JUST DO IT! BRAND NAME WOES AT NIKE?

All about pricing power!

Lessons from Shoe Dog!

- I have spent the last week reading "Shoe Dog", Phil Knight's memoir of how he went from a runner on the Oregon University track team to building Nike to be one of the great shoe companies in the world.
  - In addition to its entertainment value, I read the book for two storylines. The first is the time, effort and grit that it took to build a business, in a world where risk capital was more difficult to access than it has been in this century, and in a business where scaling up posed significant challenges.
  - The second is the building of a brand name, with a mix of happy accidents (from the naming of the company to the creation of the swoosh as the company's symbol), timing and luck all playing a role in creating one of the great brand names in apparel and footwear.
- The latter assessment led a more general consideration of what constitutes a brand name, what makes a brand name valuable (or not) and what causes brand name values to deplete and disappear over time.

Brand Name: What is it?

- The broadest definition of a brand name is that it is recognized (by employees, consumers and the market) and remembered, either because of familiarity (because of brand name longevity) or association (with advertising or a celebrity).
- That definition, though, is not particularly useful since remembering or recognizing a brand, by itself, tells you nothing about its value.
- The essence of brand name value is that the recognition or remembrance of a brand name changes how people behave in its presence.
  - With customers, brand name recognition can manifest itself in buying choices (affecting revenues and revenue growth) or willingness to pay a higher price (higher profit margins).
  - With capital providers, it may allow for lower funding costs, with equity investors pricing equity higher and lenders accepting lower interest rates and/or fewer lending covenants.
  - With other stake holders (employees, suppliers, even competitors), it may play out to your benefit as well as lower costs, higher revenues and less risk.

