Introduction

To say that, in this 21st Century, the measurement of the value of an enterprise by its tangible assets is unlikely to be a very accurate reflector of its true worth is not to say anything new. There must be very few people involved with business at this stage who do not appreciate that intangibles form a large part of the value in most businesses and that these are distinguishable from the great common covered by the word "goodwill". It is after all, almost a quarter century after Nestlé bought out Wilson-Rowntree for more than five times the latter's book value, and brought to the fore the realisation that the brands of Wilson-Rowntree were worth a vast amount of money – hundreds of millions of pounds.

That – and the flurry of deals in the 1980's which saw corporate raiders targeting companies with substantial brand portfolios – forced an adjustment in thinking which, in my view, is still far from fully developed. The figures have continued to climb – Mannesmann is reported by Brand Finance Plc to have paid £20 billion (yes, billion) for the **ORANGE** trade mark which was then only five years old. Too much, surely? Well, perhaps not – it was sold on to France Telecom for £31 billion within a year. It must be added that **ORANGE** has proven to be an exceptional brand, outperforming all its rivals in terms of customer acquisition and retention, and greatly assisted by the far higher than predicted popularity of mobile telephones which have become a lifestyle in themselves. Arguably, any reasonably distinctive brand would have done as well. This raises the inevitable question – how much of the value is really attributable to the brand itself? There are many who would reply "not a lot".

Stories of over-zealous brand valuations bearing little if any resemblance to reality abound and it is no coincidence that the facility for writing off a trade mark was withdrawn from the Income Tax Act. Indeed there are many who regard IP valuation generally and brand valuation particularly as little more than an elaborate "thumb suck", clothed in scientific language. There is more than a shred of truth in that assertion. Any exercise that looks into the future worth of an asset producing income is going to be only as accurate as the predictions on which it is based, and the reputedly best predictor of the future, Nostradamus, certainly hedged his bets!

IP valuation, as far as I can foresee the future, is never going to be a matter of "talismatic precision" (to use the words of the U.S. Tax Court) – too many of its elements involve subjective judgements for that – but it is possible to provide reasonable and fairly reliable results if the matter is addressed thoroughly. It is an important issue – for brands, certainly in consumer businesses, the importance is difficult to overstate – it is for example difficult to persuade a consumer to pay more than R40 of R50 for a plain white cotton T-shirt of good quality but place the name **DIESEL** on essentially the same T-shirt and you can get R400 for it. The question is "why". Intrinsically, there is no difference between the two T-shirts, the plain one may even be better, but consumers want the one with the brand on it.

The **ORANGE** example and listings of the top 100 global brands has worked to bring the chosen few to general attention. Yet the bulk of intangible asset value remains off balance sheets. This remains true even though modern accounting standards require intangibles to be dealt with. In South Africa, Accounting Standard AC 129 (issued June 1999) deals with "Intangible Assets" and, for most types of IP (which is not an interchangeable term with intangible assets) it provides a reasonable framework for dealing with the values that exist or are brought into being. It specifically, however, avoids recognition of internally generated brands. (AC 129.52,3).

Brands, including trade marks

A trade mark is not necessarily a "brand" and a brand is typically more than a trade mark. Normally a brand will be a collection of trade marks and I like to characterise the trade mark as the basis of a brand, like a light bulb. The bulb, or a collection of them, when placed in an appropriate setting and used (i.e. when electricity is fed to it or them) illuminate a certain space. So, with trade marks, when put in context, promoted and tied to a product identity, illuminate a part of the market.

A "mark" is any sign capable of being represented graphically. A "trade mark" is one that acts as a badge of origin and serves to distinguish goods or services connected in the course of trade with one enterprise from those connected with another. As a thing in itself it is a creation of statute and registration is a condition for its existence. I like to say that a common law trade mark does not exist because there is no property right in it apart from the overall reputation or goodwill of which it is a part.

Some have said that if the basic trade mark is not registered, then there is no brand value. That overstates the position, but non-registration will be a major negative factor in assessing worth.

Brand valuation

As noted above, the conventional approach of accountants analysing in detail the tangible elements of a business with itemised information relating to fixed assets, cash on hand, stock on hand and the like yet lumping all intangible elements of a business together as goodwill ended with AC 129. This provides a detailed analysis of intangibles and a separation between controllable assets, likely to provide a future benefit and perceived "assets" that cannot be recognised as such, and which must still be dealt with under the general head of "goodwill". This, still, does not take into account the real value of a developing brand. Revaluation of a brand is not permitted under the accounting standard because there is no active market for brands which is required for measurement of value after initial recognition (AC 129.64, 65 and 66).

