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Jack Rockwell Patent Valuation

Jack Rockwell is a company whose objective is to create profitable, marketable, expandable businesses through its services and products. To that end, Jack Rockwell has successfully developed a unique and innovative patented process producing "Créma Coffee" by the cup. Currently, Jack Rockwell's main focus will be on distribution of its patented coffee making process. This technology will deliver the patented coffee process to retail coffeehouses, hotels, restaurants, sports venues, luxury resorts and cafés across North America. Potential partners as licensees are companies such as Dunkin' Donuts, McDonald's, Peet's Coffee, Coffee Bean & Tea Leaf and other independent retail locations. The various intellectual property rights owned by Jack Rockwell (hereinafter "JR") include patents and trademarks registered in the United States. The chief intellectual property right owned by JR for purposes of this valuation is its patent.

Determining the value of an entity's intellectual property is an issue which arises with great frequency in business, specifically licensing those rights for product manufacturing. I have consulted on such matters on numerous occasions, often serving as an expert witness in the context of pending and actual litigation on the issue of determining the fair market value of intellectual property rights. I have been involved in negotiating hundreds of contracts involving all aspects of licensing intellectual property.

The conclusions made pertaining to the JR Rockwell patent valuation herein are based on the following factors and criteria:

1. Market information illustrating the popularity of specialty coffee and coffee maker products in the United States;
2. An examination of specialty coffee industry trends;
3. An analysis of companies operating in the coffee industry; and
4. Acceptable methods of patent royalty valuation when other data is unavailable.

JR Patent Exploitation Options

Intellectual property holders generally have three options for exploiting the value of their patent.[1]

[1] Patenting by Entrepreneurs, Michigan Telecommunications and Technology Law Review, 2010.

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Commercialize the Patent: Perhaps riskiest for any IP holder is the decision to commercialize the patent in-house. Under this scenario, product development, distribution, sales and marketing rests with the patent holder and his/her team. Enormous risks costs are possible here.

Sell the Patent Outright: The patent holder may wish to sell the patent rights to a third party. In this case, the IP owner cashes out early, but loses any upside benefit from a successful product commercialization.

Licensing the Patent Rights: Not all patent holders will sell their patents outright or commercialize the patent themselves; many choose to license the rights to their patent to third parties. The rationale behind efficient markets suggests that licensing will be beneficial when a company can earn more by licensing its patented invention or is otherwise incapable of fulfilling market requirements to commercialize the patent. We believe this option represents the most realistic approach for JR given the strength of its patent and its inexperience in the consumer products and coffee industry. More on the viability of this approach will be discussed below.

I. Coffee Industry Trends

A brief examination of the coffee industry is appropriate to better understand the environment in which the JR patent will be exploited. Not in question, is the tremendous popularity, if not obsession, with coffee. The United States imported more than 21.5 million bags during the 2008/09 coffee year, accounting for more than one quarter of global coffee (un-roasted) imports, making it the world's largest single buyer.[2] Clearly, the United States is a great place for JR to begin exploiting its patent.

Sustainability – "Lose the K-Cup."

In recent years, a dramatic shift is occurring in global markets that are demanding a second look into many of these previously rigorously investigated areas. Big retail has become an increasingly powerful force in shaping where and how coffee is produced and consumed globally. What is even more surprising is that the global retail chains leading this trend (e.g., McDonald's and Walmart) are doing so by adopting 'sustainability' as a crucial competitive vehicle.[3] The reasons for this of course is the recognition by these retailers that consumers are demanding environmentally

[2] Specialty Coffee Association of America, Facts & Figures, 2013
[3] Big Retail and sustainable coffee: A new development studies research agenda. Progress in Development Studies, (2014), Sara D. Elder, Institute for Resources, Environment and Sustainability, University of British Columbia, Canada, Jane Lister Liu Institute for Global Issues, University of British Columbia, Canada, Peter Dauvergne, Liu Institute for Global Issues, University of British Columbia, Canada.

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responsible and sustainable products from these brands and are willing to pay more for such products.

