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تقييم TAQEEM

The future of intangible assets in the Kingdom of Saudi Arabia

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Executive summary

This paper focuses on intangible assets and their increasing contribution towards the value composition of businesses, whether it is measured in terms of the market capitalisation of listed companies or as part of premiums paid over net tangible assets. In this regard, the paper presents key trends from the Standard and Poor's 500 (S&P 500) index over the past three decades and a comparative analysis with Tadawul, the Saudi Arabian stock index. It also presents some recent regional transactions illustrating how intangible assets are becoming a major value contributor.

Compliance with financial reporting requirements, mainly International Financial Reporting Standards (IFRS) 3R, has been the major driver to recognise intangible assets on the balance sheets of companies. However, their increased value contribution as witnessed in recent transactions has increased the focus on the intangible assets. This could also be witnessed from the share prices of publicly traded companies relative to their reported equity values, especially for those operating in the services and IT sectors. Many stakeholders involved in mergers and acquisitions (M&A) transactions now expect an analysis of what is being acquired, and the reason behind any premium in the purchase consideration over net tangible assets. This can be explained by understanding the real value drivers of the business.

In this context, our study traces the shift in the composition of the S&P 500 index from heavy industry focused corporations with significant tangible assets towards the services and less tangible focused corporations. A similar transition is projected for Tadawul index through a comparative analysis of key regional transactions. There seems to be a similarity of how businesses in Saudi Arabia are moving towards a similar direction, although at a different scale and pace.

This paper explores how intangible assets such as brand names, licenses, customer and supplier relationships, knowhow and developed software are increasingly becoming key value drivers for businesses in Saudi Arabia, which is also in line with Vision 2030 of diversifying the Saudi Arabian economy[1]. The focus on intangibles from the stakeholders, including management, shareholders or regulatory bodies, will continue to evolve in the near future, with developing, growing and protecting intangible assets becoming a key stone for having successful businesses and capital appreciation.

1 Saudi Vision 2030 https://vision2030.gov.sa/en

Definitions

An intangible asset has no physical substance, is clearly distinguishable and controllable, provides a future economic benefit and/or arises from any contractual or legal rights. They can be classified broadly into the following categories:

Intangible assets

Market related intangible assets

- Brand name, registered trademark, trade names, company/ product brand
- Service marks, collective marks and certification marks
- Internet domain names
- Non-competition agreements

Customer related intangible assets

- Customer contracts
- Customer relationships
- Order backlog
- Customer lists

Contract based intangible assets

- Contract based intangible assets
- Supply/service contracts/distribution agreements
- Supplier relationships
- Franchise agreements
- Licenses

Technology based intangible assets

- Computer software
- Databases
- Patented and unpatented technology
- Knowledge and knowhow

Artistic related intangible assets

- Plays, operas and ballets
- Books, magazines and newspapers
- Musical works such as compositions, songs and lyrics
- Pictures and photographs
- Video and audio-visual material

Creation

Intangibles can be identified by means of either a contract or legal rights for protection of benefits to be accrued from the assets or through conducting face-to-face interviews or surveys[2].

These intangibles can appear in the form of goodwill recognised through business combinations, which generally represent the future economic benefits arising from assets acquired in a transaction. Due to the prevailing accounting regime, these assets would not have been explicitly individually identified and separately recognised prior to a transaction. Future economic benefits may result from the synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements. A typical example could be an acquisition of a company at a price exceeding the value of its identifiable net assets, where the difference would represent the goodwill value.

Undisclosed/unrecognised intangibles

The phenomenon of 'undisclosed intangibles' has risen as accounting standards only recognise intangible assets when there has been a transaction to support intangible asset values[3]. According to the IFRS 3, only acquired intangible assets can be separately disclosed on the acquiring company's balance sheet. This non-recognition of intangible assets, except when there is a purchase for the relevant asset or a fair value allocation of an acquisition purchase price, can result in elimination of highly valuable intangible assets from appearing on the balance sheet.

Undisclosed intangibles	
• Intangible assets not recognised if there is no transaction to support intangible asset values in the balance sheet.	• Frequently considered more valuable than the disclosed intangibles. The undisclosed intangibles include 'internally generated goodwill' and account for the difference between the fair market value of a business and the identifiable tangible and intangible assets value.

2 IFRS 3 – Business Combinations: https://www.iasplus.com/en/standards/ifrs/ifrs3

3 Global Intangible Finance Tracker 2017

Realised and unrealised value of the intangible assets

Realised value	Unrealised value
• The value of an asset which is already accounted for in the financial statements. • Example: The book value accounted for the intangibles in the business.	• The unreported portion of the value derived from the underlying assets of business. This value could rather be reflected through the market quotations for the business as against the book value of such net assets. • Example: The intrinsic value of an asset or a premium, which market participants are willing to pay over and above the book value.

"Whether intangible assets are recognised or not is more of an accounting topic, if we for instance consider one of the recent acquisitions in the region, the Amazon – Souq.com transaction, the majority of USD 672m purchase consideration paid was for the intangibles and goodwill. The fact that such balances for intangibles were recognised on the effective date of acquisition, does not mean that they were non-existent before that day, in fact they were created, grown and protected over several years and only recognised for financial reporting purposes as of the acquisition day."

Mohammad Araj
Director, Financial Advisory, Deloitte Middle East
Accredited Member of TAQEEM

Unrealised value exists due to a disconnect between capital markets based valuation and the presentation based on accounting standards[4]. Accounting value is centred on historical costs of equipment and inventory, whereas the market value arrives from the anticipation of a company's future cash flow, which is largely derived from the intangibles such as Research and Development (R&D) efforts, knowhow and others.

At present, the financial reporting norms generally tend to hide the unrealised value derived from the intangibles. Nonetheless, there is a growing sense that the value of internally developed intangible assets need to be recognised in the financial reporting which would help stakeholders to be informed while making the requisite decisions.

Today's economy reflects a transition from industrial forefront to a service and information oriented business. The increasing number of acquisitions have started revealing the hidden value of intangible assets. Knowledge based assets are primarily accountable for such an increase in value. The key stakeholders are looking beyond the financial statements and are also looking at the market capitalisation driven by intangible factors such as the brand, customers and supplier relationships, human capital and many others.

[4] CPA Journal – Valuing Intangible Assets by Benjamin P. Foster, Robin Fletcher, and William D. Stout

Transition from asset heavy companies to technology and software related companies

As economies shift from manufacturing to service industries, an increasingly large proportion of the firms derive their value from intangible assets ranging from technological patents to human capital. Market studies suggest that the highest magnitude of this shift is witnessed in the United States, while global markets have also experienced a similar value transition since intangible assets as a percentage of market capitalisation is proportionately increasing compared to tangible assets.

Morgan Stanley Capital International (MSCI) noted in a 2018 publication that over 80% of the enterprise value of the S&P 500 index today, lies in intangible assets such as patents and trademarks, software, brands and IT acquisitions[5].

As more pharmaceutical, technology and service companies are valued, two important points are noted:

- The assets of these firms are often intangible in nature and include patents, knowhow and human capital.
- The way in which accounting has addressed investments in these assets is inconsistent with the treatment of investments in tangible assets at manufacturing firms[6].

