

The financial link between superior intangible asset management and enterprise value

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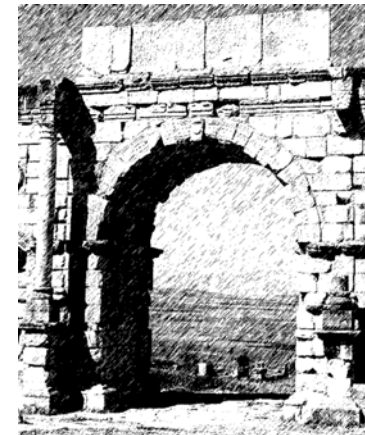
Intangible Asset Finance Society
Executive Secretary

Executive Summary

- **Intellectual property includes the patents and know how covering business processes:**
 - that enable a client to deliver products and services
 - that enable products and services that are ethical, of quality, innovative, safe, sustainable and do not compromise security
 - that are valuable business assets
 - and demand attention under the Duty of Care, and
 - that become the basis of a company's reputation
 - where failure often results in harm and financial loss
- **We're here to discuss corporate risk and reputation management**
 - as elements of holistic intellectual property management and monetization
 - comprising risk engineering
 - comprising value creation, protection and restoration
- **Because firms that have and deploy better business process IP**
 - are more financially resilient
 - outperform their peers

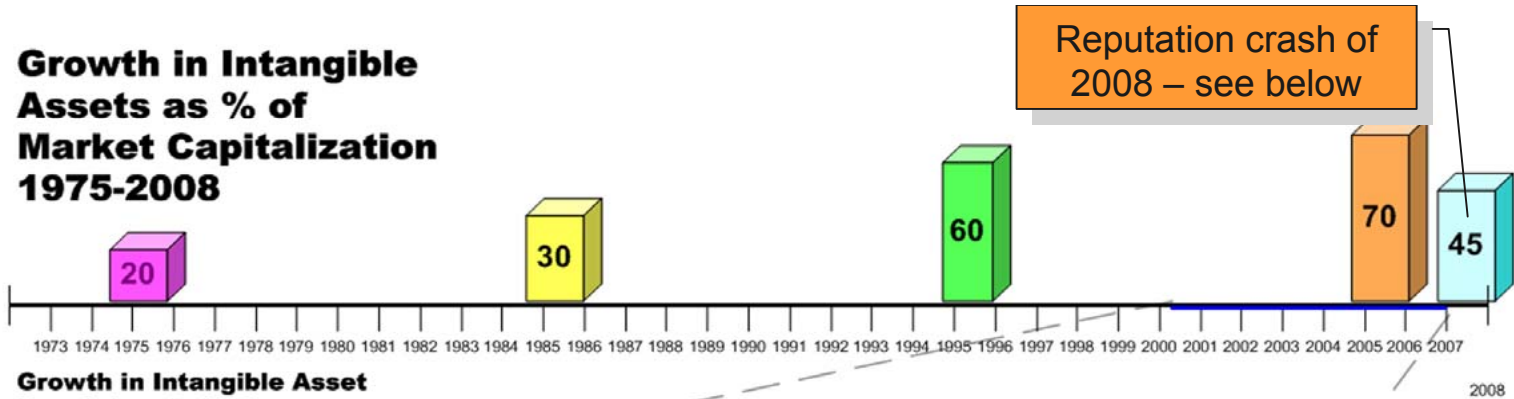
Reputation, intangibles, and value

- **The “business” intangibles**
 - These assets comprise business processes that govern ethics, innovation, quality, safety, sustainability, and security.
 - They create value through reputation which is reflected in various financial metrics
- **Non-balance sheet assets**
 - Can not be measured by standard accounting methods and GAAP metrics
- **Not managed**
 - That which is not measured is not managed
 - Failure to manage or oversee creates risk
- **Like a Roman Arch, together they create value but loss of any one can destroy value**
 - In September 2008, global financial markets lost ~5 trillion in intangible asset value

