VALUATING WINE BRANDS USING THE BRAND FINANCE METHOD - A CASE STUDY

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Abstract

Brand is a specific intangible asset which is nowadays in many companies one of the most important assets, in particular because of the economic and financial effects that brands have. Brands influence not only consumer's choice, the employees and investors, but also public authorities and the general public. In the world of endless possibilities, such an impact is of utmost importance for market success and will provide added value to shareholders. This is the reason why strategic decision-making of the management is increasingly focused on value growth asset management. Moreover, brands are specific since in many cases they outlive their companies and have a number of different owners during their life-cycle. However, brands have to be not only identified, but also valuated. Various methods are used to valuate brands, and the aim of this paper is to present brand valuation by using brand finance valuation methodology on a case study.

Keywords: *valuating brands, intangible assets, market success, profitability of business, company value.*

JEL Classification: L6, L66,R51

1. INTRODUCTION

All successful companies keep investing in their assets to increase profitability. Types of property which appear in companies are very different and one of those types are intangible (untouchable) assets. Although this type of asset has investment costs which often cause losses rather than profits, it is not enough to rely on its investment costs to determine its value. Therefore companies have major problem with evaluating this type of property and this problem is not completely solved yet. Intangible assets are truly hard to evaluate objectively, even though they exist in companies. The subject matters are brands, goodwill, patents, trademarks, licenses, human knowledge, special product names which people trust and consume traditionally. Based on its special name, a company can have even 50% higher prices on the market, in comparison to other companies which produce the same or similar products, thanks to the trust they have with their buyers. This price difference represents extra income, apropos extra profit, just because of the trust of their buyers which are willing to pay the difference. That, of course, has its value and represents intangible assets which can even be amortized by accounting rules, but only after previous purchase, if the value has been bought, emphasized in the contract and paid. The possibility of determining extra income and discounting, then bringing to present value will be shown using the example of evaluating the intangible assets of company VINO. Timeliness of this problem in practice comes from financial reports of observed company VINO, which show intangible assets of this company in value of 298.452 HRK by the end of 2013, although the subject matter are world known wines which have been consumed for centuries, have their loyal customers, win prestige awards and first prizes on world exhibitions. Of course the reasons to have a different approach to determining intangible asset values of this company are objective. After having an insight of financial reports of this company, brands of four types of wine with high financial value have been extracted: (1) Riesling, (2) Traminer, (3) white table wine and (4) Rhine Riesling.

2. METHODOLOGY OF VINO BRAND VALUE CALCULATION

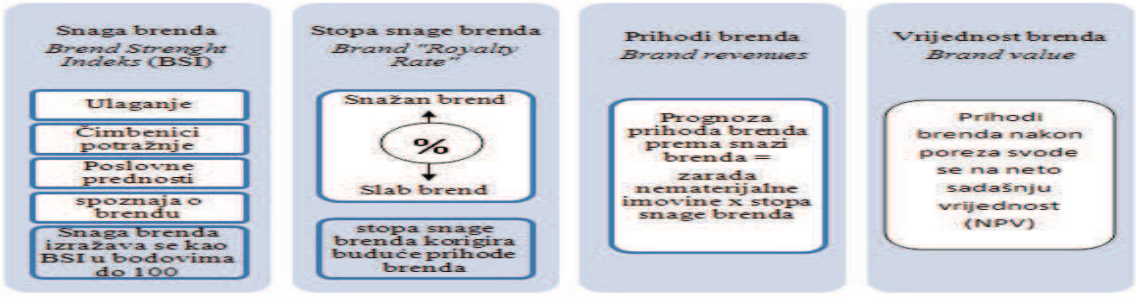
Brands do not have an active purchasing market as other types of asset, although they are often bought and sold with other types of asset. Therefore, several special and combined analytical models for brand evaluation have been

developed. Marketing approach applies to commercial (market) functions which contribute to business, while financial approach applies to expressing the brand in financial amounts. The combined approach of brand evaluation refers to combination of marketing and financial approach with weighting according to market significance and results of both methods individually. Starting from the fact that the brand is a specific type of asset which provides long term competitive advantage and provides company's profitability, it is expected that this approach could give the best results. The VINO company's main business has market share of 21,14% and is number one by total profit in 01.21 business which has 107 subjects (only subjects which give annual financial reports are counted). The VINO company is ranked by size as medium-size enterprise. Within business are 103 small enterprises and 4 medium-size enterprises. Financial value of the brand can be determined using three approaches: market approach, cost approach and profit approach. Using appropriate approach, apropos methods characteristic for individual approaches depend on ways of brand acquisition and purpose of measuring financial value. Previous researches indicate methods: (1) financial brand value, (2) DCF method, (3) method for the calculation and revision of goodwill, (4) Interbrand method and (5) Brand Finance method. This paper presents Brand Finance method.