This may result in inconsistency for basic inputs, which are used in valuation such as earnings, cash flows and return on capital. The market may be perceiving the value of the brand which is reflected in the market capitalisation, however, not recorded on the financial statements. This indicates the sentiment of the market in terms of the value that the investors are placing on the brand and the reputation of the company. Such value could be unlocked subject to the forthcoming acquisitions.

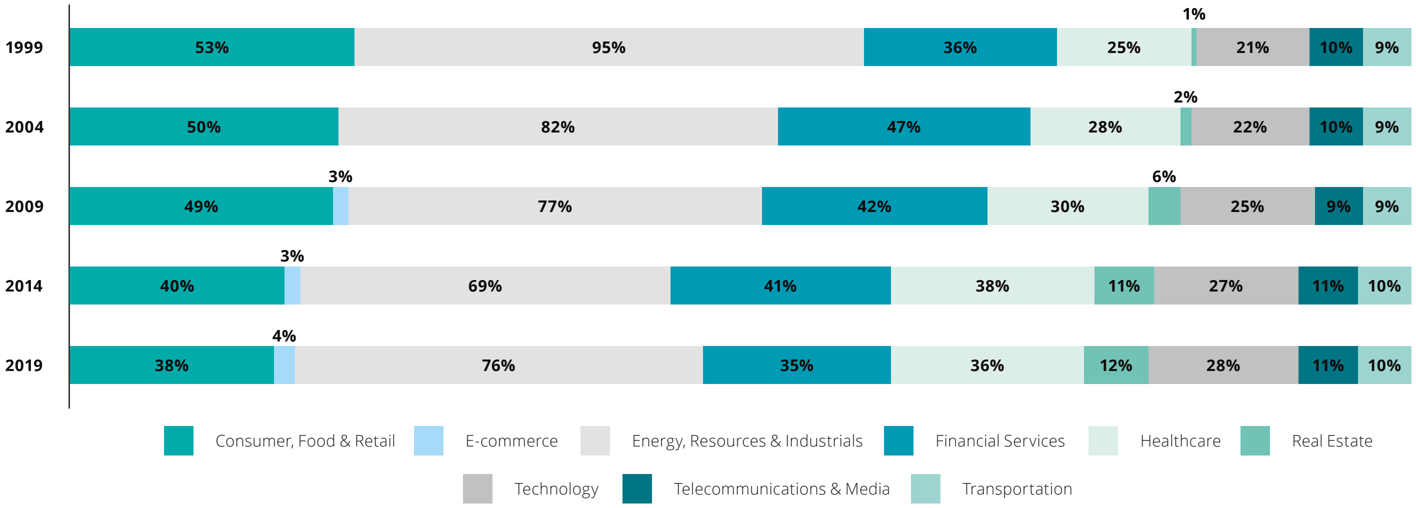
The significance of intangible assets to the overall value of many listed companies has grown tremendously and this is justified by the growing importance of knowhow for modern technology companies or for brands in the consumer industry as highlighted in the following analysis.

The shift of listed entities from tangible heavy to intangible heavy assets

As shown in **figure 1**, over the last 20 years, the following sectors have dominated the composition of the S&P 500 index:

- Energy, Resources and Industrials (ER&I);
- Financial Services
- Consumer, Food and Retail (Retail)

Figure 1: Composition of S&P 500 companies



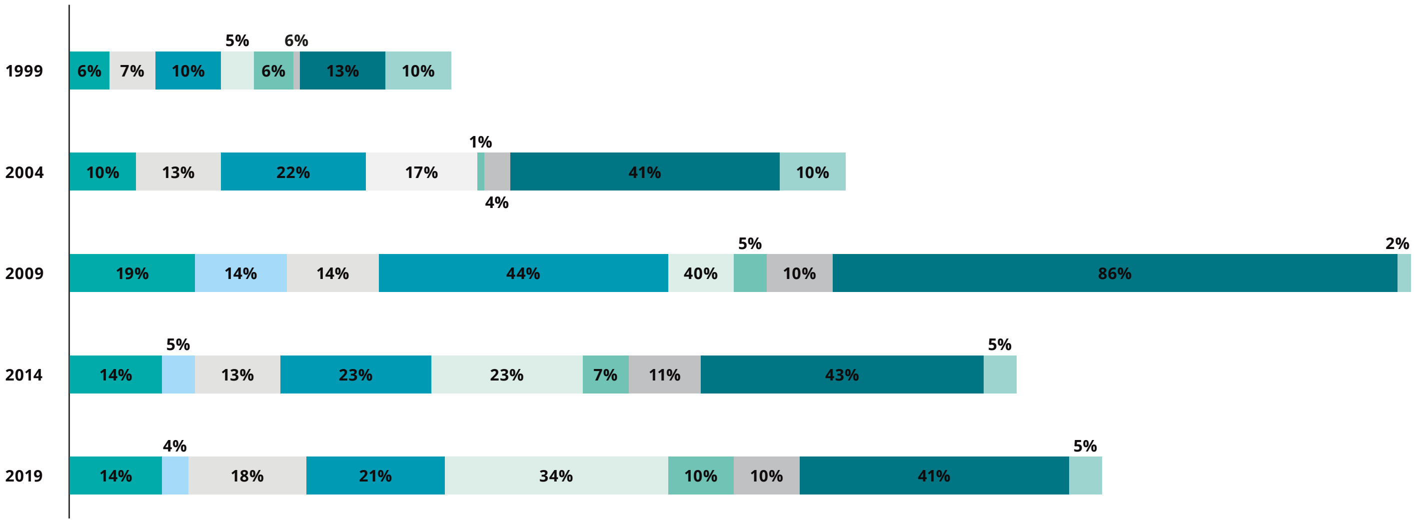
Source: S&P Capital IQ, Deloitte analysis

5 https://www.weforum.org/agenda/2018/09/when-we-can-t-quite-put-our-finger-on-it-intangibles-and-finding-better-metrics-for-financing-technological-disruption/

6 Aswath Damodaran - Valuing Companies with intangible assets – September 2009

An analysis of top 250 companies listed on the S&P 500 index over the last 20 years, as depicted in **figure 2**, clearly indicates that Telecommunication and Media (T&M) had the highest intangible to market capitalisation ratio, followed by the Healthcare sector.

