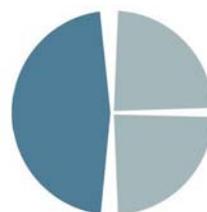


International IFRS 3

An Analysis of the International Application of IFRS 3, Business Combinations

August 2008

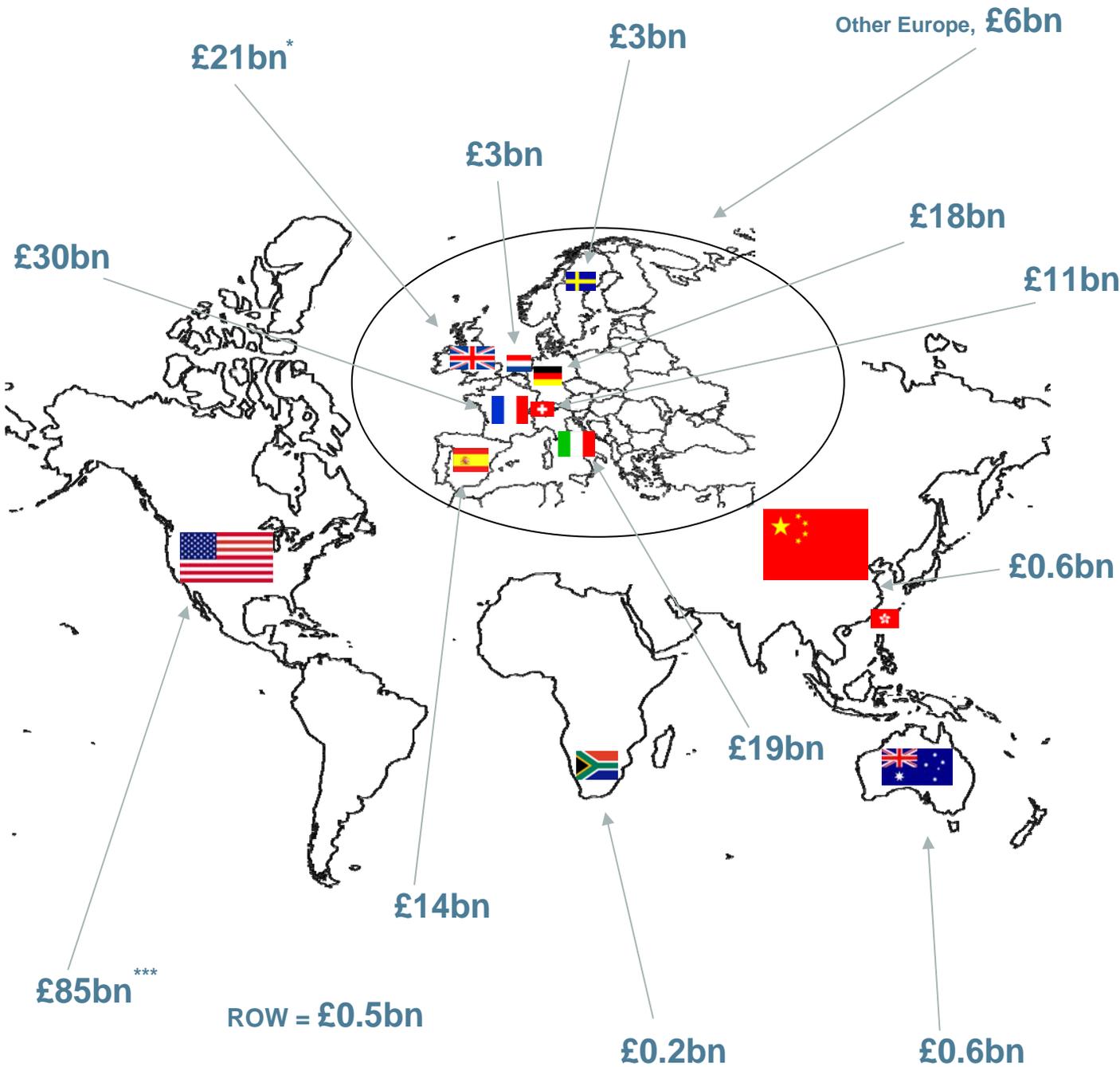


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BUSINESS

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1. Highlights

Annual Goodwill Allocation from FT Global 500 = **£210bn**



* Source: 'IFRS 3: The First Year', Intangible Business

** Source: 'SFAS 141: The First 5 Years', Intangible Business

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| | UK <small>(FTSE 100, 2006)</small> | US <small>(S&P 100, 2001 – 2007, under SFAS 141)</small> | ROW <small>(FT Global 500 who report under IFRS outside UK)</small> |
|---|--|--|---|
| • Amount spent on acquisitions | £40bn | £516bn | £226bn |
| • Number of acquisitions | 87 | 212 | 118 |
| • Average acquisition value | £0.5bn | £2.4bn | £1.9bn |
| • Total allocation to tangible assets | 17%, £6bn | 24% £126bn | 21% £48bn |
| • Total allocation to goodwill | 53% £21bn | 48% £245bn | 47% £105bn |
| • Total allocation to identifiable intangible assets | 30% £12bn | 28% £145bn | 32% £73bn |
| • Proportion of intangible value attributed to goodwill | 63% | 65% | 68% |
| • The sector allocating the least to identifiable intangibles | Technology | Financial | Financial |
| • The sector allocating the most to identifiable intangibles | Financial | Media | Media |

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International IFRS 3

2. Introduction

Previous studies from Intangible Business looked at how IFRS 3 had been applied in the UK by the FTSE 100 and how its equivalent, SFAS 141, was applied in the US by the S&P100. We found that the standards were not being adhered to fully, allocating too much to inadequately explained goodwill and not enough to identifiable intangible assets, with many disturbing examples of how the standards were being ignored.

This new report compares this with how IFRS 3 has been implemented across the rest of the world (ROW) by companies in the FT Global 500, who report under IFRS. The aim was to find if there are any difference between the world's many regions and countries and if so, what lessons could be learnt.

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3. Methodology

This study is based on the annual reports of FT Global 500 companies, which report under IFRS and are based outside the UK. This includes companies in all European Union countries, Australia, Hong Kong & China, South Africa and Switzerland. We reviewed the most recent annual reports of all the companies and analysed their reporting of significant business combinations, from both the current and the prior year.

