

On brand valuation and management

Introduction

Brand valuation has become a mainstream activity being recognised by financial practitioners for raising finance and for application to a company's balance sheet.

In this context there is a need to appreciate that brand valuation is not just a number, the valuation process itself enriches the user with a far more comprehensive understanding of how business generate cash flows through an understanding of their customers, the markets and channels they operate in, the competitive environment, and operational capability to deliver value and growth. Brand valuation by necessity is intrinsically interlinked with business and brand strategy as this defines how the brand will be exploited and managed.

Brand valuation for financial reporting and balance sheet purposes

Brand valuation and intangible asset valuation are now required for compliance with United States and International Financial Reporting Standards. Acquired intangibles which are identifiable in terms of being separable and arise from contractual or legal rights have to be valued and put on the balance sheet. Additionally these intangibles require annual impairment testing to make sure their values have not diminished. If they diminish in value then a write off to the profit and loss account is required. For example in the United States under the new accounting standards AOL Time Warner has written off \$54 billion and WorldCom \$50 billion dollars.

A robust methodology for brand valuation

Intangible Business, the leading independent brand valuation consultancy in the UK, has developed a more complete and reliable valuation methodology for both one off brand valuations and for use by management as a performance measure that quantifies and appreciates the connection between brand equity and brand performance delivery.

The methodology is made more rigorous by analysing existing comparable commercial arrangements within the company and sector and by corroborating such analysis with available external comparables (benchmarks) and the understanding of commercial affordability to reach an appropriate royalty rate. The financial analysis can assess the earnings between different points in the value chain i.e. the brand owning entity, the distributor and retailer separating the earnings applicable to the brand. Cross checks are also made with external sources.

Components of brand valuation

Component	Process	Source
Brand strength	Consumer research	Brand strength analysis
Royalty rate	Operations/margin	Profitability and brand analysis
Sales forecast	GDP/mkt sector/brand	Market analysis
Brand earnings	Calculation	Valuation model
Taxation	Application	Current rates
Discount rates	Evaluation of risk	Future weighted average cost of capital

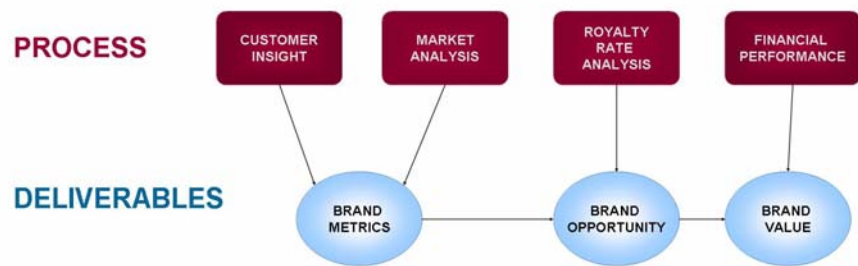


VIEWPOINT

The main variables companies manage which most heavily impact the value of a brand are brand image and strength, profitability represented in the form of a royalty rate and the market size/share and future growth where the brand is applied.

The other components that impact brand value are mostly outside of the direct influence of a company's activities in terms of tax and discount rates.

Summary Overview



Step 1

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Understanding the brand in the eyes of the Customer by segment.

Customers are the decision makers who ultimately decide to purchase a brand versus another often based on preference and availability. Preference and choice is based on previous experience and perception or a combination of both.

Brand performance from a customer perspective relative to the defined competitive set defines the strength of a brand in a defined market, and this is demonstrated in the example below.

Brand Performance

Master Brand

Category

Brand Territory

Competitor Set	Recognition	Relevance	Satisfaction	Differentiation	Loyalty	Brand Score
Our Brand	63	70	56	63	40	58
Competitor 1	50	60	80	52	45	57
Benchmark	85	90	80	65	62	76
Competitor 2	73	65	50	50	35	55
Competitor 3	80	90	75	62	50	71



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It is important to set a benchmark that can be both measured in terms of brand performance and profitability (referenced in terms of the ability to command a royalty for the use of the brand). This allows a real comparator that demonstrates the relationship between a movement in brand performance and the ability to generate profit and cash flow into the future.

The model has the ability to be used as a means of demonstrating return on investment as well as a robust method of valuation at a point in time.

For example an investment of US\$10 million will generate US\$12 million of future discounted cash flows in one scenario and in another the return is US\$15 million. The second option takes priority in terms of allocating scarce financial investment resources. This can be done for any number of brand market combinations for improved investment decision making purposes.

Measurements are better understood when relative, not absolute. See below:

Relative Brand Strength Analysis

Brand Strength Analysis					
Master Brand					
Category					
Brand Territory					
#	Brand Drivers	Brand Performance	Weighting Multiple	Benchmark Position	Brand Performance
1	Recognition	63	1	85	63
2	Relevance	70	1	90	70
3	Satisfaction	56	1	80	56
4	Differentiation	63	1	65	63
5	Loyalty	40	1	62	40
				76	58

BSA Index	76.3%	100%
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It is possible to be above or below the benchmark in terms of relative brand strength. The benchmark is chosen on the basis of comparability and relevance as well as being able to be measured in terms of profitability and consumer preference.

