Evaluating IP Metadata as Capital

Smart Hollywood Summit 2019
MESA

Edward Klaris
CEO

KLARIS IP
intellectual property transformed

Unlocking the Value of Capital Assets

KLARIS IP
intellectual property transformed

- In today's digital economy, global organizations rely heavily on value creation through the use of intangible assets and intellectual property (IP).
- Over 67% of U.S. companies own IP that is in no way commercially leveraged.
- Under current accounting rules, many forms of IP are not recognized as assets on the balance sheet, and thus the value of these assets are not made explicit to firm management, investors, or the public.
- Metadata development creates *future* value and thus should be evaluated as a capital expenditure.

KLARIS IP
intellectual property transformed

Agenda

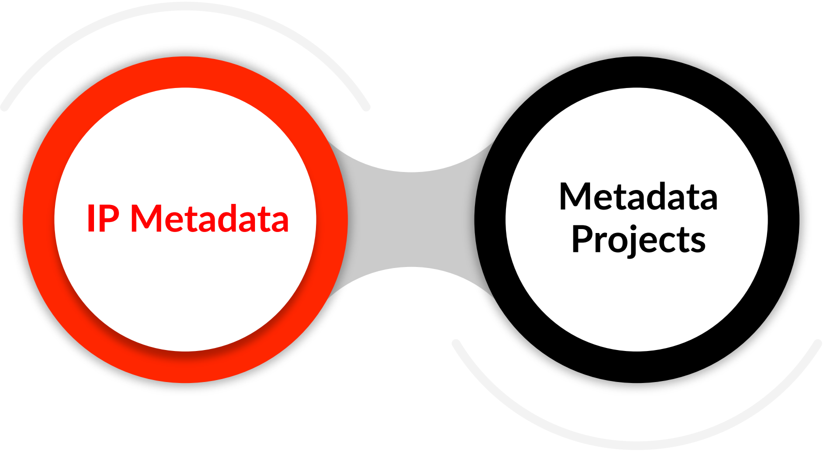
- Getting on the Same Page
- Proposition: Metadata Projects as CapEx
- Metadata Investment Creates *Future* Value
- How to Capitalize Metadata Projects

Getting on the Same Page

KLARIS IP
intellectual property transformed

What is IP Metadata?

Definition: “a set of fields and values used to describe and categorize IP content“.



“Metadata investment” or “metadata development” refers to the creation of metadata itself through one-off projects.

- For our purposes, we are excluding:
  - Metadata that describes other types of assets (i.e. patents, trademarks, etc.)
  - “Standalone” data (i.e. Big Data, data on consumer sentiment, etc.).

- For our purposes, we are excluding:
  - the acquisition of metadata software (different rules apply to these costs[1]).
  - day-to-day/ongoing maintenance of metadata by employees within the firm in the general course of business.

1: See, e.g., American Institute of Certified Public Accountants (AICPA) Statement of Position 98-1: Accounting for Costs of Computer Software Developed or Obtained for Internal Use.

Categories of IP Metadata

KLARIS IP
intellectual property transformed

Technical	Descriptive	Administrative	Rights & Ownership	Financial
Describes **attributes of the file** which stores the content *(file sizes, asset IDs, resolution of images or video, and other attributes about the data object itself)*	Describes the **content of an asset** *(descriptions, synopses, or content-based categorizations, subject, title, description, and keywords)*	Relevant to the authoring, modification, and general **lifecycle of the asset** *(author of an asset, its usage history, past versions and dates of modifications, etc.)*	Describes how the firm distributes, or has **rights to distribute** the piece of content (permissions, prohibitions, and obligations associated with the asset). Also includes internal business rules & compliance information.	Describes how the firm distributes, or has **rights to distribute** the piece of content (permissions, prohibitions, and obligations associated with the asset). Also includes internal business rules & compliance information.

Metadata Projects as CapEx

KLARIS IP
intellectual property transformed

KLARIS IP
intellectual property transformed

Problem with Missing Metadata

Acquisition Example
In an acquisition deal, Company A acquires Company B and its respective portfolio of broadcasting assets…

Company B delivers associated legal, descriptive, technical, and financial data for acquired assets in a trove of **external hard drives, computers, and filing boxes.**

Company A can either…

Option 1
…hire 2-3 FTEs to respond to requests for data on assets from programming.

Option 2
…devote $60k to organizing, digitizing, and categorizing the metadata for the acquired assets.