Some elements of goodwill are 'crisp' and very ascertainable – for instance, a registered trade mark, whereas other are by nature mutable and possibly of no lasting value such as, for instance, relationships with suppliers, or a particular management team. To treat all of these equally must clearly be wrong.

Valuation premisses

Each element of IP is an economic asset, and therefore one of its most important functions is to produce a flow of money for its owner.

Some trade marks are more equal than other trade marks - a trade mark such as **COCA-COLA** has a different value to the trade mark your cousin Johan filed last week.

Not all purchasers of a trade mark will be able to derive the same benefits from it. So the value in the hands of one purchaser may be greater than the value in the hands of another.

A trade mark is capable of being an eternal asset - it has no finite life, but abuse and changing market trends can destroy its value.
The aim of the valuation process is to establish a present value for the future benefit.
There are three key elements to calculating a value and these are:
estimating the likely cash flow over a reasonable period of time;

assessing the likelihood that the estimate will be achieved; and
capitalising the cash flow.

That portion of the future benefits (typically cash flows) that spring from the trade mark itself as opposed to that portion likely to be derived from other factors such as the marketing expertise of the purchaser, can be ascribed with reasonable accuracy.

Valuation Principles - Brand

In valuing the brand, a fair market value must be ascertained. This is a value applicable in an arm's length transaction between a willing buyer and a willing seller under orderly sale conditions (i.e. with no time constraint).

Given the nature of intellectual property, approaches to valuation such as the original cost to the vendor of acquiring the underlying trade marks are inappropriate. The historical costs of acquisition, which are essentially the costs of researching the market and devising and registering suitable trade marks, can be negligible in relation to their current value.

It is equally inappropriate to attempt to establish the cost of replacement of the trade mark. Each trade mark is unique in its nature (otherwise it would not be registrable), and the effect of say a decade of promotion of the brand makes such an approach impracticable.

Although there is a growing number of transactions in brands as property objects independent of other assets, there is not yet a lively market in any particular type of trade mark, except perhaps in very limited sectors such as the pharmaceutical industry and the food and beverage industry in major economic blocs such as North America and the European Community. Even in these restricted areas the uniqueness of every item of intellectual property makes the market-based approach to valuation approximate only, and the market history is really only useful in indicating precedents rather than actual values.

It is internationally accepted that the appropriate factor on which to base the valuation of existing and well established trade marks and other forms of intellectual property is the income-earning capability of the relevant items of intellectual property. Although there are some divergences in the most sophisticated valuation procedures, the best method in circumstances most commonly encountered is to assume that the purchaser, as an investor in the trade mark, will proceed to licence it to a suitable licensee in order to generate royalty income. The most suitable licensee may be a wholly owned subsidiary, which can be readily controlled, but there is no fixed rule in this regard. A notional licensing transaction is therefore assumed, analogous to a leaseback of fixed property.

In the notional licensing transaction that is then constructed, the parties must be at arms length and an exclusive license would be granted to the user of the mark. It would be expected to guarantee a minimum performance in the form of payment sufficient to support any necessary funding of the acquisition of the trade mark, and would provide a long-term stream of royalty income.

For this notional transaction, a suitable royalty rate must be ascertained and applied to projections of sales of the relevant products. This flow of royalty income must be reduced to its net present value (NPV). The techniques for this type of calculation involve the application of a discount factor for inflation and for the risk that, for various considered reasons, the projected income will not be achieved.

In the abstract, it is difficult to determine the period over which a forecast of sales may reasonably be made and, for the purposes of this example, we shall assume 10 years. This may be considered a short period in view of the successful use of many trade marks continuously for decades, but it takes account of the fact that the business environment in South Africa is presently subject to extreme stresses and these are likely to continue as major political, social and economic restructuring of the country occurs.

Specific Trade Mark Analysis

Registration status

A registered trade mark is far more valuable than an unregistered trade mark because the rights it represents are much easier, and therefore much less expensive, to protect in a court of law and a registered trade mark can be freely transferred with or without the business with which it is connected, whereas an unregistered “trade mark” cannot be transferred without the business it represents.

