

Financing with Intellectual Property

Hong Kong's IP Financing Sandbox, the mechanics of IP-backed lending, and the methodologies used to value intangible assets.

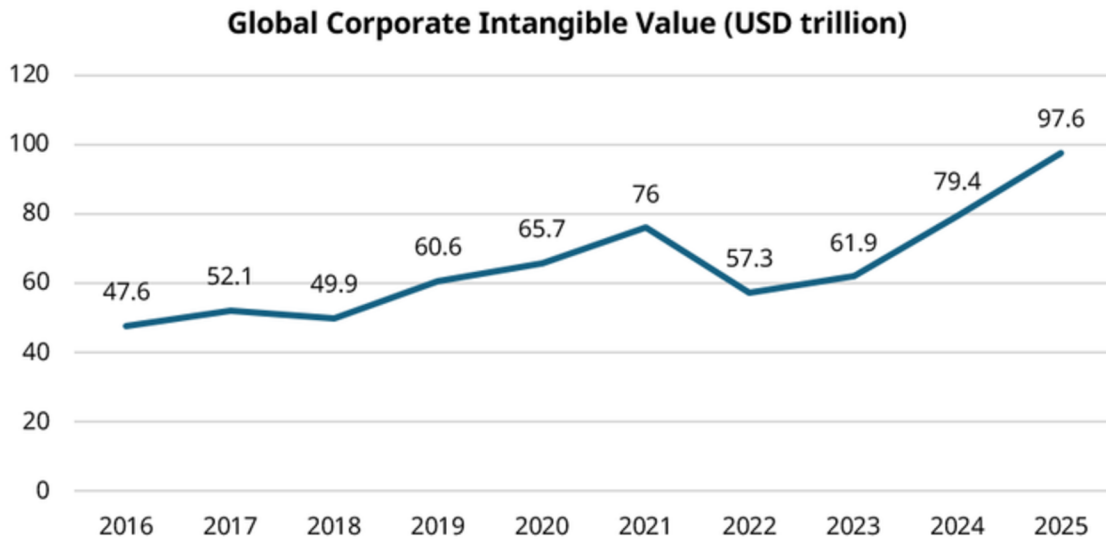


The Hong Kong Sandbox in Global Context

The Commerce and Economic Development Bureau of Hong Kong SAR government, in collaboration with the Hong Kong Monetary Authority (“**HKMA**”) and the Intellectual Property Department (“**IPD**”), launched the Intellectual Property (“**IP**”) Financing Sandbox in December 2025 to solidify its position as a regional intellectual property trading center. This initiative is designed to address the “financing gap” faced by innovative small and medium-sized enterprises (“**SMEs**”) that lack traditional physical collateral but possess significant intangible value. The sandbox provides an environment where commercial banks work alongside valuation professionals and legal experts to pilot IP-backed lending products.

A critical component of this ecosystem is the integration of standardized valuation practices. The government has earmarked HKD 28 million for the Pilot Patent Valuation Support Scheme, which subsidizes the cost for SMEs to engage professional valuers. Furthermore, the newly established Hong Kong Technology and Innovation Support Centre (“**HKTISC**”) provides qualitative patent evaluations based on national standards, helping lenders bridge the gap between technical complexity and financial creditworthiness.

While Hong Kong’s sandbox represents a significant policy-driven step forward, the local IP financing ecosystem remains in its infancy. In contrast, the United States possesses a highly mature, market-driven IP financing landscape backed by sophisticated private credit funds and advanced secondary patent markets. The financing process begins with the legal due diligence phase, where underwriters verify the clean title chain of the asset and conduct “freedom-to-operate” analyses to confirm the absence of infringement claims. Once ownership is verified, specialized intellectual property brokers or independent valuation firms deploy appropriate valuation techniques to estimate the asset’s market value. In some transactions, Collateral Protection Insurance (“**CPI**”) provides an additional credit enhancement by reviewing the valuation data and issuing a coverage policy that wraps the IP portfolio, thereby helping establish a legally binding asset value for the financing. With this enhancement in place, institutional lenders or private credit funds can finalize transaction terms and record the relevant security interests through formal filings with the U.S. Patent and Trademark Office (“**USPTO**”).