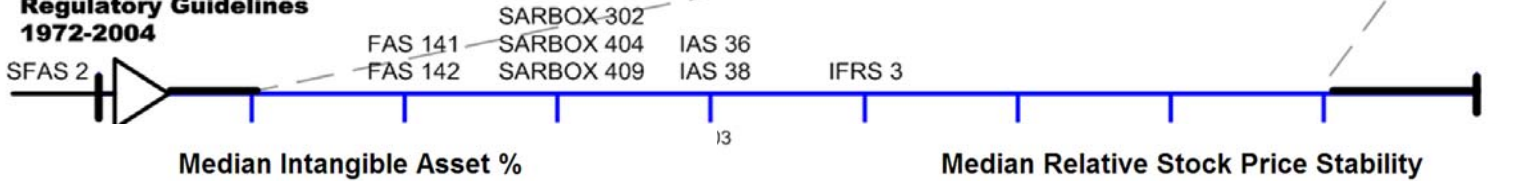


Intangible assets are a major component of market cap and price stability

Growth in Intangible Assets as % of Market Capitalization 1975-2008

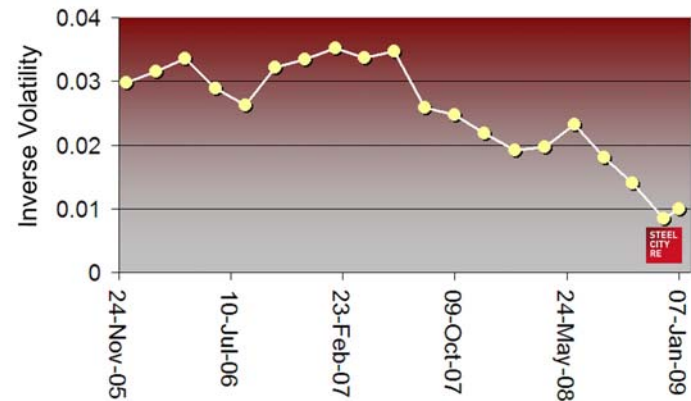
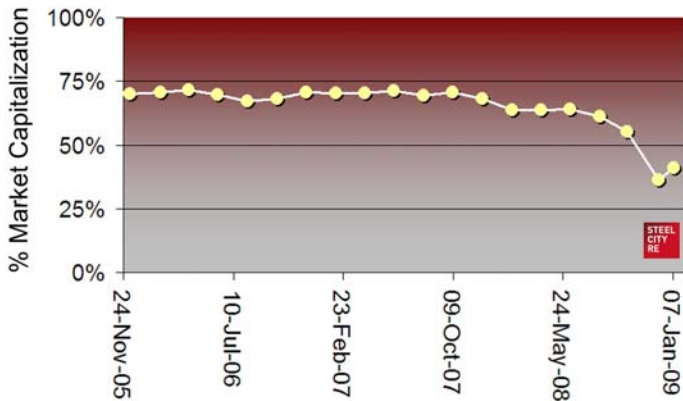