Intangible Business is a leading international independent intangible asset valuation consultancy. Valuing intangible assets has been the focus of our activities for the past eight years, during which time we have valued some of the world's biggest intangible assets for management, financial and legal purposes. Using this experience and skill, we have reviewed this analysis at an overall level, and at the level of individual transactions.

In this report we have used the following terms:

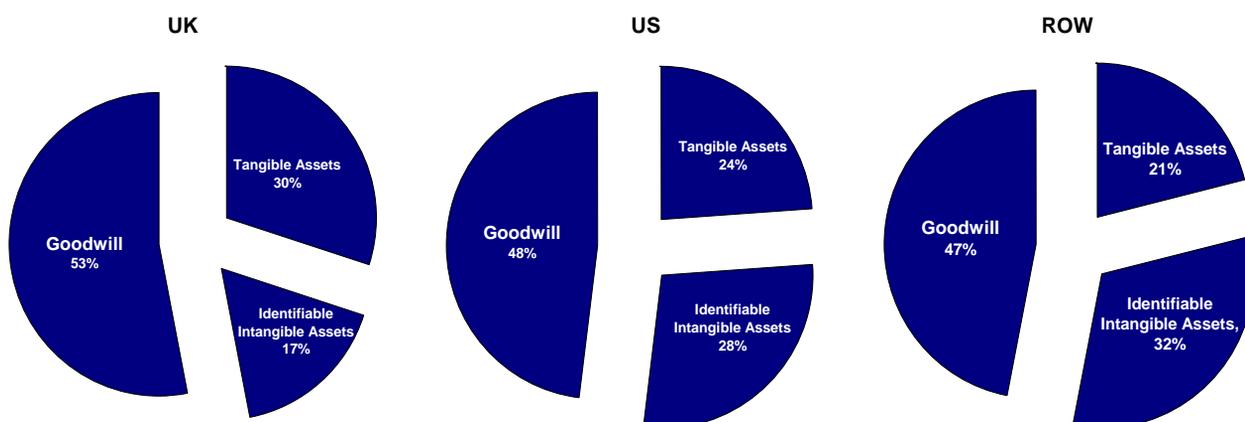
- **Purchase Price Allocation (PPA):** the allocation of the cost of an acquisition to the fair values of the underlying assets and liabilities both tangible and intangible.
- **Identifiable Intangible Assets:** an identifiable non-monetary asset without physical substance.
- **Goodwill:** future economic benefits arising from assets that are not capable of being individually identified and separately assessed.
- **Total Intangible Assets:** the total value of identifiable intangibles and goodwill.

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4. Summary

Total Asset Allocation

We analysed 118 business combinations in the Rest of World (ROW) category, worth a total of £226 billion at current exchange rates, from a total of 154 companies. Net tangible assets totalled £48 billion (21%), with total intangible assets of £178 billion. Of this, £73 billion (32%) was identifiable intangible assets and £105 billion (47%) was goodwill.



Goodwill Disclosure

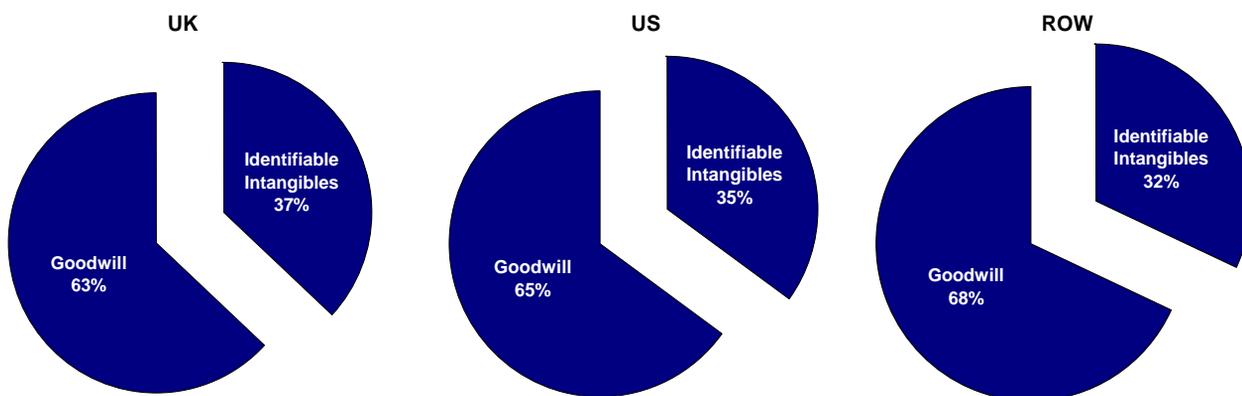
Unlike USGAAP currently (although this is changing when SFAS141R comes into force in 2009) companies reporting under IFRS are required to disclose the nature of the intangible assets comprising goodwill and explain why they cannot be valued separately. 53% of companies in the ROW failed to describe the acquired goodwill (totaling £57 billion) at all, and a further 16% made only a limited attempt (for goodwill of £13 billion). Less than one third made what we would consider to be a reasonable attempt to explain the nature of goodwill (worth £34 billion) to their shareholders.



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Identifiable Intangible Assets

We believe that the level of identifiable intangible assets as a proportion of the total, including goodwill, and taking account of the sector in which each company operates, is a good indicator of the adequacy of the valuation process. While there are companies for whom this proportion seems reasonable, the overall position in the ROW is too low with an average of only 32% of intangibles identified, leaving 68% in goodwill.



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5. Key Findings

Reported Values

The totals reported by asset category by year, together with the percentage split between identifiable intangible assets and goodwill, are summarized in the table below:

| | UK | US | ROW |
|--|-----|-----|-----|
| No. of business combinations | 87 | 212 | 118 |
| Reported value in £'bn | | | |
| Identified intangible assets | 11 | 145 | 73 |
| Goodwill | 19 | 245 | 105 |
| Total intangible assets | 30 | 390 | 178 |
| Net tangible assets | 6 | 126 | 48 |
| Total consideration | 36 | 516 | 226 |
| Average percentage split of total intangible assets | | | |
| Identified intangible assets | 37% | 35% | 32% |
| Goodwill | 63% | 65% | 68% |

Goodwill is too High

In common with our findings for UK and US companies, we believe that there is a widespread tendency to understate the value of identifiable intangible assets through a failure to identify assets separately at all and undervaluing those that are identified. In addition, there is likely to be an element of goodwill that relates to overpayment for acquisitions, although it may be some time before it becomes apparent when this has happened in specific cases. However, readers of the reports do not have sufficient information to form a view on this.

