

ACACIA RESEARCH CORP  
Form 10-Q  
April 29, 2011

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, 2011

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: 0-26068

---

ACACIA RESEARCH CORPORATION  
(Exact name of registrant as specified in its charter)

---

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

500 Newport Center Drive, Newport Beach, California 92660  
(Address of principal executive offices)

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

(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 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).  Yes  No

Edgar Filing: ACACIA RESEARCH CORP - Form 10-Q

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

Accelerated filer

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

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  No

As of April 27, 2011, 42,771,406 shares of the registrant's common stock, \$0.001 par value, were issued and outstanding.

---

ACACIA RESEARCH CORPORATION  
Table Of Contents

Part I. Financial Information

Item 1. <u>Financial Statements</u>	<u>1</u>
<u>Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010 (Unaudited)</u>	<u>1</u>
<u>Consolidated Statements of Operations for the Three Months Ended March 31, 2011 and 2010 (Unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2011 and 2010 (Unaudited)</u>	<u>3</u>
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>4</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>10</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>20</u>
Item 4. <u>Controls and Procedures</u>	<u>20</u>

Part II. Other Information 21

Item 6. <u>Exhibits</u>	<u>21</u>
-------------------------	-----------

Signatures	<u>22</u>
------------	-----------

Exhibit Index	<u>23</u>
---------------	-----------

## 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, 2011	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$313,611	\$102,515
Accounts receivable	1,198	7,987
Prepaid expenses and other current assets	2,167	1,679
Total current assets	316,976	112,181
Property and equipment, net of accumulated depreciation	172	135
Patents, net of accumulated amortization	17,586	19,803
Investments - noncurrent	1,975	2,001
Other assets	513	664
	\$337,222	\$134,784
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$9,179	\$7,099
Royalties and contingent legal fees payable	21,736	12,760
Total current liabilities	30,915	19,859
Other liabilities	649	1,072
Total liabilities	31,564	20,931
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; 42,739,368 and 36,029,068 shares issued and outstanding as of March 31, 2011 and December 31, 2010, respectively	43	36
Additional paid-in capital	375,271	197,026
Accumulated deficit	(73,838)	(86,191)
Total Acacia Research Corporation stockholders' equity	301,476	110,871
Noncontrolling interests in operating subsidiaries	4,182	2,982
Total stockholders' equity	305,658	113,853
	\$337,222	\$134,784

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



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

	Three Months Ended	
	March 31, 2011	March 31, 2010
Revenues	\$61,130	\$39,772
Operating costs and expenses:		
Cost of revenues:		
Inventor royalties	13,089	3,911
Contingent legal fees	9,367	4,407
Litigation and licensing expenses - patents	3,534	3,696
Amortization of patents	3,772	1,703
Marketing, general and administrative expenses (including non-cash stock compensation expense of \$2,901 and \$1,895 for the three months ended March 31, 2011 and 2010, respectively)	9,985	6,332
Research, consulting and other expenses - business development	708	372
Total operating costs and expenses	40,455	20,421
Operating income	20,675	19,351
Other income:		
Interest income	20	19
Gain on investments	9	—
Total other income	29	19
Income from operations before provision for income taxes	20,704	19,370
Provision for income taxes	(7,148	) (321
Net income including noncontrolling interests in operating subsidiaries	13,556	19,049
Net income attributable to noncontrolling interests in operating subsidiaries	(1,203	) (537
Net income attributable to Acacia Research Corporation	\$12,353	\$18,512
Net income per common share attributable to Acacia Research Corporation:		
Basic income per share	\$0.35	\$0.60
Diluted income per share	\$0.34	\$0.55
Weighted average number of shares outstanding, basic	35,182,811	30,847,403
Weighted average number of shares outstanding, diluted	36,448,005	33,411,093

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, 2011	March 31, 2010
Cash flows from operating activities:		
Net income including noncontrolling interests in operating subsidiaries	\$13,556	\$19,049
Adjustments to reconcile net income including noncontrolling interests in operating subsidiaries to net cash provided by operating activities:		
Depreciation and amortization	3,794	1,728
Non-cash stock compensation	2,901	1,895
Gain on investments	(9	) —
Changes in assets and liabilities:		
Accounts receivable	6,789	3,275
Prepaid expenses and other assets	(337	) (406
Accounts payable and accrued expenses	782	71
Royalties and contingent legal fees payable	8,976	(5,008
Deferred revenues	—	(1,500
Net cash provided by operating activities	36,452	19,104
Cash flows from investing activities:		
Purchases of property and equipment	(59	) (9
Sale of available-for-sale investments	35	—
Patent acquisition costs	(680	) (1,320
Net cash used in investing activities	(704	) (1,329
Cash flows from financing activities:		
Proceeds from sale of common stock, net of issuance costs	175,284	—
Distributions to noncontrolling interests in operating subsidiary	(880	) (2,484
Contributions from noncontrolling interests in operating subsidiary	877	—
Excess tax benefits from stock-based compensation	23	—
Proceeds from exercises of stock options	44	499
Net cash provided by (used in) financing activities	175,348	(1,985
Increase in cash and cash equivalents	211,096	15,790
Cash and cash equivalents, beginning	102,515	51,735
Cash and cash equivalents, ending	\$313,611	\$67,525



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

3

---

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 intellectual property acquisition, development, licensing and enforcement activities are conducted solely by certain of Acacia's wholly and majority-owned and controlled operating subsidiaries.

