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Features

Trademarks as Risk-Based Investments

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Systematic risks are often unavoidable and can quickly erode value. The current pandemic has impacted the entire economy, especially the retail and consumer goods industries.

Government regulations temporarily closed retail stores, manufacturing shutdowns disrupted supply chains, and bankruptcy filings occurred. For example, Newell Brands Inc., a consumer goods company with a brand portfolio, recently reported that COVID-19 disrupted its business as the company temporarily closed its supply chains and retail stores, and consumer demand patterns changed, triggering an impairment event, devaluing its intangible assets. Newell Brands generated strong sales in January and February 2020 but experienced a significant sales decline in March and April 2020. After testing its intangible assets, Newell Brands impaired, or devalued, its trademarks that have indefinite useful lives by US $1.3 billion, or a 35 percent decline in just three months. (Newell Brands, Form 10-Q dated May 1, 2020, and Annual Meeting dated May 11, 2020.)

Idiosyncratic risks are inherent risk factors to an individual business or a specific group of assets and may impact value over time. These risks are knowable and foreseeable, and investors and companies should scrutinize such risks in complex and asymmetric environments, like acquisitions and investments, in order to limit downside exposure (or the potential to suffer a decline in value) and protect capital.

> “[A] trademark’s standalone value is somewhat limited as consumers may associate the trademark with the licensee’s service, brand, and distribution capabilities.”

In this article, we review public-company disclosures concerning transactional trademark data and the idiosyncratic risks concerning transaction examples. The following table highlights the transaction examples and the decline in trademark values between the transaction dates and the present.

Acquirer	Target	Transaction Year	Initial Trademark's Carrying Value	Current Trademark's Carrying Value	Change in Value
Iconix	Mossimo	2006	US $140 million	US $28 million	-80%
Iconix	Danskin	2007	US $72 million	US $19 million	-73%
Apex	Liz Lange	2012	US $14 million	US $0 million	-100%
Apex	Tony Hawk	2014	US $19 million	US $7 million	-64%
Carter's	Skip Hop	2017	US $57 million	US $15 million	-74%
Tailored Brands	Jos A. Bank	2014	US $539 million	US $23 million	-96%

Background

Public-company disclosures such as annual reports or other regulatory documents submitted to the U.S. Securities and Exchange Commission (SEC filings), press releases, and earnings calls often provide the public insight into a particular transaction's proceeds, rationale, and subsequent material events. For instance, after an acquisition, the acquirer prepares a purchase price allocation, where it allocates transaction proceeds to the acquired net tangible assets, identifiable intangible assets, and goodwill, and places such values on its balance sheet (or the carrying values). An acquirer also provides transactional rationale and commentary.

In particular, an acquired trademark may be categorized as definite, where a trademark has a limited period of benefit and is amortized over a period of time; or indefinite, where a trademark has no foreseeable limit of benefit and is not amortized but is subject to impairment testing—an accounting procedure that compares an intangible asset's fair value to the carrying value and is conducted annually or more frequently if needed. If the intangible asset's fair value is less than the carrying value, then the company reduces the intangible asset's carrying value accordingly and incurs a non-cash expense (or impairment charge) on its income statement. In such cases, management often discloses its rationale for the impairment.

A trademark's value tends to be indicated by corporate actions such as acquiring a trademark in a business combination or asset acquisition, divesting it in a spin-out, using it as collateral to secure loans, licensing it to collect royalty income, enforcing its legal rights against potential infringers, and selling branded goods. Such value may be supported by quantitative information such as branded goods sales, royalty income, and comparable transactions, and qualitative information such as validity, consumer perception, and license and distribution agreements both over a period of time and in perpetuity.

Licensee Relationships Example

Iconix Brand Group and Apex Global Brands (formerly Cherokee, Inc.), two brand management companies, have both acquired brand-focused businesses with existing trademark license agreements. For example, Iconix purchased the apparel company Mossimo and its trademarks and the women's activewear brand Danskin and its trademarks; and Apex acquired the pregnancy apparel business Liz Lange and its trademarks and the lifestyle apparel brand Tony Hawk and its trademarks. These acquisitions allocated 80 percent to 100 percent of the transaction proceeds to acquired trademarks with indefinite useful lives. (Iconix, Form 10-K dated Mar. 15, 2007 and Feb. 29, 2008; Apex, Form 10-K dated Apr. 17, 2014.)

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To date, Iconix and Apex incurred significant impairment charges relating to these acquired trademarks, ranging from 64 percent to 100 percent of the original carrying values. Such charges primarily occurred because of the loss of the core licensees after acquisition. (Iconix, Form 10-K dated Mar. 14, 2018, and Mar. 18, 2019; Apex, Form 10-K, dated Apr. 19, 2018.)