Disclosure of the Classes of Identifiable Intangible Assets

This group of IFRS reports is similar to UK and US companies in their diligence in reporting the classes of acquired identifiable intangible assets, with over 38% of all companies failing to provide any breakdown of the nature of identifiable intangible assets, than is the case with UK and US companies (44% and 35% respectively).

International IFRS 3

6. Reporting by Country

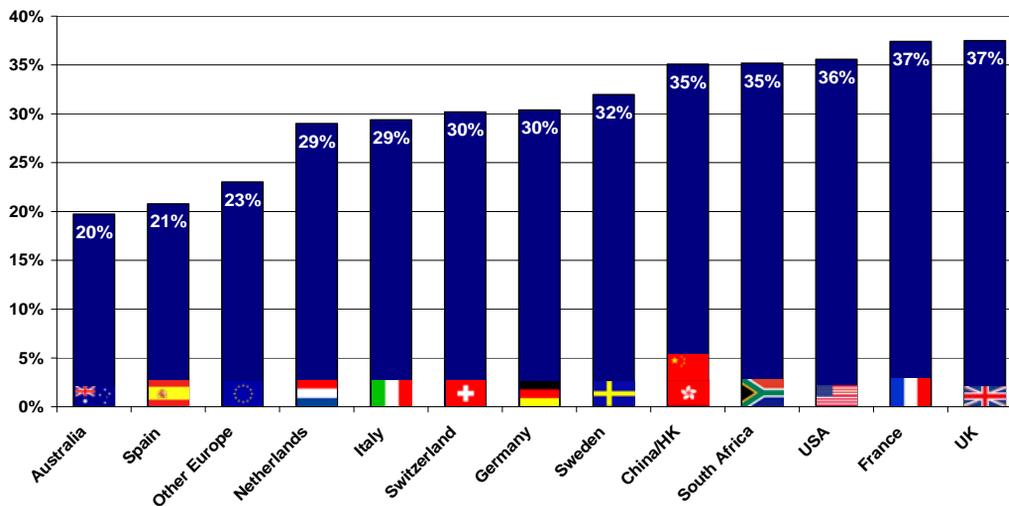
Our sample of companies reporting acquisitions came from eighteen countries across the world. We analysed significant numbers of acquisitions by companies in France (30), Switzerland (20), Germany (16), Netherlands (10), Sweden (8) Italy (5), Australia (4), Spain (3), South Africa (3). To these we have aggregated the data for China/ Hong Kong (6) and Other Europe (18). We have also included the results of our earlier research on UK (87) and US (212) reported acquisitions.

In terms of the simple average of identifiable intangible assets as a percentage of total intangible assets including goodwill, the first thing to note is that the figures are disappointingly low in all markets. At a country level, the spread is wide, ranging from 20% in Australia to 37% in the UK. This obviously means that the average percentage described as goodwill is in the range between 63% in the UK to 80% in Australia.

While the average for Chinese companies is 35%, a quarter of them reported no identifiable intangibles at all, while the top quartile reported at least 61%. In most countries, at least one company was able to identify 100% of acquired intangibles but in Australia and Italy, the highest percentages reported were 35% and 38% respectively.

“...Australia allocated the least amount to identifiable intangible assets.”

Reporting of Identifiable Intangible Assets by Country

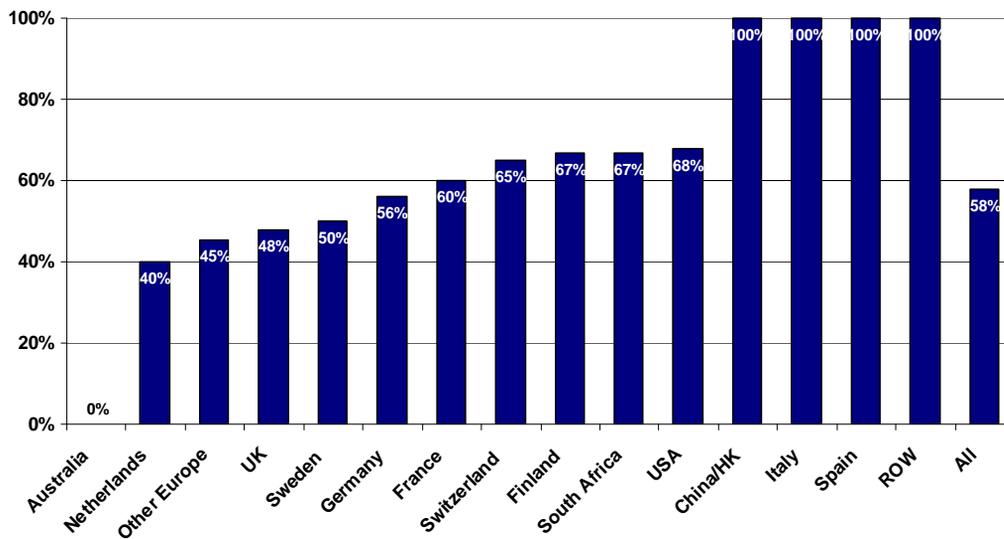


“...The UK reported the most to identifiable intangible assets.”

International IFRS 3

When we looked at the adequacy of reporting of identifiable intangible assets by asset class, again there are significant variations by country (see chart below). None of the four Australian reports disclosed asset classes at all, as did fewer than half of UK reports. The average across all countries is only 58% but companies in China, Italy and Spain all disclosed asset classes adequately.

