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Giving brand 'boot collateral' the boot

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Brands and other intangible assets are frequently under-leveraged as collateral to back secured loans and are mainly used as a way to stretch the loan value. Using brands as 'boot collateral' in asset based lending financing makes no sense to either borrower or lender. For the borrower it is a missed opportunity to lower the cost of debt. For the lender it is a missed opportunity to lend more money.

Why value brands?

Reservations about valuing brands are now no longer relevant. Since brand valuation was invented nearly twenty years ago, the process has been perfected into the robust methodology that is accepted today by courts, auditors, business and financial regulators the world over. To ignore the brands, or not give them the attention they deserve, is to ignore what is frequently the most important and valuable asset. 70% of the value of most companies is intangible, be it brands, customer relationships, contracts or software. In many circumstances, each can be separated and valued like other asset categories such as inventory, property, plant & machinery and receivables.

There is invariably a direct relationship between these other asset classes and the brand. Without a full appreciation of the intricacies of these relationships, loans secured on tangible assets may not be as secure as thought prior to the need for liquidation. For example, lending to a Champagne house may be secured on various hard asset classes such as its plant and machinery or its inventory. Valuing the hard assets is pretty straight forward but valuing the asset inventory is less simple as without the brand the stock can still be sold but at a fraction of the price it would be worth with the

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brand. These relationships exist in many sectors and brands are playing an increasingly important role. Virtually all companies, whether consumer facing or business to business, have brands and other intangible assets. This is why Intangible Business and GoIndustry have combined their knowledge of valuing intangible assets and hard assets respectively, to provide a full valuation service for corporate financing.

The brand valuation process

As with valuing hard asset classes, the starting point is to project the brand's recoveries in a liquidation situation. This is done in much the same way as other assets. Earnings directly attributable to the brand are forecast over its useful life and discounted using the discounted cash flow methodology. The value of this future cash flow is then benchmarked against comparable transactions, which are either mergers and acquisitions or licensing arrangements; with a sense check against the building or re-build costs associated with the brand; and with an appreciation of whether there is an active market for the brand and if so who could the potential buyers be and how much would the brand be worth to them.

The main differences between valuing hard and intangible assets in this situation is the change in brand value that would occur by default of it being in a distressed situation and the ability to value the brand in isolation from other supporting assets such as its stock, distribution or sales force. With the appropriate expertise on managing and valuing intangible assets, both these potential difficulties pose no threat.

The opportunity

The opportunity available is very significant. Currently, brands are secured principally as boot collateral to boost the percentage lent against other assets such as plant & machinery, inventory and receivables. The main reason for reticense is a lack of comfort because of understanding, and often the perceived view that brands a difficult to sell or exit from and therefore represent 'high risk'. Depending on the situation the opposite can actually be true. With a robust brand valuation this loan value could be increased significantly, enabling banks to lend more money and giving businesses access to greater capital at a lower interest rate, lower because more assets are secured so less risk. A win-win situation.

Conclusion

There are no more excuses for recognising the brand purely as 'boot collateral'. Valuation techniques have proven their mettle, intangible assets are frequently the most valuable asset in a company, the borrower gets more and pays less, and banks can lend more money with less risk. Using brands as 'boot collateral' should be given the boot. **ACQ**

DETAILS

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