



Grant Thornton

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Priceless thinking

Valuing intangible
media assets for confidence



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Foreword

As the economy improves and merger and acquisitions activity is on the increase, focusing on what media owners are actually buying, the intangible assets, increases in importance. This media report identifies how businesses are being valued and deals are being structured to gain maximum return.

In 2010, we published our fourth survey into accounting policies in the media sector; business combinations and the treatment of intangibles formed a key part of that research. We felt it was time to update our findings on this topic extending it to look at valuation techniques and deal structures.

In the foreword to our 2010 survey, we queried the direction of financial reporting in the sector. We identified business combinations as the area where most work needed to be done and where the gap in understanding between the City and the creative sector still existed. This report focuses on the progress of companies in improving their financial reporting since 2010.

The report brings together analysis of the UK media companies quoted on the London Stock Exchange Full List and AIM, and private companies applying IFRS, and addresses:

- what assets are being identified in media businesses and how these are being valued,
- how deals in the media sector are structured with a particular focus on the important role deferred and contingent consideration plays in this sector, and
- the financial reporting landscape for business combinations, looking at business practice from the perspective of standard-setters and regulators.

In our previous report, we asked companies and their advisers to think more about the reader of the financial statements, and get across the uniqueness of the creative sectors compared to others. We are delighted to say that, in most instances, they have and financial reporting by media companies has certainly improved. Whereas one can never rest on one's laurels, I believe the sector as a whole has much to be proud of.

Mark Henshaw

Partner, Head of Media and Entertainment
Grant Thornton UK LLP



Key findings

We analysed the results of

143 companies
both listed and privately held who report under IFRS

38 made acquisitions in the period under review and we looked at...

171
deals

Advertising & marketing services being the most active area with...

115 deals in the period

The **publishing sector** was by far the biggest by the value of intangibles acquired at...

£1.6bn

Value of intangibles separate from goodwill as a % today compared to 2010; overall the number has dropped slightly from...

45% to 40.5%

In isolation, **Advertising & marketing services**

has **increased considerably**

Goodwill

Business combination analysis

Split of intangibles

compared to goodwill has remained consistent since our study in 2010 up to the period under current review



The **value of intangibles** including goodwill exceeds the purchase price across all deals in each sub-sector



Customer relationships

are the biggest intangible for media companies followed by brands



Purchases of intangible assets

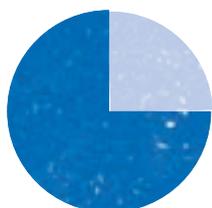
including goodwill across our one-year period totalled £3.08bn



Deal structures

Over 75% of media M&A deals

had some form of deferred consideration as part of the overall deal structure



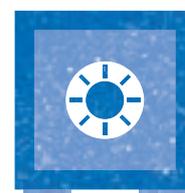
There is **no correlation** between size of the deals and deferred deal structures



Setting realistic expectations and keeping it simple are key to making an earn-out work for both the acquirer and the seller



Continued employment linked to deferred or contingent consideration is now accounted for as remuneration unless the link to services is non-substantive



The right advice

The media industry is more likely than most to have intangible assets forming a significant proportion of purchase consideration, due to its reliance on people and content. The value of intangible assets (including goodwill) of the deals in our sample was £3.08bn. This is a significant sum and underlines the importance of having robust measurement procedures in place to deal

with intangible asset valuations. Such valuations require specialist skills with an appreciation of the sector. At Grant Thornton our specialist media valuation team combines sector knowledge, expertise and years of experience. A properly executed valuation will provide both you and your investors with greater confidence regarding assets being acquired.

Pricing creativity – analysis of business combinations

Two key characteristics of the media sector are (1) that it comprises ‘people’ businesses and (2) they tend to own a lot of intellectual property (IP) – from films and programmes to magazine titles and brands. When one media business acquires another, the majority of the deal value will be intangible assets and goodwill which relate to these characteristics, rather than tangible assets.

The background

In the UK, the International Financial Reporting Standard (IFRS) has extended the concept of analysing purchase consideration beyond the traditional fair valuation of assets and liabilities covered by UK accounting standards.

IFRS 3 ‘Business combinations’ and IAS 38 ‘Intangible assets’ contain provisions mandating the fair valuation of

a wide range of identifiable intangible assets in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion set out in IFRS 3. This is of particular significance to the media sector and the following five types of intangible assets are most likely to be identified in media deals:



Marketing-related intangible assets covering assets such as brands, trademarks, trade names, service marks, newspaper/magazine mastheads and internet domain names. For a people business, non-competition agreements may be a critical part of the acquisition. Non competes generally will only relate to the main owners of the business so the value of the staff generally will not be identified as a separate intangible asset but be part of goodwill.



Customer-related intangible assets are typically one of the most common assets found in business combinations and often acquisition of those client relationships will form a key consideration in the acquisition of a media business.



For businesses in the media sector the category of **artistic-related intangible assets** is often key in acquisitions, such as literary assets, music libraries or film catalogues.



Other contract-based intangible assets such as licensing, royalty and standstill agreements and operating and broadcast rights are also likely to be a feature in media acquisitions.



A further category is **technology-based intangible assets** such as patented or unpatented technology, computer software and databases.

Most of these assets arise as a result of contractual benefits – deals that the companies have done to acquire or develop content, rights or orders that can be exploited in the future for the financial benefit of the companies.

Valuation of intangible assets is not that straightforward though and can be quite subjective, normally based upon the companies’ assessment of the future cashflows to be derived from exploiting the assets. One of the most valuable assets – the people in the business – will not however be identified and valued separately but will be subsumed within goodwill, which does explain why goodwill can form a large part of the value in a media deal.

