

Au contraire?

With many financial investors increasingly bearish on patents, true contrarians with an eye for a bargain are in a good position to profit

By Bruce Berman

An 'asset class' is defined as a group of securities that exhibit similar characteristics, behave similarly in the marketplace and are subject to the same laws and regulations. The three main asset classes are equities (stocks), fixed income (bonds) and cash equivalents (money market instruments). Some investment professionals would add real estate and commodities. Whatever the line-up, each investment is expected to reflect different risk and return characteristics and will perform differently in any given market environment.

Inter partes reviews have made it more difficult for financial investors to consider IT patents and associated business models as investible assets, even if many businesses continue to believe in their value. IP rights associated with licensing cash flows have fared better, especially trademarks, copyrights and pharmaceuticals. Uncertainty has made it more difficult to rely on many patents.

"Current low IP company share prices are a way of finding a bottom in an emerging market," says Mark Argento, head of capital markets and a senior research analyst at Lake Street Capital Partners. "It is a part of the process of patents becoming more widely understood and accepted as assets. While the shakeout is unpleasant for some, it is part of an evolutionary process."

Finding a bottom

Patents are assets without well-defined characteristics. They lack liquidity and are subject to unpredictable and often protracted legal disputes. Patents' value and time to cash are less predictable than those of more traditional asset classes. With copyrights and trademarks, cash flows can be reliably modelled, as they can with some drug patents. However, with high-tech rights, the revenue generated from licensing frequently is the asset. Strategic or defensive patent value (risk mitigation) remains locked.

The challenges associated with revenue-generating patents – validity, technological obsolescence, the cost and time to resolve disputes – make them less suitable for most direct investors. One alternative is public IP companies (PIPCOs), which offer a way to generate returns on patents through the equity markets. Despite the promise of returns illustrated in 2011 by bankrupt Nortel's \$4.5 billion sale of patents to a group led by Apple and Microsoft, and Google's \$12.5 billion purchase of Motorola Mobility, under-capitalised companies in the under-capitalised PIPCOs have performed rather poorly.

"Patents have huge potential in the right hands, at the right time, if their weaknesses and strengths can be better understood"



Bruce Berman is CEO of Brody Berman Associates, New York, United States

Higher bars for validity have put new pressure on patent values and licensing returns. For many investors, patents are no longer seen as assets, let alone part of an asset class. However, for bottom-feeders – including operating companies that can see past the confusion – acquiring patents at a steep discount is a golden opportunity to shore up their portfolios. Some IT patents can still be used to collateralise loans, although terms tend to be less attractive. Litigation funding and damages awards receivables, never a huge market, are less interesting today because of greater patent risk. Not everyone's view of patents is so sanguine. Chinese firms leveraged their patents to the tune of \$4 billion of credit in 2013. Singapore is even looking to guarantee loans backed by intellectual property.

"Truth be told," wrote Neil Wilkof in *IP Finance*, "it seems that the reason [for IP as an asset class] is simple – it sounds good. To speak of one's assets as members of an asset class is to admit oneself into the world of professional investment, be it a fund, investment bank or other source of substantial investment capital. There is a legitimate, indeed, an essential role for an ecosystem in which patents can be valued and sold. But this ecosystem is still a work very much in progress. I wish it every success – the IP profession only stands to benefit from the value that such a robust patent transaction ecosystem can bring. But let's not claim to be something that it is not, and cannot be."

Against the grain

With invention rights more uncertain, investment risks are greater. The arbitrage which investors in traditional asset classes readily accept is frequently absent with patents. Discounting patent cash risk to identify net present value (NPV) is not a simple calculation. Still, it is this very challenge that attracts some investors, especially those unable to resist a bargain – unpleasantness to some is opportunity to others.

Patents are among the most elusive and difficult to explain assets. More work needs to be done on understanding the risk profile of IT and other rights, and the strategies that support them. Patents have huge potential in the right hands, at the right time, if their weaknesses and strengths can be better understood.

Benjamin Graham wrote in *The Intelligent Investor*, a highly regarded book about value investing, that: "The investor's chief problem – and even his worst enemy – is likely to be himself."

To be a true contrarian, an investor needs to do what others are not doing when it may seem unwise to do so. It takes guts to go against a market and one's own instincts. If the investment involves patents and other IP rights which are subject to political winds, legal uncertainties and technological obsolescence, the challenge is greater still. Establishing a new asset class presents both opportunity and risk, and is subject to good timing – factors that most traditional investors do not have the experience or patience to deal with. **iam**