Interbrand brand valuation

The Interbrand method is extremely popular for valuation of brands and has been adopted in several practical purposes such as brand valuation of various food-related and beverage brands such as Coca-Cola, Pepsi, Kelloggs, Cadbury, Wrigleys and Nestle. This method majorly discusses about the extra earnings an associated brand can generate for a company or companies over a considerable period of time. The brand value is then calculated to be the present value of these discounted additional earnings which the brand generates.

The method indicates the need for choosing the target markets by segmentation of the markets through various parameters such as geographic, demographic and psychographic variables. After analysing the markets and performing a proper financial analysis in the form of estimated revenues, units of sales, associated costs and forecasts, we need to analyse what are the demand drivers of the brand. For example, in this case of evaluating the Kingfisher brand, some of the parameters of demand drivers would be related to the level of need of the brand, the elasticity of pricing the brand, the number of competitors and substitutes in a given geographical region, etc. A competitive benchmarking analysis is done to recognize the gaps associated with the branding processes and strategies adopted by Kingfisher in comparison to its competitors. Finally, the brand earnings are calculated and the brand discount rate in different specific periods for the relevant time horizon to find the brand value which is the net present value of forecasted brand earnings of Kingfisher.

Determination of Kingfisher brands weighted average differential EBIT

We will calculate the additional EBIT by using the formula:-

Differential EBIT = (EBIT) branded (EBIT) unbranded

Where EBIT i. e. Earnings before interest and taxes is the operating profit of the company. It is equal to Net Sales Total Expenditure.

In order to calculate the differential EBIT, we have used a similar brewery company in India, called Mount Shivalik Breweries Industries (MSBL), which is a public listed company which has been in existence since 1972. The company is primarily into the business of manufacturing and supplying draught beer in the Union territory of Chandigarh. It caters to both the strong beer segment as well as the mild beer segment, with the flagship brands being Thunderbolt and Golden Peacock. Although, 95% of the beer supplies to the pubs and bars in Chandigarh are being catered from MSBL, it still doesnt match to the brand quality of Kingfisher which is globally recognized. Hence, we have preferred to use MSBL as an unbranded company. Hence, Kingfishers differential EBIT is:-

(EBIT) Kingfisher (EBIT) MSBL

We have calculated the differential EBIT for the last three fiscals and then the present value has been found out by compounding them with the discount rate used as average inflation rate. The calculations are shown below:-

We have taken a conservative approach of considering the brand horizon to be around three years because efforts of brand building like heavy investment in marketing of the brand, R & D efforts for inventing new technologies, etc have an effect of at least 3 years after which there is a need for change in business process restructuring. The EBITs are proportionately weighted according to the standard amortizing schedule of 1: 2: 3, with the most recent year getting the highest weightage of 3. The relevant calculations are shown below:-

Average Inflation Rate for the past 3 years = 10. 5 %

Determination of brand differential earnings

The formula for brand differential earnings is given below:-

Brand differential earnings = Weighted differential EBIT capital charge Tax

The capital charge is estimated by multiplying the weighted average cost of capital (WACC) with the amount of capital employed by the Kingfisher brand (part of United Breweries Limited group). The average WACC is estimated by using a period of past five years and forecasting the data for next five years. The WACC calculation for the United Breweries Limited (UBL) company is shown below:-

The Beta for the United Breweries industry has been taken from capital for the years 2005 to 2010. The forecasted years data i. e the beta for years 2011 to 2015 has been estimated by using the 3-year moving average method, wherein the beta for year 2011 is the average of the betas for the preceding three years 2008-2010. Similarly, the D/E ratio for future years has been calculated by using the 3-year moving average method. The cost of equity for each year has been calculated by using the CAPM formula given below:-

Ke = Rf + Beta*Market Risk Premium

The average WACC is calculated by using the 3-yr moving average method of the forecasted years 2013-2015. The calculations are shown below:-

The brand differential earnings calculations are shown below:-

Determination of Brand Strength and Brand Multiplier

The assessment of brand strength takes into account the following factors:-

- Leadership ability to influence the market
- Stability ability to maintain a consumer franchise
- Market vulnerability of market demand to changes in tastes or technology
- International Scope cross national/cultural potential
- Trend long term appeal to consumers
- Support strength of communications
- Protection security of the brand owners legal or property rights

The greater is the brand strength of a company, the higher is its associated brand multiple. Typically, brand multiple ranges from 6 to 20.

We have tried to quantify the factors of brand strength by relating each factor with the quantifiable variables related to the operational performance of the UBL company in general and the Kingfisher brand specifically. They are shown below:-

- Leadership factor of the brand can be estimated by looking at the market share, net profit margin (NPM) it generates, market capitalization (Mkt. Cap.), and investor returns (ROE), estimated revenue growth (Rev. CAGR) and estimated profit growth (NP. CAGR) over the years.

- Stability factor can be measured by the volatility of the net profit margin (NP Var%) of the Kingfisher brand over the years
- We have compared the Kingfisher brand to its top ten competitors in the breweries industry and hence we did not incorporate any distinguishing factor of the brand in terms of distinct market conditions.
- International scope of the brand can be measured by the level of exports it generates
- The Trend factor of Kingfisher brand or any brand in general can be estimated by correlating with the change in return on assets. Typically, return on assets would be higher for high-quality assets. Brands tend to perform better with quality assets available for production, sales and marketing and consistent research and development.
- The level of Support for a brand would be reflected by additional investments to maintain the goodwill of the brand.
- The brands Protection could be quantified by analysing its threats against acquisition, bankruptcy and other financial distress costs related to management. The most efficient measure we could use to quantify the protection is interest coverage ratio (ICR).