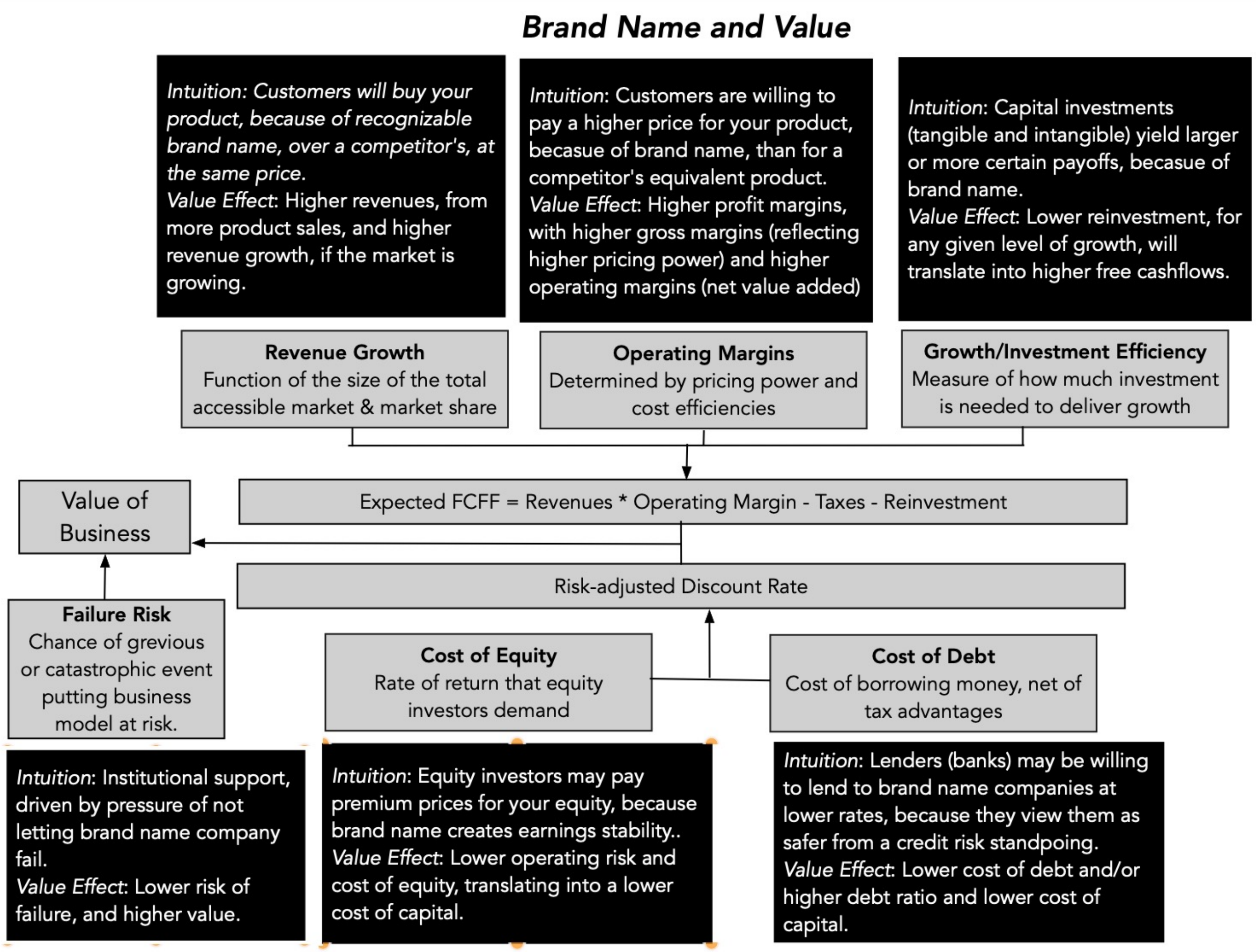
Brand Name Variants

- Brand names can attach to entire companies, to particular products or brands or even to personnel and people.
  - With a company like Coca Cola, it is the corporate brand name that has the most power, but the soft drink beverages marketed by the company (Coca Cola, Fanta, Sprite, Dasani etc.) each have their own brand names.
  - With companies like Unilever, the corporate brand name takes a back seat to the brands names of the dozens of products controlled by the company, which include Dove (soap), Axe (deodorant), Hellman's (mayonnaise) and Close-up (toothpaste).
  - There are clearly cases of people with significant brand name value, in sports (Ohtani in baseball, Messi in soccer, Kohli in cricket) and entertainment (Taylor Swift), with a spill over to the entities that attach themselves to these people.

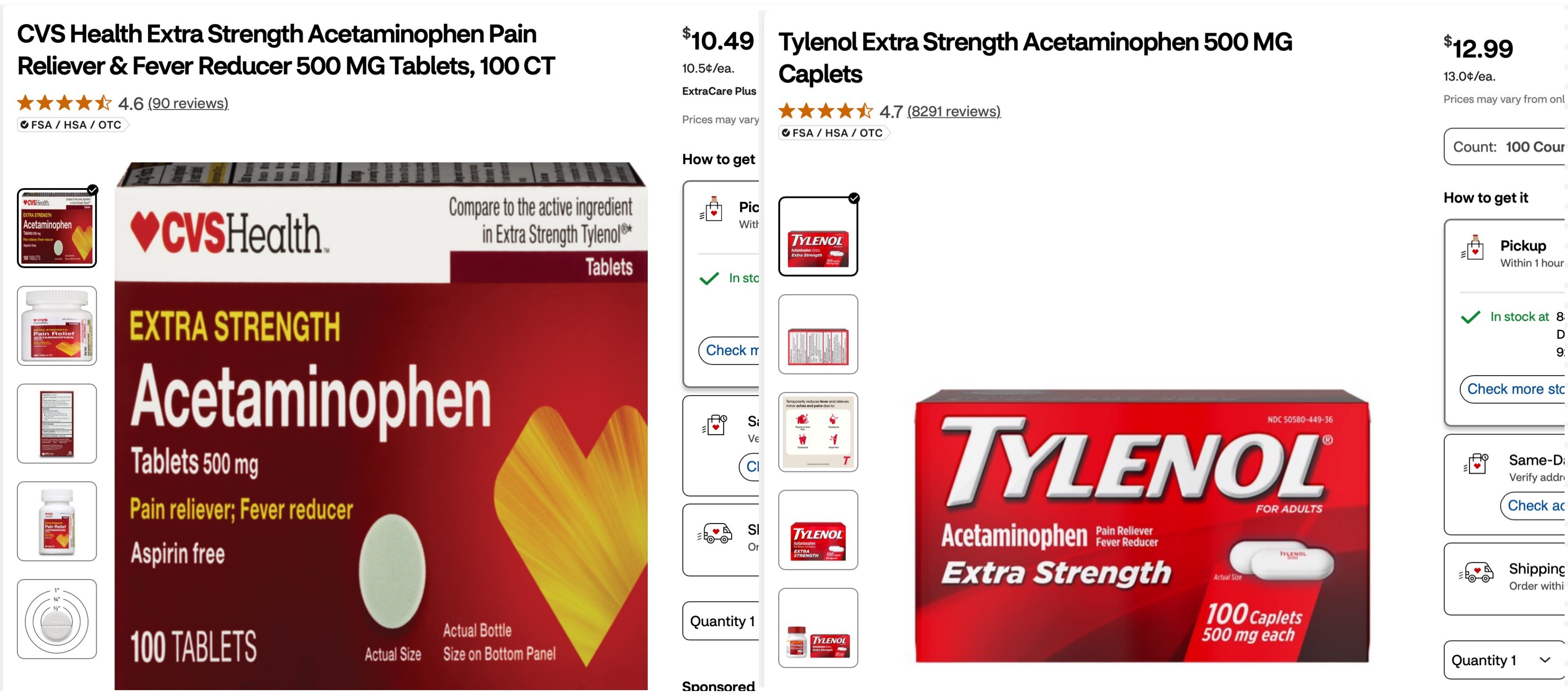
Brand Names and other competitive advantages

