

X OIV Conference 2024

Relevance of trade names in luxury goods space

*We need more information...*

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# Your Presenter Today



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# Table of Contents

## 1. Relevance of intangible assets

- Role of intangibles
- How to measure intangibles?
- Concept of gross goodwill – correction for acquisitions
- Europe's top 100 listed companies

## 2. Trade Name as example

- How does a Trade Name add value?
- Proxy of market value of a Trade Name
- Marketing expenses: reconsidered?
- Return on Invested Trade Name Capital

## 3. Need to become more tangible

- Relevant details of marketing expenses
  - How to create value?
  - If more detail available...
  - Link to future growth

Section 1

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# Relevance of Intangible Assets

# Role of Intangibles

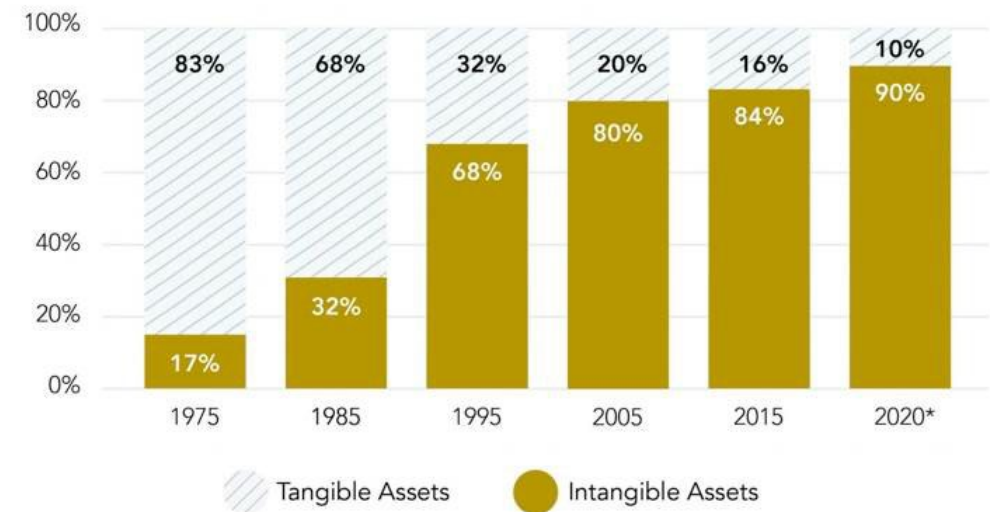
- An asset lacking physical substance
- Examples: patent, trademark/trade name, software, (non-patented) technology, goodwill
- Investing in these assets will create value – examples:
  - R&D costs
  - Marketing costs
  - Programming costs
- In several industries (e.g., Technology, Media, and Consumer Products) intangibles have become more important than tangible assets
- Should these investments be capitalized or expensed? Usually the latter, due to prudence – their impact is, however, usually longer than just for the short term



# How to measure intangibles?

- This can be a challenge, since most cash outflows are being expensed directly
- The only exception is in case of acquisitions: this will lead to intangibles coming on the balance sheet of the acquirer
- However, capital markets do value intangibles – market values are steadily outgrowing book values
- This is a sign of expected growth, but also due to less informative balance sheet info
- Hence, it would be very informative to receive more background on these intangibles and their cash flow pattern, including relevant lifetime assumptions