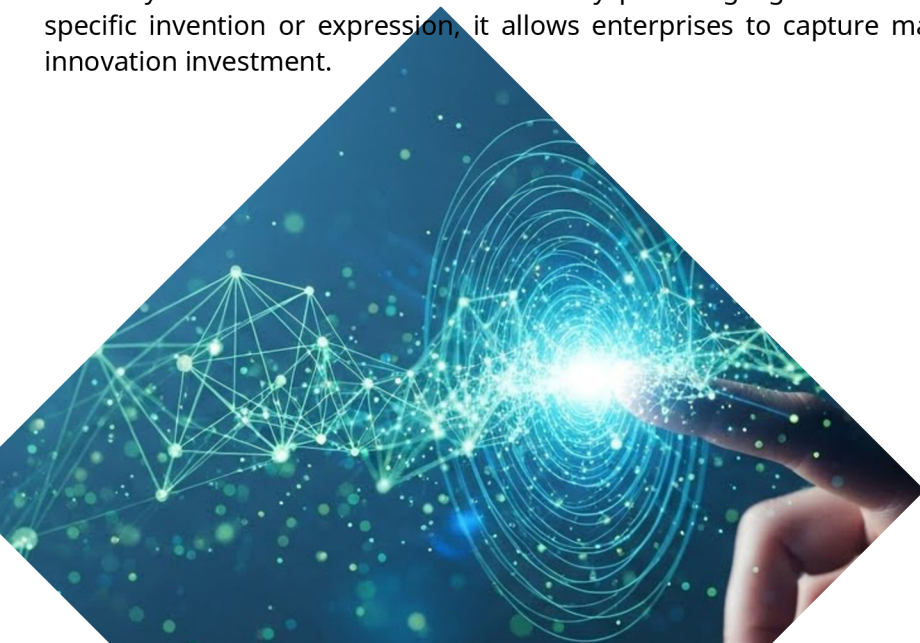


Source: WIPO's Global Innovation Index and Brand Finance Global Intangible Finance Tracker

In October 2020, Indigo Ag, a high-growth agriculture technology company utilizing microbial and digital technologies, successfully secured a debt facility in excess of USD 100 million structured entirely on the company's extensive intellectual property asset portfolio. The structure allowed the lender to advance a facility secured strictly by the intellectual property, and the company to access growth capital without pledging physical assets, providing corporate guarantees, or subjecting existing shareholders to equity dilution. Additionally, in July 2025, Concord issued USD 1.76 billion of five- to ten-year senior notes. While financing traditionally relies on physical or real estate assets to collateralize debt, this transaction was structurally engineered around the monetization of an extensive intellectual property portfolio of over 1.3 million music copyrights, including songs and recordings.

