

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2019

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File Number: 1-37721



(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

95-4405754  
(I.R.S. Employer  
Identification No.)

120 Newport Center Drive, Newport Beach, California 92660  
(Address of principal executive offices, Zip Code)

(949) 480-8300  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	ACTG	The Nasdaq Stock Market, LLC

As of May 8, 2019, 49,681,203 shares of the registrant's common stock, \$0.001 par value, were issued and outstanding.

**ACACIA RESEARCH CORPORATION**  
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**PART I--FINANCIAL INFORMATION**

**Item 1. FINANCIAL STATEMENTS**

**ACACIA RESEARCH CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share information)  
(Unaudited)

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 73,285	\$ 128,809
Trading securities - debt	93,756	33,642
Trading securities - equity	831	3,012
Accounts receivable	23,964	32,884
Prepaid expenses and other current assets	3,686	3,125
Total current assets	<u>195,522</u>	<u>201,472</u>
Investment at fair value (Note 5)	5,483	7,459
Other investments (Note 5)	8,195	8,195
Patents, net of accumulated amortization	9,681	6,587
Other non-current assets	216	236
	<u>\$ 219,097</u>	<u>\$ 223,949</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 11,448	\$ 8,347
Accrued patent investment costs	3,750	—
Royalties and contingent legal fees payable	16,149	22,688
Total current liabilities	<u>31,347</u>	<u>31,035</u>
Other liabilities	916	1,674
Total liabilities	<u>32,263</u>	<u>32,709</u>
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, par value \$0.001 per share; 10,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 49,656,067 and 49,639,319 shares issued and outstanding as of March 31, 2019 and December 31, 2018, respectively	50	50
Treasury stock, at cost, 2,919,828 shares as of March 31, 2019 and December 31, 2018	(39,272)	(39,272)
Additional paid-in capital	651,148	651,156
Accumulated deficit	(426,925)	(422,541)
Total Acacia Research Corporation stockholders' equity	<u>185,001</u>	<u>189,393</u>
Noncontrolling interests	1,833	1,847
Total stockholders' equity	<u>186,834</u>	<u>191,240</u>
	<u>\$ 219,097</u>	<u>\$ 223,949</u>

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

**ACACIA RESEARCH CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except share and per share information)

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Revenues	\$ 3,387	\$ 62,093
Portfolio operations:		
Inventor royalties	1,353	21,744
Contingent legal fees	177	15,759
Patent acquisition expenses	—	4,000
Litigation and licensing expenses - patents	3,801	2,989
Amortization of patents	656	5,330
Other portfolio expenses	650	—
Total portfolio operations	<u>6,637</u>	<u>49,822</u>
Net portfolio income (loss)	(3,250)	12,271
General and administrative expenses <sup>(2)</sup>	<u>3,695</u>	<u>3,301</u>
Operating income (loss)	(6,945)	8,970
Other income (expense):		
Change in fair value of investment, net <sup>(1)</sup>	6,908	(41,097)
Loss on sale of investment <sup>(1)</sup>	(5,590)	—
Interest income and other	1,543	207
Total other income (expense)	<u>2,861</u>	<u>(40,890)</u>
Loss before provision for income taxes	(4,084)	(31,920)
Provision for income taxes	(314)	(191)
Net loss including noncontrolling interests in subsidiaries	(4,398)	(32,111)
Net loss attributable to noncontrolling interests in subsidiaries	14	73
Net loss attributable to Acacia Research Corporation	<u>\$ (4,384)</u>	<u>\$ (32,038)</u>
Net loss attributable to common stockholders - basic and diluted	\$ (4,384)	\$ (32,038)
Basic and diluted net loss per common share	<u>\$ (0.09)</u>	<u>\$ (0.63)</u>
Weighted average number of shares outstanding - basic and diluted	<u>49,655,881</u>	<u>50,632,958</u>

<sup>(1)</sup> Refer to Note 5 for additional information.

<sup>(2)</sup> General and administrative expenses were comprised of the following:

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
General and administrative expenses	\$ 3,703	\$ 4,325
Non-cash stock compensation expense - G&A	(8)	704
Non-cash stock compensation expense - Profits Interests (Note 9)	—	(1,728)
Total general and administrative expenses	<u>\$ 3,695</u>	<u>\$ 3,301</u>

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

**ACACIA RESEARCH CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**  
(In thousands)  
(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Net loss including noncontrolling interests	\$ (4,398)	\$ (32,111)
Other comprehensive income (loss):		
Unrealized gain on short-term investments, net of tax of \$0	—	(20)
Unrealized gain (loss) on foreign currency translation, net of tax of \$0	—	(17)
Total other comprehensive loss	(4,398)	(32,148)
Comprehensive loss attributable to noncontrolling interests	14	73
Comprehensive loss attributable to Acacia Research Corporation	\$ (4,384)	\$ (32,075)

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

**ACACIA RESEARCH CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(In thousands)  
(Unaudited)

	Common Shares	Common Stock	Treasury Stock	Additional Paid-in Capital	Accumulated Comprehensive Income (Loss)	Accumulated Deficit	Noncontrolling Interests in Operating Subsidiaries	Total
Balance at December 31, 2017	50,639,926	\$ 51	\$ (34,640)	\$ 648,996	\$ (88)	\$ (320,018)	\$ 1,358	\$ 295,659
Net loss attributable to Acacia Research Corporation	—	—	—	—	—	(32,038)	—	(32,038)
Cumulative effect of new accounting principle	—	—	—	—	—	2,506	308	2,814
Stock options exercised	10,000	—	—	31	—	—	—	31
Compensation expense for share-based awards, net of forfeitures	—	—	—	704	—	—	—	704
Repurchase of restricted common stock	(2,044)	—	—	(7)	—	—	—	(7)
Net income attributable to noncontrolling interests in subsidiaries	—	—	—	—	—	—	(73)	(73)
Unrealized gain on foreign currency translation	—	—	—	—	(17)	—	—	(17)
Unrealized loss on short-term investments	—	—	—	—	(20)	—	—	(20)
Balance at March 31, 2018	50,647,882	\$ 51	\$ (34,640)	\$ 649,724	\$ (125)	\$ (349,550)	\$ 1,593	\$ 267,053
Balance at December 31, 2018	49,639,319	\$ 50	\$ (39,272)	\$ 651,156	\$ —	\$ (422,541)	\$ 1,847	\$ 191,240
Net loss attributable to Acacia Research Corporation	—	—	—	—	—	(4,384)	—	(4,384)
Compensation expense for share-based awards, net of forfeitures	16,748	—	—	(8)	—	—	—	(8)
Net income attributable to noncontrolling interests in subsidiaries	—	—	—	—	—	—	(14)	(14)
Balance at March 31, 2019	49,656,067	\$ 50	\$ (39,272)	\$ 651,148	\$ —	\$ (426,925)	\$ 1,833	\$ 186,834

*The accompanying notes are an integral part of these consolidated financial statements.*

**ACACIA RESEARCH CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)  
(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net loss including noncontrolling interests in subsidiaries	\$ (4,398)	\$ (32,111)
<b>Adjustments to reconcile net loss including noncontrolling interests in subsidiaries to net cash provided by operating activities:</b>		
Change in fair value of investment, net <sup>(1)</sup>	(6,908)	41,097
Loss on sale of investment <sup>(1)</sup>	5,590	—
Depreciation and amortization	660	5,344
Non-cash stock compensation	(8)	(1,024)
Income from trading securities	(1,077)	—
Purchases of trading securities	(60,193)	—
Maturities and sales of trading securities	3,339	—
Other	—	(87)
<b>Changes in assets and liabilities:</b>		
Accounts receivable	8,920	(59)
Prepaid expenses and other assets	(541)	(863)
Accounts payable and accrued expenses	2,343	1,065
Royalties and contingent legal fees payable	(6,539)	36,608
Net cash provided by (used in) operating activities	<u>(58,812)</u>	<u>49,970</u>
<b>Cash flows from investing activities:</b>		
Sale of investment <sup>(1)</sup>	3,294	—
Investments in Investees <sup>(1)</sup>	—	(7,000)
Purchases of available-for-sale investments	—	(33,309)
Maturities and sales of available-for-sale investments	—	4,000
Purchases of property and equipment	(6)	—
Net cash provided by (used in) investing activities	<u>3,288</u>	<u>(36,309)</u>
<b>Cash flows from financing activities:</b>		
Repurchased restricted common stock	—	(7)
Proceeds from exercises of stock options	—	31
Net cash provided by financing activities	<u>—</u>	<u>24</u>
Increase (decrease) in cash and cash equivalents	(55,524)	13,685
Cash and cash equivalents, beginning	128,809	136,604
Cash and cash equivalents, ending	<u>\$ 73,285</u>	<u>\$ 150,289</u>
<b>Supplemental schedule of noncash investing activities:</b>		
Patent acquisition costs included in accrued patent acquisition costs	<u>\$ 3,750</u>	<u>\$ —</u>

<sup>(1)</sup> Refer to Note 5 for additional information.

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

**ACACIA RESEARCH CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

*Description of Business.* As used herein, “Acacia” and the “Company” refer to Acacia Research Corporation and/or its wholly and majority-owned and controlled operating subsidiaries, and/or where applicable, its management.

Acacia’s operating subsidiaries invest in, license and enforce patented technologies. Acacia’s operating subsidiaries partner with inventors and patent owners, applying their legal and technology expertise to patent assets to unlock the financial value in their patented inventions. In recent years, Acacia has also invested in technology companies. Acacia leverages its experience, expertise, data and relationships developed as a leader in the intellectual property (“IP”) industry to pursue these opportunities. In some cases, these opportunities will complement, and/or supplement Acacia’s primary licensing and enforcement business.

