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Confederation of Indian Industry

IP-Backed Financing: Using Intellectual Property as Collateral

DECEMBER 2019

Table of Contents

Foreword by Duff & Phelps

Varun Gupta
Country Leader India and Head of APAC
Valuation Services Duff & Phelps

Dear Reader,

We are delighted to launch a joint publication with the Confederation of Indian Industry ("CII") on **Intellectual Property Backed Financing: Using Intellectual Property as Collateral.**

Businesses today largely derive their value from intangible assets. Whether it is brands or technology or patents, Intellectual Property ("IP") is what drives most companies today. With the increasing share of intangible assets in the balance sheets of top companies, there is a clear shift in investor preference. Investor interest in companies with an "idea" has grown tremendously with more and more technology companies (IP rich companies) fetching the "unicorn" and "decacorn" status. However, using IP as collateral for debt funding is still a developing area.

In this publication, we have touched upon various aspects of IP financing from a global and an Indian perspective, covering topics such as regulatory environment, recent trends and select transactions in this space. Given that IP financing has gained more traction in the western world than in India, we have included several insights from our global Intellectual Property Advisory Services practice. We also spoke to some renowned bankers to understand their perspective on the risks associated with using IP as the primary collateral, the current market scenario and steps that can be taken to deepen the market.

Based on our research and discussions with various experts, our broad observations are as follows:

1. While the regulatory environment is evolving globally and initiatives to provide impetus to IP backed financing are underway, some economies such as Singapore exhibit a sophisticated regulatory environment as well as a robust infrastructure as compared to India's National IPR Policy which is in its nascent stage.

2. IP financing transactions where IP is used as a collateral, have declined over the past 5 years globally. However, transaction financing where acquired IP is the primary collateral, and monetizing IP under a distress situation, have gained traction.

3. There is increasing interest of large global PE funds in innovative, IP based companies. These funds are not only investing in IP based companies, but also providing finance to help protect IP in certain situations.

In summary, IP-backed financing can grow rapidly if enough is done to build trust amongst the lending and the investor community. A major hindrance to IP financing is that IP is difficult to value. A tighter regulatory environment (around IP protection) and a robust banking system (with enhanced capabilities in understanding and valuing IP) can assist businesses worldwide to unlock the value trapped in their IP.

Foreword by CII

Arvind Thakur
Chairman, CII National Committee on Intellectual Property
and Senior Advisor to the Board, NIIT Technologies

Dear Reader,

Confederation of Indian Industry (CII) has been closely and actively engaged with Intellectual Property Rights ("IPR") policy making, advocacy, awareness and services for many years now. It has undertaken many new initiatives in the recent past through its National Committee on IPR. It has been watching the global development in the IPR space including laws, technologies, policies, international discourses and geo-political scenario. Some of the important ones in the technology space have been understanding emerging IPR laws and rules in the vast field of artificial intelligence and computer related inventions. The other initiatives involve encouraging mediation process in IP related disputes in the country which can bring down litigation costs substantially and reduce dispute settlement time. In order to create an awareness about using IP as a collateral for securing loans from financial institutions, CII has been discussing with multiple players. CII has decided to prepare state-of-the-art reports in these areas with the help of industry, law firms, chartered accountants and IPR professionals for its members.

Duff & Phelps has prepared an extensive report "IP-backed financing-using IP as collateral" in close association with CII which captures a large number of case studies across the globe and practices followed in many countries. The report will certainly help readers especially CII members and banks in developing a good understanding of the subject matter and proceeding in this direction. CII firmly believes that IPR should be at the central stage in competing in the global world of artificial intelligence in a meaningful manner. It is hoped that it would open a new field of financing in India.

I hope that CII members will find this report useful and encourage them to examine the connected IPR needs carefully and design future plans. I wish to congratulate Duff & Phelps and CII teams for bringing out this report.

Introduction to IP Backed Financing

Intellectual Property-Backed Financing – How it Works

Intellectual Property

The assets in a business may be largely divided into two classes: tangible assets (i.e. physical assets) including buildings, machinery, financial assets and infrastructure; intangible assets - ranging from intellectual capital (like creativity, innovation and know-how) to ideas, brands and designs. According to the World Intellectual Property Organization (WIPO)[1], intellectual property refers to creations of the mind, such as inventions, literary and artistic works, designs, and symbols, names and images used in commerce.

IP is divided into two categories:

- Industrial property includes patents for inventions, trademarks, industrial and geographical designs.
- Copyrights cover literary works (such as novels, poems and plays), films, music, artistic works (e.g., drawings, paintings, photographs and sculptures) and architectural design.

Undoubtedly, physical assets play an important role in determining the competitiveness of any company in the business arena, but intangible assets may play a bigger role and describe the potential value of the company. In many instances in the technology industry, data shows that acquisition of leading key patents by companies has resulted in an overnight increase in their value. For example, IBM has had many acquisitions, such as Red Hat, which positioned it as a leading hybrid cloud provider and accelerated its high-value business model. Similarly, Denso also made acquisitions like InfinteKey to increase its lead in developing and deploying smartphone-based automotive access, a critical component of the company's strategy to create a future with frictionless mobility.

What is IP-Backed Financing?

IP-backed financing refers to the use of IP assets to gain access to credit. IP-backed financing is gaining attention internationally. More and more, multinational corporations and Small and Medium Sized Enterprises (SMEs) are leveraging their IP assets in exchange for finance, and lending institutions around the world are considering IP as collateral when extending loans.

Normally, tangible assets such as real estate, equipment and inventory are used to secure asset-based loans; however, the collateralization of IP can also increase the amount of available credit. In cases where borrowers pledge their IP (such as patents, trademarks or copyrighted works) as collateral, the collateral pool increases in value and the potential for a successful loan can be increased. Some banks also use IP assets as a credit enhancer.[2]

In terms of structure, IP-backed financing can be rather innovative. The following are the routes that can be explored by business owners considering IP-backed financing, as highlighted in Enquiries into Intellectual Property's Economic Impact published by the Organization for Economic Cooperation and Development (OECD):

- **Direct Collateral:** IP can be pledged directly as collateral in a loan agreement so that the lender can seize it if the firm becomes insolvent or otherwise defaults on the loan. For example, a loan can be secured by the stream of revenues derived from licensing agreements, which typically involve portfolios of patents and/or other IP.
- **Securitization:** IP-backed assets can be securitized by placing an IP asset or the rights to its projected revenues (e.g. royalties) in a special purpose vehicle (SPV), which in turn issues securities in the capital markets. This way, lending institutions can eliminate the risk of holding IP assets while the IP owner can obtain more favorable funding conditions. This is because the securities issued by the SPV are, in theory, separated from the firm's risk and therefore the firm can receive more favorable credit ratings.
- **Sale-and-Leaseback:** In a sale-and-leaseback transaction, an IP owner can sell its IP to a specialized investor or a lender in exchange for immediate funding. The original IP owner is then granted a license to use the IP, whereby it is required to make specified royalty payments to the buyer for a period of time. At the end of a specified term, the firm normally retains the option to buy back the IP asset(s) at a predefined price. The advantage of this model is that the firm can increase its liquidity for short-term operations while maintaining the use of its IP.

[1]World Intellectual Property Organization
[2]World Intellectual Property Organization, Intellectual Property Financing – An Introduction

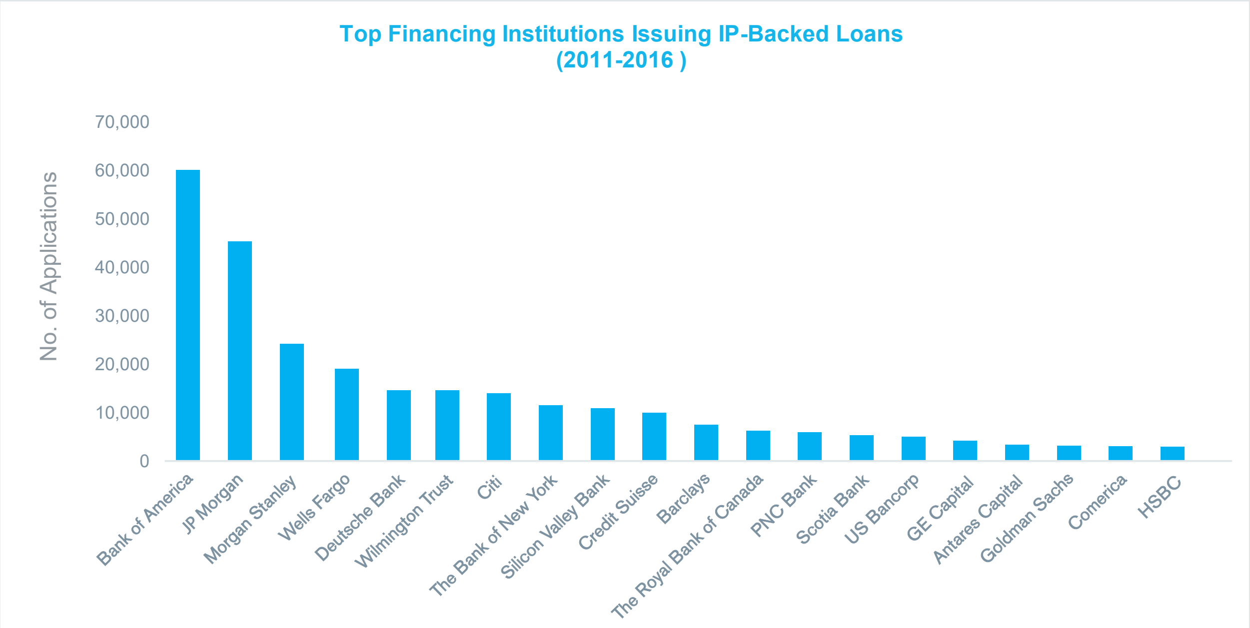
- **Venture Debt:** This finance model features both debt and equity characteristics. Formally, in this model, the firm seeking funding gains access to capital in the form of a loan on which it agrees to pay interest. Simultaneously, the firm issues warrants for equity in the company, which are acquired by the lender. IP represents a key asset to facilitate these deals, but note that the loan is typically backed by a blanket lien, i.e. a claim on all the assets of the firm in case of default.[3]

