

Accounting for business combination

A study of purchase price
allocation in India

March 2024

Foreword

We are proud to present the fifth edition of our [Purchase Price Allocation \(PPA\) study](#).

Ind AS 103 Business Combinations (Ind AS 103) impacts the way companies plan and execute their acquisition strategies. It requires identifying key intangibles and estimating their relative contribution to overall deal value while accounting for business combinations. Although detailed valuation guidelines are available and specialists are involved, the subjective nature of assumptions and workings necessitates an independent benchmarking with what other acquirers are doing for financial reporting. This study provides additional reference points for various stakeholders and may act as a broad guide while assessing the possible impact of mergers and acquisitions (M&A) on amortization expenses.

Application of IND AS 103 calls for assets/liabilities (including intangible assets and contingent liabilities, which did not exist on the balance sheet of target entities/businesses) acquired in a transaction to be measured at fair value applying appropriate valuation methods. Any residual value thereafter gets allocated to goodwill/capital reserve.

PPA not only affect the future earnings and balance sheet of a company but may also have tax implications. It is also an indicator of deal rationale and value drivers to shareholders. In the era of intense auditor and regulatory scrutiny, this matter warrants careful attention. Depending on the transaction structure, PPA could also have relevance from an income-tax perspective, as tax treatment for different intangibles and goodwill could be different.

EY has undertaken a study of business combination accounting for transactions that were disclosed in annual reports of the top 500+ listed companies in India by market capitalization and 80+ private companies (covering over 700+ transactions) since implementation of Ind AS till 31 March 2023. This study presents the results of assets (primarily intangible assets) that are typically recognized and reported by a company during an acquisition. However, the results of this study cannot be viewed in isolation, since each deal would have specific nuances.

We would appreciate any feedback that you may have on this study or if you would want to connect with our Valuations, Modelling and Economics Services team of EY.



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Fair value accounting of business combination and its manifold implications



