The intangible asset roller coaster

Like those of all other intangibles, brand values are climbing once again. This comes at a significant time as it coincides with a major breakthrough in the brand management process

By **David Haigh**

In the first quarter of each year Brand Finance plc produces two keynote reports. The first is the Global Intangible Finance Tracker (GIFT). This tracks the enterprise and asset value of all 38,000 companies quoted on the 58 leading stock markets of the world. It represents over 99% of all quoted companies in the world by value.

Enterprise value (EV) is defined as the sum of shareholders equity and long term debt at market value. In other words, the total value that investors and lenders attribute to companies: equity and debt being the main sources of long term finance. The other side of the equation is the value of the individual assets within these enterprises. These can be split into tangible assets (land, buildings, plant, equipment, stock, working capital etc) and intangible assets (patents, software, contracts, customers, brands and so on).

The second report we produce is the Global 500 which reports the values of top brands, arguably the most important single class of intangible asset owned by global enterprises.

The GIFT 2010 results (as at 31st December 2009) revealed that globally EVs had rebounded to US$56.6 trillion from a low point of US$38.5 trillion in the GIFT 2009 (as at 31st December 2008).

World equity and debt markets have been on a roller coaster in the last three years. They reached a high on 31st December 2007, when aggregate global EVs stood at an all time high of US$60 trillion. In one 12 month period US$21.5 trillion was wiped off these market values while in the following 12 months US$18.1 trillion was added back again by emotionally driven investors!

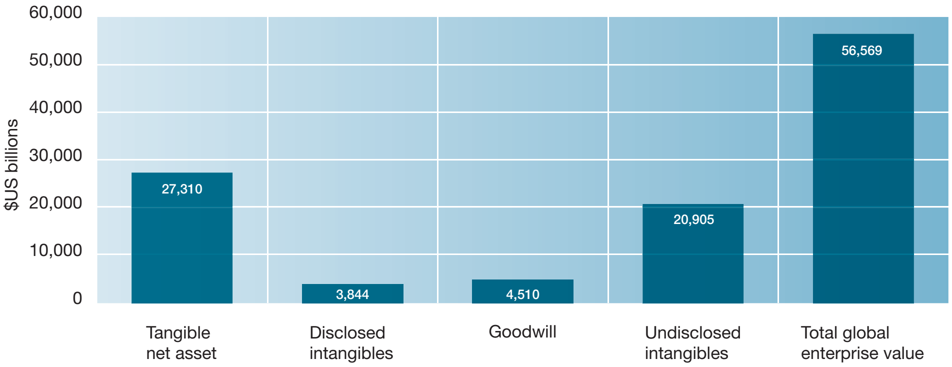
It is a cliché to say that share and asset values can go down as well as up, and that all markets are volatile, but the scale of value loss and gain over the last two years has been quite breathtaking. And for many small investors the swing in values has been more than breathtaking: it has deprived millions of them of their savings and pensions. Smart institutional investors have bought and sold well but many retail investors have been wiped out. These are not simply graphs showing wild swings. They are illustrations of human misery.

The question is whether the swing in share values should have been as extreme and whether the way companies report enterprise and asset values to investors is so flawed that it exaggerates such value swings. There has been an argument in the anorak world of financial reporting for decades about whether financial reporting succeeds or fails in its primary task of explaining to investors the true worth of the companies and assets they are putting money into. Is there a better way of explaining long term asset values to investors? Some argue that there is.

Figures 2 and 3 reveal that, after a dip in values following the dotcom crash and the ensuing downturn, enterprise and asset values rose progressively to the end of 2007.

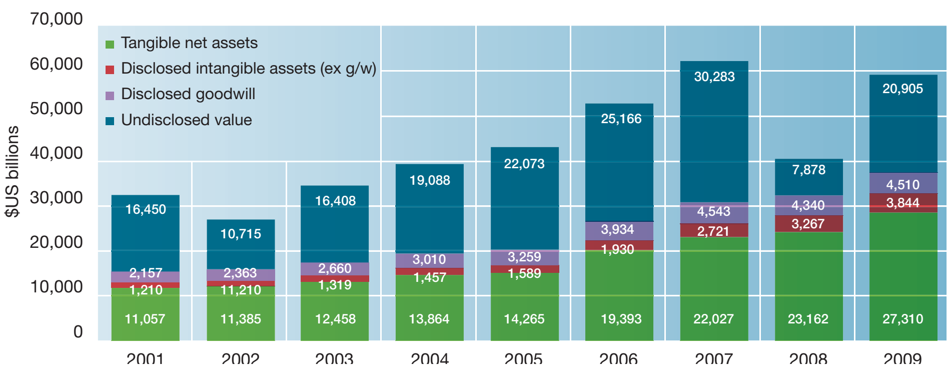
Figure 2 (absolute values) and Figure 3 (percentage values) are broken into disclosed tangible and intangible assets (obtained from the conventional balance sheets of all quoted companies studied) with the difference being undisclosed intangible