In the recent past, deals involving the securitization of intangible assets have enabled owners of Intellectual Property Rights (IPR) to borrow money more easily and safely from adequately secured lenders. IP asset-backed securitizations are common in the film and music industries, but the practice is increasing in the biotechnology and software industries as well.

Role of Intellectual Property in Facilitating Business Finance

In the mid-1990s, the use of securitization as an advanced financing tool spread to a wide variety of fields including the intellectual property arena. Among the famous transactions in the field of IP rights are the securitizations of the copyrights of the singer David Bowie, the trademark of the Domino's Pizza chain and the patent on the HIV drug developed by Yale University. With companies continuing to grow their IP portfolios, IP-backed financing is increasingly being seen as a realistic alternative to traditional financing. Many banks, non-bank lenders, government bodies, VCs and financing arms of large corporate bodies provide IP-backed financing.

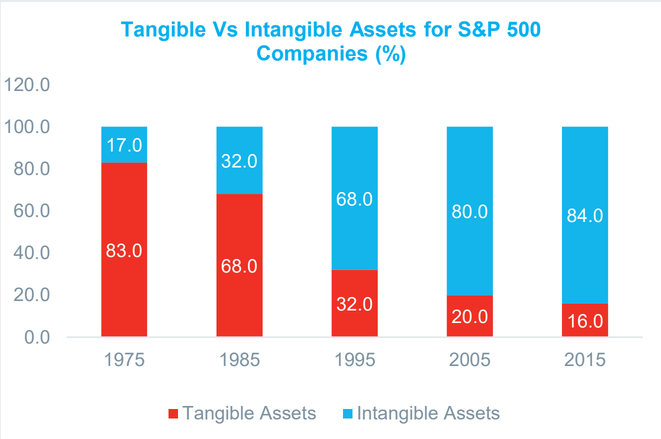
From 2011 to 2016, many large banks financed companies by accepting IP as collateral. These transactions involved companies across many industries, including automobiles, semi conductors, digital communication and others. Bank of America had the highest number of such applications (60,093), followed by JP Morgan Chase (45,304), Morgan Stanley (24,244) and Wells Fargo (19,001).[4]



Source: Relecura.com

[3]OECD, Enquiries into Intellectual Property's Economic Impact, IP-Based Financing of Innovative Firms, 2015
[4]Relucera, 2017

The proportion of tangible assets in the market value of Standard & Poor's 500 firms has declined from over 80% to under 20% in the past three decades.[5] This clearly signifies the rising contribution of intangible assets such as patents, brands, customer goodwill and employee goodwill. Digital service providers such as Google, marketplace operators such as Amazon and eBay and other social networking and digital media service providers hold no significant real assets, but have shown significant value creation over time, due to their intangible assets.[6]



Source: IP Asset Value as Collateral: The Increasing Use of Patents as Collateral in Asset-Based Lending[7]

The role played by IP in facilitating business finance is as follows: IP provides additional routes to funding as companies have broader (and potentially more valuable) asset choices to help finance its business. Businesses can commercialize IP in multiple ways, including licensing, selling, or using IP as collateral or security for debt finance. IP assets can play the following roles:

- **Drives innovation in business:** Identify, develop and leverage innovation providing competitive edge aiding in long term success of the company. IP is valuable for every business, including technology and pharmaceutical companies in particular, which invest huge sums in research and development (R&D) for creating indigenous products and services, and thus can act as an important tool for raising capital.[8]
- **Facilitates business growth:** IP can also help businesses grow through franchising or outsourcing product distribution to allow them to exploit IP commercially. Such trends are highly visible in the consumer and retail industry.
- **Additional tool to raise funds:** IP can provide an additional or alternative basis for seeking capital from private investors, VCs or banks. The investor/lender, in undertaking an appraisal of the request for equity assistance or a loan, may assess whether the products/ services offered by a company are protected by a patent, trademark, industrial design, copyright or any other related IP rights. IP ownership is thus important to convince investors/lenders of the market opportunities open to the enterprise for the commercialization of the products/services in question.[9]

IP can be used as an asset for raising funds for a large number of reasons that are specific to a company's needs. However, large transactions in which IP is used as collateral have been executed most often by companies in distress or under threat of bankruptcy. Such transactions often take place when all other options to raise loans against tangible assets have been exhausted. This is largely attributed to the higher risks like infringement, technological obsolescence and unauthorized use of intangible assets over tangible assets, as well as the consequent higher cost of financing that organizations bear due to the less reliable and marketable nature of IP as a collateral.

The following table highlights a few transactions where companies used IP as a central collateral during times of distress:

Name of the Borrower	Collateral	Period	Probable Reason
Xerox	Patents	2002	Financial fraud and certain distress in 2002
General Motors	Green technology patents	2008-2010	Bankruptcy in 2009
Eastman Kodak	Many patents, one of which is a method for enabling persistent recognition of individuals in images.[10]	2012-2015	Bankruptcy in 2012
LSI	Patents	2014	Possible financial distress in 2014 due to cost escalation
Avago	Patents related to chip manufacturing	2016	Acquisition of Broadcom

[5] IP NAV and Ocean Tomo
[6] How to get most out of IP financing, Lexology
[7] IP Asset Value as Collateral: The Increasing Use of Patent as Collateral in Asset-Based Lending
[8] Relevance of intellectual property for business, Economic Times
[9] Financing of Intellectual Property, Developing Countries' Context, SK Verma
[10] USPTO grants Kodak a broad facial recognition patent, just in time for its patent auction, Techrepublic.com

IP Financing: Regulatory and Commercial Environment

International Regulatory Scenario and Policy Initiatives

The world has started to recognize the importance of IP and various global economies have undertaken initiatives to strengthen their IP-financing infrastructure by taking several initiatives and implementing various schemes. This section focuses on such IP-financing schemes and commercialization environment across Asia.

Singapore

The IP Financing Scheme ("IPFS") – 2014 to 2018[11]

IPFS was launched by Intellectual Property Office of Singapore ("IPOS") in 2014 to increase access to IP-backed financing for a growing number of IP rich but asset light companies. It was a specific initiative aimed at facilitating IP transactions and kickstarting the transactions marketplace in Singapore.

Under this scheme, companies can use IP as a collateral to obtain loans from the Participating Financing Institutions ("PFIs") and the Singapore Government will share the risk of the IP-backed loan with the PFI.

The government also offers valuation subsidies to defray the cost of IP valuation. For this, applicants who had already drawn the loan were eligible. The subsidy was capped as follows:

- 50% of the IP valuation cost,
- 2% of the value of the IP, or
- SG$25,000, whichever is lower.

Singapore is known to have a strong regulatory infrastructure with policies in place that support protection as well as monetization of IP rights. With the launch of policies like IPFS, companies have been able to raise capital by pledging their intangible assets as collateral. One such case is that of Masai Group International, a footwear firm, which was able to raise a seven-figure loan through a leading bank (explained later in this report).

[11]Intellectual Property Financing Scheme, Information Sheet

China

The China National Intellectual Property Administration ("CNIPA")[12]

The CNIPA is primarily responsible for the organization and coordination of IPR protection work nationwide. One of its main functions is to act as the central registry of IP-backed financing pledges and setting the parameters for IP pledge loans from various banks.

IP-Pledge Financing Framework[13]

In August 2019, three government bodies - China Bank Insurance Regulatory Commission, the National Intellectual Property Administration and the National Trademark Administration jointly released a notice on strengthening IP Pledge Financing work, which includes the following objectives to be achieved in the future:

- **Optimization of IP Pledge financing service system** – It seeks to optimize the pledging of IP by extending support to commercial banks and financial institutions that accept IP as collateral for loan. The loans may be given to innovative tech enterprises, through separate credit plans, special assessment incentives, etc. For this system to be in place, the government bodies are expected to work on an in-house management mechanism and explore innovative evaluation, screening, monitoring mechanisms (e.g. based on big data, cloud computing technologies, etc.)

