Wall Street and other major financial centres.

Opportunities knock

That keynote was not the only finance-related session at the meeting. On Monday afternoon a panel session hosted by *IAM* columnist Bruce Berman featured a number of individuals who saw potential investment opportunities in intellectual property, some of which they had already begun to act upon. Berman got things started by explaining that most investors and financial institutions will not offer finance on the back of IP assets – and patents in particular. Patents, he said, were costly to obtain, uncertain and illiquid; most of them ended up being worth nothing, while

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Confusion on Wall Street

The ambivalent relationship the investment community seems to have with intellectual property is illustrated very well in the preliminary results of a survey undertaken by Charles Rivers Associates, as revealed by CRA executive Bob Goldman during the Monday afternoon session on finance, chaired by Bruce Berman.

CRA asked approximately 200 of its contacts on Wall Street – primarily equity research analysts, investment bankers and VCs – whether they believed Wall Street takes into account patent portfolios when assessing company values; 62% of those responding agreed or strongly agreed that this was the case.

However, further questioning seemed to contradict this positive finding. When asked whether patent value was reflected in cash flow projections only 22% agreed or strongly agreed, while a similar percentage agreed or strongly agreed that patent value was factored into comparable company/multiple analyses. What's more, over 50% of respondents agreed that patent value was too uncertain, that there was not enough information to assess patent values and that they lacked the scientific knowledge to assess such value.

Essentially, respondents seem to be saying that although they believe patent values are factored into company valuations, they have no real idea about how this actually happens; which is an interesting proposition, to say the least. Perhaps the finance community at large does feel that patents are an important component of company value but is still struggling to work out how to express this within current risk analysis and valuation models. And that has to be an opportunity for someone.

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those that do have potential value are hard to identify.

All of this comes at a time when there is a greater dependence on innovation than ever before, pendency times are getting longer, more patents are being issued, more disputes are occurring (though fewer are being decided by the courts, at least in the US), litigation costs are getting higher and damages awards bigger. But, Berman continued, these inefficiencies

are creating opportunities; patent-related risk may be hard to assess but for those that are willing and able to do it there is the chance to generate significant returns. For the rest of the afternoon, Berman's panellists showed how.

Investment potential

From the investment perspective, the presentation from Robert Kramer, managing partner of Altitude Capital Partners, a private investment firm whose primary focus is providing capital

to all areas of intellectual property, was the most thought-provoking. Altitude, Kramer explained, was established in the middle of 2005 with funds raised from around 25 partners, comprising family offices and hedge funds, as well as some institutional investors and high net worth individuals. The firm currently has US\$200 million under management, with a target investment range of between US\$2 million and US\$20 million.

What Altitude is offering, said Kramer, is access to money which can help IP owners solve a range of problems such as how to cover growth and operating expenses, fund future acquisitions, finance litigation and make distributions to IP owners, inventors, corporations and shareholders. Companies ripe for investment include those which have foundational IP in a particular market, own patents that cover large or multiple markets, have a high value relative to past and future damages awards or which possess robust patent portfolios in terms of number of patents and the breadth and scope of their claims and specifications. Interestingly, Altitude is also keen to partner with law firms that handle patent litigation on a contingency basis. Currently, the firm has 12 companies in its portfolio, primarily in the communications, IT and internet sectors.

For Altitude and its backers, intellectual property is just like any other asset, explained Kramer. "It is no different to a stock, bond, currency or derivative investment." That said the technical nature of IP and its ambiguities does make investment a complicated proposition. It requires a firm to have many skill sets as well as a willingness to incur high due diligence costs, while monetisation strategies are fuzzy and timetables to exit are unclear. For those who understand all of this, however, there are substantial opportunities.

Rewards available

Investors who are prepared to adapt established Wall Street thinking in order to look closely at patents could end up reaping substantial rewards – especially in the United States, with its high damages and big settlement agreements. What Kramer and his backers have realised is that many companies own patent assets that are potentially very valuable. But they struggle to raise the funds they need to grow because the mainstream financial markets find it hard or, perhaps more likely, are unwilling to spend the time and money necessary, to understand IP value. Royalty streams, however, can be long lasting and lucrative, while a beneficial litigation settlement or damages award can often generate eight or even nine figure sums. If you have robust risk assessment models, then investing a few million to buy a stake in a company and to get a piece of the action makes an awful lot of sense.

For IP owners this is good and bad news. On the plus side, the fact that Altitude and other specialist IP finance firms are out there and doing deals means there is potentially a new way to raise funds. The downside, however, is that because Altitude and the others pretty much have the field to themselves at the moment they can write the rules and do deals very much on their own terms – which means they are in a position to cherry pick their investment targets. But if this new breed of IP investor is successful that will change, as others will see the potential of their models and will look to get involved. This, in turn, will mean more competition and greater leverage for those that are seeking finance.

For the foreseeable future though, even if Altitude does find its space getting a little more crowded, such investment is going to remain a specialised field. We are still a long way away from Wall Street fully embracing IP.

Other LES highlights

The LES USA and Canada annual meeting lasted from 10th through to 14th September. Delegates were able to tune into the wisdom of a wide range of speakers.

Ted Leonsis, vice chairman of AOL, outlined his views on how the internet was in the process of change. He described three "wallets" that consumers and licensing executives deal with: these contain money, time and pixels (information). He argued that pixels have become "the new coin of the realm", and that this will drive how companies structure their internet operations.

"This is a world marked by 'coopetition'," Leonsis said. "We will license to them, and they will license to us." In this new environment, he continued, people will have to work out whether it is a good idea to license something and not get any money back, but to be content with the pixels they receive instead. Leonsis added that online advertising will be the payoff for internet companies that can attract the most pixels. "There are a lot of dollars flowing through this and it is not going to stop for a long, long time," he predicted.

Former Senator Birch Bayh gave an impassioned appeal to licensing executives not to let opponents of current licensing laws "turn back the clock". Without patent protection, he said, business and industry will not invest money to bring inventions to market. Bayh said today's critics of the Bayh-Dole Act were "small in number but very zealous in their views". They should not be denied their right to speak, "but we need to speak on our own views if we are to carry the day. These critics are intelligent and well-intentioned, but they are wrong."

On the final day of the meeting, LES President Dwight Olson passed on the gavel to 2006-07 President Allen Baum. In his acceptance speech, Baum noted that licensing professionals in the US were living through a time of great change. Publicly traded companies with business plans centred on patent collection and enforcement have sprung up, forcing many companies to pay "huge sums of money to license asserted patents". He also noted that a record number of patent cases are being heard by the US Supreme Court, while "the most extensive changes to US patent laws since adoption of the Patent Act in 1952 are pending before Congress, and the Patent Office is poised to adopt extremely significant rule changes". His hope, he said, "is that we don't overreact and squelch innovation in the process. Patent protection has fuelled investment in new technology and enabled the US – and LES professionals – to lead the world in the commercialisation of new technologies."