Rigorous legislation means that media companies—and valuers—need to pay closer attention to the nature of intangible assets such as the titles of publications.

Valuing Mastheads - Fact or Fiction?
What’s in a Name? Ask the Directors

The recent and proposed listings of gross media assets of some $4 billion on the Australian Stock Exchange has again brought the subject of masthead valuations into the spotlight of the investment community. Table 1 shows the attributes of these media groups.

The share price of some media companies failed to meet pre-float expectations. For example, at the time of writing, the share prices of Pacific Magazines and Australian Consolidated Press were still below their issue prices and, at one stage, had fallen respectively to levels some 16 per cent and 9.6 per cent below issue price.

The October 1987 crash and its aftermath highlighted the fact that many media companies had relied on or accepted incorrect valuation methodologies and had attributed excessive values to media assets. Company directors, advisers, auditors, underwriters, investors and regulators need to appreciate fully how to determine the value of mastheads to ensure that the mistakes of the mid-eighties are not repeated.

Common valuation errors

The five most common errors in masthead valuations are:
- failing to define properly what a masthead is;
- failing to distinguish between the component elements of intangible assets—identifiable (eg, mastheads) and unidentifiable (eg, goodwill);
- assuming that there is a direct correlation between the value of the masthead and the price at which an underwriter is prepared to underwrite a share-float;
- failing to understand the difference between the valuation of the whole of a business and the valuation of minority interests; and
- using rules-of-thumb rather than sound valuation methodology to value mastheads.

What is a masthead?

There is no generally accepted definition of an intangible asset, let alone a masthead. However, Exposure Draft 49 on Accounting for Identifiable Intangible Assets (released in late 1989 but subsequently withdrawn in April 1992) refers to intangible assets as non-monetary assets without physical substance which are capable of being both individually identified and specifically brought to account. Identifiable intangible assets would include:

- Wayne Lonergan is a partner in the corporate services division of Coopers & Lybrand. He is also a member of the Companies and Securities Advisory Committee, the statutory committee which advises the Attorney-General, Mr Duffy, in the development of national companies and securities legislation. He was appointed by the National Companies and Securities Commission to draft the NCSC policy statement on identifiable intangible assets.
items such as mastheads, brandnames, licences, trademarks, franchises, distribution agreements, patents and customer lists.

The concept of a masthead is more easily recognised than defined. The Oxford Dictionary defines a masthead as “title etc of newspaper etc at head of front or editorial page”. If a strict dictionary definition of a masthead were applied, it would not be possible to attribute a significant value to it, particularly as a number of the integral attributes of the business would have to be classified as unidentifiable intangible assets (such as goodwill).

A masthead can be protected by both copyright and trademark but is generally protected by the “prohibition” against “passing off”. The significant difference in value between the name of a publication and the combination of factors which are integral to its success is demonstrated by the fact that the masthead would virtually never be sold unless the previous owner was restrained from continuing to produce the former publication under a different name.

For valuation purposes, the correct definition of a masthead is the title plus that part of the goodwill of the business that attaches to the title. The critical issue facing valuers is how to assess what part, if any, of the goodwill of the business truly attaches to the masthead being valued. Many masthead valuations wrongly attribute the whole of the value of the goodwill of the business to the mastheads being valued.

The revenue of a publication comes from its wholesale cover price and from advertising. Both are dependent on circulation. Each title (or masthead) in the wide range of publications produced by the print media industry develops an established readership which reflects the editorial focus and content. In general, it is this established readership which supports circulation levels and indicates the potential market available to advertisers, in turn supporting revenue and profits.

Minimum criteria

In practice, minimum criteria must be satisfied before any value can be attributed to a masthead. They require that the masthead is:

- **Separately identifiable**: To establish the value of the asset, the expected future cashflows from the use or resale of the asset must be identified separately from those of the other net assets of the business.
- **Protected**: Mastheads are generally protected by the “prohibition” against “passing off” (although they may have some additional statutory protection such as trademark or business-name legislation).
- **Transferable**: The concept of fair market value implies an exchange value for the masthead.
- **Enduring in nature**: The masthead must have been established for a reasonable time. Alternatively, its longevity must be assured and must be independent of the immediate effects of an advertising campaign or promotion campaign—that is, it must truly be a capital asset rather than the carry-over effect of current expenditure.

In accordance with the dictionary definition, the masthead of an established publication would comply with the above criteria. However, to attribute any significant value to the masthead the definition would have to be modified to include all of the factors which are integral to the success of the masthead, including:

- the name of the masthead;
- the mix of editorial and advertising content;
- the format;
- the editorial focus and style; and
- restraint of trade agreement.