Acacia's operating subsidiaries acquire, develop, license and otherwise enforce patented technologies. Acacia's operating subsidiaries generate revenues and related cash flows from the granting of intellectual property rights for the use of, or pertaining to, patented technologies that such operating subsidiaries own or control. Acacia's operating subsidiaries assist patent owners with the prosecution and development of their patent portfolios, the protection of their patented technologies from unauthorized use, the generation of revenue from users of their patented technologies and, if necessary, the enforcement against unauthorized users of their patented technologies. Currently, on a consolidated basis, Acacia's operating subsidiaries own or control the rights to over 177 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 or (loss) is adjusted to include the net (income) or loss attributed to noncontrolling interests in the consolidated statements of operations for the applicable periods presented. Refer to the accompanying consolidated financial statements for total noncontrolling interests, and net income attributable to noncontrolling interests, for the applicable periods presented.

In August 2010, a wholly owned subsidiary of Acacia became 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 authorized to raise up to \$250 million. The Acacia IP Fund acquires, licenses and enforces intellectual property consisting primarily of patents, patent rights, and patented technologies. 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 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, 2010, 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 financial position as of March 31, 2011, and results of its operations and its cash flows for the interim periods presented. The results of operations for the three months ended March 31, 2011 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 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

ACACIA RESEARCH CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 acquisition 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, costs paid by Acacia's operating subsidiaries to acquire patents are recoverable from future net revenues. Patent acquisition 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 patent acquisition costs 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.

During the three months ended March 31, 2011 and 2010, Acacia entered into significant agreements with unrelated third parties resolving pending patent matters that resulted in the grant of certain intellectual property rights and recognition of revenues, a portion of which were not subject to inventor royalty and contingent legal fee arrangements, as well as the grant of licenses from certain of Acacia's operating subsidiaries and recognition of revenues that were subject to inventor royalties and contingent legal fee arrangements. Revenues recognized subject to inventor royalties and contingent legal fees are based on a determination by the respective operating subsidiaries.

**Use of Estimates.** The preparation of 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, and impairment of marketable securities, require its most difficult, subjective or complex judgments.

Concentrations. Two licensees individually accounted for 74% and 11% of revenues recognized during the three months ended March 31, 2011, and two licensees individually accounted for 63% and 13% of revenues recognized during the three months ended March 31, 2010. Five licensees individually represented approximately 25%, 18%, 16%, 15% and 13% of accounts receivable at March 31, 2011. One licensee represented approximately 74% of accounts receivable at December 31, 2010.

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

ACACIA RESEARCH CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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.

**Impairment of Marketable Securities.** Acacia evaluates its investments in marketable securities for potential impairment, employing a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence. If the cost or carrying value of an investment exceeds its estimated fair value, the Company evaluates, among other factors, general market conditions, credit quality of instrument issuers, the duration and extent to which the fair value is less than cost, and the Company's intent and ability to hold, or plans or ability to sell. Fair value is estimated based on publicly available market information or other estimates determined by management. Investments are considered to be impaired when a decline in fair value is estimated to be other-than-temporary. Acacia reviews impairments associated with its investments in marketable securities and determines the classification of any impairment as temporary or other-than-temporary. An impairment is deemed other-than-temporary unless (a) Acacia has the ability and intent to hold an investment for a period of time sufficient for recovery of its carrying amount and (b) positive evidence indicating that the investment's carrying amount is recoverable within a reasonable period of time outweighs any evidence to the contrary. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, the carrying amount of the investment is recoverable within a reasonable period of time. For investments classified as available-for-sale, unrealized losses that are other-than-temporary are recognized in the consolidated statements of operations.

**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 its estimate of the annual effective tax rate, and if the estimated tax rate changes, a cumulative adjustment is made. For the three months ended March 31, 2011, the provision for income taxes related primarily to Korean foreign withholding taxes totaling \$7,425,000, withheld by the Korean tax authority pursuant to the requirements of the United States - Republic of Korea Income Tax Convention, on a payment in connection with a revenue arrangement executed during the three months ended March 31, 2011. Excluding the impact of foreign withholding taxes, the 2011 annual effective tax rate is estimated to be lower than the 35% U.S. federal statutory rate due primarily to the anticipated utilization of available net operating loss ("NOL") carryforwards to reduce U.S. taxable income. For the

three months ended March 31, 2010, the provision for income taxes related primarily to state tax liabilities in jurisdictions where certain of Acacia's operating subsidiaries file separate state tax returns.

At December 31, 2010, Acacia had U.S. federal and state income tax NOLs totaling approximately \$99,267,000 and \$61,681,000, expiring between 2020 and 2030, and 2011 and 2020, respectively. Due to uncertainties surrounding Acacia's ability to generate future taxable income to fully realize these assets, a full valuation allowance has been established to offset its estimated unutilized net deferred tax assets at each balance sheet date. Utilization of NOLs and credit carryforwards can be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by Section 382 of the Internal Revenue Code of 1986, as amended, as well as similar state provisions. Currently, Acacia estimates that it will have sufficient NOL carryforwards to offset estimated taxable income, if any, for the periods presented.