- **Strengthening IP pledge financing innovation:** To begin with, the framework seeks to strengthen the IP-backed financing innovation for encouraging commercial banks to provide portfolio loans based on patents, trademarks and copyrights, it seeks to strengthen IP-financing innovation. Further, it intends to explore the expansion of the financing channel and the feasibility of innovative mechanisms based on geographical indications.

- **Optimization of IP pledge financing risk management:** The focus is to include a risk management framework that can better tolerate a higher bad loan ratio in IP pledge financing, training qualified IP pledge financing specialists, strengthening dynamic management of collaterals, strictly monitoring the business operations of borrowers, establishing a reward and punishment credit system.

[12]The US-China Business Council
[13]http://chinainnovationfunding.eu/dt_testimonials/notice-on-further-strengthening-ip-pledge-financing-work/

Korea[14]

The government of Korea supports a wide array of programs for IP development, protection and IP related financing. For instance, the Korean Development Bank (KDB) has advanced US$ 100 mn to 80 IP rich companies in the form of collateralized loans. It is also in the process of developing funds to dispose of distressed IP.

The country runs many risks sharing programs, including cost sharing for IP disputes and commercial IP insurance, bearing 70% of the risk for companies. Credit is also offered through guarantees from the Korea Credit Guarantee Fund (KODIT), one of the oldest funds in Korea.

For raising funds against IP as collateral, the valuation of IP becomes a part of the process. The valuation is subsidized by the Korean Intellectual Property Office (KIPO), and the valuation activity is undertaken by other bodies such as the Korea Invention Promotion Association (KIPA).

Korea also developed the first IP SWF investment company in Asia, Intellectual Discovery. As of 2018, the fund has reportedly made over 5,000 transactions in patents, with assets under management of US$ 500 mn.

[14]Using Intellectual Property to Access Growth Funding, 2018

Malaysia[15]

The IP Financing Scheme

The Malaysian government implemented this scheme to help and encourage SMEs in expanding their business by making use of IPs as collateral. It is a RM 200 mn IP-financing program offered through Malaysian Debt Ventures Bhd.

Interest Rate Subsidy

The Malaysian government provides 2 percent interest rate subsidy and 50 percent guarantee through Credit Guarantee Corp Malaysia Bhd. Apart from the said IP financing scheme, the Industrial Designs (Amendment) Act came into operation on July 1, 2013. This law provides that a registered industrial design can be the subject of a security interest like any tangible asset.

In 2015, a Roadmap for IP Monetization 2015-2020 was launched, a strategy to turn the country's IP into a new source of wealth.

[15] Best Practices on Intellectual Property (IP) Valuation and Financing in APEC, Asia-Pacific Economic Cooperation

India

India Policy Initiatives for IP Commercialization

The Indian Government has taken steps towards the commercialization of IP by way of its recent policy initiatives (implemented and proposed). The growth of IP in a country is indicative of technological progress and improved economic activity. The Government of India is making constant efforts at improving the IP culture in India by building awareness of IPR. Some of the efforts taken by the Government are as follows:

1. Trade-Related Aspects of Intellectual Property Rights ("TRIPS")

All IPR laws are in compliance with the Agreement on TRIPS and the legal framework is well developed. The Department of Industrial Policy & Promotion ("DIPP"), which is the nodal department for IPRs in India, has designed a National IPR Policy, which was adopted by the Union Cabinet on May 12, 2016. The Policy complies with the World Trade Organization's agreement on TRIPS, and it aims to stimulate innovation and creativity across sectors and provide a clear vision regarding IPR issues.

2. Cell for IPR Promotion and Management ("CIPAM")

CIPAM, a professional body under the guidance of the DIPP, was established to ensure focused action on issues related to IPRs. The cell is setup to assist in simplifying and streamlining IP processes, apart from undertaking steps for furthering IPR awareness, commercialization and enforcement.

3. National IPR Policy

The National IPR Policy is India's first policy which specifically aims at securitization of IP rights, allowing them to be used as collateral to raise funds for their commercial development. The policy also suggests financial support for developing IP assets through banks, venture capital, angel funds and crowdfunding mechanisms, a government official said.[16] The policy suggests setting up of an IP exchange to bring investors and IP owners together on one platform. The government aims to extend financial support and easily accessible loans to farmers, weavers and artisans through rural and cooperative banks under the policy.

The National IPR Policy outlines the following seven objectives:

1. IPR Awareness: Outreach and Promotion
2. Generation of IPRs
3. Legal and Legislative Framework
4. Administration and Management
5. Commercialization of IPR
6. Enforcement and Adjudication
7. Human Capital Development

The DIPP will assist IPR owners in establishing e-commerce platforms and create brand equity for their products. A key objective of the policy is "to create public awareness about the economic, social and cultural benefits of IPRs". Commercializing IP portfolios is a process of turning an invention or creation into a commercially viable product and service. Also, securitization of IP rights opens new opportunities for organizations to generate income from IP assets. Research also shows that the effective use of IP assets and technologies largely depends on the quality of management.[17]

The National IPR Policy also identifies tasks to be undertaken by CIPAM and supports the financial aspects of IPR commercialization by:

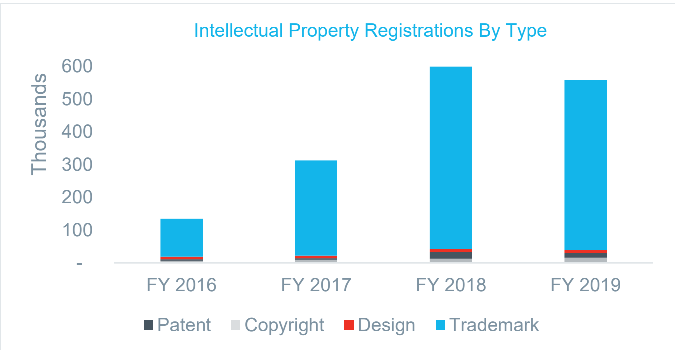
- Enabling valuation of IPRs as intangible assets through application of appropriate methodologies and guidelines, facilitating securitization of IPRs and their use as collateral by creating an enabling legislative, administrative and market framework;
- Facilitating investments in IP-driven industries and services through the proposed IP Exchange for bringing investors/ funding agencies and IP owners/users together;

[16]National IPR Policy
[17]National policy suggests use of intellectual property rights as collateral to raise funds, Economic Times, 16th December 2015

- Providing financial support to the less empowered groups of IP owners or creators (e.g., farmers, weavers, artisans, craftsmen and artists) through financial institutions like rural banks or cooperative banks offering IP-friendly loans;
- Providing financial support for development and commercialization of IP assets through links with financial institutions, including banks, venture capital funds, angel funds and crowd funding mechanisms.

The National IPR Policy recognizes that the economic value of IPRs must be fully unlocked through commercialization, which in turn, is likely to become a key driver of innovation in India and account for a fair share of its economic growth. Upon implementation of the Policy in 2016, IP registrations exhibited an increasing trend. Also, the pendency in examination of IP registration applications have fallen to as low as one month.

Source: DIPP, Annual Report 2018-2019



Based on the constant efforts taken by the government to reduce fees and provide rebates to micro, small and medium enterprises ("MSMEs") and startups like expedited review for patent filings, reduced filing fees, and technical assistance, a considerable growth in the number of IP registrations has taken place. Initiatives and programs for IPRs implemented by the government are to be targeted to make a robust IPR system, which is ultimately expected to provide an impetus to commercialize the IPRs and provide a mechanism to monetize IP for businesses in India. Some of these include Make in India, Digital India, and Startup India.

IP Exchanges

The inefficiencies in traditional, bi-lateral licensing are not exclusive to any one industry or type of IP owner. Bi-lateral transactions increase costs (such as hiring an attorney, due diligence on the IP). Further, time involved and the opacity around most IPs make IP transfer much less attractive to the participants. These barriers to successful IP transfer, often create artificial supply side constraints, hence limiting the ultimate consumer from exploiting the underlying IP.

Increasingly, companies are coming together to develop a new paradigm and rulebook that could have a positive impact of an IP. Rather than resorting to costly litigation, companies, laboratories and universities can use such platforms to monetize IP fairly and spur greater innovation.

How IP exchanges help? – The benefits of an IP exchange

An IP exchange is a financial exchange developed with input from corporate, university, and laboratory IP owners, designed to facilitate patent licensing based upon market-based principles, including transparency, price discovery, efficiency, and liquidity. The functions of IP exchanges are:

- Trading IPR between people and commercial entities;
- Buying, Selling or Licensing of patents, trademarks, copyright and industrial designs;
- Provides arrangements for users so that they can meet and trade online and use additional services provided by the platform.