Disclosure of Intangible Asset Classes by Country

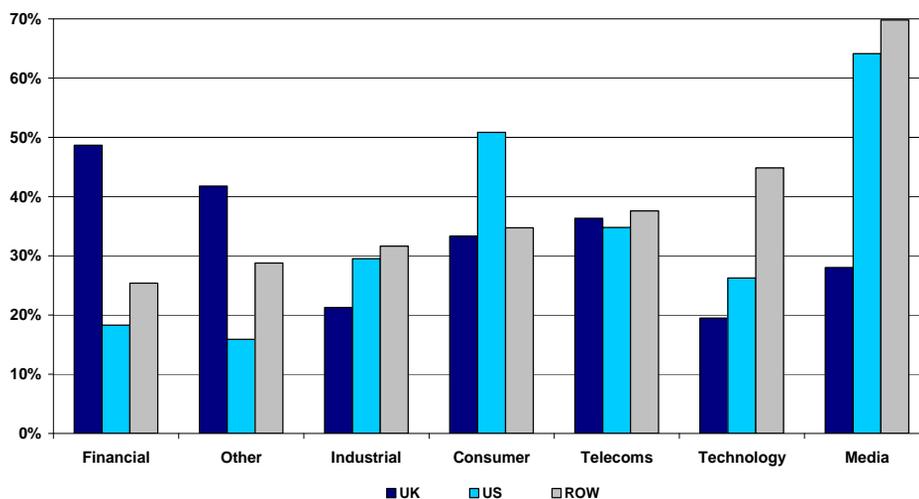


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7. Reporting by Sector

We analysed the extent to which intangibles were identified separately from goodwill by sector, as a percentage of total intangibles. The average levels of identifiable intangibles are generally lower, and goodwill higher, than we would expect in all sectors except Media, the only sector averaging over 50%. The financial sector is particularly poor at 25%, and this is similar to US companies although UK financial companies did better. Among consumer goods companies, only those in the US report above 50% on average while those in the UK and other Global 500 companies are at 33% and 35% respectively.

Identifiable Intangibles by Sector

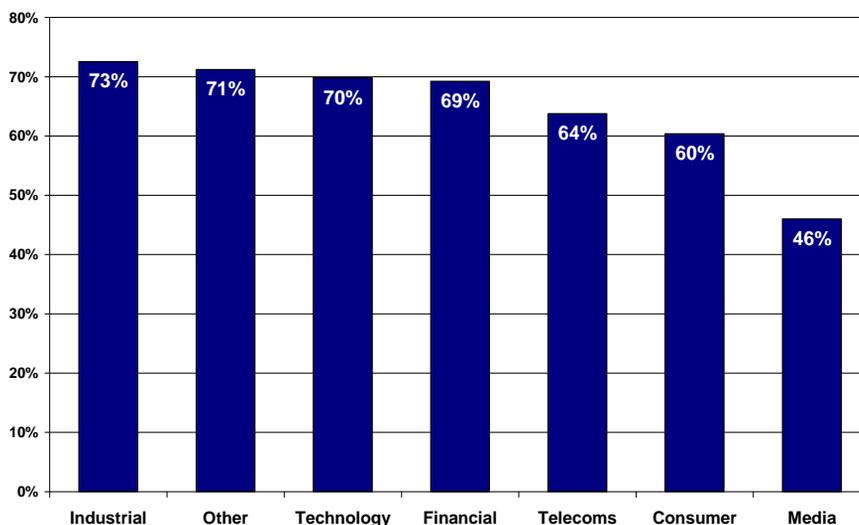


“...the Media sector allocated the highest proportion of identifiable intangible assets in the ROW category.”

“...ironically, in the ROW the Financial sector allocated the least proportion to identifiable intangible assets”

The chart below shows the total average proportion of acquisition price that is allocated to goodwill by different sectors, from the UK, US and Rest of World.

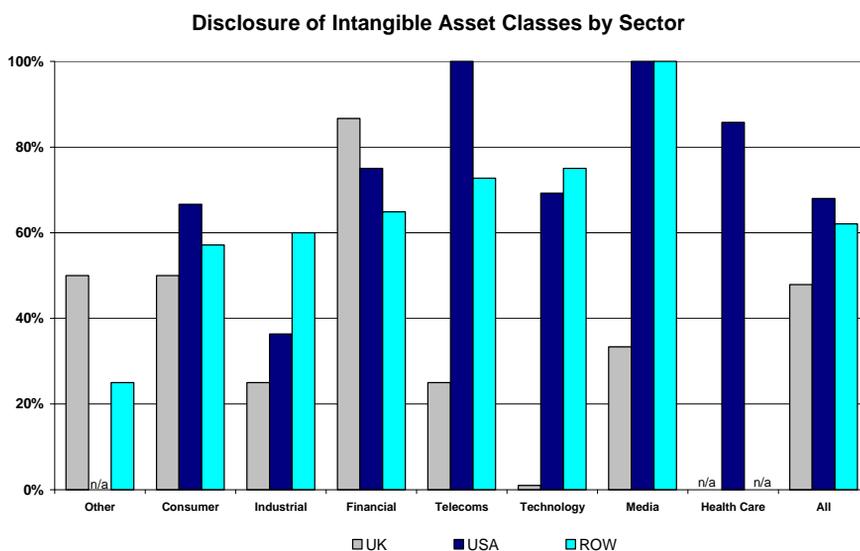
Proportion of Goodwill by Sector (International Average)



“...on average the Industrial sector allocated the most to goodwill... Media allocated the least.”

