Monetary brand valuation in financial engineering

Dr. Edelbert Häfele, Dr. Judit Inacsovszky, Christina Koller of PATEV Associates GmbH look at how an active IP management by trademark and patent lawyers can support leveraging the value of trademark and patent rights in times of a crisis or business expansion.

Résumés

Dr. Edelbert Häfele
Edelbert Häfele is a chemical engineer and holds a doctorate in process engineering. After a career in medium-sized industry, he has been managing PATEV since 2001, a solution provider for IP based business focusing on the value of IP. He is a member of numerous associations and has been listed in the international ranking of the IAM magazine "The World's Leading IP Strategists" for many years. At the IHK Munich he is "publicly appointed and sworn expert for the valuation of industrial property rights".

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Judit Inacsovszky holds a diploma and doctorate in electrical engineering with a specialization in communications engineering/computer science. She has over 20 years of professional experience in the field, including more than 10 years of experience as a collaboration partner of PATEV in the area of IP analysis and IP valuation.

Christina Koller
Christina Koller studied management and law and is working intensively on the topic of quality of Intellectual Property since then. She is working at PATEV since 2016 and currently holds the position of Director Business Intelligence. Therefore, her main responsibilities are in the field of economic valuation of intellectual property (i.e, patents, trademarks and know-how).


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Intangible assets such as brands, patents, and know-how, hold considerable value for companies. This is not only the result of our extensive experience in the field of Intellectual Property valuation but also proven by different studies of renowned auditing firms. In many cases, the consideration of IP and especially trademarks is of great importance for the future prospects of companies in industry and trade. This holds true for a number of different scenarios were valuations (i.e. determination of the monetary value of trademarks) play an important role.

This also includes possibilities of supporting financing activities through the strategic use of intangible assets, like trademarks. Especially in turbulent times (amongst others, this can include crisis situations, but also business expansion) the use of these assets brings specific advantages to supporting financing efforts within companies. It usually involves different parties (e.g. auditors, lawyers, banks, investors) to successfully run through the relevant processes, with one providing the valuation of the relevant IP asset(s).

Regarding this, it is important to understand that each brand valuation provider has its own methodology, which means that the method – and as a consequence also the result – depends strongly on the selected valuating company. Especially in Germany, however, strong tendencies towards standardization can be observed in the last decades. It is of great importance to consider the relevant standards appropriate for the respective situation/scenario in which the valuation takes place.

The following article provides a brief insight into the relevant aspects of trademark valuation in the context of financing initiatives, with a special focus on referring to and highlighting relevant use cases we encountered in the past years.

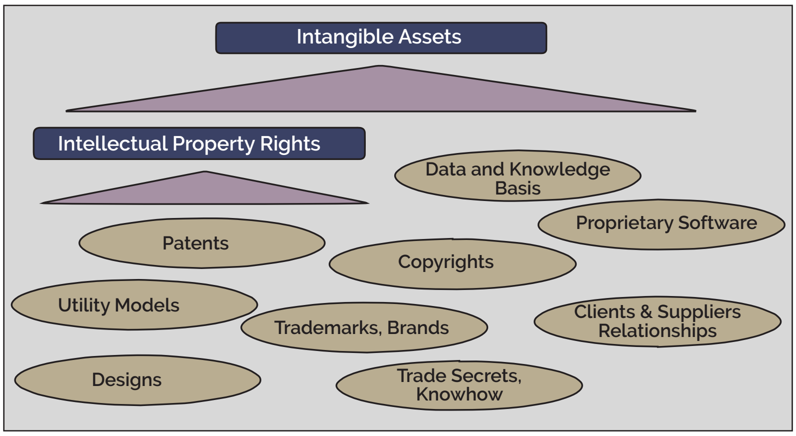

Figure 1: Types of Intellectual property

Intellectual Property as part of the company value

Especially in our knowledge-driven society, IP plays an increasingly important role. When a company is sold or valued because of different reasons, the proportion of goodwill, including intangible assets (see Figure 1) such as brands and patents, accounts for between 30 and 70 percent of the company value/purchase price (KPMG Corporate Finance, 2010).

It has to be highlighted that the share of goodwill on the overall market capitalization has increased continuously over the last years (already elaborated on in Cardoza & Basara, 2006). As a consequence, a one-sided focus on only financial and commercial aspects of the balance sheet quickly overlooks the value of patent and trademark rights that are usually not capitalized. Consideration of the value of patents and trademarks is often overseen, even though they are crucial for the future prospect and competitive advantage of the company, which is also supported through the information provided in Figure 2, that outlines the percentage share of the purchasing price associated with goodwill based on selected industries.

One especially important value driver when it comes to IP in order to make it an important commercial asset are brands (Denoncourt, 2017; Lagarden, 2012).