This is consistent with the proposition that a prudent investor would not generally acquire a masthead (according to its strict dictionary definition) as the masthead, in itself, could not be relied upon to generate significant net cashflows. The investor would not usu-
ally want the name in isolation — he would want to acquire a combination of the factors responsible for the success of the business to ensure that the masthead generates a steady stream of positive net cashflows.

This item from Reuters Textline on 24 January 1991 clearly demonstrates this principle: “In Australia, Murdoch has merged four metropolitan newspaper titles into two, creating the country’s first 24-hour papers, with estimated cost savings of about $A70M a year. In the process, however, he has destroyed four of his key mastheads and subsequently created two new ones with no track record”.

It has been suggested that the mastheads of well-known newspapers have a large inherent value. I would suggest that if The Australian Financial Review (AFR) were to change its name tomorrow, its sales would not be materially affected (assuming that the fact that only the name was being changed was well publicised).

It is not just the name that causes people to buy the paper; they buy it because it is a source of quality news and advertising presented in a form which the readers believe no competitor matches. Hence, the value is in a combination of factors such as the name, editorial and advertising content, format, style, editorial focus and market position.

However, a change in name, editorial style and layout could affect the value of the masthead, which may decline in response to a change in the public perception of the paper or changes in circulation or advertising revenue.

Accordingly, it is clear that if the term “masthead” is narrowly defined, only limited value can be attributed to it. If it is more widely defined, the wider definition should be fully disclosed and it should be acknowledged that there is a significant risk that excessive values which should properly be classified as goodwill will be incorrectly incorporated into the value of the masthead.

There have been relatively few arm’s-length sales of major print media assets in Australia. In these transactions, the extent to which buyers may have misjudged the market at the time the transactions took place, were able to take advantage of a “forced” sale, or were influenced in their purchasing decision by factors other than pure economics, may colour the apparent value of mastheads (and goodwill) in media companies for a significant period.

There have been even fewer arm’s-length transactions involving the sale of mastheads (as distinct from companies or businesses), so it is difficult to assess truly comparable market transactions as a yardstick for valuations.

Misunderstood methodology

While the valuation of mastheads should be subject to the same rigorous theoretical and practical considerations as any other business or security valuation, correct valuation methodology is widely misunderstood and in some cases has been grossly abused.

The misunderstanding and abuse was so widespread (and likely to be even more widespread following ED 49) that in January 1990 the NCSC issued a draft policy statement entitled “Identifiable Intangible Asset Valuation”. The NCSC paper examines the various valuation techniques that have been propounded for identifiable intangibles (including mastheads), focusing largely on their application to brand names, and assessed their relative economic logic and practicability.

Valuation fundamentals

The value of any asset is determined by the expected future earnings or cashflows (ie, the future net economic benefits) that can be obtained from its use or sale. If no established market in comparable assets exists, the future net economic benefits of the asset must be capable of reasonable estimation.

In reality, few transactions involve just the intangible assets. Where the transaction involves a company or business, which it normally does, it is essential to attribute separate values to the various components. It is the failure to understand this fundamental principle that has led some valuers to grossly overvalue identifiable intangible assets.

In practice, segregating the future economic benefits of a single identifiable intangible asset from those of the other assets that make up the business is difficult for the following reasons:

- the asset being valued may not have attached to it a clearly identifiable cashflow (such as a royalty stream or lease payments) that can be quantified with reasonable accuracy;
- the asset may be employed with a number of other assets, and the difficulty and cost of determining the future economic benefits of the individual assets needs to be considered in relation to the benefits of the valuation;
- the future economic benefits may be so highly dependent on the other assets employed in the business that they cannot be properly segregated and should be valued in combination.

The valuation process should therefore allocate total intangible value between the unidentified intangible assets and the separate identifiable intangible assets which, together with the net tangible assets, make up the business (see Table 2).

Valuation methodology

No single valuation methodology or formula for the valuation of identifiable intangible assets will be appropriate in all circumstances. The NCSC required (and the prudent valuer should consider) the use of a number of methodologies, each cross-checked against the others. Three main approaches are commonly used:

- comparable market transactions;
- historical or replacement cost;
- economical benefits methods, which include gross profit differential, excess profits, relief from royalty and marginal cashflows.

Having selected an appropriate valuation methodology and determined a fair market value for an identifiable intangible asset (such as a masthead), the valuer should cross-check that value against relevant methodologies, allowing for their theoretical and practical limitations. The objective of cross-checking is to confirm the value indicated by the preferred valuation methodology.