Are Metadata Project costs OpEx or CapEx?

KLARIS IP
intellectual property transformed

- Company A decides to devote $60k to organizing, digitizing, and categorizing the metadata for the acquired assets.
- **What are the benefits that Company A receives from its investment?**

Generates new revenue opportunities:

"Knowing what you own" helps the firm generate new products and quickly and nimbly exploit market opportunities.

Increases operational efficiency:

Well developed metadata can cut down on operating inefficiencies, saving labor hours and improving processes across the board.

Helps to manage legal and business risk:

Good metadata organization and management can help to reduce legal and business risks associated with the exploitation of content.

Is the $60k OpEx or CapEx?

KLARIS IP
intellectual property transformed

CapEx treatment provides advantages

"Matching" Spending to Benefits: Capital Expenditures are written off over the useful life of the investment, rather than recognized entirely in the current period.

- If the investment is booked as a capital expenditure, the expenditure is recognized through amortization in the periods in which the investment is expected to generate benefits.

"Smoothing Out" Earnings: CapEx avoids the need for managers to recognize the *entire* cost of the project in the current period.

- If the investment is booked as OpEx, the entire cost of the project must be recognized in the current period → this affects earnings and leads to "bumpy" year-over-year reporting and artificial deflation of earnings / profitability.
- Several research studies show that the majority of business managers would forego projects with positive net present value if the result of those projects was an immediate hit to net income.[1]

Recognizing Increase in Asset Value: Metadata projects increase the value of the content assets described; recognizing investment as CapEx recognizes this value increase.

- Recognizing investment as CapEx allows the firm to add the cost of the metadata project to the value of the assets described on the balance sheet.

1. Graham, John R., Campbell R. Harvey, and Shiva Rajgopal, The Economic Implications of Corporate Financial Reporting, Journal of Accounting and Economics 40, 3-73 (2005) (noting that respondent managers acknowledged that they would forego positive NPV projects to boost net income).

What Defines a Capital Expenditure?

KLARIS IP
intellectual property transformed

Capital Expenditure is an expense that creates *future benefit* in the form of a capital asset

An asset has three essential characteristics:

1. It embodies a **probable future benefit** that involves a capacity, singly or in combination with other assets, to **contribute directly or indirectly to future net cash inflows.**
2. A particular entity can obtain the benefit and control others' access to it, and
3. The transaction or other event giving rise to the entity's right to or control of the benefit has already occurred."[1]

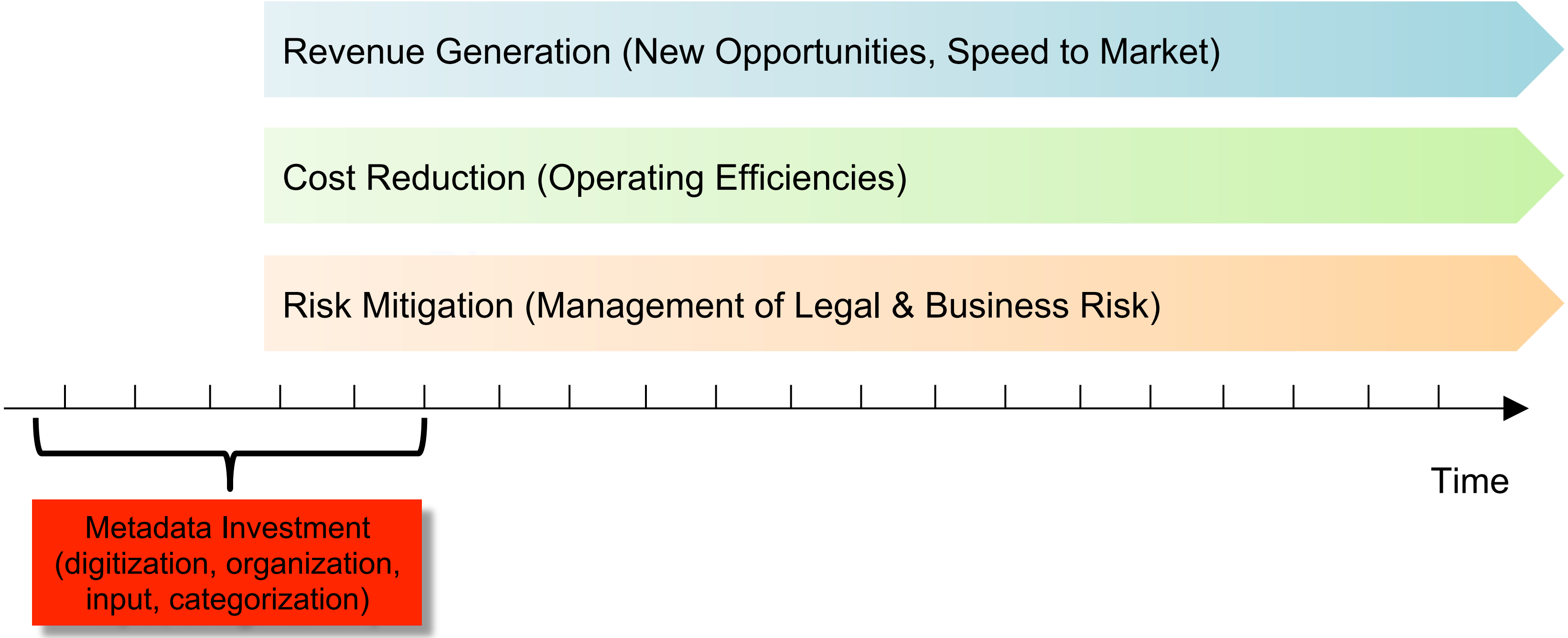
This is not about tax treatment:

- The "capital" vs. "OpEx" distinction is different from a tax perspective (ideally, the firm wants to recognize the expense as OpEx from a tax perspective and CapEx from an accounting perspective).
- Accounting treatment & tax treatment for a particular expense need not be consistent.

1. FASB, Statement of Financial Accounting Concepts no. 6 (Dec. 1985)

Investments in Metadata create Future Value

At the very least, IP metadata investment <u>behaves</u> like a capital expenditure: it promises to <u>contribute indirectly to cash flows</u> not when the cost is incurred, but in <u>future periods</u>



Incremental Revenue Generation

KLARIS IP

intellectual property transformed

Metadata can lead to Incremental Revenue

KLARIS IP
intellectual property transformed

Improving Speed to Market / New Opportunities	Enhancing Marketing, Advertising & Branding Efforts	Enabling Development of New “Derivative” Products

Metadata can lead to Incremental Revenue

KLARIS IP
intellectual property transformed

Improving Speed to Market / New Opportunities	Enhancing Marketing, Advertising & Branding Efforts	Enabling Development of New "Derivative" Products

For media companies, IP metadata makes it possible for firms to quickly respond to and exploit new opportunities

- "The *metadata that we capture for rights information is essential to continuing to move out business forward*. Without rights information, short of a situation where we own all rights to all assets, the business grinds to a halt; we wouldn't know what we can and can't do."

Good IP metadata practices also makes it possible to improve speed to market for new products and geographical markets

- One Director of Digital Asset Management indicated that by "providing [regional] marketing teams with the tools they need to access content and push promotions forward," speed-to-market could be reduced by as much as 4 months.

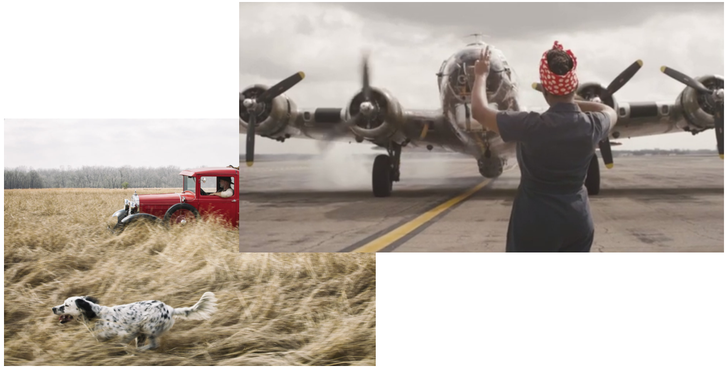
Metadata can lead to Incremental Revenue

Improving Speed to Market / New Opportunities

Enhancing Marketing, Advertising & Branding Efforts

Enabling Development of New "Derivative" Products

"Knowing what you own" by investing in metadata development can open new opportunities for connecting with consumers through brand development



1. Press Release, Carhartt's Fall Marketing Campaign Chronicles Brand's Legacy Of Meeting Workers' Product Demands (Nov. 14, 2016), at http://www.multivu.com/players/English/7708252-carhartt-full-swing-apparel/

Metadata can lead to Incremental Revenue

KLARIS IP
intellectual property transformed

Improving Speed to Market / New Opportunities

Enhancing Marketing, Advertising & Branding Efforts

Enabling Development of New “Derivative” Products

Properly developed metadata can also greatly improve the speed and ease of re-packaging owned content into new products

One cable company added six temporary staff members to "maximize the library," . . . meaning that they are repackaging old shows into short clips for the how-to Web site HowStuffWorks and Discovery's other platforms. . .