International IFRS 3

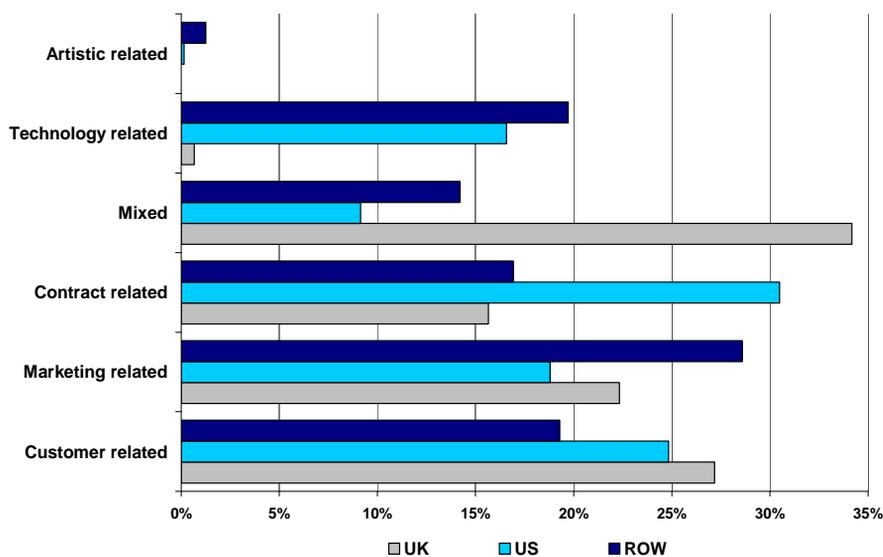
In total in the ROW category, 72 companies out of 118 (62%) adequately disclosed the classes of intangible assets acquired for individual acquisitions, as shown in the chart below. Three out of four companies in the 'other' sector failed to disclose asset classes at all, as did more than 40% of companies in the consumer and industrial sectors. Companies in the financial, telecoms and technologies sectors were more diligent in the disclosure of the classes of acquired intangible assets, with good disclosure by 65%, 73% and 75% respectively of companies in our sample. There were two acquisitions by media companies and both disclosed asset classes.



International IFRS 3

With the exception of artistic related intangible assets, there is a relatively even distribution of assets to the different intangible asset categories, with an expected leaning towards marketing related assets such as brands.

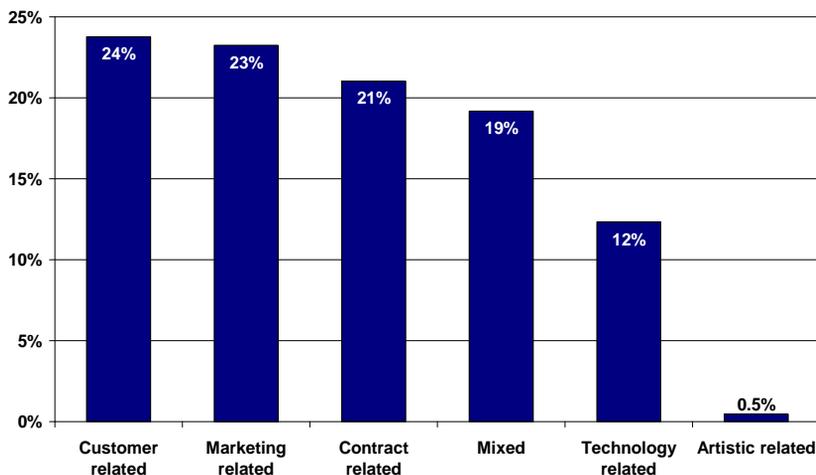
Allocation of Identifiable Intangible Assets by Category



“...most intangible assets were allocated to the Customer related category.”

On average internationally, customer related intangible assets receive the highest allocation with 24%. Marketing related intangible assets, such as brands, are the second most popular with 23%.

International Average of Identifiable Intangible Assets by Category



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IBTC CHARTERED BANK PLC
RC125097



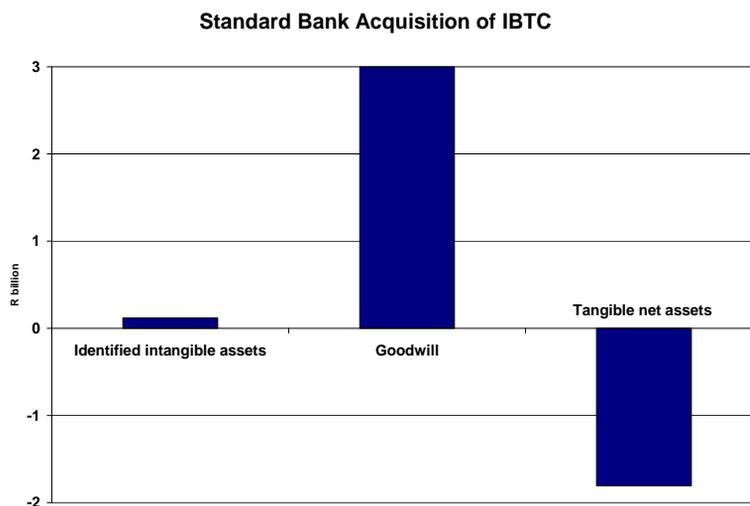
8. Examples of Inadequate Reporting

Standard Bank Acquisition of IBTC

Standard Bank of South Africa acquired the IBTC Chartered Bank in Nigeria in September 2007 for a net R1.3 billion. In its 2007 annual report, the purchase price allocation is reported on a preliminary basis with R0.1 billion of intangible assets and R3 billion of goodwill.

The absolute amount of identifiable intangibles is very low relative to goodwill and there is no breakdown of identifiable intangibles by type. After the acquisition, IBTC was merged with Standard's existing Nigerian subsidiary, Stanbic, to form Stanbic IBTC Bank so the IBTC brand was clearly of value. We would also expect significant customer related intangibles. Finally, we note that Standard Bank failed to describe the factors resulting in goodwill, as required.

"...Standard Bank kept the IBTC brand but attributed no value to it at all."



"...also, IBTC's customers were seemingly deemed worthless as no value was allocated to them. This cannot be true for a bank"

".. no description of the intangible assets that were not recognized separately from goodwill"

International IFRS 3

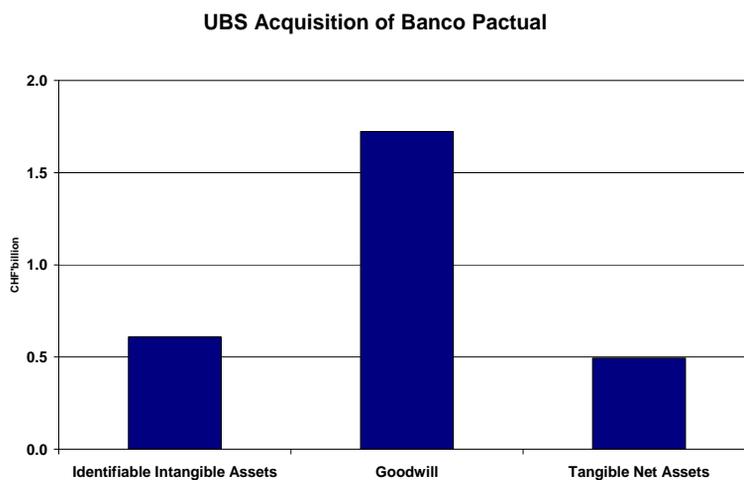


UBS Acquisition of Banco Pactual

UBS acquired Banco Pactual, based in Brazil, in December 2006 for a net CHF2.8 billion. Because of the proximity of the acquisition date to its year end, the purchase price allocation was only completed in the 2007 annual report. The total fair value of intangible assets is reported as CHF2.3 billion, of which CHF1.7 billion was goodwill. Although the note in the annual report does identify the types of intangible asset, including client relationships, favourable contracts and trademarks and trade names, the amounts allocated are not analysed.

