IP Investor

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Don't worry, be happy…

Why it makes sense to bet on IP now

New York, March 2009 ... It's been a long, cold winter. The weather has been frigid and the economic indicators bleak. And there seems to be no end to the rolling tsunami created by the sub-prime crisis. Everyone is paying the cost for false assumptions made about asset quality.

A bright spot amidst the gloom can be found in intellectual assets. What is so great about patents and other IP now? Why should businesses and investors think more about licensing, enforcing or acquiring them as the tangible part of the economy dissolves?

For all of their uncertainty patents offer something of a safe haven from the esoteric financial engineering that got us into this mess. Invention rights, the right ones at least, are attractive investments because of their inherent difficulty, not despite it. It is widely accepted that patents are too easy to obtain, difficult to understand and costly enforce. Patent-holders readily accept those assumptions.

The difference between IP assets and structured finance is that smart people made bad assumptions about questionable debt, like CMOs, but are more sanguine about the meaning of IP rights. Uncertainty makes patents less attractive to some, more to others. Intellectual Ventures reports that of its some 24,000 acquired patents the average purchase price is still only about US$60,000, up from about US$40,000 a few years ago.

Won't overpay

Patent valuations are moving targets that require context and experience. As a result patents are conservatively valued and thinly traded, which is bad for sellers and great for smart buyers. Acquirers are unlikely to overpay for patents or get caught holding assets they cannot resell because they rarely have the opportunity to do so.

This is in stark contrast to the meltdown in global asset backed securities experienced by many financial institutions. Here assumptions about asset quality and market demand ran rampant until the credit carousel stopped and banks and others actually had to mark to market dubious assets. Patent owners are never so lucky – or is that unlucky? They must live with their decisions.

There are many reasons to celebrate patents as investments. Here are nine:

- **Most IP is misunderstood.** New inventions are abstract. So are the rights that protect them. Scepticism about patents is healthy. It is what financial institutions lacked when then engaged in structured finance. Asset-backed investors blindly outbid each other for bad assets; IP investors seldom overpay for acquisitions.
- **Patents are cheap**. Despite the proliferation of IP aggregators such as RPX, Intellectual Ventures, Rembrandts, Coller and Papst, the market for patents relative to the cost in R&D, prosecution costs and filing fees is relatively cheap. The inefficient market means potential opportunities for intelligent buyers.
- **New products will help businesses emerge from the financial crisis**. Whatever the next wave of prosperity looks like, innovation and the rights that protect it will probably play a key role. The worse the financial crisis is the more important these assets will prove.
- **Strategic patents play a clearer role in profitability**. The freedom of action they provide can generate higher margins and protect market share without generating a dollar of royalties or damages.
- **Higher R&D costs are causing businesses to rethink business models.** Pharma companies learned in the 1980s that they cannot fill their pipeline with in-house discoveries. To succeed they must identify the right inventions, know-how and partnerships at the right price. They need to spend less while doing more. High-tech is just learning this.
- **Open innovation is fuelling broader, better and more efficient investments.** Open invention means greater return for more types of innovators and businesses, and greater efficiency for established ones. OI is not charity; it is good business and it requires the right patents to succeed.
- **Brand names are better positioned to endure an economic crisis; so are branded patents**. Pepsi, P&G, Kraft and McDonald's are considered among the safest investments in a weak economy. Innovation brands such as IBM, HP and Philips are likely to be seen as safer plays, too.
- **The playing field is levelling**. A more diverse and better informed worldwide pool of innovators and patent holders encourages new ideas. It has become more difficult to infringe today without being caught. This facilitates more licensing and better alternatives or design-arounds. Roadblocks for some are becoming building blocks for others.
- **Some companies need to monetise to survive**. The courts have made it more difficult, uncertain and costly to license patents and enforce them. Selling a patent can be an attractive alternative to companies without the cash, experience or timeframe to monetise it directly.

A better understanding

When wounded companies need cash all assets are scrutinised; when companies fail they often leave good assets behind. In past economic crises IP assets were often overlooked in the rush to liquidate real estate and other tangibles. That is not likely to be the case today. A better understanding of which IP rights are assets and how they return value will help businesses large and small.

Please share your reasons for IP optimism with me at bberman@brodyberman.com

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