This is significant because one of the strongest competitive aspects of the JR patent is that it offers superior quality and speed without the use of a plastic cup. Tremendous waste is generated from the discarded K-Cups every day and as such, there are some serious criticisms associated the Keurig brand. Not the least of which is the volume of waste connected with Keurig use. Each day around 2.5 million K-Cups are brewed and since 1998 in over 200,000 offices in North America over 2 billion K-Cups have been used, accounting for six percent of the market (ecori.org). Dave Fisher of ecoRI explains that, "while the company enjoys a very 'green' public perception, the K-cup seems to be the antithesis to sustainability."[4] We believe JR can exploit the weakness and capitalize on it by emphasizing its cup-less process. The Keurig machines would have to change their entire platform and coffee delivery systems in order to lose the cup, which we believe they will never do.

Furthermore, studies show that consumers are willing to pay more for environmentally sustainable products. The Nielsen Global Survey on Corporate Social Responsibility polled more than 29,000 Internet respondents in 58 countries. The percentage of consumers willing to pay more increased among both males and females and across all age groups, with respondents under age 30 most likely to say they would spend more for goods and services from companies that give back. Among consumers ages 40-44, 50 percent agree they would pay more, up from 38 percent two years ago.[5] This data suggests sustainability should be a cornerstone of the JR product offer and will undoubtedly elevate the value of its patent.

Café Quality Coffee is no longer Niche

It wasn't that long ago in the US that "Taster's Choice" quality coffee products would suit most Americans' tastes; this is simply not the case today. Specialty coffees represent 37% of US coffee cups and are considered to be the highest quality in the world.[6] In terms of cost, a 20-ounce, Venti-sized cup of brewed coffee as of June 2014, will go up to $2.35 per cup, an increase of either 10 cents or 15 cents, depending on the market.[7] This demonstrates the upward quality and price trend in coffee quality coupled with a desire by consumers for better, more authentic coffee. This is exactly what the JR patent is designed to deliver: European quality coffee in under one minute.

[4] http://www.ecori.org/composting/2011/10/11/the-keurig-k-cup-konundrum.html
[5] 50% of Global Consumers Willing to Pay more for Socially Responsible Products, Sustainable Brands.com, August 2013.
[6] Specialty Coffee Facts and Figures, 2013.
[7] Wall Street Journal Marketwatch, June 21, 2014.

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II. Coffee Maker Trends

Barrier to entry into this coffee maker industry is high; this fact operates to JR's advantage in that it already has over ten years of research and development behind its patent and has working coffee maker prototypes ready to show prospective manufacturers.

In terms of coffee maker industry growth overall, an analysis of its leader Keurig Green Mountain (KGM), formerly Green Mountain Coffee Roasters, is warranted. KGM had net sales of $4.35B for 2013 according to recent filings. KGM controls approximately 92% of the "at-home" market segment for what is known as the "compatible coffee cup" market. Competitive cup manufacturers hold the remaining 8% of that market segment. (See Green Mountain Investor Day Presentation, September 10, 2013). This is a huge opportunity for the right players to take away some of this market share.[8]

The "commercial office" coffee services market segment for KGM is estimated to account for $175 million to $250 million worth of its sales. As part of its sales strategy, KGM enters into exclusionary agreements with office specialty stores, such as Staples and Office Depot. In the wake of those agreements, many competitors have tried to acquire distribution in Staples for example, but the KGM exclusive contracts prevent such access.

Currently, about 2.5 million cups are brewed in K-Cup Brewers every day in offices and homes in North America, and billions of cups have been brewed with K-Cup Brewers since the K-Cups were created in 1998. As of January 2014, Tassimo had only captured a 2.9% share of the market of consumers who own a brewer at home (as opposed to 88% for Keurig).

In fact, "90.9% of surveyed Keurig users replied that they would try a new K-Cup brand if it were less expensive. This is more supportive evidence that K-Cup users would not necessarily be loyal to a particular brand if they found a more inexpensive option of equal quality. The rise in private label pods is far outpacing growth rates of the original K-Cups, which is good news for JR because it suggests consumers prefer choice when it comes to their brewing habits. In January 2014, IRI estimated the year-on-year growth of the top five coffee pod brands: the private-label pods posted an enormous 471%, and Green Mountain represented 29%.[9]

[8] GMCR Nasdaq filings.
[9] Here's What You Need to Know About the War on K-Cups. By: Linshi, Jack, Time.com, 6/24/2014

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III. LICENSING OF JR INTELLECTUAL PROPERTY

Since there are no JR Property licenses currently in place, an examination of comparable product licenses should be examined within the coffee industry. It is this overall assessment which will give a realistic valuation. (Trademarks owned by JR could in some cases supplement the value of its patent, but since there is no recognition of this brand in the marketplace, the primary value is exclusively derived from its patent.)