Figure 1. **Global enterprise value 2009**



Source: Brand Finance plc 2010

Figure 2. **Global enterprise value 2001-2009**



Source: Brand Finance plc 2010

assets (calculated as the difference between total enterprise values and disclosed tangible and intangible assets).

Unfortunately, the only intangible assets which can ever appear in conventional balance sheets are those which have been capitalised following an acquisition (as required by International Financial Reporting Standard 3 (IFRS 3)). This means that most high value, internally generated, intangible assets never appear in conventional balance sheets. They are valued implicitly by the market in the undisclosed asset figure. Investor ignorance and extreme sentiment mean that the undisclosed intangible asset values can and do swing wildly.

The BrandFinance Global 500 2010 is a more considered and rational valuation of at least one part of these undisclosed intangible assets.

Changes in asset values

While the peak to trough decrease in EVs during 2008 was approximately 35% and the trough to peak increase during 2009 was approximately 45% the value of specific asset types within enterprises have fared very differently.

For example, total tangible assets grew from US$22 trillion in 2007, to US$23 trillion in 2008 (5% increase) and to US$27 trillion in 2009 (17% increase). Although investment in tangible assets slowed in the depths of the recession it did not stop and began to accelerate in 2009, a good sign for global recovery.

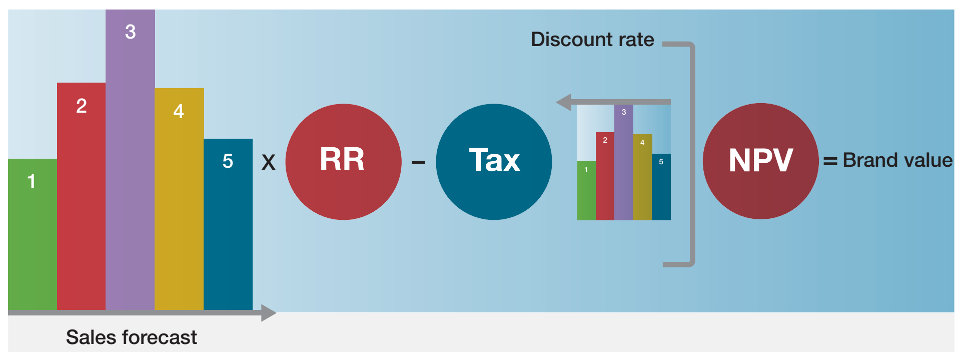
By contrast, the total value of intangible assets declined from US$38 trillion in 2007, to only US$15.5 trillion in 2008 (-59%) before rebounding to US$29.6 trillion in 2009 (88% increase). Overall sentiment in the markets dived before recovering, hitting the implied value of intangible assets. The rebound in intangible values is also a good sign of an economic recovery.

But the fact is that in 2008 the market clearly panicked and heavily oversold. Investors as a whole were unable or unwilling to look at underlying performance

Figure 3. **Global enterprise value 2002-2009 (%)**

Source: Brand Finance plc 2010

Figure 4. **Royalty Relief (RR) approach**



Source: Brand Finance plc 2010

and value the companies and their assets on the basis of their intrinsic performance.

Intrinsic value of brands

Meanwhile the BrandFinance Global 500 is based on a first principles valuation of brands using consensus analyst forecasts of revenues and profits. This means that our valuations are based on more rational data than just market sentiment.

The aggregate value of the Global 500 brands stood at US$3 trillion in 2007, against EVs of US$31.8 trillion (9.5% brand value/EV ratio on average). During 2008 total brand value dropped to US$2.3 trillion against EVs of the related businesses of US$21.5 trillion (10.7% brand value/EV on average). The EVs of these top companies had dropped by 32% while brand values had dropped by only 25%. During 2009 brand values rose to US$2.9 trillion, against EVs of US$28.7 trillion (10.1% brand value/EV on average). The EVs of these top companies had dropped by 33% while brand values had dropped by only 26%.