ACACIA RESEARCH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### 3. EARNINGS PER SHARE

Earnings Per Share. Basic income per share is computed based upon the weighted-average number of common shares outstanding, excluding unvested restricted stock. Diluted income per share is computed based upon the weighted-average number of common shares outstanding, including the dilutive effect of common stock equivalents outstanding during the periods. Potentially dilutive common stock equivalents primarily consist of employee stock options, unvested restricted stock, and restricted stock units (“Equity-based Incentive Awards”).

Potentially dilutive common shares from Equity-based Incentive Awards are 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. 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,	
	2011	2010
Weighted-average common shares outstanding - basic	35,182,811	30,847,403
Dilutive effect of Equity-based Incentive Awards	1,265,194	2,563,690
Weighted-average common shares outstanding - diluted	36,448,005	33,411,093
Equity-based Incentive Awards excluded from the computation of diluted income per share because the effect of inclusion would have been anti-dilutive	7,760	277,351

### 4. PATENTS

Acacia's only identifiable intangible assets at March 31, 2011 and December 31, 2010, are patents and patent rights. Patent-related accumulated amortization totaled \$34,320,000 and \$31,198,000 as of March 31, 2011 and December 31, 2010, respectively.

Acacia's patents and patent rights have remaining estimated economic useful lives ranging from one to seven years. The weighted-average remaining estimated economic useful life of Acacia's patents and patent rights is five years. As of March 31, 2011, scheduled annual aggregate amortization expense is estimated to be \$4,049,000 for the remainder of 2011, \$3,704,000 in 2012, \$3,322,000 in 2013, \$2,826,000 in 2014 and \$2,199,000 in 2015. For all periods presented, all acquired intangible assets were subject to amortization.

For the three months ended March 31, 2011 and 2010, Acacia paid patent / patent rights acquisition costs totaling \$680,000 and \$1,320,000, respectively. The patents and patent rights acquired have estimated economic useful lives of approximately one to seven years. Included in net additions to capitalized patent costs during the three months ended March 31, 2011 are accrued future patent acquisition costs totaling \$875,000, which management expects to incur pursuant to the terms of the underlying patent acquisition agreements. Accrued future patent acquisition costs are amortized over the estimated economic useful life of the related patents acquired.

During the three months ended March 31, 2011, certain operating subsidiaries recovered up-front patent portfolio acquisition costs from applicable net licensing proceeds pursuant to the provisions of the underlying inventor agreements, prior to the scheduled amortization of such up-front patent portfolio acquisition costs, resulting in the acceleration of amortization expense for the applicable patent related assets. Accelerated amortization expense related to the recovery of up-front patent acquisition costs totaled \$2,383,000 and \$406,000, for the three months ended



March 31, 2011 and 2010, respectively.

5. COMMITMENTS AND CONTINGENCIES

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

7

---

ACACIA RESEARCH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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, and if required to be paid by Acacia or its operating subsidiaries, could materially harm the Company's operating results and financial position.

#### 6. FAIR VALUE MEASUREMENTS AND AUCTION RATE SECURITIES

As of March 31, 2011 and December 31, 2010, Acacia held investment grade auction rate securities with a par value totaling \$2,450,000 and \$2,485,000, respectively, consisting of auction rate investments backed by student loans, issued under programs such as the Federal Family Education Loan Program, which are reflected at estimated fair value.

Due to current liquidity issues in the global credit and capital markets, these securities have continued to experience failed auctions since February 2008. In the event of a failed auction, the auction rate securities continue to pay interest at the maximum contractual rate in accordance with their terms; however, Acacia may not be able to access the par value of the invested funds until a future auction of these investments is successful, the security is called by the issuer, or a buyer is found outside of the auction process.

The fair values of these securities are estimated utilizing an analysis of certain unobservable inputs and by reference to a discounted cash flow analysis as of March 31, 2011. These analyses considered, among other items, the underlying structure of each security, the collateral underlying the security investments, the creditworthiness of the counterparty, the present value of future principal and contractual interest payments discounted at rates considered to be reflective of current market conditions, consideration of the probabilities of default, continued auction failure, or repurchase or redemption at par for each period, and estimates of the time period over which liquidity related issues will be resolved. Observable market data for instruments with similar characteristics to Acacia's auction rate securities was also considered when possible.

Due to the estimate that the market for these student loan collateralized instruments may take in excess of twelve months to fully recover, Acacia has classified these investments as noncurrent assets in the accompanying consolidated balance sheets. Further, as a result of the analysis described above, Acacia recorded an other-than-temporary loss of \$296,000 and \$263,000 in the consolidated statements of operations for the years ended December 31, 2009 and 2008, respectively. As a result of partial redemptions at par on certain of these auction rate securities subsequent to June 30, 2008, Acacia recorded realized gains totaling \$67,000, reflecting a partial recovery of the other-than-temporary loss originally recorded on these securities. As of March 31, 2011 and December 31, 2010, the net other-than-temporary loss on auction rate securities collateralized by student loan portfolios totaled \$475,000 and \$484,000, respectively.