IV. VALUATION METHODOLOGIES

There are three generally recognized methods for intellectual property valuation. These methods are admissible as expert witness testimony on valuation matters in a court of law. We will apply each of them below to JR's patent offer.

A. MARKET APPROACH

The fair market value of an invention is based on what an inventor can reasonably expect to receive on the open market for a proposed use of the invention. This method is commonly referred to as the "market approach", which examines comparables and marketplace values of other similar inventions. When applying the market approach, the following factors should be taken into account to assist in determining the value of a particular patent. Those factors include:

1. **Territory Sales Potential**: A significant factor because it determines the geographic extent and opportunity of a particular use of the patent. In JR's case, we expect the scope of the territory will initially be the United States, with future plans to develop internationally. However, unquestionably, the global demand for specialty coffee is growing[10] and represents an almost limitless opportunity for machines to deliver the product. For territory potential, the JR Patent scores a 9/10.

2. **Duration of the Patent License:** The duration of the use of the patent is very significant. In most cases, a quarterly royalty is collected by the patent holder based on a sales calculation; usually wholesale sales of the product containing the patented technology. Generally speaking, a patent royalty rate of between 1% and 2% of the wholesale price of the item is given for the use of a patent. Of course, a prospective licensee's ability to pay is always a factor in this equation. For this factor, a score of 5/10 should be assigned due to the constant development of new technologies being developed, which can reduce the value of existing patents.

[10] Coffee Beans. A Market to Watch in 2014, LA Times, October 23, 2013.

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3. **Exclusivity:** This is almost always a factor that increases costs to a manufacturer for the use a particular patent, since any exclusivity, by its nature, precludes the inventor from offering its patent elsewhere. JR should be very cautious in extending an exclusive license, however for the right opportunity, it should be a consideration. The strength of the JR patent is remarkable, offering features that offer strong differentiation in a huge growth category. This suggests that an exclusive license will likely be sought by a potential manufacturer to give it an competitive advantage in the market place. Score in this category is high at 9/10.

4. **Availability of Substitute Patents**: Also impacting the value of the JR Patent is whether the manufacturer could obtain a similar patent from another inventor. For example, if a licensee can easily substitute other patents for its product design, the inventor will likely command a reduced percentage. However, in the case of the JR patent, the language is quite broad in its coverage, suggesting the patent would be difficult to design around. A higher score of 8/10 would be reasonable in this category.

5. **Legal Strength of the Patent.** The strength of any patent is always subject for much debate, however it is also well recognized that a US Patent is the holy grail of protection sought by inventors the world over. JR's patents have issued and a score of 9/10 in this category is appropriate.

6. **Reputation:** The reputation of the inventor is generally a factor, but since JR is not known in the marketplace, there would be no reason to command a higher royalty, so a low score of 1/10 is appropriate.

7. **General Economic Market Conditions:** General economic trends clearly influence what a manufacturer is able and willing to pay to license a patent to its product design. We are seeing consistent improvement in the US economy based on GDP dollars for the last 4 years.

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Unemployment rates have also continued to fall, which suggests a positive outlook for manufacturers wishing to invest in product development. As a result, the economic outlook bodes well for JR's patenting opportunities with manufacturers.

B. COMPARABLE LICENSE AGREEMENTS

In addition to the "market approach" factors used to determine the value of the JR patents, it would be ideal to examine actual executed patent license agreements, preferably in the consumer products category. The challenge here of course is that virtually all such agreements are deemed highly confidential and are therefore largely unavailable for public examination. As a result, we must look to a court approved methods for assessing fair royalty in the absence of license agreements, such as in case where a patent infringement has occurred. In such cases, the court essentially tried to determine a reasonable royalty rate under the circumstances.

