

ACACIA RESEARCH CORP
Form 10-Q
November 14, 2016

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 SEPTEMBER 30, 2016

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

(Exact name of registrant as specified in its charter)

DELAWARE 95-4405754
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
520 Newport Center Drive, Newport Beach, California 92660
(Address of principal executive offices, Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically 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

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

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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 November 9, 2016, 50,463,380 shares of the registrant's common stock, \$0.001 par value, were issued and outstanding.

ACACIA RESEARCH CORPORATION
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PART I--FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

ACACIA RESEARCH CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share information)

(Unaudited)

| | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 116,016 | \$ 135,223 |
| Restricted cash | 14,041 | 10,725 |
| Short-term investments | 30,326 | — |
| Accounts receivable | 53,700 | 33,500 |
| Deferred income taxes | 210 | 210 |
| Prepaid expenses and other current assets | 3,773 | 4,219 |
| Total current assets | 218,066 | 183,877 |
| Loan receivable and accrued interest (Note 5) | 8,474 | — |
| Investment at cost (Note 5) | 1,720 | — |
| Property and equipment, net | 155 | 272 |
| Patents, net | 94,716 | 162,642 |
| Other assets | 365 | 1,110 |
| | \$ 323,496 | \$ 347,901 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 22,688 | \$ 17,347 |
| Accrued patent investment costs | 225 | 1,000 |
| Royalties and contingent legal fees payable | 25,009 | 14,878 |
| Total current liabilities | 47,922 | 33,225 |
| Deferred income taxes | 210 | 210 |
| Other liabilities | 362 | 311 |
| Total liabilities | 48,494 | 33,746 |
| Commitments and contingencies (Note 6) | | |
| Stockholders' equity: | | |
| Preferred stock, par value \$0.001 per share; 10,000,000 shares authorized; no shares issued or outstanding | — | — |
| Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 50,460,880 and 50,651,239 shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively | 50 | 51 |
| Treasury stock, at cost, 1,729,408 shares as of September 30, 2016 and December 31, 2015 | (34,640 |) (34,640) |
| Additional paid-in capital | 639,118 | 633,146 |
| Accumulated comprehensive loss | (59 |) (215) |
| Accumulated deficit | (331,587 |) (288,131) |

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| | | |
|--|------------|------------|
| Total Acacia Research Corporation stockholders' equity | 272,882 | 310,211 |
| Noncontrolling interests in operating subsidiaries | 2,120 | 3,944 |
| Total stockholders' equity | 275,002 | 314,155 |
| | \$ 323,496 | \$ 347,901 |

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

1

ACACIA RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share information)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues | \$64,658 | \$ 12,994 | \$ 130,730 | \$ 87,540 |
| Operating costs and expenses: | | | | |
| Cost of revenues: | | | | |
| Inventor royalties | 17,844 | 116 | 19,417 | 10,706 |
| Contingent legal fees | 7,709 | 1,972 | 22,236 | 12,268 |
| Litigation and licensing expenses - patents | 7,348 | 10,345 | 22,395 | 28,032 |
| Amortization of patents | 6,467 | 13,688 | 27,986 | 39,954 |
| General and administrative expenses (including non-cash stock compensation expense of \$2,544 and \$5,754 for the three and nine months ended September 30, 2016, respectively, and \$2,164 and \$8,588 for the three and nine months ended September 30, 2015, respectively) | 8,334 | 9,442 | 23,863 | 29,604 |
| Research, consulting and other expenses - business development | 666 | 802 | 2,522 | 2,531 |
| Impairment of patent-related intangible assets | — | — | 40,165 | — |
| Other | — | 3,465 | 500 | 3,891 |
| Total operating costs and expenses | 48,368 | 39,830 | 159,084 | 126,986 |
| Operating income (loss) | 16,290 | (26,836) | (28,354) | (39,446) |
| Total other income (expense) | 261 | (180) | 206 | (56) |
| Income (loss) before provision for income taxes | 16,551 | (27,016) | (28,148) | (39,502) |
| Provision for income taxes | (9,655) | (337) | (15,774) | (626) |
| Income (loss) including noncontrolling interests in operating subsidiaries | 6,896 | (27,353) | (43,922) | (40,128) |
| Net (income) loss attributable to noncontrolling interests in operating subsidiaries | 186 | 43 | 466 | (3,998) |
| Net income (loss) attributable to Acacia Research Corporation | \$7,082 | \$(27,310) | \$(43,456) | \$(44,126) |
| Net income (loss) attributable to common stockholders - basic and diluted | \$7,043 | \$(27,450) | \$(43,456) | \$(44,691) |
| Basic and diluted income (loss) per common share | \$0.14 | \$(0.55) | \$(0.87) | \$(0.90) |
| Weighted average number of shares outstanding - basic | 50,124,302 | 49,630,369 | 50,024,047 | 49,423,548 |
| Weighted average number of shares outstanding - diluted | 50,618,757 | 49,630,369 | 50,024,047 | 49,423,548 |
| Cash dividends declared per common share | \$— | \$ 0.125 | \$— | \$ 0.375 |

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

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ACACIA RESEARCH CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|------------|------------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income (loss) including noncontrolling interests in operating subsidiaries | \$6,896 | \$(27,353) | \$(43,922) | \$(40,128) |
| Other comprehensive income (loss): | | | | |
| Unrealized gain (loss) on short-term investments, net of tax of \$0 | 16 | (94) | 42 | (356) |
| Unrealized gain (loss) on foreign currency translation, net of tax of \$0 | 96 | — | 92 | (141) |
| Reclassification adjustment for losses included in net income (loss) | — | 274 | 22 | 617 |
| Total other comprehensive income (loss) | 7,008 | (27,173) | (43,766) | (40,008) |
| Comprehensive (income) loss attributable to noncontrolling interests | 186 | 43 | 466 | (3,998) |
| Comprehensive income (loss) attributable to Acacia Research Corporation | \$7,194 | \$(27,130) | \$(43,300) | \$(44,006) |

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

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ACACIA RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|--|------------------------------------|-------------|
| | 2016 | 2015 |
| Cash flows from operating activities: | | |
| Net loss including noncontrolling interests in operating subsidiaries | \$(43,922) | \$(40,128) |
| Adjustments to reconcile net loss including noncontrolling interests in operating subsidiaries to net cash provided by operating activities: | | |
| Depreciation and amortization | 28,105 | 40,129 |
| Non-cash stock compensation | 5,754 | 8,588 |
| Impairment of patent-related intangible assets | 40,165 | — |
| Other | (81) | (127) |
| Changes in assets and liabilities: | | |
| Restricted cash | (3,316) | (10,721) |
| Accounts receivable | (20,200) | 7,411 |
| Prepaid expenses and other assets | 1,191 | (569) |
| Accounts payable and accrued expenses | 5,392 | 2,680 |
| Royalties and contingent legal fees payable | 10,131 | (5,108) |
| Net cash provided by operating activities | 23,219 | 2,155 |
| Cash flows from investing activities: | | |
| Investments in patents/ patent rights | (1,000) | (19,504) |
| Loan receivable | (8,280) | — |
| Investment at cost | (1,720) | — |
| Purchases of property and equipment | (4) | (8) |
| Purchases of available-for-sale investments | (62,633) | (23,296) |
| Maturities and sales of available-for-sale investments | 32,352 | 82,115 |
| Net cash provided by (used in) investing activities | (41,285) | 39,307 |
| Cash flows from financing activities: | | |
| Dividends paid to stockholders | — | (19,091) |
| Repurchased restricted common stock | (25) | — |
| Distributions to noncontrolling interests in operating subsidiary | (1,358) | — |
| Proceeds from exercises of stock options | 242 | 938 |
| Net cash used in financing activities | (1,141) | (18,153) |
| Increase (decrease) in cash and cash equivalents | (19,207) | 23,309 |
| Cash and cash equivalents, beginning | 135,223 | 134,466 |
| Cash and cash equivalents, ending | \$116,016 | \$157,775 |

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

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

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business. As used herein, “Acacia” and the “Company” refer to Acacia Research Corporation and/or its wholly and majority-owned and controlled operating subsidiaries, and/or where applicable, its management. 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. In addition, our operating subsidiaries may from time to time evaluate, leveraging our intellectual property expertise, other business opportunities. In some cases, these opportunities will compliment, and / or supplement our primary licensing and enforcement business.

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.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnotes required by 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, 2015, as reported by Acacia in its Annual Report on Form 10-K filed with the SEC. 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 condensed consolidated interim financial statements of Acacia include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair statement of Acacia's consolidated financial position as of September 30, 2016, and results of its operations and its cash flows for the interim periods presented. The consolidated results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the entire fiscal year.

ACACIA RESEARCH CORPORATION
NOTES TO CONDENSED 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.

For the periods presented herein, the majority of the revenue agreements executed by the Company provided for the payment of one-time, paid-up license fees in consideration for the grant of certain intellectual property rights for patented technology rights owned by Acacia's operating subsidiaries. These rights were primarily granted on a perpetual basis, extending until the expiration of the underlying patents.

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.

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 patent-related intangible assets, the determination of the economic useful life of amortizable intangible assets, income taxes and valuation allowances against net deferred tax assets, the valuation of the loan and warrants discussed at Note 5 and the application of the acquisition method of accounting for business combinations, require its most difficult, subjective or complex judgments.