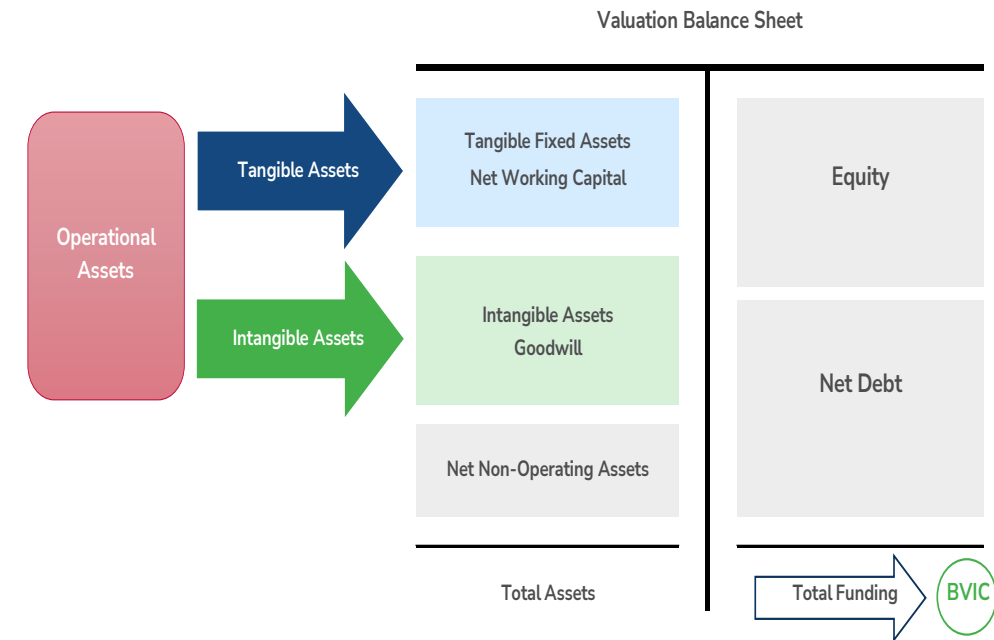
COMPONENTS of S&P 500 MARKET VALUE



SOURCE: OCEAN TOMO, LLC INTANGIBLE ASSET MARKET VALUE STUDY, 2020  
\*INTERIM STUDY UPDATE AS OF 7/1/2020

# Concept of gross goodwill

- From a valuation perspective, it is all about the Market Value of Invested Capital (equivalent of business enterprise value)
- $MVIC = \text{market cap} + \text{net debt}$
- $MVIC = \text{Operational MVIC} + \text{net non-operational items}$
- Gross goodwill equals  $MVIC - BVIC$
- Please note that acquired intangibles are already part of BVIC. Hence, gross goodwill is the market's value estimate of the relevant remaining intangibles
- How to analyze this delta further?



# Europe's top 100 listed companies

- Europe's largest companies, market value wise, have large amounts of intangibles, looking at their MVIC/BVIC
- 8 of top 10 companies are in Consumer Products / Pharma. Key intangible there is the Trade Name
- Some of them have a relatively low MVIC/BVIC, due to their acquired intangibles; e.g., Novartis and AstraZeneca
- Shell has a relatively low multiple, as it is capital intense with limited growth opportunities
- Total market of top 10 is approx. EUR 65,000 billion. Hence, a good sample reflecting the relevance of intangibles
- On average, these companies are financed with equity for about 75%

## Europe's 10 Biggest Companies

Year 2021, EUR in millions

	Market Cap	E/TC	BVIC	MVIC/BBIC
(1) Nestlé S.A.	307,047	90%	83,513	4.1x
(2) LVMH Moët Hennessy - Louis Vuitton, Société Européenne	306,466	92%	72,858	4.6x
(3) Roche Holding AG	276,422	92%	46,168	6.5x
(4) Novo Nordisk A/S	231,553	99%	10,747	21.7x
(5) Shell plc	182,696	79%	199,990	1.2x
(6) L'Oréal S.A.	177,255	98%	27,174	6.7x
(7) AstraZeneca PLC	175,092	88%	58,255	3.4x
(8) ASML Holding N.V.	173,007	102%	7,260	23.4x
(9) Novartis AG	171,310	98%	62,159	2.8x
(10) Hermès International Société en commandite par actions	127,221	104%	4,518	27.1x

## Europe's 100 Biggest Companies General Statistics Per Industry

Year 2021, EUR in millions

	CP	IP	TMT
Weighted Average MVIC/BVIC	5.6x	2.0x	6.6x
Average E/TC	87%	68%	70%
	<b>TOTAL</b>		
Average Market Cap	65,538		



Section 2

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# Trade Name as example

# How does a Trade Name add value?

- Premium pricing
- More volume growth
- Better opportunities to expand product portfolio
- Key investment: marketing expenses
- What is relevant lifetime?
- Example: Hermes (MVIC/BVIC = 46x!)
  - Revenues: high growth (>60% of sales in AsiaPac)
  - Profit margin: very profitable (almost 50% EBIT in AsiaPac)
  - Marketing expense: limited
  - One key brand, with very strong reputation and appeal
- Strong Trade Name, with limited investment

Hermès				
EUR in millions	2021		2022	
Revenues	8.982		11.602	
COGS	-2.580	-29%	-3.389	-29%
OPEX	-2.806	-31%	-3.516	-30%
EBIT	3.596	40%	4.697	40%
Out of which:				
Marketing	-421	-4,7%	-525	-4,5%
Market cap	127.221		190.000	
Equity	9.412		12.457	
Intangibles & Goodwill	300	0,2%	213	0,1%
Net WC	-177	-0,1%	-131	-0,1%
Net PP&E	3.398	2,8%	3.589	2,0%
MVIC	122.339		181.473	
BVIC	4.518		3.930	

# Proxy of market value of a Trade Name

- Consider MVIC/BVIC and existing Trade Name book value
- For LVMH:
  - Gross goodwill = 270b
  - Existing TN = 25b
  - Split TN versus goodwill (from PPAs): 50-50%
  - Market value of TN: approx. 160b
- Use relief from royalty model to determine implied (net) royalty rate: some 12-13% of revenues
- Relatively large marketing expenses needed: 11/12% revenues
- Implied growth rate: relatively low (17 times EBIT)
- Marketing spend efficiency:  $(12.5 + 11.5)/11.5 = 2x$
- Is this sufficient?