When the producer-editors want to repackage long-ago shows, the ongoing digitization of the archives allow them to mine the vault ever deeper.

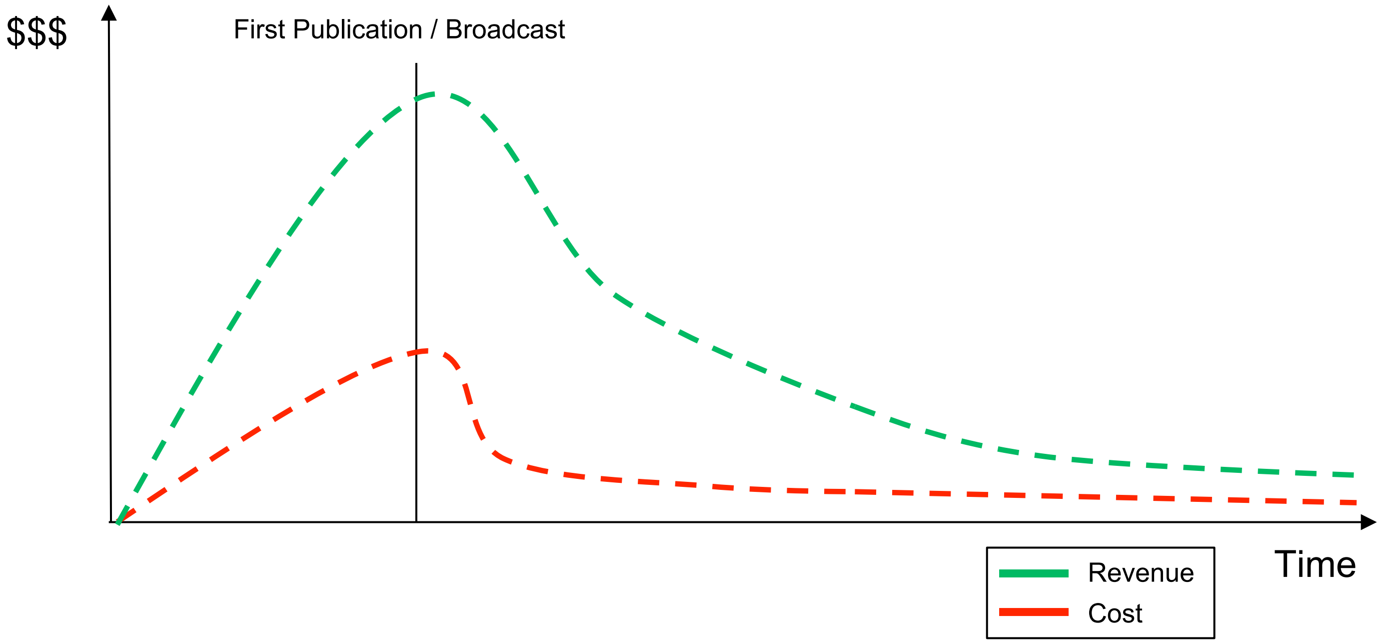
The archive . . . stores 1.3 million tapes, and when a producer wants to clip something from an old episode, the tape is brought to an editing facility . . .where a digital copy is created.

Brian Stetler, Discovery Mines its Video Vault, N.Y. Times (Jan. 25, 2009), at http://www.nytimes.com/2009/01.25/technology/25iht-vault26.1.19646704.html.