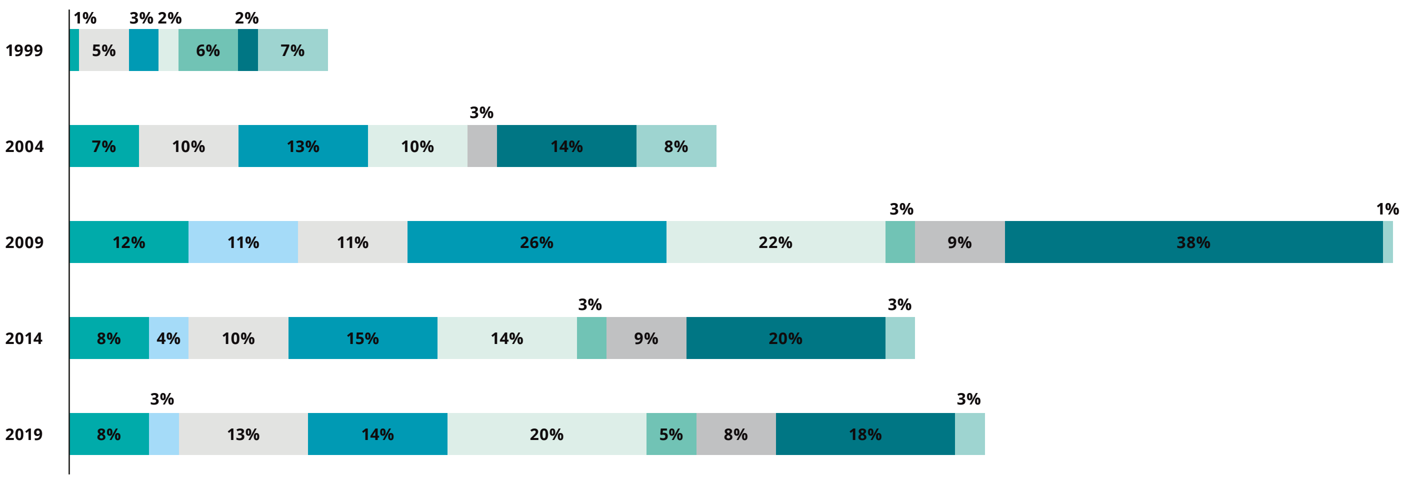
Figure 2: Intangibles as a percentage of market capitalisation



Source: S&P Capital IQ, Deloitte analysis

The same pattern is observed in goodwill to market capitalisation ratio with T&M being the highest, followed by the Healthcare and Financial Services sectors, as presented in **figure 3**.

Figure 3: Goodwill as a percentage of market capitalisation

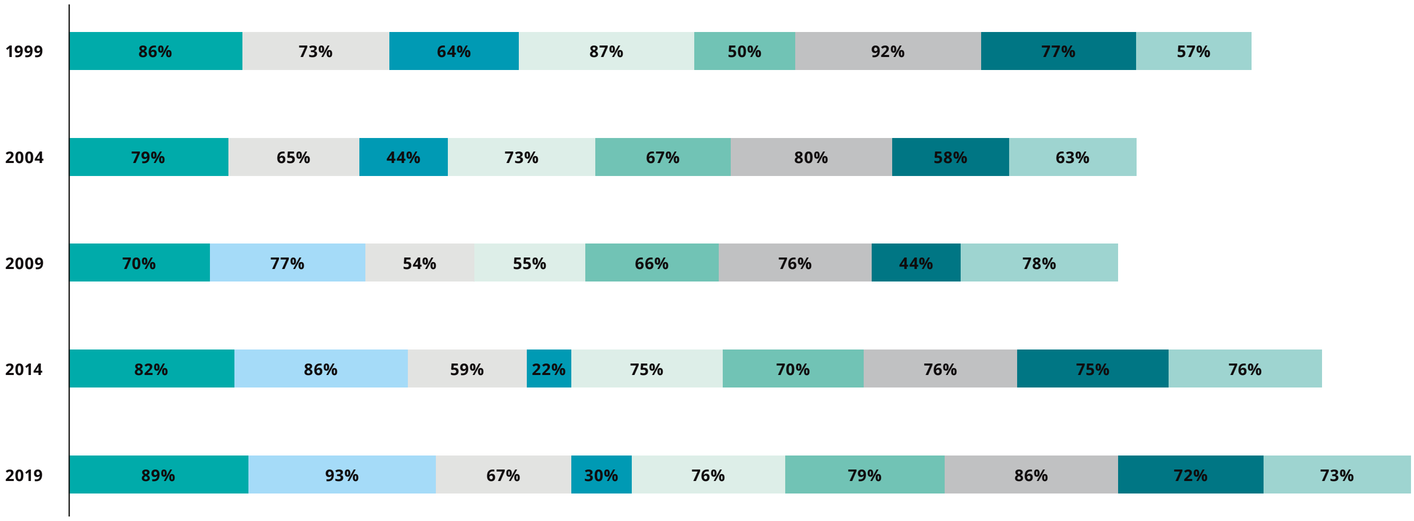


Source: S&P Capital IQ, Deloitte analysis

In 2014 and 2019, the unrealised value of businesses was highest in the e-commerce sector, owing to high valuations assigned by the private equity players to start-ups and technology based e-commerce companies. As presented in **figure 4**, over the last 20 years, the following sectors witnessed an above average level of unrealised value:

- Technology
- T&M
- Retail

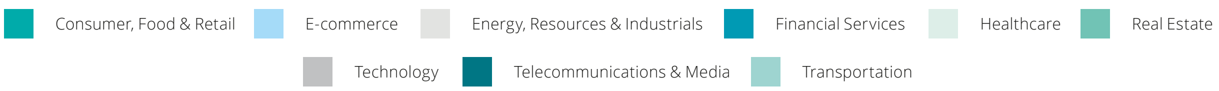
Figure 4: Unrealised value as a percentage of market capitalisation



Source: S&P Capital IQ, Deloitte analysis

The reported goodwill and intangible value has gradually increased over the years to a level of 11.7% and 19% in 2019, respectively, compared to 2.3% and 5.8% in 1999. This shift, again, underlines the transition of companies from tangible asset to intangible asset heavy balance sheets.