		Type of competitive advantage (moat)				
		Brand Name	Switching Costs	Network Benefis	Cost Advantages	Legal Protection
Moat Width	Wide	Top brand	Infinite	Global	Permanent	Full
	Narrow	Name brand	High	Local	Temporary	Partial
	No Moat	Generic	None	None	None	None
Place in story		*Margins*	*Customer Retention*	*Market Share*	*Profit margins*	*Pricing Power*

Brand Name Value



Pure Pricing Power in Brand Name



Valuing Brand Name: The Easy Route

- The Tylenol example also serves to illustrate when it is easiest to value brand name, i.e., when it is the only competitive advantage, and when it will become difficult to do, i.e., when it is one of many competitive advantages.
- It is for that reason that valuing brand name is easier to do at a beverage or cereal company, such as Coca Cola or Kellogg's, where there is little to differentiate across products other than brand name, and you can attribute the higher margins almost entirely to brand name.

Coca Cola: The "Brand Name" Company

Sep-24

Base Year and Comparison

	Company	Industry
Revenue Growth	3.13%	13.11%
Revenue	$46,465	
Operating Margin	29.73%	16.71%
Operating Income	$13,815	
EBIT (1-t)	$11,397	

Growth Story

Mature company, with moderate growth coming from nursing existing brands and adding news ones.

Profitability Story

Brand name gives pricing power, translating into much higher operating margins than the beverage sector.

Growth Efficiency

Set at industry average, but low growth translates into low reinvestment.

Terminal Value	
Growth Rate	3.72%
Cost of capital	7.42%
Return on capital	21.95%
Reinvestment Rate	16.94%

PV(Terminal value)	$ 198,205
PV (CF over next 10 years)	$ 89,448
Probability of failure =	0.00%
Value of operating assets =	$287,652
- Debt	$45,063
- Minority interests	$1,558
+ Cash	$19,000
+ Non-operating assets	$21,119
Value of equity	$281,150
- Value of options	$0
Value of equity (common stock)	$281,150
Number of shares	4,315.00
Estimated value /share	$65.16
Price per share	$72.28
% Under or Over Valued	10.93%