The Uniloc 25% Rule of Patent Valuation

Rarely will a U.S. court express an opinion on the intrinsic merit of a particular methodology for calculating damages in patent infringement litigation. But in the wake of several very large patent damages awards with questionable bases in economics and the law, a series of Federal Circuit decisions has started to place greater limits on damages theories. In *Uniloc v. Microsoft*, one of the most important of these decisions, the Federal Circuit took special aim at the "25% Rule," under which 25% of the infringer's profits are the baseline determinant for reasonable royalty damages.[11] This percentage represents the upper-end of the scale used by many courts in determining a reasonable patent royalty.

The Georgia-Pacific Approach

[11] Uniloc USA, Inc. v. Microsoft Corp., 632 F.3d 1292, 1315 (Fed. Cir. 2011).

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In another important patent infringement case, the court provided a list of factors (many of them listed in Section A above) to determine a "reasonable royalty rate." Perhaps the most compelling of the factors is the one which in which the court stated…(t)he amount that a licensor (such as the patent owner) and a licensee would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount that a prudent licensee – who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention – would have been willing to pay as a royalty and yet be able to make a reasonable profit, and which amount would have been acceptable by a prudent patent owner who was willing to grant a license.[12] This approach attempts to combine many of the factors into a single expression.

In most cases, according to RoyaltySource[13] the average patent royalty rate across all industries is 7% of gross sales, which is slightly less than the 8.2% reported for consumer products[14]. Therefore, we believe a reasonable, negotiated royalty rate between a patent holder and a licensee would be around 7.6%, which is the average of the two.

As stated above, there is no single, method of calculating reasonable patent royalties, but the fairest approach we believe is a valuation which considers both approaches (a royalty percentage based on profits and a royalty percentage based on sales.)

V. JRI Sales Forecasts

In determining JR pre-product launch sales forecasts, we believe the most accurate way to do so is analyze sales figures of same industry competitors. The reason for this is that competitors are selling the same or similar products as JR, serving the same customers as JR, and facing similar threats from economic forces, industry trends and government regulations. From these sales forecasts, we can then apply the valuation methods above to come up with a range of values.

Clearly, the ideal competitor to examine is Keurig Green Mountain. Not only do they own 92% of the coffee maker market, they serve an almost identical consumer to the JR target customer. In 2013 Keurig, did approximately 92% of its sales through the

[12] Georgia-Pacific Corp. v. United States Plywood Corp., 318 F. Supp. 1116 (S.D.N.Y. 1970), mod. and aff'd, 446 F.2d 295 (2d Cir. 1971), cert. denied, 404 U.S. 870 (1971)
[13] "Industry Royalty Rate Data Summary," Licensing Economics Review, Vol. 6, December 2007, 6-7
[14] Id.

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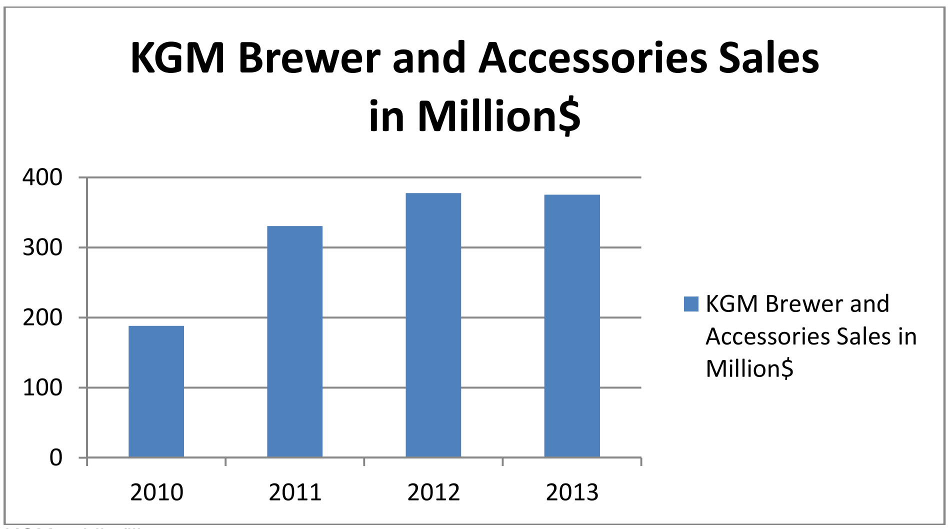
combination of portion packs and Keurig Single Cup brewers and related accessories. The company had $4.3 billion in total sales with $3.1 billion of that coming from portion pack sales and $827.6 million coming from Keurig Single Cup Brewer and accessories net sales. For purposes of the JR valuation, we will only consider KGM's single cup brewer and accessories sales for the years 2010 - 2013. We believe these years represent an appropriate period for analysis given that JR is entering a mature market by the time a manufacturer begins selling products using the JR patented technology, so sales will be generated much more quickly than in a fledgling industry. We are also taking into consideration that typical patent license is between three and five years in length, so we arrived at an average of four years for purposes of this valuation.



