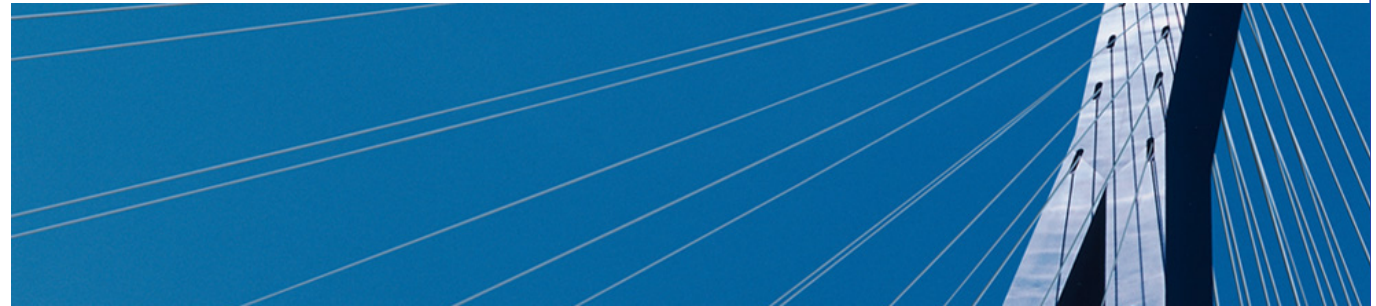
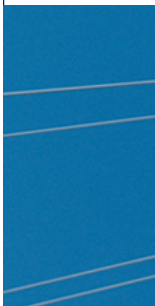


Conference „Intellectual  
Capital for Communities“

The World Bank, Paris  
May 25, 2007

# Financing based on intellectual capital

Valuation and vehicles



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## Agenda

**A**

**Valuation** of intellectual property (IP) and intellectual capital (IC)

**B**

**Vehicles** for IP/IC-based financing



## No valuation, no financing

- Thus: If ever more successful companies **thrive on their intellectual capital...**
- ... we **have to value it in a broader fashion**



## More reasons to value intellectual capital

- Companies' perspective:  
... to **improve** short-term **resource allocation** and long-term **investment strategies**, to **improve external communication** with various stakeholders  
*talent, partners, sponsors (and investors, of course)*
- Investors' and lenders' perspective:  
... to **optimize investment and lending** portfolios  
*by investing/lending even better in line with risk*
- Economies' perspective:  
... to **strengthen growth**  
*by channelling capital more reliably to most efficient users, by making capital markets less volatile, by reducing information asymmetries in capital markets*

**Sounds good – but who makes the first move?**



## Chicken and egg problem

### Typical chicken and egg problem...

- Companies: *Why report, if capital market does not appreciate IC reporting?*
- Capital market / banks: *Why learn to evaluate IC, if hardly anybody reports it?*

### ... but gradually more movement on all fronts

- *Governments*: sponsoring development of reporting frameworks/guidelines
- *Companies*: increasing number of pioneers publish IC reports
- *Capital market / banks*: joint actions to foster reporting/valuation, in Europe e. g. at
  - Action group for German financial sector (IFD)
  - Working group in Italian financial analysts society (AIAF)
  - Commission on Intellectual Capital of EFFAS



## Commission on Intellectual Capital (CIC) @ EFFAS



### Main aims of the CIC

- **Consistent positioning** of EFFAS regarding IC valuation and reporting
- Identification and **bundling of IC expertise** of European financial analysts
- **Overview of the initiatives** and experiences in US, Europe and Asia
- Development of **excellence network** with major experts world-wide