Converting IP Rights into marketable commodities - Unit License Rights[18]

To facilitate trade in IP, an IP exchange converts patent rights into standardized, transparent, tradable instruments called Unit License Rights (“ULRs”). A ULR is a contract that licenses specific patents from sponsoring patent holders (listed and sold on the IP exchange). ULRs are structured as non-exclusive sublicenses “to make, have made, use, sell, or offer for sale” a single “unit” of a product in accordance with the ULR’s field of use.

The idea is to offer a patent or group of patents as ULRs, which can be bought and sold like shares on stock exchanges. A ULR grants a one-time right to use a technology or IP in a single product or service for a certain number of units. As an illustration, a patent contract on an IP exchange for a car airbag sensor may have a ULR of 60,000 units. This would imply that a purchaser of such a contract would have the right to use the IP, i.e., the car airbag sensor patent, for 60,000 units of cars.

How can an IP be listed on an IP exchange?

To initiate the process of listing an IP, the IP holder would approach the exchange, and it would:

i. Fully review the IP rights at issue by examining validity, current infringement issues, and required due diligence. Further, the IP rights could be for unlimited application purposes, or for pre-determined applications;

ii. Determine market interest to license IP, conduct a multistage review of the marketability and validity of the IP proposed for a ULR;

iii. If the IP exchange decides to proceed after reviewing an offer, the patent holder will be required to grant the IP exchange an option for an exclusive license for the relevant patents, and IP exchange will prepare a draft “Offering Memorandum” for the ULR. The draft Offering Memorandum will include a description of the technology and fields of use, the extent of the license grant, what constitutes “consumption” of a single ULR, the material terms governing price and volume for ULRs on the primary market, the prior licensing history of the patents, and the extent of any amnesty that will be given to prior infringers of the underlying patents. The IP exchange will then contact potential licensees with its draft Offering Memorandum through a marketing “roadshow”; and

iv. Based on the information the IP exchange collects, both through the roadshow and its own due diligence, the IP exchange and the IP holder jointly make final decisions on whether to make the offering and on how to list the ULR, including on terms that govern price and volume of the ULRs offered for sale. The ULRs thus offered are standardized licenses for defined sets of IP under terms and conditions set jointly with patent holders.

How does IP trade on an IP exchange?

ULRs will initially become available through direct purchases from the IP exchange on its primary market and may also be obtained from third parties through a secondary trading market maintained by IP exchange.

[18]IP Watchdog, Will an IP Licensing Exchange Work

- The IP exchange will make available a definite number of ULRs on its primary market at any given time. Revenue from ULR sales on IP exchange's primary market will be divided, with the IP exchange typically retaining a certain percentage of the license income and passing the rest to the IP holder.
- The secondary trading will commence after the offering of a ULR, through which interested third parties will be able to obtain the ULRs. The IP exchange would earn a certain commission on such secondary market transactions, while no amount would accrue to the IP holder (unless the IP holder is part of the said secondary market transaction).

Prominent IP Exchanges

Hong Kong Intellectual Property Exchange[19]

Hong Kong Intellectual Property Exchange Limited ("HKIPEX") is a financial exchange focusing on IP. HKIPEX is aimed to facilitate the trading and transaction of IP assets and reducing IP risks. HKIPEX offers three major trading engines with different functionalities to buyers and sellers of IP:

IP Flea Market: The engine has four trading formats (buy now, auction, brokered deals, and licensing) for items worth HK$ 1,000 up to HK$ 5 mn. Sellers will list information of IP rights at HKIPEX website. HKIPEX will release the listing after auditing. Buyers and sellers will then be able to review the listing at the IP Flea Market. Platform oversees the fairness, legality of the transactions and safety of funds;

Financing Platform for IP Projects: HKIPEX's Financing Platform offers startups access to a variety of low-cost funds to scale up their development and commercialize their new products and services. Investment options may take many forms to attract different participants, such as loans, equities, property mortgages, debt convertible to equity and vice versa. HKIPEX will verify the investment project and release it via the Financing Platform to the public when it passes a thorough vetting process; and

Standardized IP Products ("SIPP"): SIPP is designed to meet the challenges of dividing intangible assets into standard and tradable units that demand large liquidity and investment of over US$ 25 mn. The cost of full ownership is so high that it will be difficult to transfer to just one or a few investors. It is then designed to reduce cost of the IP users, and effectively turn IP into productivity. It is also designed to attract public participation. Therefore, the intangible assets are unitized, offered to a larger group of participants to be traded on the Exchange Platform operated by HKIPEX.

Types of IP traded on HKIPEX

Patents and technologies: Inventions, utility models, industrial designs, technical secrets and know-how, business models and industrial resources, among others. For example, a climbing emergency braking system has been listed on HKIPEX on its financing platform.

Copyrights and cultural assets: Acrobatics, architectural design, art works, computer software, dance, drama and opera, folk literature, literary works, movies and TV programs, music, oral literature, photography, technical drawing, theater and opera, and written works. For example, the Doe Quinn Collection, a decorative fashion concept listed on HKIPEX, has recorded trading value of more than HK$ 5 mn since listing.

Trademarks and brands: 3D trademarks, alphabetic mark, color composite marks, graphic trademark, numeric mark, word mark and other composite marks.

Asia IP Exchange[20]

Asia IP Exchange was established and is being managed by the Hong Kong Trade Development Council (HKTDC). Asia IP Exchange (AIPEX) is a free online platform and database showcasing IP around the globe, with an aim to facilitate international IP trade and connecting global IP players. AIPEX has successfully formed alliances with more than 30 strategic partners from around the globe, as well as local research and development centers and technology transfer units of local universities and featured over 25,000 tradable IP listings.

Types of IP traded on AIPEX

Patent: Some of the patents available at AIPEX include analgesic compositions for drugs and opioids, and fabric touch tester, among others.

Copyrights: Works covered by copyright range from books, music, paintings, sculpture and films, to computer programs, databases, advertisements, maps and technical drawings. Some of the copyrights available on AIPEX currently include: What Why and How 1 - For Children (Book), Return Migration and Identity: A Global Phenomenon, A Hong Kong Case (Non-fiction book), and The White Storm (Movie).

Trademarks: Trademarks like Florganica (cosmetics) and Momoking (cartoon characters) are presently listed on AIPEX; and

Registered Designs: Some of the registered designs listed on AIPEX include those for charging station for iPads and mobile phones, Magic Bean mobile stand with sound amplifier, Good Night night light.

[19] HKIPEX website
[20] AIPEX website

IP Financing: Analysis and Recent Trends

Lender's Perspective

To collateralize IP assets, a lender needs to be well informed about the underlying value of the IP assets. IP value considerations include, inter alia, its cost of development, its role in generating income for the business, and the intrinsic value of the IP in isolation from the company. In general, for any lender to be able to provide funds against IP, the realizable value of the collateral in case of loan default is of utmost importance.

For most tangible assets, there is a formalized secondary market with many buyers and sellers, where determining the value of tangible assets becomes a relatively simple process. Whereas, for intangible assets such as IP, the resale value is more difficult to determine, due to the unavailability of formalized secondary markets and fewer prospective buyers. Also, given the complexities involved in IP valuation, the apprehension of lenders to provide IP-backed loans increases. While we have seen the top banks in the U.S. provide loans to companies against their patents and other IP in the past, with the increasing involvement of complex law enforcement related to IP and the uncertainty involved in determining the value of IP over time, lenders are less inclined to use IP as collateral in loan transactions.[21]

Transactions by Major Financing Entities in Various Technological Sectors During 2009-2014[22]

As per a Relecura's IP Intelligence Report in 2015, on IP-backed financing transactions by major banks, including JP Morgan, Bank of America and CITI Group, such transactions have involved loans secured by players from various technology-based sectors, including Digital Storage, Data Processing, Digital Communication, Telecommunications, and Medical Devices, among others, over 2009 – 2014.

The following chart depicts the applications received by the above three leading banks for IP-backed financing to various sectors.

	Number of Applications		
Industry	JP Morgan	Bank of America	CitiGroup
Digital Storage	4,778	NA	835
Data Processing	3,770	6,650	3,332
IT Methods for Management	2,340	2,586	524
Digital Communication	2,324	4,075	1,301
Television and Video Transmission	2,176	1,727	1,957
Mechanic Elements	2,171	1,407	2,914
Medical Devices	1,877	NA	990
Telecommunications	1,866	1,219	NA
Semiconductors	1,331	1,192	3,227

[21] IP-based financing of innovative firms, OECD, 2015
[22] IP Backed Financing, Relecura IP Intelligence Report

Industry Perspective

IP-backed financing, though not extensively used, is not a new phenomenon in the financing market. A study published by the OECD observed that the share of IP-backed loans in the U.S. originated syndicated loans grew from 11 percent in 1996 to 24 percent in 2005.[23] Another study conducted by an IP analytics platform in the US for the period between 2009 to 2014, shows an upward moving trend in using IP such as patents as a collateral to secure finance. Some of the major IP-backed financing transactions came from technological sectors, followed by pharmaceuticals and logistics.