	1	2	3	4	5	6	7	8	9	10	Terminal year
Revenue Growth	6.00%	6.00%	6.00%	6.00%	6.00%	5.54%	5.09%	4.63%	4.18%	3.72%	3.72%
Revenue	$ 49,253	$ 52,208	$ 55,341	$ 58,661	$ 62,181	$ 65,628	$ 68,967	$ 72,162	$ 75,175	$ 77,972	$ 80,872
Operating Margin	29.73%	29.73%	29.73%	29.73%	29.73%	29.73%	29.73%	29.73%	29.73%	29.73%	29.73%
Operating Income	$ 14,644	$ 15,523	$ 16,454	$ 17,441	$ 18,488	$ 19,513	$ 20,505	$ 21,455	$ 22,351	$ 23,183	$ 24,045
EBIT (1-t)	$ 12,081	$ 12,806	$ 13,574	$ 14,389	$ 15,252	$ 15,805	$ 16,302	$ 16,735	$ 17,099	$ 17,387	$ 18,034
Reinvestment	$ 1,676	$ 1,777	$ 1,884	$ 1,997	$ 1,956	$ 1,894	$ 1,812	$ 1,710	$ 1,586	$ 1,645	$ 3,056
FCFF	$ 10,405	$ 11,029	$ 11,691	$ 12,392	$ 13,297	$ 13,911	$ 14,489	$ 15,025	$ 15,512	$ 15,741	$ 14,978
										$ 405,304.98	
Cost of Capital	7.42%	7.42%	7.42%	7.42%	7.42%	7.42%	7.42%	7.42%	7.42%	7.42%	
Cumulated WACC	0.9310	0.8667	0.8069	0.7512	0.6993	0.6510	0.6061	0.5642	0.5253	0.4890	
Sales to Capital	1.76	1.76	1.76	1.76	1.76	1.76	1.76	1.76	1.76	1.76	
ROIC	23.27%	23.90%	24.52%	25.13%	25.74%	25.82%	25.83%	25.78%	25.67%	25.49%	21.95%

Risk Story

Cost of capital higher than typical US beverage company, because of emerging market exposure, but lower than typical global beverage company.

Competitive Advantages

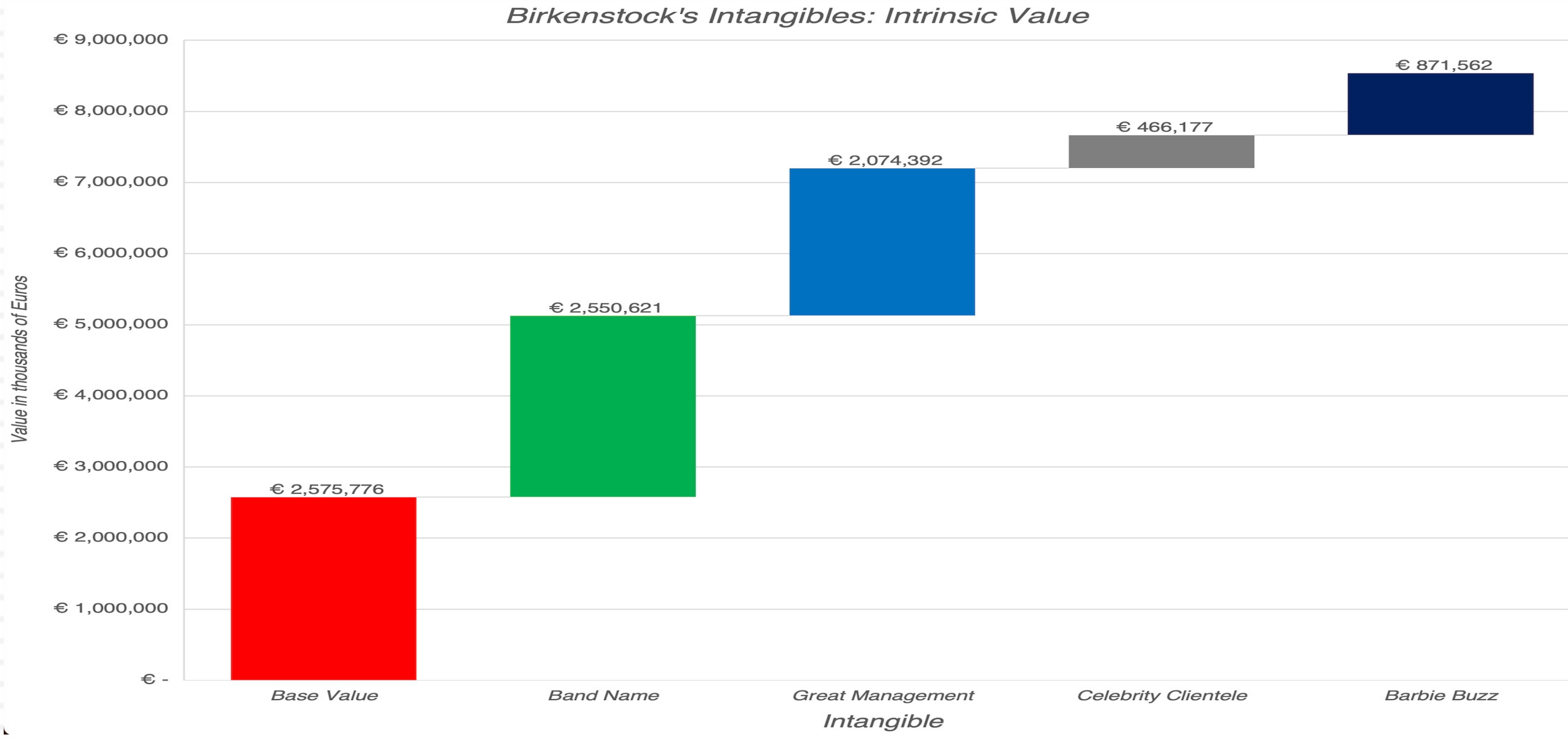
Brand name remains a sustainable advantage for the long term, allowing margins and returns on capital to stay elevated.