## LVMH Louis Vuitton - Moët Hennessy

EUR in millions

	2021	2022
<b>Revenue</b>	64.215	79.184
<b>COGS</b>	-20.355	-24.988
% of Revenue	-32%	-32%
<b>EBIT</b>	17.138	21.001
% of Revenue	26,7%	26,5%
<b>Marketing</b>	-7.291	-9.584
% of Revenue	-11,4%	-12,1%
<b>Market cap</b>	306.466	326.400
<b>Equity</b>	48.909	56.604
<b>Intangibles &amp; Goodwill</b>	50.455	51.214
<b>Net WC</b>	6.184	12.888
<b>Net PP&amp;E</b>	20.193	23.055
<b>MVIC</b>	332.205	352.072
<b>BVIC</b>	72.858	82.276

# Thinking differently re marketing expenses...

- What is the impact of marketing expenses?
- Opex or probably better as kind of capex?
- For LVMH:
  - What if marketing would have been capitalized?
  - Over certain historic period (see table)
  - Book value would have resulted
  - Level depends upon growth during this period
- What realistic book value of this TN could LVMH carry?
- Current NOPLAT *seems* to be sufficient
- But: it all depends upon the future growth, which seems more limited (4.6%)
- Relevant multiple:  $MVIC/EBIT_{2022} = 16,8x$
- Conclusion re lifetime of TN? Less growth will have strong impact

Life of intangible:		10	20	40	80
Marketing expense:		12,0%	12,0%	12,0%	12,0%
Long-term (no growth):		66,0%	126,0%	246,0%	486,0%
Long-term (growth):	8,0%	53,3%	82,5%	113,7%	136,7%
Revenues LVMH 2022	79.184				
Book value Trade Name		42.202	65.305	90.036	108.277
Invested Capital (incl TN)	30.000	72.202	95.305	120.036	138.277
Required return NOPLAT 2022	7,5%	5.415	7.148	9.003	10.371
NOPLAT/I C		21,8%	16,5%	13,1%	11,4%
MVIC		427.351	390.910	351.901	323.130
MV Trade Name		207.585	202.555	173.916	144.748

# Marketing expenses capitalized

- Hermes is rather different from LVMH:
  - Significantly lower marketing expenses (4.5%)
  - More historic growth (12%)
  
- Impact on relevant lifetime of TN:
  - More around 80 years
  
- Implied royalty rate would be almost 25%:
  - This equals some 60% of EBIT-margin vs 45% for LVMH
  - Very efficient marketing expenses
  
- Current growth potential also higher: reflected in much higher EBIT multiple
  
- Even if WACC would be slightly lower, still relatively stronger brand name

MVIC:	181.628	TN value:	100.976	
Marketing expense:	5%	life somewhat shorter		60 years
WACC:	7%	no impact on life		LTG goes down
Historic growth:	12%	life becomes longer		
Impl royalty rate:	60%	of EBIT margin		

# Trade Name intangible and marketing expenses

- Several first conclusions can be drawn:
  - Marketing expenses have a longer impact than just 1 year. Hence, capitalizing does make sense
  - Key question: for what period? If a brand is stronger, the period will probably have been longer
  - This does also impact lifing of acquired trade names
- More questions to be tackled:
  - What drives marketing expense efficiency?
  - What drives profitability of a brand?
  - What is the link between brand value and future growth?
- Larger sample of luxury brand companies will be needed
- Future research...

