

The Due Diligence Silver Bullet: Brand Valuation

By Rob Martin, Managing Director, BrandSync, a branding strategy advisory firm focused on the private equity industry.

Overview

BrandSync has developed this detailed explanation of *Brand Valuation* to clarify the process of assigning financial value to a brand as part of the due diligence process for acquisitions. This article is based upon BrandSync's own experience and propriety methodologies as well as established industry best practices. It is organized under the following headings:

- ***Purpose & Uses of Brand Valuation***
- ***Brand Valuation Techniques***
- ***Key Drivers to Brand Valuation***
- ***Brand Valuation Considerations***

Purpose & Uses of Brand Valuation

There has been a lot of confusion when people talk about *Brand Valuation*. It is often associated with "brand evaluation." *Brand valuation* is the process of assigning financial value to a brand and involves techniques that will be described in this white paper. *Brand evaluation* is the process of assessing the brand's role in the sales and marketing of a product or service and how well it connotes and expresses the underlying value proposition (the promise).

Brand Valuation is most frequently used in some sort of transaction including balance sheet recognition (listing the brand value as an asset on a company's balance sheet), securitization (using the brand asset as part of the collateral when raising corporate debt), licensing (using the brand value to set the terms of a licensing deal), or mergers & acquisitions (factoring in the value of a brand when establishing a purchase price for a company).

Brand Valuation Techniques

Brand Valuation has emerged over the last ten to fifteen years as a method for assigning a financial value to a brand that a company owns. The brand is viewed as an intangible asset, such as intellectual property or goodwill, thus it is difficult to assign it a specific and objective dollar value.

Three primary techniques have been developed to value a brand including:

1. ***Royalty Relief*** – The valuation is based on the assumption that if the brand has to be licensed from a third party there would be a royalty charge based on sales. By owning the

brand the royalties are avoided. This valuation is used on a case-by-case basis for an actual licensing deal, but is considered difficult and impractical to use as a general brand valuation model.

2. Communication Investment – A simple and direct approach is used for the *Brand Valuation* where all the communications expenses that were made on behalf of the brand are summed up in a dollar amount. This method tends to overvalue brands as it does not take into account how effective communications may have been. It also penalizes brands that do not advertise heavily.
3. Financial Valuation – This approach attempts to build a value for the brand using traditional and accepted financial modeling techniques. The basic formula is to:
 - a) forecast the future revenue from a brand (usually 10 years),
 - b) deduct the operating costs associated with the branded business in order to calculate its profit contribution,
 - c) determine what percentage of that profit is attributable solely to the brand itself, and
 - d) discount those profits to their present value using a discount rate based on the future volatility and risk associated with the future profits. Since this formula is similar to how a company's stock price is determined, the financial valuation of a brand is often shown as a percentage of the company's overall value or market capitalization.

Of the three primary techniques, the *Financial Valuation* method has become more popular because it takes many market and operating factors into consideration. However, its accuracy varies as it relies on long term predictions of revenue growth, and underlying assumptions which are subjective. It's also a static measure in a dynamic environment.

Key Drivers to Brand Valuation

Regardless of how one arrives at the valuation there are several *key drivers* that connect the brand to the dollar figure and can be assigned a brand value:

- *Type of Market* – Consumer vs. Business
- *Nature of the Product/Service Offering* – Straightforward vs. Complex
- *Role the Brand Plays in the Sales Cycle* – Closing the Deal vs. Imparting Information

Using these key drivers, brand types can be defined and plotted along a continuum to compare relative value. At one end of the continuum of key drivers is the brand type that supports a consumer product, has a simple, straightforward offering and is responsible for the entire sales cycle (i.e., the brand closes the deal). Coca Cola is a good example of this. At the other end of the continuum is the brand type that is a business product or service, and has a complex, customized value proposition where the brand imparts information to the buyer but the closing happens through an iterative process conducted by a sales force. GE is a good example of this.

The table on the following page provides further illustration by listing a number of brands in the two brand type categories that fall at either end of the key driver continuum, and comparing the associated brand value as calculated by Interbrand, a pioneer in the development of the financial valuation technique.

The brand value presented in the table is the percentage of the company value (market capitalization) that was attributed to its brand.

<u>Brand Type:</u> Consumer, Straightforward, Close the Deal	<u>Brand Value:</u> As % of Total Company Value	<u>Brand Type:</u> Business, Complex, Imparting Info	<u>Brand Value:</u> As % of Total Company Value
Coca Cola	61%	GE	9%
Nike	71%	Siemens	2%
Kellogg	58%	Boeing	6%
Wrigley's	52%	BP	2%
Polo/Ralph Lauren	76%	Merck	7%

Source: *Worlds Most Valuable Brands Ranked by Interbrand, 2001*

All of these brands are strong and well recognized both within and outside of their respective industries. The trend from the data indicates that where your brand sits along the continuum of key drivers is a strong predictor of the financial value associated with it.

Brand Valuation Considerations

Based upon industry norms, the following are some considerations for a *Brand Valuation* project:

- 1) The estimated budget required for a full scale *Brand Valuation* project using the financial valuation method ranges from \$50,000-\$150,000 and requires a minimum of 2-3 months to complete.
- 2) A *Mini-Brand Valuation* project with the narrow purpose of gauging future earnings and competitive advantage can be conducted for approximately \$25,000 and completed in a month to six weeks.
- 3) The information and assumptions that need to be developed require input and involvement by the members of a working group within the company.
- 4) If a potential name change is being considered, the brand valuation process will determine if a name change is warranted and if so, how to best implement it.
- 5) If indicated, assessing and managing the risk of a potential name change is done through the following process:
 - Develop name alternatives that directly reflect the brand identity.
 - Test those names against current names with target audiences.
 - If a decision is made to adopt a new name, develop a transition plan that minimizes internal costs and disruption while communicating the name change effectively.

For questions contact Rob Martin, (804) 545-6882, rmartin@brandsync.com

© 2006 BrandSync LLC All Rights Reserved.