ACACIA RESEARCH CORP
Form 10-Q
May 09, 2014

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED March 31, 2014
or
o 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: 0-26068

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 95-4405754 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

500 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.
x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). x Yes o No

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

| | |
|---|---|
| Large accelerated filer x | Accelerated filer o |
| | Smaller reporting company o |

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

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

As of May 5, 2014, 50,062,790 shares of the registrant’s common stock, $0.001 par value, were issued and outstanding.

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PART I--FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

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

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $133,403 | $126,685 |
| Short-term investments | 95,590 | 130,017 |
| Accounts receivable | 13,540 | 6,341 |
| Deferred income tax | 3,139 | 3,139 |
| Prepaid expenses and other current assets | 7,617 | 7,546 |
| Total current assets | 253,289 | 273,728 |
| Property and equipment, net of accumulated depreciation and amortization | 782 | 766 |
| Patents, net of accumulated amortization | 290,197 | 288,432 |
| Goodwill | 30,149 | 30,149 |
| Other assets | 309 | 318 |
| | $574,726 | $593,393 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $12,295 | $11,555 |
| Accrued patent investment costs | 19,250 | 4,000 |
| Royalties and contingent legal fees payable | 3,895 | 10,447 |
| Total current liabilities | 35,440 | 26,002 |
| Deferred income taxes | 3,747 | 4,874 |
| Other liabilities | 319 | 319 |
| Total liabilities | 39,506 | 31,195 |
| Commitments and contingencies (Note 5) | | |
| 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; 50,041,123 and 49,385,057 shares issued and outstanding as of March 31, 2014 and December 31, 2013, respectively | 50 | 49 |
| Treasury stock, at cost, 1,729,408 shares as of March 31, 2014 and December 31, 2013 | (34,640) | (34,640) |
| Additional paid-in capital | 650,934 | 653,314 |
| Accumulated comprehensive loss | (976) | (947) |
| Accumulated deficit | (86,487) | (62,066) |
| Total Acacia Research Corporation stockholders' equity | 528,881 | 555,710 |
| Noncontrolling interests in operating subsidiaries | 6,339 | 6,488 |
| Total stockholders' equity | 535,220 | 562,198 |

| | | |
|---|---|---|
| | $574,726 | $593,393 |

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

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| Revenues | $12,578 | $76,861 |
| Operating costs and expenses: | | |
| Cost of revenues: | | |
| Inventor royalties | 951 | 18,481 |
| Contingent legal fees | 1,527 | 15,032 |
| Litigation and licensing expenses - patents | 8,994 | 9,648 |
| Amortization of patents | 14,472 | 11,730 |
| Marketing, general and administrative expenses (including non-cash stock compensation expense of $4,765 for the three months ended March 31, 2014, and $5,158 for the three months ended March 31, 2013) | 11,693 | 13,851 |
| Research, consulting and other expenses - business development | 992 | 1,024 |
| Total operating costs and expenses | 38,629 | 69,766 |
| Operating income (loss) | (26,051) | 7,095 |
| Other income (loss): | | |
| Interest income | 556 | 442 |
| Net gain (loss) on investments | (447) | 848 |
| Total other income | 109 | 1,290 |
| Income (loss) before benefit from (provision for) income taxes | (25,942) | 8,385 |
| Benefit from (provision for) income taxes | 1,372 | (3,272) |
| Net income (loss) including noncontrolling interests in operating subsidiaries | (24,570) | 5,113 |
| Net loss attributable to noncontrolling interests in operating subsidiaries | 149 | — |
| Net income (loss) attributable to Acacia Research Corporation | $(24,421) | $5,113 |
| Net income (loss) attributable to common stockholders - basic | $(24,628) | $4,973 |
| Net income (loss) attributable to common stockholders - diluted | $(24,628) | $4,974 |
| Basic income (loss) per common share | $(0.51) | $0.10 |
| Diluted income (loss) per common share | $(0.51) | $0.10 |
| Weighted average number of shares outstanding - basic | 48,329,375 | 47,859,774 |
| Weighted average number of shares outstanding - diluted | 48,329,375 | 48,104,242 |
| Cash dividends declared per common share | $0.125 | $— |

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

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

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Net income (loss) attributable to Acacia Research Corporation | $(24,421) | $5,113 |
| Other comprehensive income (loss): | | |
| Unrealized gain (loss) on short-term investments, net of tax of $0 | (476) | 1,697 |
| Reclassification adjustment for (gains) losses included in net income (loss) | 447 | (848) |
| Total other comprehensive income (loss) | (24,450) | 5,962 |
| Comprehensive income attributable to noncontrolling interests | — | — |
| Comprehensive income (loss) attributable to Acacia Research Corporation | $(24,450) | $5,962 |

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

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

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income (loss) including noncontrolling interests in operating subsidiaries | $(24,570) | $5,113 |
| Adjustments to reconcile net income (loss) including noncontrolling interests in operating subsidiaries to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 14,552 | 11,774 |
| Non-cash stock compensation | 4,765 | 5,158 |
| Excess tax benefits from stock-based compensation | — | (709) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (7,199) | (35,508) |
| Prepaid expenses and other assets | (62) | (1,661) |
| Accounts payable and accrued expenses | 740 | 8,430 |
| Royalties and contingent legal fees payable | (6,552) | 24,228 |
| Deferred taxes, net | (2,106) | — |
| Net cash provided by (used in) operating activities | (20,432) | 16,825 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (96) | (241) |
| Purchases of available-for-sale investments | (14,234) | (97,225) |
| Maturities and sales of available-for-sale investments | 48,632 | 53,262 |
| Investments in patents/ patent rights | (987) | (4,010) |
| Net cash provided by (used) in investing activities | 33,315 | (48,214) |
| Cash flows from financing activities: | | |
| Dividends paid to shareholders | (6,255) | — |
| Contributions from noncontrolling interests in operating subsidiary | — | 1,920 |
| Excess tax benefits from stock-based compensation | — | 709 |
| Proceeds from exercises of stock options | 90 | 117 |
| Net cash provided by (used in) financing activities | (6,165) | 2,746 |
| Increase (decrease) in cash and cash equivalents | 6,718 | (28,643) |
| Cash and cash equivalents, beginning | 126,685 | 221,804 |
| Cash and cash equivalents, ending | $133,403 | $193,161 |
| Supplemental schedule of noncash investing activities: | | |
| Patent acquisition costs included in accrued patent acquisition costs | $15,250 | $— |

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

ACACIA RESEARCH CORPORATION
NOTES TO 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. All patent investment, prosecution, licensing and enforcement activities are conducted solely by certain of Acacia’s wholly and majority-owned and controlled operating subsidiaries.