We have assumed that all the above seven parameters have an equal weight to the brand strength of Kingfisher, except the market factor which we have taken as zero.

Brand Strength = Leadership + Stability + Market + Internationality + Trend + Support + Protection

The operational performance of the top seven companies (current data available for seven companies only) of the breweries industry in India has been compared to that of Kingfisher in order to estimate the brand strength of Kingfisher. The relevant data has been extracted from Capitaline. The columns highlighted in yellow contain negative values and needs to be normalized as shown by the data below. The remaining columns have already been normalized. The seven companies have been ranked from top to bottom on the basis of market share they hold which is equal to company net sales as a percentage of industry net sales. Similarly market capitalization has been normalized as a percentage of total industry market capitalization. Export revenues and S& A (Selling and Administration) expenses are a percentage of the total net revenues and total expenses of the company respectively. The Revenue CAGR and NP. CAGR are calculated by averaging the growth rates of revenues and net profit respectively for the past three years i. e. 2008-2010.

The columns in yellow are normalized by the process of assigning highest weights to the maximum value and assigning lowest weights to the minimum value. For example, in order to normalize the net profit margin (NPM), we have assigned a weight of 6 to Globus Spirits followed by a 5 to Mount Shivalik and finally going on assigning weights of 4, 3, 2 and 1 in the descending order to the remaining companies with a weight of 0 being assigned to SKOL Breweries, which has the minimum NPM of -10. 39. All the other negative values are also given weights ranging from 0 to 1 depending on their proportion i. e. a higher negative value of -3. 93 would be given a lower weight of say 0. 1 compared to a lower negative value of -2. 54 which would be given a weight of say 0. 5. The method of assigning weights to negative values has been purely done on a subjective basis and there is scope of further improvements. The other columns have also been normalized in the same fashion. The normalized table is shown in the next page:-

We can now calculate the consolidated brand strength based on the measured values of the quantifiable variables which relates to the seven factors responsible for brand strength.

The consolidated values of each of the seven factors are shown in the next page below. The brand strength factors such as leadership and trend which are measured by more than one quantifying variables are consolidated and then the average of the consolidated value is taken to reflect the corresponding factor. This is shown in the next page.

The next step which we need to incorporate is to find out the relationship between brand strength and brand multiplier. The Interbrand S-curve is shown below.

The S-curve function is approximated using a sigmoid function wherein we have the relation, brand multiplier = f (brand strength). From the paper Valuation of Brands and Intellectual Capital written by Pablo Fernandez, we have estimated the brand multiple of Kingfisher brand by interpolating its corresponding brand strength using the source as the four values of brand strength and corresponding brand multiples mentioned in the paper.

From the S-curve above, we can roughly estimate that the brand multiple for a brand strength of 1 would be equal to 0. 7. A brand strength of 38 has a brand multiple of 6. 3 as shown in the table beside. Hence, the brand multiple of Kingfisher brand for a brand strength of 16. 63 % would be equivalent to:-

Brand multiple = 0. 7 + {(6. 3 0. 7)/ (38-1)}*16. 63 = 3. 217

Hence brand value of Kingfisher brand is estimated to be equal to:-

Brand Value of Kingfisher = brand multiple*Kingfisher brand differential earnings

= 3. 217*72. 87 = 234. 42 crores

Royalty Relief Brand Valuation Method

This method is one of the most efficient methods currently used for brand valuation as per industry practises. In this approach, a royalty rate is estimated by the brand owner/licensor, which needs to be paid by the third party/licensee for using the brand defined under the guidelines of Intellectual Property Rights (IPR) usage. The brand value would then be determined by the present value of the royalty stream after taxes. The methodology used in the royalty savings method or the royalty relief method comprises of the following steps:-

- Estimate the branded net sales for the planning horizon (generally three to five years)

- Determine a reasonable royalty rate that the two unrelated parties would have set for the transfer of comparable brands in an arms length transaction
- Multiply the estimated royalty rate by the projected sales of the brand over its economic life. The result represents annual royalty savings
- Apply a fiscal charge in each period to estimate the after-tax royalty savings for each
- Estimate the brands perpetual growth rate, economic useful life and discount rate
- Discount the royalty stream after taxes at present value

The royalty rate used for estimating the future royalty streams in the planning horizon, depends on several factors. They are:-

- The brand strength
- The duration and termination provisions of the agreement
- The licenses exclusivity
- The parties negotiating power
- The products life cycle
- The local market conditions, particularly the margins earned in the local market

The level of operating margin or licensees sales. Generally, the 25% rule and the 5% rule are associated with this factor. The 25% rule states that the royalty rate is estimated to be 25% of the operating profit of the licensees sales whereas the 5% rule states that the royalty rate is estimated to be 5% of sales.

We have tried to estimate the royalty rate by comparing with the brand strength we obtained from the Interbrand brand valuation method. The relationship table between brand strength / brand scores between 0-100 and royalty rates has been taken from a paper whose source is mentioned below the table:-

The formula for calculating the royalty rate for brand strength of 16. 63 from the above table is shown below. It is a basic method of interpolation.

Royalty rate = 1. 0 + {(7. 0 1. 0) / (50 0)}*16. 63 = 2. 996 % of net sales

We have assumed that the economic life of a brand is approximately around three years after which the branding of the product (in this case Kingfisher) needs to be changed in the form of better R&D efforts, operational excellence, advanced innovative campaigns, etc.

The calculations of brand value using the royalty rate method is shown below:-

Thus, using the royalty relief method we see that the brand value of Kingfisher is 224. 52 crores which is almost equal to the brand value we have obtained from the Interbrand brand valuation method. Here we have assumed that the economic life of the Kingfisher brand is 3 years. Its a subjective assumption; however the assumption is based on the industry practises of brand valuation methodologies used.