

The value of intangible assets in IPO's

“As more companies are considering listing on the CSE, and as they determine the value of their share, a valuation that goes beyond net asset value will provide a holistic view of the value creating potential” says Ruchi Gunewardene, Managing Director of Brand Finance Lanka.

The case with Godrej Properties

Adi Godrej, Chairman of Godrej Group, when interviewed in September 2009 on CNBC when he was considering listing Godrej Properties stated “I don't believe companies should be valued on net asset value. There is tremendous value for a company in terms of its brands' and intangibles' ability to drive future business and its ability to drive future growth. Quality, timely delivery, customer satisfaction etc will increase the Godrej brand to secure earnings which would create long term sustainability.”

Such a startling statement being made by a Chairman of a hugely successful company in India surprised many. But to Unni Krishnan Managing Director of Brand Finance India, Mr. Godrej's comment was a challenge to change investors views of his company and in the way the value of any business should be assessed.

Increasingly, businesses do not need to hold on to tangible assets to create value. These can be outsourced as they focus on their core capabilities and expertise. This has resulted in a dramatic shift over the years in the source of value creation – from tangible assets (such as property, plant, equipment and inventory) to intangible assets (such as brands, stakeholder relationships, IP, skilled employees, corporate culture, etc) that don't show up in the balance sheets.

The components of value

The brand plays a singularly important role within the intangible assets by capturing all of the reputational, relationship and intellectual capital that resides with different stakeholders of the business

Reputational capital for example can be built through the stature of the company, through the ethics, corporate governance and timeless values untainted by scandal.

Relationship capital is that which binds the stakeholders to the business. The established relationships it has built with its customers, partners, suppliers, and its employees all of which go towards creating business value.

Intellectual capital is derived through a companys' clear vision, its cutting edge systems, processes, IT systems which are deployed into the operational aspects of

the company resulting in its competitive, proprietary advantages, cost savings and enhanced efficiencies.

These then are the intangible assets of a business which currently can be valued and which should be highlighted to current and / or potential investors.

Stakeholder relationships can be measured through research. The stronger that relationship or bond, greater the loyalty and propensity to be involved in the business which leads to commanding a premium; ensuring greater commitment or even reducing costs, all of which generates cash into the business. This in turn translates into a higher value for that branded business.

So, is there a reliable way of measuring brand value?

After nearly 20 years of brand valuation and debate between Marketing and Finance Directors, the ISO has finally produced ISO Standard 10668 to deal with the subject once and for all. This will be published in September 2010.

ISO first state the importance of brands and the need to value them consistently and transparently. It then sets out an approach which all future ISO brand valuations are subject to.

Three types of analysis must be completed:

1. Legal analysis

Brand valuation should include an assessment of the legal protection afforded to the brand in each geographical jurisdiction and product or service registration category. These legal rights vary between legal systems and need to be carefully considered when forming the brand valuation opinion.

2. Behavioural analysis

The brand valuer must understand the market size and trends, contribution of brand to the purchase decision, attitude of all stakeholder groups to the brand and all economic benefits conferred on the branded business by the brand.

3. Financial analysis

The financial analysis includes the following approaches:

- *Market approach*: measures value by reference to what other purchasers in the market have paid for similar assets.
- *Cost approach*: measures value by reference to the cost invested in creating, replacing or reproducing the brand.

- *Income approach*: 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.

Various methods are recommended under the income approach:

- *Royalty Relief method*

This assumes that the brand is not owned by the business but is licensed from a third party. The value is deemed to be the present value of the royalty payments saved by virtue of owning the brand.

- *Price Premium and Volume Premium methods*

The Price Premium method estimates the value of a brand by reference to the price premium it commands over unbranded, weakly branded or generic products or services.

The Volume Premium method estimates the value of a brand by reference to the volume premium that it generates.

- *Income-split method*

This method starts with net operating profits and deducts a charge for capital employed in the branded business, to arrive at 'economic profits' attributable to total intangible capital employed. Behavioural analysis is then used to identify the percentage contribution of brand to these intangible economic profits.

- *Multi-period excess earnings method*

The values of each tangible and intangible asset employed in the branded business (other than the brand) are valued using a variety of valuation approaches and methods depending on what is considered most appropriate to each asset. A charge is then made against earnings for each of these assets, leaving residual earnings attributable to the brand alone.

- *Incremental cash flow method*

The incremental cash flow method identifies all cash flows generated by the brand in a business, by comparison with comparable businesses with no such brand. Cash flows are generated through both increased revenues and reduced costs.

A measure that can withstand scrutiny

Each approach has merits but for financial reporting purposes accountants, lawyers and tax practitioners recommend the Royalty Relief method.

One thing is certain. Whichever method is used they will all now be completed under the ISO banner, giving credibility to a discipline which in the past was often regarded as a 'black art'.

All of this means is that for those companies which seek to have a complete view of their business being highlighted to the investment community, a reliable valuation of their intangible assets can indeed be the starting point.

The case with the Odel IPO

The value that the brand can add to a business was highlighted in the recent Odel IPO, which was not only oversubscribed but also brought in thousands of first time investors to the CSE. This demonstrated the propensity with which essentially non-investors engaged with the company, purely based on the brand's strength.

According to David Haigh, Managing Director of Brand finance plc, this was a good example of how the brand which was built around their customers was able to motivate them to shift to do something quite different, with a beneficial impact on the brand. This is the "stretch" in terms of premium, new product opportunities and stakeholder behaviour that only good brands can command.

Timely valuations enable an assessment of the strength of the brand to be made and this can be used to "sweat" this asset to generate cash for the business. To do so, a brand has to be well articulated, have a clear strategy and know where value can be extracted.

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Brand Finance is an independent consultancy focused on the management and valuation of brands and of branded businesses. Since 1996, Brand Finance has performed hundreds of brand valuations with an aggregate value of over \$150 billion. Brand Finance is headquartered in London and has offices in Toronto, São Paulo, Madrid, Amsterdam, Paris, Bangalore, Colombo, Singapore, Hong Kong and Sydney.

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