Growth in Intangible Asset Regulatory Guidelines 1972-2004



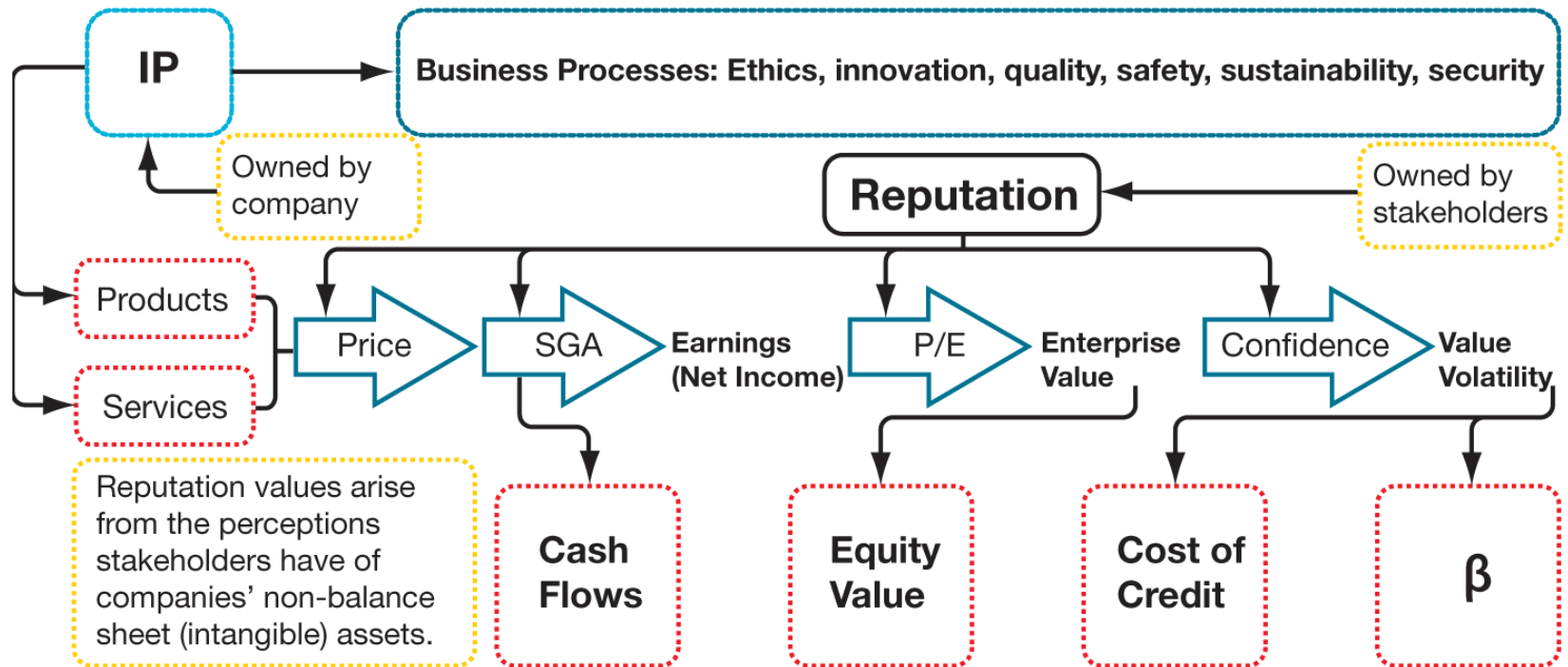
Median Intangible Asset %

Median Relative Stock Price Stability



Holistic IP Management

Figure 1. **Fundamental business asset summary**



Source: *Intellectual Asset Management* magazine, 2009:39

Business process failures underlie reputation collapse

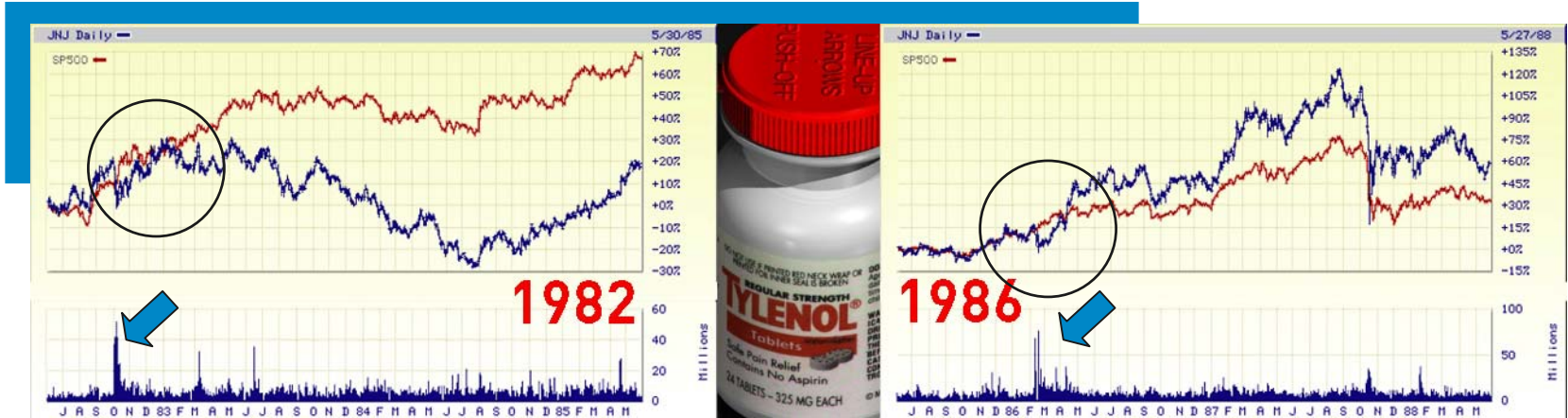
• Examples by sector

- Technology
 - creating and protecting innovation
- Food & toys
 - safety and quality
- Transportation and hospitality
 - security and customer service
- Industrial/manufacturing
 - ethics
- Retail
 - sustainability

• Examples by company

- Kellogg's/food retailers
 - supply chain ingredients;
- Mattel
 - lead paint;
- Marriott
 - Bombings/security
- Jet Blue
 - IT disaster/customer svc
- Siemens
 - ethics
- Wal-Mart
 - labor

Johnson & Johnson demonstrates superior IA management (safety)



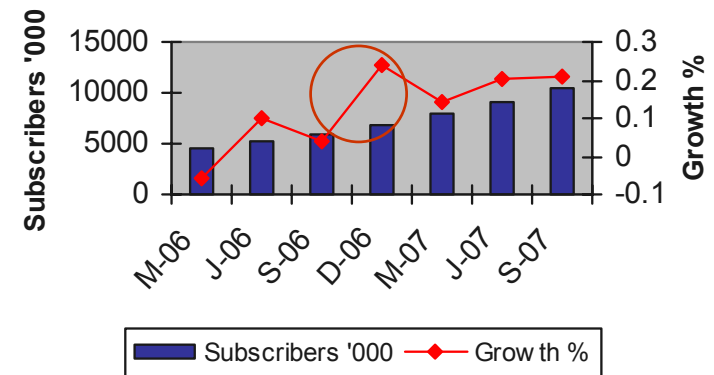
- 1982 September-October. Tylenol poisonings. J&J had limited visibility and control of its supply chain
 - Reputational loss including a 30% market cap loss
- 1984-85. Business process changes
- 1986 February. Tylenol poisonings. J&J had both control and visibility
 - Reputational resilience with a 0% market cap loss (actually, increased enterprise value as stakeholders began to understand the value of the changes)

Six reasons why a good reputation is valued

- Reputation = *expectation* for future behavior
 - *Expected* impact on cash flow and demand:
 - Customers *will* be motivated and *will* purchase and pay a premium
 - Employees *will* be attracted and *will* accept lower pay and non-cash compensation (options)
 - Vendors *will* offer superior terms
 - Internal operations *will* operate with less friction
 - *Expected* impact on enterprise value
 - Investors bid up the earnings multiple
 - Uniformity of *expectations* is evident in value volatility
- Closely linked to executive reward
 - Stock price is *forward* looking
 - Equity-based compensation is *forward* looking
 - Cash-based bonuses are affected by stakeholders *expectations*

RIM (the *Blackberry*™ co.) demonstrates superior IA management (innovation)

- RIM develops technologies supporting the BlackBerry PDA.
 - Late 2001. NTP sues RIM for patent infringement
- Conversion of invention to innovation threatened by patent litigation
 - March 2006. RIM signs 620,000 new subscribers, missing_earnings_target
 - **-6%**
 - March 2006. RIM agrees to settle patent disputes with NTP for \$612mm
- Customer reaction to reduced risk
 - Jun 06. 680,000 new subscribers per quarter
 - +15% over same quarter 2005
 - Jun 07. 1.2 million new subscribers per quarter
 - **+77% over same quarter 2006**



