

BRAND VALUATION

In the current competitive environment, brand is assuming importance as a commercial and institutional asset. It has become a critical success factor for most organisations, from commercial companies to professional firms.

WHY FIND THEIR VALUE?

Brands may need to be valued for a variety of reasons, calculating an amortization deduction, bidding for an acquisition, and estimating damages in an infringement case etc. Because so many occasions call for their valuation, understanding how they are valued can be useful.

When valuing a brand, it is particularly important "for whom" that value is being determined for, since the brand's value is not the same for the company that owns the brand as for a company with a competing brand or for another company operating in the industry with a brand that does not compete directly with it, etc.

VALUATION METHODS

A number of methods can be used to value brands. Cost based brand valuations are rarely used, as the cost of creating a brand tends to have little similarity to its current value. Market based comparisons, on the other hand, are unsatisfactory as a primary method of valuing a brand because comparative data is scarce and brands are unique. However, where available, market comparisons are useful for testing primary valuations. More commonly used approaches are a) royalty relief method & b) economic use method.

Royalty relief method

This approach is based on the theoretical assumption that if the brand had to be licensed from a third party there would be a royalty charge based on turnover, which would be levied for the privilege of using the brand. By owning the brand royalties are avoided, hence the term 'royalty relief'.

There are many examples of royalties being applied for the licensing of brands between companies. However, the information is not necessarily widely available nor are the terms on which the royalties were based. Rates often incorporate payments for the use of patents, copyrights or shared marketing costs. It can therefore be difficult to identify an appropriate rate for a particular valuation.

‘Economic Use’ method

‘Economic use’ valuations, based on discounted cash-flows analysis of net brand earnings, which are the most widely recognised approach to brand valuation. Such valuations consider the economic value of the brand to the current owner in its current use.

The focus is on the return earned as a result of owning the brand – the brand’s contribution to the business, both now and in the future. This framework is based on a discounted cash flow (DCF) analysis of forecast financial performance, segmented into relevant components of value.

The calculation of the brand value is effected by applying the appropriate discount rate to estimated future brand cash flows. The discount rate, however determined, must reflect the ‘riskiness’ of the brand’s future cash flows. These calculation are also bench-marked against whatever additional measures gleaned by the valuer to give a rounded picture in arriving at a fair estimate of value.

The DCF approach is consistent with the approach to valuation used by financial analysts to value equities and by accountants to test for impairment of fixed assets as required by new accounting standards.

For some purposes, market based valuation or the royalty relief method of valuation maybe possible. However, DCF valuation is the most widely accepted approach to brand valuation and provides a greater depth of understanding of the dynamics of the brand.

While brand valuations can be based on a multiple of historical earnings, it is clear that past performance is no guarantee of future performance and that investors base value judgements on expected future returns rather than actual historical returns. However, historical results are crucial for accurate valuation mainly because they provide information and data relationships, which help to more accurately forecast the future.

Valuations based on projected earnings are therefore most preferred approach with the condition that forecasts must be credible.