Dan Snyder's Fight for the Redskins Name - Doomed Idealism or Financial Pragmatism?

Was the value around the lost trademarks a lot or a little? The answer may surprise you.

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In the summer of 2014, the U.S. Patent and Trademark Office cancelled the registration of six trademarks associated with the Washington Redskins – the NFL franchise that represents the District of Columbia and plays in nearby Maryland. The basis of the annulment was the offensive nature of the trademark to Native Americans.

This is not the first time that the effective annulment of the Redskins trade name/trademark (in various forms) has taken place. In 1999, the P&TO ruled similarly. That ruling was overturned in 2003 in federal court. Over a decade later, history repeats itself – albeit partially. Dan Snyder, the team owner, has vowed to fight on to the U.S. Supreme Court, if necessary.

This note will not entertain a discussion of the social desirability of changing the Redskins' team name. Of interest to us are the economic ramifications of this decision. Whether or not you agree with the legal decision to annul the trademark, whether or not you agree with Snyder's repeated refusals to consider a change to the name of the team he grew up rooting for before buying it, on the surface, some value has been destroyed by a government action – a sort of eminent domain or condemnation of an intangible asset. Was the value around the trademark a lot or a little? The answer may surprise you, and it will surely inform you as to why Snyder has taken the position that he has.

The Government Wins the Toss and Has Elected to Receive

The history around the trademark is intriguing. The Washington Redskins were formerly known as the Boston Braves (just like the baseball team that eventually found its way to Atlanta). The name was changed in 1933 to the Redskins in an effort to honor their coach, William Henry "Lone Star" Dietz, who was a Native American. The trademark "Redskins" was first granted in 1967, over 30 years later [1].

Snyder purchased the Redskins in 1999 for $800 million – at the time, the richest deal for a North American sports franchise in history. Snyder has a reputation for being a lifelong avid Redskins fan, a fierce competitor and a shrewd businessman. Most of the press attributes Snyder's refusal to change the Redskins' name to his longtime rooting interest and his competitive nature, implying that the refusal to change the name is not rational. Most commentary we have seen suggests that the financially prudent course is to climb down, swallow hard and change the name. After all, owner Abe Polin in 1997 changed the name of the NBA's Washington Bullets to the Washington Wizards over concern over the de facto war zone that the Southeast region of the District of Columbia had become, with rampant gun violence a fact of life in portions of the nation's capital [2]. Numerous articles have estimated the price tag of changing the name of the Redskins to be $5 million to $20 million [3]. Hold on to that thought, or circle it, or highlight it. You are going to need that number later.

In most businesses as visible as the Redskins, the loss of a core trademark would seem devastating. Imagine if IBM's logo went away? Or the Coca-Cola trademark? What if a lowercase "i" no longer indicated an expensive Apple product? Is that why Snyder seems so determined to fight the trademark annulment?

Let's run some numbers and quantify the value of this trademark. To level set, the Redskins post approximately $350 million in revenue and have an estimated value of $2.4 billion, according to Forbes [4]. We are again relying on our old friend, the standard of fair value. The accounting rules codify fair value in Accounting Standards Codification topic 820 (or ASC 820). That definition is:

"the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

So, we're looking at financially motivated buyers and sellers. Or, in the case of trademarks and other intangible property, licensees and licensors.

Also, we are performing this analysis under the extraordinary assumption that the trademark is, in fact, in force [5]. When not in force, the value is close to zero, and you don't need an article to tell you that. The interesting question is: what has Snyder lost by virtue of this ruling and what does he hope to gain financially by overturning it?

The simplest technique to value a trademark is the relief from royalty method (RFR). The RFR is a cousin of the discounted cash flow method when valuing whole businesses – but instead of identifying cash flow from the profitable (we hope) operation of the business, cash flow is identified as royalty income that would have to be paid to the licensor (owner) by the party wishing to commercially exploit the intellectual property.

To execute the RFR, you basically need three things: a) projected cash flows associated with the intangible asset; b) a discount rate for the projected cash flows; and c) a market royalty rate.

Kickoff - Projected Cash Flows

The projected cash flows should be those that we can identify directly with the trade name. For the most part, this means merchandise – jerseys, t-shirts, pens, footballs, blankets, cozies and so forth. Specific merchandise sales data for the Redskins or even the NFL is hard to come by, but we located some credible estimates that put the annual sales at $70-$145 million [6]. At this level, the Redskins' merchandise is the 10th most popular in the league [7]. We called it $100 million and used that as our Year 1 revenue basis. Over a 10 year period, we projected the annual growth of Redskins' merchandise sales revenues to be 4.6 percent - roughly the average in NFL ticket sale revenue growth in 2004-2008 (7.2 percent) and 2009-2012 (2.1percent). It's reasonable to believe that ticket sale revenue and merchandise revenue are linked.

Visiting the Redskins' online store and counting the items bearing the Redskins name revealed that 25-30 percent of Redskins merchandise bears the Redskins' trade name – either with the team logo (protection there was still in force) or without. This author's specialization is executive decision making and not graphic design, so we reasoned that half of those items could be re-designed to carry only the logo or bear the word "Washington." Accordingly, in our model, 15 percent of merchandise revenue is exposed to the loss of trademark protection, or $15 million in year 1.