KGM public filings, 2010-2013.

We are of the opinion that with reasonable effort, JR could conservatively capture 2-5% of KGM's market share within 5 years of product launch. So, under that scenario, JR's sales would look like this:

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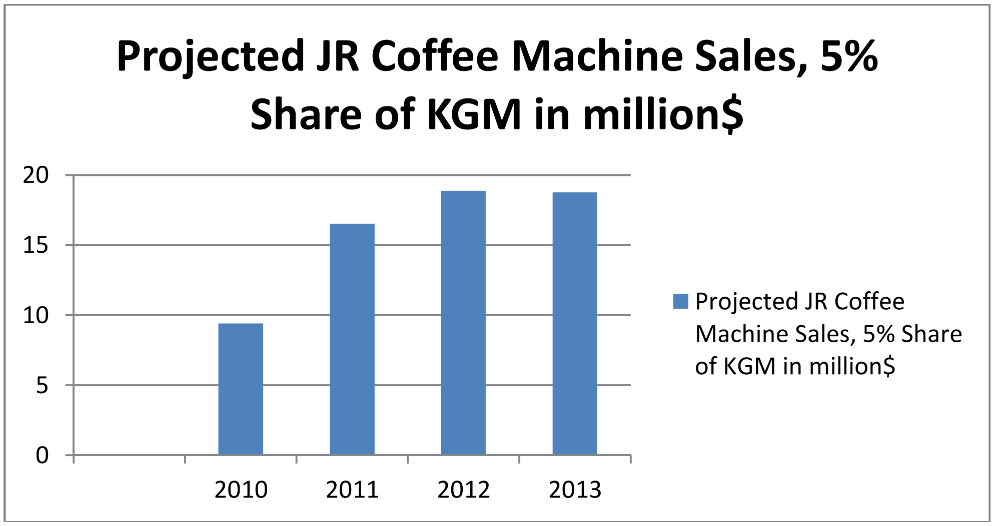

And to be conservative in our valuation of the JR patent, we will apply the lower range of each of the aforementioned valuation methods, we are assuming JR will only hold 5% of the KGM's current market share.

Patent Valuation using the discounted 25% Rule

KGM's average profit margin for the years 2010-2013 was approximately 35%, so profit would first be calculated, then multiplied by 25%:

2010: $9,400,000 x 35% = $3,290,000 x 25% =$822,500
2011: $16,520,000 x 35% = $5,782,000 x 25% =$1,445,500
2012: $18,870,000 x 35% = $6,604,500 x 25% = $1,651,125
2013: $18,760,000 x 35% = $6,566,000 x 25% = $1,641,500

<u>The JR patent is worth $5,560,625 using the 25% Rule application.</u>

Patent Valuation using the straight line 7.6% of retail sales of KGM's brewers and accessories:

2010: $188M x 5% of KGM market share = $9,400,000 7.6% = $714,400
2011: $330.4M x 5% of KGM market share = $16,520,000 x 7.6% = $1,255,520
2012: $377.3M x 5% of KGM market share = $18,870,000 x 7.6% = $1,434,120
2013: $375.1M x 5% of KGM market share = 18,760,000 x 7.6% = $1,425,760

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The JR patent is valued at $4,829,800 using the straight line 7.6% royalty figure as applied against brewer and accessories sales.

VIII. CONCLUSION

The two figures above are remarkably consistent given all of the variables.