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PRACTICE POINTS

## Grasping the intangible

**The area of valuing brands and other intangibles is a subjective affair. It is therefore essential to base the valuation on solid research and using appropriate benchmarks, writes Thayne Forbes**

When assessing losses where they are significant to the value of the whole business, it is worth remembering that, for many companies, a large part of business value is driven by intangibles (including intellectual property).

The significance of intangibles is illustrated by the fact that, for some leading companies, intangibles account for 65-80% of market capitalisation, in that there are no tangible net assets representing this part of the value. The underlying intangible assets (including intellectual property) drive their cashflow. Without it, they would be lost, and when damaged significantly, there are repercussions on cashflow and intangible asset value.

Consequently, quantifying financial losses where intangible assets are affected can result in a very significant claim. In these circumstances, it is critical to apply an extremely rigorous approach that is able to withstand severe cross-examination.

### How intangibles are damaged

Intangibles can be damaged in a number of ways through no direct fault of their owner: a contract not adhered to, faulty merchandise, counterfeit activity, defamatory accusations, standards not being met by franchisees or contractors, and trade mark or patent infringements, to name but a few.

An appreciation of the extent of the losses and what drives it is often a key element of a claim. A claim can be well founded when focusing on the impact on intangibles, which is often a more subjective area and therefore more likely to be disputed. When looking at a dispute over a contract for the supply of products, there would be a number of areas to look at quantifying, including:

- Payments not made: payments due under the contract, but not paid;



**Brands: on the balance sheet of any publicly quoted company**

- Direct loss of business: lost profits and lost business value from non-performance under the contract;
- Lost opportunity: proper contractual performance could facilitate the development of a range of other related products; and
- Loss of brand value: some products have a halo effect over the business's brand, for example by acting as entry products into the brand experience. The absence of such products may damage perception of the brand, thereby impacting sales in other areas.

It is, of course, a legal matter whether such losses can be claimed, but when they encompass brand value, then quantifying them is likely to be significant, subjective and interesting. Even if the brand value itself is not used, there are often elements of the process that are extremely useful as components of estimating losses.

### The brand valuation process and its relevance

Valuing brands and other intangible assets is now accepted practice and recognised by international courts and dispute resolution tribunals. Acquired brands are also now required to be valued and placed on the balance sheets of any publicly quoted US or European company under accounting rules. The process is recognised by the legal and financial community as well as marketers.

The best approach is often market driven, which keeps the valuation grounded in commercial reality, which a court or tribunal will be able to relate

to, understand and believe. Four ways in which this can be achieved are reviewed below.

### Internal research

Existing business plans and forecasts should be used to develop and justify projections used in the valuations. Internal sales records demonstrating the performance of a related or similar product will be useful for comparison, as would demonstrating customer demand from, for example, loyalty card data.

### Market research

Market research is often important, and data could be gathered from the sector in question and other related sectors to plot the brand's historical performance relative to the markets, as well as illustrating future trends. This could give an indication as to the degree of opportunity that has been missed.

Consumer and trade research can also provide robust insight into the extent of the damage that has been caused and how perceptions of a brand have changed or would change. This research can then be used to build and support the valuations.

### Benchmarks

Benchmarks are another key component of a robust valuation because they provide real examples of the possible performance of the damaged brand, had the damage not occurred. For example, competitors can be analysed with sensitivity applied to different circumstances. Different sectors can also be used as benchmarks

to compare situations, such as the take-up of a new technology, or the benefits of being first to market, or the popularity of certain products or type of brand.

### Appropriate methodologies

Using a market-driven valuation methodology is the key to calculating brand value and damage caused to a brand. There are three main brand valuation methodologies: the income, market and cost approaches.

The most frequently used income approach methodology is the relief-from-royalty approach, which calculates how much a brand owner would be willing to pay for the use of its own brand if it did not already own it. This is market driven because it uses a commercial methodology (like a licensing deal), and the royalty rate is established based on comparable agreements and brand strength tests.

Brand value is tested against transactions in the market, such as licensing agreements and mergers and acquisitions, with adjustments made for the different circumstances. This is market driven because it compares the brand in question to comparable activity in the market.

Calculating either the historical cost of building the asset or the cost of rebuilding, it acts as another sense check to support the income approach.

Generally, all three methodologies are used when valuing brands, with the income approach driving the valuation and the market and cost approaches acting as support.

### Conclusion

The essence of valuing brands and other intangible assets lies in forecasting the future benefits of owning them. As this is inherently subjective, basing the valuation process in solid research and using appropriate benchmarks and evidence is key to producing robust expert evidence. Combining this marketing perspective with financial acumen will often help ensure a commercial quantification of a reasonable level of losses.

*Thayne Forbes is joint managing director of independent brand valuation consultancy Intangible Business*