Start of Second Quarter – The Fair Royalty

Next, we applied a fair/comparable royalty rate to the merchandise revenue – the "royalty" part of our "relief from royalty" model. This is, in effect, the actual income element of the model. A search in ktMINE identified one royalty pertaining to major U.S. sports merchandise licensing – a transaction involving the National Hockey League's Boston Bruins as the licensor. We considered whether the royalty rate for an NFL team might be greater than that associated with an NHL team, given the greater popularity of the sport. To (unscientifically) test this hypothesis, we reviewed the prices of authentic/official team jerseys for the Redskins and the NHL's Washington Capitals on the teams' respective online stores. The jerseys as of the time of this writing were comparably priced (with Capitals jerseys slightly more expensive, perhaps due to the long sleeves?). Given the comparability of jersey prices, we decided that the Bruins' trademark royalty rate would be comparable to that of the Redskins.

The royalty rate specified in the Bruins agreement was 10 percent of revenue, but in that agreement, the licensee obtained rights to the trade name and logo, whereas only the Redskins trade name falls within the scope of our analysis. Accordingly, **we determined that the appropriate royalty rate associated with the trade name as a stand-alone asset was 3 percent.** The reasoning here was that the license for the logo and trademark would be more valuable as an assemblage then they would be separately. Accordingly, simply splitting the royalty rate in half would seem to overstate the trade name's value, and in our experience, few trademark royalty rates exceed three percent of revenues.

A note on the selection of royalties is important. In a litigation context, the royalty rate selection process outlined in Georgia-Pacific Corp. v. United States Plywood Corp., 318 FSupp 1116, 6 USPQ 235 (SD NY 1970) requires that 14 factors be considered in order to determine a so-called "reasonable royalty." The Georgia-Pacific procedures are rarely, if ever, used in any context outside of litigation. Where the context is fair value for financial reporting or for transaction pricing, the procedures for selecting such a "fair royalty" are not clearly defined or uniformly accepted, but in general, the selection procedures for fair royalties are similar to those for selecting comparable companies/transactions, and are highly dependent upon the appraiser's informed professional judgment. The product of our royalty selection procedure is best described as a "fair royalty," and not a "reasonable royalty."

Applying a three percent royalty to our merchandising revenue base over a 10-year period looks something like the following:

($ millions)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Base Revenue	$100	$105	$109	$114	$120	$125	$131	$137	$143	$150
Affected Revenue	15.0	15.7	16.4	17.2	18.0	18.8	19.6	20.6	21.5	22.5
Royalty Revenue	0.45	0.47	0.49	0.52	0.54	0.56	0.59	0.62	0.64	0.67

Although a trade name can last much longer than the 10 year horizon shown here (and probably would in the case of the Redskins), by the time you factor in time value of money, royalty revenue from years 11 forward in present value terms were deemed to be immaterial. Plus, there's only space in the document for 10 years of data.

Halftime - Expenses of Owning Intellectual Property and the Modified RFR

The conventional RFR model does not contemplate expenses associated with owning, developing and protecting intellectual property. We think this is a substantial shortcoming of the model and, if left unaddressed, lessens the relevance of the model for real world transactions. Happily, we don't allow ourselves to be constrained by convention if it gets in the way of producing a credible value result!

There are (at least) two groups of expenses associated with owning intellectual property. There are legal maintenance fees (renewal of documentation, enforcing rights and exclusivity, suing the government when they attempt to nullify your intellectual property) and operating expenses (operations to promote merchandise, develop licensee relationships and develop new products).

To estimate these expenses as a percentage of royalty revenue, we relied on data from the University of California 2006 Office of Technology Transfer Annual Report, which were 7.5 percent of revenues for legal expenses and 16.7 percent of revenue for operational expenses. We adjusted the operational expense to revenue ratio down by half on the belief that the operational expenses to maintain one intellectual property asset are less than those required to maintain a technology transfer office. Adding in these expenses produced the following annual profit from a theoretical license of the trademark.

We taxed the royalty profits at a rate of 40 percent, intended to be inclusive of federal and state taxes [8].

($ millions)										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Royalty Revenue	0.45	0.47	0.49	0.52	0.54	0.56	0.59	0.62	0.64	0.67
Legal Expenses	(0.03)	(0.04)	(0.04)	(0.04)	(0.04)	(0.04)	(0.04)	(0.05)	(0.05)	(0.05)
Operating Expenses	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)
Pre-Tax Profit	0.40	0.42	0.44	0.46	0.48	0.50	0.52	0.55	0.57	0.60
Profit Taxes	(0.16)	(0.17)	(0.17)	(0.18)	(0.19)	(0.20)	(0.21)	(0.22)	(0.23)	(0.24)
After-Tax Royalty Savings	**0.24**	**0.25**	**0.26**	**0.27**	**0.29**	**0.30**	**0.31**	**0.33**	**0.34**	**0.36**

The Discount Rate Halftime Show - Converting Promised Dollars into Dollars in Hand

Any forecast bears with it a degree of uncertainty, and dollars invested have a market return requirement (at least under the fair value definition) that is commensurate with the perceived risks of failing to achieve projected cash flows. The higher the required return, the lower the value placed on future promise cash flows. Because required returns are expected to be cumulative (compounding), the farther out in the future the promised income, the more heavily that promised income is discounted. The required return used to discount future cash flows into current dollars is called a discount rate.