Using metadata can increase asset ROI

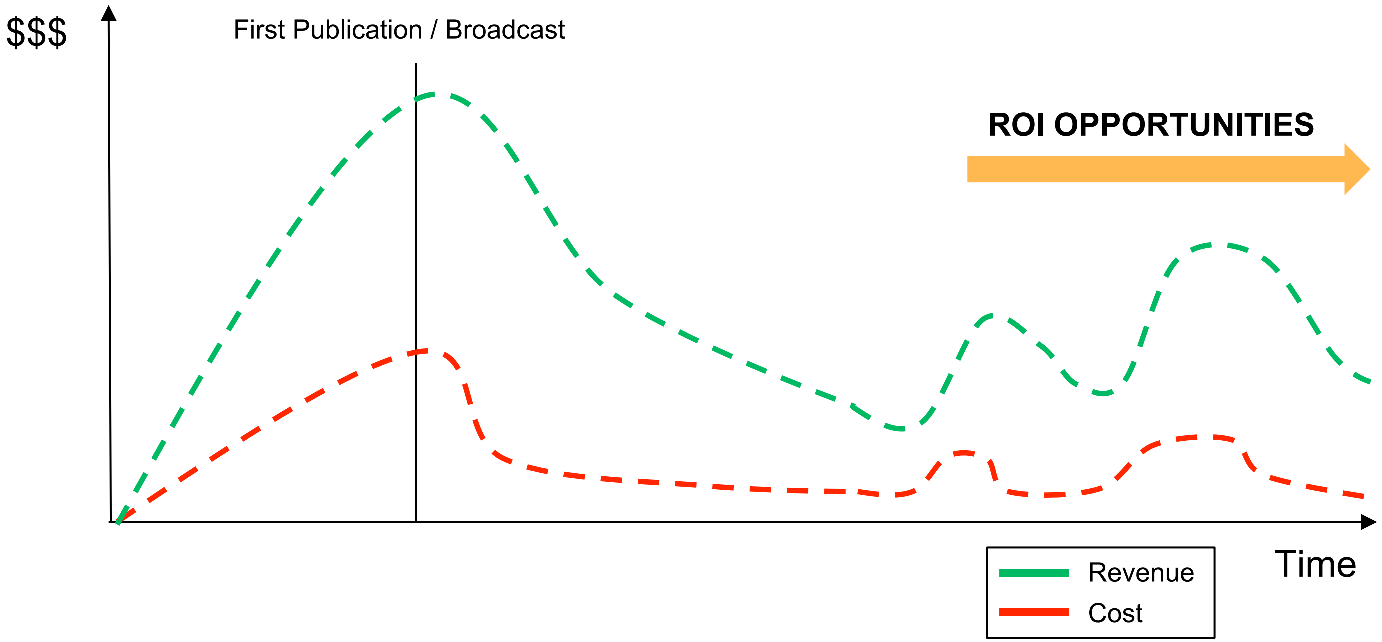
KLARIS IP
intellectual property transformed

Generally, revenue from new assets peaks once, and then declines after initial exploitation



Using metadata can increase asset ROI

Using metadata to put pre-existing assets to work helps to improve asset ROI through exploitation of "long-tail" revenue opportunities



Reduce Costs & Increase Efficiency

KLARIS IP
intellectual property transformed

Cutting Down Costs & Increase Efficiency

KLARIS|P
intellectual property transformed

Avoiding Unnecessary Expenses	▪ Without transparency across assets owned by the organization as a whole, managers may buy / license content when they could just exploit assets / licenses already owned by the firm ▪ One former Global Marketing Systems and Archives Manager estimated that good metadata practices could have reduced one project's costs from \$150k to \$20k
Improving Operating Efficiency	▪ Reducing barriers to information makes it easier for employees to find information for programming, product development, marketing efforts, etc. ▪ Good metadata can save labor hours, boost morale, and improve employee productivity ▪ One SVP at a large media company said: "We have shows that we know nothing about. We don't even have the intellectual property rights documents; when we need them, we have to go and find them. . . We don't know if this information is sitting in a computer in a closet, or in a binder somewhere . . . I can cite many instances in which I have not been able to make sales because I did not have this type of information."

Managing Risk

KLARIS IP
intellectual property transformed

Reduction of Business, Technical & Legal Risk

KLARIS IP intellectual property transformed

Reducing Legal Risk

Good metadata can help managers avoid exposure to legal risks by providing transparent information about license terms.

In 2014, Pearson PLC (publishing company) was sued for using copyrighted photos in textbooks beyond the agreed-upon limited usage – *good metadata can avoid this "underlicensing"*

Reducing Business & Technical Risk

Good metadata can help managers avoid operational mistakes and mitigate technical risk factors.