The following table presents the auction rate securities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the interim periods presented (in thousands):

	Three Months Ended March 31,	
	2011	2010
Balance as of January 1	\$2,001	\$2,152
Total gains (realized or unrealized):		

Edgar Filing: ACACIA RESEARCH CORP - Form 10-Q

Recognized gains included in earnings <sup>(1)</sup>	9	—
Settlements	(35	) —
Balance as of March 31	\$1,975	\$2,152

(1) Total realized gains on redemptions or partial redemptions at par of auction rate securities for the periods presented.

8

---

ACACIA RESEARCH CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

7. EQUITY OFFERING

In March 2011, Acacia completed a public offering of 5,750,000 shares of common stock. The public offering price was \$31.50 per share, and the net proceeds to the Company totaled approximately \$175,284,000, after deducting underwriting discounts and related offering expenses. Acacia retained broad discretion over the use of the net proceeds from the sale of common stock and intends to use the net proceeds for operations and for other general corporate purposes, including, but not limited to, working capital, strategic acquisitions and other transactions. The shares of common stock were offered and sold under a prospectus supplement that was filed with the SEC pursuant to Rule 424(b)(5) of the Securities Act of 1933, as amended, in connection with an offering pursuant to Acacia's automatic shelf registration statement on Form S-3 (Registration No. 333- 173045).

8. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standards Update No. 2010-06 ("ASU No. 2010-06") . Certain provisions of ASU No. 2010-06 became effective for Acacia during the first quarter of 2011. Those provisions require the Company to disclose in the footnotes as separate line items, all purchases, sales, issuances, and settlements of financial instruments valued using significant unobservable inputs (Level 3) in the reconciliation of fair value measurements, in contrast to the aggregate presentation as a single line item. The adoption of this provision of the standard did not have a material impact on the Company's consolidated financial statements or related disclosures.

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

### Cautionary Statement

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, 2010, filed with the SEC on February 28, 2011, as amended on March 24, 2011.

This Quarterly Report on Form 10-Q contains forward-looking statements that have been made pursuant to the “safe harbor” provisions 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,” “anticipate,” “intend,” “predict,” “potential,” “continue,” 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 future 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, 2010.

### 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 acquire, develop, license and otherwise enforce patented technologies. Our operating subsidiaries generate revenues and related cash flows from the granting of intellectual property rights for the use of, or pertaining to, patented technologies that our operating subsidiaries own or control. 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 revenue from users of their patented technologies and, if necessary, with the enforcement against unauthorized users of their patented technologies.

We are a leader in licensing patented technologies and have established a proven track record of licensing success with over 995 license agreements executed to date across 99 of our technology licensing programs. Currently, on a consolidated basis, our operating subsidiaries own or control the rights to over 177 patent portfolios, which include U.S. patents and certain foreign counterparts covering technologies used in a wide variety of industries.

We were originally incorporated in California in January 1993 and reincorporated in Delaware in December 1999.

## Executive Overview

Our operating activities for the periods presented were principally focused on the continued development, licensing and enforcement of the patent portfolios owned or controlled by our operating subsidiaries, including the continued pursuit of our ongoing technology licensing and enforcement programs and the commencement of new technology licensing and enforcement programs. In addition, we continued our focus on business development, including the acquisition of several additional patent portfolios by certain of our operating subsidiaries and the continued pursuit of additional opportunities to partner with patent owners and continue our unique intellectual property licensing, development and enforcement activities.

In March 2011, we completed a public offering of 5,750,000 shares of common stock. The public offering price was \$31.50 per share, and the net proceeds to the Company totaled approximately \$175.3 million after deducting underwriting discounts and related offering expenses. We retained broad discretion over the use of the net proceeds from the sale of common stock and intend to use the net proceeds for operations and for other general corporate purposes, including, but not limited to, working capital, strategic acquisitions and other transactions.

Operating activities during the periods presented included the following:

	Three Months Ended March 31,	
	2011	2010
Revenues (in thousands)	\$61,130	\$39,772
New agreements executed	35	40
Licensing and enforcement programs generating revenues - during the respective period	32	29
Licensing and enforcement programs with initial revenues	8	13
New patent portfolios	8	11
Cumulative number of licensing and enforcement programs generating revenues - inception to date	99	73

Our revenues historically have fluctuated quarterly, and can vary significantly, based on the dollar amount of agreements executed each period, fluctuations in the total number of agreements executed each period, the number of patented technology portfolios owned or controlled by our operating subsidiaries, the timing, results and uncertainties associated with patent filings and other enforcement proceedings relating to our intellectual property rights, the number of active licensing and enforcement programs, the relative maturity of active licensing programs during the applicable periods and other external factors. Additional factors impacting the amount of revenues recognized each period are discussed below. 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.