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

Concentrations. Two licensees individually accounted for 60% and 27% of revenues recognized during the three months ended September 30, 2016, and three licensees accounted for 30%, 27% and 13% of revenues recognized during the nine months ended September 30, 2016. Three licensees individually accounted for 54%, 15% and 13% of revenues recognized during the three months ended September 30, 2015 and two licensees accounted for 34% and 23% of revenues recognized during the nine months ended September 30, 2015. For the three and nine months ended September 30, 2016, 93% and 78%, respectively, of revenues were attributable to licensees domiciled in foreign jurisdictions, based on the jurisdiction of the entity obligated to satisfy payment obligations pursuant to the applicable revenue arrangement. For the three and nine months ended September 30, 2015, 5% and 34%, respectively, of revenues were attributable to licensees domiciled in foreign jurisdictions. The Company does not have any material foreign operations.

Two licensees individually represented approximately 73% and 22% of accounts receivable at September 30, 2016. Two licensees individually represented approximately 72% and 21% of accounts receivable at December 31, 2015.

Stock-Based Compensation. The compensation cost for 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 (the vesting period of the equity award) which is two to four years. The fair value of each option award (excluding options with market based vesting conditions) is estimated on the date of grant using a Black-Scholes option valuation model. 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.

During the nine months ended September 30, 2016, the Company granted 2,250,000 of performance-based stock options with market based vesting conditions, with a weighted-average exercise price of \$5.75 per share. The options are earned by the grantee based upon the Company achieving specified stock price targets over a four-year period. Under the terms of the award, the number of stock options that will actually vest is based on the extent to which the Company achieves the specified performance targets during the four-year performance period. The stock options vest in equal installments of 25% upon the Company's achievement of 30-day average share prices ranging from \$7.00 to \$10.00. As of September 30, 2016, all options with market conditions remain unvested. As of September 30, 2016, unrecognized expense for options with market conditions totaled \$4.4 million which is expected to be recognized over an estimated 1.3 year period.

The effect of a market condition is reflected in the estimate of the grant-date fair value of the options utilizing a Monte Carlo valuation technique. Compensation cost is recognized for an option with a market condition provided that the requisite service is rendered, regardless of when, if ever, the market condition is satisfied. The service period for options with a market condition is inferred from the application of the Monte Carlo valuation technique. The derived service period represents the duration of the median of the distribution of share price paths on which the market condition is satisfied. The duration is the period of time from the service inception date to the expected date of satisfaction, as determined from the valuation technique. Assumptions utilized in connection with the Monte Carlo valuation technique included: estimated risk-free interest rate of .92%; expected volatility of 55%; and expected dividend yield of 0%. The risk-free interest rate was determined based on the yields available on U.S. Treasury zero-coupon issues. The expected stock price volatility was determined using historical volatility. The expected dividend yield was based on expectations regarding dividend payments.

Fair Value Measurements. U.S. GAAP defines fair value as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction

between market participants on the measurement date, and also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs, where available. The three-level hierarchy of valuation techniques established to measure fair value is defined as follows:

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.

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

Patents. Patents include the cost of patents or patent rights (hereinafter, collectively “patents”) acquired 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 eight 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 expected undiscounted future cash flows resulting from the use of the asset is less than the carrying amount of the asset, an impairment loss is recorded equal to the excess of the asset’s carrying value over its fair value. If an asset is determined to be impaired, the loss is measured based on quoted market prices in active markets, if available. If quoted market prices are not available or not indicative of current fair value, 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 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 income 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, or if it is determined that there is uncertainty regarding future realizability of such assets.

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

The Company's effective tax rates were 58% and 56% for the three and nine months ended September 30, 2016, respectively, and 1% and 2% for the three and nine months ended September 30, 2015. The effective rates for the periods presented primarily reflect the impact of foreign withholding taxes related to certain revenue agreements executed with third party licensees domiciled in foreign jurisdictions.

3. INCOME (LOSS) PER SHARE

The Company computes net income (loss) 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 (loss) (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.

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|-------------|---------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Numerator (in thousands): | | | | |
| Basic and Diluted | | | | |
| Net income (loss) | \$7,082 | \$(27,310) | \$(43,456) | \$(44,126) |
| Undistributed earnings allocated to participating securities | (39) | — | — | — |
| Total dividends declared / paid | — | (6,342) | — | (19,091) |
| Dividends attributable to common stockholders | — | 6,202 | — | 18,526 |
| Net income (loss) attributable to common stockholders – basic and diluted | \$7,043 | \$(27,450) | \$(43,456) | \$(44,691) |
| Denominator: | | | | |
| Weighted-average shares used in computing net income(loss) per share attributable to common stockholders – basic | 50,124,309 | 49,630,369 | 50,024,047 | 49,423,548 |
| Effect of potentially dilutive securities: | | | | |
| Common stock options and restricted stock units | 494,455 | — | — | — |
| Weighted-average shares used in computing net loss per share attributable to common stockholders – diluted | 50,618,764 | 49,630,369 | 50,024,047 | 49,423,548 |
| Basic and diluted net income (loss) per common share | \$0.14 | \$(0.55) | \$(0.87) | \$(0.90) |
| Anti-dilutive equity-based incentive awards excluded from the computation of diluted income (loss) per share | 3,593,708 | 71,468 | 4,410,974 | 71,468 |
| Minimum price of awards excluded from the computation of diluted income (loss) per share | \$— | \$— | \$— | \$— |
| Maximum price of awards excluded from the computation of diluted income (loss) per share | \$13.38 | \$13.38 | \$13.38 | \$13.38 |

4. PATENTS

Acacia's only identifiable intangible assets at September 30, 2016 and December 31, 2015 are patents and patent rights. Patent-related accumulated amortization totaled \$349,646,000 and \$281,495,000 as of September 30, 2016 and December 31, 2015, respectively.

Acacia's patents have remaining estimated economic useful lives ranging from one to eight years. The weighted-average remaining estimated economic useful life of Acacia's patents is approximately five years. The following table presents the scheduled annual aggregate amortization expense as of September 30, 2016 (in thousands):

| | |
|-----------------------------------|---------|
| For the years ending December 31, | |
| Remainder of 2016 | \$6,222 |
| 2017 | 23,312 |
| 2018 | 22,111 |
| 2019 | 19,412 |

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| | |
|------------|----------|
| 2020 | 6,787 |
| Thereafter | 16,872 |
| | \$94,716 |

For the nine months ended September 30, 2016 and 2015, Acacia paid patent related investment costs, including up-front patent portfolio advances and previously accrued milestone payments related to patent related investments made in prior

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periods, totaled \$1,000,000 and \$19,504,000, respectively. The underlying patents have estimated economic useful lives of approximately two to nine years.

Acacia recorded impairment of patent-related intangible asset charges of \$40,165,000 for the nine months ended September 30, 2016, primarily comprised of the write-off of the remaining carrying value of our Adaptix portfolio. The impairment charges were realized in the period due to a reduction in expected estimated future net cash flows and certain patent portfolios that management determined it would no longer allocate future resources to in connection with the licensing and enforcement of such portfolios, due primarily to the overall determination that future resources would be allocated to other licensing and enforcement programs. The impairment charges consisted of the excess of the asset's carrying value over its estimated fair value.

5. INVESTMENTS

On August 15, 2016, Acacia entered into an Investment Agreement with Veritone, Inc. ("Veritone"), which provides for Acacia to invest up to \$50 million in Veritone, consisting of both debt and equity components. Pursuant to the Investment Agreement, on August 15, 2016, Acacia entered into a secured convertible promissory note with Veritone (the "Veritone Loan"), which permits Veritone to borrow up to \$20 million through two \$10 million advances, each bearing interest at the rate of 6.0% per annum (included in Other Income (Expense) in the consolidated statement of operations). On August 15, 2016, Acacia funded the initial \$10 million loan (the "First Loan"), which has a one-year term. If Veritone draws the second \$10 million loan (the "Second Loan"), the Second Loan will also have a one-year term from the date of issuance, and the maturity date of the First Loan will automatically extend to the maturity date of the Second Loan. As a result, if Veritone draws the Second Loan, both the First Loan and the Second Loan will become due and payable on the first anniversary of the issuance date of the Second Loan. Veritone's obligations under the Veritone Loan are secured by substantially all of Veritone's assets pursuant to a security agreement that Acacia entered into with Veritone dated August 15, 2016.

In addition, commencing on the earlier of Veritone's consummation of a private round of financing of at least \$10 million (a "Next Equity Financing") and the maturity date of the Veritone Loan, Acacia has the right, under certain circumstances, to convert all or a portion of the principal and accrued interest of the First Loan into shares of Veritone's Series B Preferred Stock or, if Veritone consummates a Next Equity Financing, into shares of Veritone capital stock issued in such financing, at various conversion rates, with the exact conversion rate to depend upon (i) whether Veritone consummates a Next Equity Financing, (ii) the price per share in such Next Equity Financing and (iii) whether or not Acacia elects to convert all of the outstanding principal and accrued interest under the Veritone Loan. If Acacia funds the Second Loan, it will have the right, under certain circumstances, to convert all or a portion of the principal and accrued interest of the Second Loan into shares of Veritone's Series B Preferred Stock or, if Veritone consummates a Next Equity Financing, into shares of Veritone capital stock issued in such financing, at various conversion rates, with the exact conversion rate to depend upon (i) whether Veritone consummates a Next Equity Financing, (ii) the price per share in such Next Equity Financing and (iii) whether or not Acacia elects to convert all of the principal and accrued interest under the Veritone Loan. If Veritone consummates a qualified public offering of its common stock, any outstanding principal and accrued interest under the Veritone Loan will automatically convert into shares of Veritone's common stock.