Regarding brands, the following three main and important functions (i.e. value drivers) have to be distinguished, they are also important for the considerations expressed later on, when it comes to the valuation of trademarks in different financing activities/scenarios (Brand Valuation Forum, 2008; Lagarden, 2012):

1. **Communication:**
   Trademarks are important signals in order to enable the communication towards the customer but also other stakeholders for which they are relevant (e.g. employees, suppliers, investors). This means that one of the main functions of brands and their underlying trademark rights is to provide a clear message about the company as a whole or certain products/services the particular company offers. Essentially this enables the company to guarantee recognition as well as continuity in communication. Summarizing, the brand plays an important role to ensure/support efficient investments in communication initiatives.
2. **Differentiation:**
   Trademarks help to shape the perception of the brand on the market. In doing so they help customers and other stakeholders to distinguish them from the competitors and – at best – enables (purchase) decisions in favor of the brand. As technologies, markets, processes and know-how as well as the resulting products/services are increasingly exchangeable, there is a shift in value creation to assets which successfully set themselves apart over a long period and cannot be copied.
   In case the trademark manages to build such a strong differentiating potential this goes hand in hand with several advantages, like the fact that products / services might be offered for a higher price. Additionally, this also supports moving into new business fields or product generations and communicate these convincingly to a (new) set of customers and other relevant stakeholders. Such a dominant position in the market is very likely to directly result in higher future cash flows.

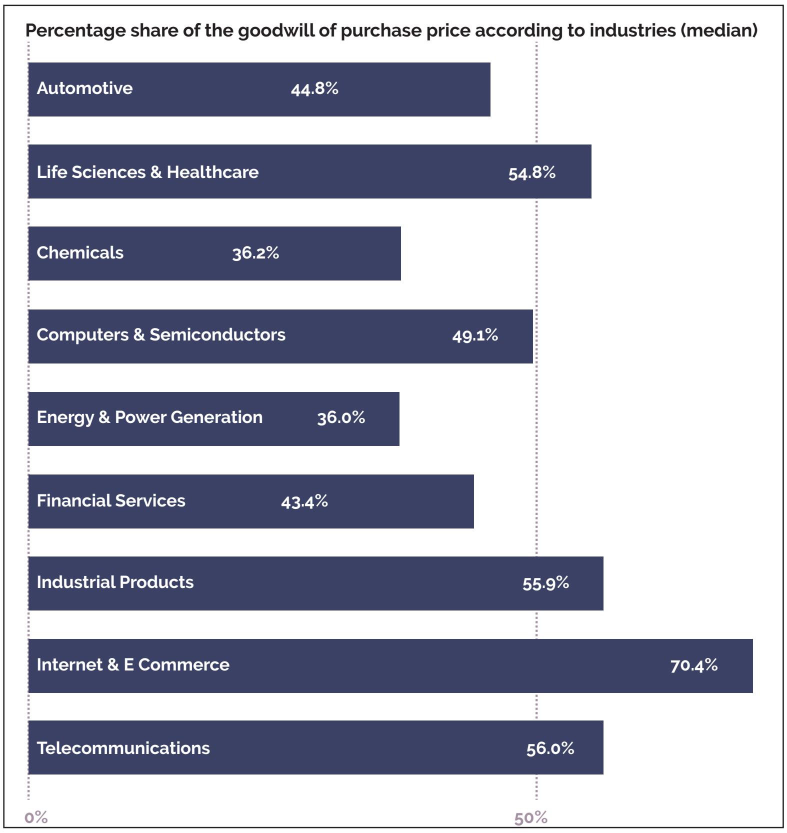

Figure 2: Relevance of Intangible Assets (Source: KPMG Corporate Finance, 2010; also refer to: PricewaterhouseCoopers/FHDW Hannover, 2018)

3. **Value over time:**
   A trademark is often perceived as one of the most important constants when it comes to the relationship between a customer or other stakeholders and the company. The experiences – good and negative – are strongly associated with the brand. If the brand has a strong and well-perceived position in the market, this fosters future demand and stronger, long-term cash-flows. This even holds true, after other intellectual property rights (e.g., more related to technological aspects like patents) are no longer in place.

Brand valuation in Germany

Brand valuation faces the strong dilemma that different valuation methods lead to different results in the value of the brand. At present, a number of efforts are under way to standardize the valuation methods – especially also in Germany. For instance, the German standards association, Deutsches Institut fur Normung, elaborated a standard to establish an international ISO procedure regarding trademark valuation which is already in place since several years. Additionally, also the institute of certified accountants in Germany, IDW, has published a standard on the evaluation of intangible assets (IDW S5, see www.idw.de). Against this background the leading brand valuation experts established the "Brand Valuation Forum" that focuses on the development of the 10 principles of monetary brand valuation. Although compatible with each other, these different standards focus on different valuation occasions.

In the following section the most relevant considerations regarding these most important standardization approaches in Germany are outlined.