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 were as follows (in thousands):

As of Date:	Trailing Twelve -Month Revenues	% Change	
March 31, 2011	\$153,187	16	%
December 31, 2010	131,829	(5	)%
September 30, 2010	138,585	53	%

Edgar Filing: ACACIA RESEARCH CORP - Form 10-Q

June 30, 2010	90,805	1	%
March 31, 2010	90,155	—	%



Revenues for the three months ended March 31, 2011 included fees from the following technology licensing and enforcement programs:

- Audio Communications Fraud Detection technology
- Camera Support technology
- Catheter Insertion technology<sup>(1)</sup>
- Computer Architecture and Power Management technology<sup>(1)</sup>
- Computer Graphics technology
- Digital Video Enhancement technology
- DMT® technology
- Document Generation technology
- Facilities Operation Management System technology
- Image Resolution Enhancement technology
- Improved Commercial Print technology
- Interactive Mapping technology
- Lighting Control technology<sup>(1)</sup>
- Location Based Services technology
- Magnetic Storage technology<sup>(1)</sup>
- Manufacturing Data Transfer technology
- Messaging technology<sup>(1)</sup>
- Microprocessor Enhancement technology
- Mobile Computer Synchronization technology
- Network Remote Access technology
- NOR Flash technology<sup>(1)</sup>
- Online Auction Guarantee technology
- Optical Switching technology
- Pop-up Internet Advertising technology
- Power Management Within Integrated Circuits technology<sup>(1)</sup>
- Rule Based Monitoring technology
- Storage technology
- Telematics technology
- User Programmable Engine Control technology<sup>(1)</sup>
- Virtual Server technology
- Visual Data Evaluation technology
- Website Crawling technology

---

<sup>(1)</sup> Initial revenues recognized during the three months ended March 31, 2011.

Revenues for the three months ended March 31, 2010 included fees from the following technology licensing and enforcement programs:

- Audio Communications Fraud Detection technology
- Authorized Spending Accounts technology
- Business Process Modeling (BPM) technology<sup>(1)</sup>
- Compiler technology<sup>(1)</sup>
- Credit Card Fraud Protection technology
- Database Access technology
- Database Management technology
- Disk Array Systems & Storage Area Network technology<sup>(1)</sup>
- DMT® technology
- Facilities Operation Management System technology<sup>(1)</sup>
- High Performance Computer Architecture technology
- Improved Lighting technology<sup>(1)</sup>
- Interactive Mapping technology<sup>(1)</sup>
- Internet Radio Advertising technology
- Medical Image Stabilization technology
- Medical Monitoring technology<sup>(1)</sup>
- Network Monitoring technology<sup>(1)</sup>
- Network Remote Access technology<sup>(1)</sup>
- Picture Archiving & Communications System technology
- Pop-up Internet Advertising technology
- Records Management technology<sup>(1)</sup>
- Rule Based Monitoring technology
- Software Installation technology<sup>(1)</sup>
- Storage technology
- Telematics technology
- Virtual Computer Workspaces technology
- Virtual Server technology
- Visual Data Evaluation technology<sup>(1)</sup>
- Website Crawling technology<sup>(1)</sup>

---

<sup>(1)</sup> Initial revenues recognized during the three months ended March 31, 2010.



Summary of Results of Operations - Overview  
For the Three Months Ended March 31, 2011 and 2010

	Three Months Ended March 31,		% Change	
	2011	2010		
Revenues	\$61,130	\$39,772	54	%
Operating costs and expenses	40,455	20,421	98	%
Operating income	20,675	19,351	7	%
Provision for income taxes	(7,148	) (321	) *	
Net income attributable to noncontrolling interests in operating subsidiaries	(1,203	) (537	) 124	%
Net income attributable to Acacia Research Corporation	12,353	18,512	(33	)%

\*Percentage change in excess of 300%

Revenues increased by \$21.4 million, or 54%, due primarily to an increase in the average revenue per executed agreement.

**Cost of Revenues and Other Operating Expenses:**

Inventor royalties, net income attributable to noncontrolling interests in operating subsidiaries, or net income attributable to noncontrolling interests, and contingent legal fees, on a combined basis, increased \$14.8 million, or 167%, primarily reflecting the increase in related revenues for the three months ended March 31, 2011. The increase was greater than the percentage increase in related revenues due to, in the aggregate, lower or no inventor royalty or contingent legal fee arrangement obligations associated with the revenues generated during the three months ended March 31, 2010, as compared to the three months ended March 31, 2011.

Litigation and licensing expenses—patents decreased \$162,000, or 4%, to \$3.5 million, due to a lower net level of litigation support, third party technical consulting and professional expert expenses incurred during the three months ended March 31, 2011. The decrease was partially offset by an increase in litigation and licensing expenses incurred in connection with our continued investment in ongoing licensing and enforcement programs and new licensing and enforcement programs commenced since the end of the prior year period.

Marketing, general and administrative expenses increased \$3.7 million, or 58%, to \$10.0 million, due primarily to an increase in non-cash stock compensation charges resulting from an increase in the average grant date fair value of restricted shares expensed during the first quarter of 2011, an increase in annual one-time variable performance based compensation charges recorded in the first quarter of 2011, an increase in other variable performance based compensation charges, a net increase in engineering and licensing personnel since the end of the prior year period, and a minor net increase in corporate, general and administrative costs.

Patent amortization increased \$2.1 million, or 121%, to \$3.8 million, due primarily to the acceleration of scheduled patent amortization related to recoupable up-front patent portfolio acquisition costs that were recovered from related net licensing proceeds during the three months ended March 31, 2011, pursuant to the provisions of the underlying inventor agreements.

The increase in provision for income taxes reflects the impact of foreign withholding taxes withheld by the Korean tax authority pursuant to the requirements of the United States - Republic of Korea Income Tax Convention, on a payment in connection with a licensing arrangement executed in the first quarter of 2011.