Acacia’s operating subsidiaries generate revenues and related cash flows from the granting of IP rights for the use of patented technologies that its operating subsidiaries control or own. Acacia’s operating subsidiaries assist patent owners with the prosecution and development of their patent portfolios, the protection of their patented inventions from unauthorized use, the generation of licensing revenue from users of their patented technologies and, where necessary, with the enforcement against unauthorized users of their patented technologies through the filing of patent infringement litigation.

Acacia’s operating subsidiaries are principals in the licensing and enforcement effort, obtaining control of the rights in the patent portfolio, or control of the patent portfolio outright. Acacia’s operating subsidiaries own or control the rights to multiple patent portfolios, which include U.S. patents and certain foreign counterparts, covering technologies used in a wide variety of industries.

Neither Acacia nor its operating subsidiaries invent new technologies or products; rather, Acacia depends upon the identification and investment in new patents, inventions and companies that own IP through its relationships with inventors, universities, research institutions, technology companies and others. If Acacia’s operating subsidiaries are unable to maintain those relationships and identify and grow new relationships, then they may not be able to identify new technology-based opportunities for sustainable revenue and/or revenue growth.

During the three months ended March 31, 2019, Acacia obtained control of two new patent portfolios. During fiscal year 2018 Acacia did not obtain control of any new patent portfolios. During fiscal year 2017 Acacia obtained control of one new patent portfolio and in fiscal year 2016 Acacia obtained control of two new patent portfolios.

*Basis of Presentation.* The accompanying condensed consolidated financial statements include the accounts of Acacia and its wholly and majority-owned and controlled subsidiaries. Material intercompany transactions and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnotes required by U.S. GAAP in annual financial statements have been omitted or condensed in accordance with quarterly reporting requirements of the Securities and Exchange Commission (“SEC”). These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2018, as reported by Acacia in its Annual Report on Form 10-K filed on March 15, 2019 with the SEC. The December 31, 2018 condensed consolidated balance sheet was derived from audited financial statements but does not include all disclosures required by U.S. GAAP.

The condensed consolidated interim financial statements of Acacia include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair statement of Acacia’s consolidated financial position as of March 31, 2019, and results of its operations and its cash flows for the interim periods presented. The consolidated results of operations for the three months ended March 31, 2019 are not necessarily indicative of the results to be expected for the entire fiscal year.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Revenue Recognition.* Revenue is recognized upon transfer of control of promised bundled IP rights (hereinafter “IP Rights”) and other contractual performance obligations to licensees in an amount that reflects the consideration we expect to

**ACACIA RESEARCH CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

receive in exchange for those IP Rights. Revenue contracts that provide promises to grant the right to use IP Rights as they exist at the point in time at which the IP Rights are granted, are accounted for as performance obligations satisfied at a point in time and revenue is recognized at the point in time that the applicable performance obligations are satisfied and all other revenue recognition criteria have been met.

For the periods presented, revenue contracts executed by the Company primarily provided for the payment of contractually determined, one-time, paid-up license fees in consideration for the grant of certain IP Rights for patented technologies owned or controlled by Acacia (“Paid-up Revenue Agreements”). Revenues also included license fees from sales-based revenue contracts, the majority of which were originally executed in prior periods, that provide for the payment of quarterly license fees based on quarterly sales of applicable product units by licensees (“Recurring Revenue Agreements”). Revenues may also include court ordered settlements or awards related to our patent portfolio. IP Rights granted included the following, as applicable: (i) the grant of a non-exclusive, retroactive and future license to manufacture and/or sell products covered by patented technologies, (ii) a covenant-not-to-sue, (iii) the release of the licensee from certain claims, and (iv) the dismissal of any pending litigation. The IP Rights granted were perpetual in nature, extending until the legal expiration date of the related patents. The individual IP Rights are not accounted for as separate performance obligations, as (i) the nature of the promise, within the context of the contract, is to transfer combined items to which the promised IP Rights are inputs and (ii) the Company’s promise to transfer each individual IP right described above to the customer is not separately identifiable from other promises to transfer IP Rights in the contract.

Since the promised IP Rights are not individually distinct, the Company combined each individual IP right in the contract into a bundle of IP rights that is distinct, and accounted for all of the IP Rights promised in the contract as a single performance obligation. The IP Rights granted were “functional IP rights” that have significant standalone functionality. Acacia’s subsequent activities do not substantively change that functionality and do not significantly affect the utility of the IP to which the licensee has rights. Acacia’s operating subsidiaries have no further obligation with respect to the grant of IP Rights, including no express or implied obligation to maintain or upgrade the technology, or provide future support or services. The contracts provide for the grant (i.e., transfer of control) of the licenses, covenants-not-to-sue, releases, and other significant deliverables upon execution of the contract. Licensees legally obtain control of the IP Rights upon execution of the contract. As such, the earnings process is complete and revenue is recognized upon the execution of the contract, when collectibility is probable and all other revenue recognition criteria have been met. Revenue contracts generally provide for payment of contractual amounts with 30-90 days of execution of the contract, or the end of the quarter in which the sale or usage occurs for Recurring Revenue Agreements. Contractual payments made by licensees are generally non-refundable.

For sales-based royalties, the Company includes in the transaction price some or all of an amount of estimated variable consideration to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Notwithstanding, revenue is recognized for a sales-based royalty promised in exchange for a license of IP Rights when the later of (i) the subsequent sale or usage occurs, or (ii) the performance obligation to which some or all of the sales-based royalty has been allocated has been satisfied. Estimates are generally based on historical levels of activity, if available.

Revenues from contracts with significant financing components (either explicit or implicit) are recognized at an amount that reflects the price that a licensee would have paid if the licensee had paid cash for the IP Rights when they transfer to the licensee. In determining the transaction price, the Company adjusts the promised amount of consideration for the effects of the time value of money. As a practical expedient, the Company does not adjust the promised amount of consideration for the effects of a significant financing component if the Company expects, at contract inception, that the period between when the entity transfers promised IP Rights to a customer and when the customer pays for the IP Rights will be one year or less.

In general, the Company is required to make certain judgments and estimates in connection with the accounting for revenue contracts with customers. Such areas may include identifying performance obligations in the contract, estimating the timing of satisfaction of performance obligations, determining whether a promise to grant a license is distinct from other promised goods or services, evaluating whether a license transfers to a customer at a point in time or over time, allocating the transaction price to separate performance obligations, determining whether contracts contain a significant financing component, and estimating revenues recognized at a point in time for sales-based royalties.

**ACACIA RESEARCH CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

Revenues were comprised of the following for the periods presented (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Paid-up Revenue Agreements	\$ —	\$ 60,063
Recurring Revenue Agreements	3,387	2,030
	\$ 3,387	\$ 62,093

Refer to “Inventor Royalties and Contingent Legal Expenses” below for information on related direct costs of revenues.

*Portfolio Operations.* Cost of revenues include the costs and expenses incurred in connection with Acacia’s patent licensing and enforcement activities, including inventor royalties paid to original patent owners, contingent legal fees paid to external patent counsel, other patent-related legal expenses paid to external patent counsel, licensing and enforcement related research, consulting and other expenses paid to third-parties and the amortization of patent-related investment costs. These costs are included under the caption “Portfolio operations” in the accompanying condensed consolidated statements of operations.

*Inventor Royalties and Contingent Legal Expenses.* Inventor royalties are expensed in the condensed consolidated statements of operations in the period that the related revenues are recognized. In certain instances, pursuant to the terms of the underlying inventor agreements, upfront advances paid to patent owners by Acacia’s operating subsidiaries are recoverable from future net revenues. Patent costs that are recoverable from future net revenues are amortized over the estimated economic useful life of the related patents, or as the prepaid royalties are earned by the inventor, as appropriate, and the related expense is included in amortization expense in the condensed consolidated statements of operations. Any unamortized upfront advances recovered from net revenues are expensed in the period recovered, and included in amortization expense in the condensed consolidated statements of operations. Cost of revenues for the three months ended March 31, 2018 included \$4.0 million of costs to acquire certain patent rights related to revenues recognized in the period.

Contingent legal fees are expensed in the condensed consolidated statements of operations in the period that the related revenues are recognized. In instances where there are no recoveries from potential infringers, no contingent legal fees are paid; however, Acacia’s operating subsidiaries may be liable for certain out of pocket legal costs incurred pursuant to the underlying legal services agreement.

Inventor royalty and contingent legal agreements typically provide for payment by the Company of contractual amounts 30 days subsequent to the fiscal quarter end during which related license fee payments are received from licensees by the Company.

*Use of Estimates.* The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Acacia believes that, of the significant accounting policies described herein, the accounting policies associated with revenue recognition, the valuation of equity instruments, stock-based compensation expense including the valuation of profits interests, impairment of patent-related intangible assets, the determination of the economic useful life of amortizable intangible assets, income taxes and valuation allowances against net deferred tax assets, require its most difficult, subjective or complex judgments.

*Concentrations.* Two licensees individually accounted for 70% and 21% of revenues recognized during the three months ended March 31, 2019. One licensee accounted for 96% of revenues recognized during the three months ended March 31, 2018. For the three months ended March 31, 2019, 75% of revenues were attributable to licensees domiciled in foreign jurisdictions, based on the jurisdiction of the entity obligated to satisfy payment obligations pursuant to the applicable revenue arrangement. For the three months ended March 31, 2018, 2% of revenues were attributable to licensees domiciled in foreign jurisdictions. The Company does not have any material foreign operations. Three licensees individually represented

**ACACIA RESEARCH CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

approximately 52%, 25% and 10% of accounts receivable at March 31, 2019. Four licensees individually represented approximately 38%, 36%, 12% and 11% of accounts receivable at December 31, 2018.