Measuring reputation

Figure 2. **Measuring reputation**

- **Primary opinion survey**

Fortune, FT, Forbes

- **Survey of media tone**

Vanno, Predictiv

- **Expert panel**

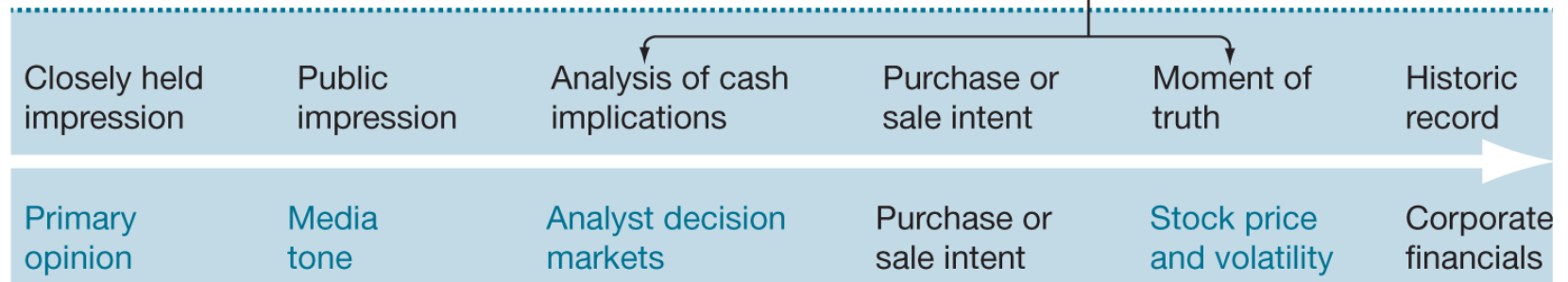
Interbrand, Ethisphere

- **Expectation-linked decision market (finance)**

Stock price

- **Expectation-linked behavior and decision market (finance)**

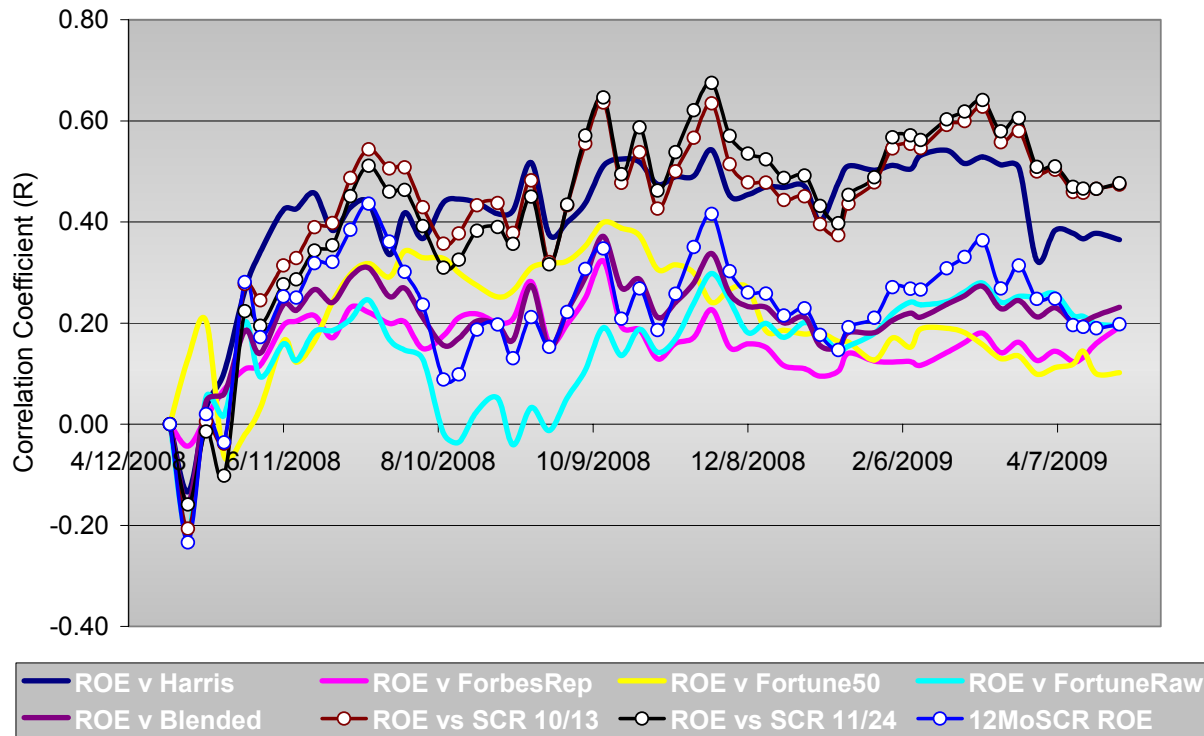
Steel City Re



Source: *Intellectual Asset Management* magazine, 2009:39

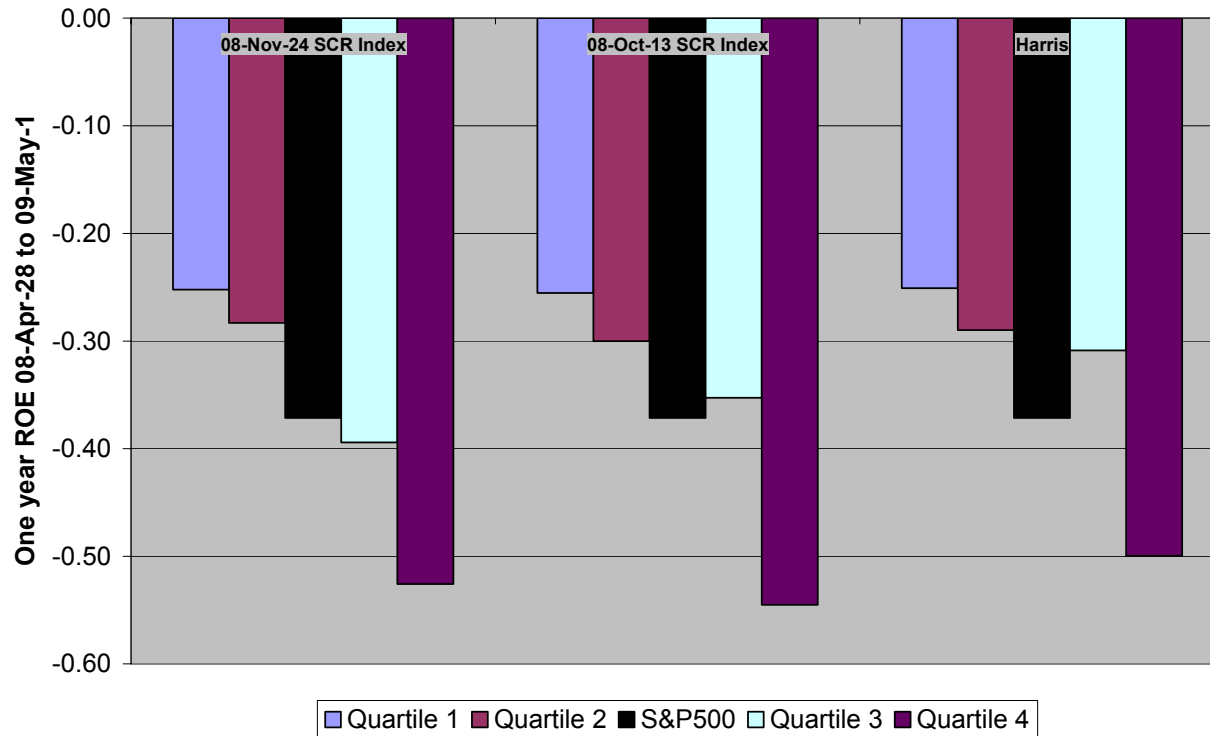
Correlation of reputation ranking to the ranking of the periodic economic return

Correlation of Ranking with One-Year Economic Return



One-Year Discriminatory ROE Comparability

Returns for SCR v Harris Reputation Indices by Quartile