The companies

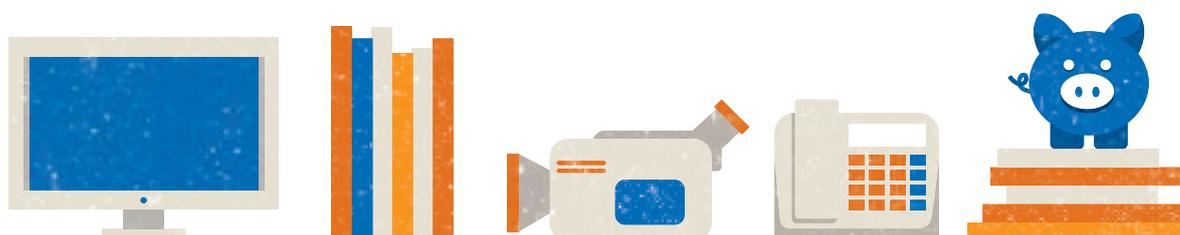
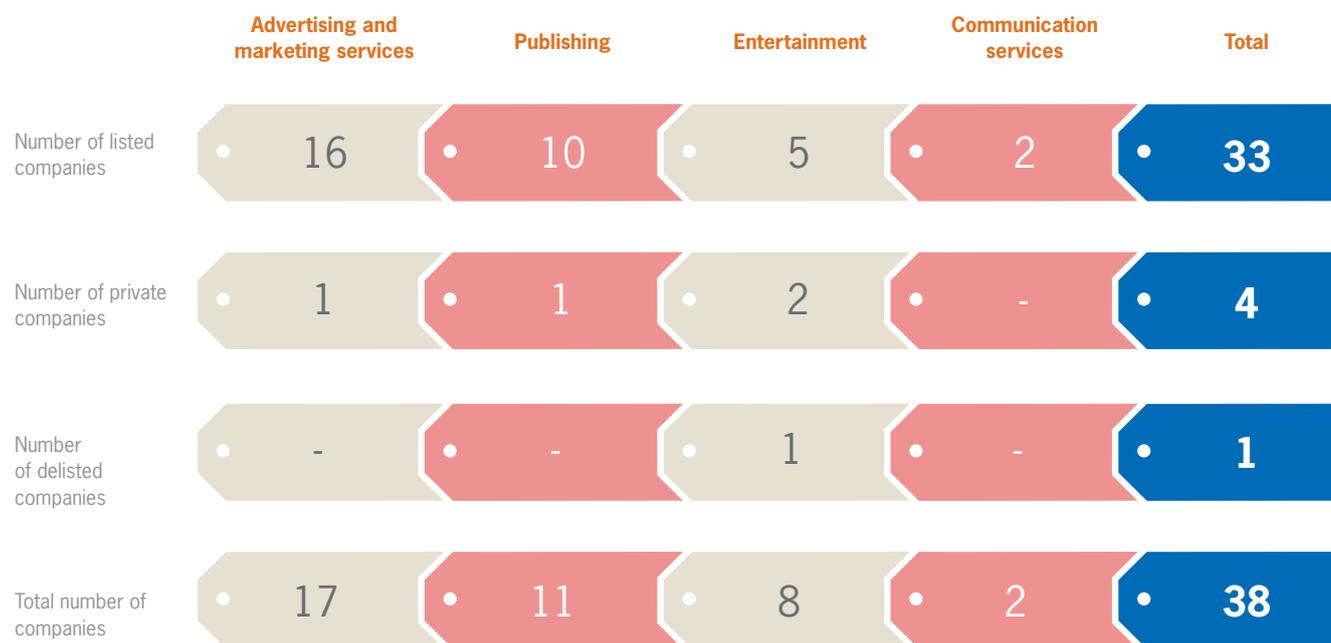
Our analysis covers companies in the media sector that have adopted IFRS in their financial statements. This includes the quoted UK media sector and also some private companies headquartered in the UK. Our survey sample included 143 companies, 90 public and 53 private. We have focused on the 38 companies that made acquisitions publicly disclosed in the financial statements or annual reports publicly available at January 2014.

The UK media sector has a broad diversity of company size and business activity. For the purposes of our analysis we have split the sector into four sub-sectors: advertising & marketing services, publishing, entertainment and communication services.

Many of these companies have areas of overlap between the sub-sectors. Our analysis is based on a subjective view of the best fit of the companies’ activities based upon the information contained in their published reports.

Table 1: Analysis of companies in survey

Note: Audio visual combined with Entertainment
 Note: Business services included in Advertising and marketing services



The deals

We looked at all acquisitions reported by the 38 listed and private companies in our sample. Our survey covers the 171 acquisitions, summarised in Appendix 1, set out in their published financial reports.

The total consideration in relation to intangible assets (IA) was reviewed, and split between Separately Identified Intangible Assets (SIIA) and goodwill (GW).

The goodwill figure is the difference between consideration paid and the fair value of the identifiable assets and liabilities acquired.

Table 2 opposite shows that goodwill forms the majority of the purchase price but also shows little is acquired by way of tangible assets. Most deals surveyed across sub-sectors included the acquisition of net liabilities such as working capital obligations primarily in the form of creditors and, consequently, the total value of goodwill and intangible assets is greater than the consideration paid.

Purchases of intangible assets including goodwill across our one-year period totalled approximately £3.08bn. This compares to our study undertaken in 2010 where the total value of intangibles acquired in a three-year period was approximately £11.3bn. However this included three extreme acquisitions each of which involved a total intangible value three to four times the value of the next highest deal in the sample. These three 'super deals' accounted for £6.9bn of the intangibles i.e. 62% of the total.

In Table 3, the amounts for SIAs and goodwill on each deal have been split across the sub-sectors.



Table 2: Proportion of goodwill as a % of total consideration

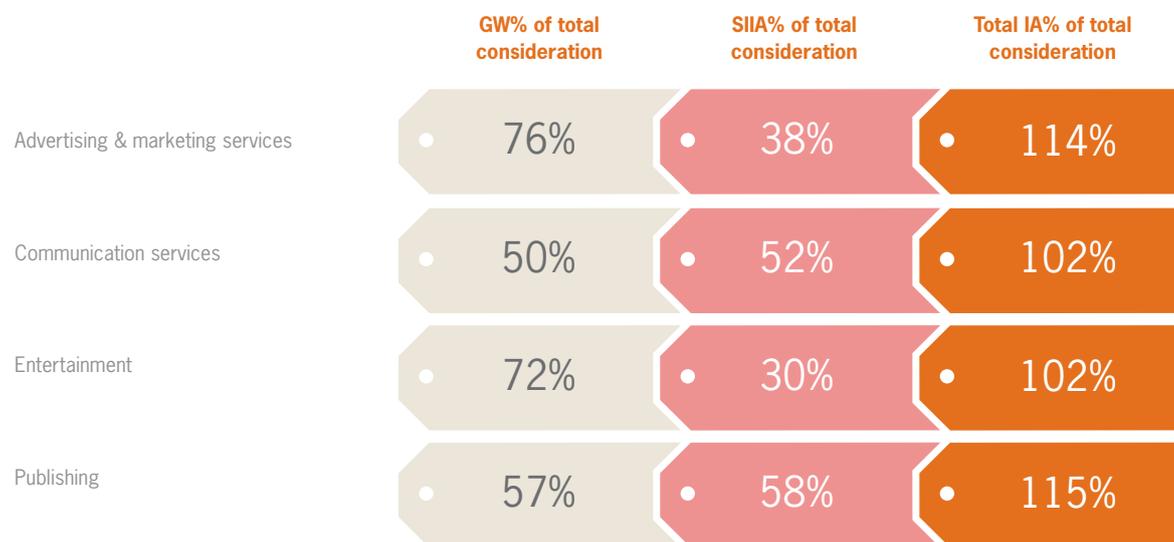


Table 3: Deal value of intangibles across sub-sectors (in £'000s)