Valuing Coca Cola's brand name

Valuing Brand Name: The Complex Route

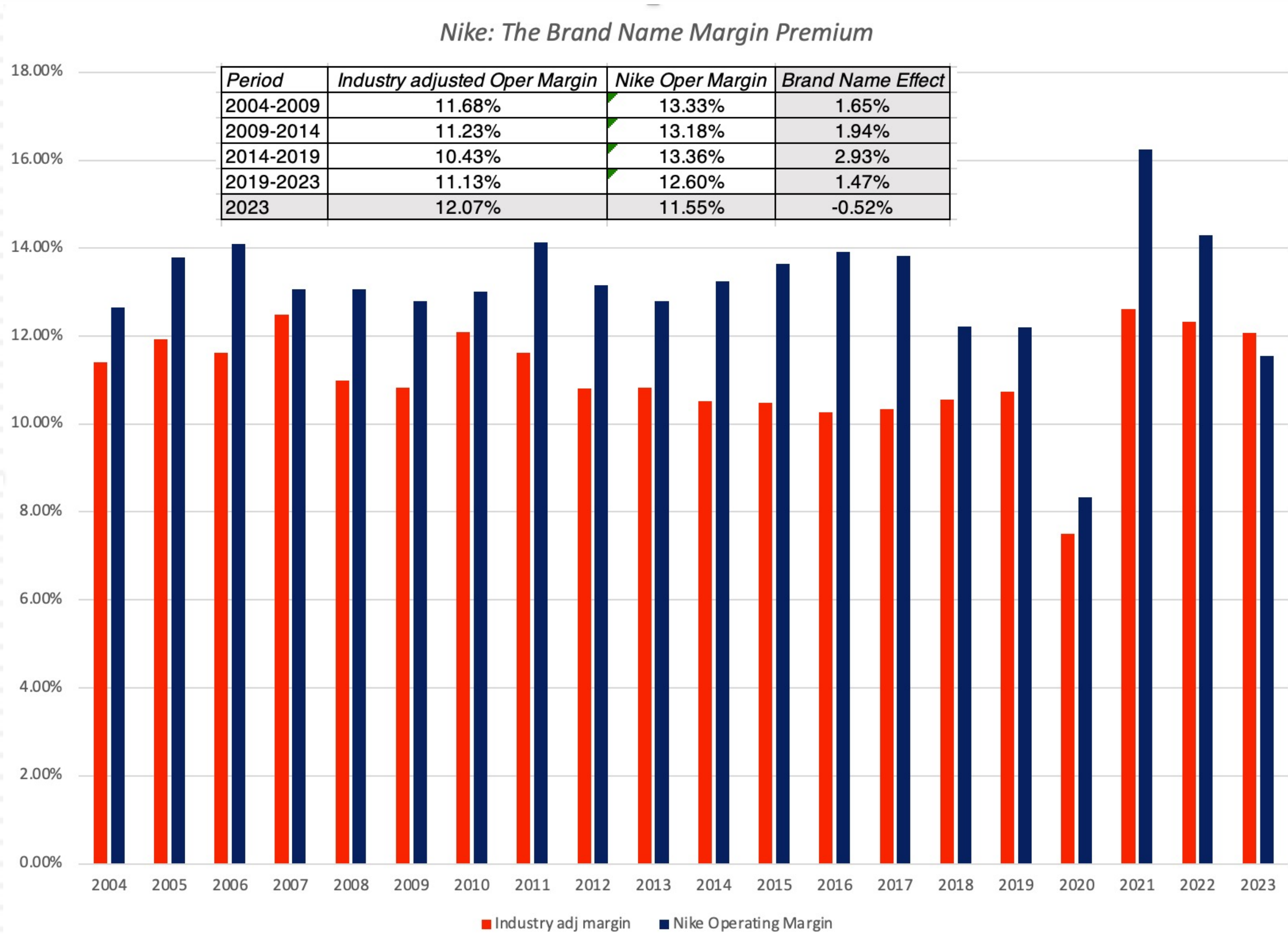
- Brand names become more difficult to isolate and value, when a company has multiple competitive advantages, since the higher margins or growth or returns on capital will reflect the composite effect of all of the advantages.
- Thus, with a company like Apple, where brand name is a factor, as is a proprietary operating system, a superior styling and a unique app ecosystem, the higher margin can be attributed to a multitude of factors, making it more difficult, perhaps even impossible, to isolate the brand name value.
- That is why I remain skeptical of the brand name measurers of the world (like Interbrand) and of accounting attempts to isolate and value brand name, to show on balance sheets.