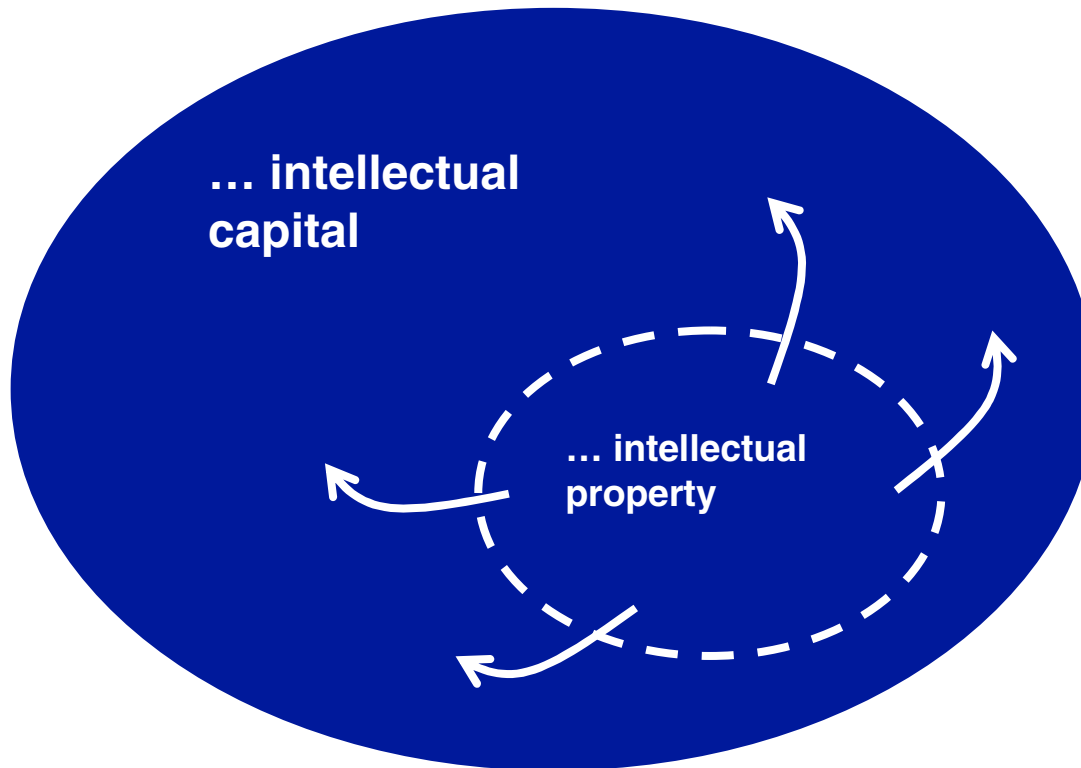
[www.effas.com/en/commissions.htm](http://www.effas.com/en/commissions.htm)



## Don't forget *IP*-based financing

(IC = Intellectual Capital, IP = Intellectual Property)

Financing based on...



- **Build on experience** in IP valuation
- Use IP-based products to **acclimatise investors** to intangibles



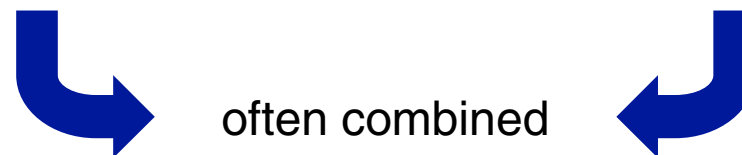
## IP valuation

### Monetary valuation

- All three “classic” approaches used  
*Income, cost, market*
- More recently also econometric methods used  
*enabling efficient valuation of large patent portfolios*
- A lot of real world experience

### Non-monetary valuation

- Usually broad set of indicators used  
*breadth of protection, legal security, holders human resources to capitalise IP etc.*
- Mainly for internal IP management
- Econometric models used, too  
*for academic and political purposes*





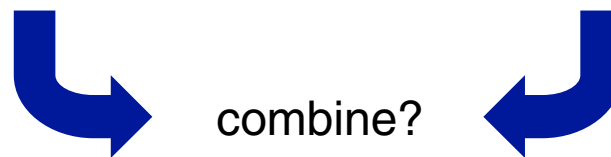
## IC valuation – monetary yardstick needed?