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. Acacia is an intermediary in the patent marketplace, bridging the gap between invention and application, facilitating efficiency and delivering monetary rewards to patent owners.

Acacia’s operating subsidiaries generate revenues and related cash flows from the granting of intellectual property 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.

Basis of Presentation. The accompanying 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. Noncontrolling interests in Acacia’s majority-owned and controlled operating subsidiaries (“noncontrolling interests”) are separately presented as a component of stockholders’ equity in the consolidated statements of financial position for the applicable periods presented. Consolidated net income (loss) is adjusted to include the net (income) loss attributed to noncontrolling interests in the consolidated statements of operations. Refer to the accompanying consolidated financial statements for total noncontrolling interests, net (income) loss attributable to noncontrolling interests and contributions from and distributions to noncontrolling interests, for the applicable periods presented.

A wholly owned subsidiary of Acacia is the general partner of the Acacia Intellectual Property Fund, L.P. (the “Acacia IP Fund”), which was formed in August 2010. The Acacia IP Fund is included in the Company’s consolidated financial statements for the periods presented, as Acacia’s wholly owned subsidiary, as the majority owner and general partner, has the ability to control the operations and activities of the Acacia IP Fund.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America in annual financial statements have been omitted or condensed in accordance with quarterly reporting requirements of the Securities and Exchange Commission (“SEC”). These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013, as reported by Acacia in its Annual Report on

Form 10-K. The year-end consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The consolidated 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, 2014, 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, 2014 are not necessarily indicative of the results to be expected for the entire fiscal year.

ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition. Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been substantially performed pursuant to the terms of the arrangement, (iii) amounts are fixed or determinable, and (iv) the collectibility of amounts is reasonably assured.

In general, revenue arrangements provide for the payment of contractually determined fees in consideration for the grant of certain intellectual property rights for patented technologies owned or controlled by Acacia's operating subsidiaries. These rights typically include some combination of the following: (i) the grant of a non-exclusive, retroactive and future license to manufacture and/or sell products covered by patented technologies owned or controlled by Acacia's operating subsidiaries, (ii) a covenant-not-to-sue, (iii) the release of the licensee from certain claims, and (iv) the dismissal of any pending litigation. The intellectual property rights granted may be perpetual in nature, extending until the expiration of the related patents, or can be granted for a defined, relatively short period of time, with the licensee possessing the right to renew the agreement at the end of each contractual term for an additional minimum upfront payment. Pursuant to the terms of these agreements, Acacia's operating subsidiaries have no further obligation with respect to the grant of the non-exclusive retroactive and future licenses, covenants-not-to-sue, releases, and other deliverables, including no express or implied obligation on Acacia's operating subsidiaries' part to maintain or upgrade the technology, or provide future support or services. Generally, the agreements provide for the grant of the licenses, covenants-not-to-sue, releases, and other significant deliverables upon execution of the agreement, or upon receipt of the minimum upfront payment for term agreement renewals. As such, the earnings process is complete and revenue is recognized upon the execution of the agreement, when collectibility is reasonably assured, or upon receipt of the minimum upfront fee for term agreement renewals, and when all other revenue recognition criteria have been met.

Cost of Revenues. 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 "Cost of revenues" in the accompanying consolidated statements of operations.

Inventor Royalties and Contingent Legal Expenses. Inventor royalties are expensed in the 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 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 consolidated statements of operations.

Contingent legal fees are expensed in the 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. Legal fees advanced by contingent law firms that are required to be paid in the event that no license recoveries are obtained are expensed as incurred and included in liabilities in the consolidated balance sheets.

Use of Estimates.  The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 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, stock-based compensation expense, impairment of marketable securities and intangible assets, the determination of the economic useful life of amortizable intangible assets, income taxes and valuation allowances against net deferred tax assets and the application of the acquisition method of accounting for business combinations, require its most difficult, subjective or complex judgments.

Concentrations. One licensee individually accounted for 39% of revenues recognized during the three months ended March 31, 2014, and three licensees individually accounted for 65%, 14% and 13% of revenues recognized during the three months ended March 31, 2013. Two licensees individually represented approximately 43% and 28% of accounts receivable at March 31, 2014. Two licensees individually represented approximately 60% and 22% of accounts receivable at December 31,

ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2013. For the three months ended March 31, 2014, 16% of revenues were attributable to licensees domiciled in foreign jurisdictions. For the three months ended March 31, 2013, 15% of revenues were attributable to licensees domiciled in foreign jurisdictions.

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. Stock-based compensation expense is recorded only for those awards expected to vest using an estimated forfeiture rate.

Fair Value Measurements. U.S. generally accepted accounting principles define 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:

Level 1 - Observable Inputs: Quoted prices in active markets for identical investments;
Level 2 - Pricing Models with Significant Observable Inputs: Other significant observable inputs, including quoted prices for similar investments, interest rates, credit risk, etc.; and
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.

Investments in Marketable Securities. Investments in securities with original maturities of greater than three months and less than one year and other investments representing amounts that are available for current operations are classified as short-term investments, unless there are indications that such investments may not be readily sold in the short term. The fair values of these investments approximate their carrying values. At March 31, 2014 and December 31, 2013, all of Acacia's short term investments were classified as available-for-sale, which are reported at fair value on a recurring basis using significant observable inputs (Level 1), with related unrealized gains and losses in the value of such securities recorded as a separate component of comprehensive income (loss) in stockholders' equity until realized. Realized and unrealized gains and losses are recorded based on the specific identification method. Interest on all securities is included in interest income.