*Fair Value Measurements.* U.S. GAAP defines fair value as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date, and also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs, where available. The three-level hierarchy of valuation techniques established to measure fair value is defined as follows:

- (i) **Level 1 - Observable Inputs:** Quoted prices in active markets for identical investments;
- (ii) **Level 2 - Pricing Models with Significant Observable Inputs:** Other significant observable inputs, including quoted prices for similar investments, interest rates, credit risk, etc.; and
- (iii) **Level 3 - Unobservable Inputs:** Significant unobservable inputs, including the entity's own assumptions in determining the fair value of investments.

Whenever possible, the Company is required to use observable market inputs (Level 1 - quoted market prices) when measuring fair value. In such cases, the level at which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The assessment of the significance of a particular input requires judgment and considers factors specific to the asset or liability being measured. In certain cases, inputs used to measure fair value fall into different levels of the fair value hierarchy. Financial assets and liabilities measured at fair value on a recurring basis were as follows (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets as of March 31, 2019:			
Trading securities - debt	\$ —	\$ 93,756	\$ —
Trading securities - equity	831	—	—
Investment at fair value - warrants (Note 5)	—	1,367	—
Investment at fair value - common stock (Note 5)	4,116	—	—
Total recurring fair value measurements as of March 31, 2019	<u>\$ 4,947</u>	<u>\$ 95,123</u>	<u>\$ —</u>
Assets as of December 31, 2018:			
Trading securities - debt	\$ —	\$ 33,642	\$ —
Trading securities - equity	3,012	—	—
Investment at fair value - warrants (Note 5)	—	2,064	—
Investment at fair value - common stock (Note 5)	5,395	—	—
Total recurring fair value measurements as of December 31, 2018	<u>\$ 8,407</u>	<u>\$ 35,706</u>	<u>\$ —</u>
Liabilities as of March 31, 2019:			
Profits interest units	<u>\$ —</u>	<u>\$ 591</u>	<u>\$ —</u>
Liabilities as of December 31, 2018:			
Profits interest units	<u>\$ —</u>	<u>\$ 591</u>	<u>\$ —</u>

*Stock-Based Compensation.* The compensation cost for all stock-based awards is measured at the grant date, based on the fair value of the award, and is recognized as an expense on a straight-line basis over the employee's requisite service period (generally the vesting period of the equity award) which is generally two to four years. The fair value of restricted stock and restricted stock unit awards is determined by the product of the number of shares or units granted and the grant date market price of the underlying common stock. The fair value of each option award is estimated on the date of grant using a Black-Scholes option-pricing model. Stock-based compensation expense for awards with service and/or performance conditions that affect vesting is recorded only for those awards expected to vest using an estimated forfeiture rate. The Company accounts for forfeitures of awards as they occur.

Profits Interest Units ("Units") are accounted for in accordance with Accounting Standards Codification ("ASC") 718-10, "Compensation - Stock Compensation." The vesting conditions do not meet the definition of service, market or performance conditions, as defined in ASC 718. As such, the Units are classified as liability awards. Liability classified awards are measured at fair value on the grant date and re-measured each reporting period at fair value until the award is settled.

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Compensation expense is adjusted each reporting period for changes in fair value prorated for the portion of the requisite service period rendered. Initially, compensation expense was recognized on a straight-line basis over the employee's requisite service period (generally the vesting period of the equity award) which was five years. Upon full vesting of the award, which occurred during the three months ended September 30, 2017, previously unrecognized compensation expense was immediately recognized in the period, and will continue to be fully recognized for any changes in fair value, until the Units are settled. The Company has a purchase option to purchase the vested Units that are not otherwise forfeited after termination of continuous service. The exercise price of the purchase option is the fair market value of the Units on the date of termination of continuous service. At each reporting date, the value of the Units that are subject to the purchase option will be measured at the fair value on the termination date. Non-cash stock compensation expense related to the Units is reflected in general and administrative expense in the accompanying condensed consolidated statements of operations.

*Treasury Stock.* Repurchases of the Company's outstanding common stock are accounted for using the cost method. The applicable par value is deducted from the appropriate capital stock account on the formal or constructive retirement of treasury stock. Any excess of the cost of treasury stock over its par value is charged to additional paid-in capital, and reflected as Treasury Stock on the condensed consolidated balance sheets.

*Cash and Cash Equivalents.* Acacia considers all highly liquid, short-term investments with original maturities of three months or less when purchased to be cash equivalents. For the periods presented, Acacia's cash equivalents are comprised of investments in AAA rated money market funds that invest in first-tier only securities, which primarily includes: domestic commercial paper, securities issued or guaranteed by the U.S. government or its agencies, U.S. bank obligations, and fully collateralized repurchase agreements. Acacia's cash equivalents are measured at fair value using quoted prices that represent Level 1 inputs.

*Trading Securities- Debt.* Investments in debt securities are reported at fair value on a recurring basis, with related realized and unrealized gains and losses recorded in the statements of operations in other income (expense). Realized and unrealized gains and losses are recorded based on the specific identification method. Interest is included in other income (expense).

*Trading Securities - Equity.* Investments in equity securities are reported at fair value on a recurring basis, with related realized and unrealized gains and losses in the value of such securities recorded in the statements of operations in other income (expense). Dividend income is included in other income (expense).

Short-term investments for the periods presented were comprised of the following (in thousands):

<u>Security Type</u>	<u>Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
March 31, 2019:				
Trading securities - debt	\$ 93,464	\$ 294	\$ (2)	\$ 93,756
Trading securities - equity	829	8	(6)	831
	<u>\$ 94,293</u>	<u>\$ 302</u>	<u>\$ (8)</u>	<u>\$ 94,587</u>
December 31, 2018:				
Trading securities - debt	\$ 33,643	\$ 18	\$ (19)	\$ 33,642
Trading securities - equity	3,389	27	(404)	3,012
	<u>\$ 37,032</u>	<u>\$ 45</u>	<u>\$ (423)</u>	<u>\$ 36,654</u>

*Patents.* Patents include the cost of patents or patent rights (hereinafter, collectively "patents") acquired from third-parties or obtained in connection with business combinations. Patent costs are amortized utilizing the straight-line method over their remaining economic useful lives, ranging from one to five years.

*Investments at Fair Value.* On an individual investment basis, Acacia may elect to account for investments in companies where the Company has the ability to exercise significant influence over operating and financial policies of the investee, at fair value. If the fair value option is applied to an investment that would otherwise be accounted for under the equity method of accounting, it is applied to all of the financial interests in the same entity that are eligible items (i.e., common stock and warrants).

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*Other Investments.* Equity investments in common stock and in-substance common stock without readily determinable fair values in companies over which the Company has the ability to exercise significant influence, are accounted for using the equity method of accounting. Acacia includes its proportionate share of earnings and/or losses of its equity method investees in equity in earnings (losses) of investee in the condensed consolidated statements of operations.

Investments in preferred stock with substantive liquidation preferences are accounted for at cost, (subject to impairment considerations, as described below, if any), as adjusted for the impact of changes resulting from observable price changes in orderly transactions for identical or similar investments of the same issuer. In-substance common stock is an investment in an entity that has risk and reward characteristics that are substantially similar to that entity's common stock. An investment in preferred stock with substantive liquidation preferences over common stock, is not substantially similar to common stock, and therefore is not considered in-substance common stock. A liquidation preference is substantive if the investment has a stated liquidation preference that is significant, from a fair value perspective, in relation to the purchase price of the investment. A liquidation preference in an investee that has sufficient subordinated equity from a fair value perspective is substantive because, in the event of liquidation, the investment will not participate in substantially all of the investee's losses, if any.

The initial determination of whether an investment is substantially similar to common stock is made on the initial date of investment if the Company has the ability to exercise significant influence over the operating and financial policies of the investee. That determination is reconsidered if (i) contractual terms of the investment are changed, (ii) there is a significant change in the capital structure of the investee, including the investee's receipt of additional subordinated financing, or (iii) the Company obtains an additional interest in an investment, resulting in the method of accounting for the cumulative interest being based on the characteristics of the investment at the date at which the Company obtains the additional interest. Refer to Note 5 for additional information.

*Impairment of Investments.* Acacia reviews its investments quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, Acacia considers available quantitative and qualitative evidence in evaluating potential impairment of its investments. If the cost of an investment exceeds its fair value, Acacia evaluates, among other factors, general market conditions and the duration and extent to which the fair value is less than cost. Acacia also considers specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in the condensed consolidated statements of operations and a new cost basis in the investment is established.

*Impairment of Long-lived Assets.* Acacia reviews long-lived assets and intangible assets for potential impairment annually (quarterly for patents) and when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. In the event the expected undiscounted future cash flows resulting from the use of the asset is less than the carrying amount of the asset, an impairment loss is recorded equal to the excess of the asset's carrying value over its fair value. If an asset is determined to be impaired, the loss is measured based on quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including a discounted value of estimated future cash flows. In the event that management decides to no longer allocate resources to a patent portfolio, an impairment loss equal to the remaining carrying value of the asset is recorded. Refer to Note 4 for additional information.

Fair value is generally estimated using the "Income Approach," focusing on the estimated future net income-producing capability of the patent portfolios over the estimated remaining economic useful life. Estimates of future after-tax cash flows are converted to present value through "discounting," including an estimated rate of return that accounts for both the time value of money and investment risk factors. Estimated cash inflows are typically based on estimates of reasonable royalty rates for the applicable technology, applied to estimated market data. Estimated cash outflows are based on existing contractual obligations, such as contingent legal fee and inventor royalty obligations, applied to estimated license fee revenues, in addition to other estimates of out-of-pocket expenses associated with a specific patent portfolio's licensing and enforcement program. The analysis also contemplates consideration of current information about the patent portfolio including, status and stage of litigation, periodic results of the litigation process, strength of the patent portfolio, technology coverage and other pertinent information that could impact future net cash flows.