The decline in brand values and their subsequent rebound was less extreme than the swing in intangible asset values as a whole because the Brand Finance valuations are based on fundamentals which fluctuate less than market sentiment.

The bottom line is that brand values, based on fundamentals are less volatile than share prices driven by market sentiment. When disclosed they underpin share prices and help reduce market volatility.

Calculating brand value

It is important to understand the steps in the valuation process. They are as follows:

1. Determine forecasted revenue – estimate future sales for each brand over a five year explicit forecast period, by referencing historic revenue trends, market growth estimates, competitive forces and analyst projections.
2. Assess brand strength – determine brand strength using a variety of quantitative and qualitative metrics and

Figure 5. **Most valuable global brand by sector**

Sector	Brand	Brand value	Brand rating
Banking	HSBC	28,472	AAA+
Auto Manufacturers	TOYOTA	27,319	AAA
Beverages	Coca-Cola	34,844	AAA+
Technology	IBM	33,706	AA
Food	Nestlé	11,178	AAA-
Telecommunications	vodafone	28,995	AAA
Media	Walt Disney	20,053	AAA
Oil and Gas	Shell	16,997	AAA-
Retail	Walmart	41,365	AA
IT/Software	Google	36,191	AAA+

data sources and calculate a ßrandßeta Index score.

3. Determine royalty rate for each subject brand – review comparable licensing agreements. Analyse margins and value drivers in the sector under review. Establish royalty rate range. Apply ßrandßeta Index score to royalty rate range to determine royalty rate for the brand.
4. Determine the discount rate – the discount rate is used to calculate the present value of future brand earnings (accounting for the time value of money and the associated risk). Weighted average cost of capital (WACC) is used as a discount rate in the valuation, after adjusting for brand specific risk as determined by the ßrandßeta Index. WACC represents the average costs of a firm's sources of financing. It also is the overall required rate of return on the firm.
5. Brand valuation calculation – the net present value (NPV) of post-tax royalties equals the brand value calculated as set out in Figure 4.

The leading global brands by value

Once again this year Walmart is the most valuable brand in the world, increasing its brand value by 2% to US$41.4 billion. When one considers that Walmart turns over US$300 billion a year, operates 8,000 retail stores, employs 2.1 million staff and purchases 15% of all manufactured output from China, it is easy to see why it came top again. It has been criticised in the past, but has tried hard address the consumer agenda of sustainability and good corporate citizenship.

But while Walmart is the most valuable brand in absolute terms, the fastest growing brand by value in the Top 50 is Santander. While Walmart's brand value grew by only 2% this year, Santander grew its brand value by 136% to become the thirteenth most valuable brand in the world – rising from 41st place last year. Santander has benefitted from two strong trends: the first is the massive rebound of the banking sector as a whole; and the second is the rationalisation of various local banking brands under the Santander master brand.

Leading sector brands by value

The most valuable brands in major sectors are set out in Figure 5.

HSBC has pursued its simple retail banking model to dominate the world banking sector, while Vodafone goes from strength to strength in mobile phones. For its part, Coca Cola has revived its performance to dominate the drinks category and Google is rapidly expanding from search and internet advertising into software and other adjacent categories.

It will be seen from the valuation process and from the individual sector results that brand strength rating analysis is a crucial part of the brand valuation process. Some very large brands by value have a relatively weak brand rating score, which indicates that they may be vulnerable to value loss going forward. By contrast some much smaller brands have very high brand rating scores which is a leading indicator of future value growth.