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

| | March 31, 2014 | | | |
|---|---|---|---|---|
| Security Type | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government fixed income securities[1] | $96,573 | $14 | $(997) | $95,590 |
| Total short-term investments | $96,573 | $14 | $(997) | $95,590 |

(1) Maturity dates ranging from 2014 to 2015.

| | December 31, 2013 | | | |
|---|---|---|---|---|
| Security Type | Cost | Gross Unrealized | Gross Unrealized | Fair Value |

| | | Gains | Losses | |
|---|---|---|---|---|
| U.S. government fixed income securities | $130,971 | $21 | $(975) | $130,017 |
| Total short-term investments | $130,971 | $21 | $(975) | $130,017 |

The gross unrealized loss can be primarily attributed to a combination of market conditions as well as the demand for and duration of the U.S. government fixed income securities. The Company has the ability to hold these securities until maturity, currently has no intent to sell, there is no requirement to sell and the Company believes that it can recover the amortized cost of these investments. The Company has found no evidence of impairment due to credit losses in its portfolio.

ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Therefore, these unrealized losses were recorded in other comprehensive income (loss). However, the Company cannot provide any assurance that its portfolio of short-term marketable securities will not be impacted by adverse conditions in the financial markets, which may require the Company in the future to record an impairment charge for credit losses which could adversely impact its financial results.

Patents. Patents includes the cost of patents or patent rights (hereinafter, collectively "patents"), obtained from third-parties or obtained in connection with business combinations. Capitalized patent costs are amortized utilizing the straight-line method over their remaining economic useful lives, ranging from one to ten years. Certain patent application and prosecution costs incurred to secure additional patent claims, that based on management's estimates are deemed to be recoverable, are capitalized and amortized over the remaining estimated economic useful life of the related patent portfolio.

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 sum of 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 equal to the excess of the asset's carrying value over its fair value is recorded. 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.

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 share 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 consolidated financial statements or consolidated tax returns. A valuation allowance is established to reduce deferred tax assets if all, or some portion, of such assets will more than likely not be realized.

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 made.

A reconciliation of the federal statutory income tax rate and the estimated effective income tax rate for the periods presented is as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| Statutory federal tax rate - benefit (expense) | 35 % | (35 )% |

| | | |
|---|---|---|
| Noncontrolling interests in operating subsidiaries | (1 )% | — % |
| Nondeductible permanent items | (3 )% | (5 )% |
| Other | (1 )% | — % |
| Valuation allowance | (25 )% | 1 % |
| | 5 % | (39 )% |

The change in the valuation allowance for the three months ended March 31, 2014 included valuation allowances recorded for the majority of net operating loss carryfowards and certain other deferred tax assets generated during the period, due to uncertainty regarding future realizability pursuant to guidance set forth in ASC 740, "Income Taxes." In future periods, if the Company determines it will more likely than not be able to realize certain of these amounts, the applicable portion of the

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ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

benefit from the release of the valuation allowance will generally be recognized in the statement of operations in the period the determination is made.

## 3. EARNINGS (LOSS) PER SHARE

The Company computes net income attributable to common stockholders using the two-class method required for capital structures that include participating securities. Under the two-class method, securities that participate in non-forfeitable dividends, such as the Company's outstanding unvested restricted stock, are considered "participating securities."

In applying the two-class method, (i) basic net income (loss) per share is computed by dividing net income (less any dividends paid on participating securities) by the weighted average number of shares of common stock and participating securities outstanding for the period and (ii) diluted earnings per share may include the additional effect of other securities, if dilutive, in which case the dilutive effect of such securities is calculated by applying the two-class method and the treasury stock method to the assumed exercise or vesting of potentially dilutive common shares. The method yielding the more dilutive result is ultimately reported for the applicable period. Potentially dilutive common stock equivalents primarily consist of employee stock options, and restricted stock units for calculations utilizing the two-class method, and also include unvested restricted stock, when utilizing the treasury method.

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

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Numerator (in thousands): | | |
| Basic | | |
| Net income (loss) | $(24,421) | $5,113 |
| Undistributed earnings allocated to participating securities | — | (140) |
| Total dividends declared / paid | (6,255) | — |
| Dividends attributable to common stockholders | 6,048 | — |
| Net income (loss) attributable to common stockholders – basic | $(24,628) | $4,973 |
| | | |
| Diluted | | |
| Net income (loss) | $(24,421) | $5,113 |
| Undistributed earnings allocated to participating securities | — | (139) |
| Total dividends declared / paid | (6,255) | — |
| Dividends attributable to common stockholders | 6,048 | — |
| Net income (loss) attributable to common stockholders – diluted | $(24,628) | $4,974 |
| | | |
| Denominator: | | |
| Weighted-average shares used in computing net income (loss) per share attributable to common stockholders – basic | 48,329,375 | 47,859,774 |
| Effect of potentially dilutive securities: | | |
| Common stock options and restricted stock units | — | 244,468 |
| | 48,329,375 | 48,104,242 |

| | | |
|---|---|---|
| Weighted-average shares used in computing net income (loss) per share attributable to common stockholders – diluted | | |
| Basic net income (loss) per common share | $(0.51 ) | $0.10 |
| Diluted net income (loss) per common share | $(0.51 ) | $0.10 |

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ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Anti-dilutive equity-based incentive awards excluded from the computation of diluted income (loss) per share were immaterial for the applicable periods presented.

Revision of Prior Period Earnings (Loss) Per Share - Two-Class Method. In connection with the preparation of the Company’s Quarterly Report on Form 10-Q as of and for the three months ended September 30, 2013, the Company determined that its basic and diluted net income (loss) per share calculations should have been prepared using the “two-class method.” Previously, basic earnings (loss) per share was computed based upon the weighted-average number of common shares outstanding, excluding unvested restricted stock, and diluted income (loss) per share was computed based upon the weighted-average number of common shares outstanding, including the dilutive effect of common stock equivalents outstanding during the periods, determined by applying the treasury stock method to the assumed exercise of outstanding employee stock options, and the assumed vesting of outstanding unvested restricted stock and restricted stock units.