	Number of deals	Total IA	GW	SIIA	SIIA as % of IA 2014	SIIA as % of IA 2010
Advertising & marketing services	115	855,627	565,507	290,120	33.9%	18%
Communication services	2	189,797	51,532	138,264	72.8%	n/a*
Entertainment	17	419,115	261,053	158,062	37.7%	35%
Publishing	37	1,614,440	953,530	660,910	40.9%	49%
Total	171	3,078,979	1,831,622	1,247,356	40.5%	45%

* not identified separately in the 2010 survey



Table 4: Super deals (in £m)



Acquirer	Target	Total IA incl Goodwill	Goodwill	SIIA	SIIA as % of IA
Pearson	Embanet Compass	424	350	74	17.5%
Entertainment One	Alliance Film Holdings	188	104	84	44.7%
BSkyB	Be Un Limited	186	49	137	73.7%
Perform Group	RunningBall Holdings	112	82	30	26.8%
Total		910	585	325	35.7%

The advertising & marketing services sub-sector witnessed most activity, with 115 deals. Publishing carried the highest total value of intangibles, at £1.6bn.

There were four major acquisitions which involved a total intangible value of more than double the value of the next highest deal in the sample, comprising one third of the total deal value. These are set out above in Table 4.

In Table 5, we have summarised the

SIIA as a percentage of total spend on intangibles by sub-sector.

The ‘identified’ category labelled ‘Other SIIA’ relates to a combination of provisional allocations made and connected intangible assets.

For example, Pearson describe ‘Other SIIAs’ as including ‘content, technology, contracts and software rights’.

ITV reports key intangibles acquired, classified as ‘Other Intangibles’ and

identified as ‘contractual arrangements, brands, customer contracts, software licences etc’ with no further specific split across these intangibles.

No disclosure was available in the accounts relating to the items comprising ‘Other Intangibles’ in relation to Perform Group’s acquisition of RunningBall or Sportal GmbH.

Table 5: Key intangibles acquired as a % of total SIIA

	Customer relationships	Brands	Non competes	Software/ Technology	Artistic related intangibles	Other SIIA	Total SIIA	Balance of IA - Goodwill
Advertising & marketing services	3.0%	1.0%	0.0%	0.3%	0.0%	22.5%	33.9%	66.1%
Communication services	72.0%	0.0%	0.1%	0.3%	0.0%	0.0%	72.8%	27.2%
Entertainment	5.0%	8.0%	1.6%	4.7%	15.1%	2.8%	37.7%	62.3%
Publishing	11.0%	3.0%	0.3%	1.6%	0.8%	23.6%	40.9%	59.1%



Content v Contacts

IP in media is more prevalent in the entertainment and publishing sub-sectors than in advertising & marketing services. This is likely due to the incidence of the various forms of content such as programmes, libraries, rights, exclusive content, films and books. The value in the creation and exploitation of content underpins the value of entities in these sub-sectors. The main identified intangibles relating to the entertainment sector are artistic-related intangibles. Libraries form a valuable asset for the acquirer due to the expected income stream such as royalties.

In contrast, the advertising & marketing services and publishing sub-sectors typically have little artistic related intangibles. Their

IP instead lies within brands and customer relationships. They rely on the quality of its creative talent and people at the account management levels, and the strength of their client relationships – their contacts. Valuing such assets is not easy but client relationships can be valued through assessing the propensity of those clients to make repeat purchases and how long those relationships can be realistically maintained.

This is why we see a higher level of identifiable intangibles in respect of content or IP in the entertainment sub-sector, compared with publishing and advertising & marketing services sub-sectors. Notably, also, non competes are more present for entertainment businesses – reflecting the creative nature of the business being acquired.



Key identified intangible assets

The table below ranks the key SIAs on the basis of percentage of total SIAs. Some companies did identify intangibles on acquisition but did not specify the nature of intangibles, instead classifying them in a broad category of ‘Other Intangibles’.

Table 6: Sector split of key intangibles acquired (in £’000s)

	Customer relationships	Brands	Non competes	Software/ Technology	Artistic related intangibles	Other SIIA	Total SIIA	Goodwill
Advertising & marketing services	26,217	12,533	-	2,732	-	192,180	290,120	565,507
Communication services	137,486	-	166	612	-	-	138,264	51,532
Entertainment	21,618	35,014	6,800	19,831	63,100	11,699	158,062	261,053
Publishing	179,606	55,584	4,600	26,635	12,917	381,568	660,910	953,530
Total	364,927	103,131	11,566	49,810	76,017	585,447	1,247,356	1,831,622
SIIA as % of Total IA	29.3%	8.3%	0.9%	4.0%	6.1%	46.9%	100.0%	na

In the table above, “Other SIIA” relates to, for example, in the case of the publishing sub-sector, content, technology, contracts and software rights acquired in acquisitions made by Pearson. In certain other cases, they represent brands, licences, contractual agreements, customer contracts and film libraries valued on a provisional basis. Next year’s accounts will therefore be needed in order to understand

the SIAs that were acquired and valued on a provisional basis as in most cases we would expect such intangible assets to be identifiable and capable of reliable measurement.

Customer relationships are therefore the single largest intangible asset identified across all sub-sectors with brands also being a key acquired intangible but varying by category across the sub-sectors.

Comparison with the 2010 study

We performed a similar analysis in March 2010 where transactions of listed companies in the media sector were surveyed over two to three years totalling 132 acquisitions.

Our 2014 study validates observations made in the 2010 study with respect to specific identified intangibles by sub-sector. The entertainment sub-sector reported more intangible assets such as IP and artistic intangible assets than the advertising & marketing sector which instead had more value attributable to brands.

Residual goodwill and 'synergies'

Goodwill remains a key element of acquisition price.

Goodwill as a residual value can be expected to include the value of synergies which should be ignored in determining identifiable intangibles, unless all market participants can be expected to benefit from them. Equally, of course, goodwill can include what might be considered to be over-payments by the acquirer.

Benefits from synergies

'Synergies' is a term widely used in practice to describe expected benefits from combining an acquired group of assets or a business with an existing business. These are deemed to include, for example, additional revenues from marketing the acquirer's products and services to the acquiree's customers (cross-selling) and cost savings and economies of scale from integration of operating facilities

In principle, most acquirers would consider that they expect to benefit from synergies through combining revenues and rationalising overheads, but also realise additional potential synergies between people, processes, and systems. Before the acquisition, buyers carry out detailed due diligence, making estimates of those synergies which influence the price the buyer is ultimately willing to pay. The reality, however, is that the benefits often tend not to be as great as expected – potentially leading to impairment.

In practice, in order to make an acquisition in a competitive bid process, the winning bidder will be that company which is prepared to pay more than anyone else, and this element of premium paid can be hard to measure.

What does goodwill represent?