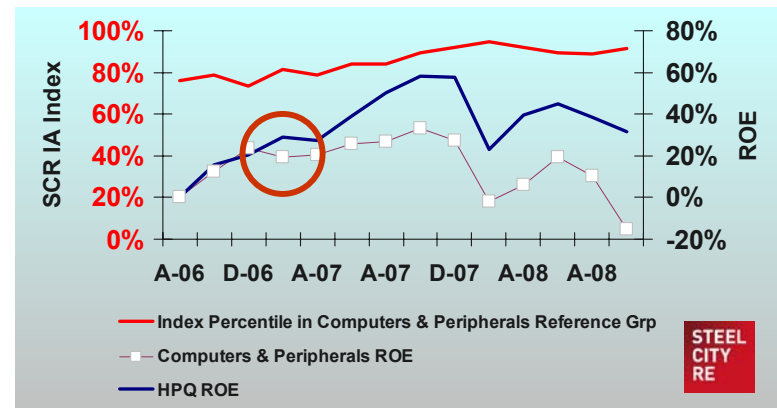
Risk and reputation management

- IA management and quantitative tools are integrated with pre-existing corporate operations to
 - establish intangible asset management best practices,
 - monitor and enforce compliance,
 - forecast and mitigate operational and headline risk, and
 - communicate the value created to stakeholders.



Hewlett Packard demonstrates superior IA management (governance)

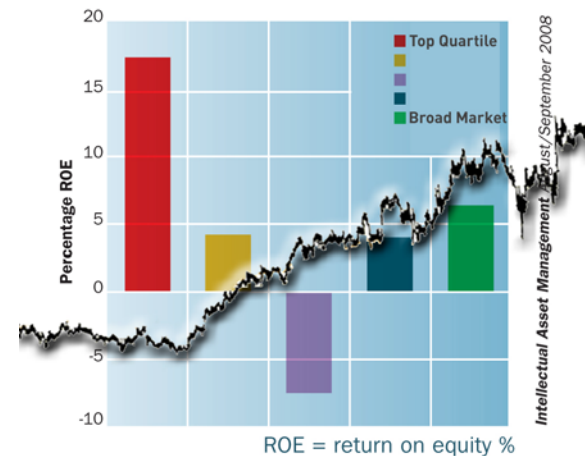
- Early years of new century marked by chaos in the boardroom
 - Feb 2005: Fiorina removed
 - Dunn becomes third Chairman in 5 years
 - Jun-Aug 2006: HP loses 30% of market cap
 - Sep 2006: End of board purge and internal spying scandal; Dunn is removed
- Feb 2007 Changes
 - HP initiates governance transparency program



