



EXTRACTING VALUE FROM IP

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Why is IP valuable?

- Forces redevelopment – redevelopment cost / time
- Reputation attracts custom
- Monopoly over feature demanded by market
- Protects process / feature that saves people money
- Is a “building block”



1. Redevelopment cost

Account for:

- Cost to redevelop
- Associated risk
- Time in the market



2. Drives sales

Royalty = **20%** to **33%** of PBIT

Use of the 25 Per Cent Rule in Valuing IP by Robert Goldschreider, John Jarosz and Carla Mulher
December 2002 at p123)



Industry	No licences	Median royalty rate	Royalty rates and successful licences ratio	
			Avg operating profits	Royalty as a % of profit
Automotive	35	4.0%	11.3%	44.1%
Chemicals	72	3.6%	12.0%	25.0%
Computers	68	4.0%	8.3%	33.3%
Consumer Goods	90	5.0%	18.4%	27.1%
Electronics	132	4.0%	13.1%	34.3%
Energy & Environment	86	5.0%	9.2%	38.1%
Food	32	2.8%	14.2%	15.8%
Healthcare Products	280	4.8%	18.5%	21.6%
Internet	47	7.5%	10.4%	48.0%
Machine/Tools	84	4.5%	9.6%	35.0%
Media & Entertainment	19	8.0%	-13.5%	-66.7%
Pharma & Biotech	328	5.1%	25.8%	17.4%
Semiconductors	78	3.2%	31.9%	7.8%
Software	119	6.8%	25.1%	21.4%
Telecom	63	4.7%	14.5%	34.5%
Total	1533		18.8%	26.6%

25% Rule - example



PBIT example:

Sales: R15,000,000
 Cost of sales: (R10,000,000)
 Overheads: (R2,000,000)
 Interest: (R500,000)
 Tax: (R600,000)

PBIT: R3,000,000

Applying 25% Rule: Royalty = R750,000 pa
 = 5% of turnover (i.e. R750k/R15m)

Q: What if you are already licensing in technology and paying R150,000 royalty?

25% Rule



Where in the range?



V

ALC ▲ TEL

3. Cost saving



- You generate 10% PBIT
- Someone offers you technology that will add 2% to your profits (i.e. PBIT = 12%)
- How much royalty will you pay?

Discount rate



Unsystematic risk premium:

Relative risk and return

Risk free rate	3%
Mature product	10% (ie 2% UR)
Pre-national launch	15% (ie 7% premium)
Technology only is sure	25% (ie 12% premium)
Embryonic R&D (US info – 5% SR)	50% (ie 42% premium)

Discount rate



"Valuation and pricing of technology-based IP" by R. Razgaitis (2005):

- **"Risk free"** such as building a duplicate plant to make more of a currently made and sold product in response to presently high demand. Approximates corporate rate of borrowing: **10-18%**
- **"Very low risk"**, such as incremental improvements with a well-understood technology into making a product presently made and sold in response to existing demand: **15-20%**; discernibly above the corporation's goals for return on investment to its shareholders
- **"Low risk"**, such as making a product with new features using well-understood technology into a presently served and understood customer segment with evidence of demand for such features: **20-30%**
- **"Moderate risk"**, such as making a new product using well-understood technology to a customer segment presently served by other products made by the corporation and with evidence of demand for such a new product: **25-35%**
- **"High risk"**, such as making a new product using a not well-understood technology and marketing it to an existing segment or a well-understood technology to a new market segment: **30-40%**
- **"Very high risk"**, such as making a new product with new technology to a new segment: **35-45%**
- **"Extremely high risk"**, such as creating a startup company to go into the business of making a product no presently sold or even known to exist using unproven technologies: **50%-70% of even higher**

(corresponds to a Treasury Bond of 7% and SRP of 5%)

Discount rate



Example:

<u>DR</u>	<u>5yr</u>	<u>10yr</u>
15%	Benchmark	Benchmark
25%	?%	?%
35%	?%	?%
45%	?%	?%

Discount rate



Example:

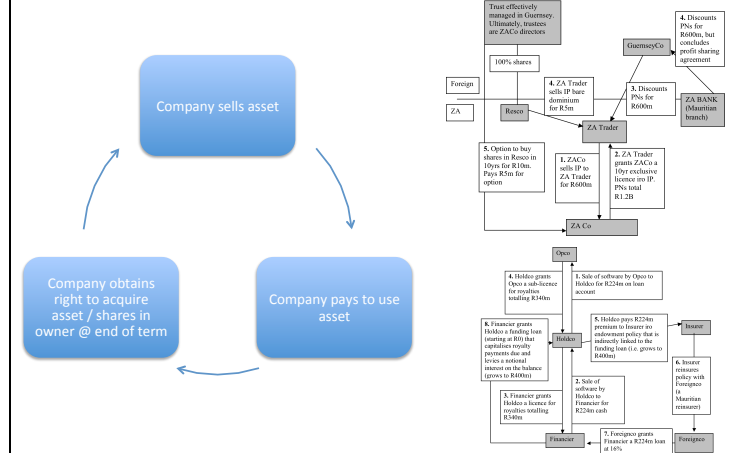
<u>DR</u>	<u>5yr</u>	<u>10yr</u>
15%	Benchmark	Benchmark
25%	-21%	-33%
35%	-36%	-52%
45%	-47%	-63%

Transactions



- Supply / Distribution
- Licence
- Assignment

IP as financing asset



Shifting IP offshore



Consider:

- CFC tax legislation
- Transfer pricing legislation
- Dividends
- Exchange controls
- Economic ownership
- Effective management
- Whether have BE
- Withholdings taxes - DTAs