Written by
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Let the shake-out begin

Over the next three to five years, half or more of the 30 or so public patent licensing companies are likely to merge, go private or otherwise disappear. That's not necessarily bad news for IP investors or holders

The Intangible Investor has been given first access to a revealing new public IP company (PIPCO) value study conducted by Dr Kevin Klein, director of IP licensing at Freestyle Semiconductor, a provider of embedded processing solutions. PIPX Intellectual Property Sector Index is designed to provide a measure of the general health of the PIPCO sector by comparing the relative value of key companies over time.

The index tracks changes in market cap over approximately three years for 12 PIPCOs with a value of more than $100 million. It shows that the value of many of these companies has fallen, and that their performance was significantly below that of the S&P 500. Tessera, Rambus, InterDigital, Vringo and Virnetx all increased their portion of the PIPCO pie. However, as a group, PIPX companies (valued collectively at about $9 billion) significantly underperformed in the Russell 2000 for the same period, some by as much as 100%. The best performers over the past year were Rambus (up 36.5%), Vringo (21.1%) and Network-1 (20.7%).

Peculiar performance

Klein's tracking begins on July 1 2011, a day after the conclusion of the $4.5 billion Nortel-Rockstar auction, and continues to the end of the first quarter of 2014, just one quarter shy of three years. (A second watershed event for IP value, Google's $12.5 billion buy-out of Motorola Mobility, also took place at about this time.) While patent values for wireless portfolios were at historic highs in mid-2011, they were not reflected in the stock performance of dedicated IP licensing companies going forward.

The takeaway is not as clear-cut as investors might think. Despite the price of IP asset sales and some large patent damages awards, investors clearly did not welcome all PIPCOs equally. Part of this may have to do with inflated expectations, disappointing performance or poor communications. Other factors may include impending patent legislation, increased rhetoric about trolls, a reduction in the number of large damages awards actually paid and greater investor interest in value stocks.

It appears that the bulk of the low-hanging fruit has already been consumed. Tessera, which had much of its senior management and board replaced by activist investor Starboard Value, fared better, its shares doubling from a late-2011 low.

Better adapted

The IP licensing business has been more challenging than many investors had anticipated. It is becoming apparent that some models are better adapted for long-term success than others. Despite this, the inevitable consolidation in the IP licensing sector should not be feared. Industries from biotech to entertainment have experienced similar evolutionary frustrations and have emerged the stronger for them. The bigger question is: how many IP monetisation models do we need and which ones are best adapted for long-term success?

Says Klein: "The lower returns and higher volatility of the PIPX as compared to the broad market imply that there are challenges facing investment in IP licensing as the business evolves and matures. This could be due to a deflating patent bubble. However, it may also be a sign that there are some underlying characteristics of this business that may need to be better understood to help make IP licensing a more comfortable investment for the broader market."

The entire PIPX Index and additional analysis can be seen at www.ipcloseup.com.

The likely shake-out in the PIPCO sector as companies face financial pressures and legislative uncertainty will be painful for some. Those companies that focus on getting deals done and that can initiate scores of licensing and settlement opportunities, not just a handful, are most likely to survive. Patent quality and good opportunities will be more important than ever; so will access to capital. Because I believe in this group, and in intellectual property as an asset class, I am unusually hard on it. There is a future for PIPCOs.

The so-called 'elephant hunters' – those going after the biggest game for the highest damages awards – may not necessarily fare the best. It is more likely to be those who can produce time-sensitive returns in the face of hurdles. On one level, patent licensing is likely to be more of a numbers game, with more cases brought; on another, the best assets are likely to be worth more than previously. It will be necessary to have a strategy based on quality that resonates with both licensees and investors. Whatever operating companies and lawmakers think about IP licensing businesses, they are a catalyst for patent value and quality. They beg the questions: what are IP assets and how are they best used?

Heightened impact

PIPCOs will need to distinguish themselves over time or risk being a tool of short sellers who are focused not on quality or innovation, but on getting in and out at the right time. For smaller, more nimble IP players (less than $100 million in value), the movements are magnified, and a Markman hearing or refusal of the Patent and Trademark Appeal Board to hear an IP rights case can have a disproportionate impact on shares. For many, these companies will be more fun to watch than own. That does not mean that they do not deserve serious consideration.

Whatever they may lack, PIPCOs are willing to step up and say, "Judge me" on the value of my assets and ability to generate a return. Most patent holders would rather hide behind a rock.

Bruce Berman is CEO of Brody Berman Associates in New York. Eleven years of his columns are anthologised a new book, *The Intangible Investor – Companies' Most Elusive Assets.*