Steel City Re Index Metrics

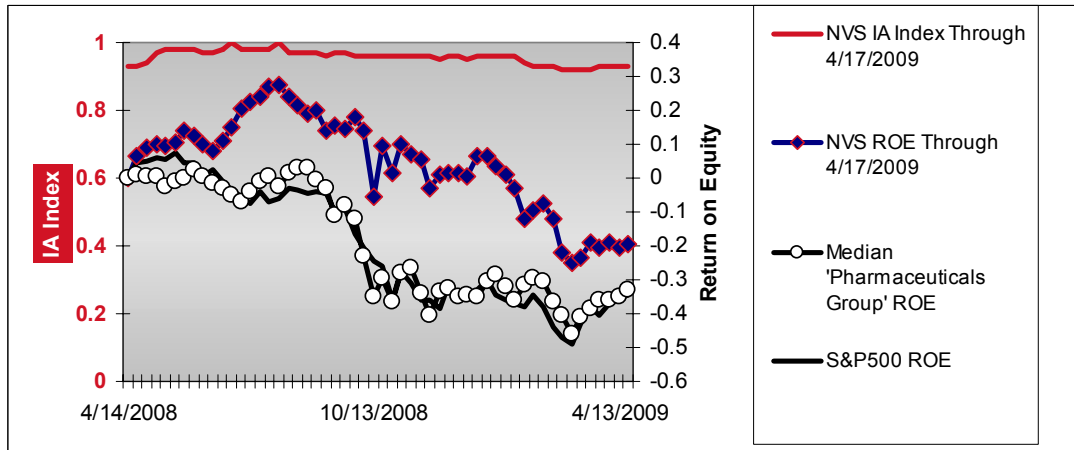
- Key enterprise value observations bridging the “moment of truth.”
 - Higher sales
 - Higher net incomes
 - Higher P/E multiples
 - More stable stock prices
 - Greater resilience in down markets
- Pharma case study
 - NVS, PFE, LLY

Reduce reputation risk transparently; create value

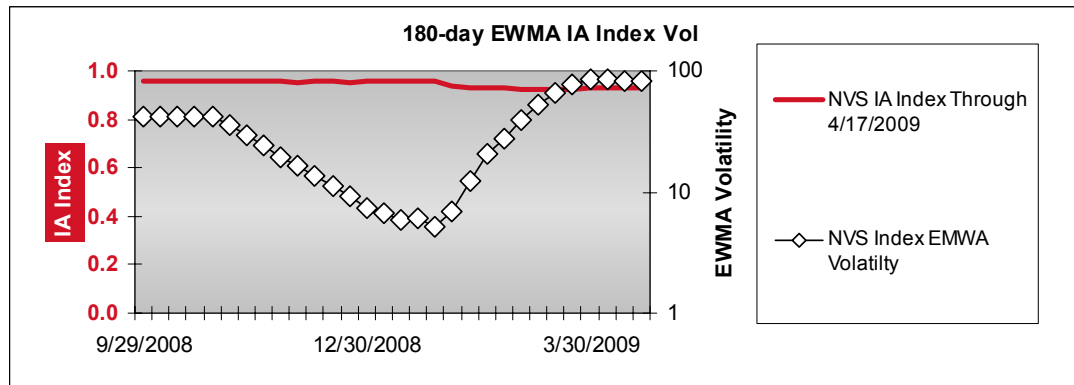


On average, superior intangible asset managers rewarded their shareholders with returns 3x greater than the broad market. ROE Dec 2005 – Feb 2008.

Novartis (NYSE:NVS)



Over this time period, NVS's IA index has fluctuated around 0.93. IA volatility is generally low. Financially, it is outperforming its peers.

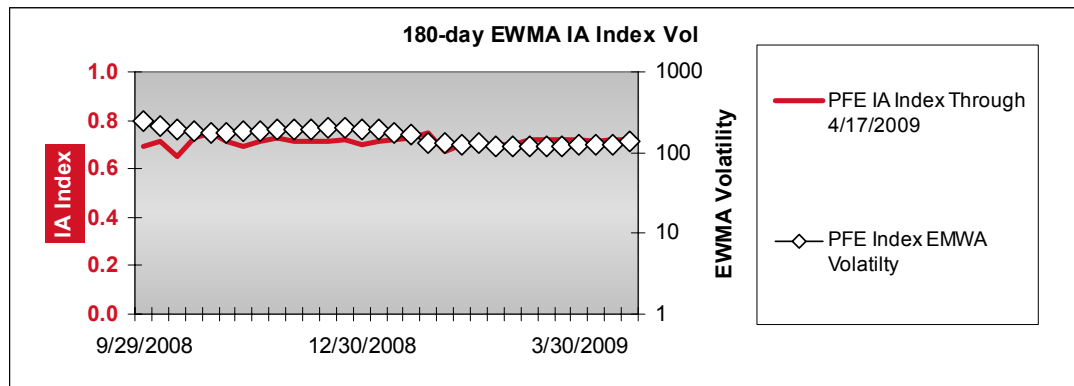
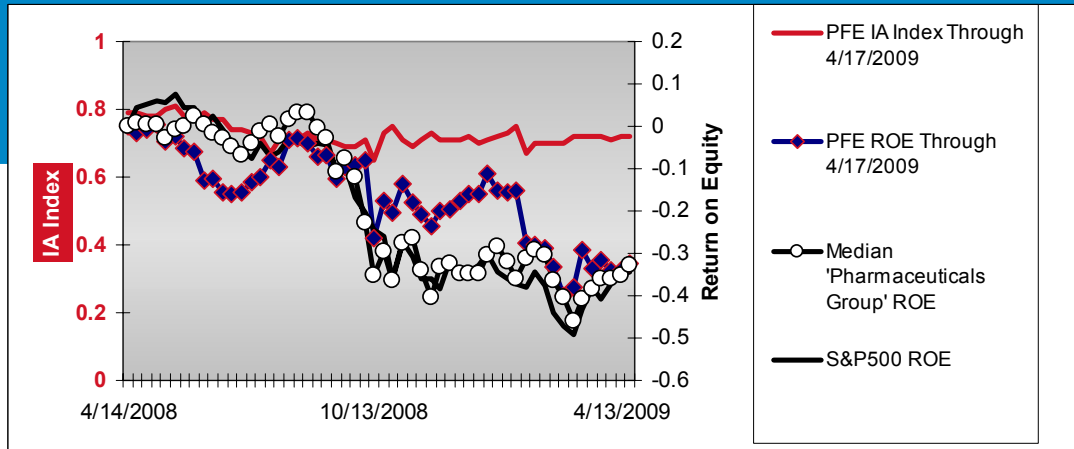