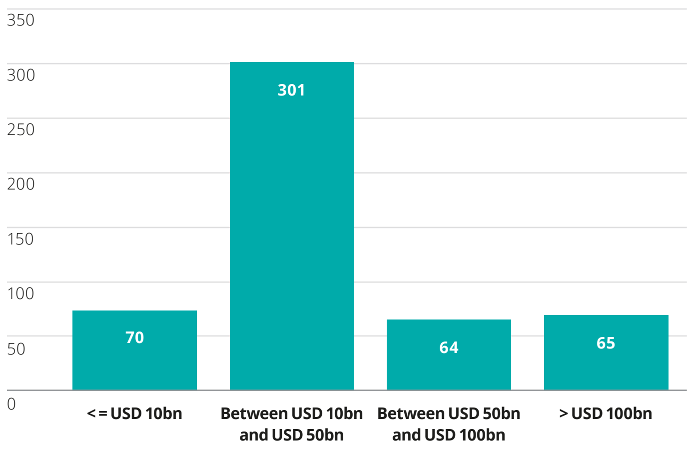
Key: Figure 2, 3 & 4



A comparative analysis of the S&P 500 and Tadawul indices

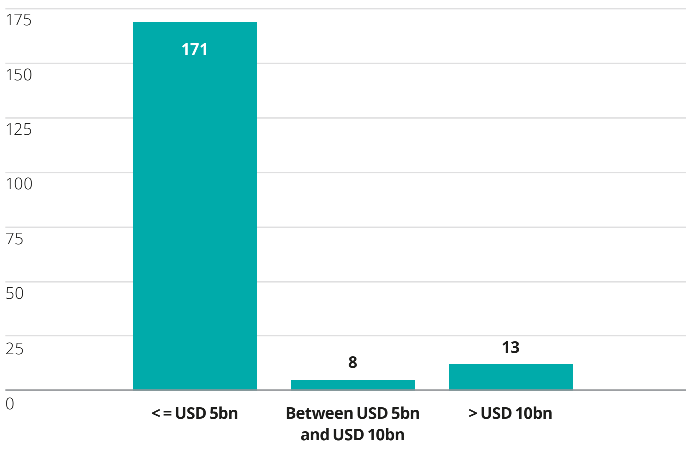
We have conducted a comparative analysis of the S&P 500 index, comprising of the 500 largest companies listed on US stock exchanges, and Tadawul, the Saudi Arabian stock index. The analysis was conducted on the information as on 31 December 2019 with an aim to draw parallels between the two indices. The figures below present a size comparison between both the indices indicating that majority of the companies listed on the S&P 500 index are between the market cap ranges of USD 10bn to USD 50bn while that on Tadawul is below USD 5bn.

Figure 5: Market – Cap classification – S&P 500



Source: S&P Capital IQ, Deloitte analysis

Figure 6: Market – Market cap classification – Tadawul



Source: Tadawul index, Deloitte analysis

As seen in **figure 7 and 8**, the sector composition of the S&P 500 index and Tadawul are similar. The ER&I sector is the largest sector on both the indices, with a contribution of 30% and 31%, respectively. Retail and Financial Services are the other major sectors represented.

Figure 7: Industry composition – SAP 500

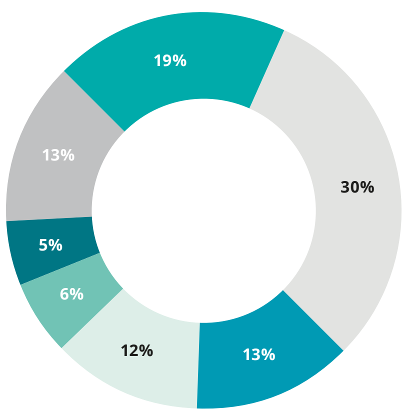
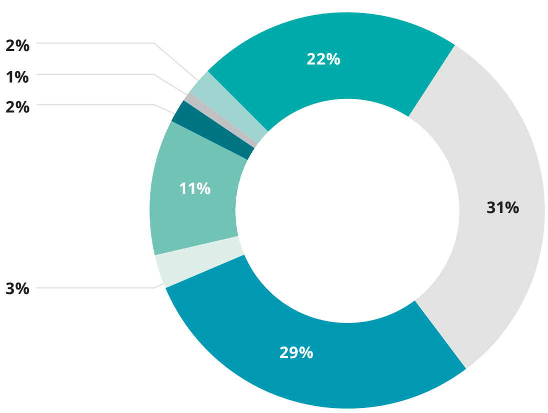


Figure 8: Industry composition – Tadawul



Consumer, Food & Retail | Energy, Resources & Industrials | Financial Services | Healthcare | Real Estate | Telecommunications & Media | Technology | Transportation

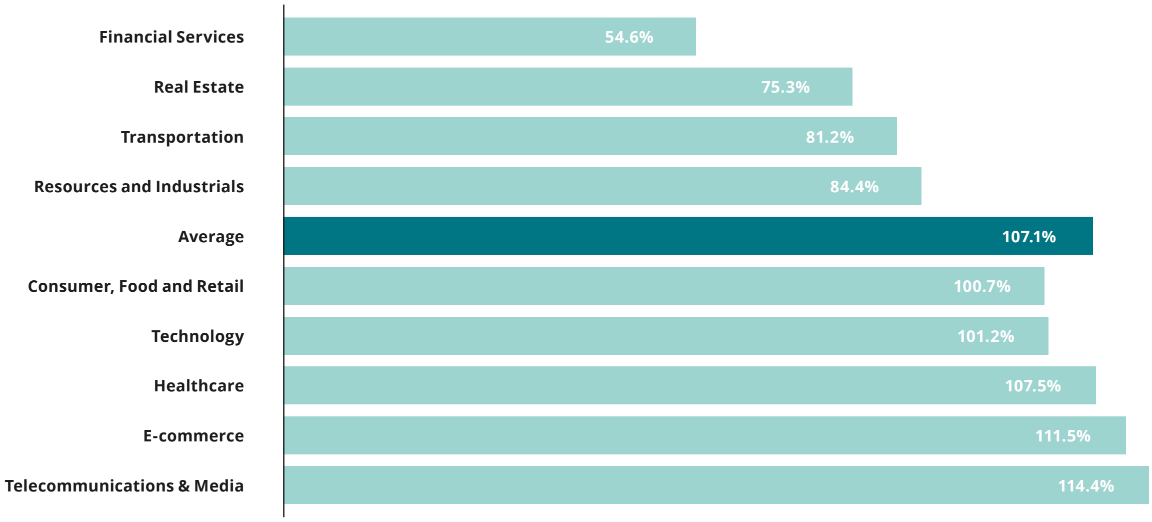
Source: S&P Capital IQ, Deloitte analysis

Source: Tadawul index, Deloitte analysis

This comparative analysis between the S&P 500 index and Tadawul highlights the similarities between the two indices and could suggest that the Saudi Arabian market is expected to follow a similar transition pattern. Such transition necessitates need to acknowledge the importance of the intangibles for the Saudi Arabian market in the years to come and to make efforts now to realise its full benefits.

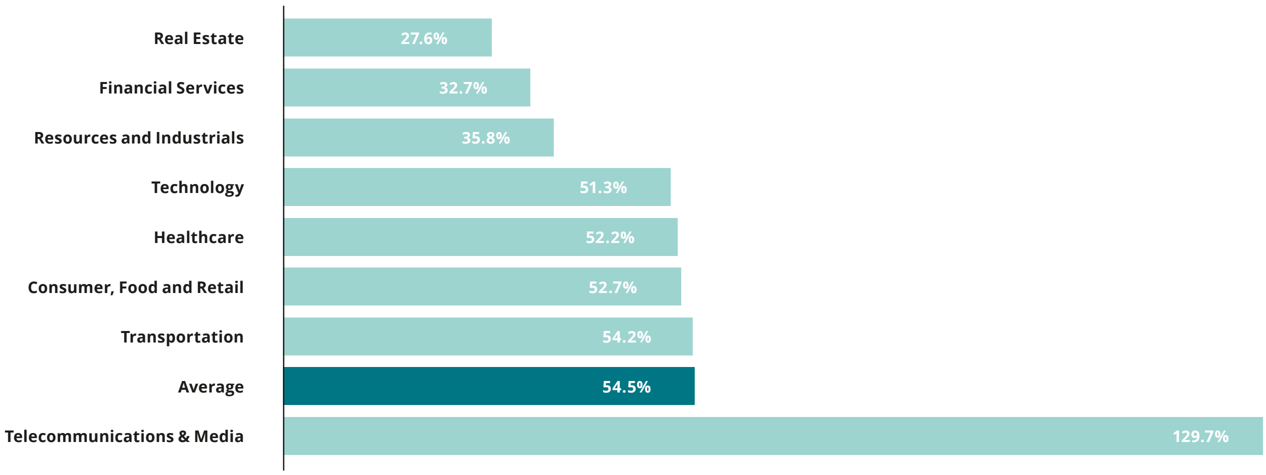
An analysis of the unrealised value, which is the difference between market capitalisation and book value of the assets on the balance sheet, of the companies on both the indices also reveal similar trends as shown in **figures 9 and 10**. The T&M sector has the highest unrealised value on both the indices, followed by Healthcare and Technology. This trend clearly indicates the importance of the intangibles to the overall value of the business and highlights the need for creating and protecting their value.