Figure 6. **The world's strongest brands by brand rating**

Rank 2010	Rank 2009	Brand	Industry group	Domicile	Brand value 2010	Brand rating 2010	Brand value 2009	Brand rating 2009
5	4	Microsoft	Software	United States	33,604	AAA+	30,882	AAA+
309	245	Harley-Davidson	Leisure Time	United States	2,928	AAA+	2,785	AAA+
117	94	Gillette	Cosmetics/Personal Care	United States	6,835	AAA+	6,554	AAA+
2	5	Google	Internet	United States	36,191	AAA+	29,261	AAA
3	2	Coca-Cola	Beverages	United States	34,844	AAA+	32,728	AAA+
98	71	Kellogg's	Food	United States	7,982	AAA+	7,857	AAA+
13	41	Santander	Banks	Spain	25,576	AAA+	10,840	AA
38	89	Goldman Sachs	Banks	United States	13,887	AAA+	6,753	AAA-
12	11	Bank of America	Banks	United States	26,047	AAA+	21,017	AAA
8	7	HSBC	Banks	United Kingdom	28,472	AAA+	25,364	AAA+
97	125	Porsche	Auto Manufacturers	Germany	7,994	AAA+	5,431	AAA+
72	57	PWC	Commercial Services	United States	9,908	AAA	9,458	AAA
19	18	Walt Disney	Media	United States	20,053	AAA	16,750	AAA
270	210	Louis Vuitton	Fashion	France	3,293	AAA	3,151	AAA
204	179	BlackBerry	Computers	Canada	4,122	AAA	3,792	AAA-
10	10	Toyota	Auto Manufacturers	Japan	27,319	AAA	21,995	AAA
33	22	Nike	Apparel	United States	15,808	AAA	14,583	AAA-
225	246	Singapore Airlines	Airlines	Singapore	3,654	AAA	2,776	AAA-
231	NS1	Petronas	Oil&Gas	Malaysia	3,578	AAA	3,104	AAA-
7	8	Vodafone	Telecommunications	United Kingdom	28,995	AAA	24,647	AAA
52	34	Sony	Electronics	Japan	12,648	AAA	11,597	AAA

Brand rating process

Each brand in the study is given a unique brand rating score. This balanced rating of brands includes measures of financial performance (net revenues, forecasted revenue growth, net income, margin percentage), some measure of risk and security for the trademarks and the brand (visual identity management, distribution and credit rating) and finally brand equity measures (functional, emotional, conduct and loyalty). The performance of each individual brand is compared with its global peers and an overall percentage score is determined.

The most highly rated brands in the world are set out in Figure 6. They are not always the largest or most valuable, Harley Davidson, Gillette, Loius Vuitton and Blackberry being good examples of this phenomenon.

Brand management lessons

Brand values that are well communicated can help to stabilise the market perception and value of branded enterprises, while brand strength rating is a vital indicator of future brand value.

Every senior executive needs to be aware of and embrace measurement and communication techniques flowing from the brand valuation process. This is why the International Standards Organisation (ISO) has spent the last three years developing a new standard for brand valuation (ISO 10668) which every brand manager should be aware of and employ.

ISO 10668 applies to brand valuations commissioned for all purposes, including: accounting and financial reporting; insolvency and liquidation; tax planning and compliance; litigation support and dispute resolution; corporate finance and fundraising; licensing and joint venture negotiation; internal management information and reporting; strategic planning; and brand management. The last of these applications includes brand and marketing budget determination, brand portfolio review, brand architecture analysis and brand extension planning.

ISO 10668 is a meta standard which succinctly specifies the principles to be followed and the types of work to be conducted in any brand valuation. It is a summary of existing best practice and intentionally avoids detailed methodological work steps and requirements.

ISO 10668 specifies that when conducting a brand valuation the brand valuer must conduct three types of analysis before passing an opinion on the brand's value.