Aside from losing the core licensees, these examples share several similarities:

1. Licensed trademarks had predominantly exclusive licenses and distribution relationships with national retailers;
2. Licensed trademarks had longstanding relationships with core licensees ranging from 3 to 10 years as of the transaction dates, and 13 to 18 years as of the license agreement expiration dates;
3. Several core licensees had license renewal options, meaning the core licensees could unilaterally exercise such options subject to the license terms and maintain the relationship with consumers; and
4. Upon termination, Iconix and Apex were unable to replace core licensees or agree to comparable historical royalty rates and minimum guaranteed royalties with new licensees.

These examples indicate that a trademark's standalone value is somewhat limited as consumers may associate the trademark with the licensee's service, brand, and distribution capabilities. Over time, it seems that sales of branded goods shift away from brand loyal customers to core licensee.

Customer Relationships Example

Carter's Inc., a baby and young children's apparel company, acquired Skip Hop, a young children's accessories company, for US $143 million in February 2017 and allocated US $57 million of the purchase price to a trade name with an indefinite useful life. Carter's touted Skip Hop as a recognized brand name with products distributed in more than 5,000 stores including Babies "R" Us and Target. (Carter's, Form 10-K, dated Feb. 27, 2018, and Business Update, dated Feb. 23, 2017.)

From 2017 to 2019, Carter's management team increased Skip Hop sales by 50 percent and recognized it as a "terrific brand." Despite this, Skip Hop generated a profit of less than US $5 million, which was much lower than Carter's original expectations. The limited profitability triggered an impairment test, resulting in a US $31 million write-off in the third quarter of 2019, reducing the carrying value by 54 percent. Carter's cited the loss of Babies "R" Us, its largest wholesale customer, and higher tariffs as contributing factors to lower profitability relative to its initial expectations. The parent company of Babies "R" Us filed for bankruptcy in late 2017 and closed all stores in 2018. (Carter's, Earnings Call, dated Oct. 24, 2019.)

In this example, the operational and financial activities of its largest wholesale customer impacted the Skip Hop trademark value. Similar to the previous examples, the lack of diversification of distribution channels can be problematic, especially when the primary distribution channel unilaterally ceases a relationship with a brand.

Further, in 2020, Carter's wrote down another US $11 million relating to the Skip Hop trademarks due to the current pandemic.

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Customer Loyalty Example

Tailored Brands, Inc. (formerly Men's Wearhouse) purchased Jos. A. Bank Clothiers Inc. in cash for US $1.5 billion, allocating US $539 million to trade names and US $769 million to goodwill in March 2014. Tailored Brands' management touted this acquisition as creating one of the largest men's apparel chains. In an effort to transform the brand, Tailored Brands ended Jos. A. Bank's "Buy 1, Get 3 Free" events as such promotions were deemed to be "toxic" and inconsistent with its customer research suggesting customers valued quality not quantity. (Tailored Brands, Form 10-K dated Mar. 25, 2016, and Guidance/Update Call dated Nov. 5, 2015).

Eighteen months later, Tailored Brands incurred significant impairment charges as it wrote off 80 percent and 100 percent of acquired trade name and goodwill carrying values, respectively, as sales and profitability suffered. (Tailored Brands, Form 10-K dated Mar. 25, 2016.)

Although Tailored Brands viewed these promotions as detrimental to the business, certain customers were tied to the promotional strategies, impacting overall sales and damaging customer relationships. In fact, Jos. A. Bank's sales declined from US $1 billion annually pre-acquisition (2011–2013) to less than US $750 million annually post-acquisition (2016–2019). Further, it is unclear if the customer research was representative of Jos. A. Bank's customer base. Regardless, as control and strategic decision-making shift, a new owner must understand the brand's existing customer base along with other business dynamics prior to making major changes to how the brand interacts with the relevant customer base.

Also, in 2020, Tailored Brands wrote down another US $90 million relating to the Jos A. Bank trademarks due to the current pandemic, resulting in a current carrying value of US $23 million.

Final Thoughts

In addition to these examples, other public-company disclosures suggest that industry trends, association with a brand spokesperson, and public criticism can be detrimental to a trademark's value. In sum, a trademark's acceptance, viability, and loyalty may be tied to something outside the trademark and brand itself, hindering long-term value and use. Scrutinizing the underlying trademark and brand risks like legal, financial, and operational risks can help guide current decision-making and avoid future shortcomings.

Although every effort has been made to verify the accuracy of this article, readers are urged to check independently on matters of specific concern or interest.

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