In conjunction with the First Loan, Veritone issued Acacia a four-year \$700,000 warrant to purchase shares of Veritone's common stock at various exercise prices, with the actual exercise price to be determined by the type and/or valuation of Veritone's future equity financings, if any. If Acacia funds the Second Loan, Veritone will issue to Acacia two additional four-year \$700,000 warrants to purchase shares of Veritone's common stock with similar terms. In addition, pursuant to the Investment Agreement, Veritone issued Acacia a five-year Primary Warrant to purchase up to \$50 million, less all converted amounts or amounts repaid under the Veritone Loan, worth of shares of Veritone's

common stock at various exercise prices, with the actual exercise price per share to be determined by the amount of principal and accrued interest under the Veritone Loan converted into shares of Veritone common stock. Acacia may exercise the Primary Warrant at any time during its five year term after the earlier of August 15, 2017 or the completion of a public offering with gross proceeds to Veritone of at least \$15.0 million. Immediately subsequent to such a public offering, Veritone has the right to elect that Acacia exercise the Primary Warrant, and upon such election, Acacia agrees to exercise the Primary Warrant in full, provided that the then current fair market value of Veritone common stock is equal to or greater than the exercise price per share of the Primary Warrant. Immediately following Acacia's exercise of the Primary Warrant in full, Veritone has the obligation to issue to Acacia an additional 10% Warrant that provides for the issuance of additional shares of Veritone common stock, with 50% of the shares underlying the 10% Warrant vesting as of the issuance date of the 10% Warrant, and the remaining 50% of shares vesting on the anniversary of the issuance date of the 10% Warrant.

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Our Investment Agreement, as described above, represents a variable interest in Veritone for which Acacia is not the primary beneficiary, primarily due to a lack of a controlling interest in Veritone. As of September 30, 2016, the First Loan is not considered in-substance common stock and the common stock purchase warrants are unexercised, and therefore, the equity method of accounting is not applied. In addition, the First Loan does not meet the criteria for classification as a debt security. As such, the First Loan and the related common stock purchase warrants described above are accounted for as separate units of account based on the relative estimated fair values of the separate units as of the effective date of the transaction, with the \$10 million amount of the First Loan allocated to (1) the First Loan, which is accounted for as a long-term loan receivable and (2) the common stock purchase warrants, which are accounted for at cost. The estimated relative fair value allocation of the \$10 million investment to the First Loan and the related common stock purchase warrants was determined using a Monte Carlo simulation model. Key inputs to the model included the estimated value of Veritone's equity on the effective date of the transaction, related volatility of equity assumptions, discounts for lack of marketability, assumptions related to liquidity scenarios, and assumptions related to recovery scenarios on the Veritone Loans. A summary of assumptions used in connection with estimating the relative fair values were as follows:

| Valuation Technique | Significant Unobservable Inputs | Range of Inputs |
|------------------------------|---------------------------------|-----------------|
| Monte Carlo simulation model | Volatility | 40% - 50% |
| | Marketability discount | 7% |
| | Scenario probabilities | 25% - 75% |

The loan and warrants are reflected in the accompanying financial statements as follows (in thousands):

| | August 15, 2016 (Effective Date) | As of and For the Three Months Ended September 30, 2016 |
|--------------------------------|---|---|
| Loan receivable | \$ 8,280 | \$ 8,280 |
| Accretion on loan discount | — | 194 |
| Adjusted Veritone Loan balance | — | 8,474 |
| Investment at cost | 1,720 | 1,720 |
| Total | \$ 10,000 | \$ 10,194 |
| Interest receivable | | \$ 75 |
| Interest income | | \$ 269 |

The loan discount, representing the difference between the face amount of the First Loan and the relative fair value allocated to the First Loan, is accreted over the expected life of the loan, which is one year, using the effective interest method, with the related interest amounts reflected in Other Income in the consolidated statement of operations. Acacia will re-evaluate its variable interest in Veritone and related accounting conclusions and disclosure requirements each reporting period.

6. COMMITMENTS AND CONTINGENCIES

Bank Guarantee

In March 2015, an operating subsidiary of Acacia entered into a standby letter of credit and guarantee arrangement ("Guarantee") with a bank for purposes of enforcing a court ruling in a German patent court granting an injunction against the defendants in the related patent infringement case. An injunction is an equitable remedy in the form of

a court order that compels the defendant(s) to cease marketing, offering for sale or importing applicable infringing products into applicable jurisdiction(s). Under German law, in order to enforce the injunction granted by the court, a Guarantee is required to be furnished by the operating subsidiary, the plaintiff in the case, for potential payment to the defendants of any applicable claims which may be incurred by the defendants as a result of the enforcement of the injunction, only in the event that the aforementioned court ruling is subsequently successfully appealed by the defendants or otherwise amended. The Guarantee is required to be issued unlimited with respect to time, until appropriately extinguished in accordance with German law. The Guarantee will be extinguished when a relevant extinguishment order by the court having jurisdiction takes effect, typically occurring when the related infringement case has been settled or a final non-appealable decision has been issued by the court.

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The Guarantee is secured by a cash deposit at the contracting bank, which is classified as restricted cash in the accompanying balance sheets, totaling \$14,041,000 and \$10,725,000 as of September 30, 2016 and December 31, 2015, respectively. Changes in the balance are primarily a result of additional court rulings granting injunctions with respect to additional defendants, and foreign currency exchange rate fluctuations and the related impact on the underlying collateral, which is denominated in U.S. dollars. The Guarantee expires on April 10, 2017, however, it is automatically extended without amendment for a period of one (1) year from the present or any future expiration date, unless at least 30 days prior to any expiration date, the Guarantee is extinguished in accordance with German law. The Guarantee facility fee is 1.15% per year, and the related expense is included in the consolidated statement of operations.

Patent Enforcement

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

For the nine months ended September 30, 2016 and 2015, other operating expenses were \$500,000 and \$3,891,000, respectively. Other operating expenses includes expense accruals for court ordered attorney's fees and settlement and contingency accruals for other matters.

Other

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.

7. STOCKHOLDERS' EQUITY

Cash Dividends. The Company paid quarterly cash dividends totaling \$19,091,000 during the nine months ended September 30, 2015 in the amount of \$0.125 per share. On February 25, 2016, Acacia announced that its Board of Directors terminated the company's dividend policy effective February 23, 2016. The Board of Directors terminated the dividend policy due to a number of factors, including the Company's financial performance and its available cash resources, the Company's cash requirements and alternative uses of capital that the Board of Directors concluded would represent an opportunity to generate a greater return on investment for the Company and its stockholders.

Tax Benefits Preservation Plan. On March 15, 2016, Acacia's Board of Directors announced that it unanimously approved the adoption of a Tax Benefits Preservation Plan (the "Plan"). The purpose of the Plan is to protect the Company's ability to utilize potential tax assets, such as net operating loss carryforwards ("NOLs") and tax credits to offset potential future taxable income.

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

In connection with the adoption of the Plan, Acacia's Board of Directors authorized and declared a dividend distribution of one right, under the plan, for each outstanding share of the Company's common stock to shareholders of record at the close of business on March 16, 2016.

Approval of 2016 Acacia Research Corporation Stock Incentive Plan. On April 26, 2016, Acacia's Board of Directors adopted the 2016 Acacia Research Corporation Stock Incentive Plan, or the Plan, which was approved by the stockholders in

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June 2016. The Plan will expire on the 10th anniversary of the date of its approval by shareholders, except with respect to awards then outstanding, and no further awards may be granted thereafter.

Summary of the Plan

Purposes of the Plan. The purposes of the Plan are (a) to enhance our ability to attract and retain the services of qualified employees, officers, directors, consultants and other service providers upon whose judgment, initiative and efforts the successful conduct and development of our business largely depends, and (b) to provide additional incentives to such persons or entities to devote their utmost effort and skill to the advancement and betterment of our company, by providing them an opportunity to participate in the ownership of our company and thereby have an interest in the success and increased value of our company.

Shares Available. The number of shares of our common stock initially reserved for issuance under the Plan shall be 4,500,000 shares plus any shares remaining available for issuance under our 2013 Acacia Research Corporation Stock Incentive Plan, or the 2013 Plan, as of the effective date of the Plan. As of the approval date of the Plan, 625,390 shares of our common stock were available for grant under the 2013 Plan.

Eligibility. Options, restricted stock units and direct stock awards may be granted under the Plan. Options may be either “incentive stock options,” as defined in Section 422 of the Internal Revenue Code of 1986, as amended, or the Code, or non-qualified stock options. Awards may be granted under the Plan to any employee, non-employee member of the Board of Directors, consultant or advisor who provides services to us or our subsidiaries, except for incentive stock options which may be granted only to our employees.

Administration. Generally, the Plan will be administered by either the entire Acacia Board of Directors or a committee of the Board of Directors, which shall consist of at least two members of the Board, each of whom must qualify as a “non-employee director” under Rule 16b-3 under the Exchange Act, an “outside director” under Section 162(m) of the Code and an “independent director” under the Nasdaq Listing Rules.

Discretionary Option Awards. The Plan administrator may grant either non-qualified stock options or incentive stock options. A stock option entitles the recipient to purchase a specified number of shares of our common stock at a fixed price subject to terms and conditions set by the Plan administrator, including conditions for exercise that must be satisfied, which typically will be based on continued provision of services. The exercise price of stock options granted under the Plan cannot be less than 100% of the fair market value of our common stock on the date the option is granted.

Direct Stock Awards. Direct stock awards may be issued under the Stock Issuance Program (as defined in the Plan) either alone or in addition to other awards granted under the Plan. The Plan administrator determines the terms and conditions of direct stock awards, including the number of shares of common stock granted, and the conditions for vesting that must be satisfied, if any, which typically will be based on continued provision of services but may include a performance-based component. Unless otherwise provided in the award agreement, the holder of a restricted direct stock award will have the rights of a stockholder from the date of grant of the award, including the right to vote the shares of common stock and the right to receive distributions on the shares.