In common with many other companies, UBS fails to describe the factors resulting in goodwill, as required.

“...there is no adequate separation of intangible assets.”



International IFRS 3



ING Acquisition of Oyak Bank

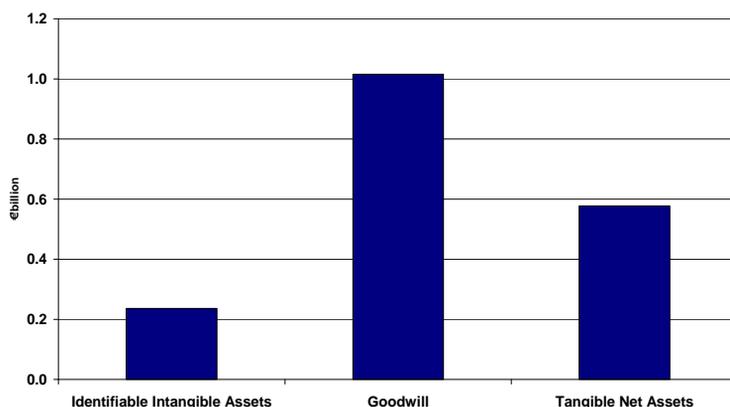
Oyak Bank, based in Turkey, was acquired by ING, the Dutch financial services company, in 2007 for €1.8 billion. Identifiable intangible assets were fair valued at €0.2 billion and goodwill at €1.0 billion.

Oyak Bank has a 3% market share in Turkey and 1.3 million retail customers, so its brand name and customer relationships have value. Interestingly, ING is rebranding under the ING brand. Nevertheless the Oyak name undoubtedly had value to other potential acquirers. The Oyak brand should have been valued and that value written off, reflecting ING's decision not to use the asset. There is no indication that any value was attributed to the brand or written off.

ING has been rather cavalier with its disclosures in the annual report. The only class of identifiable intangible asset separately reported is software, so a book value of €722 million is all reported as 'other'. There is no explanation of the reasons for acquired goodwill. Bizarrely the acquired goodwill and other intangible assets are reported on different lines in the intangible assets note, with the goodwill reported as "additions" (bought) while the other intangible assets are reported as both that and "changes in the composition of the group".

"...both the OYAK brand and its 1.3 million retail customers had little or no value, according to ING."

ING Acquisition of Oyak Bank



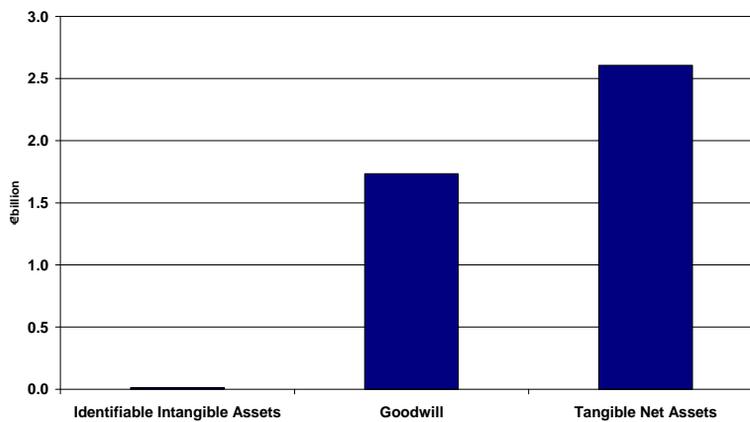
International IFRS 3




e.on Acquisition of OGK-4

The acquisition of OGK-4, a Russian power plant company, by e.on was completed in October 2007 for €4.3 billion. Of this, €1.7 billion was allocated to intangible assets, almost all of it goodwill. Identifiable intangible assets were a mere €11 million, barely half of one percent of the total, which seems implausible. e.on fails to describe the intangible assets that were not recognised separately from goodwill, as required.

e.on Acquisition of OGK-4



“...identifiable intangible assets hardly register in this €4.3 billion acquisition.”

International IFRS 3



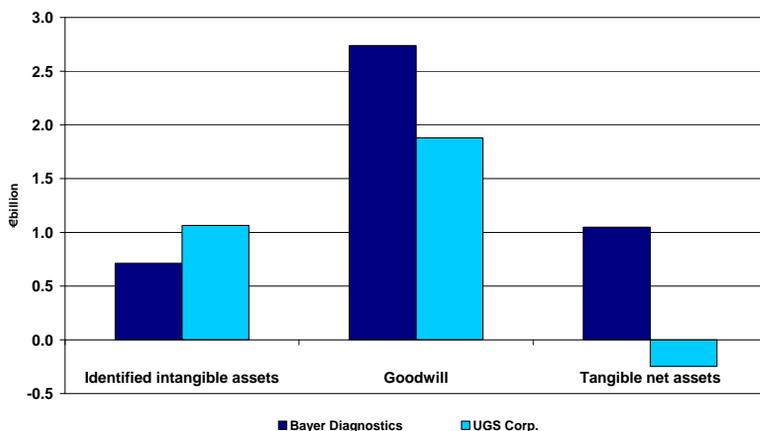
Siemens Acquisition of Bayer Diagnostics and UGS Corp.

Siemens completed two major acquisitions in the year to September 2007 with the Bayer diagnostics division, a leader in the in vitro diagnostics healthcare market, at a cost of €4.5 billion, and UGS Corp., a provider of product lifecycle software and services, for €2.7 billion, but reported them somewhat inconsistently. In the acquisitions note in the annual report, the identifiable intangible assets of the Bayer acquisition totals €0.8 billion and are split between customer relationship and trademarks and trade names. For the latter acquisition, intangible assets subject to amortisation are €1.1 billion, but no analysis into asset class is provided.