Pursuant to the guidance set forth in SAB No. 99, "Materiality," the Company concluded that the errors were not material to any of its prior period financial statements. Although the errors were immaterial to prior periods, the prior period financial statements presented herein were revised. The impact of the revision to the comparable prior period earnings (loss) per share calculations using the two-class method were as follows:

| | Three Months Ended March 31, 2013 |
|---|---|
| Numerator (in thousands): | |
| Net income attributable to common stockholders – basic and diluted - As Reported | $5,113 |
| Net income attributable to common stockholders – basic - As Adjusted | $4,973 |
| Net income attributable to common stockholders – diluted - As Adjusted | $4,974 |
| | |
| Denominator: | |
| Weighted-average shares used in computing net income per share attributable to common stockholders – basic - As Reported | 47,859,774 |
| Weighted-average shares used in computing net income per share attributable to common stockholders – basic - As Adjusted | 47,859,774 |
| Weighted-average shares used in computing net income per share attributable to common stockholders – diluted - As Reported | 48,354,444 |
| Weighted-average shares used in computing net income per share attributable to common stockholders – diluted - As Adjusted | 48,104,242 |
| | |
| Basic net income per common share - As Reported | $0.11 |
| Basic net income per common share - As Adjusted | $0.10 |
| Diluted net income per common share - As Reported | $0.11 |
| Diluted net income per common share - As Adjusted | $0.10 |

4. PATENTS

Acacia’s only identifiable intangible assets at March 31, 2014 and December 31, 2013 are patents. Patent-related accumulated amortization totaled $126,795,000 and $112,323,000 as of March 31, 2014 and December 31, 2013, respectively.

Acacia's patents have remaining estimated economic useful lives ranging from one to ten years. The weighted-average remaining estimated economic useful life of Acacia's patents is approximately seven years. The following table presents the scheduled annual aggregate amortization expense as of March 31, 2014 (in thousands):

ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

| | |
|---|---|
| Remainder of 2014 | $37,371 |
| 2015 | 48,586 |
| 2016 | 45,503 |
| 2017 | 44,293 |
| 2018 | 40,421 |
| Thereafter | 74,023 |
| Total | $290,197 |

For the three months ended March 31, 2014 and 2013, Acacia paid patent investment costs totaling $987,000 and $4,010,000, respectively. The underlying patents have estimated economic useful lives of approximately four to ten years. Included in net additions to capitalized patent costs during the three months ended March 31, 2014 are accrued patent investment costs totaling $15,250,000, which are amortized over the estimated economic useful life of the related patents.

During the three months ended March 31, 2014 and 2013, certain operating subsidiaries recovered up-front patent portfolio advances from applicable net licensing proceeds prior to the scheduled amortization of such up-front patent portfolio advances, resulting in the acceleration of amortization expense for the applicable patent related assets. Accelerated amortization expense related to the recovery of up-front patent portfolio advances totaled $48,000 and $483,000 for the three months ended March 31, 2014 and 2013, respectively. Included in amortization of patents for the three months ended March 31, 2014 was accelerated amortization related to the partial write-down of a patent portfolio, due to a reduction in expected estimated future net cash flows, totaling $2,565,000.

## 5. COMMITMENTS AND CONTINGENCIES

In February 2011, Michael Strathmann served a Complaint for Violation of the Insurance Fraud Prevention Act (California Insurance Code Section 1871.7) against Acacia Research Corporation, CombiMatrix Corporation and Dr. Amit Kumar in the Superior Court of the State of California in connection with a prior lawsuit that was settled with Nanogen, Inc. On September 22, 2011, the Superior Court entered Judgment in favor of Acacia Research Corporation, CombiMatrix and Dr. Amit Kumar, dismissed the Complaint and awarded the parties attorneys ' fees and costs. Mr. Strathmann filed an Appeal of the Judgment to the Court of Appeal for the State of California, and filed an undertaking on appeal on November 21, 2011. On October 24, 2012, the Appellate Court reversed the Superior Court's decision, permitted Mr. Strathmann to file an Amended Complaint, and remanded the matter back to the Superior Court for further proceedings. Discovery commenced in this matter, and a Motion for Summary Judgment requesting that judgment be entered in our favor was heard and denied on April 30, 2014. The case is set for trial on June 9, 2014 in the Orange County Superior Court. Acacia believes that there is no merit to Mr. Strathmann's claims and intends to vigorously defend against them. However, there can be no assurance that Acacia will ultimately be successful in this matter. Acacia believes that the results of the above noted litigation will not have a material adverse effect on Acacia’s financial condition, results of operations or liquidity.

### Patent Enforcement and Other Litigation

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 consolidated financial position, results of operations or cash flows.

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.

ACACIA RESEARCH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

6. STOCKHOLDERS' EQUITY

Repurchases of Common Stock. On November 15, 2013, Acacia's Board of Directors authorized a program for repurchases of shares of Acacia's outstanding common stock. Under the stock repurchase program, effective November 15, 2013, Acacia was authorized to purchase in the aggregate up to $70,000,000 of its of its outstanding common stock through the period ending May 14, 2014.

Repurchases may be made from time to time by Acacia in the open market or in block purchases in compliance with applicable Securities and Exchange Commission rules. Repurchases to date were made using existing cash resources and occurred in the open market. The authorization to repurchase shares presented an opportunity to reduce the outstanding share
count and enhance stockholder value. The following are our monthly stock repurchases for the periods presented, all of which were purchased as part of publicly announced plans or programs:

| | Total Number of Shares Purchased | Average Price paid per Share | Approximate Dollar Value of Shares that May Yet be Purchased under the Program | Plan Expiration |
|---|---|---|---|---|
| December 4, 2013 - December 11, 2013 | 600,000 | $13.18 | $ 62,074,000 | May 14, 2014 |
| Totals for 2013 | 600,000 | | | |

Cash Dividends. On April 23, 2013, Acacia announced that its Board of Directors approved the adoption of a cash dividend policy that calls for the payment of an expected total annual cash dividend of $0.50 per common share, payable in the amount of $0.125 per share per quarter. Under the policy, the Company has paid quarterly cash dividends totaling $6,255,000 during the three months ended March 31, 2014. Future cash dividends are expected to be paid on a quarterly basis and will be at the discretion of the Company's Board of Directors.

