PURCHASE PRICE ALLOCATION

PPA in M&A Transactions and the Role of Asset Valuation

What is PPA, why does it matter after an M&A deal, and how does asset valuation shape the goodwill and the values recognized in the consolidated financial statements?

01 WHAT IS PPA? WHY DOES PPA MATTER?

PPA (Purchase Price Allocation) is the process of determining and allocating the value of a business acquisition once the acquirer has obtained control. Under **IFRS 3 – Business Combinations**, for a transaction within the standard's scope, the acquirer must identify the identifiable assets acquired and liabilities assumed, and measure these items on the appropriate measurement basis as of the acquisition date. For most assets and liabilities, the measurement basis applied is fair value at the acquisition date.

One of the important aspects of PPA is identifying intangible assets that have economic value but may not previously have been separately recognized on the acquiree's financial statements. These assets may include trademarks, customer relationships, technology, software, licenses, contractual rights, and other intangible assets. When the recognition criteria under IFRS 3 are met, these intangible assets are measured at fair value as of the acquisition date and recognized separately from goodwill.

Separately identifying and valuing these assets provides a fuller picture of the nature and sources of the economic value of the deal, rather than allocating the entire difference between the purchase price and net asset value to goodwill. At the same time, the value allocated to assets with a finite useful life may give rise to depreciation or amortization expense in accounting periods following the acquisition date, thereby affecting the acquirer's operating results and financial indicators.

From a tax perspective, recognizing an increase in asset value or identifying additional intangible assets in a PPA **does not automatically create a tax benefit or deduction**. Whether depreciation, amortization, or a deduction is available for tax purposes depends on the transaction structure, the tax basis of the asset, and the applicable tax regulations. In addition, differences between the values recognized under the PPA and their corresponding tax bases can give rise to deferred tax assets or liabilities, which in turn continue to affect the identifiable net asset value and goodwill.

HOW GOODWILL IS DETERMINED UNDER IFRS 3

Consideration transferred + **Non-controlling interest** + **FV of previously held interest*** – **Identifiable net assets at FV** = **Goodwill**

After determining the value of the identifiable assets acquired and liabilities assumed, goodwill is determined as the residual amount under the IFRS 3 calculation mechanism. Conversely, if the identifiable net asset value exceeds the total amounts used to determine goodwill, after performing the reassessment required by IFRS 3, the difference may be recognized as a gain on bargain purchase.

** In the case of a step acquisition, if applicable.*

In practice, the PPA report is one of the important documents supporting a business in performing acquisition accounting and preparing consolidated financial statements after an M&A deal. The report provides the valuation basis for recognizing assets and liabilities at the acquisition date, the separately identified intangible assets, and the goodwill or gain on bargain purchase arising from the deal. The results, methods, and valuation assumptions in the PPA report are also an important basis for the business to explain the recognized values to its auditors.

Therefore, **PPA is not simply a goodwill calculation** following an M&A deal. It is a process that combines transaction analysis, identification of assets and liabilities, valuation, and consolidation accounting requirements, so as to fairly reflect the economic substance of the deal and the values the acquirer actually receives at the acquisition date.

IN SUMMARY, PPA NEEDS TO CLARIFY 4 KEY QUESTIONS

- **Q1** What identifiable assets did the acquirer receive from the deal?
- **Q2** What liabilities and obligations did the acquirer assume?
- **Q3** What is the fair value of each asset and liability at the acquisition date?
- **Q4** After identification and measurement, is the residual recognized as goodwill or as a gain on bargain purchase?

02 THE ROLE OF VALUATION IN PPA

VALUATION APPROACHES

- **Market approach**
- **Income approach**
- **Cost approach**

Valuation plays a **central role** in the PPA process, since one of the key requirements of IFRS 3 is to determine the fair value of the identifiable assets acquired and liabilities assumed at the acquisition date. The scope of valuation includes not only assets already recognized on the acquiree's financial statements, such as real estate, machinery and equipment, and other assets, but also identifiable intangible assets that were not previously separately recognized, such as trademarks, customer relationships, technology, software, licenses, and contractual rights.