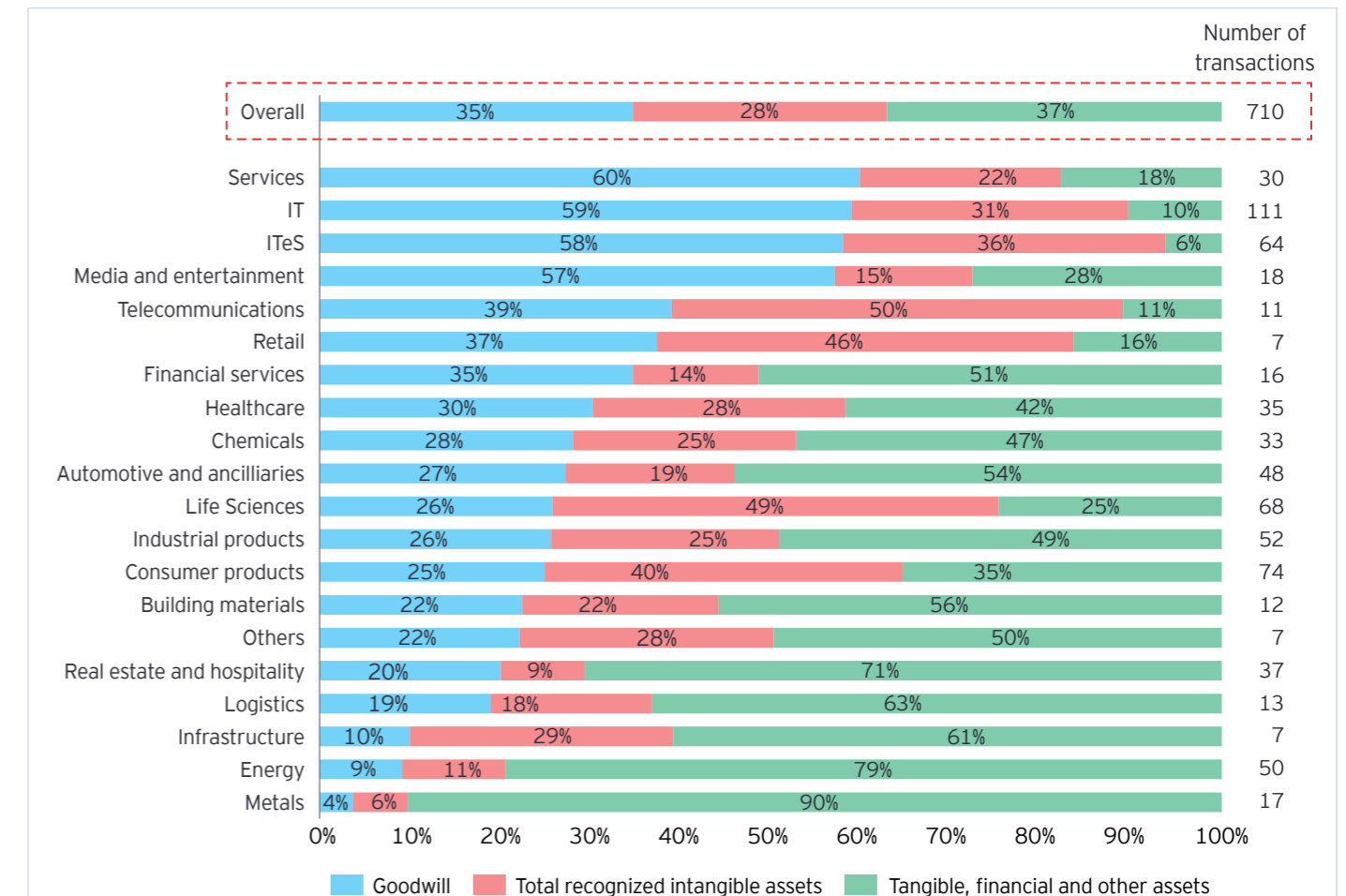
Goodwill: an important element



Key findings

Based on the study, 28% of the enterprise value of acquired companies was allocated to identified intangible assets and 35% was attributable to goodwill, with the allocation varying

considerably from industry to industry. The allocation to goodwill in India is largely in line with the proportion allocated in global deals (e.g., in the US).



*Tangible, financial, and other assets for financial services are higher due to higher composition of financial assets (i.e., loans and advances)

Note 1: The above numbers are average and should not be considered as a benchmark for the sector, as allocation of assets and goodwill may vary significantly based on transaction-specific facts.

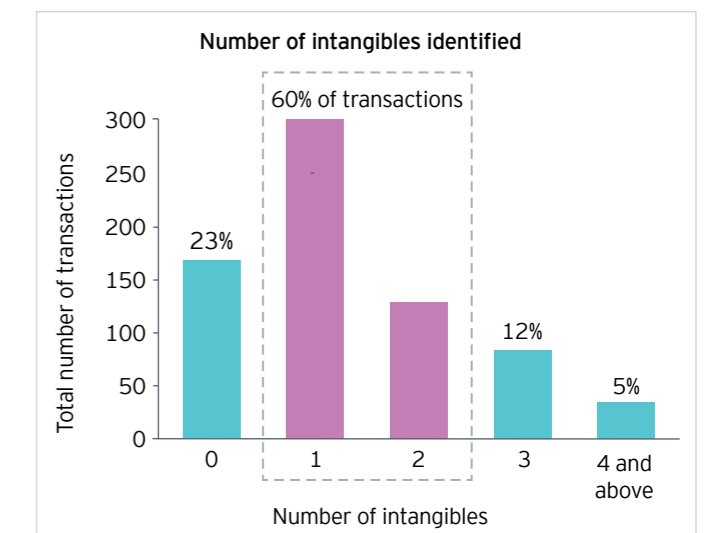
Note 2: Sectors with less than five transactions are categorized under "Others". These include companies from industries such as leasing, charter aircraft and railways.

Note 3: Average goodwill is after considering adjustment for capital reserves.

In sectors such as telecommunications, life sciences, retail, consumer products and technology (IT/ITES), a larger portion of deal value is allocated to intangible assets. This is reflected by the underlying products, brands, intellectual property, customer relationships, etc.

Capital-intensive sectors, such as real estate and hospitality, energy and metals, allocate more than two-thirds of their enterprise value to tangible assets.

In 23% of the transactions analyzed, no intangible asset was recognized. These transactions majorly pertained to asset heavy sectors, such as real estate and hospitality, energy, industrial products, automotive and ancillaries, etc. Transactions where more than two intangible assets were identified pertained majorly to sectors like IT, ITeS, consumer products, chemicals and life sciences.