Discretionary Restricted Stock Unit Awards. The Plan provides that the Plan administrator may grant restricted stock units to Plan participants. A restricted stock unit entitles the recipient to receive upon settlement thereof a specified number of shares of our common stock subject to terms and conditions set by the Plan administrator. The restricted stock units will vest as prescribed by the Plan administrator. The Plan permits payment of the purchase price of

restricted stock units, if any, to be made by cash or cash equivalents, shares of our common stock previously acquired by the underlying optionee, cancellation of indebtedness, waiver of compensation due for services rendered or to be rendered, any other form of legal consideration determined by the Plan administrator, or any combination of the foregoing.

Termination of Employment. The Plan administrator will determine and set forth in the award agreement whether any awards will continue to be exercisable, and the terms of such exercise, on and after the date the participant ceases to be employed by, or to otherwise provide services to, us, whether by reason of death, disability, voluntary or involuntary termination of employment or service, or otherwise, but in no event shall any unvested awards vest after the date the participant ceases to be employed by, or otherwise provide services to, us.

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

8. RECENT ACCOUNTING PRONOUNCEMENTS

Recent Accounting Pronouncements - Recently Adopted.

In June 2014, the Financial Accounting Standards Board (the “FASB”) issued a new accounting standard which requires that a performance target that affects vesting and could be achieved after the requisite service period shall be treated as a performance condition. Adoption of this standard is required for annual periods beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard effective January 2016 did not have a material impact on the Company's consolidated financial statements and related disclosures.

Recent Accounting Pronouncements - Not Yet Adopted.

In March 2016, the FASB issued a new standard that changes the accounting for certain aspects of share-based payments to employees. The new guidance requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee’s shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted. Management is currently assessing the impact that adopting this new accounting guidance will have on its financial statements and footnote disclosures.

In June 2016, the FASB issued guidance on the measurement and recognition of credit losses on most financial assets. For trade receivables, loans, and held-to-maturity debt securities, the current probable loss recognition methodology is being replaced by an expected credit loss model. For available-for-sale debt securities, the recognition model on credit losses is generally unchanged, except the losses will be presented as an adjustable allowance. The guidance will be applied retrospectively with the cumulative effect recognized as of the date of adoption. The guidance will become effective at the beginning of our first quarter of fiscal 2021 but can be adopted as early as the beginning of our first quarter of fiscal 2020. Management is currently assessing the impact that adopting this new accounting guidance will have on its financial statements and footnote disclosures.

In August 2016, the FASB amended guidance was issued to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are aimed at reducing the existing diversity in practice. The guidance should be applied using a retrospective transition method to each period presented and will be effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is permitted, including adoption in an interim period. Management is currently assessing the impact that adopting this new accounting guidance will have on its financial statements and footnote 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, 2015, filed with the SEC on March 15, 2016.

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and which concern matters that involve risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Reference is made in particular to the description of our plans and objectives for future operations, assumptions underlying such plans and objectives, and other forward-looking statements set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this Quarterly Report on Form 10-Q. Such statements may be identified by the use of forward-looking terminology such as "may," "will," "should," "could," "expect," "plan," "believe," "estimate," "anticipate," "intend," "predict," "potential," "continue" or similar terms, variations of such terms or the negative of such terms, although not all forward-looking statements contain these terms. Such statements are based on management's current expectations and are subject to a number of factors and uncertainties, which could cause actual results to differ materially from those described in the forward-looking statements. Such statements address future events and conditions concerning intellectual property acquisition and development, licensing and enforcement activities, other related business activities, capital expenditures, earnings, litigation, regulatory matters, markets for our services, liquidity and capital resources and accounting matters. Actual results in each case could differ materially from those anticipated in such statements by reason of factors such as our ability to invest in new technologies and patents, future global economic conditions, changes in demand for our services, legislative, regulatory and competitive developments in markets in which we and our subsidiaries operate, results of litigation and other circumstances affecting anticipated revenues and costs. We expressly disclaim any intent, obligation or undertaking to update or revise any forward-looking statements contained herein to conform such statements to actual results or to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. Readers are urged to carefully review and consider the various disclosures made by us, which attempt to advise interested parties of the risks, uncertainties, and other factors that affect our business, including without limitation the disclosures made under the captions "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Financial Statements" in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and disclosures made under the captions "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Risk Factors" and "Financial Statements and Supplementary Data" included in our Annual Report on Form 10-K for the year ended December 31, 2015.

General

As used in this Quarterly Report on Form 10-Q, "we," "us" "our" and "Company" refer to Acacia Research Corporation, a Delaware corporation, and/or its wholly and majority-owned and controlled operating subsidiaries, and/or where applicable, its management. All 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 intellectual property 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 patent licensing and enforcement and our operating subsidiaries have established a proven track record of licensing success with more than 1,500 license agreements executed to date, across 192 patent portfolio licensing and enforcement programs. Currently, on a consolidated basis, our 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. To date, we have generated gross licensing revenue over \$1.3 billion, and have returned more than \$723 million to our patent partners.

Executive Summary

Overview

Our operating activities during the periods presented have been principally focused on the continued operation of our patent licensing and enforcement business, including the continued pursuit of our ongoing patent licensing and enforcement programs. In addition, our operating subsidiaries may from time to time evaluate, leveraging our intellectual property expertise, other business opportunities. In some cases, these opportunities will compliment, and / or supplement our primary licensing and enforcement business. For the three months ended September 30, 2016, we reported revenues of \$64.7 million from 11 new revenue agreements covering 14 different licensing programs. Cash, restricted cash and investments totaled \$160.4 million as of September 30, 2016, as compared to \$145.9 million as of December 31, 2015.

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

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

For example, for the nine months ended September 30, 2016, we obtained control of only 2 new patent portfolios. Further, in fiscal year 2015, we obtained control of 3 new patent portfolios, compared to 6 new patent portfolios, and 25 new patent portfolios in fiscal years 2014 and 2013, respectively. This decrease in our patent portfolio intake reflects in part our strategic decision in 2013 to shift the focus of our operating business to serving a smaller number of customers, each having higher quality patent portfolios. As a result, our gross number of patent portfolio acquisitions has decreased significantly. This decrease in our patent portfolio intake also reflects in part industry trends impacting our ability to acquire patent portfolios. For example, legislative and legal changes have increased the complexity of patent enforcement actions and may significantly affect the market availability of suitable patent portfolios for acquisition. These industry trends have continued, and as a result, our recent and future patent portfolio intake has been or may be negatively impacted, resulting in a decrease in future revenue generating opportunities, and continued negative adverse impacts on the sustainability of our licensing and enforcement business. We continue to experience significant adverse challenges with respect to our patent intake efforts, and if these adverse challenges continue, we will be unable to profitably sustain our licensing and enforcement business going forward.

As a result of the foregoing, our operating subsidiaries may from time to time evaluate other business opportunities which compliment, or supplement, our primary licensing and enforcement business and leverage our intellectual property expertise. For example, in August 2016, we announced the formation of a strategic partnership with Veritone, Inc. (“Veritone”), a leading cloud-based Artificial Intelligence (“AI”) technology company that is pioneering next generation search and analytics through their proprietary Cognitive Media Platform™ . Under the partnership, we expect to leverage our IP expertise to assist Veritone with building its patent portfolio and executing upon its overall intellectual property strategy. In order to enhance Veritone’s leadership position in the field of machine learning and AI, we agreed to provide up to \$20 million in funding to Veritone in the form of two \$10 million loans, each convertible upon the occurrence of certain events into Veritone equity. Additionally, upon the occurrence of certain events and the achievement of certain milestones by Veritone, we may invest up to an additional \$30 million in Veritone, for a total investment of up to \$50 million. Our Board of Directors unanimously approved the investment, and believes that this partnership with Veritone will be synergistic with our business strategies.

Operating activities during the periods presented included the following:

| | Three Months | | Nine Months | |
|--|---------------|---------------|---------------|---------------|
| | Ended | | Ended | |
| | September 30, | September 30, | September 30, | September 30, |
| | 2016 | 2015 | 2016 | 2015 |
| Revenues (in thousands) | \$64,658 | \$12,994 | \$130,730 | \$87,540 |
| New agreements executed | 11 | 8 | 30 | 51 |
| Licensing and enforcement programs generating revenues | 14 | 13 | 27 | 28 |

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 | |
| September 30, 2016 | \$ 168,227 | 44 | % |
| June 30, 2016 | \$ 116,563 | 1 | % |
| March 31, 2016 | \$ 115,548 | (8) | % |
| December 31, 2015 | \$ 125,037 | 5 | % |
| September 30, 2015 | \$ 118,570 | — | % |

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

- the dollar amount of agreements executed each period, which can be driven by the nature and characteristics of the technology or technologies being licensed and the magnitude of infringement associated with a specific licensee;
- the specific terms and conditions of agreements executed each period including the nature and characteristics of rights granted, and the periods of infringement or term of use contemplated by the respective payments;
- fluctuations in the total number of agreements executed each period;
- the number of, timing, results and uncertainties associated with patent licensing negotiations, mediations, patent infringement actions, trial dates and other enforcement proceedings relating to our patent licensing and enforcement programs;
- the relative maturity of licensing programs during the applicable periods;
- other external factors, including the periodic status or results of ongoing negotiations, the status or results of ongoing litigations and appeals, actual or perceived shifts in the regulatory environment, impact of unrelated patent related judicial proceedings and other macroeconomic factors; and
- historically, based on the merits and strength of our operating subsidiary's patent infringement claims and other factors, many prospective licensees have elected to settle significant patent infringement cases and pay reasonable license fees for the use of our patented technology, as those patent infringement cases approached a court determined trial date.