These are legal, behavioural and financial analysis. All three types of analysis

The world’s 50 most valuable brands

Rank 2010	Rank 2009	Brand	Industry Group	Domicile
1	1	Wal-mart	Retail	United States
2	5	Google	Internet	United States
3	2	Coca-Cola	Beverages	United States
4	3	IBM	Computers	United States
5	4	Microsoft	Software	United States
6	6	GE	Miscellaneous manufacturers	United States
7	8	Vodafone	Telecommunications	Britain
8	7	HSBC	Banks	Britain
9	9	hp	Computers	United States
10	10	Toyota	Auto manufacturers	Japan
11	14	at&t	Telecommunications	United States
12	11	Bank of America	Banks	United States
13	41	Santander	Banks	Spain
14	15	Verizon	Telecommunications	United States
15	23	WELLS FARGO	Banks	United States
16	19	Budweiser	Beverages	United States
17	20	Tesco	Food	Britain
18	12	McDonald’s	Retail	United States
19	18	Walt Disney	Media	United States
20	27	Apple	Computers	United States
21	13	Nokia	Telecommunications	Finland
22	24	The Home Depot	Retail	United States
23	28	Samsung	Semiconductors	South Korea
24	16	China Mobile	Telecommunications	Hong Kong
25	17	Orange	Telecommunications	France
26	0	Mitsubishi	Miscellaneous manufacturers	Japan
27	30	Shell	Oil&Gas	Netherlands
28	25	Intel	Semiconductors	United States
29	26	BMW	Auto manufacturers	Germany
30	45	AXA	Insurance	France
31	21	Pepsi	Beverages	United States
32	37	L’Oréal	Cosmetics/Personal Care	France
33	22	Nike	Apparel	United States
34	31	Target	Retail	United States
35	66	Siemens	Miscellaneous manufacturers	Grmany
36	54	Citi	Banks	United States
37	58	BNP Paribas	Banks	France
38	89	Goldman Sachs	Banks	United States
39	52	Mercedes-Benz	Auto manufacturers	Germany
40	64	Chase	Banks	United States
41		Christian Dior	Apparel	France
42	79	Amazon.com	Internet	United States
43	75	Bradesco	Banks	Brazil
44	32	UPS	Transportation	United States
45	77	Barclays	Banks	Britain
46	35	Honda	Auto manufacturers	Japan
47	40	GDF Suez	Gas	France
48	65	Allianz	Insurance	Germany
49	39	Oracle	Software	United States
50	50	American Express	Diversified Finan Serv	United States

Brand value 2010	Brand rating 2010	Enterprise value 2010	Brand value / enterprise value 2010 (%)	Brand value 2009	Enterprise value 2009*	Brand value / enterprise value 2009 (%)	Brand rating 2009
41,365	AA	190,803	22%	40,616	165,823	24%	AA
36,191	AAA+	157,971	23%	29,261	79,164	37%	AAA
34,844	AAA+	87,814	40%	32,728	67,937	48%	AAA+
33,706	AA	180,028	19%	31,530	136,675	23%	AA
33,604	AAA+	199,990	17%	30,882	140,383	22%	AAA+
31,909	AA+	528,713	6%	26,654	381,576	7%	AA
28,995	AAA	178,604	16%	24,647	152,551	16%	AAA
28,472	AAA+	193,794	15%	25,364	131,577	19%	AAA+
27,383	AAA-	100,998	27%	23,837	76,930	31%	AA+
27,319	AAA	185,402	15%	21,995	153,060	14%	AAA
26,585	AA+	229,793	12%	19,850	156,769	13%	AA+
26,047	AAA+	111,754	23%	21,017	65,529	32%	AAA
25,576	AAA+	128,087	20%	10,840	46,100	24%	AA
23,029	AA	196,293	12%	18,854	162,663	12%	AA
21,916	AA	131,225	17%	14,508	108,691	13%	AA
21,279	AAA-	96,950	22%	16,692	49,900	33%	AAA-
20,654	AAA-	73,969	28%	16,408	53,618	31%	AA+
20,192	AAA-	77,140	26%	20,003	73,815	27%	AAA-
20,053	AAA	67,141	30%	16,750	51,631	32%	AAA
19,829	AAA-	156,416	13%	13,648	47,327	29%	AA
19,558	AAA-	48,162	41%	19,889	53,828	37%	AAA-
19,013	AA-	51,076	37%	14,310	46,113	31%	AA-
18,925	AA+	86,384	22%	13,541	43,855	31%	AA
18,673	AA+	153,077	12%	17,196	153,188	11%	AA+
18,352	AA	120,119	15%	16,799	133,525	13%	AA
17,805	AA+	231,268	8%	0	0		0
16,997	AAA-	52,214	33%	12,376	40,959	30%	AAA-
16,642	AA+	95,316	17%	13,976	64,506	22%	AA
16,616	AAA-	91,170	18%	13,659	75,319	18%	AAA-
16,403	AA-	44,326	37%	10,213	30,338	34%	A+
15,991	AA+	44,866	36%	15,034	34,146	44%	AA-
15,890	AAA-	66,208	24%	11,234	37,880	30%	AAA-
15,808	AAA	24,776	64%	14,583	20,318	72%	AAA-
15,224	AA	51,678	29%	12,253	45,225	27%	AA
14,709	AA+	102,939	14%	8,209	32,490	25%	AA+
14,362	A+	70,105	20%	9,810	34,673	28%	A
14,060	AA	67,144	21%	9,360	47,996	20%	AA-
13,887	AAA+	93,316	15%	6,753	36,361	19%	AAA-
13,883	A+	78,057	18%	9,844	48,619	20%	AAA-
13,400	AA	69,901	19%	8,747	24,183	36%	A+
13,343	AA	40,912	33%				
13,340	AA	54,962	24%	7,466	19,437	38%	AA-
13,299	AAA-	56,583	24%	7,698	29,794	26%	AA
13,170	AA+	61,885	21%	11,873	56,419	21%	AA+
13,134	AA	56,155	23%	7,583	18,598	41%	A-
13,083	AA+	82,377	16%	11,461	68,084	17%	AA+
12,878	A+	146,131	9%	11,016	94,460	12%	AA+
12,836	AA	57,334	22%	8,224	34,428	24%	A+
12,775	AA+	105,194	12%	11,106	83,854	13%	AA+
12,737	AA	42,043	30%	9,944	25,866	38%	AA