*Income Taxes.* Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in Acacia's condensed consolidated financial statements or consolidated income tax returns. A valuation allowance is established to reduce

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deferred tax assets if all, or some portion, of such assets will more than likely not be realized, or if it is determined that there is uncertainty regarding future realization of such assets.

The provision for income taxes for interim periods is determined using an estimate of Acacia's annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter, Acacia updates the estimate of the annual effective tax rate, and if the estimated tax rate changes, a cumulative adjustment is recorded.

The Company's effective tax rates were 8% and 1% for the three months ended March 31, 2019 and 2018, respectively. Tax expense for the periods presented primarily reflects the impact of state taxes and foreign withholding taxes incurred on revenue agreements executed with third-party licensees domiciled in foreign jurisdictions. The Company has recorded a full valuation allowance against our net deferred tax assets as of March 31, 2019 and 2018. These assets primarily consist of foreign tax credits, capital loss carryforwards and net operating loss carryforwards.

### 3. LOSS PER SHARE

The following table presents the weighted-average number of shares of common stock outstanding used in the calculation of basic and diluted net income (loss) per share:

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Weighted-average shares used in computing net loss per share attributable to common stockholders - basic and diluted	49,655,881	50,632,958
Basic and diluted net loss per common share	\$ (0.09)	\$ (0.63)
Anti-dilutive equity-based incentive awards excluded from the computation of diluted loss per share	2,059,631	5,898,369
Maximum price of awards excluded from the computation of diluted loss per share	\$ 6.75	\$ 6.75

### 4. PATENTS

Acacia's only identifiable intangible assets at March 31, 2019 and December 31, 2018 are patents and patent rights. Patent-related accumulated amortization totaled \$320,236,000 and \$319,580,000 as of March 31, 2019 and December 31, 2018, respectively. Acacia's patents have remaining estimated economic useful lives ranging from one to five years. The weighted-average remaining estimated economic useful life of Acacia's patents is approximately four years.

The following table presents the scheduled annual aggregate amortization expense as of March 31, 2019 (in thousands):

<u>For the years ending December 31,</u>	
Remainder of 2019	\$ 2,464
2020	2,421
2021	1,561
2022	1,561
2023	1,486
Thereafter	188
	<u>\$ 9,681</u>

For the three months ended March 31, 2019, Acacia accrued patent and patent rights acquisition costs totaling \$3,750,000. The patents and patent rights acquired have estimated economic useful lives of approximately five years.

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**5. INVESTMENTS**

*Investment at Fair Value*

*Veritone Investment Agreement.* On August 15, 2016, Acacia entered into an Investment Agreement with Veritone, Inc. (“Veritone”) pursuant to which Acacia funded in aggregate \$20 million of loans to Veritone which were converted into 1,523,746 shares of Veritone’s common stock upon the public offering of Veritone common stock on May 17, 2017 (“IPO”), based on a conversion price of \$13.61 per share. Veritone also issued Acacia a total of 154,312 warrants to purchase shares of Veritone’s common stock at an exercise price of \$13.61 per share expiring in 2020.

In addition, in August 2016, Veritone issued Acacia a five-year warrant to purchase up to \$50 million worth of shares of Veritone’s common stock at an exercise price of \$13.61 per share subject to certain adjustments. Upon the consummation of Veritone’s IPO, Acacia exercised its option to purchase an additional 2,150,335 shares of Veritone common stock, at an aggregate purchase price of \$29.3 million. Acacia then received an additional warrant that provides for the issuance of an additional 809,400 shares of Veritone common stock at an exercise price of \$13.61 per share expiring in 2022.

*Veritone Bridge Loan.* On March 14, 2017, Acacia entered into an additional secured convertible promissory note with Veritone pursuant to which Acacia funded \$4.0 million which was converted into 445,440 shares of Veritone’s common stock at a conversion price of \$13.61 per share in the IPO. Acacia also received a 10-year warrant to purchase up to 156,720 shares of Veritone common stock at an exercise price of \$13.61 per share expiring in 2027.

As a result of the foregoing transactions, Acacia received an aggregate total of 4,119,521 of Veritone shares and 1,120,432 of warrants in Veritone. On October 5, 2018, a registration statement on Form S-3 registering all of Acacia’s shares of Veritone common stock was declared effective by the SEC. During the year ended December 31, 2018, Acacia sold 2,700,000 shares Veritone common stock at prices ranging from \$4.95 to \$10.44 and recorded a realized loss of \$19.1 million. During the three months ended March 31, 2019, Acacia sold 628,048 shares Veritone common stock at prices ranging from \$4.71 to \$7.13 and recorded a realized loss of \$5.6 million.

At March 31, 2019, the fair value of the 791,473 shares of Veritone common stock owned by Acacia totaled \$4,116,000. At March 31, 2019, the fair value of the 1,120,432 common stock purchase warrants held by Acacia totaled \$1,367,000.

Changes in the fair value of Acacia’s investment in Veritone are recorded as unrealized gains or losses in the consolidated statements of operations. For the three months ended March 31, 2019 and 2018, the accompanying consolidated statements of operations reflected the following (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Change in fair value of investment, warrants	(697)	(7,647)
Change in fair value of investment, common stock	7,605	(33,450)
Loss on sale of investment, common stock	(5,590)	—
Net realized and unrealized gain (loss) on investment at fair value	<u>\$ 1,318</u>	<u>\$ (41,097)</u>

*Miso Robotics Investment*

In June 2017, Acacia made an investment in the Series A Preferred financing round for Miso Robotics, Inc. (“Miso Robotics”), an innovative leader in robotics and artificial intelligence solutions, totaling \$2,250,000, acquiring a 22.6% ownership interest in Series A preferred stock of Miso Robotics, and one board seat. In February 2018, Acacia made an additional equity investment in the Series B Preferred financing round for Miso Robotics totaling \$6,000,000, increasing its ownership interest (Series B preferred stock) in Miso Robotics to approximately 30%, and acquiring an additional board seat.

As of February 2018, the preferred stock was not deemed to be in-substance common stock due to the substantive liquidation preference associated with the preferred stock. As such, as of February 2018, the cumulative investment in Miso Robotics is recorded at cost and assessed for any impairment at each balance sheet date. Prior to February 2018, the equity method of accounting was applied.

## **6. COMMITMENTS AND CONTINGENCIES**

### *Patent Enforcement*

Certain of Acacia's operating subsidiaries are often required to engage in litigation to enforce their patents and patent rights. In connection with any of Acacia's operating subsidiaries' patent enforcement actions, it is possible that a defendant may request and/or a court may rule that an operating subsidiary has violated statutory authority, regulatory authority, federal rules, local court rules, or governing standards relating to the substantive or procedural aspects of such enforcement actions. In such event, a court may issue monetary sanctions against Acacia or its operating subsidiaries or award attorney's fees and/or expenses to a defendant(s), which could be material.

### *Leases*

The Company primarily leases office facilities under operating lease arrangements that will end in January 2020 and July 2020. The Company has elected to not apply any discount rate in our calculation given the short remaining lease term. Operating lease costs were \$153,000 and \$335,000 for the three months ended March 31, 2019 and 2018 respectively. The Company has subleased a facility that we ceased using in December 2018, and the sublease will go through the remaining term of the lease. The total sublease income received was \$195,000 for the three months ended March 31, 2019.

### *Other*

On June 17, 2015, Celltrace Communications Ltd., or Celltrace, filed a lawsuit against Acacia in U.S. District Court for the Southern District of New York, Case No. 1:15-cv-04746, alleging, among other things, significant damages for alleged breach of contract, unjust enrichment and fraud. Acacia disputes the allegations and does not believe that Celltrace is entitled to any damages. Acacia successfully moved to compel arbitration of the dispute, and the District Court stayed the litigation pending arbitration before the International Court of Arbitration for the International Chamber of Commerce, or the ICC. Celltrace appealed the decision to the U.S. Court of Appeals for the Second Circuit, which denied the appeal. Celltrace filed its request for arbitration of the claims with the ICC on November 28, 2016. Acacia filed an answer denying all allegations of wrongdoing and asserting affirmative defenses. A tribunal was appointed to preside over the arbitration and conducted its first case management conference on June 26, 2017. The parties conducted discovery and submitted their cases in chief to the tribunal in a series of written submissions per the tribunal's orders between January 2018 and December 2018. The tribunal held an evidentiary hearing with live witness testimony in New York City between February 4, 2019 and February 13, 2019. At the end of the hearing, the tribunal set a schedule for post-hearing briefing by the parties, which concluded in April 2019. Acacia continues to vigorously contest all allegations of wrongdoing.

In a separate case on December 6, 2017, the Federal Court of Canada allowed a counterclaim for invalidity of a patent asserted by Rapid Completions LLC and awarded costs payable by Rapid Completions LLC in an amount to be determined.

Acacia is subject to claims, counterclaims and legal actions that arise in the ordinary course of business. Management believes that the ultimate liability with respect to these claims and legal actions, if any, will not have a material effect on Acacia's condensed consolidated financial position, results of operations or cash flows. During the three months ended March 31, 2019, operating expenses included expenses for settlement and contingency accruals totaling \$650,000.

