IP-backed financing and valuation in the UK

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Introducing Inngot

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Specialists in IP finance theory and practice

- *The theory:* our research and policy work for a range of national and international stakeholders, including OECD and WIPO
- *The practice:* the online IP identification and valuation platform we have built to serve customers consistently and affordably, used by banks including HSBC UK and NatWest

Members of the International Valuation Standards Council

Three questions

When lending to scale-up companies, why are UK banks turning to IP?

Where banks are utilising IP, what difference does it make?

When banks want to take IP as security, how do they value it?

When lending to scale-up businesses,

WHY ARE UK BANKS TURNING TO IP?

IP = lower defaults and losses

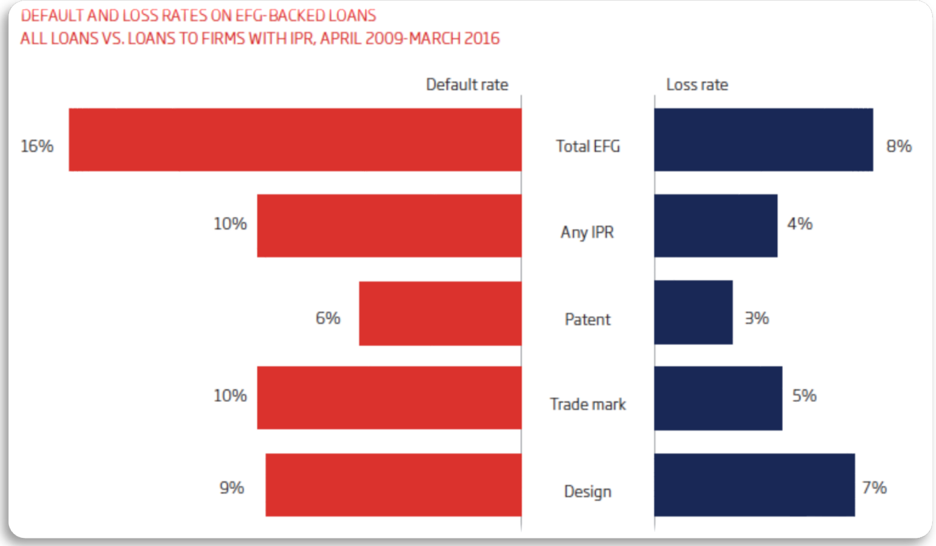
2018 British Business Bank and UK Intellectual Property Office research

- Investigated correlation between registered IP and financial performance of 20,000+ guaranteed loans

The findings showed that, where IP assets were present:

- Probability of default was **38%** lower
- Loss given default was **50%** lower

These are better businesses to back!



Source: Using Intellectual Property to Access Growth Funding, BBB/IPO, 2018

BRITISH BUSINESS BANK

"The test results support the view that at the 95% significance level, the probability of defaulting is conditional on holding IP."

Bank benefits of IP assessment

IP fills a knowledge gap

- Intangibles cannot be properly recognised in statutory accounts, so IP-rich businesses often appear asset-light
- They look very good at burning cash! when in reality they are investing for the long term
- When you can see the assets created by this investment, you can judge the expected returns

IP addresses important governance points

- Finds core assets that can become subject to an effective security interest
- Investigates key questions: IP ownership, vulnerability to attack, fitness for purpose
- Helps a bank better understand competitive positioning and strengths

Bank benefits of IP security

Powerful behavioural influence

- If the IP is good, it’s also likely business-critical, which means founders and investors will not want to lose control over it
- IP brings them to the table if difficulties arise

Reduction and diversification of asset risk

- Charges/pledges provide a mechanism to establish priority over the assets on default
- IP can escape in distress if it is not properly secured

Genuine prospect of value realisation

- Where the IP is associated with cash flows (or licensing income), there will be a buyer for it
- These assets sell faster than stock and tangibles (which may not find buyers at all)

A way to improve bank competitiveness by lending earlier on better terms

- ‘Part-secured’ pricing: capital repayment holidays

Where banks are utilising IP,

WHAT DIFFERENCE DOES IT MAKE?