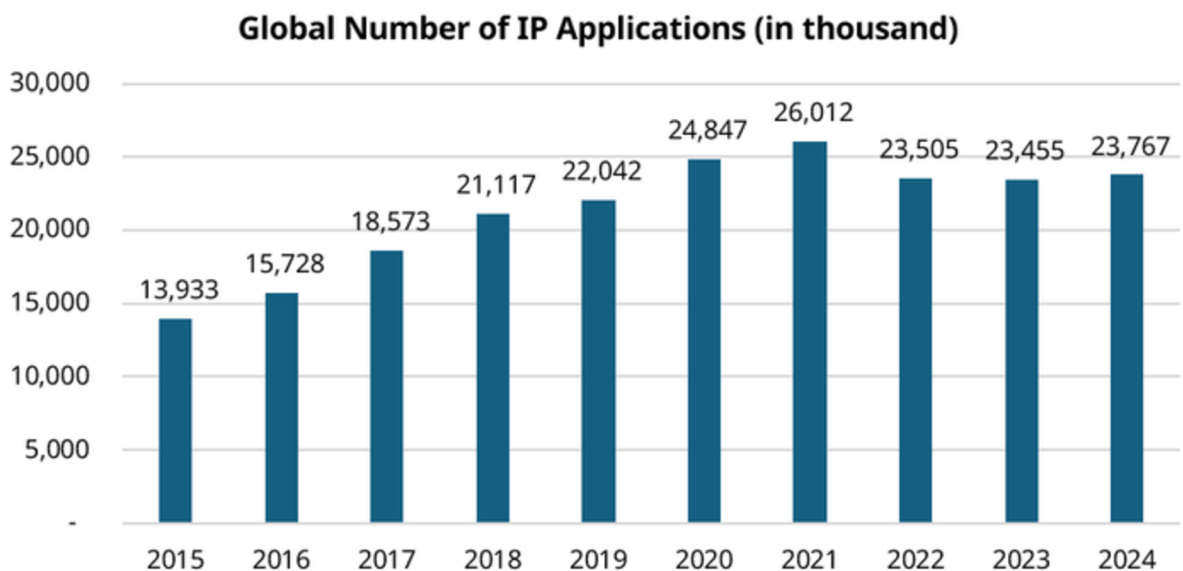
Understanding Intellectual Property

IP represents a distinct category of assets encompassing the intangible creations of human intellect. Unlike tangible assets, which are defined by their physical substance and presence, intellectual property is characterized by a framework of statutory legal rights granted to creators. These protections safeguard original ideas, technical innovations, and commercial identities. At its core, IP serves as a critical economic mechanism designed to incentivize creativity and commercial advancement. By providing rights holders with a temporary monopoly over the use of a specific invention or expression, it allows enterprises to capture market value and achieve a sustainable return on innovation investment.



Major Classifications of Intellectual Property Assets

- **Trademarks:** Distinctive, recognizable signs, designs, or expressions utilized to identify and differentiate the products or services of one enterprise from those of competitors. These typically encompass corporate logos, brand names, and proprietary nomenclature vital to establishing market goodwill.
- **Patents:** Exclusive legal rights granted for a novel technological invention. A patent empowers the owner to legally exclude third parties from manufacturing, using or commercializing the invention for a limited statutory period.
- **Copyrights:** Legal protections automatically assigned to original works of authorship. In a modern corporate context, this extends beyond literary and artistic works to encompass foundational software source code, proprietary algorithms, and corporate publications.
- **Trade Secrets:** Confidential, non-public business information that provides an enterprise with a distinct competitive advantage. This category relies on strict internal controls rather than public registry and includes proprietary chemical formulations, manufacturing processes, or commercial algorithms.
- **Registered Designs:** Legal protections governing the specific visual, aesthetic, or ornamental design of physical objects that are not purely utilitarian. This applies to high-value industrial differentiation, such as the proprietary geometry of a consumer electronic device or a luxury timepiece.



Source: WIPO Statistics Database

The profound commercial value of these classifications is routinely demonstrated in high-stakes corporate transactions, where the strategic rationale centers entirely on the accumulation of robust IP portfolios rather than industrial infrastructure. A definitive example is the acquisition of Marvel Entertainment by The Walt Disney Company in 2009 for approximately USD 4 billion. In this transaction, the premium paid by the acquirer did not reflect physical manufacturing capacity or significant real estate holdings. Instead, it was an isolated, highly targeted acquisition of an intangible asset library consisting of copyrights and trademarks for more than 5,000 distinct fictional characters—including globally recognized figures such as Iron Man, Thor and Captain America. By integrating these IP assets into its established global distribution, merchandising, and media ecosystems, the acquirer successfully transformed a localized library of creative expressions into an institutional asset class generating tens of billions of dollars.