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

Revenues for the nine months ended September 30, 2016 included fees from the following technology licensing and enforcement programs:

- 4G Wireless technology
- Audio Communications Fraud Detection technology
- Bone Wedge technology
- Broadband Communications technology
- Cardiology and Vascular Device technology
- Diamond and Gemstone Grading technology⁽¹⁾⁽²⁾
- DisplayPort and MIPI DSI technology
- DRAM and Flash Memory technology
- Electronic spreadsheet, data analysis and software development technology
- Flash Memory technology⁽²⁾
- Gas Modulation Control Systems technology
- High Speed Circuit Interconnect and Display Control technology
- Interstitial and Pop-Up Internet Advertising technology
- Knee Replacement technology
- Lighting Ballast technology
- Oil and gas drilling technology⁽²⁾
- Online Auction Guarantee technology
- Optical Networking technology
- Reflective and Radiant Barrier Insulation technology
- Semiconductor 3D die stacking technology⁽²⁾
- Semiconductor memory circuit and manufacturing processes technology⁽²⁾
- Shared Memory for Multimedia Processing technology
- Speech codes used in wireless and wireline systems technology
- Super Resolutions Microscopy technology
- Telematics technology
- Variable Data Printing technology⁽¹⁾⁽²⁾
- Wireless Infrastructure and User Equipment technology

⁽¹⁾ Initial revenues recognized during the three months ended September 30, 2016

⁽²⁾ Initial revenues recognized during the nine months ended September 30, 2016

Revenues for the nine months ended September 30, 2015 included fees from the following technology licensing and enforcement programs:

- 360 Degree View Technology⁽¹⁾
- 3G & 4G Cellular Air Interface and Infrastructure technology
- 4G Wireless technology
- Audio Communications Fraud Detection technology
- Automotive Safety, Navigation and Diagnostics technology
- Bone Wedge technology
- Broadband Communications technology
- Cardiology and Vascular Device technology
- DisplayPort and MIPI DSI technology⁽¹⁾
- Electronic Access Control technology
- Gas Modulation Control Systems technology
- Innovative Display technology
- Intercarrier SMS technology
- Interstitial and Pop-Up Internet Advertising technology
- Location Based Services technology
- Messaging technology
- Oil and Gas Production technology
- Online Auction Guarantee technology
- Optical Networking technology
- Optimized Microprocessor Operation technology
- Reflective and Radiant Barrier Insulation technology
- Semiconductor Testing technology⁽¹⁾
- Speech codes used in wireless and wireline systems technology
- Super Resolutions Microscopy technology
- Surgical Access technology
- Suture Anchors technology
- Telematics technology
- Unicondylar Knee Replacement technology

⁽¹⁾ Initial revenues recognized during the three months ended September 30, 2015

⁽²⁾ Initial revenues recognized during the nine months ended September 30, 2015

Summary of Results of Operations - Overview

For the Three and Nine Months Ended September 30, 2016 and 2015

(In thousands, except percentage change values)

| | Three Months Ended | | | Nine Months Ended | | |
|--|--------------------|--------------------|----------|--------------------|--------------------|----------|
| | September 30, 2016 | September 30, 2015 | % Change | September 30, 2016 | September 30, 2015 | % Change |
| Revenues | \$64,658 | \$12,994 | 398 % | \$130,730 | \$87,540 | 49 % |
| Operating costs and expenses | 48,368 | 39,830 | 21 % | 159,084 | 126,986 | 25 % |
| Operating income (loss) | 16,290 | (26,836) | (161)% | (28,354) | (39,446) | (28)% |
| Income (loss) before provision for income taxes | 16,551 | (27,016) | (161)% | (28,148) | (39,502) | (29)% |
| Provision for income taxes | (9,655) | (337) | * | (15,774) | (626) | * |
| Net (income) loss attributable to noncontrolling interests in operating subsidiaries | 186 | 43 | 333 % | 466 | (3,998) | (112)% |
| Net income (loss) attributable to Acacia Research Corporation | 7,082 | (27,310) | (126)% | (43,456) | (44,126) | (2)% |

*Percentage change in excess of 400%

Overview - Three months ended September 30, 2016 compared with the three months ended September 30, 2015

Revenues increased \$51.7 million, or 398%, to \$64.7 million for the three months ended September 30, 2016, as compared to \$13.0 million in the comparable prior year quarter, due primarily to an increase in average revenue per agreement.

Income before taxes was \$16.6 million for the three months ended September 30, 2016, as compared to a loss before income taxes of \$27.0 million for the three months ended September 30, 2015. The change was due primarily to a \$51.7 million increase in revenue, partially offset by a net decrease in operating expenses, including the following:

Cost of Revenues and Other Operating Expenses:

Inventor royalties and contingent legal fees, on a combined basis, increased \$23.5 million, in excess of 400%, compared to the 398% increase in related revenues for the same periods, due primarily due to lower average inventor royalty rates for the portfolios generating revenues in the third quarter of 2015, as compared to the portfolios generating revenues in the third quarter of 2016.

Litigation and licensing expenses-patents decreased \$3.0 million, or 29%, to \$7.3 million, due primarily to a net decrease in litigation support costs associated with upcoming trials and a decrease in patent prosecution and litigation expenses associated with ongoing licensing and enforcement programs.

Amortization expense decreased \$7.2 million, or 53%, to \$6.5 million, due to a decrease in scheduled amortization on existing patent portfolios resulting from various patent portfolio impairment charges previously recorded in the fourth quarter of 2015 and second quarter of 2016.

General and administrative expenses decreased \$1.1 million, or 12%, to \$8.3 million, due primarily to a net decrease in personnel costs in connection with head count reduction activities in 2015 and 2016.

Other operating expense was \$3.5 million for the three months ended September 30, 2015. Other operating expense included expense accruals for court ordered attorney fees related to a matter initiated in 2010, and settlement and

contingency accruals for other matters.

Overview - Nine months ended September 30, 2016 compared with the nine months ended September 30, 2015

- Revenues increased \$43.2 million, or 49% to \$130.7 million, as compared to \$87.5 million in the comparable prior year period, due primarily to an increase in average revenue per agreement.

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Loss before income taxes decreased 29%, to \$28.1 million, as compared to \$39.5 million in the comparable prior year period, due to the 49% increase in revenues, offset by an increase in inventor royalties and contingent legal fees and \$40.2 million of patent impairment charges.

Cost of Revenues and Other Operating Expenses:

Inventor royalties and contingent legal fees, on a combined basis, increased \$18.7 million, or 81%, as compared to the 49% increase in related revenues for the same periods, due to lower average inventor royalty and contingent legal fee rates the portfolios generating revenues during the nine months ended September 30, 2015 as compared to the portfolios generating revenues during the nine months ended September 30, 2016.

Litigation and licensing expenses-patents decreased \$5.6 million, or 20%, to \$22.4 million, due primarily to a net decrease in litigation support costs associated with upcoming trials and a decrease in patent prosecution and litigation expenses associated with ongoing licensing and enforcement programs.

Amortization of patents decreased \$12.0 million, or 30%, to \$28.0 million, due primarily to a decrease in scheduled amortization on existing patent portfolios resulting from various patent portfolio impairment charges previously recorded in the fourth quarter of 2015 and the second quarter of 2016.

Marketing, general and administrative expenses decreased \$5.7 million, or 19%, to \$23.9 million, due primarily to a net decrease in non-cash stock compensation charges and a decrease in personnel costs in connection with head count reduction activities in 2015 and 2016.

Impairment of patent-related intangible asset charges totaled \$40.2 million for the nine months ended September 30, 2016, reflecting the impact of reductions in expected estimated future net cash flows for certain patent portfolios and certain patent portfolios that management determined it would no longer allocate resources to in future periods.

The effective tax rates for the nine months ended September 30, 2016 and 2015 were 56% and 2%, respectively. Tax expense for the periods presented primarily reflects the impact of foreign withholding taxes related to revenue agreements executed with third party licensees domiciled in foreign jurisdictions.

Investments in Patent Portfolios

Certain of our operating subsidiaries continue to identify and explore opportunities to partner with patent owners with quality patent assets, across a range of technology areas. During the nine months ended September 30, 2016, we acquired control of two additional patent portfolios, one portfolio from our patent partner Renesas Electronics of Japan, comprised of 24 U.S. and 12 foreign patents covering technologies such as semiconductor chips for power management, system-on-chip architecture in microprocessors and packaging technology in memory and semiconductors. The second portfolio acquired contains 29 U.S. and 31 foreign patents covering circuits used in DRAM and Flash Memory. During the nine months ended September 30, 2015, we acquired control of two new patent portfolios. Refer to "Liquidity and Capital Resources" below for information regarding the financial statement impact, if any, of our patent partnering and investment activities during the periods presented.

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

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

For example, for the nine months ended September 30, 2016, we obtained control of only 2 new patent portfolios. Further, in fiscal year 2015, we obtained control of 3 new patent portfolios, compared to 6 new patent portfolios, and 25 new patent portfolios in fiscal years 2014 and 2013, respectively. This decrease in our patent portfolio intake reflects in part our strategic decision in 2013 to shift the focus of our operating business to serving a smaller number of customers, each having higher quality patent portfolios. As a result, our gross number of patent portfolio acquisitions has decreased significantly. This decrease in our patent portfolio intake also reflects in part industry trends impacting our ability to acquire patent portfolios. For example, legislative and legal changes have increased the complexity of patent enforcement actions and may significantly affect the market availability of suitable patent portfolios for acquisition. These industry trends have continued, and as a result, our recent and future patent portfolio intake has been or may be negatively impacted, resulting in a decrease in future revenue generating opportunities, and continued negative adverse impacts on the sustainability of our licensing and enforcement business. We continue to experience significant adverse challenges with respect to our patent intake efforts, and if these adverse challenges continue, we will be unable to profitably sustain our licensing and enforcement business going forward.