**Enforcement Considerations**

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, 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, case-related audio/video presentations and other litigation support and administrative costs, could increase our operating costs and decrease our revenue 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;

13

---

New legislation, regulations or rules related to enforcement actions could significantly increase our operating costs and decrease our revenue generating opportunities; and

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.

#### 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 the number of patent portfolios owned or controlled by our operating subsidiaries on a consolidated basis. As of March 31, 2011, December 31, 2010, and March 31, 2010, on a consolidated basis, our operating subsidiaries owned or controlled the rights to approximately 177, 171 and 145 patent portfolios, respectively, which include U.S. patents and certain foreign counterparts, covering technologies used in a wide variety of industries.

During the three months ended March 31, 2011, certain of our operating subsidiaries continued to execute their business strategy in the area of patent portfolio acquisitions, including the acquisition of, or the acquisition of the rights to, 8 patent portfolios covering a variety of applications, including the following:

**Flash Memory.** This patented technology consists of 16 flash memory patents relating to architecture, manufacturing and operation of flash memory, including NOR flash. The patented technology covers techniques for enhancing the performance and reliability of the flash memory cell. NOR flash memory is extensively used in cell phones.

**Cellular Air Interface.** This patented technology has 200 patents covering 3G and 4G cellular air interface and infrastructure technologies. These technologies may be found in mobile handsets, base stations, routers and other related equipment.

Patent portfolio acquisitions for the three months ended March 31, 2011 also included the acquisition of, or the rights to, additional patent portfolios related to Radiation Therapy technology, Prescription Lens technology, Application Authentication technology and DDR SDRAM technology.

Refer to “Liquidity and Capital Resources” below for information regarding the impact of patent and patent rights acquisitions on the consolidated financial statements for the periods presented.

As of March 31, 2011, certain of our operating subsidiaries had several option agreements with third-party patent portfolio owners regarding the potential acquisition of additional patent portfolios. Future patent portfolio acquisitions will continue to expand and diversify our future revenue generating opportunities.

#### 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, 2010. In

addition, 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, 2011 and 2010

Revenue (In thousands)

	Three Months Ended March 31,	
	2011	2010
Revenues	\$61,130	\$39,772

Revenues. 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 our 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 our operating subsidiaries, (ii) covenants-not-to-sue, (iii) the release of the licensee from certain claims, and (iv) the dismissal of any pending litigation.

	Three Months Ended March 31,	
	2011	2010
New agreements executed	35	40
Licensing and enforcement programs with initial revenues	8	13

Two licensees accounted for 74% and 11% of revenues recognized during the three months ended March 31, 2011, and two licensees accounted for 63%, and 13% of revenues recognized during the three months ended March 31, 2010.

On a consolidated basis, as of March 31, 2011, 99 of our licensing programs had begun generating licensing revenues, up from 91 as of December 31, 2010, and 73 as of March 31, 2010.

Revenues recognized by our operating subsidiaries fluctuate from period to period primarily based on the following factors:

- 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;

- fluctuations in the sales results or other royalty per unit activities of our licensees that impact the calculation of fees due;

- the timing of the receipt of periodic payments and/or reports from licensees; and

- fluctuations in the net number of active licensees from period to period.

The increase in revenues for the three month periods presented was due primarily to an increase in the average revenue per executed agreement. In the first quarter of 2011 and 2010, we entered into separate significant revenue agreements with unrelated third parties resolving pending patent matters.



## Cost of Revenues (In thousands)

	Three Months Ended March 31,	
	2011	2010
Cost of revenues:		
Inventor royalties	\$13,089	\$3,911
Contingent legal fees	9,367	4,407
Litigation and licensing expenses - patents	3,534	3,696
Amortization of patents	3,772	1,703
Net income attributable to noncontrolling interests in operating subsidiaries	(1,203	) (537

Inventor Royalties, Net Income Attributable to Noncontrolling Interests and Contingent Legal Fees Expense. Net income attributable to noncontrolling interests represents the portion of net income from the licensing and enforcement activities of our majority-owned operating subsidiaries that are distributable to the operating subsidiary's noncontrolling interest holders pursuant to the underlying operating agreements. The economic terms of the inventor agreements, operating agreements and contingent legal fee arrangements associated with the patent portfolios owned or controlled by our operating subsidiaries, if any, including royalty rates, contingent fee rates and other terms, vary across the patent portfolios owned or controlled by our operating subsidiaries. As such, these costs 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.

	Three Months Ended March 31, 2011 vs. 2010	
Increase in revenues	54	%
Increase in inventor royalties and net income attributable to noncontrolling interests	221	% Note (a)
Increase in contingent legal fees expense	113	% Note (b)
Increase in inventor royalties expense, net income attributable to noncontrolling interests and contingent legal fees expense	167	% Note (a),(b)

	Three Months Ended March 31,		
	2011	2010	
Inventor royalties and net income attributable to noncontrolling interests as a percentage of revenues	23	% 11	% Note (a)
Contingent legal fees expense as a percentage of revenues	15	% 11	% Note (b)
Inventor royalties, net income attributable to noncontrolling interests and contingent legal fees, combined, as a percentage of revenues	39	% 22	% Note (a),(b)

The increase in inventor royalties and net income attributable to noncontrolling interests was greater than the increase in revenues for the periods presented, primarily due to a larger portion of revenues recognized during the (a) period ended March 31, 2010 having no corresponding inventor royalty arrangement obligations, and in the aggregate, lower inventor royalty rates associated with the portfolios generating revenues during the three months ended March 31, 2010, as compared to the three months ended March 31, 2011.

