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Case Study

Valuing Intellectual Property Licenses

Topics discussed in this paper include

Licensing | Royalty Rates | Intellectual Property

A software developer is enjoying significant success with a product deployed in call-centres. The unique product has attracted the attention of a number of large firms keen to acquire the software for themselves. The developer would prefer to retain control and license the product to others. The developer has a challenge: how to properly weigh up the offers to buy the Intellectual Property rights against the long-term income that would be derived from licensing the software.

Background

Software development company Amber Orange Ltd has developed a unique product that is becoming highly sought after. The tool assists IT Help Desk operators to quickly and accurately determine faults in users hardware or software. This reduces average call times, thereby providing considerable labour cost savings and improvements in customer experience.

Situation Analysis

Software (or code) is Intellectual Property, the ownership of which is protected automatically under copyright in the same manner as written work or art.

Several large IT and software companies are interested in the software and Amber Orange has been approached by various parties seeking to purchase the IP/copyright outright. The company's founder, Ms Copper, did not wish to sell the IP/copyright, preferring instead to issue licensing rights to use the software. The offers being made for purchase were so substantial her decision was complex.

On the advice of her Accountant, Ms Copper sought an independent valuation of the IP/copyright inherent in the software to help guide her considerations if she decided to sell.

The valuation also needed to help her set a benchmark for an appropriate fee if she decided to retain ownership and go down the road of licensing usage instead.

In the first instance, the Valuer used a ***'Discounted Cash Flow Method'*** to value the business enterprise (including IP). A residual approach was then used: the tangible assets of the business were deducted from the enterprise value to determine the intangible asset component, which includes Goodwill and IP/copyright.

The final step to determine the IP value was to allocate the intangible component between Goodwill and IP. This is a very difficult step that can at times become subjective. This is where the benefit of using an experience and independent valuer is invaluable.

Once the value of the IP was determined, the Valuer used an ***'Industry or Market Method'*** to value the license fee associated with the Intellectual Property. This method was adopted as it is one of the most widely accepted methods for valuing license fees and royalties. The valuer accessed a large database of royalty rates used in other software licensing deals as the basis for this assessment.

Outcome

The fundamental principles of IP valuation and license/royalty rates are closely aligned, both are driven by the earnings capability of the asset. By having an independent market value of both the IP and the license to use the IP, Ms Copper was then able to make an appropriate and informed decision about the next step in the successful development of her valuable product.

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