We can estimate required returns or discount rates through market observation. Discount rates are rarely, if ever, observed directly. Fortunately, indirect observation is sufficiently robust that valuation practitioners and, more importantly, actual buyers and sellers of businesses find the required return data reliable. In a previous issue of Executive Decisions, in which we explained the financial thought process behind Steve Ballmer's purchase of the Los Angeles Clippers, we estimated the required return based on that of Manchester United F.C., the U.K. soccer club that went public in 2012.

Typically, valuation practitioners apply a required return on equity to intellectual property cash flows, because most banks will not accept intangible assets, such as trademarks, as collateral (though one might imagine the Redskins' trademark might be a notable exception). To estimate the Redskins' cost of equity, we analyze that of Manchester United, which is determined using the Capital Asset Pricing Model (CAPM) – a model that revolutionized modern finance some decades ago and earned the Noble Prize in Economics. CAPM estimates a company's cost of equity by using the risk-free rate as a starting point, and then adding to it a risk premium to be in the equity markets, modified by the tendency of the public stock's price to vary with or against the market (called beta). The formula is

Cost of Equity = Risk-free Rate + [beta x (Equity Risk Premium)]

Manchester United's beta, the measure of risk as compared to the market as a whole, is 0.6 according to Yahoo! Finance. Invoking the CAPM model, and assuming a risk-free rate of four percent and an equity risk premium of six percent, MANU's cost of capital equity should be approximately 4% + .6*(6%) = 4% + 3.6% = 7.6%.

However, we're not quite finished yet. A company's cost of equity is representative of the company's collection of assets and liabilities. Each asset and liability has its own stand-alone required return and risk profile that is ultimately blended into a portfolio that is the whole company. While required returns on tangible assets (such as stadiums) may be lower than the required return for the company as a whole, the required returns on intangible assets, such as goodwill and trademarks, are likely to be greater than that of the company as a whole. Because our standard is fair value, we are valuing the trademark as a stand-alone asset – not as an asset integrated with other, complementary assets.

Accordingly, the return required in conjunction with the trademarks should incorporate a premium over the Redskins' estimated overall cost of equity. There are no widely accepted methods for estimating that premium; asset-specific risk premiums are largely the product of the appraiser's informed professional judgment. We added a risk premium of four percent to the trademark over the Redskins' cost of equity. The factors considered in this risk premium adjustment were:

- The risk associated with de-coupling the trademark from other of the Redskins' assets, such as the logo;
- The potentially offensive nature of the trademark to Native Americans; and
- The continued legal challenges to the validity of the trademark.

Adding four percent to the Redskins' cost of equity of 7.6 percent produces a required return for the trademark of 11.6 percent, and hence is the discount rate to be applied to the cash flows associated with the trademark. We use the mid-year discounting convention, which is why each year is measured in half years. This convention is appealing because it considers the fact that cash flows are received more or less equally over the year.

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Mike Blake is the founder of Arpeggio Advisors, a boutique business appraisal and corporate strategy advisory firm in Atlanta. Mike's background has included work in venture capital, investment banking, and public accounting.

For the first eight years of his career, Mike worked in venture capital and investment banking in the U.S. and abroad. In 2004, Mike entered the business appraisal profession full-time, working most recently for Habif, Arogeti & Wynne, LLP (the largest independent public accounting firm headquartered in Atlanta). Mike led HA&W's effort to become the first appraisal practice in Georgia to earn the International Society of Business Analysts' Gold Seal of Trust, the only peer review recognition for observing best practices in the business appraisal profession in the United States.

Mike has particular expertise in the appraisal of firms in the fields of professional services, information technology, aerospace, and alternative energy. In addition, he has developed specific expertise in the appraisal of intellectual property and intangible assets.

Mike is an active educator. He is a Special Instructor of Business Valuation in the Georgia Tech/Emory University TI:GER (Technology Innovation: Generating Economic Results) program. In addition, he is regularly invited to provide instruction on entrepreneurship, corporate finance, and business valuation to graduate level classes at the Georgia Institute of Technology, Emory University, Kennesaw State University, the University of South Carolina, Georgia State University, and the University of Georgia. Furthermore, he regularly provides continuing professional education for his peers in the business valuation profession.

Mike earned a Bachelor's degree in Economics and French (Cum Laude) from Franklin & Marshall College, from which he graduated Phi Beta Kappa. In addition, he holds a Master of Business Administration degree from Georgetown University. Mike is also a member of the Leadership Atlanta Class of 2014.

Mike's additional professional and community-service passions include supporting entrepreneurship through education and nonprofit board involvement, raising awareness of and funding to combat Lou Gehrig's Disease, promoting alternative energy development through market forces, advocating for de-stigmatizing mental illness and disorders, and expanding the inclusiveness of the Atlanta high technology community.

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