Businesses are expected to disclose what supports goodwill and to assert that goodwill simply represents 'synergies' does not give the full story for the goodwill, which in most cases, will represent well over half of the acquisition price. In practice, most intangibles are amortised over a period of up to ten years and, as businesses can be assumed to have an indefinite life, there will inevitably be goodwill that represents the ability of the business to generate future value.

What do businesses disclose?

Given the lack of detail in IAS 3 with respect to disclosing the nature of what goodwill represents, we did not expect to see meaningful disclosure in this area. We looked at a number of published sets of accounts to see what was disclosed.

For example, in the case of Pearson, goodwill was disclosed to be representative of 'substantial cost and revenue synergies and benefits that cannot be separately recognised such as assembled workforce'.

Similarly with ITV, goodwill was said to be 'strategic benefits of acquisitions specific to the group' such as enhanced ability to promote the Freeview platform, business relationships with channels and additional capacity. This also included operational benefits and prospects to diversify and grow in areas such as content formats.

In the case of Tarsus Group, goodwill was stated to include provisional allocations and other intangible assets that cannot be separately identified such as sector knowledge and anticipated future profitability of the target company.



Overall observations

Goodwill and intangibles account for a large portion of the purchase price. Encouragingly for the reader of accounts, most companies have sought to identify intangibles rather than leaving everything in goodwill.

Different intangibles have differing importance in the sub-sectors of the media sector. Overall, brands appear to be less than customer-related intangibles as a percentage of total intangibles acquired, except in the case of the advertising & marketing services sub-sector. Of the identified intangible assets, customer relationships in overall terms are the most important asset that companies acquire.



Balancing deferred or earn-out components of consideration is key to delivering media deals

Whenever there is a difference between what a buyer thinks a business is worth and what the seller wants, a deferred or contingent payment (referred to hereafter as earn-outs) can help bridge that gap. Our analysis of the 171 deals shows that 75% of those deals had a deferred component that formed a significant part of the overall purchase price.

Table 12: Analysis of M&A deals in the UK media sector

Sub-sector	No. of deals	Having deferred component	%
Advertising & marketing services	115	95	82.6%
Publishing*	37	25	67.6%
Entertainment	17	8	47.1%
Communication services	2	1	50.0%
Total	171	129	75.4%

* Includes smaller acquisitions made by Informa, Pearson and Reed Elsevier, of which the number of acquisitions has not been disclosed

A common feature of many acquisitions, an earn-out stipulates that the vendors of a business are in certain circumstances contractually obligated to stay with the business through a transition period. They may be provided with the incentive to have a demonstrable effect on the business's financial performance going forward. Achieving or exceeding

a certain level of performance – criteria are typically set over a period of several years – means the vendors will earn additional consideration from the sale. For buyers, an earn-out can offer protection against overpaying for a business that does not end up performing in the way the vendors expected. It can also smooth the period of ownership transition.

WPP, a global advertising and marketing services giant, famous for its prolific appetite for M&A, acquired 65 companies globally during the period under review. The majority of these deals had a deferred element.

Negotiating a sale of a privately-held business is never a simple process – and the use of deferred payment mechanisms in the media sector reflects the need to tie in a future commitment from the vendors, who may be one of the most valuable intangible resources, on whom fixing an ascribed value is difficult. It is worth clarifying here that, under IAS 38 (15), ‘skilled staff’ do not meet the definition of an intangible asset.

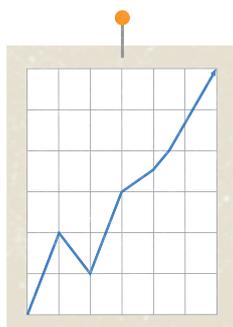
Our analysis shows that:

- there is no correlation between the size of acquisitions and how their consideration is structured between upfront and deferred payments, and
- the use of earn-out mechanisms is common across the full deal spectrum. This is most likely due to the sheer number of other variables that need to be considered when structuring an acquisition.

Setting realistic expectations

Where a gap exists between a vendor and an acquirer in the perceived value of a business, it is usually caused by the expected future growth of the company. Understanding the expectation of the other party is vital because the range of earn-out terms that could be offered is vast. A buyer might agree to pay the majority of the total purchase price upfront with any remainder paid in shares or cash after a year of earn-out time. Alternately, the buyer might agree to pay little to none of the total purchase price upfront and instead pay it at a later date in the form of cash or shares, during which time the owner must agree to stay with the company and optimise its performance. Often, but not always, this is coupled with target expectations which must be met in order for the earn-out to be paid.

When St Ives (a marketing solutions and print services group) acquired 100% of Amaze, it paid 100% cash upfront vis-à-vis 48% cash upfront when it acquired 100% of Branded3. We note that the acquisition of Branded3 also included an upfront payment of shares in St Ives equaling 11% of total consideration. This is often done in order to tie management into the acquiring company and to retain key employees.

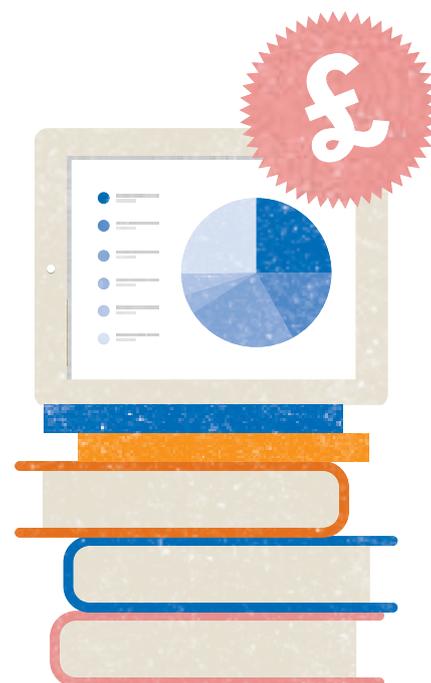


Keeping it simple

For entrepreneurs looking for a quick sale of their business, the simplest earn-out is none at all. There are significant risks involved in any acquisition that involves future conditions – especially for the seller. However, reality in the media sector is a heavy reliance on intangible assets. Consequently, most purchasers will fight tooth and nail for deferred consideration where possible, or a heavy discount for day one cash-out.

Many earn-outs depend on a complicated matrix of variables and goals. This should be avoided if possible. Earn-outs are most effective as an incentive for both sides when the size of the payout is determined based upon one or two simple variables.

Aiming for simplicity is best too for the future relationship between a company and its new owners. With aligned incentives and clear objectives, there will be less cause for arguing – or potential legal squabbles – when it’s time for the payout.



Increasing the chances for success (and avoid disaster)

Four questions both parties should consider before signing on the dotted line:

1. Will the acquired party have enough autonomy?

Earn-outs tend to work well when the business is going to continue to run pretty much as before. To that end, a seller should get in writing the buyer's commitment to leave operations largely unchanged. If certain redundancies are to be made or back-office functions are to be folded into the acquiring company, that's fine. The parties need to be clear how the business will run post acquisition.