IP Backed Financing in SMEs and Rise of Equity Financing

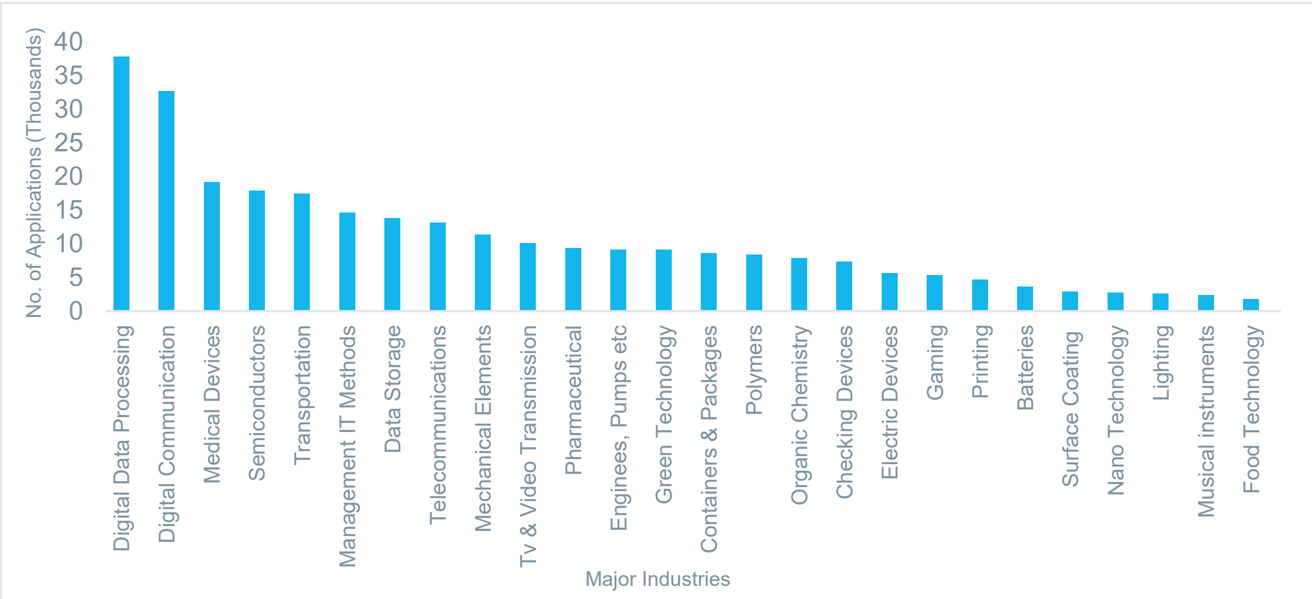
Most of the knowledge intensive young startups and SMEs have an abundance of IP assets and only a few tangible assets which could be leveraged to raise funding in case of lack of liquidity or to further their growth and sustenance. However, in most cases, due to lack of understanding of IP as a resource and its value, the SMEs are unable to identify their IP and register the same. Due to this, usage of IPs as a collateral in SMEs are much lower as compared to larger companies with huge IP portfolios.

For any IP intensive firms, IP assets along with other aspects such as human resource, customer relationships, brand image, etc. helps create a unique business environment which results in the success of the business due to which valuing an IP in isolation may become difficult. In case of young startups and SMEs, the cost of accessing the creditworthiness of the firm and the IP might be costlier due to lack of market information and availability secondary market for the sale of IP.

Large public companies can leverage their brand equity, market confidence in their companies, historical success story of their products and the huge portfolios of IP to gain confidence of the lenders while securitizing their IP assets, whereas the same parameters cannot be simply determined in case of a young startup or SMEs. This creates a major hindrance for SMEs to grow their business due to absence of funds.

There is an increasing trend towards private equity players investing in IP rich companies. With large global PE funds launching funds focused on intellectual property, IP financing is shifting towards equity financing as compared to debt financing using IP as a collateral. Also, these funds have higher risk appetites and loss bearing capacities as compared to private or public sector banks, making monetization of IP easier through this route.

The below graph depicts industries that raised applications to secure debt financing using their patents as collateral:[24]



Source: Relecura.com

[23]IP based financing of innovative firms, OECD
[24]IP Intelligence Report, 2015

IP-Intensive Industries

IP-intensive industries can exploit their IP assets to their full potential by using them to secure funding, either to further their R&D activities or fund their other business needs. In the remainder of this section, we discuss IP-backed financing for four IP intensive industries, including the typical IP assets used as collateral, the general industry-specific structure of IP-backed financing transactions, and some challenges associated with these financing structures.

Entertainment Industry

In the music industry, IP (particularly copyrighted work) is gaining traction as an alternative asset class since it is not correlated to any other asset class. One of the reasons for this development is the dramatic change in the past decade in the way a song's owner gets paid. Traditionally, an artist would receive upfront capital as payment for an album, but with the advent of streaming music, it creates a steady flow of royalties until the copyright for the song expires. Some people may view subscriptions to services like Spotify as discretionary spending, with a downside risk in a recession, but the way younger people pay for music it, is more like transferring into a utility service.

The music and film industry have experienced many notable instances of IP-backed securitization. In 1997, David Bowie securitized the future revenues generated by his catalogues of 25 albums and raised US$ 55 mn. Another landmark transaction includes Nickolas Ashford and Valerie Simpson raising US$ 25 mn by using copyrights of 247 songs as assets to issue bonds. In a similar manner, DreamWorks raised US$ 1 bn in 2002 by securitizing a copyright of a film portfolio to refinance outstanding credit facilities. However, as the music sharing industry started flourishing, the demand for recorded music diminished, reducing the viability of such bonds.

While it is widely agreed that asset-backed securitization in the entertainment industry has a great deal of potential, the volatility of the market and a lack of understanding of the music business by the investment community, still remains as challenges to be overcome before the practice picks up.[25]

[25]Is intellectual property the next big alternative asset?, BenefitsCanada,com, November 2018

Examples of IP Financing in Entertainment Industry: Bowie Bond and Michael Jackson

Bowie Bond

In 1997, David Bowie, an English musician and songwriter, issued a US$ 55 mn bond with 7.9 % annual return. The bond was backed by the publishing and recording copyrights to 287 of Bowie's songs. Copyright royalties from those songs provided the cash flow to pay the bond's principal and interest obligations. The bond was rated single A by all major bond rating agencies.

Michael Jackson

In 1985, Michael Jackson paid US$ 47.5 mn to purchase ATV Music Publishing, which owned the copyrights of more than 200 songs written by the Beatles. In 1995, Jackson was approached by Sony, who offered US$ 95 mn to merge ATV Music with their catalogue company and form a new joint-owned publishing powerhouse. In 2001, Jackson used his stake in Sony/ATV as a collateral to secure a US$ 380 mn bank loan from Bank of America.

Indian Scenario

The government of India conferred industry status to the entertainment industry including films in the year 2000 after considering suggestions by the working group which was formulated to suggest a suitable methodology for financing the film industry. Further, Reserve Bank of India issued guidelines on various aspects of lending to the film industry so that banks may participate in financing this important economic activity. Given the need for institutional finance for film production, the eligibility criteria to obtain financing was as follows:

1. Banks may provide financing to film producers (corporate as well as non-corporate entities) with a good track record in the relative field.

2. Banks may also provide financing to these entities for production of films in participation with the National Film Development Corporation

As per the guidelines, the following are prescribed with respect to security / collateral obtained for financing the film industry:

a. Assignment of all agreements and IPRs in favors of the lenders. Lenders to have right in negotiation for valuation of all IPRs.

b. Banks may obtain the Laboratory Letter conveying rights on the negatives.

c. The Music Audio/Video rights, CD/DVD/internet rights, Satellite Rights, Channel Rights, Export/International Rights, etc. should also be assigned to the banks to serve as main security along with the negative rights in the form of lab letter, through appropriate documentation.

d. First hypothecation charge on all the tangible movable assets under the project.

e. A Trust and Retention Account (TRA) may be maintained for all capital as well as revenue inflows and outflows. Thus, receivables on sale of all IPRs may be credited to a TRA.

Technology Industry

The Technology sector is one of the most IP intensive industries worldwide, where the IP assets are used to generate significant revenues for firms in the industry. IP related to digital data processing, software as a service, IT methods for management, cloud computing and analytical tools are some of the IP assets used by the technology companies to raise financing. Netlist, a cloud computing and storage company in the U.S., secured debt financing of US$ 15 mn from Fortress Investment Group using some of its patents in high-performance and hybrid memory solutions as collateral. These IP assets were leveraged by Netlist to increase its revenues and grow its business, which gave Fortress confidence in lending against Netlist's IP.[26]

The IP in the technology sector is particularly subject to technological obsolescence, due to rapid development in underlying technology and extensive R&D activities undertaken by competing firms. As such, determining the return on investment of technology-related IP involves much uncertainty, which may make IP-backed financing difficult to secure lenders unwilling to lend against the such firms.

