What’s it Worth? Valuation of IP

May 5, 2022

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The value of IP is a common topic of discussion at start-up companies. Founders may be trying to value their company for investment or sale purposes. In some cases, they may be trying to value the IP for purposes of licensing it out to a third party. IP-backed financing (e.g., loans, notes) is also becoming more common. For example, the Business Development Corporation offers IP-backed financing for certain companies.

Valuation is not straightforward, and a proper valuation requires professionals skilled in the area. However, there are good, recent publications that provide an introductory-level overview for entrepreneurs. This article will provide a few basic resources for valuing early-stage IP.

Sample resources

The International Chamber of Commerce has published a broad overview in its Handbook On Valuation of IP Assets. The Asia-Pacific Economic Cooperation organization also has published a manual. The Canadian Intellectual Property Office published its own overview on valuation. The World Intellectual Property Office also has published a guide (See link to: IP Panorama: Module 11 (IP valuation)).

The valuation process

Valuation may be simpler for companies that are already monetizing or licensing their IP. This is because the present value of the potential future cash flow would be a starting goal for assessing IP value. Among the various potential IP valuation methods (cost method, market method, income method, etc.) the discounted cash flow (DCF) income method is often useful in early-stage IP valuations. It is relatively formulaic and can be straightforward to apply. The DCF method provides flexibility when considering different future options and asset management strategies. Here is a very high-level overview of steps in the DCF calculation analysis (see the resources noted above for further information):

1. Identify the potential commercial use and market.
2. Determine the potential cash flow that could be generated from that IP (i.e. attributable to that IP). The profit consequences of defaulting to the next best alternative may be considered.
3. Estimate the expected growth arising from exploitation of that IP, as embodied in a commercial product or service. Project the expected cash flow over the life of the IP asset.
4. Subtract associated costs to determine net cash flow.
5. Discount projected future net cash flow, for example, on a per year basis. Consider factors such as interest rates and risk premiums.
6. Arrive at the valuation.

See some simple examples of DCF calculations here. There are risks to the valuation, such as third-party infringement, IP invalidation or obsolescence of the IP. Once IP, such as a patent, expires, competitors are free to use that IP to compete in the marketplace. Valuation upon IP expiration can be estimated through estimation of post-expiration cash flow.

Valuation can be a particularly complex task for early stage, pre-revenue companies. It is difficult to assess the potential
market and cash flow. There may not even be comparable benchmarks for unique technologies. Professional advisors can provide a value, but it may be a rougher valuation.

Next steps after valuation

The ultimate value of IP, like any asset, depends on what others are willing to pay for it. So, after the valuation is done, the IP owner needs to make and implement commercial arrangements to exploit that value, whether by commercializing the IP solo, raising investment, securing IP-backed financing, sale or licensing. There are many resources available to assist with these next steps, such as WIPO publications on technology transfer and licensing.

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