2.1. Brand Finance method

Brand Finance method has developed the procedure of brand evaluation which takes into account market and financial information in last three years and based on those information carries out brand forecast. From brand forecast follows EVA (economic value added) which depends on demand and market index, resulting with added value of the brand. Added value of the brand is adjusted with risk factors and brand beta analysis, which results with discount rate, bringing added value to present value and determines the brand value. Each asset value, including brand value represents net present value (NPV) of cash flows, in which the investment is represented as capital cost. (Brand Finance, 2015).

Figure 1. Brand Finance methodology



Source: Production of authors (Brand Finance, 2015)

To calculate discount rate, CAMP (Capital Asset Pricing Model) can be applied, which describes the relation between systematic risk, expected return and estimation of asset value. CAMP model is shown as (Vukičević, M., et al.; 2010: 165-176, 261- 272, 357- 365.).: $R_j = R_f + \beta (R_m - R_f)$, where is:

R_j = expected yield – discount rate

R_f = risk-free interest rate on government bonds

β = measure of systematic risk – Brand Beta

R_m = market yield

Brand is intangible asset, so to calculate market yield, return on asset indicator should be taken from top 10 enterprises which have 77% business share by total income (later referred to as Top 10 index). Risk-free rate is taken as average interest rate on issued international Croatian government bonds in 2013 (Ministry of Finance RH, 2015), and *Beta Brand*, as a measure of systematic risk, is calculated as relation between company income covariance and market covariance and market variance.

where is:

$cov(Rj,R_{m)}$ = company income covariance and market covariance

$\sigma^2(R_m)$ = market variance

Collecting data about business share by income first required enterprise classification analysis, and data about agricultural cooperatives were collected via e-mail request. Table no.1 shows top 10 business shares in business 01.21 by total income, return on assets, systematic risk calculation and adjusted CAMP.

Table no. 1. Business share by total income in 2013 and ROA of top 10 in the industry (Top 10)

Rank	Company name	Share in top 10	Share in business	ROA 2012	ROA 2013
1.	VINO d.d.	27,42%	21,14%	9,44%	2,08%
2.	SAINT HILLS d.o.o.	19,15%	14,76%	3,40%	34,36%
3.	BLATO 1902 d.d.	13,56%	10,46%	2,65%	4,93%
4.	PZ DINGAČ	9,47%	7,30%	-2,65%	7,14%
5.	ERDUTSKI VINOGRADI	8,72%	6,73%	9,95%	-7,05%
6.	VRGORKA VINARIJA d.d.	5,67%	4,37%	0,08%	1,02%
7.	PZ SVETI KRIŽ ZAČRETJE	5,47%	4,22%	0,84%	2,48%
8.	PZ POŠIP	4,06%	3,13%		
9.	AZRRI d.o.o.	3,57%	2,75%	1,36%	3,09%
10.	GALIĆ d.o.o.	2,90%	2,24%	0,60%	1,15%
	Total:		77,10%		
	Other enterprises in the business		22,90%		
	Average			2,85%	5,47%
	Variance		0,000171		
	Covariance		-0,00048		
	Beta		-2,81682		
	Risk free rate		5,77%		
	CAPM		6,63%		
	Adjusted CAPM for Beta 0,5		6,20%		

Source: Author's calculations by public reports of FINA

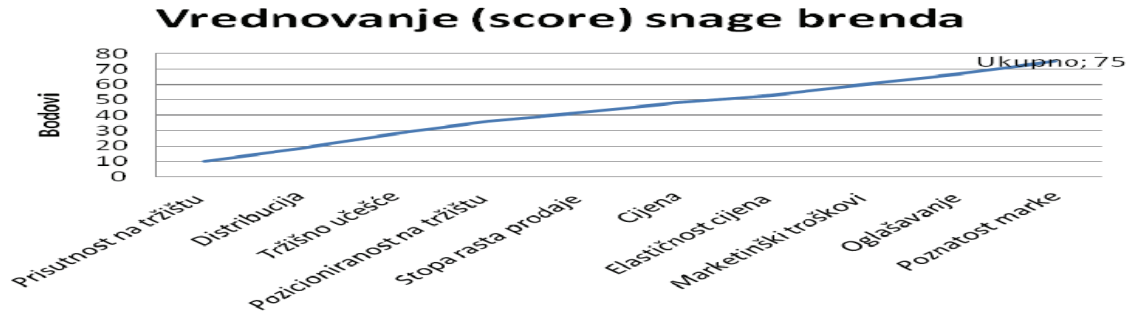
Previous table shows that average return on asset has growth tendency, but some companies have negative ROA, which means that their assets create losses, while VINO has positive ROA with tendency to fall, and in 2013 is 2,08% (for comparison purposes of ROA as a performance measure between different companies, ROA= EBIT/Assets was used). Following is the calculation of market risk in order to calculate systematic risk index of company VINO. After the calculation of market variance (top 10 index) which amounts 0,000171, calculation of market covariance and observed company should be made, which is easiest with MS Excel function COVAR. Following by calculation of covariance, beta, apropos company risk and expected CAMP, which will represent discount rate, used to calculate the brand value. According to CAMP model, discount rate amounts 6,63%, decreasing the values of NOPAT (net operating profit after tax). It is known that higher the discount rate is, lower