At the same time, the technology sector is one of the most cash-rich industries, which allows firms in the sector to operate with minimal debt requirements to grow and sustain their businesses. However, since the companies in this sector are relatively low on tangible assets, the intangible assets of these companies make up a significant portion of their total book value. Hence, to the extent these firms are looking to raise additional capital for their businesses, considering intangible assets as collateral for financing is of the utmost importance.

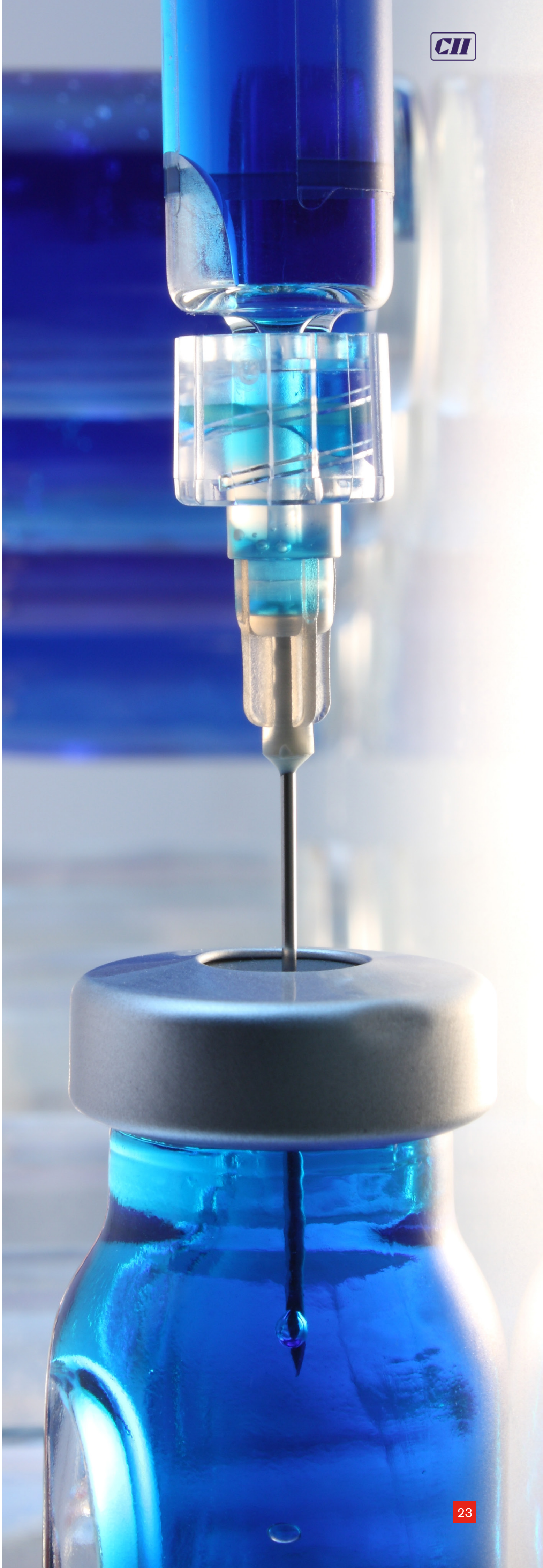
Example of IP-Backed Financing in Industrial Technology: Cambridge Display Technology, UK[27]

Cambridge Display Technology ("CDT") held special IP rights in patents that were central to the next generation of flat panel display technology. In 2004, CDT wanted to introduce polymer-based organic light emitting diode ("PLED") technology and thus needed funds to sponsor research & development projects. Also, it was looking to break away from its equity owners and was focused on becoming a self-sustaining business entity. As a result, it raised US$ 15 mn from a British bank by using its portfolio of patents as collateral. This transaction is summarized in the table below:

Year	2004
Borrower	Cambridge Display Technologies
Financing Entity	A large British retail and commercial bank
Amount Raised	15 mn, 3-year revolving credit facility
Collateral	Patent Portfolio – related to IP rights on fundamental patents that were central to the next generation of flat panel display technology.

The licenses held by CDT were set to start producing royalty income beginning in mid-2005, but CDT required financing for the interim period. Therefore, CDT was able to raise an alternative source of working capital from the UK-based corporate bank by using its patent portfolio as collateral.

[26] 5 Ways To Turn Your Patents Into Gold, Forbes, Feb 2016
[27] Intellectual Property in Consumer Electronics, Software and Technology Startups, Gerald B. Halt, Jr., John C. Donch, Jr., Amber



Pharmaceutical Industry

Some of the IP in the pharmaceutical sector relates to pharmaceutical compounds, new or improved products for diagnostics, new dosage forms of known therapeutics, microorganisms, novel combinations of known compounds, processes and methods used for manufacturing a particular product, new and/or improved manufacturing equipment and new and/or improved drug delivery mechanisms or technologies.[28] However, due to stringent law enforcement in IPR of pharmaceutical know-how, most large firms accumulate IP assets inorganically and leverage their IP assets to secure debt-funding.

Example of IP-Backed Financing in Pharmaceutical Industry

In December 2005, a pharmaceutical company which develops ophthalmic pharmaceutical products and other therapeutic products for common eye problems like infection, pain and inflammation in ocular surgery and glaucoma raised US$ 6 mn from debt financing. In this transaction, Bank of New York was collateral agent and a global pharmaceutical development and healthcare investment firm was the main investor. This transaction is summarized in the table below:

Year	2005
Borrower	U.S. based pharmaceutical company
Financing Entity	Healthcare investment firm
Amount Raised	US$ 6 mn
Collateral	32 pharmaceutical patents

The all-asset collateral included the company's portfolio of patents which were eight years old on an average. A press release from the date of the deal closing announced that the funds would go towards clinical trials and future applications for approval of new products.

[28]Intellectual Property Rights for SMEs in the Pharmaceutical Industry, World Intellectual Property Organization

Telecommunications ("Telecom") Industry

The telecom industry is considered to be a very debt-intensive sector, with most of the players leveraging their telecom towers and spectrum licenses as the collateral assets. Hence, protecting spectrum rights is extremely important to firms in the telecom industry. In India, spectrum was approved as a mortgageable asset in 2012.

With the 5G spectrum auction gaining traction, it can be a highly valuable collateral to secure financing. IP in the telecom industry derives much of its value from the cash flows it generates and can be very valuable to telecom firms in successfully running their business. However, in India, the high price for 5G spectrum is making the debt-ridden telecom companies reluctant to bid for auctions, making the future IP collateralization a difficult venture, given the possibility of low market returns on the investment. The telecom industry in India is already witnessing a highly competitive scenario due to the entry of Reliance Jio, while the spectrum cost remains very high in India as compared to the global average.

Example of IP-Backed Financing in the Telecom Industry

A French global telecommunications equipment company that supplied its products to major telecom players in U.S. and France was acquired for US$ 16.6 bn in 2015. The acquirer was a Finnish MNC that has its operations in telecommunications, IT and consumer electronics sector. Prior to the acquisition, the French company was in a crisis with its financial investors, customers and employees. One of the late financial steps by the company was to secure an emergency loan of US$ 2.1 bn from major financial institutions. This loan was obtained by the company on the basis of its rich patent portfolio being provided as a collateral.

This transaction is summarized in the below table:

Year	2012
Borrower	Telecommunications equipment company
Financing Entity	Global financial institution
Amount Raised	US$ 2.1 bn
Collateral	29,000 patents – including voice recognition and video conferencing technology.

This transaction gave the company a temporary financial respite, allowing it to use these funds to pay its debt and help finance its restructuring program, including its exit from some unprofitable managed services contracts. Prior to receiving the loan, the company had been dealing with poor quarterly earnings and restructuring costs and the company was ultimately acquired by a Finnish telecommunications player.

IP Financing: Case Studies

Case Study: Masai Group International ("Masai Group"), Singapore (2016)

Sector/ Industry - Footwear

Collateralized asset - Patents

About the company - Founded in 1998 in Switzerland, Masai designs, markets and distributes shoes internationally through its subsidiary. It offers athletic, casual and professional shoes and sandals that provide fitness and orthopedic benefits.

In 2008, the company patented the technology for physiological footwear known as 'Masai Barefoot Technology (MBT)', which creates a natural instability underfoot that stimulates and exercises the body's supporting muscle system. These shoes are so popular that every day, on an average, five pairs of lower priced counterfeit MBT shoes arrive on Germany's shores from the unlicensed factories in China and Indonesia.

Owing to the tough competition, the company filed for bankruptcy and was subsequently acquired by a Singaporean shoe distributor and retailer. There were a lot of counterfeit products in the market, which significantly impacted the sales of Masai Group. However, after the takeover, Mr. Andy Chaw, the new CEO of the acquired company, secured a loan from a multinational bank, using its IP as collateral.

Transaction – Masai Group is the first company in Singapore to secure an IP-backed loan under the IPFS. The Bank approved the seven-figure loan against the IP of Masai Group.