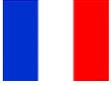
In common with many others, Siemens fails to describe the factors resulting in goodwill, as required.

“...€4.6billion of goodwill (64% of total purchase price) was not described - flouting the standard.”

Siemens Acquisitions of Bayer Diagnostics & UGS Corp.

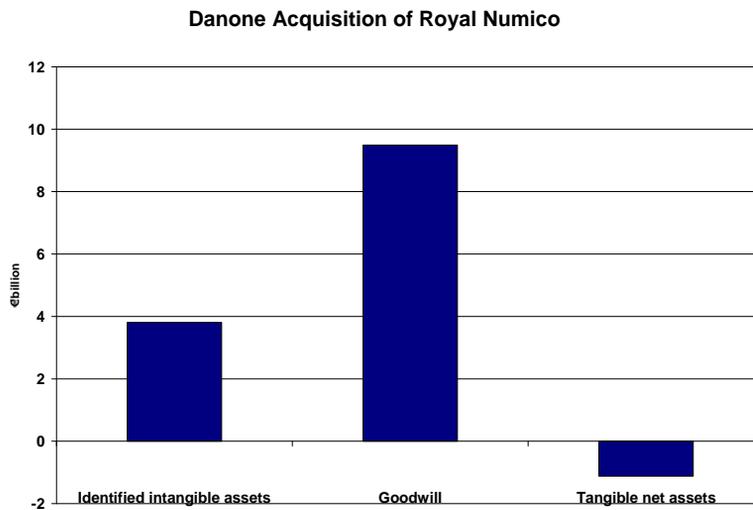


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Danone Acquisition of Royal Numico

Royal Numico is a baby food and medical nutrition producer, listed on the Amsterdam stock exchange. Danone acquired Royal Numico in October 2007 with a total acquisition cost of €12.2 billion, of which €9.5 billion was allocated to goodwill and €3.8 billion to identifiable intangible assets. At 29%, the percentage of identifiable intangible assets appears very low for a strongly branded consumer goods company. Danone does however disclose the components of goodwill fairly comprehensively, as the workforce, revenue and cost reduction synergies, market shares & entry barriers, control premium and a portfolio effect.



“...identifiable intangible assets at less than 30% of the acquisition price seems low for a branded consumer goods company.”

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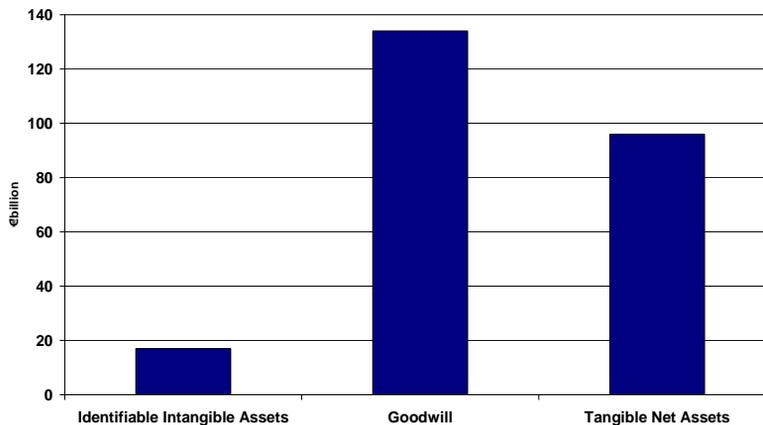
Heineken Acquisition of Krusovice and Syabar

Krusovice and Syabar are beer brands in the Czech Republic and Belarus respectively. Heineken reported the purchase price allocation for the two acquisitions, in September and December 2007 respectively, on a combined basis for confidentiality reasons, at a total cost of €247 million. Total intangibles are reported at €151 million in total, of which only €17 million is identified, all relating to software, R&D and other.

Given that Heineken made great play of the importance of the brands, which were both reported to be growing strongly, it is odd that none of the intangible asset value was allocated to brands. On the other hand, Heineken attributes much of the goodwill to synergies, the implication being that they will be able to sell more of the flagship Heineken brand on the back of the acquired local brands.

“...none of the purchase price was allocated to the brands, despite Heineken’s admiration for them..”

Heineken Acquisition of Krusovice and Syabar



International IFRS 3

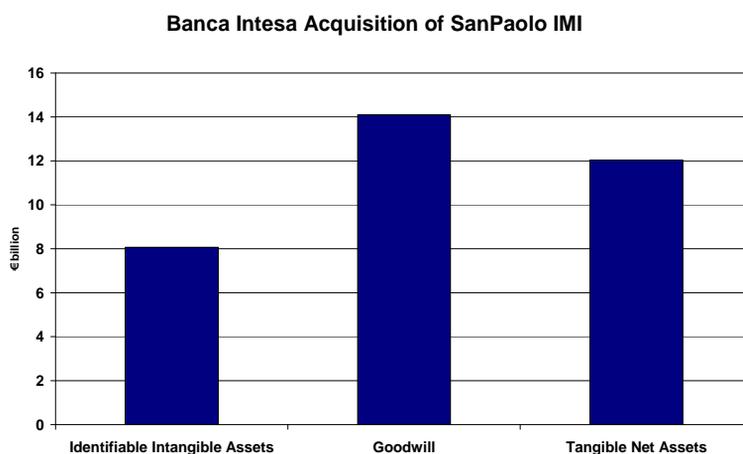


9. Examples of Better Reporting

Banca Intesa Acquisition of SanPaolo IMI

Although described as a merger of equals in the Italian banking sector, the transaction was accounted for as an acquisition of SanPaolo IMI by Banca Intesa with a total acquisition cost of €34.2 billion, of which €22.2 billion was allocated to intangible assets. Identifiable intangible assets were core deposits (€2.2 billion), asset management portfolio (€2.8 billion), insurance portfolio (€0.7 billion) and brand name (€2.4 billion), with a further €14.1 billion in goodwill.

The related notes to the financial statements at December 2007 are extensive, detailed and informative, giving descriptions of both the nature and method of valuation of each class of intangible asset. However, Intesa fails to describe the factors resulting in goodwill, as required.