Novartis AG (ADS)
Group:Pharmaceuticals

IA Index Trend
ROE Trend
Magnitude
Volatility Trend
Volatility Magnitude

Symbol:NVS
Comprising an average of
84 companies.
Index Through 4/17/2009
Decreasing
Superior
13.14%
Increasing
2

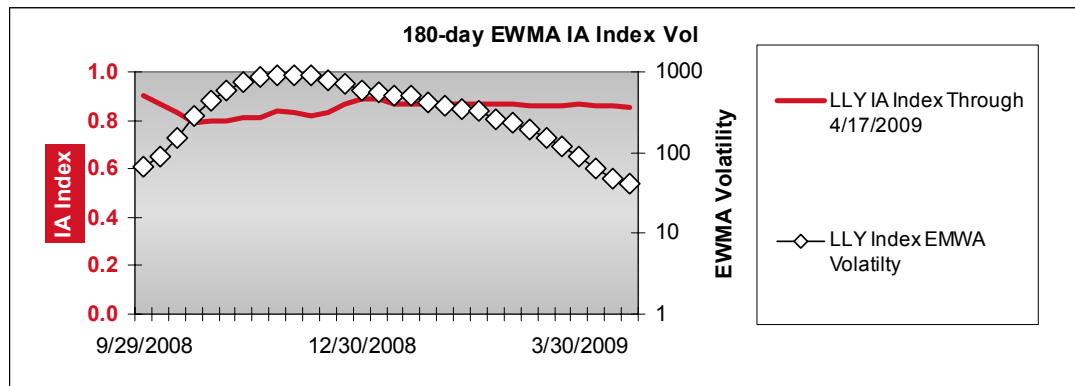
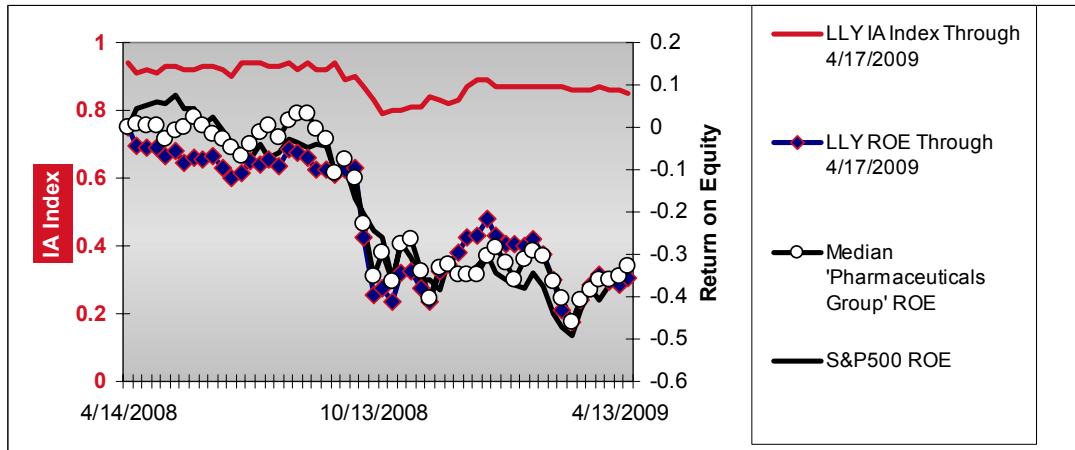
Pfizer (NYSE:PFE)



Over this time period, PFE's IA index decreased from 0.79 to .72. IA volatility has been dropping slightly. Financially, it is marginally outperforming its peers.