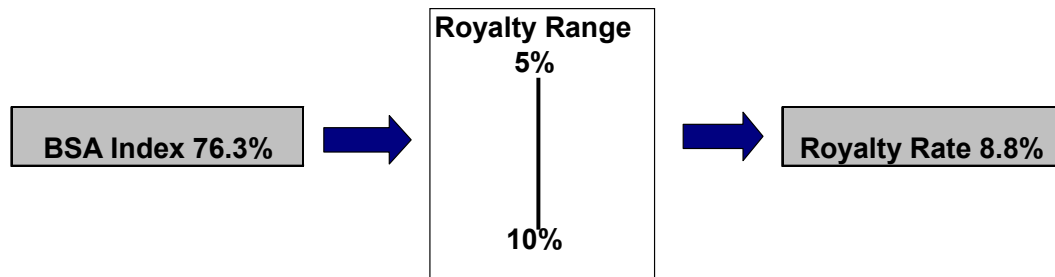
Step 2

Brand premium analysis (royalty rate determination)

Royalty rates, to derive a range applicable to comparable brands, are determined either from public records or from internal and external market information including the benchmark brand.



VIEWPOINT



A royalty rate is effectively a profit sharing mechanism most often applied to net turnover to derive a brand cash flow. The royalty rate is a reflection of the bottom line operating profitability of a brand that can be earned by the owner of that brand, derived purely from the brand itself, not other capabilities such as distribution or manufacturing.

This profitability is normally reflected in terms of a royalty applied to net turnover. It is important to understand at which point in the value chain the royalty is applied i.e. manufacturer, wholesale or retail. At whatever point the royalty is applied the value will be the same if the valuation is done properly and accurately.

Licensing and brand valuation are naturally interlinked as the royalty rate reflects a profit sharing mechanism between a brand owner (licensor) and an operator of the brand in the market (licensee). The stronger the brand the more the brand can earn and command in license fees.

Many companies and organisation would like to know what they could/should earn in royalty income for licensing the rights to their brand. It should also be appreciated that licensing as an activity does not necessarily dilute the brand equity, in fact it should be an integral part of a companies brand strategy that lends itself to improving the equity and saliency of the brand.

Step 3

Market Analysis

Once a royalty rate has been determined through the understanding of competitively benchmarked brand strength and profitability analysis the next step is to determine the future share of market or turnover that the royalty rate should be applied to.

The table below demonstrates some of the aspects of the market that will need to be determined and taken into account

o	Historic	Current	Future outlook
Macro economic	GDP value	GDP value	Plus 3%
Sector growth	4%	3%	Plus 2.5%
Share of market	5%	5.5%	3%
Share of voice	4%	6%	4%
Consumer offtake	Full vs discount%	%	%
Average pricing	£85	£87	£93
Turnover	£100m	£110.5	£136m



VIEWPOINT

The market analysis is a full situational analysis of the total market, competitive positions and strategy, life style trends and forecasts of the future outlook including innovations and new product development.

At a point in time this will derive the most accurate view of the future market opportunity and determine the value opportunity available to the brand we are valuing.

Step 4

Valuation

The royalty rate is applied to the turnover to derive a brand profit/cash flow which is then taxed and discounted to bring future earnings back to a present value.

The apparent simplicity of the final model hides the thorough analysis that has gone in to the valuation thereby ensuring the valuation is robust and reliable.

Brand Premium Royalty	8.80%
Discount rate:	7.20%
Tax Rate	30.00%
Growth rate to 2007	3.00%
EVA growth rate post 2007	2.50%

All amounts in £000's	2003	2004	2005	2006	2007
Net Turnover	110,500	116,493	122,746	129,270	136,074
Brand Premium Royalty Rate	8.80%	8.80%	8.80%	8.80%	8.80%
Brand Profit/Cash Stream	9,724	10,251	10,802	11,376	11,975
Taxation	- 2,917	- 3,075	- 3,240	- 3,413	- 3,592
Profit after tax	6,807	7,176	7,561	7,963	8,382
Discount Factor	1.072	1.149	1.232	1.321	1.416
	6,350	6,244	6,138	6,030	5,921

BRAND VALUE CALCULATION

Brand Value to 2004	30,682
Perpetuity calculation	129,124
Total Brand Value	159,807

There is much to be discussed concerning the determination and justification of future growth rates, taxation rates and the discount factor which takes into account the future gearing and return expectations of the investors who require a return on their relative risk.

All components of brand valuation need to be thoroughly researched, analysed and substantiated before they can be signed off by auditors for application to a company's balance sheet for inclusion in the accounts of a listed company.