“...a model of how an acquisition should be reported.”

“Extensive, detailed and informative reporting on intangible value, other than goodwill..”

International IFRS 3

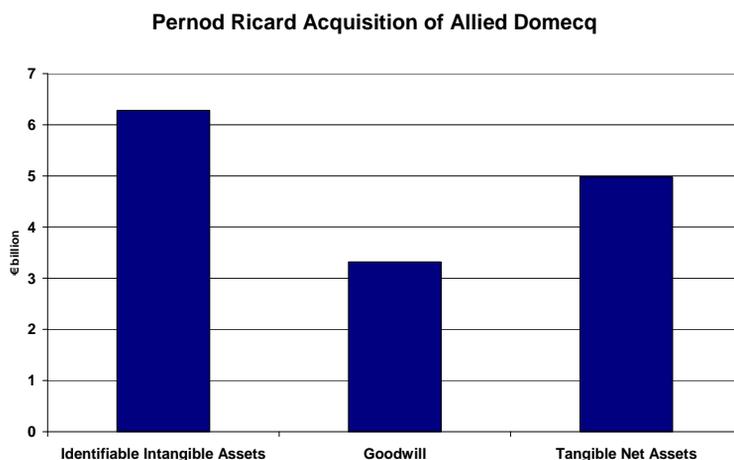


Pernod Ricard Acquisition of Allied Domecq

Pernod acquired Allied Domecq in July 2005, in a complex deal which saw it immediately dispose of a substantial number of brands and other assets to Fortune Brands. The net acquisition cost was €14.6 billion including acquired debt less cash. Of this, €6.3 billion was allocated to brands, including Ballantine's, Beefeater, Kahlua and Malibu, and a further €3.3 billion to goodwill. This appears to us to be a reasonable reflection of the fair value of the intangible assets acquired.

However, Pernod fails to describe the factors resulting in goodwill, as required. These relate largely to synergies in both production and distribution arising from the combination of two powerful brand portfolios.

"...identifiable intangible assets accounted for 43% of the acquisition cost – prima facie much more reasonable."



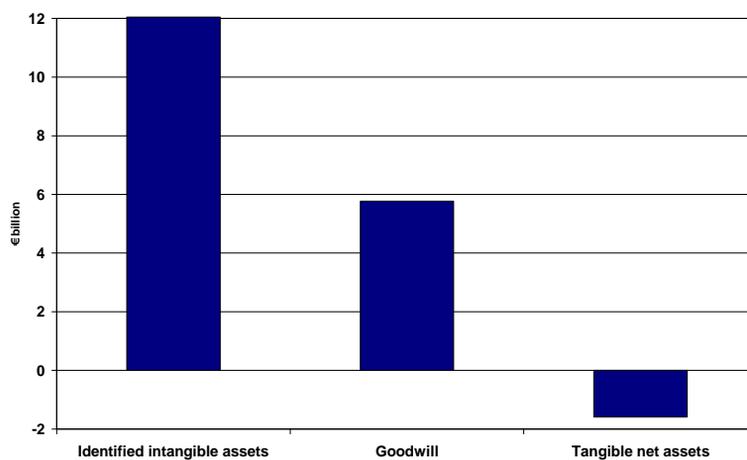
International IFRS 3



Bayer Acquisition of Schering

The pharmaceutical group, Bayer, acquired a majority interest in Schering in June 2006 for a net total of €16.2 billion. Of this, €12.0 billion was allocated to intangible assets in five separate classes including marketing and technology related assets. Goodwill of €5.8 billion is described as relating to synergies and cost savings across various business functions, as well as the strengthening of Bayer's global market position.

Bayer Acquisition of Schering



“...74% of the purchase price was allocated to identifiable intangibles – the highest proportion seen.”

International IFRS 3



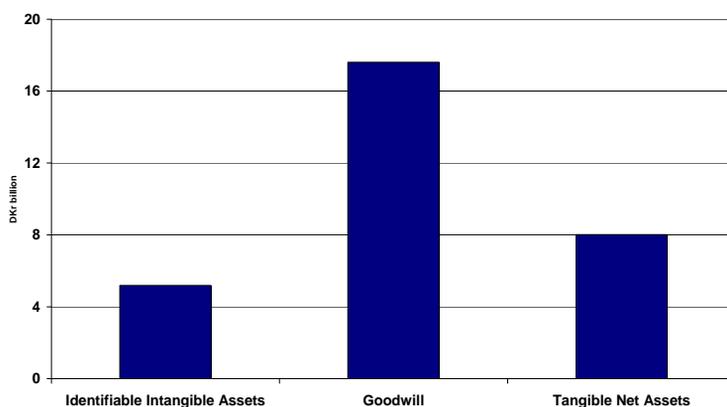
Danske Bank

SAMPO

Danske Bank Acquisition of Sampo Bank in Finland

Danske Bank acquired Sampo Bank in Finland in February 2007 for DKr 30.8 billion with identifiable intangibles of DKr 5.2 billion and goodwill of DKr 17.6 billion. The identifiable intangibles were mainly customer related (DKr 4.4 billion) with the remainder split between rights to the name and contract rights. While the proportion of intangibles represented by goodwill appears high at 77%, the notes to the financial statements do spell out that the goodwill represents workforce, position in the community and synergies.

Danske Bank Acquisition of Sampo Bank



“...77% was allocated to goodwill but this was adequately described.”

International IFRS 3

10. Conclusion

Sadly, the quality of reporting of acquired intangible assets under IFRS leaves a great deal to be desired. In some areas the quality of reporting is even poorer than that which we found for UK companies and US companies under USGAAP. We have three key areas of criticism.

- We believe that the level of identifiable intangible assets is frequently understated with a corresponding overstatement of goodwill, some of which probably relates to overpayment for acquired companies.
- Even when intangible assets are identified, there is frequently inadequate analysis by asset class which IFRS 3 requires.
- IFRS 3 also requires disclosure of the factors resulting in goodwill and, too often, this requirement is either ignored or paid only lip service with poor, glib or meaningless statements.

Intangible Business

Intangible Business is the world's leading independent brand valuation consultancy, specializing in valuing intangible assets such as brands, for financial, banking, management and litigation purposes.

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