Source: Brand Finance plc 2010

quote

are required to arrive at a thorough brand valuation opinion.

Legal analysis

The first requirement is to define what is meant by brand and which intangible assets should be included in the brand valuation opinion. The brand valuer must precisely determine the intangible assets included in the definition of brand subject to valuation. He may include names, terms, signs, symbols, logos, designs, domains or other related Intellectual Property (IP) rights intended to identify goods and services, and which create distinctive images and associations in the minds of stakeholders, generating economic benefits for the branded business.

The brand valuer is required to assess the legal protection afforded to the brand by identifying each of the legal rights that protect it, the legal owner of each relevant legal right and the legal parameters influencing negatively or positively the value of the brand.

Behavioural analysis

The second requirement when valuing brands under ISO 10668 is a thorough behavioural analysis. The brand valuer must understand and form an opinion on likely stakeholder behaviour in each of the geographical, product and customer segments in which the subject brand operates.

To do this it is necessary to understand:

- Market size and trends – determined by conducting a critical review of predicted trends in distribution channels, customer demographics, market volumes, values and margins.
- Contribution of brand to the purchase decision – determining the monetary brand contribution in the geographical, product and customer segments under review.
- Attitude of all stakeholder groups to the brand – to assess the long term demand for the brand, any risks to the branded business and the appropriate cost of capital.
- All economic benefits conferred on the branded business by the brand – to assess the sustainability of future revenues and profits.

The brand valuer needs to research brand value drivers, including an evaluation of relevant stakeholders' perceptions of the brand in comparison with competitor brands. Measures commonly used to understand brand strength include awareness, perceptual attributes, knowledge, attitude and loyalty. The brand valuer needs to assess the brand's strength in order to estimate future sales volumes, revenues and risks.

Financial analysis

The third requirement when valuing brands under ISO 10668 is a thorough financial analysis. It specifies three alternative brand valuation approaches – the market, cost and income approaches.

The income approach is the recommended approach because it measures value by reference to the economic benefits expected to be received over the remaining useful economic life of the brand. This involves estimating the expected future, after-tax cash flows attributable to the brand then discounting them to a present value using an appropriate discount rate.

A major breakthrough

Brand valuation is a mechanism for decision making which is driven by data, analysis and assumptions that may prove to be incorrect. The ISO standard insists that sensitivity analysis showing a range of values, based on different assumptions, should be included in an opinion, not just a single value.

A brand valuation is an opinion at a point in time. Brand valuation models need to be updated and reviewed on a regular basis, and management decisions need to change in the light of changing conclusions flowing from them.

Brand valuation is a technique to support management which is why it is vital that the technique should be consistent, transparent and reproducible as required by ISO 10668.

Royalty relief is the most widely used method used to determine brand cash flows and is the method used in the Brand Finance study. It assumes that the Brand is not owned by the branded business but is licensed in from a third party. The value is deemed to be the present value of the royalty payments saved by virtue of owning the brand.

The royalty rate applied in the valuation is determined after an in-depth analysis of available data from licensing arrangements for comparable brands and an appropriate split of brand earnings between licensor and licensee, using behavioural and business analysis.

The royalty relief method is widely used because it is grounded in commercial reality and can be benchmarked against real world transactions.

A robust brand valuation can help ensure future value creation. ISO 10668 will not only help brand managers but will help to integrate trademark counsel into a multi-disciplinary brand management team. Trademark counsel will no longer be working in their own technical silo.

IS 10668 is a major breakthrough which will help further professionalise the business of brand management. *iam*

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