7. SUBSEQUENT EVENTS

On April 17, 2014, Acacia announced that its Board of Directors approved a quarterly cash dividend payable in the amount of $0.125 per share. The quarterly cash dividend will be paid on May 30, 2014 to stockholders of record at close of business on May 1, 2014. Future cash dividends are expected to be paid on a quarterly basis and will be at the discretion of the Company's Board of Directors.

8. RECENT ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncements - Adopted Effective January 1, 2013.

In July 2013, the FASB issued a new accounting standard addressing when unrecognized tax benefits should be presented as reductions to deferred tax assets for net operating loss carryforwards in the financial statements. This standard is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption and retrospective application is permitted. The adoption of this standard did not have a material impact on the Company's consolidated financial statements and related disclosures.

In March 2013, the FASB issued a new accounting standard addressing the accounting for the cumulative translation adjustment when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. This standard is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this standard did not have a material impact on the Company's consolidated financial statements and related disclosures.

## 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 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, 2013, filed with the SEC on March 3, 2014.

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and 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,” “ant “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 acquisition and development, licensing and enforcement 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, 2013.

### General

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

Our operating subsidiaries invest in, license and enforce patented technologies. Our operating subsidiaries 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 are an intermediary in the patent marketplace, bridging the gap between invention and application, facilitating efficiency and delivering monetary rewards to patent owners.

Our operating subsidiaries 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. Our 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.

We are a leader in licensing patented technologies and have established a proven track record of licensing success with over 1,365 license agreements executed to date, across 169 of our patent licensing and enforcement programs. Currently, on a consolidated basis, our operating subsidiaries own or control the rights to over 200 patent portfolios, which include U.S. patents and certain foreign counterparts, covering technologies used in a wide variety of industries.

Executive Summary

During the periods presented, we continued our business of empowering patent owners and rewarding invention by providing a path to patent monetization for the people and companies who have contributed valuable patented inventions to an industry, but who require a professional, experienced independent third-party licensing partner to get rewarded for those inventions.

Our operating activities for the periods presented were principally focused on the continued investment in and development of our patent licensing and enforcement business, including the continued pursuit of our ongoing patent licensing and enforcement programs and the commencement of new patent licensing and enforcement programs. In addition, we continued our focus on business development, including the acquisition of several additional high quality patent portfolios by certain of our operating subsidiaries and the continued pursuit of additional opportunities to partner with patent owners or invest in patent portfolios, and continue our industry leading patent licensing and enforcement activities.

For the three months ended March 31, 2014, we reported revenues of $12.6 million from 20 new revenue agreements covering 21 different licensing programs, including 3 licensing programs generating initial revenues in the quarter. Cash and investments totaled $229.0 million as of March 31, 2014 as compared to $256.7 million as of December 31, 2013.

During the three months ended March 31, 2014, we invested in 3 new patent portfolios, incurring $16.2 million (including $15.3 million in future payments accrued as of March 31, 2014) of patent portfolio related up-front advances / payments to patent owners with whom we partnered for the licensing of their patented technologies.

Operating activities during the periods presented included the following:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| Revenues (in thousands) | $12,578 | $76,861 |
| New agreements executed | 20 | 29 |
| Licensing and enforcement programs generating revenues | 21 | 31 |
| Licensing and enforcement programs with initial revenues | 3 | 11 |
| New patent portfolios | 3 | 9 |
| Cumulative number of licensing and enforcement programs generating revenues - inception to date | 169 | 154 |

We measure and assess the performance and growth of the patent licensing and enforcement businesses conducted by our operating subsidiaries based on consolidated revenues recognized across all of our technology licensing and enforcement programs on a trailing twelve-month basis. Trailing twelve-month revenues during the periods presented were as follows (in thousands, except percentage change values):

| As of Date: | Trailing Twelve -Month Revenues | % Change |
|---|---|---|
| March 31, 2014 | $66,273 | (49)% |
| December 31, 2013 | $130,556 | (28)% |

| | | |
|---|---|---|
| September 30, 2013 | $181,755 | (10)% |
| June 30, 2013 | $201,174 | (12)% |
| March 31, 2013 | $228,548 | —% |

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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 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; and
- other external factors, including the periodic status or results of ongoing negotiations, the status of ongoing litigations, actual or perceived shifts in the regulatory environment, impact of unrelated patent related judicial proceedings and other macroeconomic factors.

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, most likely, 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.

Although revenues from one or more of our patents or patent portfolios may be significant in a specific reporting period, we believe that none of our individual patents or patent portfolios is individually significant to our licensing and enforcement business as a whole

Going forward, we have strategically chosen to shift the focus of our operating business to increasingly serve a smaller number of customers each having higher quality patent portfolios. High quality patent portfolios are typically associated with higher numbers of varied defensible claims, higher revenue potential, originating from high-pedigreed patent owners and/or possessing a relatively large number of prospective licensees. In this regard, in 2014, we have continued the shift in our focus at our point of patent intake from quantity to quality.

We continue to identify and assess additional opportunities to partner with companies in the technology, energy, medical technology and other sectors for the licensing and enforcement of their high quality patented technologies, and are also expanding our activity in international markets, both of which we expect will expand and diversify our future revenue generating opportunities.