Company	Hermes	LVMH
Marketing expenses	4,5%	12%
TN / MVIC	56%	49%
TN / gross GW	57%	54%
Life of TN	80	40
Implied roy rate	25%	12%
Impl roy rate / EBIT	61%	45%

# Marketing expenses for less luxury brands

- What is the relevant amount of detail provided here?
- Very minimal:
  - It often includes both Advertising and Promotion
  - It can be combined with Admin expenses
  - What is spent per brand (e.g., LVMH)?
  - What is considered lifetime of the brand?
- Compare Nestlé and L’Oreal:
  - Large expense category
  - Hardly any details
  - Promotions must be included
  - Relates to diverse families of brands
  - More info is required here for investors

	Nestlé S.A.		L’Oréal S.A.	
	2021		2021	
<i>EUR in millions</i>				
<b>Revenue</b>	84.001		32.288	
<b>COGS</b>	-43.856	-52%	-8.433	-26%
<b>OPEX</b>	-25.769	-31%	-17.705	-55%
<b>EBIT</b>	14.376	17%	6.150	19%
Out of which:				
<b>Marketing</b>	-7.638	-9%	-10.591	-33%
<b>Market cap</b>	307.047		177.255	
<b>Equity</b>	51.823		23.593	
<b>Intangibles &amp; Goodwill</b>	51.348	15,1%	14.537	8,0%
<b>Net WC</b>	-4.234	-1,2%	-2.184	-1,2%
<b>Net PP&amp;E</b>	27.340	8,1%	4.774	2,6%
<b>MVIC</b>	339.303		180.843	
<b>BVIC</b>	83.513		27.174	

# Return on Invested Trade Name Capital

- Investors would like to analyze the Return on the Invested Trade Name Capital
- If marketing expenses would have been capitalized, this would have been straightforward
- Now, proxy analyses have to be done:
  - Total investment in TN: capitalize historic expenses
    - How long back?
  - Use marketing spend efficiency
  - Calculate return on invested TN capital
- See table at the right:
  - Relevant WACC (benchmark): around 6%

	MV Trade Name	Royalty Rate	Marketing spend efficiency	Cost of Trade Name	ROIC
Nestlé S.A.	123,3	3,5	158%	78,2	4,5%
L'Oréal S.A.	63,5	1,8	121%	52,6	3,3%
LVMH	152,7	6,4	210%	72,6	8,9%
Hermès	58,9	1,3	501%	11,8	11,4%



## Section 3

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Need to become more tangible

# Relevant detail of marketing expenses

- How much marketing is precisely spent?
- For what purpose?
- How to measure efficiency of marketing spend?
- What is the expected lifetime of marketing expense?
- How does marketing contribute to:
  - Growth
  - Profit margin
  - Wider product portfolio
  - Etc.
- Marketing should be seen as an investment in the relevant TN: perform an NPV analysis
- Provide more info on this important cost category (CP)
- L'Oreal: 30% less marketing will increase EBIT with 50%



# How to create value?

- More information on intangibles is not just relevant for investors / analysts
- A better understanding could also improve corporate decision making
- Consider the comparison of the 4 CP companies:
  - Nestlé and L'Oreal need to keep family of brands alive and kicking
  - Hermes sits on iconic brand: hardly marketing needed
  - LVMH has several categories and probably needs to keep few brands alive as well
- Relevant to consider the overall TN asset and what amount of marketing is needed to keep it up to its task or more



HERMÈS  
PARIS

L'ORÉAL

## If more detail available...

- Return on Invested TN Capital too low for L'Oreal now
- What if other ratio between TN and goodwill?
- What if total marketing expense would only be Advertising for 50%?
- Still not sufficient: Adv should decrease with factor 9...
- Probably no indefinite life: what if only 40 years?
- Hence, with 25% TN vs 75% gw, 50-50% Adv – Promotion and 40 years life, we would almost be there

### LESSON LEARNED:

- No need to formally capitalize the intangible: just analyze! Relevant info required for this one

	MV Trade Name	Royalty Rate	Marketing spend efficiency	Cost of Trade Name	ROIC
L'Oréal S.A.					
Base	63,5	1,8	121%	52,6	3,3%
Other TN/gw	40,4	1,1	113%	35,7	3,1%
Only 50% Adv	40,4	1,1	126%	32,0	3,5%
11% Adv needed	40,4	1,1	218%	18,6	6,0%
TN: 40 year life?	40,4	1,7	140%	28,8	5,9%

# Link to future growth

- Ultimately, intangible assets should contribute to growth
- Enhanced disclosures will make a better understanding of the involved expenses possible
- The role of the specific intangible may vary per company
  
- Link to relevant valuation methods for TN (intangibles):
  - Relief from royalty is probably too simple
  - Relevant rates turn out to be often too low
  - Lifetime questions are key
  - Profit split methods should be based on testable assumptions
  
- Growing the intangible should be based on smart information, which can be made transparent

**INTANGIBLES GET MORE AND  
MORE IMPORTANT**

**ENHANCED DISCLOSURES ARE  
MORE NEEDED**

**PLEASE MAKE THEM MORE  
TANGIBLE**

**USE ALTERNATIVE APPROACH  
LIKE CAPITALIZING**

Thank you!

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