Determining the fair value of each type of asset requires specialized knowledge and professional valuation judgment, since each asset has different economic characteristics, ability to generate benefits, and availability of market information. Depending on the nature of the asset and the data that can be gathered, the valuer selects the appropriate valuation approach and method, including the market approach, the income approach, and the cost approach.

For tangible assets such as land, buildings, and machinery and equipment, the valuation needs to consider market information, technical specifications, actual condition, remaining useful life, as well as wear and obsolescence factors. **For intangible assets**, the valuation generally requires deeper analysis of the asset's ability to generate future economic benefits, its useful life, the level of risk, and factors specific to each asset.

The role of the valuer in a PPA therefore does not stop at applying a single valuation method to calculate value. The valuer needs to understand the nature of the transaction and the acquiree's business operations; determine which assets need to be valued; select appropriate methods and assumptions; analyze financial, operational, and market data; and check the reasonableness and consistency of the valuation results.

The valuation results are one of the important bases for determining the identifiable net asset value at the acquisition date and, from there, goodwill or the gain on bargain purchase. The quality of the valuation work therefore has a direct impact on the reasonableness and defensibility of the PPA results, as well as on the values recognized in the consolidated financial statements.

03 IDENTIFIABLE INTANGIBLE ASSETS AND VALUATION METHODS

Under IFRS 3 and IAS 38, an asset is identifiable if it meets **one of the following two criteria:**

SEPARABLE

Capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so.

CONTRACTUAL OR LEGAL RIGHTS

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.

Source: IFRS 3

Identifying intangible assets in a PPA should not rely solely on the line items already recognized on the acquiree's financial statements. The valuer needs to examine the business model, revenue sources, customer base, intellectual property, contracts, licenses, technology, and other factors that create economic advantage for the business, in order to determine whether there are intangible assets that need to be recognized separately from goodwill.

COMMON INTANGIBLE ASSETS IN M&A

Trademark
Relief from Royalty

Customer Relationships
With and Without Method

Patents
Replacement/Reproduction Cost / Comparable Transactions

Website
Replacement/Reproduction Cost Method

Licenses
Excess Earnings Method

DEFINITIONS OF VALUATION METHODS

Relief from Royalty: Values the intangible asset as the present value of the royalty income that would be received from licensing its use. It assumes that a party not owning the asset must pay to use it, so the value equals the royalty payments saved by owning the asset.

Excess Earnings Method: Values the asset through the present value of the cash flows attributable to its contribution, after excluding the portion of cash flows attributable to the contribution of other assets.

With and Without Method: Estimates value as the difference between the present values of two discounted cash flow scenarios: one in which the business uses the intangible asset to generate excess income, and one in which it does not.

Replacement/Reproduction Cost: Based on the costs to reproduce or replace the asset's economic functionality; a rational investor would not pay more than the cost to develop or acquire an equivalent substitute.

Comparable Transactions: A market-based approach using comparable assets traded in the market – the value a willing buyer and willing seller agree upon at arm's length, with full information on the asset and the transaction.

TMS CONSULTANCY – SUPPORTING BUSINESSES IN PREPARING PPA REPORTS

1. Transaction analysis
2. Consideration & scope
3. Identify assets & liabilities
4. Value tangible & intangible assets
5. Goodwill / bargain purchase
6. PPA report

With a strong foundation in business, tangible asset, and intangible asset valuation, TMS Consultancy is able to provide comprehensive PPA services, from transaction analysis and determining the scope of purchase price allocation to preparing and finalizing the PPA report. The scope of work may include reviewing the key information and terms of the transaction, determining the consideration transferred, identifying the assets acquired and liabilities assumed, valuing tangible assets, identifying and valuing intangible assets, and determining goodwill or the gain on bargain purchase.

By combining an understanding of M&A transactions, financial and business analysis, and valuation expertise, TMS Consultancy builds the PPA results on a basis that is consistent across the valuation components and the overall transaction value. The PPA report TMS provides not only sets out the purchase price allocation results but also presents the basis for asset identification, the valuation methods used, the key assumptions, and the basis for determining value — thereby supporting the business in recording the transaction, preparing consolidated financial statements, and explaining the recognized values to auditors after the deal.