Figure 9: Average unrealised value industry wise on S&P 500



Source: S&P Capital IQ, Deloitte analysis

Figure 10: Average unrealised value industry wise on Tadawul



Source: Tadawul index, Deloitte analysis

Financial reporting requirements for intellectual property and intangible assets

Currently 166 countries have adopted IFRS, with additional countries and reporting jurisdictions either permitting or requiring IFRS compliance for domestically listed companies[7].

Under IFRS 3R, only intangible assets that have been acquired can be separately disclosed on the acquiring company's balance sheet (disclosed intangible assets). Internally generated intangibles cannot be disclosed on the balance sheet, but are often significant in value, and should be understood and managed appropriately. Through the method of recognising the target's identifiable assets (tangible and intangible), liabilities and contingent liabilities at their fair value, the acquirer should be able to determine the price of business combination as at the date of acquisition. The difference between the total of the net assets acquired and the cost of acquisition regarded as goodwill or gain on a bargain purchase[8].

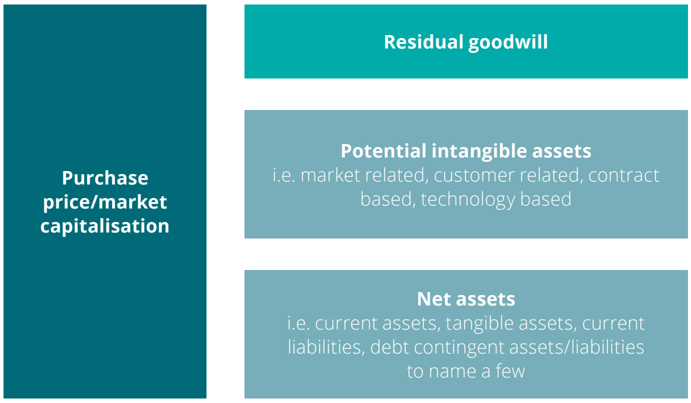
Goodwill: According to the International Accounting Standards (IAS) 22A, goodwill was amortised over its useful economic life assumed as not to exceed 20 years. However, as per IFRS 3, amortising goodwill is not permitted and is subjected to impairment testing at least once a year. The recognised goodwill should be recorded at cost less accumulated impairment charges.

Gain on a bargain purchase: When the purchase price is determined to be less than the fair value of the net assets acquired, the transaction is termed to be a gain on bargain purchase. The profit should be immediately recorded on the profit and loss account. However, as per IFRS 3, acquired identifiable assets and liabilities are required to be reassessed in terms of identification and measurement prior to concluding that negative goodwill has arisen.

As per the revised IAS 36 'Impairment of Assets', an annual impairment test is compulsory for certain assets, namely:

- Goodwill
- Intangible assets with an indefinite useful economic life and intangible assets not yet available for use

All the entities in Saudi Arabia are also required to adopt IFRS for their financial reporting and prepare IFRS compliant financial statements.



"With the importance of intangible assets in today's economies, the need for valuation standards becomes crucial. TAQEEM built a robust infrastructure for the valuation of intangible assets and adopted the internationally recognised standards set by the International Valuation Standards Council, which results in promoting transparency and confidence in Saudi Arabia's economy. This will contribute to achieving the financial sector development program that is vital to Vision 2030 realization."

Sultan Aljorais
Secretary General
TAQEEM

[7] https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/#filing

[8] Global Intangible Finance Tracker 2017

Purchase price allocation trends

Purchase Price Allocation (PPA) is an application of goodwill accounting whereby one company, when acquiring another, allocates the purchase price into various assets and liabilities acquired from the transaction.

A PPA is primarily used for accounting purposes, but it also provides a useful analysis of the components that make up goodwill. Prior to this practice, the purchase price was allocated to all of the tangible net assets such as working capital and equipment, with the remainder allocated entirely to goodwill. In a PPA, an analysis and valuation of the identifiable intangible assets must be performed. Examples of identifiable intangibles may include customer/supplier relationships, brand names, patents and trademarks.

Although a PPA is performed post-acquisition primarily as an accounting exercise, it could be used prior to selling a business that does not have significant tangible net assets. The analysis can be presented to the buyer in order to justify a significant goodwill balance by valuing all of the identifiable intangible assets within the business.

Houlihan Lokey Inc., an American investment bank, conducts an annual PPA study in the North American region based on the transactions involving publicly listed companies in the USA[9]. As per their analysis over a five-year period from 2012 to 2017 (historical period), it is concluded that the count of transactions declined by a Compounded Annual Growth Rate (CAGR) of 4% in the historical period as summarised in **table 1**.

Six of the nine industries experienced a negative CAGR in the number of transactions. Aerospace, defence and government sectors had the highest growth of 18.5% in terms of number of transactions, while financial institutions witnessed a decline of 17.8% during the historical period.

Table 1: Recent transactions in the North American region

Industries	Count						
	2012	2013	2014	2015	2016	2017	*CAGR*
All industries	**507**	**422**	**534**	**563**	**455**	**404**	**-4.4%**
Aerospace, defence and government	9	6	12	18	26	21	18.5%
Retail	67	71	95	80	74	86	5.1%
E&R	28	12	24	18	8	19	-7.5%
Financial institutions	56	55	89	86	65	21	-17.8%
Healthcare	75	80	72	112	91	62	-3.7%
Industrials	99	62	65	67	48	54	-11.4%
Infrastructure services and materials	12	18	18	29	20	18	8.4%
Technology	153	111	154	145	116	117	-5.2%
T&M	8	7	5	8	7	6	-5.6%

Source: Houlihan Lokey Industry Reports for respective years – https://hl.com/

9 Houlihan Lokey Industry Reports – https://hl.com/

As noted in **Table 2**, financial institutions recorded the largest percentage increase of 76.2% for purchase consideration (PC) allocated to identifiable intangible assets and goodwill over the historical period. While the ER&I sector witnessed the largest decline of 8.8% for purchase price allocated to identifiable intangible assets.