2. Is the purpose of the earn-out financial or strategic?

An earn-out can be made to protect the buyer financially, or a buyer can be making a bet on the seller's ability to expand the business. Be clear on the objectives to maximise the chances of success for the buyer and seller.

3. Who is the umpire? How will progress against an earn-out's goals be evaluated?

Consider both who will be evaluating the business's performance under new ownership, and when evaluations will take place. Is it simply at the end of the period set in the contract, or will progress be tracked more regularly? Will the earn-out be allocated piecemeal or in one lump sum? There's no right answer, but these questions should be addressed early on in negotiations.

4. What will happen in the event outside factors drastically change the outcome?

Factors in neither party's control can harm the buyer's and seller's ability to maximise the rewards pledged in an earn-out. What if a new sector emerges? What if a key creative leaves? What if long-standing clients leave? Make sure contingency plans are created to address the most unlikely of scenarios – especially if you're entering into a long-term earn-out deal.

Advice for vendors: Avoid earn-out burn-out

If as a vendor you believe strongly in your company's potential and want to guide its success through new ownership, an earn-out might give you the opportunity to do so. But ensuring that a few key elements are in place in your agreement can greatly strengthen the new arrangement.

Each of these standards, which you and your buyer will

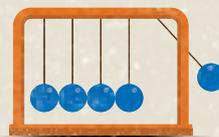
negotiate, can and should be included in your earn-out agreement. To vet that document, enlist acquisition specialists on both the legal and financial front.

In earn-outs you have to be very, very careful. Know the people that you're dealing with on the other side of the table, and work very hard to get the incentives aligned for all of the parties.



Retaining the key management

If other executives were integral to your company's growth and success, will your company be able to function under new ownership without them? If not, come up with deals to lock them in too.



Make sure you have control where necessary

Ensure that the contract expressly states that you will oversee any departments that will be executing on the goals and standards set forth in the earn-out. You should never allow yourself to be accountable for what you cannot control.



Keep the length of your contract as short as possible

It sounds obvious, but you'll minimise the potential for burn-out by minimising your time working with your new parent company. You can always renew and re-negotiate, but can't hit undo. And if you leave before the end of your contracted term, you may suffer hefty financial penalties. It's that simple.



Ensure that incentives are in place

You know what motivates you at work; one is seeing your business succeed and the other is money. If you've made a lot of cash in the initial sale, it's natural to lose attachment to future goals for the company. The earn-out percentage should be high enough to keep you from losing interest, especially in the event of a setback. If you are going to commit, commit fully.

Changes to and influence on accounting for business combinations

In preparing this report we thought it would be useful to provide an update on the technical accounting aspects of business combinations overall, and specifically in respect of distinguishing identifiable intangibles. IFRS 3 (revised) came into effect following the period covered by the financial statements reviewed for our 2010 survey.

Set out in Appendix 2 are the key changes to IFRS 3. Most importantly for this report, however, was the IASB's amendment to IAS 38 introduced at that time which removed the reliability of measurement criterion for intangible assets acquired in a business combination. In other words, if an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, the reliable measure criterion is always considered to be met (IAS 38.33). IFRS 3 BC172-174 contains the rationale for this decision.

The effect of this change for the purpose of this survey is that we would have expected more intangible assets to be identified on business combinations as a result of these changes.

So has this been the case and/or have any other factors been influential in changes in reporting behaviour?

Our 2010 survey

Our 2010 survey (which covered financial statements from 2008 and 2009) highlighted where we thought there was good practice and shone the spotlight on those companies that were out of step with the norm. In that survey we looked at the percentage of intangibles identified compared to total intangibles including goodwill. Table 3 on page 9 has a column which compares the performance then to 2014 (which covers 2012 and 2013 financial statements) in terms of the overall allocation.

Overall the percentage of separately identifiable intangibles has not changed significantly, in fact there has been a small decline overall. Publishing has fallen as a percentage and this has impacted the numbers overall. On analysis, and as mentioned earlier in our report (page 8), the publishing findings from 2010 can be attributed to some very high 'super deals' carried out by Reed and Yell in 2008/9. Overall, advertising & marketing services companies have seen a significant improvement in identifying intangible assets compared with our 2010 survey.

In particular in 2010, we highlighted a 'worryingly' large range of interpretation within the advertising and marketing services sector itself when it came to valuing intangible assets. We spotlighted Mission Marketing as a company that had taken the view that they 'were unable to identify any intangibles other than goodwill'. We questioned this at the time, especially when similar companies, making similar acquisitions, were able to. In the two acquisitions made by that company covered by the 2014 survey they attributed 33% to separate intangible assets which is in line with the norm for that sub-sector.



The Financial Reporting Council – Conduct Committee (formerly the Financial Reporting Review Panel)

During the last five years there has been a greater focus on financial reporting. The Financial Reporting Council (FRC) produce an annual report on corporate reporting and business combinations has been a key focus for the last three years in particular identifying intangibles. The reports, issued in the Autumn of each year, have in 2010, 2011 and 2012 specifically identified this area as one where they saw room for improvement. Their reports stated:

2010

‘The Panel approached a number of companies that had reported a significant business combination where there was a question whether all identifiable intangible assets meeting the IFRS recognition and measurement criteria on acquisition had been appropriately distinguished and recorded.’

In addition in 2010, they issued a separate report ‘Accounting for Acquisitions’ which focused on all areas of business combinations. With regard to identifying intangibles they had the following to say:

‘Seven of the companies failed to comply with the IFRS requirement to identify separately the different classes of intangible asset arising from each material transaction...’

‘This restricted the ability of the reader of the accounts to understand which classes and amounts of intangible assets arose from individually material acquisitions.’

2011

‘The Panel also raised questions in respect of combinations where there are indications that not all intangible assets meeting the IFRS recognition requirements and measurement criteria on acquisition had been appropriately distinguished and recorded.’

‘The FRC considers that there is a need for improved compliance with the disclosure requirements of IFRS, so that investors and other stakeholders can better relate the intangible assets recorded for material acquisitions to the account of the transaction given in the business review. A high level of consistency between the information in the business review and the audited accounts would improve the quality and transparency of the information about acquisitions.’

2012

‘The Panel continues to be concerned that not all identifiable intangible assets which meet the criteria for recognition and measurement in the financial statements are recognised on acquisition.’

In the August 2013 report, the panel said there had been improvement which, for advertising & marketing services in particular is borne out by this research. Our view is that focus on this topic will not go away and therefore must remain an area front of mind for CFOs when accounting for business combinations. During the drafting stage of this report the FRC published a Staff Research Paper, conducted by their Accounting and Reporting Policy team, entitled, Investor Views on Intangible Assets and their Amortisation. That Paper reflects the views of 27 (mainly UK-based) investors on the accounting treatment of different classes of intangible assets in financial statements.