The increase in contingent legal fees expense was greater than the increase in revenues for the periods presented, primarily due to a larger portion of revenues recognized during the three months ended March 31, 2010 having no (b)corresponding contingent legal fee arrangement obligations, and in the aggregate, lower contingent legal fee rates associated with the portfolios generating revenues during the three months ended March 31, 2010, as compared to the three months ended March 31, 2011.

Certain revenue agreements with unrelated third parties entered into in the first quarters of 2011 and 2010 resulted in the grant of certain intellectual property rights and recognition of revenues, portions of which were not subject to inventor royalty and contingent legal fee arrangements, as well as the grant of licenses from certain of our operating subsidiaries and recognition of revenues that were subject to inventor royalties and contingent legal fee arrangements. Revenues recognized subject to inventor royalties and contingent legal fees are based on a determination by the respective operating subsidiaries.

**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 fluctuate from period to period based on patent enforcement and prosecution activity associated with ongoing licensing and enforcement programs and the timing of the commencement of new licensing and enforcement programs in each period.

Litigation and licensing expenses-patents decreased slightly due to lower net levels of litigation support, third-party technical consulting and professional expert expenses associated with our continued investment in ongoing licensing and enforcement programs. The decrease was partially offset by an increase in litigation and licensing expenses incurred in connection with our continued investment in new licensing and enforcement programs commenced since the end of the prior year quarter.

We expect patent-related legal expenses to continue to fluctuate period to period based on the factors summarized above, in connection with upcoming scheduled and/or anticipated trial dates and our current and future patent acquisition, development, licensing and enforcement activities.

**Amortization of Patents.** The increase was due primarily to a net increase in scheduled patent amortization expense related to patent portfolios acquired since the end of the prior year period, and the acceleration of patent amortization related to recoupable up-front patent portfolio acquisition costs that were recovered from related net licensing proceeds during the three months ended March 31, 2011, pursuant to the provisions of the underlying inventor agreements. Accelerated amortization expense related to the recovery of up-front patent acquisition costs totaled \$2,383,000 and \$406,000, for the three months ended March 31, 2011, and 2010, respectively.

#### Operating Expenses (In thousands)

	Three Months Ended March 31,	
	2011	2010
Marketing, general and administrative expenses (including non-cash stock compensation expense of \$2,901 and \$1,895 for the three months ended March 31, 2011 and 2010, respectively)	\$9,985	\$6,332

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

Three Months

Ended March 31,  
2011 vs. 2010

Addition of licensing, business development and engineering personnel and other personnel costs	\$502
Increase in annual variable performance-based compensation and other variable performance-based compensation costs	1,726
Corporate, general and administrative costs	419
Non-cash stock compensation expense	1,006

## Provision for Income Taxes (in thousands)

	Three Months Ended March 31,		
	2011	2010	
Provision for income taxes	\$7,148	\$321	
Effective tax rate	35	% 2	%

Provision for Income Taxes. The increase in our effective tax rate reflects the impact of Korean foreign withholding taxes totaling \$7.4 million, which were withheld by the Korean tax authority pursuant to the requirements of the United States - Republic of Korea Income Tax Convention, on a payment in connection with a licensing arrangement executed in the first quarter of 2011. In general, foreign taxes withheld may be claimed as a deduction on future U.S. corporate income tax returns, or as a credit against future U.S. income tax liabilities. We continue to record a full valuation allowance against our net deferred tax assets due to management's determination that the criteria for recognition have not been met. As a result, amounts related to foreign taxes withheld are reflected in tax expense for the three months ended March 31, 2011.

## Liquidity and Capital Resources

## General

Our primary sources of liquidity are cash and cash equivalents and investments generated from our operating activities. In March 2011, we completed a public offering of 5,750,000 shares of common stock. The public offering price was \$31.50 per share, and the net proceeds to the Company totaled approximately \$175.3 million after deducting underwriting discounts and related offering expenses. We retained broad discretion over the use of the net proceeds from the sale of common stock and intend to use the net proceeds for operations and for other general corporate purposes, including, but not limited to, working capital, strategic acquisitions and other transactions.

Our management believes that the cash and cash equivalent balances, investments, anticipated cash flow from operations, and other external sources of available credit, will be sufficient to meet our cash requirements through at least April 2012 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, 2010. 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 2011. 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 there can be no assurance that the commercial paper markets will be a reliable source of short-term financing for us. If we fail to obtain additional funding when needed, we may not be able to execute our business plans and our business, conducted by our operating subsidiaries, may suffer.

In August 2010, our wholly owned subsidiary became the general partner of the Acacia Intellectual Property Fund, L.P., or Acacia IP Fund, which was formed in August 2010. The Acacia IP Fund is authorized to raise up to \$250 million. The Acacia IP Fund acquires, licenses and enforces intellectual property consisting primarily of patents, patent rights, and patented technologies.