Highlights of the Transaction

- The bank approved the seven-figure loan after taking into account the valuation of Masai's patents.
- The company decided to use around 25% of the loan for IP protection efforts, 50% of the loan was earmarked for research and development, another 15% was to be used on advertising the brand, and the remaining 10% towards administrative fees involved in IP registration.

Conclusion: This is a typical case where the company took a loan to protect its IP. The bank recognized that acquiring Masai's patents would prevent other companies from making or selling similar products, essentially translating to future earnings. Masai also appointed brand protection company Pointer to find and shut down websites selling counterfeit MBT products. "We'll use the funds to protect and strengthen our IP by continuing to invest in R&D and filing new patents, which will drive growth. We expect a 25% growth in sales for MBT shoes annually, for the next three years, thanks to a new patent and new styles." said Mr. Chaw after the financing.[29]

[29]IP-backed loan to help shoe firm make strides, The Straits Times

IP Financing: Case Studies

Case Study: SITO Mobile, U.S. (2014)

Sector/ Industry - Application Software

Collateralized asset - Patents

About the company - SITO is a leading mobile data technology company, founded in 2002, that provides strategic insights and media campaign delivery services. The company is headquartered in New Jersey. The company was listed on NASDAQ and has recently been delisted as of 23 August 2019

Transaction - SITO Mobile signed a US$ 11 million deal with an investment management group in 2014, where US$ 10 million was raised through debt and US$ 1 million was through equity investment. The credit facility was secured against SITO's intellectual property portfolio of patents.

Highlights of the Transaction

Year	2014
Borrower	SITO Mobile
Financing Entity	An Investment Management Group
Amount Raised	US$ 10 mn
Collateral	Many patents related to mobile related technology like inclusion of automatic provisioning of abbreviated dialing codes.

Instruments Details

Particulars	Amount	Details
Debt	US$ 10 mn	The debt was issued against SITO's intellectual property portfolio as collateral. The original principal amount of the notes bore interest at a rate equal to LIBOR plus 9% per annum.
Equity	US$ 10 mn	The company issued 261,954 new shares of common equity to the Investment Management Group at US$ 3.8 per share.

Conclusion: According to Jerry Hug, SITO's interim chief executive, the partnership will help SITO Mobile fulfill its potential in the rapidly evolving mobile marketing and advertising space. This investment will help fuel our organic growth, drive next stage product development, provide flexibility to make selective acquisitions, and deepen the reserves for our IP monetization initiative."[30]

[30]https://www.privatedebtinvestor.com/sito-mobile-seals-11-million-debt-equity-deal-with-fortress/

IP Financing: Case Studies

Case Study: Large publicly listed manufacturer of pharmaceutical, medicinal, chemical and botanical products in India and internationally, India (2018)

Sector/Industry – Pharmaceutical

Collateralized Asset – Portfolio of brands owned by the company

About the company - Large publicly listed manufacturer of pharmaceutical, medicinal, chemical and botanical products in India and internationally.

Transaction - The bank had extended a loan to the company which was secured against a portfolio of brands of certain prescription and non-prescription drugs and consumer products. The bank wanted to evaluate the fair value of these collateralized brands to understand if a provision was required towards the loan provided against these brands. Banks typically perform this exercise at regular intervals to assess loan to value coverage to be maintained and seek additional security in case of any deficit.

Highlights of the Transaction

Year	2018
Borrower	Large pharmaceutical company (publicly listed)
Financing Entity	Private listed Indian bank
Collateral	Portfolio of brands of certain prescription and non-prescription drugs and consumer products

The company had taken a loan against a portfolio of following brand categories:

- Baby Care
- Gastro-Intestinal (OTC) Portfolio
- Acquired Portfolio from a large global pharmaceutical giant (which included a nutritional supplement for children, medicated soap, muscular pain and cough and cold medicine)

Typically, a major hinderance to IP-backed financing is that IP is difficult to value due to its unique nature. Lenders are sceptical of valuation methodologies and therefore an in-depth analysis is required from a risk perspective.

The following analysis was performed to analyse the risks from an IP-backed financing standpoint:

- Primary research and competitor profiling: Primary research was conducted across a sample set of pharmacies in western Mumbai to observe if the products are widely available. Major competitors were identified for each product to identify if these products are preferred over the company's products.
- Historical analysis of the company's brands under which these products are sold: Analysed the growth of brand performance over the years from the time the products were launched in terms of revenue and number of outlets where the branded products are available. We understand that these brands were acquired by the company and we analysed the rationale behind the acquisition with regards to its placement in the overall portfolio.

IP Financing: Case Studies

Thereafter, the following analysis was performed to determine the value of the collateralized asset to ensure that the loan was secured fully / partially and if any provision was required by the Bank:

Income Approach

- A discounted cash flow analysis was performed based on the products under one category (for e.g. there were 5 products under the Baby care category, cash flows for these were considered on a consolidated level to estimate the value of the brand under which these products are sold)
- Brands typically play a significant role in consumer product and healthcare segments. Accordingly, these brands were considered to have longer useful life based on the nature of the products.
- Based on industry research, a percent of the enterprise value was estimated which were attributed to Brands under which these products are sold and the balance towards distribution channels, goodwill, etc.
- The value of the brands was also calculated using a relief from royalty approach (to capture the savings in royalty because the company owns the brand and does not have to license them) using a royalty rate observable in market transactions.

Market Approach

- We analysed implied revenue multiples in transactions involving stake sale of Consumer healthcare/ OTC companies/ divisions in India
- The Enterprise Value of individual products derived using the market approach was then apportioned to the rands based on industry benchmarks.

Conclusion – While banks look at the history of the brands which are offered as collateral, they also assess the credibility of the borrower and the underlying cashflows of the company. Therefore, mature companies or brands with a long history of positive operating cash flows are preferred candidates for raising debt funds. The example above illustrates how company's dominance in the Industry as well as the long history of the Brands helped in rasing funds.

Case Study: Large Consumer Products Manufacturer, India (2019)

Sector/Industry – Consumer Products

Collateralized Asset – A prominent hair care brand which has been in existence for about three decades. Products under the brand include Hair Oil, Hair Treatment products and Hair Styling & other related products, wherein ayurvedic hair oil contributed to majority revenues of the products under the brand.

About the company - The company is a manufacturer of hair care, personal care, baby care and home care products. The hair care products contribute ~ 90% of the company's revenues.

Transaction - A large global PE player acquired certain assets of the hair care brand (mentioned above) through a business transfer agreement by setting up a new entity under the brand. To fund this acquisition, it obtained a rupee term loan from one of the largest private banks. To avail the credit facility from the bank, the hair care brand was offered as a primary collateral.

Highlights of the Transaction

Year	2018
Borrower	Ayurvedic product manufacturer
Financing Entity	Private listed Indian bank
Collateral	Prominent hair care brand

Conclusion – While IP such as brands can be offered as collateral to raise fresh funds, it can also serve for transaction financing purposes. This is an interesting case of IP financing using a brand as collateral. Since the hair care brand in this case contributes a significant portion to the company, as it had a proven stream of revenues and stable market share, a loan was successfully secured against the same.

Distressed IP Assets : Case Studies

Case Study: A renowned digital imaging company, U.S. (2012)

Sector/Industry – Photographic film products

Collateralized Asset – Patents -1,100 digital imaging and processing patents

About the company - The company is an American imaging company that began in the 19th century. By 2012, the company had accumulated 22,000 patents and other IP covering 160 countries. From 2003 to 2011, licensing that IP to other companies, it had earned over US$3 bn. However, sales of the company began to decline, and it was forced to file for bankruptcy in 2012, hoping to restructure.

The company's managers hoped to escape from bankruptcy by selling part of a portfolio of patents that was said to be worth around US$ 2.5 bn. However, the company was running out of time and if it couldn't complete the deal, its plan to emerge out of bankruptcy would fall through. Hence the company was not in a position to negotiate and finally, a group of tech heavyweights, joined forces to purchase approximately 1,100 digital imaging and processing patents from the company for US$ 525.0 mn.

Highlights of the transaction

Year	2012
Borrower	Digital imaging company
Financing Entity	Global investment bank
Collateral	Patents - 1,100 digital imaging and processing patents

According to the Chairman and Chief Executive Officer of the company, the proposed transaction would enable the company to repay a substantial amount of its initial DIP loan, satisfying a key condition for its new financing facility, and position its commercial imaging business for further growth and success.

Conclusion - Eventually, without its anticipated multibillion-dollar payoff, the company was forced to hand over its iconic photographic film and paper businesses, as well as potentially lucrative new technologies like digital printing kiosks, to a spin-off owned by its U.K. pension fund due to tough market conditions. In September 2013, it finally limped out of bankruptcy.

Case Study: A Leading Toy Retailer Company, U.S (2017)

A leading toy retailer in the U.S. since 1948 was at its peak and was competing with other leading toy retailers in the U.S. such as Walmart and Target. However, the continued presence of online shopping such as Amazon.com significantly hurt the company. Also, in 2005, it was taken private by investors through a US$ 6.6 bn leveraged buyout which substantially increased the debt for the company. The increase in long-term liabilities negatively affected the financial situation of the company by limiting the flexibility of the company (there were underlying covenants), exposing it to higher interest rates, and causing possible non-strategic divestitures.

