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## >technical matters

# INTANGIBLE ASSETS

**Stuart Whitwell** explains why it's particularly important to understand the value of your intangibles as accurately as possible in a downturn.

**Well-managed brands and customer relationships** are the principal drivers of corporate value. But a company can realise this value only if these elements are properly understood. If they are not, it risks losing out in the following ways:

- Lower market return. Undervalued assets do not motivate managers to generate a proper market return on them, making the business become flabby and inefficient.
- Low sale price. If you do not appreciate the commercial value of an intangible

asset to your organisation or a potential buyer, you may under-utilise a brand or sell the asset for less than it's worth. For example, in 1996 Allied Domecq sold its Plymouth Gin brand to a group of investors for a pittance. A few years later this became one of the UK's best-selling premium gin brands and in 2005 was sold to V&S for millions of pounds. If Allied Domecq had realised the equity still in the brand, it might have sold it for more or relaunched Plymouth Gin itself. Ownership

changes or rebranding exercises can also lead to the removal of once-popular brands from the market. These "orphans" may still have value, but it is not being realised. For example, BT still owns the Cellnet brand but does not use it.

- Poor planning. If you do not understand the value of a brand, you tend to set unrealistic targets that usually underestimate potential. This can have a knock-on effect on income, profit, supply chain management and staff morale.
- Poor performance delivery. A poor understanding of the true value of intangible assets weakens their commercial application. For example, Ted Baker generated £4m of licensing income in 2007. If, for instance, the brand used a royalty rate of five per cent and undervalued the brand by two

## Case study: the perfect blend for refinancing

Asset-based borrowing is becoming an increasingly popular way for firms to raise funds during the credit crunch. Last month, for example, HSBC Commercial Bank launched an asset-based lending division in the UK. The bank explained that this would give businesses the chance to borrow on the strength of their balance sheets and stock, including machinery, plant and commercial property.

But some companies are also borrowing against their intangible assets. Earlier this year Burn Stewart Distillers, which produces premium single malts such as Tobermory and Deanston, refinanced with KBC Business Capital. Its £31m package was linked to the values of assets including brands, inventories, accounts receivable and distilleries. It was intended to increase the firm's flexibility and to restructure its existing debt.

"We have put in place a banking structure with sufficient flexibility to support our growth aspirations," says Fraser Thornton, managing director at Burn Stewart.

Paul Hooper, sales director at KBC Business Capital, adds that using a combination of tangible and intangible assets will allow Burn Stewart to find a funding structure that is more appropriate for the industry than those available using more traditional financing methods.

The integrated valuation of both tangible and intangible assets was performed by a new partnership launched in April between Intangible Business and hard-asset valuation consultancy GoIndustry.

per cent, it would lose over £1.4m a year. Brand value is not necessarily linked to profit. For example, in a portfolio a leading brand such as Coca-Cola may pull the rest of the brands into profit.

This factor needs to be understood fully, because mis-valuing the portfolio could lead to ill-informed decisions and undermine the business.

- Poor resource direction. Intangibles require constant investment to maintain their value. Badly informed managers are likely to misjudge the correct amount of investment needed to create the best results.
- Loss of investor confidence. All these problems together could affect shareholders' faith in the company, which could depress its share price or reduce its ability to secure extra funds. Under IFRS3 and FASB141, acquired intangible assets must be valued and put on the

balance sheet. These standards give managers an incentive to undervalue intangibles to avoid potential impairment write-downs. Consequently, the proportion attributed to goodwill is significantly greater than it should be. This, together with the fact that goodwill is not described clearly, implies that the firm has paid too much, which perpetuates the loss of confidence. Overvaluing intangible assets also has consequences. For example, eBay paid \$2.6bn for Skype in 2005. In 2007 it took a \$1.4bn impairment charge for the acquisitions, admitting that it had overvalued goodwill by \$900m.

- Vulnerability to collapse or takeover. This may seem extreme, but whether mis-valuing intangible assets is deliberate or unintentional, the consequences are the same and significant. Ignorance is bliss only for the competition.

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