Table 2: Intangible assets as a percentage of PC

Industries	Intangible assets as a percentage of PC (median values)						
	2012	2013	2014	2015	2016	2017	*CAGR*
All industries	**30%**	**31%**	**28%**	**31%**	**33%**	**35%**	**3.1%**
Aerospace, defence and government	17%	20%	23%	33%	29%	37%	16.8%
Retail	30%	34%	27%	32%	36%	37%	4.3%
E&R	19%	31%	20%	21%	30%	12%	-8.8%
Financial institutions	1%	2%	1%	1%	1%	17%	76.2%
Healthcare	40%	43%	43%	42%	50%	39%	-0.5%
Industrials	27%	36%	32%	32%	33%	33%	4.1%
Infrastructure services and materials	22%	21%	21%	26%	28%	36%	10.4%
Technology	35%	33%	33%	36%	35%	35%	0.0%
T&M	30%	49%	4%	37%	48%	28%	-1.4%

Source: Houlihan Lokey Industry Reports for respective years – https://hl.com/

Table 3 shows the percentage of goodwill recorded as a percentage of PC. Financial institutions recorded the highest goodwill as a percentage of PC at 12.9%, followed by T&M sector at 8.2% during the historical period. Industrials sector showed a decline of 1.1% during the historical period.

Table 3: Goodwill as a percentage of PC

Industries	Goodwill as a percentage of PC (median values)						
	2012	2013	2014	2015	2016	2017	*CAGR*
All industries	**39%**	**35%**	**39%**	**38%**	**36%**	**40%**	**0.5%**
Aerospace, defence and government	45%	33%	52%	43%	37%	42%	-1.4%
Retail	32%	27%	33%	38%	35%	33%	0.6%
E&R	28%	30%	28%	27%	34%	30%	1.4%
Financial institutions	6%	5%	6%	6%	5%	11%	12.9%
Healthcare	42%	36%	41%	41%	37%	41%	-0.5%
Industrials	36%	42%	40%	36%	45%	34%	-1.1%
Infrastructure services and materials	28%	21%	24%	32%	28%	37%	5.7%
Technology	49%	55%	54%	52%	50%	49%	0.0%
T&M	27%	23%	30%	47%	22%	40%	8.2%

Source: Houlihan Lokey Industry Reports for respective years – https://hl.com/

As seen in **table 4**, developed technology, In-Process Research and Development (IPR&D), trademarks and trade names and customer-related assets were the commonly identified intangible assets. Trademarks and tradenames recorded the highest increase in frequency of identification during the historical period, as compared to IPR&D which was at the lowest.

Table 4: Frequently recognised intangible assets

Frequently identified intangible assets	Count (percentage of sample)						
	2012	2013	2014	2015	2016	2017	*CAGR*
Developed technology	44%	49%	40%	44%	49%	51%	3.0%
IPR&D	14%	11%	7%	10%	12%	7%	-12.9%
Customer-related assets	57%	61%	59%	69%	69%	79%	6.7%
Trademarks and trade names	45%	48%	45%	50%	49%	65%	7.6%

Source: Houlihan Lokey Industry Reports for respective years – https://hl.com/

Table 5 shows the PC allocation to intangible assets, where customer-related assets show the highest increase over the historical period. The allocation to IPR&D was reduced by 10.6% CAGR in the historical period. Trademarks and tradenames remained almost constant and developed technology also reduced by 4.7%.

Table 5: Intangible assets as a percentage of PC

Frequently identified intangible assets	Median percentage of PC						
	2012	2013	2014	2015	2016	2017	*CAGR*
Developed technology	14%	14%	9%	12%	11%	11%	-4.7%
IPR&D	7%	15%	6%	15%	6%	4%	-10.6%
Customer-related assets	14%	11%	14%	18%	18%	19%	6.3%
Trademarks and trade names	3%	3%	4%	4%	4%	3%	0.0%

Source: Houlihan Lokey Industry Reports for respective years – https://hl.com/

Case study:
Role of intangibles in mergers and acquisitions

M&A transactions in T&M Sector

Over the years, the number of T&M companies listed on the S&P 500 index have more or less remained the same. As observed in **table 6**, T&M companies such as Verizon, AT&T and Comcast have been the top players in terms of their market capitalisation.

Table 6: Market capitalisation for T&M companies on S&P 500

Companies listed on S&P 500	Market Capitalisation in USD m				
	1999	2004	2009	2014	2019
Verizon Communications Inc.	95,593.4	112,170.5	92,764.0	194,124.1	253,937.2
AT&T Inc.	166,304.8	85,438.2	165,405.0	174,231.3	285,479.4
Comcast Corporation	35,836.4	73,773.2	48,130.0	149,451.0	204,579.8
The Walt Disney Company	60,428.8	56,803.3	60,146.6	159,719.0	260,680.9
TEGNA Inc.	22,737.3	20,854.0	-	-	-
Omnicom Group Inc.	17,744.6	15,711.1	12,185.1	19,226.5	-
The Interpublic Group of Companies, Inc.	16,190.1	5,666.7	-	-	-
The New York Times Company	8,412.9	5,919.0	-	-	-
CenturyLink, Inc.	6,617.3	4,773.2	10,773.4	22,588.5	-
Meredith Corporation	2,151.9	-	-	-	-
eBay Inc.	-	77,122.8	-	-	29,376.4
Electronic Arts Inc.	-	18,832.9	-	-	31,390.7
Alphabet Inc.	-	-	196,701.3	358,536.7	922,946.3
Facebook, Inc.	-	-	-	217,507.9	585,321.0
Netflix, Inc.	-	-	-	20,580.8	141,805.0
Discovery, Inc.	-	-	-	21,418.8	-
Charter Communications, Inc.	-	-	-	-	104,185.5
T-Mobile US, Inc.	-	-	-	-	67,094.2
Activision Blizzard, Inc.	-	-	-	-	45,650.0
Twitter, Inc.	-	-	-	-	24,834.2

Source: S&P Capital IQ, Deloitte analysis

Below is a summary of a few transactions from Figure 13 above, along with details on acquisitions made by Saudi Telecom Company (STC).[10]

AT&T – Bell South
In 2006, AT&T acquired Bell South for a purchase consideration of USD 66.8bn making it one of the largest deals in the history of T&M sector. As a result of the deal, AT&T recognised approximately USD 10.2bn of intangible assets and USD 24.9bn goodwill. The intangible assets were primarily related to existing customer relationships, brand name and license costs.

In this acquisition, goodwill as a percentage of purchase consideration accounted for 26.3%, signalling a huge difference between the recorded goodwill in the books of AT&T prior to the acquisition which was around USD 7.7bn (30 September 2006).

Charter Communications – Time Warner Cable
In May 2016, Charter Communications acquired Time Warner Cable for a purchase consideration of USD 60.5bn, making it the third largest M&A deal in 2016. As a result of the transaction, Charter Communications assumed net liabilities to the tune of USD 35.3bn and recognised intangibles and goodwill of approximately USD 67.5bn and USD 28.3bn respectively. The newly recognised intangible assets were primarily related to existing Time Warner Cable franchise agreements and the company's existing customer relationships.

Cable One – Clearwave Communications
In November 2018, Cable One acquired Clearwave Communications, for a purchase consideration of USD 358.8m. The deal resulted in USD 90.0m of newly recognised intangible assets, majorly in the form of customer relationships and brand name. The goodwill recognised was USD 183m, which accounted for 51.3% of the purchase consideration.