## **7. STOCKHOLDERS' EQUITY**

*Repurchases of Common Stock.* In February 2018, Acacia's Board of Directors authorized the repurchase of up to \$20,000,000 of the Company's outstanding common stock in open market purchases or private purchases, from time to time, in amounts and at prices to be determined by the Board of Directors at its discretion (the "Stock Repurchase Program"). In determining whether or not to repurchase any shares of Acacia's common stock, Acacia's Board of Directors consider such factors as the impact of the repurchase on Acacia's cash position, as well as Acacia's capital needs and whether there is a better alternative use of Acacia's capital. Acacia has no obligation to repurchase any amount of its common stock under the Stock Repurchase Program. Repurchases to date were made in the open market in compliance with applicable SEC rules. The authorization to repurchase shares presented an opportunity to reduce the outstanding share count and enhance stockholder value. The repurchased shares are expected to be retired. Monthly stock repurchases for the periods presented, all of which were purchased as part of a publicly announced plan or program, were as follows:

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	<b>Total Number of Shares Purchased</b>	<b>Average Price paid per Share</b>	<b>Approximate Dollar Value of Shares that May Yet be Purchased under the Program</b>	<b>Plan Expiration</b>
May 1, 2018- May 30, 2018	1,190,420	\$ 3.89	\$ 15,366,000	February 28, 2019
Totals for 2018	<u>1,190,420</u>	<u>\$ 3.89</u>		

*Tax Benefits Preservation Plan.* On March 12, 2019, Acacia’s Board of Directors announced that it unanimously approved the adoption of a Tax Benefits Preservation Plan (the “Plan”). The purpose of the Plan is to protect the Company’s ability to utilize potential tax assets, such as net operating loss carryforwards (“NOLs”) and tax credits to offset potential future taxable income.

The Plan is designed to reduce the likelihood that the Company will experience an ownership change by discouraging any (i) person or group from acquiring beneficial ownership of 4.9% or more of the Company’s outstanding common stock and (ii) any existing shareholders who, as of the time of the first public announcement of the adoption of the Plan, beneficially own more than 4.9% of the Company’s then-outstanding shares of the Company’s common stock from acquiring additional shares of the Company’s common stock (subject to certain exceptions). There is no guarantee, however, that the Plan will prevent the Company from experiencing an ownership change.

In connection with the adoption of the Plan, Acacia’s Board of Directors authorized and declared a dividend distribution of one right for each outstanding share of the Company’s common stock to shareholders of record at the close of business on March 16, 2019. On or after the distribution date, each right would initially entitle the holder to purchase one one-thousandth of a share of the Company’s Series B Junior Participating Preferred Stock, \$0.001 par value for a purchase price of \$12.00.

**8. RECENT ACCOUNTING PRONOUNCEMENTS**

*Recent Accounting Pronouncements - Recently Adopted.*

In February 2016, FASB issued ASU 2016-02, Leases ("ASC 842") which requires a lessee to recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset. In July 2018, FASB issued ASU 2018-11, Leases, which provides an additional transition option for an entity to apply the provisions of ASC 842 by recognizing a cumulative effect adjustment at the effective date of adoption without adjusting the prior comparative periods presented. Further, in January 2019, FASB issued ASU 2019-01, Leases: Codification Improvements, which provides disclosure relief for the interim periods when adopting ASC 842. The primary impact of adopting ASC 842 for the Company was the recognition in the consolidated balance sheet of certain lease-related assets and liabilities for operating leases with terms longer than 12 months as of January 1, 2019. Such amounts were not previously accounted for in the Company's consolidated balance sheets. The Company has adopted ASC 842, electing the practical expedient approaches and has recognized approximately \$628,000 of right-of-use assets and an increase of \$1.2 million in lease-related liabilities as of March 31, 2019. The adoption of ASC 842 is expected to have no material impact on the Company's consolidated results of operations for the year ending December 31, 2019.

There have been no other material changes to the Company's significant accounting policies during the three months ended March 31, 2019.

**9. FAIR VALUE DISCLOSURES**

Acacia holds the following types of financial instruments at March 31, 2019 and December 31, 2018.

*Trading securities - debt.* Debt securities includes corporate bonds with fair value that is determined by third party quotations from outside pricing services and/or computerized pricing models, which may be based on transactions, bids or estimates. Acacia classifies the fair value of corporate bonds within Level 2 of the valuation hierarchy.

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*Trading securities - equity.* Equity securities includes investments in public companies common stock and are recorded at fair value based on the quoted market price of each share on the valuation date. The fair value of these securities are within Level 1 of the valuation hierarchy.

*Investments at fair value - common stock.* Acacia's equity investment in Veritone common stock is recorded at fair value based on the quoted market price of Veritone's common stock on the applicable valuation date.

*Investments at fair value - warrants.* Warrants are recorded at fair value, as based on the Black-Scholes option-pricing model (Level 2).

*Profits interests.* At March 31, 2019 and December 31, 2018, the fair value of the Units was estimated at 40% of the fair value of the 10% Warrant, based on the Black-Scholes option-pricing model (Level 2).

## **Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Cautionary Statement Regarding Forward Looking Statements**

You should read the following discussion and analysis in conjunction with the condensed consolidated financial statements and related notes thereto contained in Part I, Item 1 of this Quarterly Report on Form 10-Q. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Securities and Exchange Commission, or the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on March 15, 2019, amended by Amendment No. 1 to our Annual Report on Form 10-K, filed with the SEC on April 30, 2019. Our Annual Report on Form 10-K, as amended, is referred to herein as our “Annual Report.”

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and which concern matters that involve risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Reference is made in particular to the description of our plans and objectives for future operations, assumptions underlying such plans and objectives, and other forward-looking statements set forth under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and other sections of this Quarterly Report on Form 10-Q. Such statements may be identified by the use of forward-looking terminology such as “may,” “will,” “should,” “could,” “expect,” “plan,” “believe,” “estimate,” “anticipate,” “intend,” “predict,” “potential,” “continue” or similar terms, variations of such terms or the negative of such terms, although not all forward-looking statements contain these terms. Such statements are based on management’s current expectations and are subject to a number of factors and uncertainties, which could cause actual results to differ materially from those described in the forward-looking statements. Such statements address future events and conditions concerning intellectual property, or IP, acquisition and development, licensing and enforcement activities, other related business activities, capital expenditures, earnings, litigation, regulatory matters, markets for our services, liquidity and capital resources and accounting matters. Actual results in each case could differ materially from those anticipated in such statements by reason of factors such as our ability to invest in new technologies and patents, future global economic conditions, changes in demand for our services, legislative, regulatory and competitive developments in markets in which we and our subsidiaries operate, results of litigation and other circumstances affecting anticipated revenues and costs. We expressly disclaim any intent, obligation or undertaking to update or revise any forward-looking statements contained herein to conform such statements to actual results or to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. Readers are urged to carefully review and consider the various disclosures made by us, which attempt to advise interested parties of the risks, uncertainties, and other factors that affect our business, including without limitation the disclosures made under the captions “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Financial Statements” in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and disclosures made under the captions “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Risk Factors” and “Financial Statements and Supplementary Data” included in our Annual Report on Form 10-K for the year ended December 31, 2018.

### **General**

As used in this Quarterly Report on Form 10-Q, “we,” “us” “our” and “Company” refer to Acacia Research Corporation, a Delaware corporation, and/or its wholly and majority-owned and controlled operating subsidiaries, and/or where applicable, its management. All IP acquisition, development, licensing and enforcement activities are conducted solely by certain of Acacia Research Corporation’s wholly and majority-owned and controlled operating subsidiaries.

We invest in IP and related absolute return assets and engage in the licensing and enforcement of patented technologies. We partner with inventors and patent owners, applying our legal and technology expertise to patent assets to unlock the financial value in their patented inventions. We generate revenues and related cash flows from the granting of patent rights for the use of patented technologies that our operating subsidiaries control or own. We assist patent owners with the prosecution and development of their patent portfolios, the protection of their patented inventions from unauthorized use, the generation of licensing revenue from users of their patented technologies and, where necessary, with the enforcement against unauthorized users of their patented technologies through the filing of patent infringement litigation. We are principals in the licensing and enforcement effort, obtaining control of the rights in the patent portfolio, or control of the patent portfolio outright.

We have a proven track record of licensing and enforcement success with over 1,560 license agreements executed to date, across nearly 200 patent portfolio licensing and enforcement programs. To date, we have generated gross licensing revenue of approximately \$1.6 billion, and have returned more than \$767 million to our patent partners.

## Executive Summary

### Overview

For the three months ended March 31, 2019 and 2018, we reported revenues of \$3.4 million and \$62.1 million, respectively. Cash and short-term investments totaled \$167.9 million as of March 31, 2019, as compared to \$165.5 million as of December 31, 2018. Our operating activities during the periods presented were focused on the continued operation of our patent licensing and enforcement business, including the continued pursuit of our ongoing patent licensing and enforcement programs.

Our team’s expertise in identifying and evaluating complex IP, and in developing and cultivating long-term business relationships, provides us a unique window into innovation and technological advancement. We are increasing our efforts to leverage our expertise and experience to create new avenues and monetize our existing IP assets, which we believe will lead to increased shareholder value. We will leverage our experience, expertise, data and relationships developed as a leader in the IP industry to pursue these opportunities.

*Investment in Veritone.* In connection with its previous investment in Veritone, Inc., or Veritone, in August 2016, Acacia received an aggregate total of 4,119,521 shares and 1,120,432 warrants of Veritone. In fiscal year 2018, Acacia sold 2,700,000 shares of Veritone common stock at a weighted average price of \$7.07 and recorded a realized loss of \$19.1 million on the sale. During the three months ended March 31, 2019, Acacia sold 628,048 shares of Veritone common stock at a weighted average price of \$5.24 and recorded a realized loss of \$5.6 million on the sale. Refer to Note 5 to the consolidated financial statements elsewhere herein for additional information regarding our investment in Veritone.