Ownership of Intellectual Property

From a legal perspective, identifying the corporate ownership of intellectual property is a critical primary step in establishing its validity, financial value, and enforceability. Ownership typically originates with the individual creator; however, in a corporate or institutional context, this baseline is routinely modified by statutory “work-for-hire” doctrines or specific employment contracts. Under these regulatory frameworks, the intellectual property rights for creations developed within the scope of an employee's duties are automatically vested in the employer. For third-party collaborations, ownership must be structurally verified through formal assignment agreements, where the legal title is explicitly and irreversibly transferred from the external developer to the corporate entity.

Once corporate ownership is definitively established, these rights must be formally recorded through statutory registration to transform corporate title into an unassailable, bankable financial asset. In intellectual property financing, lenders typically require the perfection of security interests across public registries, to protect the collateral from competing creditor claims. A failure to register the chain of title or record the subsequent lien creates an unperfected interest, leaving the lender vulnerable to priority disputes or asset dissipation.

The critical overlap between corporate ownership and design protection is highly apparent in consumer-driven IP ecosystems. As an asset's commercial peak dictates its economic useful life, market leaders must deploy aggressive enforcement strategies to prevent infringement from prematurely eroding market share. A definitive example of this proactive asset protection occurred in March 2026, when global pop-culture entertainment entity Pop Mart shifted to an aggressive litigation stance to defend its proprietary aesthetic designs from unauthorized digital and physical commercial exploitation. This strategy culminated in a landmark settlement with 3D-printer manufacturer Bambu Lab regarding the unauthorized distribution of proprietary files for Pop Mart's highly lucrative “Labubu” character. The dispute went directly to Pop Mart's exclusive commercial reproduction rights.



Market Recognition and Intrinsic Value

The modern economic landscape has fundamentally altered the relationship between a corporation's balance sheet and its public market valuation, with capital markets increasingly recognizing IP not merely as a passive legal shield, but as a dynamic strategic moat.

This market recognition is empirically observable through distinct operational and legal lenses. It manifests directly via licensing royalty rates, which establish the baseline commercial clearing price third parties are willing to pay for proprietary access, and through court-awarded infringement damages that set an institutional floor for an asset's worth based on lost profits or reasonable royalties. A stark example of this dynamic is Geely Holding Group's landmark trade secret litigation against WM Motor, a 2023 dispute driven by asset protection and core technology strategy. By defending its proprietary electric vehicle chassis designs and digital engineering models against large-scale corporate misappropriation, the automotive group was awarded over RMB 640 million from the Supreme People's Court of China.

While market recognition reflects external pricing, the intrinsic value of intellectual property is fundamentally derived from its capacity to generate excess earnings that exceed the opportunity cost of capital for a generic equivalent asset. This structural earnings engine materializes through three distinct economic vectors: price premiums, where trademark strength and brand equity unlock pricing power and lower consumer elasticity; cost savings, where proprietary trade secrets or patented processes lower operational expenditures below industry peers; and market barriers, where exclusionary legal protections insulate a specific niche from competitive erosion. A vivid demonstration of this recognition is China's accelerating cross-border intellectual property royalty trade volume, a macro movement heavily propelled by a national strategy to monetize indigenous tech innovation. Driven by aggressive outbound licensing, China's total imports and exports of IP royalties reached over RMB 425 billion in 2025, expanding from the historical baseline of RMB 399 billion recorded in 2024.

Valuation Methodologies for Intellectual Property

The valuation of intellectual property requires a rigorous convergence of robust financial modeling and analysis. Appraisers primarily rely on three universally accepted methodologies to quantify its value: the Income Approach, the Market Approach, and the Cost Approach. Each methodology views the asset's economic utility through a different lens and the selection of the primary method depends heavily on the nature of the IP.

The Income Approach is the most widely utilized methodology for valuing intellectual property, as it directly ties the asset's worth to the present value of the future economic benefits it is forecasted to generate over its remaining legal or useful life. Within this approach, two specialized techniques dominate corporate finance practice.