The choice of the most appropriate methodology will depend on the circumstances, quality and timeliness of information, and the subjective view of the valuer.

In a previous JASSA article enti...
### TABLE 2: Components of intangible assets

Set out below are a number of the factors which form part of the masthead and goodwill of a typical media company. The table also discloses a number of other identifiable intangible assets.

<table>
<thead>
<tr>
<th>Masthead</th>
<th>Goodwill of business</th>
<th>Other identifiable intangibles</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Title</td>
<td>• Superior management and operating team (usually evidenced by track record)</td>
<td>• Company name</td>
</tr>
<tr>
<td>• Mix of editorial and advertising content</td>
<td></td>
<td>• Distribution agreements</td>
</tr>
<tr>
<td>• Format</td>
<td>• Efficient distribution network</td>
<td>• Patents</td>
</tr>
<tr>
<td>• Editorial focus and style</td>
<td>• Sound labour relations</td>
<td>• Licences</td>
</tr>
<tr>
<td>• Restraint of trade agreement</td>
<td>• Synergistic benefits resulting in long-term sustainable cost advantages</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Printing and publishing expertise</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Regulatory barriers to entry (eg, government licensing policy, Foreign Takeovers Act, FIRA)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Strong/dominant market share leading to strong negotiating position with suppliers and customers</td>
<td></td>
</tr>
</tbody>
</table>

Many valuation practitioners confuse the value of the business as a whole and the value of the masthead. In the above example, it would not be uncommon for valuation practitioners to mistakenly attribute a value of $110 million to the masthead, rather than attributing merely part of that amount. This simplistic approach shows a lack of understanding of exactly what a masthead is and how to value it.

#### Identifiable and unidentifiable intangibles

The failure to identify the difference between goodwill and identifiable intangibles is the major conceptual weakness in many of the valuations of intangible assets.

While it is difficult to apportion precise values to separate intangible components such as goodwill and mastheads, it is necessary to form a view on the reasonable allocation of these values.

Goodwill exists because a business has a demonstrated capacity to earn cashflows exceeding those which would result from investing the same level of tangible and identifiable intangible net assets in a similar business, starting from scratch.

In reality, goodwill is the rump of unidentifiable assets left after subtracting the value of both net tangible assets and identifiable intangible assets from the value of the whole business. Items included in goodwill would normally include:

- superior management team;
- the benefit of superior marketing;
- regulatory barriers to entry, eg, television licences;
- long-term sustainable cost advantages or economies of scale;
- efficient distribution networks;
- strong or dominant market share leading to strong negotiating position with suppliers and customers.

Table 2 sets out a list of the factors which are integral to the success of a masthead and a number of the factors which make up the goodwill of a typical media company.

#### Masthead value vs underwritten value

It has been suggested that the valuation of a masthead can be determined as a function of the price placed on shares in the prospectus by the underwriter.

This proposition fails because of its inherent circularity; ie, the underwriter cannot determine the value he is prepared to underwrite without first knowing the masthead value. The masthead value cannot be determined (as a function of the issue price) without knowing the value the underwriter is prepared to underwrite.

In any event, the underwriter is primarily influenced by the state of the equities market in determining the underwritten value. What is floated to the public are minority parcels and the aggregate of these parcels is not equivalent to the value of the business as a whole.

Further, if an underwriter were to misjudge the issue price and this resulted in either overvaluation or un-
dervaluation of the company, the error would be reflected in a dollar-for-dollar error in the carrying value of mastheads in the company’s balance sheet.

If the proposition that the value of the masthead is a function of its share issue price were true (which it is not), this implies that if the share price trades below the issue price then the carrying value of the company’s mastheads is overstated.

It also implies that the annual carrying values of the mastheads should be regularly reassessed in accordance with changes in the equities market.

While masthead values should be regularly reassessed, this should be based on the underlying cashflows and profitability of the business, changes in interest rates, competitor actions etc., and not simply on the level of the equities market.

Control premiums

Investment fundamentals dictate, and actual takeover premiums prove, that the value of the whole of a company is normally greater than the sum of the values attributable to the shares of that company based on day-to-day transactions of minority shareholdings in the stockmarket.

This difference, often referred to as a “premium for control”, must be taken into account by investors and lenders when examining any prospectus, valuation or loan documents.

For example, assume that a newspaper company with 120 million shares on issue has the following assets:

**$M**

<table>
<thead>
<tr>
<th>Fixed and current assets</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mastheads</td>
<td>90</td>
</tr>
<tr>
<td>Goodwill</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>120</strong></td>
</tr>
</tbody>
</table>

It is unlikely that a parcel of 1,000 shares will have a market value of $1,000. In practice, the market value will be determined by earnings per share, dividend policy and net asset backing.