*Investment in Miso Robotics.* In June 2017, Acacia made a \$2.25 million equity investment in Miso Robotics, Inc., or Miso Robotics, as part of Miso Robotics’ closing of \$3.1 million in Series A funding. In February 2018, we made an additional strategic equity investment totaling \$6.0 million in the Series B financing round for Miso Robotics. Refer to Note 5 to the consolidated financial statements elsewhere herein for additional information regarding our investment in Miso Robotics.

*Patent Portfolio Intake.* During the three months ended March 31, 2019, we acquired two new patent portfolios with enterprise networking equipment and residential gateways technology and customization of ad insertion for Internet radio streaming technology.

*Operating Activities.* Operating activities during the periods presented included the following:

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Revenues (in thousands)	\$ 3,387	\$ 62,093
New agreements executed	—	4
Licensing and enforcement programs generating revenues	3	4
New patent portfolios	2	—

Our revenues historically have fluctuated quarterly, and can vary significantly, based on a number of factors including the following:

- the dollar amount of agreements executed each period, which can be driven by the nature and characteristics of the technology or technologies being licensed and the magnitude of infringement associated with a specific licensee;
- the specific terms and conditions of agreements executed each period including the nature and characteristics of rights granted, and the periods of infringement or term of use contemplated by the respective payments;
- fluctuations in the total number of agreements executed each period;

- the number of, timing, results and uncertainties associated with patent licensing negotiations, mediations, patent infringement actions, trial dates and other enforcement proceedings relating to our patent licensing and enforcement programs;
- the relative maturity of licensing programs during the applicable periods;
- other external factors, including the periodic status or results of ongoing negotiations, the status or results of ongoing litigations and appeals, actual or perceived shifts in the regulatory environment, impact of unrelated patent related judicial proceedings and other macroeconomic factors; and
- fluctuations in overall patent portfolio related enforcement activities which are impacted by the portfolio intake challenges discussed above.

Our management does not attempt to manage for smooth sequential periodic growth in revenues period to period, and therefore, periodic results can be uneven. Unlike most operating businesses and industries, licensing revenues not generated in a current period are not necessarily foregone but, depending on whether negotiations, litigation or both continue into subsequent periods, and depending on a number of other factors, such potential revenues may be pushed into subsequent fiscal periods.

Revenues for the three months ended March 31, 2019 and 2018 included fees from the following technology licensing and enforcement programs:

- Bone Wedge technology<sup>(1)(2)</sup>
- Super Resolutions Microscopy technology<sup>(1)(2)</sup>
- Speech codes used in wireless and wireline systems technology<sup>(1)(2)</sup>
- Video Conferencing technology<sup>(2)</sup>

<sup>(1)</sup> 2019 period

<sup>(2)</sup> 2018 period

*Summary of Results of Operations - Overview  
For the Three Months Ended March 31, 2019 and 2018  
(In thousands, except percentage change values)*

	<b>Three Months Ended March 31,</b>		<b>% Change</b>
	<b>2019</b>	<b>2018</b>	
Revenues	\$ 3,387	\$ 62,093	(95)%
Operating costs and expenses	10,332	53,123	(81)%
Operating loss	(6,945)	8,970	(177)%
Other income (expense), net	2,861	(40,890)	(107)%
Loss before provision for income taxes	(4,084)	(31,920)	(87)%
Provision for income taxes	(314)	(191)	64 %
Net loss attributable to Acacia Research Corporation	(4,384)	(32,038)	(86)%

\* Percentage change in excess of 200%

*Overview - Three months ended March 31, 2019 compared with the three months ended March 31, 2018*

- Revenues decreased \$58.7 million to \$3.4 million for the three months ended March 31, 2019, as compared to \$62.1 million in the comparable prior year quarter, due primarily to a decrease in the number of new agreements executed during the quarter. Refer to “*Investments in Patent Portfolios*” below for additional information regarding the impact of portfolio acquisition trends on current and future licensing and enforcement related revenues.
- Loss before provision for income taxes was \$4.1 million for the three months ended March 31, 2019, as compared to \$31.9 million for the three months ended March 31, 2018. The net change was primarily comprised of the change in revenues described above, a \$6.9 million unrealized gain for the three months ended March 31, 2019 as compared to a \$41.1 million unrealized loss for the comparable prior year period on our equity investment in Veritone, and other changes in operating expenses as follows:
  - Inventor royalties and contingent legal fees, on a combined basis, decreased \$36.0 million, primarily due to the decrease in related revenues for the periods.

- Litigation and licensing expenses—patents increased \$812,000, or 27%, to \$3.8 million, due primarily to a net increase in litigation support and third-party technical consulting expenses associated with ongoing litigation.
- Amortization expense decreased \$4.7 million, or 88%, due to a decrease in scheduled amortization resulting from patent portfolio impairment charges previously recorded in the second quarter of 2018.
- General and administrative expenses, excluding non-cash stock compensation, decreased \$622,000, or 14%, to \$3.7 million, due primarily to an decrease in performance-based compensation costs.
- Net non-cash stock compensation expense increased \$1.0 million, or 99%, due to the three months ended March 31, 2018 including a \$1.7 million credit for the decrease in fair value of our Veritone related profits interest units, or Profits Interests, consistent with the decrease in the underlying Veritone stock price since December 31, 2017. In addition, the decrease was due to a decrease in expense for employees and board members that were terminated in 2018.
- During the three months ended March 31, 2019, operating expenses included expenses for settlement and contingency accruals totaling \$650,000.

### *Patent Licensing and Enforcement*

*Patent Litigation Trial Dates and Related Trials.* As of the date of this report, our operating subsidiaries have no pending patent infringement case with a scheduled trial date in the next six months. Patent infringement trials are components of our overall patent licensing process and are one of many factors that contribute to possible future revenue generating opportunities for us. Scheduled trial dates, as promulgated by the respective court, merely provide an indication of when, in future periods, the trials may occur according to the court's scheduling calendar at a specific point in time. A court may change previously scheduled trial dates. In fact, courts often reschedule trial dates for various reasons that are unrelated to the underlying patent assets and typically for reasons that are beyond our control. While scheduled trial dates provide an indication of the timing of possible future revenue generating opportunities for us, the trials themselves represent the possible future revenue generating opportunities. These future opportunities can result in varying outcomes. In fact, it is difficult to predict the outcome of patent enforcement litigation at the trial level and outcomes can be unfavorable. It can be difficult to understand complex patented technologies, and as a result, this may lead to a higher rate of unfavorable litigation outcomes. Moreover, in the event of a favorable outcome, there is a higher rate of successful appeals in patent enforcement litigation than more standard business litigation. Such appeals are expensive and time consuming, resulting in increased costs and a potential for delayed or foregone revenue opportunities in the event of modification or reversal of favorable outcomes. Although we diligently pursue enforcement litigation, we cannot predict with reliability the decisions made by juries and trial courts.

*Litigation and Licensing Expense.* We expect patent-related legal expenses to continue to fluctuate from period to period based on the factors summarized herein, in connection with future trial dates, international enforcement, strategic patent portfolio prosecution and our current and future patent portfolio investment, prosecution, licensing and enforcement activities. The pursuit of enforcement actions in connection with our licensing and enforcement programs can involve certain risks and uncertainties, including the following:

- Increases in patent-related legal expenses associated with patent infringement litigation, including, but not limited to, increases in costs billed by outside legal counsel for discovery, depositions, economic analyses, damages assessments, expert witnesses and other consultants, re-exam and inter partes review costs, case-related audio/video presentations and other litigation support and administrative costs could increase our operating costs and decrease our profit generating opportunities;
- Our patented technologies and enforcement actions are complex and, as a result, we may be required to appeal adverse decisions by trial courts in order to successfully enforce our patents. Moreover, such appeals may not be successful;
- New legislation, regulations or rules related to enforcement actions, including any fee or cost shifting provisions, could significantly increase our operating costs and decrease our profit generating opportunities. Increased focus on the growing number of patent-related lawsuits may result in legislative changes which increase our costs and related risks of asserting patent enforcement actions. For instance, the United States House of Representatives passed a bill that would require non-practicing entities that bring patent infringement lawsuits to pay legal costs of the defendants, if the lawsuits are unsuccessful and certain standards are not met;

- Courts may rule that our subsidiaries have violated certain statutory, regulatory, federal, local or governing rules or standards by pursuing such enforcement actions, which may expose us and our operating subsidiaries to material liabilities, which could harm our operating results and our financial position;
- The complexity of negotiations and potential magnitude of exposure for potential infringers associated with higher quality patent portfolios may lead to increased intervals of time between the filing of litigation and potential revenue events (i.e. markman dates, trial dates), which may lead to increased legal expenses, consistent with the higher revenue potential of such portfolios; and
- Fluctuations in overall patent portfolio related enforcement activities which are impacted by the portfolio intake challenges discussed above could harm our operating results and our financial position.

### **Investments in Patent Portfolios**

One of the significant challenges in our industry continues to be quality patent intake due to the challenges and complexity associated with the current patent environment. During the three months ended March 31, 2019, we acquired two new patent portfolios. In fiscal year 2018 we did not acquire any patent portfolios, compared to one portfolio during fiscal year 2017.

With respect to our licensing, enforcement and overall business, neither we nor our operating subsidiaries invent new technologies or products; rather, we depend upon the identification and investment in patents, inventions and companies that own intellectual property through our relationships with inventors, universities, research institutions, technology companies and others. If our operating subsidiaries are unable to maintain those relationships and identify and grow new relationships, then we may not be able to identify new technology-based patent opportunities for sustainable revenue and /or revenue growth.