### Monetary valuation

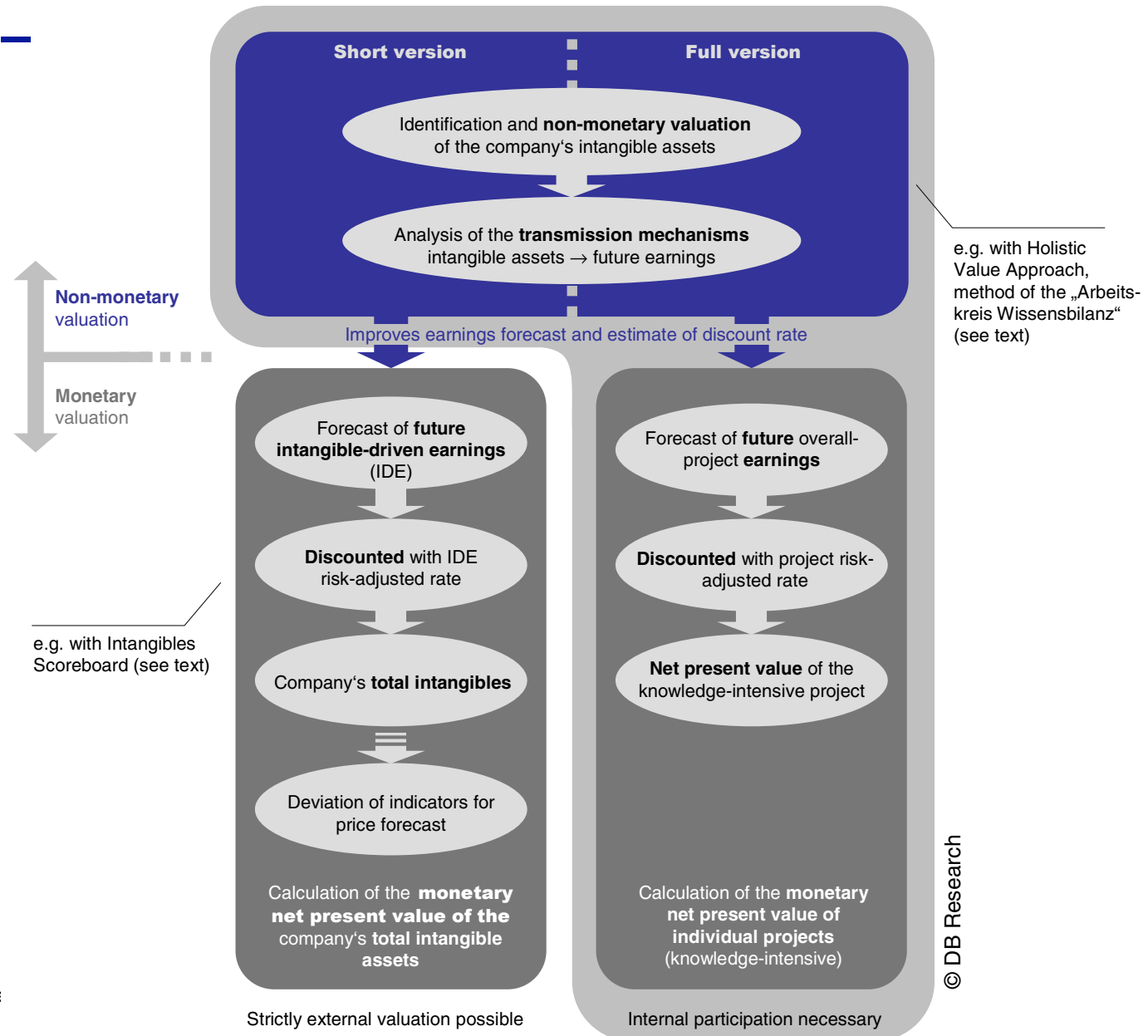
- Only “income approach” used  
*“Cost approach” rarely makes sense for intangibles, “market approach” lacks sufficiently liquid and transparent market*
- Many assumptions to be made
- Possible without inside knowledge
- Little real world experience  
*but see e. g. Baruch Lev’s “Intangibles Scoreboard” as IC valuation example*

### Non-monetary valuation

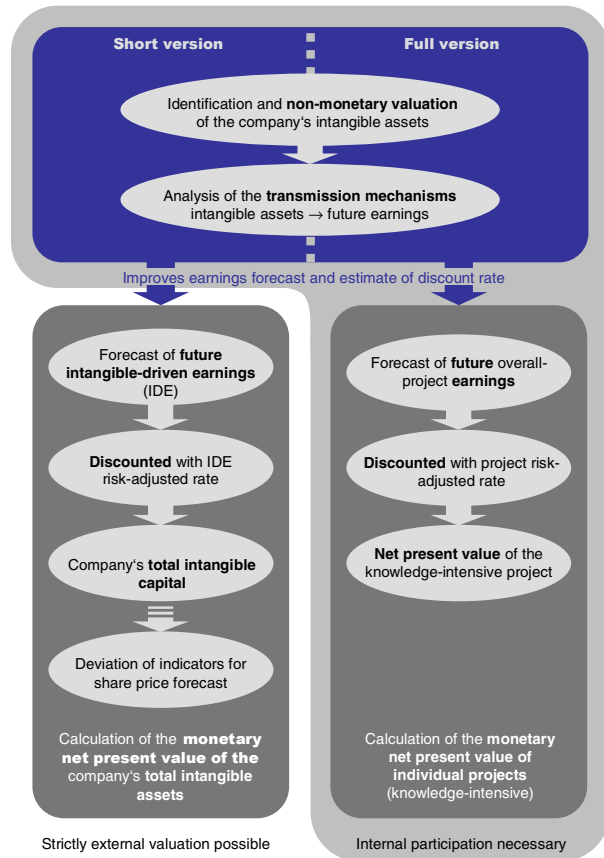
- Broad set of indicators used  
*which should be company-specific?*
- Worthwhile only if benchmarked  
*be it with companies’ own historical values or those of other companies*
- Is complex, usually needs inside knowledge  
*Laborious finding, filtering, assessing and integrating process*
- Growing real world experience