IP = better lending, earlier in the cycle

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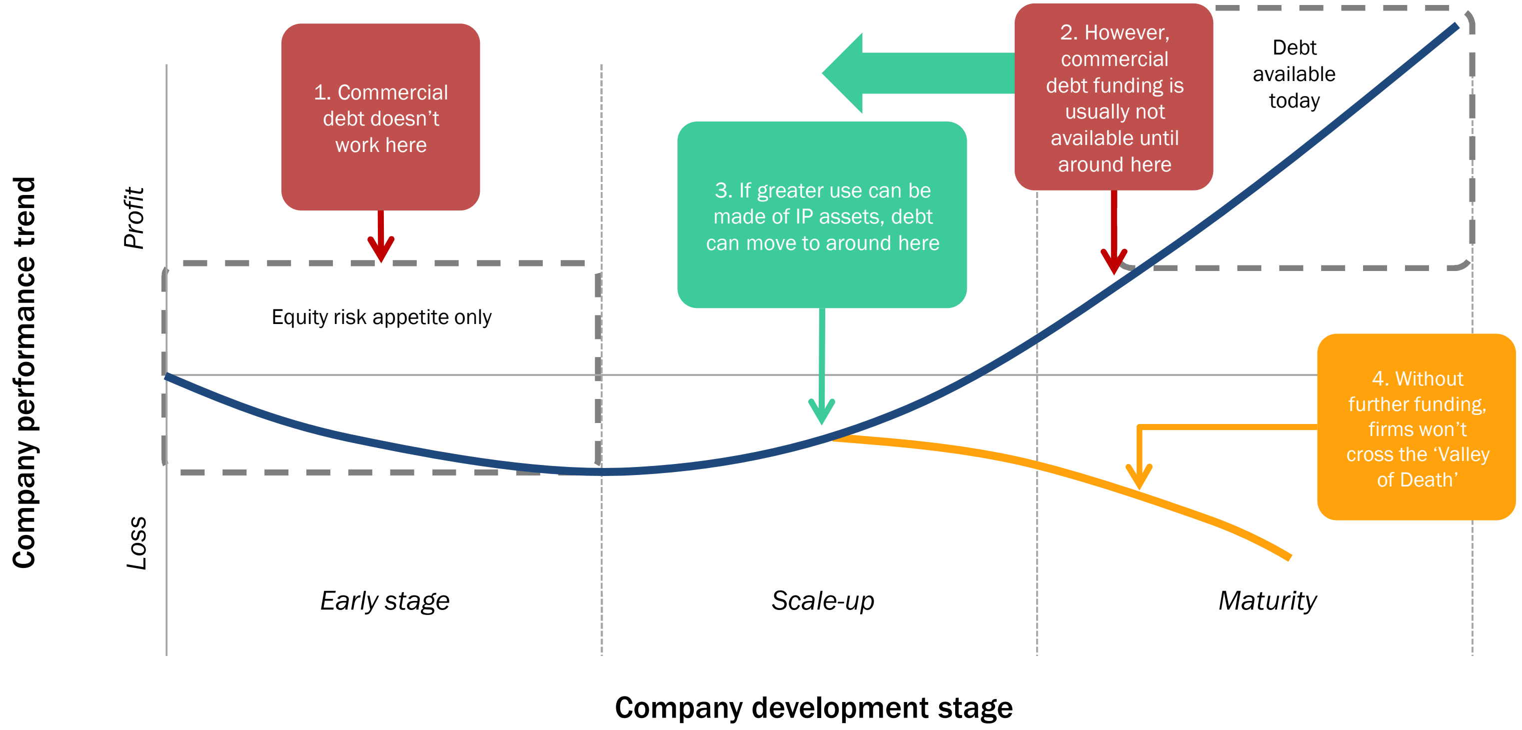

Different approaches to IP

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HSBC UK

Growth Lending proposition

- First deals announced in late 2022
- Targeting high growth tech-based scale-up companies
- Turnover £7m+, growth 20%+ per year, £25m+ equity raised
- Loans of £5m - £15m as a ‘bridge to profitability’

Fund originally £250m, enlarged to £350m

- Now expanding IP use into other lending to technology companies

Every company’s IP is identified, valued and taken as security

- Bank refers customers to Inngot

NatWest

High Growth lending rules updated to include IP security

- First deals announced in early 2024
- Sector-agnostic approach, covering all types of IP rights
- Loans of £250k - £10m for any growth purpose
- The IP value sets the deal size (subject to LTV and serviceability)

Recent government submissions indicate £500m ‘earmarked’ for growth company lending

Every company’s IP is identified, valued and taken as security and monitored over loan life

- Bank refers customers to Inngot

Beneficiaries

E-commerce retail model for sunglasses: core IP is trade marks and software copyright

Games developer (best known for its 'Queen's Gambit' game): core IP is digital copyright

Beneficiaries

Innovative prosthetic limb manufacturer: core IP is patents

Early stage search engine optimisation specialist: core IP is software copyright and algorithms

When banks want to take IP as security,

HOW DO THEY VALUE IT?