One interviewee (V.P. at a media & entertainment company) provided an example: if a studio distributes children's content without a rating, poor metadata practices may result in their classification as "unrated"

Because some distribution platforms use "age-gate" systems that block "unrated" content from younger users, this poor metadata practice may result in these pieces of content being unavailable to some target users

How to Capitalize the Metadata Investment

KLARIS IP
intellectual property transformed

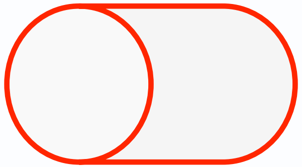
What is a Metadata Asset?

There are two ways to frame the "metadata as capital" question:

1. Metadata as a **separate asset**

Content Portfolio | Metadata Set

2. Metadata as a **capital improvement**



Content Portfolio + Metadata "Improvement"

Here, we characterize the metadata (describing the content portfolio) as a distinct *intangible* asset.

This is <u>problematic</u> for several reasons:

- Metadata isn't really separate; it only has value in conjunction with the assets it describes.

Here, we characterize the metadata as an improvement in the value + useful economic life of the underlying content assets.

Metadata can (conceptually) be considered a "capital improvement" if:

- The firm already recognizes the underlying content asset on its balance sheet
- The metadata is likely to improve the "useful economic life" of the content asset

So Far…

Investments in metadata development are **investments in future benefits** – i.e. metadata projects continue to "pay off" 2, 5, or 10 years after the project is completed.

Accordingly, **metadata development expenditures act as "capital expenditures"** (or investment in assets which are expected to generate "probable future benefit[s]" in later periods).

Metadata development costs **should be seen as the costs of *improving* or *adding value to* existing content assets** recognized on the balance sheet.

Factors to Consider with Metadata

KLARIS IP
intellectual property transformed

Are the content assets on the balance sheet?

- If content assets are not recognized on the balance sheet already, the firm can't recognize the metadata expense as an "improvement" to a capital asset.
- Note: typically, firms will recognize intangibles on their balance sheet if they acquired them (vs. internally generated them). Some specific industry rules do allow capitalization of internally generated intangibles.[1]

How "probable" are the future benefits?

- Why does the firm need metadata investment?
- How will this project lead to value, and in what periods?
- Will the project lead to additional revenue, reduced operational costs, or mitigation of risk?

Can the firm allocate the costs to the asset?

How simple will it be to determine the full amount of "cost" to be capitalized?

- If the project is <u>externally-executed</u>, it will be simple for the firm to allocate the entire cost of the contract to the capital improvement.
- If the project is <u>internally-executed</u> (i.e. carried out by employees) allocation of expenses to the metadata project will be more difficult.

As long as:

- The metadata project improves an asset that is already on the balance sheet.
- The future benefits are "probable" and the firm can estimate the timeframe of the future benefits.
- The firm can reliably allocate the costs of the investment to capital expense.

--> Capitalization may be appropriate

1: See FASB Statements Nos. 141, 50 & 53

KLARIS IP
intellectual property transformed

Final Thoughts

The state of metadata around a content portfolio speaks volumes about how content can be leveraged.

- A content portfolio without good metadata can't be easily utilized.
- Without good metadata, operational efficiency of exploitation will be low and the business will not be able to manage legal or business risks.

In the context of asset acquisitions, the firm should consider the state of metadata.

- Ignoring metadata during the due diligence process is a crucial mistake, which leads to unexpected operational costs and barriers to exploitation.
- "Not only should the [acquirer of an IP asset] value the catalog based on the exploitable rights, the [acquirer] should evaluate the catalog based on the state of the assets and the metadata. . . **If the metadata is all over the place**, with different video and audio codecs, different content identifiers, and different formats . . . **This could mean real dollars for the acquiring studio**, and it could have **a real impact on the speed and expense** through which the acquiring studio can deploy the acquired assets. **If the metadata surrounding those assets is not sufficient to make those assets exploitable on Day 1, then the [acquirer] is losing money.**"

Assets which come with complete metadata should command a higher price.

- Assets sold with well-developed metadata should be valued more highly by an acquirer - Well-developed metadata will avoid the need for the acquirer to invest labor hours in order to extract the metadata and exploit the asset.

1: See FASB Statements Nos. 141, 50 & 53

Thank You

To find out more, please go to:

KlarisIP.com

Or contact:
Edward Klaris
edward.klaris@klarisip.com

KLARIS IP
intellectual property transformed