Revenues for the three months ended March 31, 2014 included fees from the following technology licensing and enforcement programs:

- 3G & 4G Wireless Patents
- 4G Wireless technology
- Audio Communications Fraud Detection technology
- Broadband Communications technology
- Computer-Aided Design technology(1)
- Core Fiber Optic Network Architectures technology
- DMT technology
- Electronic Access Control technology(1)
- Gas Modulation Control Systems technology
- Improved Lighting technology
- Messaging technology
- Online Gaming technology
- Reflective and Radiant Barrier Insulation technology
- Semiconductor Packaging technology
- Software Activation technology
- Super Resolutions Microscopy technology(1)
- Suture Anchors technology
- Telematics technology
- Video Analytics for Security technology
- Wireless Monitoring technology
-

Interstitial and Pop-Up Internet Advertising technology

(1) Initial revenues recognized during the three months ended March 31, 2014

Revenues for the three months ended March 31, 2013 included fees from the following technology licensing and enforcement programs:

- 4G Wireless Handsets technology[1]
- Audio Communications Fraud Detection technology
- Camera Support technology
- Computer Architecture and Power Management technology
- Digital Imaging technology[1]
- Digital Signal Processing Architecture technology
- DMT® technology
- Domain Name Redirection technology
- Electronic spreadsheet, data analysis and software development technology[1]
- Enhanced Mobile Communications technology
- Facilities Operation Management System technology
- Gas Modulation Control Systems technology[1]
- Greeting Card technology[1]
- Improved Memory Manufacturing technology
- Intercarrier SMS technology[1]
- Location Based Services technology
- Memory Circuit and Packaging technology[1]
- Messaging technology
- Mobile Computer Synchronization technology
- NOR Flash technology
- Online Auction Guarantee technology
- Online Gaming technology
- Pop-up Internet Advertising technology
- Power Management Within Integrated Circuits technology
- Prescription Lens technology[1]
- Semiconductor Memory and Process technology[1]
- Surgical Access technology
- Suture Anchors technology
- Telematics technology
- Wireless Data Synchronization & Data Transfer technology[1]
- Wireless Location Based Services technology[1]

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(1) Initial revenues recognized during the three months ended March 31, 2013

Summary of Results of Operations - Overview
For the Three Months Ended March 31, 2014 and 2013
(In thousands, except percentage change values)

| | Three Months Ended March 31, 2014 | 2013 | % Change |
|---|---|---|---|
| Revenues | $12,578 | $76,861 | (84 )% |
| Operating costs and expenses | 38,629 | 69,766 | (45 )% |
| Operating income (loss) | (26,051 ) | 7,095 | (467 )% |
| Benefit from (provision for) income taxes | 1,372 | (3,272 ) | (142 )% |
| Net income (loss) attributable to Acacia Research Corporation | (24,421 ) | 5,113 | (578 )% |

Overview - Three months ended March 31, 2014 compared with the three months ended March 31, 2013

- Revenues decreased $64.3 million, or 84%, to $12.6 million, as compared to $76.9 million in the comparable prior year quarter, due primarily to a decrease in the average revenue per executed agreement and a decrease in the total number of agreements executed.

- Cost of Revenues and Other Operating Expenses:

- Inventor royalties and contingent legal fees, on a combined basis, decreased $31.0 million, or 93%, as compared to the 84% decrease in related revenues for the same periods, due primarily to a higher percentage of revenues generated during the three months ended March 31, 2014 having, on average, no inventor royalty or contingent legal fee obligations and lower overall average inventor royalty rates, as compared to the revenues generated during the three months ended March 31, 2013.

- Litigation and licensing expenses-patents decreased $654,000, or 7%, to $9.0 million, due primarily to a net decrease in litigation costs, which were partially offset by an increase in strategic and other patent related prosecution costs associated with ongoing and new licensing and enforcement programs commenced since the end of the comparable prior year quarter.

- Amortization of patents increased $2.7 million, or 23%, to $14.5 million, due primarily to an increase in scheduled amortization expense for patent portfolios invested in since the end of the prior period totaling $981,000 and accelerated amortization related to patent portfolio write-downs totaling $2,565,000. The increase was partially offset by a decrease in accelerated patent amortization related to the recoupment of upfront advances to partners of $435,000 and other scheduled amortization totaling $369,000.

- Marketing, general and administrative expenses decreased $2.2 million, or 16%, to $11.7 million, due primarily to a decrease in variable performance-based compensation costs and a decrease in other corporate, general and administrative costs.

- The effective tax rates were 5% and (39%) for the three months ended March 31, 2014 and 2013, respectively. The effective rate for the first quarter of 2014 reflects the impact of an increase in the valuation allowance recorded for certain tax assets generated during the three months ended March 31, 2014.

Investments in Patent Portfolios

We also measure and assess the performance and growth of the patent licensing and enforcement businesses conducted by our operating subsidiaries based on patent portfolio partnering / intake opportunities closed by our operating subsidiaries on a consolidated basis during the applicable reporting periods. During the three months ended March 31, 2014, patent portfolio intake activities included the following:

- In February 2014, we partnered with a leading research institute to monetize the institute's patents relating to ceramics and associated manufacturing processes for medical devices.

- In March 2014, we invested in U.S. patents and foreign counterparts related to the use of shared memory in multimedia processing systems such as mobile phones, tablets and other consumer electronic devices.

Refer to "Liquidity and Capital Resources" below for information regarding the impact on the consolidated financial statements of upfront advances in connection with patent partnering and investment arrangements entered into during the periods presented.

As of March 31, 2014, certain of our operating subsidiaries had several patent partnering option agreements with third-party patent portfolio owners regarding potential additional patent portfolio partnering / investment opportunities. Future patent portfolio intake arrangements will continue to expand and diversify our future revenue generating opportunities. Our 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.

Patent Licensing and Enforcement

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 acquisition, 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;

- 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; and

- 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.

Critical Accounting Estimates

Our unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these consolidated statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these consolidated financial statements. 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, 2013. Refer to Note 2 to the consolidated financial statements included in this report.

Consolidated Results of Operations
Comparison of the Results of Operations for the Three Months Ended March 31, 2014 and 2013

Revenues (in thousands)

| | Three Months Ended March 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | $ | % |
| Revenues (in thousands, except percentage change values) | $12,578 | $76,861 | $(64,283) | (84)% |
| New agreements executed | 20 | 29 | | |
| Average revenue per agreement (in thousands) | $629 | $2,650 | | |

A reconciliation of the change in revenues for the periods presented, in relation to the revenues reported for the comparable prior year period, is as follows:

| | Three Months Ended March 31, 2014 vs. 2013 (in thousands) |
|---|---|
| Decrease in number of agreements executed | $(23,853) |
| Decrease in average revenue per agreement executed | (40,430) |
| Total change in revenues | $(64,283) |

One licensee individually accounted for 39% of revenues recognized during the three months ended March 31, 2014, and three licensees individually accounted for 65%, 14%, and 13% of revenues recognized during the three months ended March 31, 2013.