Patent Licensing and Enforcement

Patent Litigation Trial Dates and Related Trials. As of the date of this report, our operating subsidiaries have nine pending patent infringement cases with a scheduled trial date in the next six months. Patent infringement trials are components of our overall patent licensing process and are one of many factors that contribute to possible future revenue generating opportunities for us. Scheduled trial dates, as promulgated by the respective court, merely provide an indication of when, in future periods, the trials may occur according to the court's scheduling calendar at a specific point in time. A court may change previously scheduled trial dates. In fact, courts often reschedule trial dates for various reasons that are unrelated to the underlying patent assets and typically for reasons that are beyond our control. While scheduled trial dates provide an indication of the timing of possible future revenue generating opportunities for us, the trials themselves and the immediately preceding periods represent the possible future revenue generating opportunities. These future opportunities can result in varying outcomes. In fact, it is difficult to predict the outcome of patent enforcement litigation at the trial level since outcomes can be unfavorable. It is often difficult for juries and trial judges to understand complex patented technologies, and as a result, this may lead to a higher rate of unfavorable outcomes. Moreover, in the event of a favorable outcome, there is a higher rate of successful appeals in patent enforcement litigation than more standard business litigation. Such appeals are expensive and time consuming, resulting in increased costs and a potential for delayed or foregone revenue opportunities in the event of modification or reversal of favorable outcomes. Although we diligently pursue enforcement litigation, we cannot predict with significant reliability the decisions made by juries and trial courts.

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

- Increases in patent-related legal expenses associated with patent infringement litigation, including, but not limited to, increases in costs billed by outside legal counsel for discovery, depositions, economic analyses, damages assessments, expert witnesses and other consultants, re-exam and inter partes review costs, case-related audio/video presentations and other litigation support and administrative costs could increase our operating costs and decrease our profit generating opportunities;

- Our patented technologies and enforcement actions are complex and, as a result, we may be required to appeal adverse decisions by trial courts in order to successfully enforce our patents. Moreover, such appeals may not be successful;

New legislation, regulations or rules related to enforcement actions, including any fee or cost shifting provisions, could significantly increase our operating costs and decrease our profit generating opportunities. Increased focus on the growing number of patent-related lawsuits may result in legislative changes which increase our costs and related risks of asserting patent enforcement actions. For instance, the United States House of Representatives passed a bill that would require non-practicing entities that bring patent infringement lawsuits to pay legal costs of the defendants, if the lawsuits are unsuccessful and certain standards are not met;

Courts may rule that our subsidiaries have violated certain statutory, regulatory, federal, local or governing rules or standards by pursuing such enforcement actions, which may expose us and our operating subsidiaries to material liabilities, which could harm our operating results and our financial position; 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, 2015. 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 and Nine Months Ended September 30, 2016 and 2015

Revenues and Pretax Net Income (Loss)

| | Three Months Ended September 30, 2016 | | Change | | Nine Months Ended September 30, 2016 | | Change | |
|--|---------------------------------------|----------|----------|------|--------------------------------------|----------|----------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Revenues (in thousands, except percentage change values) | \$64,658 | \$12,994 | \$51,664 | 398% | \$130,730 | \$87,540 | \$43,190 | 49% |
| New agreements executed | 11 | 8 | | | 30 | 51 | | |
| Average revenue per agreement (in thousands) | \$5,878 | \$1,624 | | | \$4,358 | \$1,716 | | |

A reconciliation of the change in revenues (based on average revenue per agreement) for the periods presented, using the prior year period as the base period, is as follows (in thousands):

| | Three Months Ended September 30, 2016 vs. 2015 | Nine Months Ended September 30, 2016 vs. 2015 |
|--|--|---|
| Change in number of agreements executed | \$4,873 | \$(36,046) |
| Change in average revenue per agreement executed | 46,791 | 79,236 |
| Total change in revenues | \$51,664 | \$43,190 |

Two licensees individually accounted for 60% and 27% of revenues recognized during the three months ended September 30, 2016, and three licensees accounted for 30%, 27% and 13% of revenues recognized during the nine months ended September 30, 2016. Three licensees individually accounted for 54%, 15% and 13% of revenues recognized during the three months ended September 30, 2015 and two licensees accounted for 34% and 23% of

revenues recognized during the nine months ended September 30, 2015.

For the periods presented herein, the majority of the revenue agreements executed provided for the payment of one-time, paid-up license fees in consideration for the grant of certain intellectual property rights for patented technology rights owned by our operating subsidiaries. These rights were primarily granted on a perpetual basis, extending until the expiration of the underlying patents.

| | Three Months Ended September 30, | | Change | | Nine Months Ended September 30, | | Change | |
|---|----------------------------------|------------|----------|--------|---------------------------------|------------|----------|-------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| (in thousands, except percentage change values) | | | | | | | | |
| Income (loss) before provision for income taxes | \$16,551 | \$(27,016) | \$43,567 | (161)% | \$(28,148) | \$(39,502) | \$11,354 | (29)% |

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

| | Three Months Ended September 30, | | 2016 vs. 2015 | | % | | Nine Months Ended September 30, | | 2016 vs. 2015 | | % | |
|---|----------------------------------|------|---------------|----------|-------|---|---------------------------------|--|---------------|--|---|--|
| | | | | | | | | | | | | |
| (in thousands, except percentage values) | | | | | | | | | | | | |
| Increase in revenues | \$51,664 | 119 | % | \$43,190 | 380 | % | | | | | | |
| Increase in inventor royalties and contingent legal fees | (23,465) | (54) | % | (18,679) | (165) | % | | | | | | |
| Decrease in general and administrative expenses | 1,108 | 3 | % | 5,741 | 51 | % | | | | | | |
| Decrease in litigation and licensing expenses | 2,997 | 7 | % | 5,637 | 50 | % | | | | | | |
| Decrease in patent amortization expenses | 7,221 | 17 | % | 11,968 | 105 | % | | | | | | |
| Increase in impairment of patent-related intangible assets | — | — | % | (40,165) | (354) | % | | | | | | |
| Other | 4,042 | 8 | % | 3,662 | 33 | % | | | | | | |
| Total change in income (loss) before provision for income taxes | \$43,567 | 100 | % | \$11,354 | 100 | % | | | | | | |

Cost of Revenues

| | Three Months Ended September 30, | | Change | | Nine Months Ended September 30, | | Change | |
|---|----------------------------------|---------|----------|------|---------------------------------|----------|---------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| (in thousands, except percentage change values) | | | | | | | | |
| Inventor royalties | \$17,844 | \$116 | \$17,728 | * | \$19,417 | \$10,706 | \$8,711 | 81% |
| Contingent legal fees | \$7,709 | \$1,972 | \$5,737 | 291% | \$22,236 | \$12,268 | \$9,968 | 81% |

* change in excess of 400%

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, using the prior year period as the base period, is as follows (in thousands, except percentage values):

| Three Months Ended September 30, | Nine Months Ended September 30, |
|----------------------------------|---------------------------------|
| | |

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| | 2016 vs. 2015 | | 2016 vs. 2015 | |
|---|------------------|-------|------------------|--------|
| Inventor Royalties: | | | | |
| Increase in total revenues | \$493 | 3 % | \$ 5,609 | 64 % |
| Increase in inventor royalty rates | 17,430 | 98 % | 12,501 | 144 % |
| Increase in revenues without inventor royalty obligations primarily due to upfront advance related preferred returns | (195) | (1)% | (9,399) | (108)% |
| Total change in inventor royalties expense | \$17,728 | 100 % | \$ 8,711 | 100 % |

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Contingent Legal Fees:

| | | | | |
|---|----------|--------|---------|-------|
| Increase in total revenues | \$8,089 | 141 % | \$6,191 | 62 % |
| Increase (decrease) in contingent legal fee rates | (1,686) | (29)% | 4,460 | 45 % |
| Increase in revenues without contingent legal fee obligations | (666) | (12)% | (683) | (7)% |
| Total change in contingent legal fees expense | \$5,737 | 100 % | \$9,968 | 100 % |

| | Three Months | | Change | | Nine Months | | Change | |
|---|---------------|---------------|-----------|-------|---------------|---------------|------------|--------|
| | Ended | Ended | | | Ended | Ended | | |
| | September 30, | September 30, | | | September 30, | September 30, | | |
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| (in thousands, except percentage change values) | | | | | | | | |
| Litigation and licensing expenses - patents | \$7,348 | \$10,345 | \$(2,997) | (29)% | \$22,395 | \$28,032 | \$(5,637) | (20)% |
| Amortization of patents | \$6,467 | \$13,688 | \$(7,221) | (53)% | \$27,986 | \$39,954 | \$(11,968) | (30)% |
| Impairment of patent-related intangible assets | \$— | \$— | \$— | — % | \$40,165 | \$— | \$40,165 | 100 % |

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 three and nine month periods presented due to a net decrease in litigation support costs associated with upcoming trials and a decrease in patent prosecution and litigation expenses associated with ongoing licensing and enforcement programs. 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 a decrease in scheduled amortization on existing patent portfolios resulting from various patent portfolio impairment charges previously recorded in the fourth quarter of 2015 and second quarter of 2016.