Highlights of the transaction

Year	2017
Borrower	Toy retailer company
Assets for Liquidation	Intellectual property, including the company's name, website, and its brand mascot

Due to increasing competition, a shift towards ecommerce, and the fact that the company was unable to obtain enough financing to get through the holiday season in 2016, the company decided to file for bankruptcy in 2017.

As part of the liquidation of assets, it had plans to auction off its IP, including the company's name, website, and its brand mascot. According to Reuters, it could be one of the most valuable brands ever sold by a company going out of business.

However, in 2018, the company decided to abandon the sale of the its brand and, instead, chose to find ways to resurrect the brand in a new and re-imagined way. The investors believed that there is more value in maintaining the group of assets than selling them individually. Thus far, the company's brand has clearly lived beyond the death of its stores, and it will be exciting to see how investors revive it, but overall, this is an interesting case of significance of a retailer's intellectual property.

Case Study: A Leading Travel Agency, UK (2019)

The company is a 178-year-old UK-based travel agency with EUR 9 bn in revenues, 19 mn customers and 22,000 staff in 19 countries. The company filed for bankruptcy in September 2019. The half-year accounts illustrated the precarious position of the company.

A Chinese investment company, a large shareholder in the subject company, was part of the group of lenders and bondholders that sought to put together a EUR 900 mn rescue package that would have saved it in September 2019. But the plan collapsed after the company failed to secure an extra EUR 200 mn needed to win support for the deal, leading to the travel agency bankruptcy.

After it filed for its bankruptcy, the investment company made an offer to acquire the subject company's name, related operations such as its upmarket brands, and other IP, including domain names, apps, social media and Internet Protocol addresses.

Highlights of the transaction

Target	Travel leading agency, UK
Acquirer	A Chinese investment company
Assets Acquired	Company's brand and its intellectual property assets
Transaction Value	£11mn

The investment company acquired the company's brand and other IP assets for £11m, which could allow the business to be revived as an online travel agent months after collapsing into administration. The acquired business, would in effect allow the Chinese company to create a digital travel agent using the subject company's brand, which still carried considerable weight among European travelers.

Conclusion

For any economy that wishes to be competitive in the 21st century, an IP friendly environment is imperative. The mature economies where innovation is central to economic policy, have been visibly making efforts to reduce the uncertainty around IP and developing an IP commercial framework. Specifically in Asia, it can be seen that the local governments have been introducing various policies to encourage and develop the IP financing ecosystem. Further, IP exchanges have been setup, which not only offers a wide platform for buyers and sellers to trade IP, but also bring transparency and price discovery for IP assets.

India is standing at the cusp of an IP revolution. The brand values of our country's most valuable companies have increased by more than 40 percent in the last five years.[31] We have also emerged as the third largest economy for startups in IP intensive industries including technology and bio-pharmaceuticals. This requires nurturing given the underlying potential to innovate and create ground breaking products. Looking at the potential, the Government of India launched National IPR Policy in 2016 for spurring interest in IPR commercialization. With the logo "Creative India, Innovative India", the policy aimed to establish an ecosystem in the country which is conducive to innovation and creativity not only in terms of IP awareness and creation, but also commercialization and enforcement. The Government has also provided incentives to SMEs under the 'Start Up India' and the 'Make in India' initiatives.

While these policies have been active for the last few years, there have been hardly any noticeable IP financing transactions in India. Based on the discussions with one of the leading banks, we understand that the lending framework in India has still not evolved enough to encourage IP backed financing deals. The traditional asset securitization process is still very much embedded in our lending process. Other reasons for this slow pace of IP financing include lack of consciousness to treat IP as a business asset, insufficient market and legal infrastructure for monetizing IP assets, challenges in IP licensing and transfer, and lack of uniformity in valuation of IPs.

India can possibly take lessons from IP friendly countries like Singapore and Korea, who have taken concrete steps to set up an IP financing ecosystem. The schemes introduced in these countries not only encourage IP financing for the SMEs and startups, but also come with benefits for the participating lending institutions. Other IP support mechanisms include provision of interest rate subsidy on IP backed loans and inclusion of credit guarantees for risk sharing between the lending institution and the government. Further, countries like Hong Kong have also set up a robust IP exchange platform which supports IP assets and companies to attract different types of financing options such as loans, equity (including preference capital), debt convertible to equity and vice versa, etc. All these initiatives are creating an investment friendly environment for IP intensive industries. Hence, we urgently require a joint and a consistent effort between the regulator and the lending institutions to set up a progressive IP financing infrastructure, which can then harvest the value trapped in our country's IP assets.

[31]Based on Brand Value as a percentage of Enterprise Value analysis. The brand value has been sourced from Brand Finance India 100 report - 2013 and 2018 reports.

About CII

Confederation of Indian Industry

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India's development process. Founded in 1895, India's premier business association has more than 9100 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 300,000 enterprises from 291 national and regional sectoral industry bodies.

CII charts change by working closely with Government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialized services and strategic global linkages. It also provides a platform for consensus-building and networking on key issues.

Extending its agenda beyond business, CII assists industry to identify and execute corporate citizenship programmes. Partnerships with civil society organizations carry forward corporate initiatives for integrated and inclusive development across diverse domains including affirmative action, healthcare, education, livelihood, diversity management, skill development, empowerment of women, and water, to name a few.

India is now set to become a US$ 5 trillion economy in the next five years and Indian industry will remain the principal growth engine for achieving this target. With the theme for 2019-20 as 'Competitiveness of India Inc - India@75: Forging Ahead', CII will focus on five priority areas which would enable the country to stay on a solid growth track. These are - employment generation, rural-urban connect, energy security, environmental sustainability and governance.

With 68 offices, including 9 Centres of Excellence, in India, and 11 overseas offices in Australia, China, Egypt, France, Germany, Indonesia, Singapore, South Africa, UAE, UK, and USA, as well as institutional partnerships with 394 counterpart organizations in 133 countries, CII serves as a reference point for Indian industry and the international business community.

Confederation of Indian Industry
The Mantosh Sondhi Centre
23, Institutional Area, Lodi Road,
New Delhi – 110 003 (India)
T: 91 11 45771000 / 24629994-7
F: 91 11 24626149
info@cii.in
www.cii.in

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Reach us via our Membership Helpline: 00-91-124-4592966 / 00-91-99104 46244
CII Helpline Toll Free Number: 1800-103-1244

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Duff & Phelps (India) Private Limited
14th Floor, Raheja Tower
Bandra-Kurla Complex, Bandra East
Mumbai, 400051
T: +91 22 6623 1000

CONTACTS

Varun Gupta
Country Leader India and Head of APAC Valuation Services
Varun.Gupta@duffandphelps.com

Aviral Jain
Managing Director, Valuation Advisory Services and Co-Head Restructuring Services
Aviral.Jain@duffandphelps.com

Santosh N
Managing Director
Santosh.N@duffandphelps.com

Umakanta Panigrahi
Managing Director
Umakanta.Panigrahi@duffandphelps.com

REPORT CONTRIBUTORS:

Report Team from Duff & Phelps

1. Aviral Jain, Managing Director Valuation Services and Co-Head Restructuring
2. Umakanta Panigrahi, Managing Director Valuation Services
3. Khyati Gujrathi, Senior Consultant, Valuation Services, India
4. Palak Khandelwal, Consultant, Valuation Services, India
5. Anant Gupta, Consultant, Valuation Services, India
6. Neha Rao, Analyst, Valuation Services, India
7. Priyanshi Parekh, Analyst, Valuation Services, India
8. Bhavya Sehgal, Trainee, Valuation Services, India

Expert Contributors from Duff & Phelps

1. Chris Bakewell, Managing Director, Disputes and Investigations and Global Head of Intellectual Property Advisory Services, US
2. David Larsen, Managing Director, Alternative Asset Advisory, US
3. Srividya Gopalakrishnan, Managing Director, Valuation Services, South East Asia
4. Gary Roland, Managing Director, Office of Professional Practice
5. James Palmer, Managing Director, Valuation Services, UK
6. Zachary Gray, Vice President, Disputes & Investigations, US

Marketing Team from Duff & Phelps

1. Sherri Saltzman, Director Marketing Valuation Services
2. Disha Hoskote, Vice President Marketing, India and Southeast Asia
3. Haris Khanche, Marketing Design Associate

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i. Confederation of Indian Industry (CII), The Mantosh Sondhi Centre; 23, Institutional Area, Lodi Road, New Delhi 110003, India, Tel: +91-11-24629994-7, Fax: +91-11-24626149; Email: info@cii.in; Web: www.cii.in; and

Duff & Phelps

ii. Worldmark 2, Unit no. 206 and 207 Asset Area no. 08, NH-8, New Delhi, Delhi 110037