Cost of Revenues

| | Three Months Ended March 31, | | Change | |
|---|---|---|---|---|
| | 2014 | 2013 | $ | % |
| | (in thousands, except percentage change values) | | | |
| Inventor royalties | $951 | $18,481 | $(17,530) | (95)% |
| Contingent legal fees | 1,527 | 15,032 | (13,505) | (90)% |
| Total | $2,478 | $33,513 | $(31,035) | (93)% |

Inventor Royalties and Contingent Legal Fees Expense. 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. A summary of the main drivers of the change in inventor royalties expense and contingent legal fees expense for the comparable periods presented, is as follows (in thousands, except percentage change values):

| | Three Months Ended March 31, 2014 vs. 2013 | % |
|---|---|---|
| Inventor Royalties: | | |
| Decrease in total revenues | $(16,456) | 94 % |
| Decrease in inventor royalty rates | (292) | 2 % |
| Decrease in percentage of revenues without inventor royalty obligations | (782) | 4 % |
| Total change in inventor royalties expense | $(17,530) | 100 % |
| Contingent Legal Fees: | | |
| Decrease in total revenues | $(13,207) | 98 % |
| Decrease in contingent legal fee rates | (25) | — % |
| Decrease in percentage of revenues without contingent legal fee obligations | (273) | 2 % |
| Total change in contingent legal fees expense | $(13,505) | 100 % |

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Litigation and licensing expenses - patents | $8,994 | $9,648 |
| Amortization of patents | 14,472 | 11,730 |

Litigation and Licensing Expenses - Patents. Litigation and licensing expenses-patents include patent-related prosecution and enforcement costs incurred by outside patent attorneys engaged on an hourly basis and the out-of-pocket expenses incurred by law firms engaged on a contingent fee basis. Litigation and licensing expenses-patents also includes licensing and enforcement related third-party patent research, development, consulting, and other costs incurred in connection with the licensing and enforcement of patent portfolios.

Litigation and licensing expenses-patents decreased for the periods presented due primarily to a net decrease in litigation costs, which were partially offset by an increase in strategic and other patent related prosecution costs associated with ongoing and new licensing and enforcement programs commenced since the end of the comparable prior year quarter. We expect patent-related legal expenses to continue to fluctuate period to period as we incur increased costs related to upcoming scheduled and/or anticipated trial dates, international enforcement activities and strategic patent portfolio prosecution activities over the next several fiscal quarters, as we continue to focus on our investments in these areas.

Amortization of Patents. The change in amortization expense for the comparable periods presented was due to the following:

| | Three Months Ended March 31, 2014 vs. 2013 (in thousands) |
|---|---|
| Amortization of patent portfolios obtained since the end of the comparable prior year period | $981 |
| Decrease in scheduled amortization related to patent portfolio investments made prior to the current period | (369) |
| Decrease in accelerated amortization related to recovery of upfront advances | (435) |
| Partial patent portfolio write-down | 2,565 |
| Total change in patent amortization expense | $2,742 |

Included in amortization of patents for the three months ended March 31, 2014 was accelerated amortization related to the partial write-down of a patent portfolio, due to a reduction in expected estimated future net cash flows, totaling $2,565,000.

Operating Expenses (in thousands)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| Marketing, general and administrative expenses | $6,928 | $8,693 |
| Non-cash stock compensation expense | 4,765 | 5,158 |
| Total marketing, general and administrative expenses | $11,693 | $13,851 |

Marketing, General and Administrative Expenses. Marketing, general and administrative expenses include employee compensation and related personnel costs, including variable performance based compensation and non-cash stock compensation expenses, office and facilities costs, legal and accounting professional fees, public relations, marketing, stock administration, state taxes based on gross receipts and other corporate costs. A summary of the main drivers of the change in marketing, general and administrative expenses for the periods presented, is as follows:

| | Three Months Ended March 31, 2014 vs. 2013 (in thousands) |
|---|---|
| Licensing, business development, engineering and other personnel costs | $185 |
| Variable performance-based compensation costs and other corporate, general and administrative costs | (1,427) |
| Corporate, general and administrative costs | (1,048) |
| Non-cash stock compensation expense | (393) |
| Non-recurring employee severance costs | 525 |
| Total change in marketing, general and administrative expenses | $(2,158) |

Income Taxes

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |

| | | |
|---|---|---|
| Benefit from (provision for) income taxes (in thousands) | $1,372 | $(3,272) |
| Effective tax rate | 5% | 39% |

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Benefit from (Provision for) Income Taxes. Tax benefit (expense) for the periods presented included the impact of the following:

- The tax benefit for the three months ended March 31, 2014 reflects the application of an estimated annual effective tax rate to the GAAP pre-tax net loss reported for the first quarter of 2014 and the impact of an increase in the valuation allowance recorded for a portion of net operating losses and certain other deferred tax assets generated during the three months ended March 31, 2014.

- Our effective tax rate for the three months ended March 31, 2013 was approximately 39%, mainly comprised of U.S. federal and state incomes taxes, foreign withholding taxes and nondeductible permanent expenses.

Other

Revision of Prior Period Earnings (Loss) Per Share - Two-Class Method. In connection with the preparation of our Quarterly Report on Form 10-Q as of and for the three months ended September 30, 2013, we determined that our basic and diluted net income (loss) per share calculations should have been prepared using the “two-class method.” Under the two-class method, securities that participate in dividends are considered “participating securities.” Our unvested restricted shares outstanding are considered “participating securities” because they include non-forfeitable rights to dividends.

Pursuant to the guidance of Staff Accounting Bulletin (“SAB”) No. 99, "Materiality," we concluded that the errors were not material to any of our prior period financial statements. Although the errors were immaterial to prior periods, the prior period financial statements presented herein were revised, in accordance with SAB No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." Refer to Note 3 to the consolidated financial statements included in this report.

Liquidity and Capital Resources

General

Our primary sources of liquidity are cash, cash equivalents and investments on hand generated from our operating activities and proceeds from previous equity financings.