Patent Impairment Charges. Patent portfolio impairment charges totaled \$40.2 million for the nine months ended September 30, 2016, primarily comprised of the write-off of the remaining carrying value of our Adaptix portfolio in the second quarter of 2016. The impairment charges for the applicable periods presented reflect the impact of reductions in expected estimated future net cash flows for certain patent portfolios and certain patent portfolios that management determined it would no longer allocate resources to in future periods. The impairment charges consisted of the excess of the asset's carrying value over its estimated fair value as of the applicable measurement date.

Operating Expenses (in thousands, except percentage change values)

| | Three Months | | Change | | Nine Months | | Change | |
|-------------------------------------|---------------|---------------|-----------|-------|---------------|---------------|-----------|-------|
| | Ended | Ended | | | Ended | Ended | | |
| | September 30, | September 30, | | | September 30, | September 30, | | |
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| General and administrative expenses | \$5,790 | \$7,278 | \$(1,488) | (20)% | \$18,109 | \$21,016 | \$(2,907) | (14)% |
| Non-cash stock compensation expense | 2,544 | 2,164 | 380 | 18 % | 5,754 | 8,588 | (2,834) | (33)% |

Total general and administrative expenses \$8,334 \$9,442 \$(1,108) (12)% \$23,863 \$29,604 \$(5,741) (19)%

General and Administrative Expenses. 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, stock administration, state taxes based on gross receipts and other corporate costs. A summary of the main drivers of the change in general and administrative expenses for the periods presented, is as follows (in thousands, except percentage values):

| | Three Months Ended September 30, 2016 vs. 2015 | | Nine Months Ended September 30, 2016 vs. 2015 | |
|---|--|--------|---|--------|
| | | % | | % |
| Personnel cost reductions due to headcount reductions | \$(1,509) | 136 % | \$(4,745) | 83 % |
| Variable performance-based compensation costs | 979 | (88)% | 783 | (14)% |
| Corporate, general and administrative costs | 447 | (40)% | 1,781 | (31)% |
| Non-cash stock compensation expense | 380 | (34)% | (2,834) | 49 % |
| Non-recurring employee severance costs | (1,405) | 126 % | (726) | 13 % |
| Total change in general and administrative expenses | \$(1,108) | 100 % | \$(5,741) | 100 % |

Other

For the nine months ended September 30, 2016 and 2015, other operating expenses were \$500,000 and \$3,891,000, respectively. Other operating expenses includes expense accruals for court ordered attorney's fees and settlement and contingency accruals for other matters.

Income Taxes

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2016 | |
|---|---------------------------------------|---------|--------------------------------------|---------|
| | 2015 | | 2015 | |
| Provision for income taxes (in thousands) | \$(9,655) | \$(337) | \$(15,774) | \$(626) |
| Effective tax rate | (58)% | 1 % | 56 % | 2 % |

The increase in tax expense for the periods presented primarily reflects the impact of foreign withholding taxes related to certain revenue agreements executed with third party licensees domiciled in foreign jurisdictions.

Liquidity and Capital Resources

General

Our primary sources of liquidity are cash and cash equivalents on hand generated from our operating activities. Our management believes that our cash and cash equivalent balances and anticipated cash flows from operations will be sufficient to meet our cash requirements through at least November 2017 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, 2015. 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 in recent years, and the volatility and impact of the disruption has continued into 2016. 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.

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

Cash, Cash Equivalents and Investments

Our consolidated cash and cash equivalents and investments on hand, excluding restricted cash balances, totaled \$146.3 million at September 30, 2016, compared to \$135.2 million at December 31, 2015. The net change in cash and cash equivalents for the periods presented was comprised of the following (in thousands):

Nine Months
Ended
September 30,
2016 2015

Net cash provided by (used in):

| | | |
|----------------------|-----------|----------|
| Operating activities | \$23,219 | \$2,155 |
| Investing activities | (41,285) | 39,307 |
| Financing activities | (1,141) | (18,153) |

Cash Flows from Operating Activities. Cash receipts from licensees for the nine months ended September 30, 2016 increased 17% to \$111.3 million, as compared to \$95.0 million in the comparable 2015 period, due to the net impact of the timing of cash receipts from licensees. Cash outflows from operations for the nine months ended September 30, 2016 increased 3% to \$84.7 million, as compared to \$82.1 million in the comparable 2015 period, primarily due to the net impact of the timing of related payments of inventor royalties and contingent legal fees and the timing of payments to other third-parties in the ordinary course, for the same periods. Refer to “Working Capital” below for additional information.

Restricted Cash. In March 2015, an operating subsidiary of ours entered into a Guarantee with a bank in connection with enforcing a ruling in a German patent court granting an injunction against the defendants in the related patent infringement case. The Guarantee is secured by a cash deposit (classified as restricted cash in the accompanying balances sheets) at the contracting bank, totaling \$14.0 million and \$10.7 million, at September 30, 2016 and December 31, 2015, respectively. See 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):

Nine Months Ended
September 30,
2016 2015

| | | |
|---|------------|-----------|
| Available-for-sale investments, net | \$(30,281) | \$58,819 |
| Investments in patents/ patent rights | (1,000) | (19,504) |
| Loan receivable | (8,280) | — |
| Investment at cost | (1,720) | — |
| Purchases of property and equipment | (4) | (8) |
| Net cash provided by (used in) investing activities | \$(41,285) | \$39,307 |

Strategic Partnership. In August, we formed a strategic partnership with Veritone pursuant to which we expect to leverage our expertise in intellectual property licensing and enforcement to help Veritone build its patent portfolio and execute upon its overall intellectual property strategy. As a part of this strategic partnership, we entered into an Investment Agreement with Veritone that provides for us to invest up to \$50 million in Veritone, consisting of both debt and equity components. Pursuant to the Investment Agreement, on August 15, 2016, we entered into a secured convertible promissory note with Veritone (the “Veritone Loan”), which permits Veritone to borrow up to \$20 million through two \$10 million advances, each bearing interest at the rate of 6.0% per annum. On August 15, 2016, we funded the initial \$10 million loan (the “First Loan”), which has a one-year term. If Veritone draws the second \$10

million loan (the “Second Loan”), the Second Loan will also have a one-year term from the date of issuance, and the maturity date of the First Loan will automatically extend to the maturity date of the Second Loan. As a result, if Veritone draws the Second Loan, both the First Loan and the Second Loan will become due and payable on the first anniversary of the issuance date of the Second Loan. Veritone’s obligations under the Veritone Loan are secured by substantially all of Veritone’s assets pursuant to a security agreement that we entered into with Veritone dated August 15, 2016.

In addition, commencing on the earlier of Veritone’s consummation of a private round of financing of at least \$10 million (a “Next Equity Financing”) and the maturity date of the Veritone Loan, we have the right, under certain circumstances,

to convert all or a portion of the principal and accrued interest of the First Loan into shares of Veritone's Series B Preferred Stock or, if Veritone consummates a Next Equity Financing, into shares of Veritone capital stock issued in such financing, at various conversion rates, with the exact conversion rate to depend upon (i) whether Veritone consummates a Next Equity Financing, (ii) the price per share in such Next Equity Financing and (iii) whether or not Acacia elects to convert all of the outstanding principal and accrued interest under the Veritone Loan. If we fund the Second Loan, we will have the right, under certain circumstances, to convert all or a portion of the principal and accrued interest of the Second Loan into shares of Veritone's Series B Preferred Stock or, if Veritone consummates a Next Equity Financing, into shares of Veritone capital stock issued in such financing, at various conversion rates, with the exact conversion rate to depend upon (i) whether Veritone consummates a Next Equity Financing, (ii) the price per share in such Next Equity Financing and (iii) whether or not Acacia elects to convert all of the principal and accrued interest under the Veritone Loan. If Veritone consummates a qualified public offering of its common stock, any outstanding principal and accrued interest under the Veritone Loan will automatically convert into shares of Veritone common stock.

In conjunction with the First Loan, Veritone issued us a four-year \$700,000 warrant to purchase shares of Veritone's common stock at various exercise prices, with the actual exercise price to be determined by the type and/or valuation of Veritone's future equity financings, if any. If we fund the Second Loan, Veritone will issue to us two additional four-year \$700,000 warrants to purchase shares of Veritone's common stock with similar terms.

In addition, pursuant to the Investment Agreement, Veritone issued us a five-year Primary Warrant to purchase up to \$50 million, less all converted amounts or payments under the Veritone Loan, worth of shares of Veritone's common stock at various exercise prices, with the actual exercise price per share to be determined by the amount of principal and accrued interest under the Veritone Loan converted into shares of Veritone common stock. Acacia may exercise the Primary Warrant at any time during its five-year term after the earlier of August 15, 2017 or the completion of a public offering of common stock by Veritone with gross proceeds to Veritone of at least \$15.0 million. Upon the consummation of a public offering as described above, and subject to the satisfaction of certain other conditions, Veritone has the right to elect that we exercise the Primary Warrant, and upon such election, we agree to exercise the Primary Warrant in full.

Immediately following our exercise of the Primary Warrant in full, Veritone has the obligation to issue to us an additional 10% Warrant that provides for the issuance of additional shares of Veritone common stock, with 50% of the shares underlying the 10% Warrant vesting as of the issuance date of the 10% Warrant, and the remaining 50% of shares vesting on the anniversary of the issuance date of the 10% Warrant.