Regional transactions

Acquisitions by STC
Saudi Telecom Company is the largest T&M player in Saudi Arabia. They are in the business of mobile, landline, internet, TV on demand services, international telecommunication, broadband and other related services. In past eight years, STC has made a number of acquisitions in the fields of technology, software, wireless technology and retail stores for mobile connections.[11] Acquisition of Axis Telekom Indonesia in 2011 is a prominent acquisition. The company acquired licenses for Saudi Arabian Riyal (SAR) 229m, trademarks and contractual relations for SAR 27m, and goodwill for SAR 405m.

Date	Role of STC	Target company	Transaction (USD m) size
Jan-20	Buyer	Vodafone Egypt	2390
Jan-17	Buyer	Sale Advanced	106.6
Jan-16	Buyer	Kuwait Telecommunications Company K.S.C.P.	662.6
Jan-14	Buyer	Public Telecommunications Company Ltd.	-
Mar-14	Seller	PT. Axis Telekom Indonesia	865.0
Dec-11	Buyer	Cell Communications and Distribution Ltd.	55.5
Dec-11	Buyer	Intigral	24.0
Apr-11	Buyer	PT Natrindo Telepon Seluler (nka:PT. Axis Telekom Indonesia)	-

Source: S&P Capital IQ, Deloitte analysis

Uber - Careem
In January 2020, Uber acquired Middle East based start-up Careem Networks FZ-LLC for USD 3.1bn. The details on intangibles and goodwill for this is limited as this is a recent transaction.

10 Global Intangible Finance Tracker 2017

11 S&P Capital IQ

Amazon.com - Souq.com FZ-LLC
Amazon.com (Amazon) is involved in the retail sale of consumer products and subscriptions globally. The company is also engaged in manufacturing electronic devices for home and personal use, apart from providing internet content services. In 2017, Amazon acquired Souq.com for USD 672m.[14] Souq.com provides small and medium enterprises, merchants, brands, and distributors an online platform to sell their products. The total intangibles acquired were of USD 250m:

- Customer relationship for USD 48m
- Tradename for USD 62m
- Technology for USD 108m
- Contracts for USD 32m
- Goodwill for USD 425m

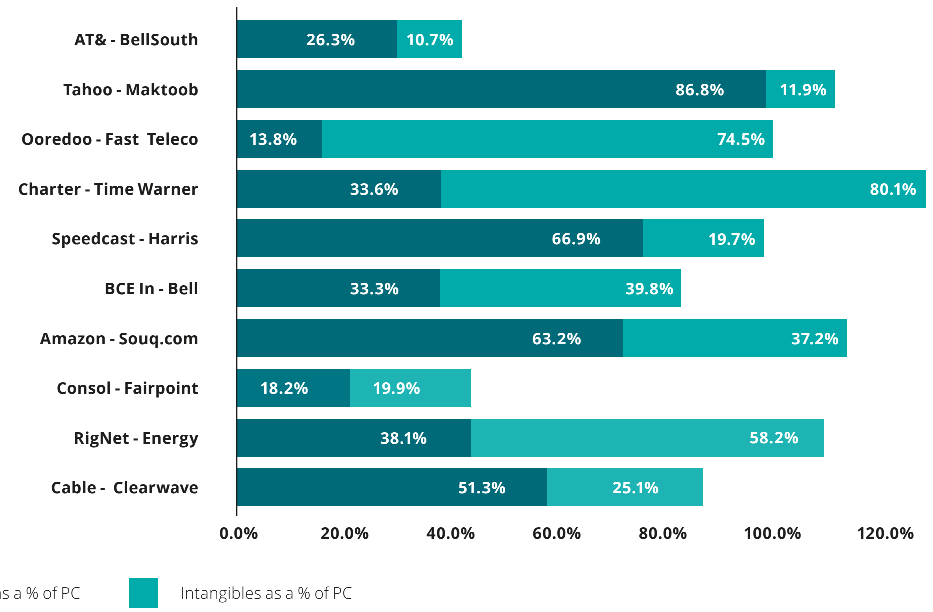
Net liabilities of USD 3m were assumed by Amazon as part of the transactions. The goodwill formed a significant part of the purchase price, accounting for 63.2% of the total purchase consideration and the intangibles accounting for 37.2%.

Yahoo – Maktoob.com
In 2009, Yahoo acquired Maktoob.com, a UAE based online portal that offered services including search, payments, social network and auctions for USD 164.4m.

The total identified intangibles of USD 19.4m were customer relationships for USD 1.9m, brand for USD 4.4m, technology for USD 13.1m and goodwill for USD 142m. The goodwill formed a major part of the purchase price, accounting for 86.8% of the total purchase consideration and the intangibles accounting for 11.9%.[13]

Figure 11 summarises the allocation of goodwill and intangibles as a percentage of PC for the transactions discussed above. Two regional transactions, Yahoo's acquisition of Maktoob and Amazon's acquisition of Souq.com, resulted in the highest Goodwill at 86.8% and 63.2% of the PC.

Figure 11: Goodwill and Intangibles as a percentage of PC

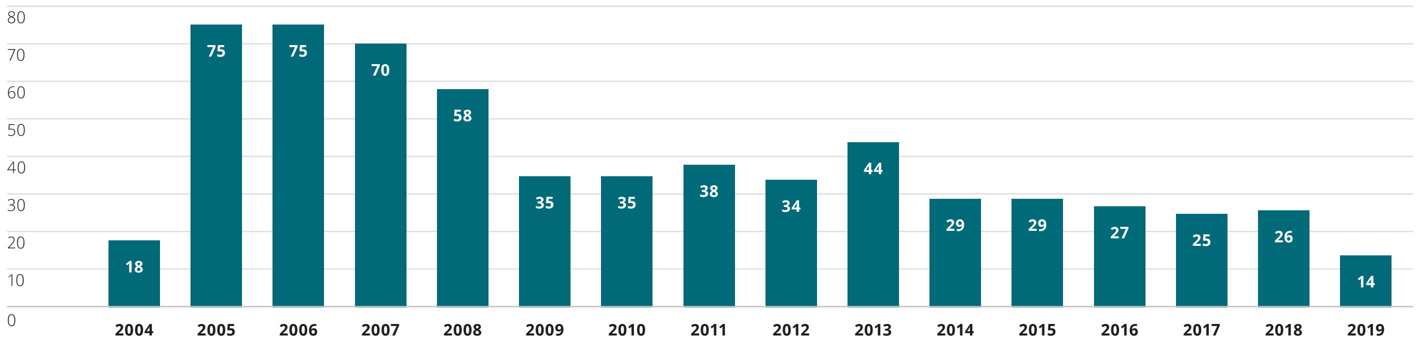


12 S&P Capital IQ and company filings

13 S&P Capital IQ and company filings

With the increase in M&A activity across the globe, the T&M companies are expanding their presence by acquiring licenses and/or other T&M companies. T&M also accounts for the highest intangible value reporting. They have the highest proportion of intangibles to tangibles. However, **figure 12** shows there is a declining trend speci ically in the United States and Canada over the last 15 years regarding the number of transactions in the T&M sector.