International availability

A brand that has global potential must be more valuable than one which does not. Certain trade marks that are ideal for the South African market, may be anticipated in other markets or the word elements may have unfortunate meanings in other languages. **POCARI SWEAT**, a cool drink brand in the Far East, is not likely to appeal to English speakers.

A strong brand in South Africa which has the potential to become global, must be worth more than one which will be limited to this market.

Market stability

The question of the business in which the trade mark is used is crucial to determining a reasonable basis for assessing its future value. Certain markets are very stable and, by this, I mean that they change slowly and infrequently. For instance, the market for heavy machinery such as **CATERPILLAR** is a long term one - the product is very expensive and long lasting and earth moving is not subject to the vagaries of fashionable trends. The fashion clothing market, on the other hand, can be both very volatile and very stable, depending on the brand itself and its market segment.

Trends

Certain brands are closely linked to trends in the market and some of these, by their very nature, are extremely short lived. The **TEENAGE MUTANT NINJA TURTLES** are a prime example - for nearly two years, this brand boasted phenomenal consumer appeal and phenomenal sales - if one had valued the brand early in its career and decided that it had a ten year life at that sort of level of sales, it would have been over-valued considerably.

Customer loyalty

Certain brands have fanatical followings. It is important to establish whether the brand being valued falls into this category. If it does, its value must be enhanced.

Inherent registrability/distinctiveness

This is related to the question of whether the trade mark is registered. There is a spectrum of distinctiveness which goes from the most distinctive trade mark, generally consisting of invented words such as **KODAK** and **EXXON**, which have no meaning other than trade mark or brand meaning. These travel down through arbitrary marks, such as
MUSTANG
for cars to suggestive marks, such as
BODY ON TAP
for shampoos, to obliquely descriptive marks such as
CHICKEN LICKEN
, to surnames and then to very descriptive trade marks such as
BITTER LEMON.
Generally, the less distinctive the trade mark, the lower its value since the protection granted by registration may prove illusory when one comes to enforce one’s imagined rights and finds that the court determines that the trade mark should never have been registered in the first place!

Acquired distinctiveness/secondary meaning

It would have been noted above that surnames came low on the list of distinctive trade marks. This is because traditionally surnames have not been protectable trade marks on the principle that a common surname cannot be monopolised since other people, having that surname, may well need to use it in trade. There does come a stage in the use of such a trade mark, however, where it acquires what the Americans call a secondary meaning. The surname **McDONALDS** is a celebrated example.

Effects of competition

Having considered the relative strength of the brand, one must consider its future likely strength in the face of foreseeable changes in the market and foreseeable competition. Here much turns on the nature of the business that the purchaser is in and the nature of the business from which the brand is drawn.

Certain industries are likely to have constant and concentrated competition which, in association with many of the other factors listed in the relative strength analysis above, will lead to the conclusion that the brand is unlikely to have a long life. Here the relative strength, capitalisation and ability to control the market held by the purchaser may have a significant effect on value. For instance, if the purchaser controlled a large chain of retail outlets dominant in the market, its commitment to promote the purchased brand at the expense of would be competitors within in its own retail outlets, would enhance the value over the same brand being sold to a smaller player in a poorer position to control the market.

Valuation calculation

The most straightforward means of calculating the valuation would be to take the expected annual royalty cashflow over the appropriate period (for the present purpose, we should say 10 years) and reflect the royalty value as an after-tax amount. The non-discounted value would then be the total of the royalty flow over the next 10 years. This is then discounted by the amount of inflation which is expected over the next 10 year period and further discounted according to the dangers in the particular market, and according to all the other factors which have been mentioned above. The net present value is the result of taking all of these considerations into account.

Conclusion

Brand valuation is more of an art than a science - although it has been done, it is not something which can properly be undertaken on a fixed mathematical formula and it has to be questioned how effectively an accountant, acting alone, can value something of this nature, since most accountants will not be able to analyse the strength of the underlying trade mark. On the other hand, trade mark attorneys, acting alone, may well be weak on the accounting elements of the valuation. It follows that a good valuation will combine both sets of skills.

As with any art, the results will not be precise, although the figure presented at the end of the exercise may lend the illusion of precision. The reason is that many of the factors affecting the valuation have a high subjective content, however objectively one may work at ascertaining them.

The approach outlined here, though, has a way of producing similar results when applied by different people and represents a reasonable means of assessing value that has found generalised acceptance from revenue agencies, sellers and buyers alike.