Our current or future relationships may not provide the volume or quality of technologies necessary to sustain our licensing, enforcement and overall business. In some cases, universities and other technology sources compete against us as they seek to develop and commercialize technologies. Universities may receive financing for basic research in exchange for the exclusive right to commercialize resulting inventions. These and other strategies employed by potential partners may reduce the number of technology sources and potential clients to whom we can market our solutions. If we are unable to maintain current relationships and sources of technology or to secure new relationships and sources of technology, such inability may have a material adverse effect on our revenues, operating results, financial condition and ability to maintain our licensing and enforcement business.

### **Critical Accounting Estimates**

Our unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these condensed consolidated statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these condensed consolidated financial statements. The SEC has defined a company's critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and results of operations, and which require a company to make its most difficult and subjective judgments. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in the audited consolidated financial statements and notes thereto and under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" included in our Annual Report on Form 10-K for the year ended December 31, 2018. In addition, as set forth in Note 2 to the condensed consolidated financial statements included in this report, certain accounting policies were identified during the current period, based on activities occurring during the current period, as critical and requiring significant judgments and estimates.

### **Recently Adopted Accounting Pronouncements**

In February 2016, FASB issued ASU 2016-02, Leases ("ASC 842") which requires a lessee to recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset. In July 2018, FASB issued ASU 2018-11, Leases, which provides an additional transition option for an entity to apply the provisions of ASC 842 by recognizing a cumulative effect adjustment at the effective date of adoption without adjusting the prior comparative periods presented. Further, in January 2019, FASB issued ASU 2019-01, Leases: Codification Improvements, which provides disclosure relief for the interim periods when adopting ASC 842. The primary impact of adopting ASC 842 for the Company was the recognition in the consolidated balance sheet of certain lease-

related assets and liabilities for operating leases with terms longer than 12 months as of January 1, 2019. Such amounts were not previously accounted for in the Company's consolidated balance sheets.

The Company has adopted ASC 842, electing the practical expedient approaches, and has recognized approximately \$628,000 of right-of-use assets and an increase of \$1.2 million in lease-related liabilities as of March 31, 2019.

Except as described above, the adoption of the new lease accounting standard did not have a material impact on the condensed consolidated financial statements. The adoption of ASC 842 is expected to have no material impact on the Company's consolidated results of operations for the year ending December 31, 2019.

## Consolidated Results of Operations

### Comparison of the Results of Operations for Three Months Ended March 31, 2019 and 2018

#### Revenues and Pretax Net Income (Loss)

	Three Months Ended March 31,		Change	
	2019	2018	\$	%
Revenues (in thousands, except percentage change values)	\$ 3,387	\$ 62,093	\$ (58,706)	(95)%
New agreements executed	—	4		

Two licensees individually accounted for 70% and 21% of revenues recognized during the three months ended March 31, 2019. One licensee accounted for 96% of revenues recognized during the three months ended March 31, 2018.

For the periods presented herein, the majority of the revenue agreements executed provided for the payment of one time, paid-up license fees in consideration for the grant of certain IP rights for patented technology rights owned by our operating subsidiaries. These rights were primarily granted on a perpetual basis, extending until the expiration of the underlying patents. Refer to "Investments in Patent Portfolios" above for information regarding the impact of portfolio acquisition trends on current and future licensing and enforcement related revenues.

	Three Months Ended March 31,		Change	
	2019	2018	\$	%
(in thousands, except percentage change values)				
Loss before provision for income taxes	\$ (4,084)	\$ (31,920)	\$ 27,836	(87)%

A reconciliation of the change in pretax loss for the periods presented is as follows:

	<b>Three Months Ended March 31, 2019 vs. 2018</b>		<b>%</b>
	<b>(in thousands, except percentage values)</b>		
Decrease in revenues	\$	(58,706)	(211)%
Decrease in inventor royalties, contingent legal fees and patent acquisition expenses		39,973	144 %
Decrease in general and administrative expenses, excluding non-cash stock compensation		622	2 %
Increase in non-cash stock compensation expenses		(1,016)	(4)%
Increase in litigation and licensing expenses		(812)	(3)%
Decrease in patent amortization expenses		4,674	17 %
Change in realized and unrealized gain (loss) on investment		42,415	152 %
Other		686	3 %
<b>Total change in loss before provision for income taxes</b>	<b>\$</b>	<b>27,836</b>	<b>100 %</b>

### Cost of Revenues

	<b>Three Months Ended March 31,</b>		<b>Change</b>	
	<b>2019</b>	<b>2018</b>	<b>\$</b>	<b>%</b>
	<b>(in thousands, except percentage change values)</b>			
Inventor royalties	\$ 1,353	\$ 21,744	\$ (20,391)	(94)%
Contingent legal fees	\$ 177	\$ 15,759	\$ (15,582)	(99)%
Patent acquisition expenses	\$ —	\$ 4,000	\$ (4,000)	(100)%

*Inventor Royalties, Contingent Legal Fees Expense and Other.* Inventor royalties and contingent legal fee expenses fluctuate period to period based on the amount of revenues recognized each period, the terms and conditions of agreements executed each period and the mix of specific patent portfolios with varying economic terms and obligations generating revenues each period. Other operating expenses for the three months ended March 31, 2018 also included \$4.0 million in other direct cost of revenues related to patent rights acquired and licensed in the first quarter of 2018.

	<b>Three Months Ended March 31,</b>		<b>Change</b>	
	<b>2019</b>	<b>2018</b>	<b>\$</b>	<b>%</b>
	<b>(in thousands, except percentage change values)</b>			
Litigation and licensing expenses - patents	\$ 3,801	\$ 2,989	\$ 812	27 %
Amortization of patents	\$ 656	\$ 5,330	\$ (4,674)	(88)%

\* Percentage change in excess of 200%

*Litigation and Licensing Expenses - Patents.* Litigation and licensing expenses-patents increased for the periods presented due to a net increase in litigation support and third-party technical consulting expenses associated with ongoing litigation.

*Amortization of Patents.* Amortization expense decreased \$4.7 million, or 88%, due to due to a decrease in scheduled amortization resulting from patent portfolio impairment charges previously recorded in the second quarter of 2018.

## Operating Expenses (in thousands, except percentage change values)

	Three Months Ended March 31,		Change	
	2019	2018	\$	%
General and administrative expenses	\$ 3,703	\$ 4,325	\$ (622)	(14)%
Non-cash stock compensation expense - G&A	(8)	704	(712)	(101)%
Non-cash stock compensation expense - Profits Interests	\$ —	\$ (1,728)	\$ 1,728	(100)%
Total general and administrative expenses	<u>\$ 3,695</u>	<u>\$ 3,301</u>	<u>\$ 394</u>	<u>12 %</u>

*General and Administrative Expenses.* A summary of the main drivers of the change in general and administrative expenses for the periods presented, is as follows (in thousands, except percentage values):

	Three Months Ended March 31,	
	2019 vs. 2018	%
Personnel costs and board fees	\$ 267	68 %
Variable performance-based compensation costs	(803)	(204)%
Corporate, general and administrative costs	(167)	(42)%
Non-cash stock compensation expense	1,016	258 %
Non-recurring employee severance costs	81	20 %
Total change in general and administrative expenses	<u>\$ 394</u>	<u>100 %</u>

The credit recorded for the three months ended March 31, 2018 for our Profits Interests non-cash stock compensation expense was due to a decrease in the estimated fair value of our Profits Interests, as a result of the changes in Veritone's stock price from December 31, 2017 to March 31, 2018. The decrease in non-cash stock compensation expense - G&A for the periods presented was primarily due to a decrease in expense for employees and board members that were terminated in 2018.

## Other Operating Income (Expense)

*Change in Fair Value of Investment, net.* Acacia's investment in Veritone is recorded at fair value, and marked to market at each balance sheet date, with changes in fair value, primarily based on changes in Veritone's stock price, reflected in the statement of operations each period. Results for the three months ended March 31, 2019 included an unrealized gain on our investment in Veritone totaling \$6.9 million. Results for the three months ended March 31, 2018 included an unrealized loss on our investment in Veritone totaling \$41.1 million. The three months ended March 31, 2019 include a realized loss of \$5.6 million from the sale of 628,048 shares at a weighted average price of \$5.24 per share.

## Income Taxes

	Three Months Ended March 31,	
	2019	2018
Provision for income taxes (in thousands)	\$ (314)	\$ (191)
Effective tax rate	8%	1%

Tax expense for the periods presented primarily reflects the impact of state taxes and foreign withholding taxes incurred on revenue agreements executed with third-party licensees domiciled in foreign jurisdictions.

## Liquidity and Capital Resources

### General

Our primary sources of liquidity are cash and cash equivalents on hand generated from our operating activities. Our management believes that our cash and cash equivalent balances and anticipated cash flows from operations will be sufficient to meet our cash requirements through at least May 2020 and for the foreseeable future. We may, however, encounter unforeseen difficulties that may deplete our capital resources more rapidly than anticipated, including those set forth in our Annual Report on Form 10-K for the year ended December 31, 2018. Any efforts to seek additional funding could be made through issuances of equity or debt, or other external financing. However, additional funding may not be available on favorable terms, or at all. The capital and credit markets have experienced extreme volatility and disruption periodically and such volatility and disruption may occur in the future. If we fail to obtain additional financing when needed, we may not be able to execute our business plans and our business, conducted by our operating subsidiaries, may suffer.

Certain of our operating subsidiaries are often required to engage in litigation to enforce their patents and patent rights. In connection with any of our operating subsidiaries' patent enforcement actions, it is possible that a defendant may request and/or a court may rule that an operating subsidiary has violated statutory authority, regulatory authority, federal rules, local court rules, or governing standards relating to the substantive or procedural aspects of such enforcement actions. In such event, a court may issue monetary sanctions against us or our operating subsidiaries or award attorney's fees and/or expenses to a defendant(s), which could be material.