DIN ISO 10668

DIN ISO 10668 is an international set of standards that considers different perspectives and purposes (e.g., financial, liquidation, litigation, internal purposes, …). The standards outline that each valuation has to, basically, consider three perspectives, which are a Legal, Behavioral and Financial analysis (Brand Finance, 2010).

IDW S5

These standards focus on the relevant aspects for auditors and puts business related considerations regarding valuation in the foreground.

10 principles of monetary brand valuation

Their aim is to develop uniform principles on the basis of the existing valuation methods in order to provide a guideline to examine and make an informed decision about the relevant valuation approach. These principles include but are not limited to the following standards: Relevance of occasion, kind of brand and function, protection, target group relevance, brand status, economic life of the brand, brand-specific cash flows and net present value methods (risk), brand specific risks (market and competitive) as well as reproducibility and transparency (Brand Valuation Forum, 2008).

> **"Consideration of the value of patents and trademarks is often overseen."**

In most cases the valuation of brands does not only involve one single entity; our experience has shown that the valuation is usually part of a more comprehensive process also strongly dependent on the respective underlying scenario that is relevant in the given context. This – besides a valuation expert – in general also requires legal advisors as well as auditors that built the framework for the valuation scenario.

Also, in terms of compliance issues (especially if third parties like tax authorities or banks are involved) it is advisable to rest these responsibilities on different shoulders.

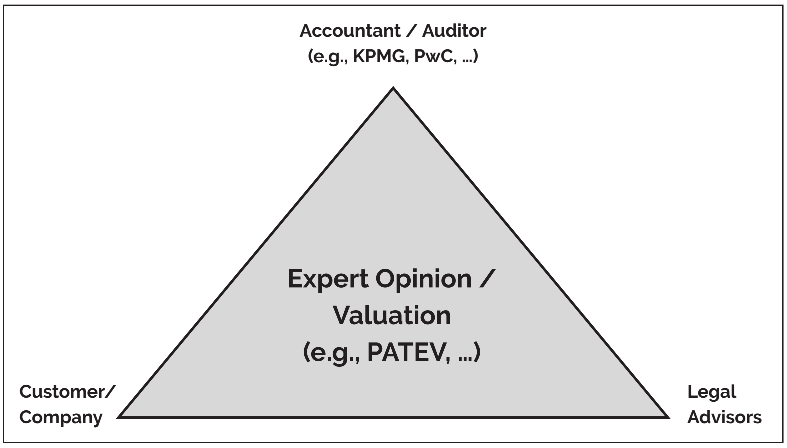

Figure 3: Patent Valuation - Involved Parties

Trademark valuation in "financial engineering"

As outlined above, one of the most crucial aspects in the valuation process is the actual situation in which the valuation takes place. Below we have collected four use cases from our 20 years of experience in providing expert opinions for numerous companies and their financing partners in order to support different financial scenarios. All these cases took place in Germany.

These examples provide a first brief idea regarding the different scenarios in which IP (with a focus on trademarks) can play an important role to support the financial constraints and needs that companies are facing, especially in times of crisis or business expansion.

INITIAL SITUATION	SOLUTION
A well-known company from the construction industry with annual sales of over EUR50 million gets into difficulties with high levels of supply shortages through no fault of its own. This results in a short-term liquidity bottleneck.	- Additional bridge financing by the consortium partners (security: trademark rights) is required - PATEV expert opinion as a basis for the financing framework (i.e., credit line) - Regular continuation of business operations and later repayment of the loan/release of the collateral
A well-known company from the communication industry with over EUR500 million annual turnover needs a strong, international partner. The main intention is to sell the company. The company has high debt and all tangible collateral has already been completely transferred. A bridging loan is required for the divestment process.	- Trademarks, in particular, are identified as assets of enduring value by PATEV. - The trademark rights turned out to be primarily interesting for an Asian investor. - The company is completely newly financed through this investor and the loans are repaid.
A regionally known trading company with approximately EUR200 million annual turnover is being restructured. This process requires additional financing. No further tangible securities are available. Umbrella brand and product brands are well-positioned in the business model of the company and play a significant role.	- Possibility to achieve financing through a bank consortium (security: trademark rights) - PATEV trademark expert opinion as the basis to set up the financial framework - Regular continuation of the business operations with approximately 1,000 employees and subsequent repayment of the loan.
An electrical engineering company, which has significant patents and has over EUR100 million annual turnover, requires a bridging loan. Subsequently, a part of the business (i.e., subdivision of the company) is to be sold. For the corresponding negotiations with potential buyers it is important to determine the value of the underlying IP.	- Determination of the value of the IP – in this case patents turned out to be the most important value drivers – as a basis for negotiations. - PATEV valuation report as framework for successful interim financing.

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“It is important to understand that each brand valuation provider has its own methodology.”

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