The Paper, which CFOs will find makes interesting reading, is published at a time when the IASB is also undertaking a post-implementation review of IFRS 3 again seeking the views of the investor and financial reporting community. It is safe to say this topic will remain in the sights of the standard setters for some time

Other changes to reporting business combinations – contingent consideration linked to continued employment

As part of this report we have also looked at the structure of deals and the part deferred or contingent consideration play in them for media transactions. Perhaps the most interesting points of clarity that has arisen since our last survey affecting deal mechanics has been the IFRS Interpretations Committee decision in January 2013 that, where there are contingent payments to vendors, and these are subject to the continued employment of the vendor, they should be accounted for as remuneration and not cost of investment, unless the continued employment is ‘not substantive’. Not substantive is generally taken to mean having little or no commercial substance.

The guidance was provided as arrangements of this nature had previously been a grey area. IFRS 3 para B55 provides guidance/indicators for users to help them form a judgement. However, para B55 (a) in particular uses very definitive terms ‘a contingent consideration arrangement in which the payments are automatically forfeited is remuneration for post-combination services’. Some in the profession saw this as a bright line, others that B55 (a) was only one of the indicators and should be treated with equal weight with the others.

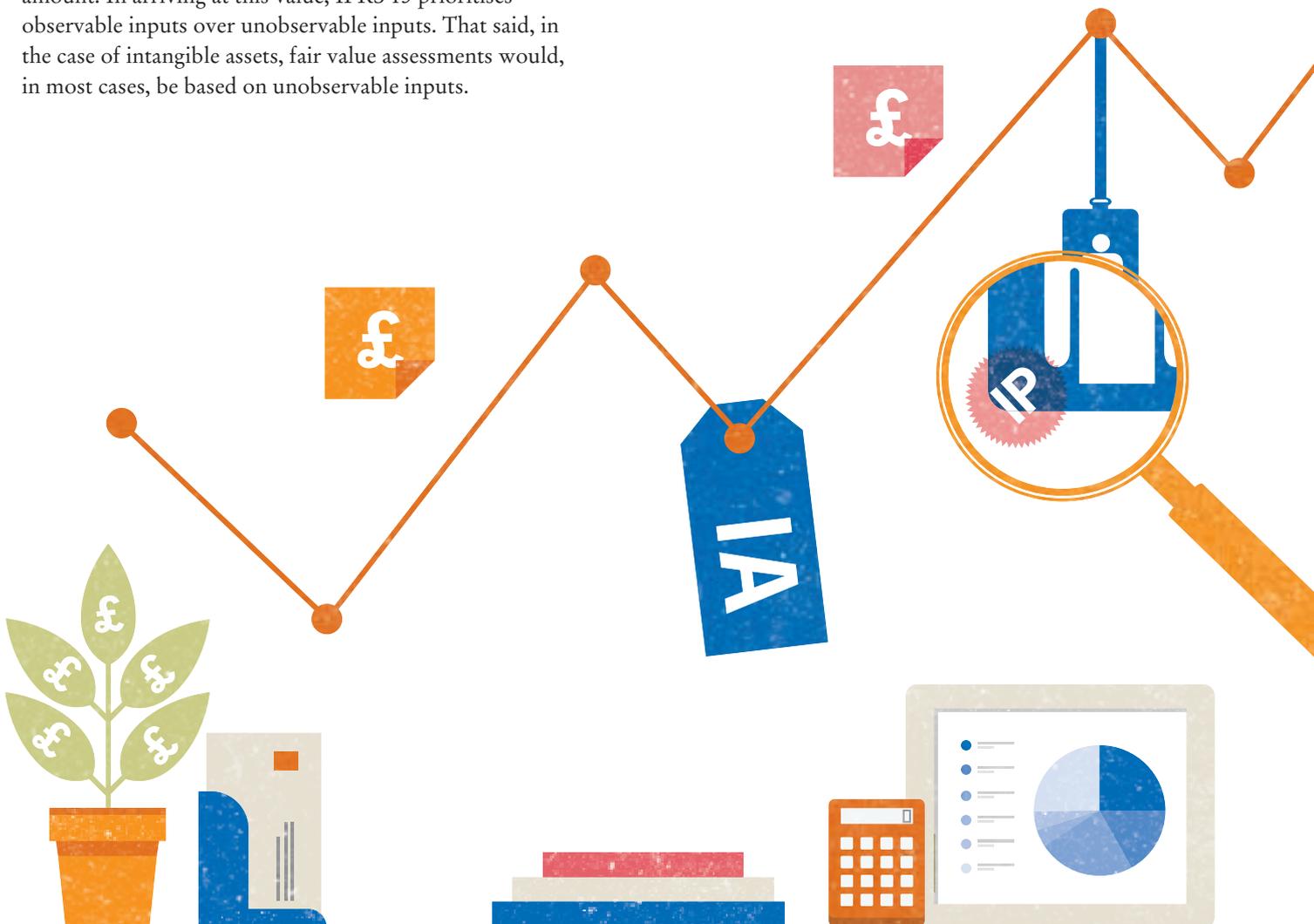
IFRS 13 – future reporting

Although not covered by this survey, as the financial statements reviewed were for accounting periods beginning before 1 January 2013, the date the standard became effective, IFRS 13 – Fair Value Measurement does have an impact on the valuation of intangible assets acquired going forward. Fair value, as defined by (IFRS 13 Appendix A), 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.

The fair value concept is therefore based on what is sometimes described as a hypothetical ‘exit’ transaction – the exchange of the asset or liability in question at a specified date. It is worth noting that it is possible for the settlement value of a liability to be different to its transfer value. For this purpose the IFRS 13 definition requires management to determine the transfer value rather than the settlement value of a liability. Fair value is the amount that would be paid or received in this hypothetical transaction. It also follows that fair value is an estimate – not an absolute or definitive amount. In arriving at this value, IFRS 13 prioritises observable inputs over unobservable inputs. That said, in the case of intangible assets, fair value assessments would, in most cases, be based on unobservable inputs.

IFRS 13 also states that the fair value takes into account the highest and best use of an asset from the perspective of market participants. This provides further guidance on fair value as, although under IRRS 3.B43 there was a requirement to measure assets acquired in business combinations at fair value in accordance with its use by other market participants, it did not specify the highest and best use.

Specific valuation models and techniques have emerged for estimating fair values, or for providing inputs into such estimates. The selection of the appropriate approach, technique or combination of techniques depends both on the nature of the asset in question and the availability and reliability of the information available to apply the technique.