#### *Cash, Cash Equivalents and Investments*

Our consolidated cash and cash equivalents and investments on hand totaled \$167.9 million at March 31, 2019, compared to \$165.5 million at December 31, 2018. The net change in cash and cash equivalents for the periods presented was comprised of the following (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Net cash provided by (used in):</b>		
Operating activities	\$ (58,812)	\$ 49,970
Investing activities	3,288	(36,309)
Financing activities	—	24

*Cash Flows from Operating Activities.* Cash receipts from licensees for the three months ended March 31, 2019 decreased 80% to \$12.3 million, as compared to \$62.1 million in the comparable 2018 period, due to the net impact of the timing of cash receipts from licensees. Cash outflows from operations, excluding the impact of purchases and maturities of trading securities, for the three months ended March 31, 2019 increased 18% to \$14.3 million, as compared to \$12.1 million in the comparable 2018 period, primarily due to the net impact of the timing of related payments of inventor royalties and contingent legal fees and the timing of payments to other third-parties in the ordinary course, for the same periods. Refer to "Working Capital" below for additional information.

*Cash Flows from Investing Activities.* Cash flows from investing activities and related changes were comprised of the following for the periods presented (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Sale of investment <sup>(1)</sup>	\$ 3,294	\$ —
Investments in Investees	—	(7,000)
Net sale of short-term investments	—	(29,309)
Purchases of property and equipment	(6)	—

<sup>(1)</sup> Refer to Note 5 for additional information

#### *Working Capital*

Working capital at March 31, 2019 decreased to \$164.2 million, compared to \$170.4 million at December 31, 2018. Consolidated accounts receivable from licensees decreased to \$24.0 million at March 31, 2019, compared to \$32.9 million at

December 31, 2018. Accrued patent investment costs increased to \$3.8 million at March 31, 2019. Consolidated royalties and contingent legal fees payable decreased to \$16.1 million at March 31, 2019, compared to \$22.7 million at December 31, 2018.

The majority of royalties and contingent legal fees payable are scheduled to be paid through the third quarter of 2019, subsequent to receipt by us of the related fee payments from licensees, in accordance with the underlying contractual arrangements.

### **Off-Balance Sheet Arrangements**

As of March 31, 2019, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established to facilitate any off-balance sheet arrangements or for any other contractually specified purposes.

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The primary objective of our short-term investment activities is to preserve principal while concurrently maximizing the income we receive from our short-term investments without significantly increasing risk. Some of the securities that we invest in may be subject to interest rate risk and/or market risk. This means that a change in prevailing interest rates, with respect to interest rate risk, or a change in the value of the United States equity markets, with respect to market risk, may cause the principal amount or market value of the short-term investments to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the current value of the principal amount of our investment may decline. To minimize these risks in the future, we intend to maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds, high-grade corporate bonds, government and non-government debt securities and certificates of deposit.

At March 31, 2019 and December 31, 2018, our short-term investments were comprised of AAA rated money market funds that invest in first-tier only securities, which primarily include domestic commercial paper, securities issued or guaranteed by the U.S. government or its agencies, U.S. bank obligations, and fully collateralized repurchase agreements (included in cash and cash equivalents in the accompanying consolidated balance sheets), and direct investments in short term, highly liquid, investment grade, U.S. government and corporate securities (included in short-term investments in the accompanying consolidated balance sheets).

In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. Accordingly, a 100 basis point increase in interest rates or a 10% decline in the value of the United States equity markets would not be expected to have a material impact on the value of such money market funds. Investments in U.S. government fixed income securities are subject to interest rate risk and will decline in value if interest rates increase. However, due to the relatively short duration of our short-term investment portfolio, an immediate 10% change in interest rates would have no material impact on our financial condition, results of operations or cash flows. Declines in interest rates over time will, however, reduce our interest income.

*Investment Risk.* We are exposed to investment risks related to changes in the underlying financial condition of certain of our equity investments in these technology companies. The fair value of these investments can be significantly impacted by the risk of adverse changes in securities markets generally, as well as risks related to the performance of the companies whose securities we have invested in, risks associated with specific industries, and other factors. These investments are subject to significant fluctuations in fair value due to the volatility of the securities markets and of the underlying businesses. As of March 31, 2019 and December 31, 2018, the carrying value of our common stock and warrants in public and private companies was \$14.5 million and \$18.7 million, respectively. We record our common stock and warrant investments in publicly traded companies at fair value, which is subject to market price volatility, and represents \$6.3 million and \$10.5 million of our assets as of March 31, 2019 and December 31, 2018, respectively. As of December 31, 2018, a hypothetical 10% adverse change in the market price of Veritone's publicly traded common stock would have resulted in a decrease of approximately \$540,000 in the fair value of our equity and equity warrant investments in Veritone and a decrease of approximately \$301,000 in our other equity investments. As of March 31, 2019, a hypothetical 10% adverse change in the market price of Veritone's publicly traded common stock would have resulted in a decrease of approximately \$658,000 in the fair value of our equity and equity warrant investments in Veritone and a decrease of approximately \$83,000 in our other equity investments. We evaluate our equity and equity warrant investments in private companies for impairment when events and circumstances indicate that the decline in fair value of such assets below the carrying value is other-than temporary. Our analysis includes a review of recent operating results and trends, recent sales/acquisitions of the investee securities, and other publicly available data. The current global economic

climate provides additional uncertainty. Valuations of private companies are inherently more complex due to the lack of readily available market data. As such, we believe that market sensitivities are not practicable for our private company equity investments.

#### **Item 4. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures.* Under the supervision and with the participation of our management, including our Chief Intellectual Property Officer and Corporate Controller, we conducted an evaluation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act.

Based on this evaluation, our Chief Intellectual Property Officer and Corporate Controller concluded that, as of March 31, 2019, our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Intellectual Property Officer and Corporate Controller, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods prescribed by the SEC.

*Changes in Internal Control Over Financial Reporting.* There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter (the quarter ended March 31, 2019) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*Inherent Limitations on Effectiveness of Controls.* Our management, including our Chief Intellectual Property Officer and Corporate Controller, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

## PART II--OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

On June 17, 2015, Celltrace Communications Ltd., or Celltrace, filed a lawsuit against Acacia in U.S. District Court for the Southern District of New York, Case No. 1:15-cv-04746, alleging, among other things, significant damages for alleged breach of contract, unjust enrichment and fraud. Acacia disputes the allegations and does not believe that Celltrace is entitled to any damages. Acacia successfully moved to compel arbitration of the dispute, and the District Court stayed the litigation pending arbitration before the International Court of Arbitration for the International Chamber of Commerce, or the ICC. Celltrace appealed the decision to the U.S. Court of Appeals for the Second Circuit, which denied the appeal. Celltrace filed its request for arbitration of the claims with the ICC on November 28, 2016. Acacia filed an answer denying all allegations of wrongdoing and asserting affirmative defenses. A tribunal was appointed to preside over the arbitration and conducted its first case management conference on June 26, 2017. The parties conducted discovery and submitted their cases in chief to the tribunal in a series of written submissions per the tribunal's orders between January 2018 and December 2018. The tribunal held an evidentiary hearing with live witness testimony in New York City between February 4, 2019 and February 13, 2019. At the end of the hearing, the tribunal set a schedule for post-hearing briefing by the parties, which concluded in April 2019. Acacia continues to vigorously contest all allegations of wrongdoing.

### Item 1A. RISK FACTORS

An investment in our common stock involves risks. Before making an investment decision, you should carefully consider all of the information in this Quarterly Report on Form 10-Q, including in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part I, Item 2 in this Quarterly Report on Form 10-Q, as well as our condensed consolidated financial statements and the accompanying notes thereto. In addition, you should carefully consider the risks and uncertainties described below and in the section entitled "Risk Factors" in Part I, Item 1A of our Annual Report, as well as in our other public filings with the SEC. If any of the identified risks are realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that case, the trading price of our common stock may decline, and you could lose all or part of your investment. In addition, other risks of which we are currently unaware, or which we do not currently view as material, could have a material adverse effect on our business, financial condition, operating results and prospects.

### Item 6. EXHIBITS

<b>EXHIBIT NUMBER</b>	<b>EXHIBIT</b>
10.1	<a href="#">Separation Agreement and General Release of Claims, dated February 12, 2019, by and between Acacia Research Group, LLC and Kirsten Hoover (incorporated by reference to Acacia Research Corporation's Current Report on Form 8-K filed on February 13, 2019 (File No. 001-37721))</a>
31.1#	<a href="#">Certification of Principal Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934</a>
31.2#	<a href="#">Certification of Principal Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934</a>
32.1**#	<a href="#">Certification of Principal Executive Officer Pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350</a>
32.2**#	<a href="#">Certification of Principal Financial Officer Pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350</a>
101#	<a href="#">Interactive Data Files Pursuant to Rule 405 of Regulation S-T</a>

# Filed herewith.

\*\* The certifications attached as Exhibits 32.1 and 32.2 that accompany this Quarterly Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, shall not be deemed "filed" by the Registrant for purposes of Section 18 of the Exchange Act and are not to be incorporated by reference into any of the Registrant's

filings under the Securities Act or the Exchange Act, irrespective of any general incorporation language contained in any such filing.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACACIA RESEARCH CORPORATION

/s/ Marc Booth

By: Marc W. Booth

Chief Intellectual Property Officer

(Principal Executive Officer and Duly Authorized  
Signatory)

/s/ Li Yu

By: Li Yu

Corporate Controller

(Principal Financial Officer)

Date: May 10, 2019

## EXHIBIT INDEX

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