Brand Valuation of Intangible Assets: Hot Topics of 2014

Scott D Hakala
Brand Valuation of Intangible Assets

Hot Topics for 2014
And Beyond

Scott D. Hakala, Ph.D., CFA
Managing Director, CBIZ Valuation Group, LLC
email: shakala@cbiz.com
Overview

- Identification of the nature and reasons for value of the brand is critical to valuation.
- The costs of maintaining and retaining brand value need to be identified and measured.
- How do brands generate value, revenue?
- Valuation is often not simple and may be subjective or produce a range of value.
- Issues with valuation of brands in the context of allocation of purchase price and asset impairment/goodwill impairment studies.
- Brands sometimes sell for consideration after the business fails.
Identification of the nature and reasons for value of the brand is critical to valuation

- Is it protected: trade dress, trademark, copyrighted material or registered company name?

- Signal of quality, association with reputation of company and company goodwill (if so, the brand may not be driving the value so much as the reputation and changing the brand name may have limited impact on the value)

- Provides a barrier to entry and competition

- Familiarity leading to greater visibility and volume of sales
The costs of maintaining and retaining brand value need to be identified and measured

- Value erodes naturally over time in the absence of effort and may erode as a result of “regression to the mean”

- Advertising and marketing expense and strategy tied to brand value need to be identified and quantified

- Costs of maintaining image and quality, preserving quality control may need to be additionally quantified
How do brands generate value, revenue?

- Caveat: Often brand value is not easily separated from goodwill and customer relationships and intellectual property
- The primary brand value typically comes from enhancement of revenues through premium pricing (increased pricing and greater gross margins) or greater volumes or some combination of the two relative to generic competition
- Reduction in direct selling expenses and marketing and advertising expense through “walk in” or often now “click through” sales as a result of “front of mind” presence of brand is more common now as a brand value, even when customers will not pay a premium but will more likely buy the brand or go to the branded store or web site to buy if no significant price premium is observed
Valuation is often not simple and may be subjective or produce a range of value.

• Revenue benefits may be separately modeled or approximated by a relief from royalty method
  – Relief from royalty implies a price premium for the brand that needs to be estimated by some market method of comparison with generic or guideline reference prices and royalty rates
  – Estimates of positive unit volume impacts might have to be separately modeled as well but may conflict with the price premium (increasing price reduces the unit quantity sold) and needs to be disentangled

• Expenses associated with increasing or maintaining brand awareness and perceived quality/reputation need to be identified and grossed up for overhead and management
Valuation is often not simple and may be subjective or produce a range of value (continued)

- The profits and value associated with a brand are often limited by the overall margins and the existence of other intangible and tangible assets required to generate the associated revenues (see concept of capital charges discussed later). This can and surprisingly often does mean well-known brands may have little real value (Surprising examples!)
- Future income must be forecast with realistic projections of risk of declining revenue and expenses or modeled with some attrition rate over time
- Discount rates are typically greater than the cost of capital of the company (equity rates with little or no debt financing) and are typically associated with greater systematic risk and less leverage and more equity associated with brand values
Issues with valuation of brands in the context of allocation of purchase price and asset impairment/goodwill impairment studies

• Concept of capital charges for use of assets
  – A capital charge is like charging rent for the use of the other tangible and intangible assets required to produce and sell the products or services associated with the brands being valued. Failure to impute a capital charge for the use of other assets may mistakenly overvalue a brand if using certain revenue-based income approaches.

• Reconciling values such that the sum of parts equals the whole
  – A basic principle is that the sum of the tangible and intangible assets appraised cannot exceed the purchase price for the assets or the market value of the net assets of the company.

• Priority in valuation and allocation when the sum of the values of assets exceed the value of the business
  – When businesses are underperforming, the values of the intangible assets, particularly brand and goodwill and related values must be reduced to comply with the above principle. This may lead to an impairment of assets in the business and write-off of value.
• Brands sometimes sell for consideration after the business fails.

• Why and what is the buyer paying for?
Brand valuation in the context of trademark, trade dress or copyright infringement actions

Damages require some evidence of “impact” (causation in fact and evidence of customer confusion and reliance on falsely branded products/services)

Damages Based on

- Lost Sales to Infringers
- Reduction in selling price of owner due to infringement
- Damage to goodwill
- Cost to cure (advertising, legal and other expenses)

Damages May be Presumptive

- Causation in Fact may lead to plaintiff only needing to legally prove up the defendants’ sales revenues in some instances.
- Defendant may then have the burden of proving what costs and expenses should be applied to such sales revenues to reduce damages.
- Even with presumptive damages, it is common to estimate costs and expenses for lost profits in the plaintiff report.

Can the use of competitor brands in metadata, purchased adword search terms, and tags on Internet sites be a form of trademark or copyright infringement due to diversion of click thru traffic? A growing issue not fully resolved.
Valuation - Disclaimers

- The material presented is the opinion of the author and should not be interpreted as representing the views of CBIZ Valuation Group, LLC.
- This material is for educational purposes only. This course material should not be relied upon as a substitute for specialized advice in connection with any particular matter.
- Although the course material has been carefully prepared, the author does not accept legal responsibility for its contents or for any consequences arising from its use.
Scott D. Hakala, Ph.D., CFA - Managing Director, CBIZ Valuation Group, LLC

Dr. Hakala has been with CBIZ Valuation Group, Inc. since 1992. He brings to the firm extensive practical intellectual property, knowledge of finance, economics and statistics and is responsible for managing projects ranging from the valuation of a small personal services business to valuing a large conglomerate or providing economic analysis and forecasts of future demand. Dr. Hakala has served as an expert and testified on a number of occasions.

Prior to joining CBIZ Valuation Group, Dr. Hakala was an assistant professor of economics at Southern Methodist University. Dr. Hakala is a graduate of the University of Minnesota with a Ph.D. in economics, specializing in monetary theory, international economics and financial economics. He received an undergraduate degree (summa cum laude) from the University of Minnesota with a major in economics (industrial organization and managerial economics) and a minor in business administration.

He has spoken on the issue of the valuation of intangible assets and allocations of purchase prices a number of times. He is an author and co-author of numerous publications, addressing issues on the valuation of intangible assets, including employment and non-competition agreements, patents, trademarks, trade secrets, and customer relationships. Dr. Hakala has performed over one hundred purchase price allocations. Recent work has included valuations for secured lending, allocations of purchase prices for financial reporting purposes, and valuation analyses and asset allocations as part of the due diligence process and to assist in pricing acquisitions.
For more information, please contact:

Scott D. Hakala, Ph.D., CFA
Managing Director, CBIZ Valuation Group, LLC
email: shakala@cbiz.com

Phone: 972.406.6916 (direct);
972.620.0400 ext. 916 (thru main number);
Cell Phone: 214.293.4920
Fax: 972.620.8650
www.cbizvaluation.com
CBIZ, Inc. (NYSE: CBZ)