Pfizer Inc.	Symbol:PFE
Group:Pharmaceuticals	Comprising an average of 84 companies.
	Index Through 4/17/2009
IA Index Trend	Decreasing
ROE Trend	Superior
Magnitude	0.44%
Volatility Trend	Decreasing
Volatility Magnitude	2

Eli Lilly (NYSE:LLY)



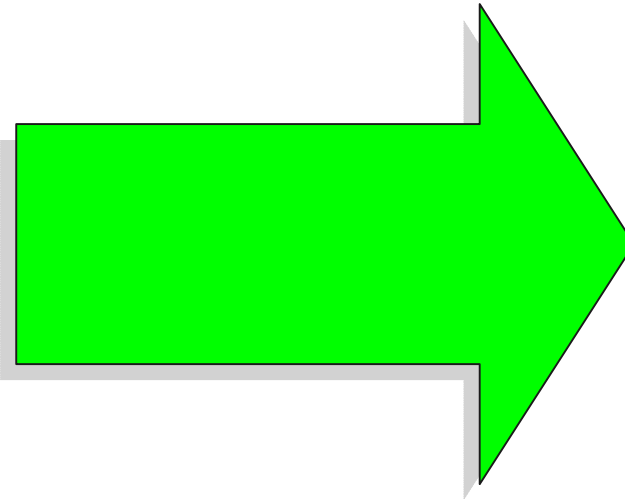
Over this time period, LLY's IA index decreased from 0.94 to .85. IA volatility has been fluctuating. Financially, it is underperforming its peers.

Eli Lilly & Co.
Group:Pharmaceuticals

IA Index Trend
ROE Trend
Magnitude
Volatility Trend
Volatility Magnitude

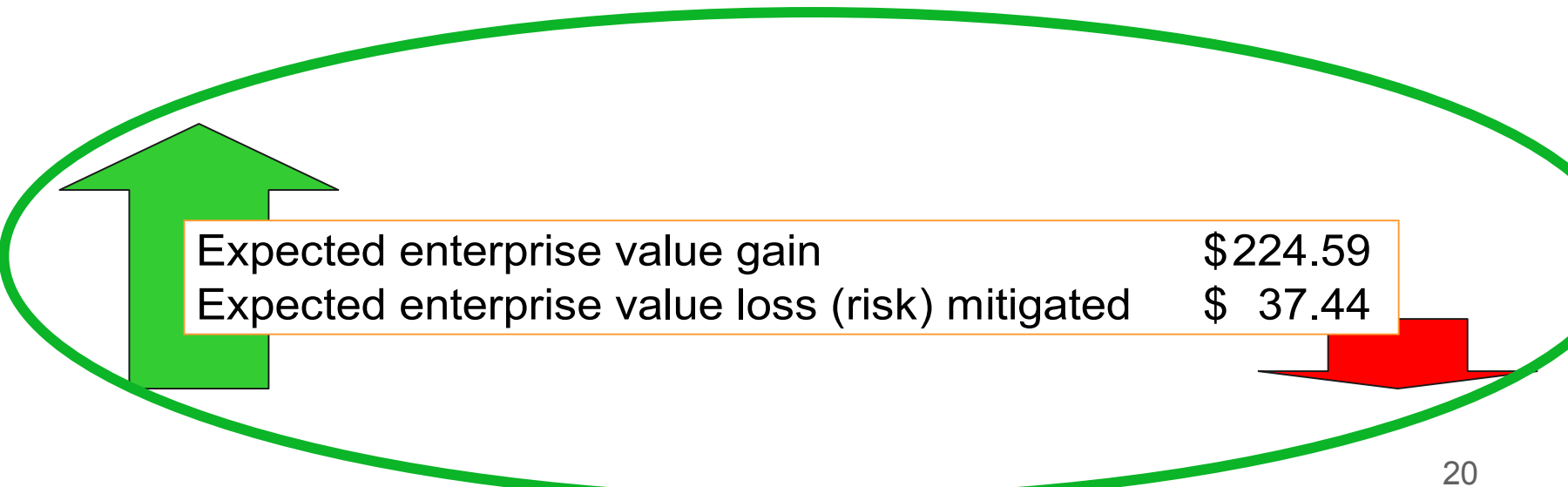
Symbol:LLY
Comprising an average of 84 companies.
Index Through 4/17/2009
Decreasing
Underperform
-2.96%
Decreasing
3

Business Case





- Cost Savings
- Revenue
- Adverse Event Costs
- Enterprise Value Changes

Enterprise value benefits



Expected enterprise value gain	\$224.59
Expected enterprise value loss (risk) mitigated	\$ 37.44



Summary

- Reputation has significant economic value
 - It is a product of intangible asset (IP) management
- Numerous companies/Boards have had failures of (risk management) business processes (IP)
 - They need measurement systems and
 - They need management controls,
- Holistic IP management comprises:
 - Board level reputation protection
 - Operational level tangible and intangible asset monetization
- Benefits of Superior Management & Measurement
 - Value enhancement, protection and recovery



STEEL CITY RE provides corporate reputation protection.

Our scalable risk and reputation management solutions improve managerial visibility and control by breaking down unhelpful barriers between corporate silos.

Through a common best-practices framework governing the monitoring and enforcement of international labor standards, product safety, security, quality, ethics and innovation practices, we enable our clients to save substantial costs in redundant operations, create value by transparently reducing risk and efficiently signal value to stakeholders.

www.steelcityre.com





Intangible assets include business processes, patents, trademarks; reputations for ethics and integrity; quality, safety, sustainability, security, and resilience.

The Intangible Asset Finance Society provides a forum for finance, innovation, legal and management professionals to discover better ways to create, capture and preserve the value of these assets.

Visit our blog, MISSION:INTANGIBLE for insight into the intangible asset finance matters behind today's business headlines.

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