The Relief-from-Royalty (“**RfR**”) Method operates on the premise that the value of the IP is equivalent to the present value of the hypothetical royalty payments the enterprise is relieved from paying to a third party by owning the asset outright. The execution begins by determining the arm's-length royalty rate. This royalty rate is applied to the subject product line's projected net revenues over the asset's remaining economic useful life. The resulting hypothetical royalty stream is adjusted for tax effects to reflect the loss of tax-deductible royalty expenses, establishing the net after-tax cash flows. Finally, these cash flows are discounted to present value using a risk-adjusted discount rate reflecting the specific IP-related risks inherent in the asset, and a tax amortization benefit factor is added to capture the present value of future tax deductions allowed under the applicable accounting standards.

EXHIBIT 1 | RELIEF-FROM-ROYALTY VALUATION OF A PATENT

HKD'000 (unless otherwise specified)

Parameter	2026E	2027E	2028E	2029E	2030E
Revenue contributing to the Patent	5,000	8,000	10,000	11,000	11,500
Royalty Rate (%)			5.00%		
Pre-tax Royalty Fee Relieved	250	400	500	550	575
Less: Income Tax Expenses	(62)	(100)	(125)	(137)	(144)
After-tax Royalty Fee Relieved	188	300	375	413	431
Discount Rate			20.00%		
PV of Free Cash Flow	171	228	238	218	190
Total PV of Free Cash Flow	1,045				
Add: Tax Amortization Benefit	205				
Fair Value of the IP (RfR Method)	1,250				

Meanwhile, the Multi-Period Excess Earnings Method (“**MEEM**”) isolates the specific cash flows directly attributable to the specific IP. The analysis begins with a multi-period financial forecast for the operating unit that relies on the IP. From these total operating cash flows, contributory asset charges are deducted to compensate for the use of secondary assets required to generate those revenues, including net working capital, fixed assets, the assembled workforce, and secondary intangibles. The net operating cash flow then represents the pure economic cash flow generated strictly by the primary asset. These net excess cash flows are then tax-adjusted, discounted to present value using a risk-adjusted discount rate, and augmented by the tax amortization benefit to establish the value of the IP.

Conversely, the Market Approach seeks to establish value by comparing the subject intellectual property to identical or highly similar assets that have been recently sold, transferred, or licensed in the open market. This approach faces severe execution challenges in practice: because an asset must be legally “unique” to qualify for intellectual property protection, locating genuinely comparable transactions with transparent royalty rates or pricing multiples is exceptionally difficult.

On the other hand, the Cost Approach is deployed based on the economic principle of substitution. This approach is applied using either Reproduction Cost or Replacement Cost. Under either variant, the valuation considers direct development expenses, indirect overhead and legal fees, and an entrepreneur’s profit margin. Crucially, the aggregate creation cost must be adjusted downward for accumulated obsolescence, specifically capturing functional obsolescence and economic obsolescence. As the Cost Approach accounts only for historical or replacement creation expenses and ignores the future profitability or cash-generating capacity of the asset, it is generally reserved for early-stage or uncommercialized IP, internal-use software, or back-office technical infrastructure.

EXHIBIT 2 | REPLACEMENT COST VALUATION OF A SELF-DEVELOPED SYSTEM

HKD'000 (unless otherwise specified)

Parameter	Ref.	
Number of Source Code Lines (excluding comment lines)	A	1,500,000
Productivity (lines per person per month)	B	2,500
Reuse Factor	C	0.7
Core Development Workload	$D = A / B \times C$	420
Development Cost	$E = (e1 + e2 + e3) \times e4$	38.5
Personnel Costs	e1	25
Office Expenses	e2	7
Pre-tax Profit Margin	e3	3
Admin & Supporting Cost Coefficient	e4	1.1
Fair Value of the IP (Replacement Cost)	$= D \times E$	16,170

Conclusion

Intellectual property has evolved from a niche legal concern to the primary driver of corporate value. Understanding the interplay between legal protection, economic life, and rigorous valuation modeling is essential for any firm looking to leverage its intangible innovations in the global marketplace.

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