Frequency of intangible assets recognized by sector

Sector	Number of transactions	Brand/ Trademark/ IPR	Software/ Technology/ platform/design/ know-how	Customer contract/ relationship	Dealer network	Non-compete agreement	License and rights	Other intangibles
Automotive and ancillaries	48	21%	27%	17%	2%	2%		40%
Building materials	12	25%	33%	8%		8%	17%	42%
Chemicals	33	36%	27%	21%	6%	18%	3%	33%
Consumer products	74	58%	23%	22%	9%	19%	4%	16%
Energy	50	2%	12%	14%			8%	22%
Financial services	16	19%	31%	31%	13%		13%	19%
Healthcare	35	29%	11%	20%		14%	9%	37%
Industrial products	52	17%	23%	27%		15%	8%	29%
Infrastructure	7		29%				43%	43%
IT	111	30%	32%	67%	2%	21%	3%	23%
ITeS	64	31%	28%	73%	2%	17%	3%	31%
Life sciences	68	72%	22%	12%		3%	9%	18%
Logistics	13	15%	23%	23%	8%	15%	15%	38%
Media and entertainment	18	17%	22%	17%		6%	11%	39%
Metals	17	12%	6%	12%				47%
Retail	7	57%	43%		14%		14%	
Real estate and hospitality	37	5%	5%	3%			8%	14%
Services	30	23%	20%	33%		17%		60%
Tele-communications	11	36%	36%	45%		18%	27%	27%
Total	703	31%	23%	31%	2%	12%	6%	28%

0% <15% Between 15% to 30% Between 30% to 45% Above 45%

Note: Sectors classified as "Others" are not considered in the analysis.

* Other intangibles in services, infrastructure, automotive and ancillaries, building material and metals sector appear higher as the break-up of intangibles was not adequately disclosed.

Marketing-related intangibles were the key acquisition driver in the consumer products, life sciences and retail sector.

Customer-related intangibles seem to be the acquisition driver in IT/ITeS sector.



Allocation within intangible assets

The average allocation of an intangible asset's value within different types of intangible assets (excluding goodwill), recognized among sectors, is tabulated below:

Sector wise	Brand/ Trademark/ Product/ANDA	Technology/ platform/design/ know-how	Customer contract/ relationship	Dealer network	Non-compete agreement	License and rights	Other intangibles
Automotive and ancillaries	17%	22%	18%	0%	0%		42%
Building materials	10%	1%	5%		3%	25%	56%
Chemicals	34%	12%	13%	5%	4%	1%	31%
Consumer products	60%	6%	14%	3%	2%	5%	10%
Energy	1%	8%	28%			17%	46%
Financial services	1%	30%	39%	5%		10%	14%
Healthcare	32%	4%	14%		1%	8%	41%
Industrial products	13%	14%	28%		9%	8%	27%
Infrastructure		20%				60%	20%
IT	8%	15%	56%	0%	2%	3%	15%
ITeS	6%	10%	59%	1%	2%	3%	19%
Life sciences	65%	12%	6%		0%	4%	13%
Logistics	8%	1%	23%	8%	11%	15%	33%
Media and entertainment	8%	16%	20%		3%	6%	47%
Metals	13%	1%	18%				68%
Retail	52%	20%		14%		13%	0%
Real estate and hospitality	14%	10%	4%			26%	45%
Services	19%	6%	27%		3%		46%
Tele-communications	14%	11%	40%		2%	30%	4%
Total	20%	12%	22%	2%	2%	12%	30%

0% <15% Between 15% to 30% Between 30% to 45% Above 45%

Note: Sectors classified as "Others" are not considered in the analysis.

Generally, a non-compete agreement is a part of most acquisitions as a safeguard to the buyer. However, allocation of value to non-compete agreement is on the lower side - possibly indicating either a shorter life or probability/impact of competition is perceived to be minimal.

Methodology

This study is based only on annual reports of the top 500+ listed companies in India by market capitalization for FY17 to FY23 and private companies in India reporting revenue in FY23 greater than INR5,000 crores. Transactions with enterprise value less than INR10 crores were ignored. A total of 710 transactions were found where adequate information about PPA was disclosed. Appropriate assumptions were considered with regard to classification of intangibles where full information was not disclosed.

For certain transactions, only the total value was disclosed for all intangible assets recognized. For such transactions, the value of intangible assets was classified under other intangible assets.

Results are presented as percentages of enterprise value. If cash and cash equivalents are not disclosed, gross debt is assumed as net debt.

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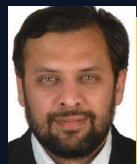
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