Figure 12: Number of transactions in the T&M sector



Source: S&P Capital IQ, Deloitte analysis

Table 7 summarises some of the major transactions in the T&M sector in recent years along with the details of the allocation of PC to the goodwill and identified intangible asset acquired.

Table 7: Market capitalisation for T&M companies on S&P 500

Transaction date	Acquirer	Target	Transaction name	Effective PC	Reported goodwill	Total Intangibles	Goodwill as a % of PC	Intangibles as a % of PC
Nov-18	Cable One, Inc.	Delta Communications	Cable - Clearwave	356.9	183.2	89.7	51.3%	25.1%
Jul-17	RigNet, Inc.	Energy Satellite Services	RigNet- Energy	22.2	8.5	12.9	38.1%	58.2%
Jul-17	Consolidated Communications Holdings	Fairpoint Communications, Inc.	Consol- Fairpoint	1,526.1	278.4	303.2	18.2%	19.9%
Mar-17	BCE	Bell MTS	BCE - Bell	3,921.0	1,307.0	1,561.0	33.3%	39.8%
Nov-16	Speedcast International Ltd.	Harris CapRock Communications	Speedcast - Harris	415.9	278.1	81.8	66.9%	19.7%
May-16	Charter Communications	Spectrum Management Holding Co.	Charter- Time Warner	84,363.0	28,337.0	67,545.0	33.6%	80.1%
May-16	National Mobile Telecom Co.	Fast Telecommunications Company Kuwait	Ooredoo- Fast Teleco	14.0	1.9	10.4	13.8%	74.5%
Dec-06	AT&T	BellSouth	AT&T - BellSouth	94,568.0	24,913.0	10,160.0	26.3%	10.7%

Source: S&P Capital IQ, Company filings, & Deloitte Analysis

Intellectual Property Regulatory environment in Saudi Arabia

Sensing their growing importance, a number of steps have been taken at the government level over the last couple of years to create a regulatory environment to foster intellectual property (IP) creation. The establishment of the Saudi Authority for Intellectual Property (SAIP) is one such effort. SAIP aims to organise, support, sponsor, protect and promote IP in Saudi Arabia in accordance with global best practices. SAIP is responsible for preparing a strategy of intellectual property, ensuring its implementation post adoption, and development of work plans and timelines in coordination and cooperation with the relevant authorities[14].

The SAIP aims to make Saudi Arabia a leader of IP in the Middle East and North Africa regions, through the stimulation of the market economy by further developing the legal system of intellectual property and enhancing the level of respecting intellectual property rights[15]. Saudi Arabia adopted the unified GCC trademark law and is also a member of the GCC patent law.

For effective management of IP in Saudi Arabia, the following steps can be adhered to:

- An overall strategy should be in place, in order to protect IP rights.
- It is recommended that there should be awareness regarding the availability and scope of protection for IP rights in Saudi Arabia, since IP laws differ from country to country.
- For the IP laws to be enforced, it is compulsory that the rights are registered in Saudi Arabia, under local laws.
- In addition, rights such as trademark registration or patents filed in other countries would not be applicable in Saudi Arabia[16].

Importance of intangibles in M&A in the GCC region

"Historically, enterprises would typically only formally calculate the value of brands and trade names for post-acquisition accounting, which requires the valuation of the intangible assets of a purchased business. Recently, we find ourselves working more and more with enterprises in assisting them to determine the value associated with their internally generated intangible assets for strategic planning purposes. We find that when clients quantify the value of these existing assets they reveal intriguing characteristics they had not previously observed."

Doug Eastman
Director, Intangibles specialist
Deloitte UK

The same sentiment is echoed by Mohammad Araj, Director, Financial Advisory, Deloitte Middle East and an Accredited Member of TAQEEM, in a recent TAQEEM podcast:

"Another point worth mentioning is that we are seeing an increased number of stakeholders from within the GCC requesting for a pre-transaction purchase price allocation analysis, some of which we have worked with in Saudi Arabia. That is a clear indication that investors are interested to know beforehand what they are paying for and in understanding the value of the intangibles in their target companies. This would provide a justification for any premium paid over and above the proposed purchase price."

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14 https://www.saip.gov.sa

15 https://www.saip.gov.sa

16 https://www.export.gov/article?id=Saudi-Arabia-Protecting-Intellectual-Property

Create, grow and protect

As demonstrated throughout the paper, there is a growing inclination towards intangible assets becoming essential for value creation and protection processes for present and future organisations by introducing a requirement to create, grow and protect the intangible assets and IP[17].

The recommended method for value creation is effective and efficient management of intangible assets. In the past thirty years, the intangibles of S&P 500 index companies have grown three times in value; earlier, intangible assets were only 20% of an organisation's total value, whereas now the intangibles make up over 50% of the total market value of companies. Companies in industries such as advertising, technology, pharmaceuticals or personal care have intangibles forming up to 80% of their organisation's total value.

The business environment has developed with a focus on the strategic importance of intangible assets for value creation and management. The companies are required to transform themselves through effective management of intangible assets with an aim to attract investment, retain customers and talent and achieve superior level of satisfaction, loyalty and trust.

With the Saudi Arabian economy having an increasing number of intangible assets driven businesses, management of intangible assets become essential. While each business will have its own characteristics and stages of developing to protecting its intangibles, the following could be considered a broad guideline of a three stage approach for managing intangibles:

- **Initial stage (diagnosis and measurement)**: Identifying the assets and evaluating them. It is noted that 52% of companies do not progress further.
- **Control stage (involvement and value creation)**: Involvement of key members of the organisation on management of intangibles and associating non-financial indicators with business results for the purpose of value creation. 45% of companies develop to this stage.
- **Advanced stage (differentiation)**: Developing differentiating strategies and leveraging on the intangibles, can be integrated into business. 3% of companies reach this stage[18].

It is pertinent to emphasise that the wave of change is coming and it is of utmost importance that organisations as well as the market regulators in Saudi Arabia be prepared for their maximum benefit.

[17] Global Intangible Finance Tracker 2017

[18] Global Intangible Finance Tracker 2017

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Glossary

Historical Period	FY 2012 to FY 2017
Amazon	Amazon.com
Aramco	Saudi Arabian Oil Company
bn	Billion
CAGR	Compounded Annual Growth Rate
CFO	Chief Financial Officer
ER&I	Energy, Resources and Industrials
GDP	Gross Domestic Product
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IP	Intellectual Property
IPR&D	In-Process Research and Development
IPO	Initial Public Offer
IT	Information Technology
M	Million
M&A	Mergers and Acquisitions
MSCI	Morgan Stanley Capital International Index
NGL	Natural Gas Liquids
NSIPW	National Strategy of Intellectual Property Work
PC	Purchase Consideration
R&D	Research and Development
Retail	Consumer, Food and Retail
S&P 500	Standard and Poor's 500 index
SAIP	Saudi Authority for Intellectual Property
SAR	Saudi Arabian Riyal
T&M	Telecommunications and Media
USD	United States Dollar

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