# IC valuation – a combined model...

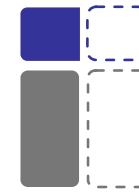


# ... applied to specific valuation purposes



### Credit rating

- Monetary valuation not necessary
- Full version of non-monetary valuation (usually) too costly



### M&A, major investment

- Monetary valuation decisive
- Non-monetary preparation possible owing to close contact with the company



### Minor/medium-sized investment

- Monetary valuation desired
- Information for non-monetary valuation often not available



### In-house planning

- Monetary valuation customary
- Full version of non-monetary valuation sensible, as it can be put to many uses

## Agenda

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## Evolution of IP/IC-based financing vehicles

- **Credit ratings** will further embrace IP (and later IC) valuation  
*Basel II might help*
- **Equity analysts** will broaden their IC/IP valuation  
*Analysts societies envision extension of their training*
- More and more **mergers and acquisitions** are all about IC/IP  
*Just look at the prices paid recently for internet community site companies*
- **Bundling IP in funds, securitising IP** are growing markets  
*and IP valuation the prerequisite*

... and even more sophisticated IP/IC-based products are to follow



Example 1

## IC/IP-embracing credit rating

A possible – if costly – procedure would be to:

1. Identify and analyse (only) those **intangibles of particular relevance** to the company-specific value-added process  
*In doing so, (a) gear the approach to a proven method of (non-monetary) IC valuation, and (b) try to condense them into one single indicator (in a systematic way)*
2. Analyse the **transmission mechanisms** that transform those pivotal intangibles into future revenues  
*Are internal training and external networking synchronised with the R&D roadmap? Is the roadmap conducive to the realisation of the general corporate strategy? Etc.*
3. **Re-use** this pattern for follow-up ratings  
*The analysis profile developed in (1) and (2) can be applied again, decreasing average costs*

These three steps can **complement the classic credit risk review**  
*but would make new/adapted business models necessary*



Example 2

## Patent funds

- Products hit the market in recent years
- Level of sophistication is rising
- Latest examples: “Patent Select I, II”



### Patent Select I, II

(Deutsche Bank, Clou Partners)

- sophisticated patent **selection process** (starting from very large candidate pool)
- 12 patents (or patent families) acquired
- patents to be **refined by fund** (development of prototypes etc.)
- closed fund, finite duration (appr. 6 years)



## Example 3

**Securitisation of IP**

The market is still young and mostly opaque – but promising:

**Securitised intangibles**

Securitisations of future income backed by intangible assets

<b>Issuer</b>	<b>Assets</b>	<b>Value (USD)</b>	<b>Year</b>
David Bow ie	Music rights	55 m	1997
James Brow n	Music rights	30 m	1999
DreamWorks	Film rights	1 bn	1997
DreamWorks	Film rights	1 bn	2002
Guess?	Brand rights	75 m	2003
Royalty Pharma*	Pharmaceutical patents	225 m	2003
Athlete's Foot	Franchising/brand rights	30-50 m	2003
Dunkin' Brands	Franchising/brand rights**	1.7 bn	2006

\* Earlier securitisation of an individual patent failed owing to lack of diversification

\*\* Includes a minor share of rights to tangible assets

Sources: The Pullman Group, Washington Core





Example 4

## Patent auctions

Latest one **last week in Munich**, Germany

- “Live market valuation”
- Appr. 400 patents offered, in three hours
- About a third each by corporates, research institutes and individual inventors



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