the brand value is. As the goal is to evaluate real brand value, CAMP should be adjusted (Miller & Muir, 2004: 232). In CAMP model, β stands for company's risk, followed by logical question: what is with company's strength? Company's strength should also be stated as index (*Beta Brand)* which will additionally strengthen risk premium (R_m - R_f), plus company's risk $\beta_{r,}$ apropos beta brand must be multiplied with β (R_m - R_f), which give us: $R_j = R_f + \beta (R_m - R_f)^* \beta_b$. Next problem is the determination of branding index which is used to adjust the value of immaterial brand profit. *Beta Brand* (BSI score) is calculated with known approach of score evaluation methodology by *Brand Finance*, where market presence, distribution, market participation, market position, sales growth rate, price, price elasticity, marketing costs, advertising and brand awareness are evaluated with scores from 0 to 10, which sums up to total value of 0 to 100 (for calculation of components score, to check measures for price, market, distribution, etc., see Grbac & Meler; 2010). While evaluating, the most important thing is to have precise market information to avoid disputing of brand value or strength. Score of VINO is presented based on information from distribution channel (local retail chain), which, by analysis of company GFK, takes over 30% of domestic market (GFK analysis gives information from 2012, but market chain share is even bigger today because of additional company's acquisition in period till 2014). Furthermore, information form market research of consumer behaviour of company Median d.o.o. have been used, conducted on sample of 4053 citizens of Republic of Croatia from all counties (information available only through agreement with Market Research Institute and media of Median) and information of author's survey conducted in 2015 on sample of 400 citizens from all counties (information available to Faculty of Economics in Osijek, Marketing of special fields Cathedra). On the other hand, what should be taken into account is, if, while evaluating, will be observed companies in the same business, in this case 01.21 (grape cultivation) or total supply on the market, with enterprises registered as 11.02 – manufacturing wine from grapes. Given that the information of distribution channel includes information of all enterprises, the score was calculated for both groups.

Branding index for enterprises in the business 01.21 amounts 75, and for business 11.02 amounts 50. In calculations, the score of 75 was used, because the whole analysis was made for business 01.21, but the score for the whole market could also be used. In that case, the brand value is falling, so it is not realistic to compare manufacturers of grapes and wine with companies which

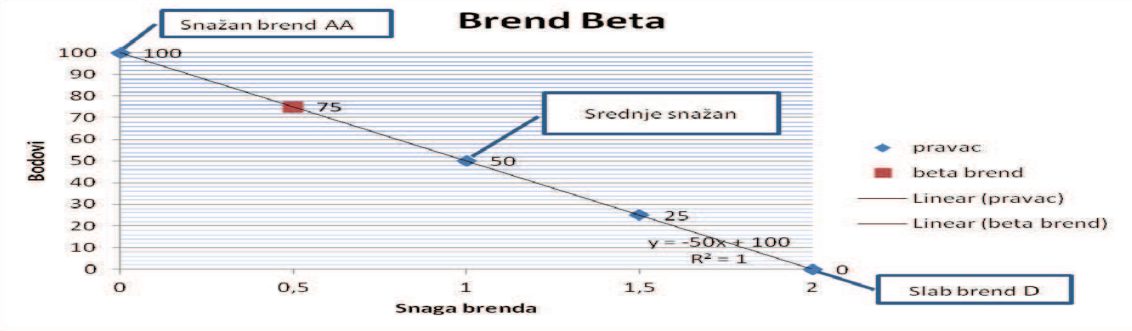
manufacture wine from grapes bought from different sources, without knowing the origin of raw materials, as with importers which operate in completely different economic conditions than domestic manufacturers.