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

| | Nine Months Ended | |
|---|-------------------|------------|
| | September 30, | |
| | 2016 | 2015 |
| Dividends paid to stockholders | \$— | \$(19,091) |
| Distributions to noncontrolling interests in operating subsidiary | (1,358) | — |
| Repurchased restricted common stock | (25) | — |
| Proceeds from exercises of stock options | 242 | 938 |
| Net cash used in financing activities | \$(1,141) | \$(18,153) |

We paid quarterly cash dividends totaling \$19.1 million during the nine months ended September 30, 2015 in the amount of \$0.125 per share. On February 25, 2016, Acacia announced that its Board of Directors terminated the company's dividend policy effective February 23, 2016.

Working Capital

Working capital (including restricted cash) at September 30, 2016 increased to \$170.1 million, compared to \$150.7 million at December 31, 2015. Consolidated accounts receivable from licensees increased to \$53.7 million at September 30, 2016, compared to \$33.5 million at December 31, 2015. Consolidated royalties and contingent legal fees payable increased to \$25.0 million at September 30, 2016, compared to \$14.9 million at December 31, 2015.

The majority of accounts receivable from licensees at September 30, 2016 were collected or scheduled to be collected in the fourth quarter of 2016, 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 fourth quarter of 2016 or first quarter of 2017, subsequent to receipt by us of the related fee payments from licensees, in accordance with the underlying contractual arrangements.

Standby Letter of Credit and Guarantee Arrangement

In March 2015, an operating subsidiary of ours entered into a standby letter of credit and guarantee arrangement (“Guarantee”) with a bank for purposes of enforcing a court ruling in a German patent court granting an injunction against the defendants in the related patent infringement case. An injunction is an equitable remedy in the form of a court order that compels the defendant(s) to cease marketing, offering for sale or importing applicable infringing products into applicable jurisdiction(s). Under German law, in order to enforce the injunction granted by the court, a Guarantee is required to be furnished by our operating subsidiary, the plaintiff in the case, for potential payment to the defendants of any applicable claims which may be incurred by the defendants as a result of the enforcement of the injunction, only in the event that the aforementioned court ruling is subsequently successfully appealed by the defendants or otherwise amended. The Guarantee is required to be issued unlimited with respect to time, until appropriately extinguished in accordance with German law. The Guarantee will be extinguished when a relevant extinguishment order by the court having jurisdiction takes effect, typically occurring when the related infringement case has been settled or a final non-appealable decision has been issued by the court.

The Guarantee is secured by a cash deposit at the contracting bank totaling \$14.0 million and \$10.7 million, as of September 30, 2016 and December 31, 2015, respectively. Changes in the balance are primarily due to additional defendants that were added to the patent infringement case in the second quarter of 2016. Additional changes are a result of foreign currency exchange rate fluctuations and the related impact on the underlying collateral, which is denominated in U.S. dollars. The Guarantee expires on April 10, 2017, however, it is automatically extended without amendment for a period of one (1) year from the present or any future expiration date, unless at least 30 days prior to any expiration date, the Guarantee is extinguished in accordance with German law. The Guarantee facility fee is 1.15% per year, and the related expense is included in the statement of operations.

Off-Balance Sheet Arrangements

Except as set forth below, we have not entered into off-balance sheet financing arrangements. We have no long-term debt. The following table lists our known contractual obligations and future cash commitments as of September 30, 2016 (in thousands):

| 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, net of guaranteed sublease income | \$4,219 | \$201 | \$2,569 | \$1,449 | \$ — |
| Investment Agreement - Second Loan, contingent obligation ⁽¹⁾ | 10,000 | 10,000 | — | — | — |
| Investment Agreement - Primary Warrant Put Right, contingent obligation ⁽¹⁾ | 30,000 | — | 30,000 | — | — |
| Total contractual obligations | \$44,219 | \$10,201 | \$32,569 | \$1,449 | \$ — |

(1) - Refer to description of Strategic Partnership - Veritone, above

Uncertain Tax Positions. At September 30, 2016, we had total unrecognized tax benefits of approximately \$2.1 million, 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 September 30,

2016. Recognition of the tax benefits would not have a material impact on 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.

During the periods presented, 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-rated, 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. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) 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 on Form 10-Q. As a result of a material weakness in our internal control over financial reporting relating to the accounting for infrequent, unusual, or complex accounting matters, as described below, our management has assessed the effectiveness of our disclosure controls and procedures and have determined that our disclosure controls and procedures were not effective as of September 30, 2016.

A “material weakness” in internal control over financial reporting is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of a company’s annual or interim financial statements will not be prevented or detected on a timely basis by the company’s internal controls. The matter involving internal controls and procedures that our management considered to be a material weakness involves the sufficiency of company resources with accounting technical knowledge and expertise related to the accounting and disclosure of infrequent, unusual, or complex accounting matters. Specifically, a control failure occurred that allowed for misapplication of Accounting Standards Codification (“ASC”) 718-10, “Compensation - Stock Compensation,” in connection with the accounting for stock options with market vesting conditions, granted during the third quarter of 2016, which impacted stock based compensation expense for the third quarter of 2016. The non-cash

stock compensation expense has been properly reflected in the accompanying consolidated financial statements. Remediation Plan. We are in the process of developing a plan to address the material weakness and enhance our control procedures related to infrequent, unusual, or complex accounting matters, and anticipate implementation in the fourth quarter of 2016.

Changes in Internal Controls. Except as described above, there have been no changes in our internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Inherent Limitations on Effectiveness of Controls.

Our management, including our chief executive officer and chief financial officer, 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 1A. RISK FACTORS

The risk factors set forth below contain changes to the description of the applicable risk factors previously disclosed in Item 1A. to our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 filed with the SEC on March 15, 2016.

Our operating subsidiaries depend upon relationships with others to provide technology-based opportunities that can develop into profitable royalty-bearing licenses, and if they are unable to maintain and generate new relationships, then they may not be able to sustain existing levels of revenue or increase revenue.

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

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

For example, for the nine months ended September 30, 2016, we obtained control of only 2 new patent portfolios. Further, in fiscal year 2015, we obtained control of 3 new patent portfolios, compared to 6 new patent portfolios, and 25 new patent portfolios in fiscal years 2014 and 2013, respectively. This decrease in our patent portfolio intake reflects in part our strategic decision in 2013 to shift the focus of our operating business to serving 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, each originating from highly-pedigreed patent owners and/or possessing a relatively large number of prospective licensees. In this regard, commencing in the latter half of 2013 and in early 2014, we continued to shift our focus at the point of patent intake from quantity to quality. As a result, our gross number of patent portfolio acquisitions has decreased significantly. This decrease in our patent portfolio intake also reflects in part industry trends impacting our ability to acquire patent portfolios. For example, legislative and legal changes have increased the complexity of patent enforcement and may significantly affect the market availability of suitable patent portfolios for acquisition. These industry trends have continued, and as a result, our recent and future patent portfolio intake has been or may be negatively impacted, resulting in a decrease in future revenue generating opportunities, and continued negative adverse impacts on the sustainability of our licensing and enforcement business. We continue to experience significant adverse challenges with respect to our patent intake efforts, and if these adverse challenges continue, we will be unable to profitably sustain our licensing and enforcement business going forward.

Failure to maintain effective internal control over our financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act could cause our financial reports to be inaccurate

We are required pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, or Section 404, to maintain internal control over financial reporting and to assess and report on the effectiveness of those controls. This assessment

includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting. As a result of a material weakness identified in our internal control over financial reporting relating to the accounting for infrequent, unusual, or complex accounting matters, our management assessed the effectiveness of our disclosure controls and procedures and determined that our disclosure controls and procedures were not effective as of September 30, 2016. We are in the process of developing a plan to address the material weakness and enhance our control procedures related to infrequent, unusual, or complex accounting matters. While management believes the enhanced internal controls, once implemented, will remediate the material weakness identified, there is no assurance that the changes will remediate the identified material weakness or that the controls will prevent or detect future material weaknesses. If we are not able to maintain effective internal control over financial reporting, our financial statements, including related disclosures, may be inaccurate, which could have a material adverse effect on our business.

Item 5. OTHER INFORMATION

Subsequent to our third quarter 2016 earnings press release and Form 8-K filed with the SEC on October 27, 2016, we (1) completed the accounting and valuation analysis for our Veritone, Inc. transaction (described earlier herein), and (2) based upon completion of the related valuation analysis, recorded additional non-cash stock compensation expense related to options with market based vesting conditions granted in third quarter of 2016. The amounts recorded had the following impact on the preliminary net income (loss) and income (loss) per share previously announced (in thousands, except per share information):

| | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2016 |
|--|--|---|
| Preliminary net income (loss), initially included in release | \$ 7,989 | \$(42,549) |
| Interest income and accretion on First Loan ⁽¹⁾ | 269 | 269 |
| Additional non-cash stock compensation - options with market based vesting conditions ⁽²⁾ | (1,176) | (1,176) |
| Adjusted net income (loss), as reported on Form 10-Q | \$ 7,082 | \$(43,456) |
| | | |
| Preliminary income (loss) per share, initially included in release | \$ 0.16 | \$(0.85) |
| Adjusted income (loss) per share, as reported on Form 10-Q | \$ 0.14 | \$(0.87) |

⁽¹⁾ - Refer to Management's Discussion and Analysis of Financial Conditions and Results of Operations - "Liquidity and Capital Resources" and Note 5 to the consolidated financial statements elsewhere herein.

⁽²⁾ - Non-cash stock compensation expense relates to options granted with market based vesting conditions during the third quarter of 2016. Refer to Note 2 to the consolidated financial statements elsewhere herein.

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/ Marvin Key

By: Marvin Key

Interim Chief Executive Officer

(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: November 14, 2016

EXHIBIT INDEX

EXHIBIT
NUMBER

- | EXHIBIT
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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. |