Financing IP requires a shift in mindset

Banks understand commodities and (correlated) property assets

- Familiarity and regulation encourage their use
- However, IP has value because it is **not** a commodity (or correlated)

IP will appreciate in value if well managed

- NatWest says it has seen an average 32% uplift at revaluation
- This opens up opportunities for facility increases

IP is generally licensed, not bought and sold

- So that many people can use it at once
- And because it is so valuable to the companies that own it

For these reasons, IP is seldom traded on transparent markets

- There is very little supply – without which, you can't generate demand
- Normal price discovery/market comparison approaches **don't work**

Image: Satheesh Sankaran

International standards can help

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IAS 38	• Sets out the criteria for recognising intangible assets in **company accounting** • Cost of acquisition or development (note: **not** research) is the only recognised approach
IFRS 3	• Covers treatment of IP in **business combinations (merger and acquisition activity)** • Purchase price will be allocated to different asset classes
IFRS 13	• Sets out what **fair value** means and how it should be measured • For intangibles, acknowledges **market methods generally don't work**
IVS (esp. IVS 210)	• Provides guidelines referencing the above for valuers on **approaches and methods** • Relevant standard focuses mainly on **measurement of economic benefit (income)**
ISO 10668	• Sets out a framework for monetary valuation of **brands** • Also acknowledges **income approaches are usually most applicable**
OECD BEPS Guidance	• Rules for **transfer pricing** (moving assets between business entities) • For intangibles, focuses almost entirely on **economic benefit**

We value in three stages

Q1 – What is the IP?

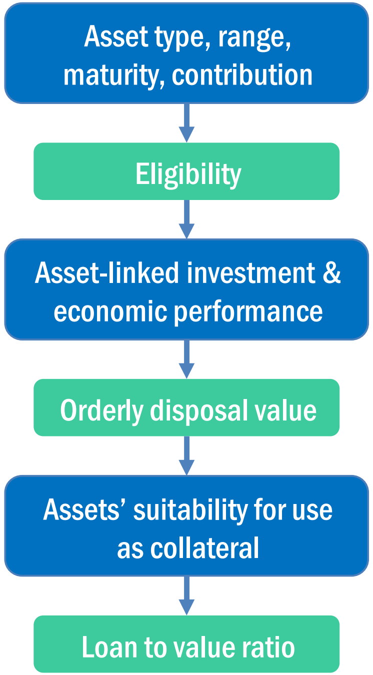
- The first consideration for a lender is whether any IP assets of value are present
- A (free) pre-qualification check satisfies consumer duty requirements

Q2 – How much is it worth?

- *Quantitative* assessment establishes the assets' 'materiality', providing values that can inform a range of credit decisioning processes
- All customer IP is valued in exactly the same way, treating customers fairly

Q3 – How much reliance can be placed on the value found?

- *Qualitative* assessment is done once materiality has been established and the feasibility of a financing arrangement has been confirmed
- Deep dive into ownership, traction, markets, competitive landscape



How do we determine IP value?

In nearly all cases, the main consideration is the economic benefit the IP delivers

- Our preferred method is ‘relief from royalty’, widely accepted and well-documented in international standards
- As inputs, we use the company’s recent factual performance and its own forecasts
- We compare these against sector average growth rates, and stress-test them by modelling a downturn (as that is the only scenario in which the assets are likely to be sold)

The amount the company has invested is also a consideration – especially with software

- We use a cost amortisation algorithm to show what would be on the balance sheet now, if you could show all assets
- We supplement this by modelling how the position may develop over the next two years

We then blend the results according to industry sector and IP portfolio content

How do we take recoverability into account?

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IP always delivers value in a particular context – which includes the health of the business

- The precise context for, and timing of, any future recovery is not knowable in advance
- Generally, a distress situation will impact realisable IP value
- The key to optimising value is to have maximum warning and good market intelligence on potential disposal routes

We do not attempt to identify a 'fire sale' or forced sale value for the IP

- This would massively undervalue the IP in use and could not form the basis for a viable lending product
- Also, fire sales should always be avoidable with proper monitoring

All our research points to the need for an Orderly Disposal Value (ODV)

- An estimated price at which the assets could be remarketed while the business is still a going concern
- Calculated without reference to customer forecasts (which often feature optimism bias)
- Considering the future potential downside value **at the initiation of the loan, when it is sized** – not when it starts to have issues, when time is of the essence

(Auf Englisch, bitte!)...

ANY QUESTIONS?

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