Figure 1. Cumulative display of brand success indicators (total brand strength)



Source: Author's calculation

Figure 2. Beta Brand display



Source: Author's calculation

Previous graphic shows score of 75, which means that the brand strength is 0,5, so the CAMP should be adjusted for this brand strength, apropos *Beta Brand*, which is shown in table 2. The use of *Brand Finance* method in calculation of brand value, where brand index of 72,85% was applied, shows the following results (Schultz, Don E., 2001):

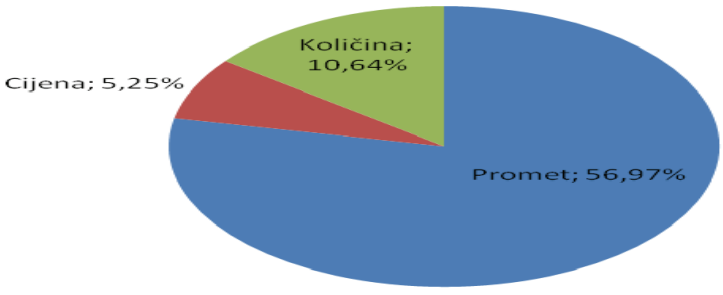
Table no. 2. The calculation of brand VINO with Brand Finance method

	2014	2015	2016	2017	2018
I. BUSINESS INCOMES	80.143.335	82.747.422	85.436.122	88.212.187	91.078.454
II. BUSINESS COSTS	75.643.112	78.100.973	80.638.698	83.258.880	85.964.199
EBIT (Earnings Before Interest & Tax)	4.500.223	4.646.449	4.797.425	4.953.307	5.114.254
Capital Expenditure (CAPEX)	4.455.566	4.600.340	4.749.818	4.904.154	5.063.504
Economic profit EP	331.049	341.805	352.912	364.379	376.218
Intangible assets earnings	4.169.175	4.304.643	4.444.513	4.588.928	4.738.036
Brand index	3.037.244	3.135.933	3.237.828	3.343.034	3.451.659
Tax	607.449	627.187	647.566	668.607	690.332
Earnings after taxes	2.429.795	2.508.746	2.590.262	2.674.427	2.761.327
Discount factor (adjusted CAPM)	0,9416196	0,88664744	0,8348846	0,78614369	0,7402483
Discounted Cash Flow (DCF)	2.287.943	2.224.373	2.162.570	2.102.484	2.044.068
Total amount of DCF	10.821.438	Brand index -72,85% CAPM – 6,20% Tax - 20% EP- 7,43%			Adjusted
The residual value of the brand	56.626.204				
Growth rate	0%				
Brand value NPV	43.790.274				

Source: Author's calculation

Previous table shows company's VINO considerably high brand value of 43.790.274 HRK. Even though this business has a relatively high strong competition, those are not world conditions of wine manufacturing and selling, capital market is deformed, branding index is estimated, etc. which results in expected doubt in stated brand value.

Figure 3. Brad Value Added (BVA)



Source: Author's calculation

Figure 3 shows components on which the Brand Value Added was calculated (BVA). In BVA calculation, authors often call for industry index, which is here not applicable, because of characteristic falling trend in last five years in all positions, as reported in statistical data of Republic of Croatia: from cultivation number of grape wines, manufactured quantity, selling, consumption share with consumers. If the BVA is observed from that position, then there's no added brand value. On the other hand, if you take into account that VINO achieves average sale about 20% from their total production in this channel which represents more than 30% of Croatian market (in this channel are about 7 million litres sold annually, achieved turnover around 180 million HRK, 100 suppliers participate on average with total of about 1370 wine items) and achieves a premium price (calculation of premium price with key competitors is available at Grbac & Meler; 2010:131.) in last three years, and the total quantity is higher than 3% in the channel, leading to calculation of index of VINO of 1,72. Using Brand Finance methodology, brand value of four types of wine, which realize 60% of company's income, has been calculated: Riesling 20.318.687 HRK; Coupage 4.803.793 HRK; Traminer 5.683.978 HRK and Rhine Riesling 2.005.595 HRK, which amounts in total 32.812.053 HRK.

3. CONCLUSION

Applying the *Brand Finance* method in brand value calculations of wines, Riesling, Coupage of red and white wine, Traminer and Rhine Riesling, results of the calculations show that the brands values considerably differ. The results could be combined to determine specific weights for the individual results, but those are not needed in this case, because of big difference in results. By applying the *Brand Finance* method, Riesling wine is shown as most valuable brand of company VINO, which is logical because this brand brings one third of income. But there is always the question: who would pay, especially in today's economic and financial situation, because fair value and market price must correspond not only with profitability, but also with desirability, interest to buy, demand and buyer's ability to pay.

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