## Cash and Investments

Our consolidated cash and cash equivalents and investments totaled \$315.6 million at March 31, 2011, compared to \$104.5 million at December 31, 2010. The net change in cash and cash equivalents for the periods presented was comprised of the following (in thousands):

18

---

	Three Months Ended March 31,	
	2011	2010
Net cash provided by (used in):		
Operating activities	\$36,452	\$19,104
Investing activities	(704	) (1,329
Financing activities	175,348	(1,985

**Cash Flows from Operating Activities.** Cash receipts from licensees for the three months ended March 31, 2011 increased to \$68.1 million, from \$41.5 million in the comparable 2010 period, primarily reflecting the net increase in revenues for the same periods, as discussed above. Cash outflows from operations for the three months ended March 31, 2011 increased to \$31.6 million, as compared to \$22.4 million in the comparable 2010 period, due to the net increase in cost of revenues and other operating expenses, as discussed above, and the impact of the timing of payments to inventors, attorneys and other vendors.

**Cash Flows from Investing Activities.** Net cash used in investing activities for the three months ended March 31, 2011 included patent-related acquisition costs totaling \$680,000, as compared to \$1.3 million in the comparable 2010 period.

**Cash Flows from Financing Activities.** Net cash provided by financing activities during the three months ended March 31, 2011 included net proceeds from the sale of common stock totaling \$175.3 million, as described above. Net cash provided by financing activities during the three months ended March 31, 2011 also included proceeds from exercises of stock options totaling \$44,000, as compared to \$499,000 in the comparable 2010 period. Net cash provided by financing activities during the three months ended March 31, 2011 also included \$877,000 in capital contributions to the Acacia IP Fund, offset by distributions to non-controlling interests totaling \$880,000. Distributions to non-controlling interests totaled \$2.5 million for the three months ended March 31, 2010.

#### Working Capital

Working capital at March 31, 2011 was \$286.1 million, compared to \$92.3 at December 31, 2010. The primary components of working capital are cash and cash equivalents, accounts receivable, prepaid expenses, accounts payable, accrued expenses, and royalties and contingent legal fees payable. Refer to "Liquidity and Capital Resources - Cash and Investments" above for a discussion of the impact of activities related to cash and investments on working capital for the periods presented.

Consolidated accounts receivable from licensees decreased to \$1.2 million at March 31, 2011, compared to \$8.0 million at December 31, 2010. Accounts receivable balances fluctuate based on the timing, magnitude and payment terms associated with revenue agreements executed during the period, and the timing of cash receipts on accounts receivable balances recorded in previous periods.

Consolidated royalties and contingent legal fees payable increased to \$21.7 million at March 31, 2011, compared to \$12.8 million at December 31, 2010. Royalties and contingent legal fees payable balances fluctuate based on the factors described above and the timing of payment of current and prior period royalties and contingent legal fees payable to inventors and outside attorneys, respectively.

The majority of accounts receivable from licensees at March 31, 2011 were collected or scheduled to be collected in the second quarter of 2011, 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 quarter of 2011, upon receipt by us of the related fee payments from licensees, in accordance with the underlying contractual arrangements.

Accounts payable and accrued expenses increased to \$9.2 million at March 31, 2011, from \$7.1 million at December 31, 2010, due primarily to the related timing of payments to attorneys and other vendors, and an increase in accrued variable performance based compensation charges.



## 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 2011. 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, 2011:

Contractual Obligations	Payments Due by Period (In thousands)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	\$3,811	\$540	\$1,497	\$1,408	\$366
Scheduled patent acquisition related payments	1,825	1,325	250	250	—
Payments to consultants	850	650	200	—	—
Total contractual obligations	\$6,486	\$2,515	\$1,947	\$1,658	\$366

As of March 31, 2011, the liability for uncertain tax positions, associated primarily with state income taxes, was \$86,000, none of which is expected to be paid within one year. The liability for uncertain tax positions is recorded in other long-term liabilities in our consolidated balance sheets included in this report.

## 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 may invest in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment 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 will decline. To minimize this risk 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. As of March 31, 2011, our investments were comprised of money market funds and auction rate 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. A hypothetical 100 basis point increase in interest rates would not have a material impact on the fair value of our available-for-sale securities as of March 31, 2011. Refer to "Liquidity and Capital Resources" and Note 6 to the consolidated financial statements included in this report for additional information.

## 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, 2011) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II--OTHER INFORMATION

Item 6. EXHIBITS

EXHIBIT NUMBER	EXHIBIT
1.1	Underwriting Agreement dated March 24, 2011 by and between Acacia Research Corporation and Barclay's Capital Inc. (Incorporated by reference to Exhibit 1.1 to Acacia Research Corporation's Current Report on Form 8-K, filed with the SEC on March 29, 2011).
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

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

By: /s/ Paul R. Ryan  
Paul R. Ryan  
Chief Executive Officer

By: /s/ Clayton J. Haynes  
Clayton J. Haynes  
Chief Financial Officer and Treasurer

Date: April 29, 2011

EXHIBIT INDEX

EXHIBIT  
NUMBER

EXHIBIT

1.1	Underwriting Agreement dated March 24, 2011 by and between Acacia Research Corporation and Barclay's Capital Inc. (Incorporated by reference to Exhibit 1.1 to Acacia Research Corporation's Current Report on Form 8-K, filed with the SEC on March 29, 2011).
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