The Birkenstock IPO



Intangible	*Input with intangible*	*Input without Intangible*	*Value Without*	*Value Effect*
Barbie Buzz Effect	Higher revenue growth in the next year (25%)	Revenue growth in year 1 reverts to CAGR of 15% in year s 2-5.	€ 7,666,966	€ 871,562
Celebrity Clientele	Growth delivered more efficiently, with sales to capital of 2.62 (third quartile of big brand apparel/footwear)	Growth delivered as efficiently as typical brand name company (1.59)	€ 7,200,789	€ 466,177
Good/Great Management	Expected CAGR of 15% in revenues, tripling revenues oer next decade.	Expected CAGR of 8.66%, matching growth at big, brand name apparel/footwear firms.	€ 5,126,397	€ 2,074,392
Brand Name	Operating margin of 23% next year, rising to 25% in year 5.	Operating margin set to 14.74%, average for entire apparel/footwear sector.	€ 2,575,776	€ 2,550,621

Nike: The Brand Name Effect



Period	*Industry adjusted Oper Margin*	*Nike Oper Margin*	*Brand Name Effect*
2004-2009	11.68%	13.33%	1.65%
2009-2014	11.23%	13.18%	1.94%
2014-2019	10.43%	13.36%	2.93%
2019-2023	11.13%	12.60%	1.47%
2023	12.07%	11.55%	-0.52%

Nike Valuation

	Revenue Growth & Operating Margin		
	2014-18 average	*2019-23 average*	*Last 12 months*
Growth rate	8.40%	6.97%	3%
Operating margin	13.36%	12.60%	13.15%
Value of equity	$126,455	$115,651	$94,729
Value per share	$83.33	$76.21	$62.42

- You can see why Nike acted swiftly to change its CEO, since its value will dip substantially, if its growth stays down and margins do not bounce back.
- At the $71 stock price that the stock was trading at, just six weeks ago, the investing odds would have been in your favor, but the bounce back in the stock price to $88, after the new CEO hire, suggests that the market is pricing in the expectation that the company will bounce back to higher growth and better margins.

