Re-thinking Brand Valuations

Art Meets Science

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Brands in the UK and the US are increasingly becoming ubiquitous as collateral for asset-based loans (ABLs). What once was included as mere boot collateral to supplement the value of tangible assets is now the primary asset securing many loans. In Europe however, to date brands have been frequently under-leveraged – ironic when you consider the plethora of international brands in markets such as Italy and France. Yet, as demand for ABL financing is starting to increase in the Eurozone, using brands merely as boot collateral just doesn't make sense - borrowers miss out on the opportunity to obtain additional liquidity, and lenders miss out on the opportunity to put more funds to work.

Whether it is the cost, market, income or relief from royalty approach, the basics of valuing a brand are similar in each instance, involving a detailed review of the company's historical and current financial statements and projections, which satisfy courts, auditors and business regulators across the globe. However, the valuation of a brand as the primary collateral for a loan requires a much deeper analysis that extends beyond the surface evaluation of the numbers.

In addition to a detailed examination of the current state of a company's finances, operations, historical and projected sales and gross margins, one must also focus on the same elements that a potential purchaser would analyse. Why? Because the most important question an appraisal must answer for a lender is the following: How much would a buyer be willing to pay to acquire the collateral if exiting the loan became necessary? Answering this question through a comprehensive brand valuation involves much more than plugging numbers into an Excel spreadsheet.

An Imperfect Science

Analysing a brand's true value must go beyond simply calculating a multiple of EBITDA or revenue, or determining the discounted cash flow (DCF) of hypothetical future royalty streams. With a DCF analysis, the outcome depends on the accuracy of predicted factors, such as cash flow forecasts, discount rates, and terminal growth rate, to name a few. If one of these factors is off by even a few basis points, it would result in a huge swing in the brand's valuation – as the saying goes, "rubbish in, rubbish out." The key to an accurate multiple and DCF analysis is obtaining and using correct data, and then measuring the result in the real world.

Looking at recent sales of comparable brands, if any are available, is one way of testing the formula results, but even a comp analysis does not tell the whole story. Each brand is unique and holds different potential value at different points in time. There is also the possibility that an entire sector is either being undervalued or overvalued, and thus comps considered in a vacuum can be misleading.

As a matter of fact, the value of a brand is greatly dependent on a number of changing market conditions and affected by the overall economic environment, liquidity, consumer preference, availability of financing, and, most importantly, the potential universe of buyers for that brand. For example, ten years ago, there were virtually no companies acquiring brands for the sole purpose of licensing the trademarks. Today, there is an established and growing stable of such buyers, which collectively play a significant and active role in the acquisition of brands, in competition with strategic purchasers and private equity funds.

Make no mistake, granularity is important. But accurate value is determined by making a qualitative analysis in addition to a quantitative one, providing lenders not only a formulaic evaluation, but intelligence on the subjective factors underlying the likely results of an assumed distressed sale of the collateral.

It is essential to understand that there is as much art as science to properly valuing brands. Besides what is contained in financial statements, analysts need to gather and interpret all of the subjective data that ultimately determines value.

The Artist at Work

The qualitative analysis of a brand's value must begin by developing a detailed understanding of the consumer's perception and affinity for the brand. One must also examine existing and potential distribution channels, geographical concentration and expansion opportunities. Consumers' familiarity with the brand, its history, relevance and reputation, as well as general trends in the marketplace are additional important elements that ought to be scrutinized.

The analysis must also focus on whether the brand would provide a solution or a competitive advantage to other businesses. For example, who are the probable licensees that would be willing to pay royalties to have use of the brand? What are the likely royalty rates these licensees could reasonably commit to pay? Is the brand best suited to a wholesale licensing model or would it be better adapted to a direct-to-retail license with a major retailer? Is this a retail "storefront" brand or a brand that could be identified with and affixed to products sold through third-party retail channels? Is there a direct-to-consumer business associated with the brand that would be attractive to a purchaser?

Finally, one cannot overlook the certain negative impact that a distressed sale (and the precedent deteriorating conditions that normally lead to an orderly liquidation sale) would have on the brand value, in addition to the subsequent disruption of sales caused by the conversion from a vertical model to a licensing or other structure.

Whenever possible, the analyst should consult with experienced merchants to obtain real world answers to many of the consumer-related questions; with M&A experts to fully grasp the potential buyers for a particular brand at that point in time and in the near future; and with licensing experts to fully scrutinize the relief from royalty analysis.

Conclusion

The valuation of brands for collateral purposes, particularly when they are the sole or primary asset securing a loan, represents a much greater appraisal risk than the valuation of tangible assets. Despite the fact that ABLs have not been in Europe as long as in the US, they are gaining popularity and Europe, 'The 'Land of Brands', must start to recognise that the brand can frequently be the most valuable asset in a company. Although impossible to fully eliminate risk for a secured lender by consulting appraisals that consider a purchaser's thought process and apply the combination of both quantitative and qualitative factors, lenders can significantly increase their comfort with that risk.

It is only through the "art" of interpreting the results of these "scientific" analyses that one can formulate accurate assumptions for a brand valuation and advance against intangible assets with confidence.

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