Our management believes that our cash and cash equivalent balances, investments, anticipated cash flows from operations, and other external sources of available credit will be sufficient to meet our cash requirements through at least May 2015 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 under the caption “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2013. 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 since late 2007, and the volatility and impact of the disruption has continued into 2014. At times during this period, the volatility and disruption has reached unprecedented levels. In several cases, the markets have exerted downward pressure on stock prices and credit capacity for certain issuers, and the commercial paper markets may not be a reliable source of short-term financing for us. 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.

Cash, Cash Equivalents and Investments

Our consolidated cash and cash equivalents and investments on hand totaled $229.0 million at March 31, 2014, compared to $256.7 million at December 31, 2013. The net change in cash and cash equivalents for the periods presented was comprised of the following (in thousands):

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Net cash provided by (used in): | | |
| Operating activities | $(20,432) | $16,825 |
| Investing activities | 33,315 | (48,214) |
| Financing activities | (6,165) | 2,746 |

Cash Flows from Operating Activities.  Cash receipts from licensees for the three months ended March 31, 2014 decreased to $5.4 million, from $41.4 million in the comparable 2013 period, primarily reflecting the net decrease in revenues for the same periods, as discussed above. Cash outflows from operations for the three months ended March 31, 2014 increased to $25.8 million, as compared to $24.5 million in the comparable 2013 period, primarily due to the net impact of the timing of cash receipts from licensees and 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):

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Purchases of property and equipment | $(96) | $(241) |
| Purchases of available-for-sale investments | (14,234) | (97,225) |
| Maturities and sales of available-for-sale investments | 48,632 | 53,262 |
| Investments in patents/ patent rights | (987) | (4,010) |
| Net cash provided by (used in) investing activities | $33,315 | $(48,214) |

Cash Flows from Financing Activities. Cash flows from financing activities and related changes included the following for the periods presented (in thousands):

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Dividends paid to shareholders | (6,255) | — |
| Contributions from noncontrolling interests in operating subsidiary | — | 1,920 |
| Excess tax benefits from stock-based compensation | — | 709 |
| Proceeds from exercises of stock options | 90 | 117 |
| Net cash provided by (used in) financing activities | $(6,165) | $2,746 |

On April 23, 2013, we announced that our Board of Directors approved the adoption of a cash dividend policy that calls for the payment of an expected total annual cash dividend of $0.50 per common share, payable in the amount of $0.125 per share per quarter. Under the policy, we paid cash dividends totaling $6.3 million during the three months ended March 31, 2014.

Repurchases of Common Stock. On November 15, 2013, our Board of Directors authorized a program for repurchases of shares of our outstanding common stock. Under the stock repurchase program, effective November 15, 2013, we are authorized to purchase in the aggregate up to $70,000,000 of our outstanding common stock through the period ending May 14, 2014. Repurchases may be made from time to time by us in the open market or in block purchases in compliance with applicable Securities and Exchange Commission rules. Refer to the notes to the consolidated financial statements included elsewhere herein for additional information.

Working Capital

Working capital at March 31, 2014 decreased to $217.8 million, compared to $247.7 million at December 31, 2013. Consolidated accounts receivable from licensees increased to $13.5 million at March 31, 2014, compared to $6.3 million at December 31, 2013. Consolidated royalties and contingent legal fees payable decreased to $3.9 million at March 31, 2014, compared to $10.4 million at December 31, 2013.

The majority of accounts receivable from licensees at March 31, 2014 were collected or scheduled to be collected in the second quarter of 2014, in accordance with the terms of the related underlying agreements. The majority of royalties and contingent legal fees payable are scheduled to be paid in the second or third quarter of 2014, subsequent to receipt by us of the related fee payments from licensees, in accordance with the underlying contractual arrangements.

Off-Balance Sheet Arrangements

We have not entered into off-balance sheet financing arrangements, other than operating leases. We have no significant commitments for capital expenditures in 2014. We have no committed lines of credit or other committed funding or long-term debt. The following table lists our known contractual obligations and future cash commitments as of March 31, 2014 (in thousands):

| | Payments Due by Period (In thousands) | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Operating leases | $4,653 | $1,041 | $2,471 | $643 | $498 |
| Scheduled patent acquisition related payments | 19,250 | 19,250 | — | — | — |
| Total contractual obligations | $23,903 | $20,291 | $2,471 | $643 | $498 |

Uncertain Tax Positions. At March 31, 2014, we had total unrecognized tax benefits of approximately $857,000, including a recorded noncurrent liability of $85,000, related to unrecognized tax benefits primarily associated with state taxes. No interest and penalties have been recorded for the unrecognized tax benefits as of March 31, 2014. If recognized, approximately $857,000 would impact our effective tax rate. We do not expect that the liability for unrecognized tax benefits will change significantly within the next 12 months. There was no activity related to the gross unrecognized tax benefits for the periods presented.

Recent Accounting Pronouncements

Refer to Note 8 to the consolidated financial statements included in this report.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary objective of our investment activities is to preserve principal while concurrently maximizing the income we receive from our 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 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, 2014, 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 highly liquid, AAA, U.S. government securities.

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 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.

## Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures.

Our management, with the participation and under the supervision of our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of the end of the period covered by this quarterly report. Based on that evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report 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 executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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, 2014) 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 CEO and CFO, 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 6. EXHIBITS

| EXHIBIT NUMBER | EXHIBIT |
|---|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934 |
| 32.1 | Certification of Chief 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 |
| 32.2 | Certification of Chief 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 |
| 101 | Interactive Data Files Pursuant to Rule 405 of Regulation S-T |

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/ Matthew Vella
By: Matthew Vella
Chief Executive Officer and President
(Principal Executive Officer and Duly Authorized Signatory)

/s/ Clayton J. Haynes
By: Clayton J. Haynes
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

Date: May 9, 2014

EXHIBIT INDEX

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| 32.1 | Certification of Chief 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 |
| 32.2 | Certification of Chief 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 |
| 101 | Interactive Data Files Pursuant to Rule 405 of Regulation S-T. |