Brand Name Creation

- Brand name does add value, if it gives the company that owns it pricing power, but how does a company end up with a valuable brand name.
- There are facile answers and they include history, with long-lived companies having more recognizable brand names, and advertising, where more spending is assumed to result in a more valuable brand name.
- To see why I attach the "facile" prefix to these answers, consider again the example of AT&T, a company that has been around for more than a century and remains one of the ten largest spenders on advertising in the United States. None of that spending has translated into a significant brand name value, thought there may other benefits that the company accrues.

Ingredients in Brand Creation

1. *Attachment to an emotional factor/need*: Rational or not, consumers may reach for a branded product, because they associate the product with freedom, reliability, happiness, patriotism or aspiration, if that association exists in their minds.
2. *Celebrity connection*: Earlier, we talked about personal brand names, and argued that Nike benefited from its association with Michael Jordan, in building its brand name. In fact, Apple (in its streaming service) and Major League Soccer benefited mightily from Lionel Messi playing Interleave Miami.
3. *Fortuitous events/ choices*: There is a third factor that is not covered in most brand name management classes, and for good reason, and that is the effect of luck or choices that play out in unpredictable ways. (Nike's swoosh, symbol and name are all accidental)
4. *Advertising*: While there may be little or no link between overall advertising spending and brand name, it is undeniable that there are ads that catch people's attention and alter perceptions of a product. Nike has had its share of iconic commercials, and I still remember this Nike ad, with Michael Jordan, from 1997, showing how long the shelf life can be for a great ad.

The Trade Off on Brand Name

- If asked to advice a company that was intent on creating a brand name, my suggestion would be to start with a product or service that is differentiated from the competition, and to give the brand name time to build around that differentiation.
- That may require sacrifices on scaling up (accepting less growth to preserve the product differential), a higher cost structure (if it is a quality difference) and perhaps even more reinvestment, but trade offs are inherent to almost everything of value in business.
- If the expected costs of building a brand name exceed its benefits, though, it may be worth asking whether brand name is the competitive advantage that the company should be aspiring for, since there are other competitive advantages that can add as much or much more value in the business the company operates in.

Brand Name Destruction

1. *Aging brand/consumer base*: Even the most highly regarded brand names eventually age, and no matter how much managers try to resurrect them, they never recover their mojo.
2. *Benign neglect*: Brand names may provide sustainable competitive advantages, but the companies owning them need to spend the money to maintain them. There are legendary brand names that have effectively been neglected, treated as cash cows with no new investment or sprucing up needed, and have faded in value.
3. *Cultural changes*: There are products and services that have lost their allure over time, because the cultural mores or social norms of the consumers has changed.
4. *Changing tastes*: There are some businesses, where the demand for products is transient and fad-driven, and new brands replace old ones, as tastes shift.
5. *Toxic connections*: A brand name that is built up over time can sometimes very quickly fall back to earth, if the company or its personnel bring toxic connections.

Brand Reincarnation…

- It is worth noting that there are companies that have redeemed brand name value, sometimes by remaking the product or service, sometimes by repackaging it and sometimes by repositioning it.
  - Crocs, whose brand name soared in the 2000s, but crashed by the end of the decade, repackaged itself around celebrity endorsements to become a successful brand again.
  - Lego, a venerable brand name in the toy business, sold off its theme parks, and refocused attention on its core product, while redirecting its offerings to adults.
- In general, though, reincarnating a brand becomes easier for niche brands than for widely used ones, for product brands than for company brands, and for younger brands than for older ones.

Nike: A Wake-up Call!

- In the post-COVID years, Nike did shift away from store sales to digital sales, with Nike Digital, accounting for almost 43% of revenues in 2022. While that shift may reflect a change in consumer preferences towards shopping online, there is a question of how much shoe stores, over the decades, have contributed to the Nike brand, by highlighting their most iconic shoes.
- While the footwear business has been more resistant to fads than the apparel business, Nike is losing market share, especially among younger customers, to newcomers in the space like On and Hoka, and among runners (Nike's original core market) to older companies like New Balance that have rediscovered their mojo.
- In an age where celebrities come with problems, and politics divides us on even the most trivial of issues, Nike's celebrity-driven advertising campaigns may hurt more than help the company.