Appendix 1: Business combinations surveyed

The companies

Acquirer	SIIA in £'000s	Other SIIA in £'000s	Total SIIA in £'000s	Goodwill in £'000s	IA incl GW in £'000s	SIIA%
Advertising & marketing services						
Jaywing	1,282	-	1,282	-	1,282	100.0%
Twelve Marketing Services	1,491	-	1,491	707	2,198	67.8%
ITE Group	9,341	-	9,341	7,049	16,390	57.0%
Ebiquity	2,307	-	2,307	2,949	5,256	43.9%
Communisys	1,198	-	1,198	1,970	3,168	37.8%
UBM	13,600	800	14,400	27,700	42,100	34.2%
M&C Saatchi	-	575	575	1,157	1,732	33.2%
Mission Marketing Group	-	933	933	1,886	2,819	33.1%
WPP	-	186,500	186,500	385,300	571,800	32.6%
Next Fifteen	1,110	-	1,110	2,625	3,735	29.7%
Porta Communications	1,135	-	1,135	2,925	4,060	28.0%
St Ives	7,449	-	7,449	19,324	26,773	27.8%
Tarsus Group	-	3,372	3,372	29,901	33,273	10.1%
Chime	2,569	-	2,569	26,169	28,738	8.9%
Creston	-	-	-	2,183	2,183	0.0%
Mood Media	56,459	-	56,459	53,021	109,479	51.6%
Motivcom	-	-	-	641	641	0.0%

Communication services						
BSkyB	137,000	-	137,000	49,000	186,000	73.7%
InternetQ	1,264	-	1,264	2,532	3,797	33.3%
Entertainment						
Entertainment One	92,400	-	92,400	110,900	203,300	45.5%
ITV	-	16,000	16,000	26,000	42,000	38.1%
Perform Group	46,695	2,699	49,394	116,109	165,503	29.8%
UTV Media	268	-	268	4,260	4,528	5.9%
Red BEE Media	-	-	-	2,939	2,939	0.0%
MBL Group	-	-	-	450	450	0.0%
Ram Active Media	-	-	-	40	40	0.0%
Prime Focus London	-	-	-	355	355	0.0%
Publishing						
Bloomsbury Publishing	1,871	-	1,871	274	2,145	87.2%
Dods Group	1,294	-	1,294	342	1,636	79.1%
Progressive Media Group	840	4,449	5,289	2,222	7,511	70.4%
Wilmington Group	3,965	1,819	5,784	3,291	9,075	63.7%
Reed Elsevier	229,000	-	229,000	165,000	394,000	58.1%
Daily Mail	33,600	4,300	37,900	46,300	84,200	45.0%
Pearson	177,000	110,000	287,000	505,000	792,000	36.2%
Centaur Media	9,100	-	9,100	16,700	25,800	35.3%
Informa	50,400	32,000	82,400	173,100	255,500	32.3%
Euromoney	1,272	-	1,272	39,585	40,857	3.1%
Independent News & Media	-	-	-	1,716	1,716	0.0%



The deals

Acquirer	Target	Total consideration in £'000s	Total IIA in £'000s	Goodwill in £'000s	Total Intangibles in £'000s
Advertising & marketing services					
Chime	PH Associates	12,478	1,554	10,336	11,890
Chime	Succinct Communications	7,687	247	6,689	6,936
Chime	Harvey Walsh	2,560	-	2,392	2,392
Chime	Hooper Galton	678	49	437	486
Chime	iLUKA	5,258	719	5,339	6,058
Chime	Rough Hill	988	-	805	805
Chime	McKenzie Clark	600	-	171	171
Communis	Yomogo Limited	375	55	328	383
Communis	Orchestra Bristol Limited	2,249	970	1,416	2,386
Communis	Kieon Limited	956	173	226	399
Creston	DJM Digital Solutions Limited	2,618	-	2,183	2,183
David Wood & Associates	DWA Media Pte Ltd	1	-	-	-
Ebiquity	FirmDecisions ASJP Group Limited	5,436	2,307	2,949	5,256
ITE Group	Beautex Co LLC	7,094	4,234	3,919	8,153
ITE Group	LLC Autoexpo	4,516	3,019	1,466	4,485
ITE Group	Unitech	1,326	959	367	1,326
ITE Group	Convention & Fairs assets	1,238	555	683	1,238
ITE Group	Jacket Required Limited	1,079	574	614	1,188
Jaywing	Iris Associates	1,080	1,282	-	1,282
M&C Saatchi	Bang Pty Ltd	1,737	575	1,157	1,732
Mission Marketing Group	Balloon Dog (Friars 573 Ltd)	2,823	731	1,514	2,245
Mission Marketing Group	Addiction Worldwide	85	202	372	574
Mood Media	DMX Holdings	32,278	32,463	34,677	67,140
Mood Media	BIS Bedrijfs Informatie Systemen	17,435	7,974	8,917	16,891
Mood Media	Independent Communications inc	16,922	9,478	4,383	13,861
Mood Media	Technomedia	14,140	6,544	5,044	11,588
Motivcom	Treatme.Net Limited	300	-	641	641
Next Fifteen	Trademark Public Relations	2,715	669	1,922	2,591
Next Fifteen	Paratus Communications Limited	1,041	441	703	1,144

Next Fifteen	CMG Worldwide Limited	894	-	-	-
Porta Communications	WFCA	1,383	395	2,232	2,627
Porta Communications	Twenty20 Media Group	685	490	493	983
Porta Communications	Hansard Communications	371	250	195	445
Porta Communications	Cruse Horse Brand response	5	-	5	5
St Ives	Amaze	15,302	4,783	11,551	16,334
St Ives	Branded3	19,666	2,666	7,773	10,439
Tarsus Group	LifeMedia Fuarcilik	18,605	1,949	17,143	19,092
Tarsus Group	China international Automotive Aftermarket Industry and Tuning Trade Fair	11,058	1,070	10,152	11,222
Tarsus Group	CYF Fuarcilik	2,812	353	2,606	2,959
Twelve Marketing Services	bChannels Limited	1,856	1,491	707	2,198
UBM	10 acquisitions	30,400	14,400	27,700	42,100
WPP approximate allocation	65 acquisitions	501,500	185,339	385,300	570,639
Communication services					
BSkyB	Be Un Limited	205,000	137,000	49,000	205,000
InternetQ	IPOP Networks Pte	3,346	1,269	2,540	3,809
Entertainment					
Entertainment One	Alliance Film Holdings	167,400	83,900	103,900	187,800
Entertainment One	Hopscotch group	18,300	8,500	7,000	15,500
ITV	So TV	10,000	7,000	3,000	10,000
ITV	Mediacircus and Tarinatalo	4,000	1,000	3,000	4,000
ITV	Gurney Productions	37,000	8,000	20,000	28,000
MBL Group	3 acquisitions	720	-	450	450
Perform Group	RunningBall Holding AG	106,228	29,891	82,286	112,177
Perform Group	Goal.com	18,072	9,290	12,643	21,933
Perform Group	Mackolik Internet Hizmetleri	17,712	6,789	13,578	20,367
Perform Group	Spox Media	6,926	2,725	6,492	9,217
Perform Group	Sportal GmbH	942	699	1,110	1,809
Prime Focus London	PF Broadcast and Commercial	385	-	355	355
Ram Active Media	Brandplay UK	166	-	40	40
Red BEE Media	TVGenius Limited	2,700	-	2,939	2,939
UTV Media	Simply Zesty	4,671	268	4,260	4,528
Publishing					
Bloomsbury Publishing	Fairchild Books	3,823	1,188	(210)	978
Bloomsbury Publishing	Applied Visual Arts	1,755	683	484	1,167

Acquirer	Target	Total consideration in £'000s	Total IIA in £'000s	Goodwill in £'000s	Total Intangibles in £'000s
Centaur Media	E-Consultancy.com Limited	23,500	9,100	16,700	25,800
Daily Mail	7 acquisitions	74,100	37,900	46,300	84,200
Dods Group	Holyrood Communications	471	663	478	1,141
Dods Group	Total Politics Limited	799	631	(136)	495
Euromoney	Ned Davis Research	68,405	-	35,345	35,345
Euromoney	Global Commodities Group Sarl	5,211	1,272	4,240	5,512
Independent News & Media	International House Dublin	1,558	-	1,722	1,722
Informa	Brazil Trade Shows Partners	62,500	23,600	46,800	70,400
Informa	Informa Canada Inc	34,300	9,600	29,400	39,000
Informa	Zephyr Associates	29,300	6,900	40,100	47,000
Informa	4 acquisitions	22,000	11,700	12,200	23,900
Informa	Fertecon Limited	20,700	5,700	15,000	20,700
Informa	Other acquisitions	17,500	14,000	5,800	19,800
Informa	Ibratexpo Feiras E Eventos LTDA	17,200	7,700	11,500	19,200
Informa	Sagient Research Systems	14,100	3,200	12,300	15,500
Pearson	Global English	63,000	37,000	46,000	83,000
Pearson	Author Solutions	69,000	35,000	56,000	91,000
Pearson	Certiport	88,000	54,000	58,000	112,000
Pearson	Embanet Compass	411,000	74,000	350,000	424,000
Pearson	Other acquisitions	57,000	86,000	(5,000)	81,000
Progressive Digital Media	Kable	2,300	840	2,222	3,062
Progressive Media Group	SPG Media	1,702	4,449	-	4,449
Progressive Media Group	Cornhill Publications	2,263	-	-	-
Reed Elsevier	Multiple Targets	341,000	229,000	165,000	394,000
Wilmington Group	NHIS	6,199	4,304	3,291	7,595
Wilmington Group	Inese	1,151	1,480	-	1,480

Appendix 2: Headline changes in IFRS 3 Business Combinations

IFRS 3 (as revised in 2008)	Previous requirements
Acquisition costs	
<ul style="list-style-type: none"> recognised as an immediate expense 	<ul style="list-style-type: none"> included in the cost of the business combination and in the determination of goodwill
Price paid for the acquiree	
<ul style="list-style-type: none"> now referred to as consideration transferred and comprises only amounts transferred in exchange for the assets and liabilities of the acquiree excludes acquisition costs (see above) but includes contingent consideration (see below) payments relating to transactions that are not part of the business combination exchange are accounted for separately 	<ul style="list-style-type: none"> referred to as the purchase price or the cost of the business combination the aggregate of the: <ul style="list-style-type: none"> fair values of assets given, liabilities incurred or assumed and equity instruments issued costs directly attributable to the business combination
Contingent consideration	
<ul style="list-style-type: none"> recognised and measured at fair value on acquisition date, irrespective of the probability of an outflow of resources subsequent changes in contingent consideration classified as a liability usually affect post-combination earnings 	<ul style="list-style-type: none"> recognised on the acquisition date when outflow of resources is probable and reliably measurable when recognition criteria are met after the acquisition date, treated as an adjustment to the cost of the combination with a corresponding effect on goodwill
A choice in measuring non-controlling interests (NCI)	
<ul style="list-style-type: none"> acquirer has an option to measure NCI that are present ownership interests either at fair value or at the NCI's proportionate interest in recognised net assets. Other types of NCI are measured at fair value 	<ul style="list-style-type: none"> all types of NCI are measured at the proportionate interest in recognised net assets
Goodwill formula	
<ul style="list-style-type: none"> goodwill is measured as the excess of: <ul style="list-style-type: none"> the sum of: <ul style="list-style-type: none"> the fair value of consideration transferred in exchange for the acquiree any recognised amount of NCI the fair value of any previously held equity interest (see below) over the recognised amount of the acquiree's identifiable net assets 	<ul style="list-style-type: none"> goodwill is measured as the excess of <ul style="list-style-type: none"> the cost of the combination over the acquirer's share of the acquiree's net assets
Calculation of goodwill in business combinations achieved in stages	
<ul style="list-style-type: none"> goodwill is determined on the date the acquirer obtains control any previously held investment is remeasured to its acquisition date fair value and is included in the goodwill calculation (see above). Any resulting gain or loss from the remeasurement is recognised in earnings 	<ul style="list-style-type: none"> goodwill is measured at each stage of the combination, using the original cost of each investment and the proportionate fair value of the acquiree's net assets at each stage

Glossary

Business combination – the bringing together of separate entities or businesses into one reporting entity

Earn-out – a provision written into some financial transactions whereby the seller of a business will receive additional payments based on the future performance of the business sold

Goodwill – future economic benefits arising from assets that are not capable of being individually identified and separately recognised

IAS 38 ‘Intangible asset’ – an identifiable non-monetary asset without physical substance

Separately identified intangible assets – intangible assets that are recognised and accounted for independently from goodwill. An intangible asset is identifiable if it: (a) is separable i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset or liability, or, (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations

IFRS – International Financial Reporting Standards

IFRS 3 ‘Business combinations’ – a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as ‘true mergers’ or ‘mergers of equals’ are also business combinations as that term is used in this IFRS

IFRS Interpretations Committee (IFRS-IC) – the interpretative body, the mandate of which is to review on a timely basis widespread accounting issues that have arisen within the context of current International Financial Reporting Standards (IFRS)

Intellectual Property (IP) – refers to creations of the mind: inventions, literary and artistic works and symbols, names, images and designs used in commerce

Non competes – agreements frequently entered into in the course of a business combination offering a degree of protection to the new owner of a business from competition by the vendor, the vendor’s owners and its key personnel

Other separately identified intangible assets – includes intangible assets either provisionally identified and valued or intangible assets that could not be separately identified or valued by the acquirer

Residual value – consideration for the business combination less the fair value of all identifiable net assets acquired in the business combination which is generally recognised as goodwill

Synergies – benefits available only to the specific acquirer. Typical examples include cost savings from an expanded customer base or similar economies of scale



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