For the sake of demonstrating the principle of the difference between minority and majority parcels, the value of a minority shareholding of 1,000 shares could be as low as, say, $780, calculated as follows:

- **Value of whole** 120
- **Less: Discount for minority interest (premium for control) say** 42% 42

Divided by 120 million shares:

\[
\frac{78}{120} = 0.65 \text{ per share}
\]

*35% discount used for demonstration purposes only.*

It should be noted that the aggregate value of the minority shareholdings of $78 million does not have a direct correlation to the value of the mastheads above of $90 million.

**Disclosure requirements**

To ensure that investors are fully informed, prospectuses which include masthead valuations should disclose the underlying methodology, the assumptions made and the sensitivity of the valuation to changes in those assumptions. Assuming that the valuation methodology is sound, this will assist investors in their assessment of the likely market price of their shares after the flotation and will clearly discharge the obligations of those involved in the preparation of prospectuses under Section 1022 of the Corporations Law. This section requires, among other things, that prospectuses contain “all such information as investors and their professional advisers would reasonably require, and reasonably expect to find in the prospectus, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the corporation”.

**Rules-of-thumb**

The use of valuation rules-of-thumb is of interest in industries where they are adopted as surrogates for theoretically sound valuation methodologies. The rule-of-thumb may be the only valuation indicator available where, say, it is not possible to determine the true net cashflows (or profits) of the business.

It is common for valuation practitioners to use industry rules-of-thumb to cross-check values obtained by adopting theoretically sound valuation methodologies. The use of rules-of-thumb may be relevant where they are used to support one or more generally accepted valuation methodologies such as those set out in the NCSC draft policy statement on “Identifiable Intangible Asset Valuation”. This assumes that the valuer is able to explain quantitatively or qualitatively any differences resulting from the use of different methodologies.

In valuing mastheads, a number of practitioners have adopted rules-of-thumb such as multiples of gross revenue, sometimes adjusted for various factors (such as loyalty and risk factors) as their primary valuation methodology.

In my view, the valuation of a masthead based on a multiple of gross revenue (such as one or two years’ revenue) is inappropriate. The suggestion that the value of a masthead is in direct proportion to the gross revenue it generates fails to incorporate the basic business principle that the value of a business (or asset) is a function of its actual net cashflows and profits rather than its gross turnover.

There may be circumstances where there is a reasonable correlation between revenue and masthead value, ie., high levels of gross turnover may lead to high profits and cashflows. However, there is not necessarily always a correlation between turnover and masthead value.

For example, the fact that a number of larger media companies and certain publications failed in the 1980s illustrates the danger of focusing attention on gross revenues in assessing the value of mastheads—for example, the Perth Daily News, the Business Daily and The National Times, all of which are now closed. The merger of the Daily Telegraph and the Daily Mirror in Sydney, and the merger of the Sun News-Pictorial and the Herald in Melbourne demonstrated even more dramatically these dangers, as they were established papers with high gross turnover.

**Reconciliation of the valuation**

Where an identifiable intangible asset being valued is material to the value of the business as a whole, the fair market value of the business
should be reconciled to the fair market values of the identifiable net assets comprising the business (both tangible and intangible) and the resulting goodwill. The reconciliation should be reviewed to ensure that all the assets and liabilities have been properly valued and that there is sufficient allowance for goodwill, if appropriate (the accounting recognition of goodwill is subject to the requirements of AASB 1013).

Since the introduction of Statement of Accounting Standards SAS18 “Accounting for Goodwill” in March 1984, some cynics have suggested there has been a tendency in the market to allocate an excessive portion of the value of the pool of intangible assets to identifiable intangibles such as mastheads. Such allocation avoids the requirement to amortise goodwill over a maximum 20-year period in the profit-and-loss account. Interestingly, relatively few media companies reflect any value for goodwill in their balance sheets.

Company directors need to consider each year whether they have fulfilled their obligations under Section 294(4)(a) of the Corporations Law, which requires that the carrying value of a non-current asset not be greater than it would have been reasonable for the company to expend to acquire that asset. In essence, this is a “recoverable amount” test. This suggests that it is important that directors of media companies review the carrying values of mastheads each year.

The revised AASB 1010 “Accounting for the Revaluation of Non-Current Assets” (issued in September 1991) seeks to clarify the application of the “recoverable amount” test. However, the wording of the standard is not yet tight enough to force directors to write down the value of mastheads where the book value exceeds the fair market value. This is due mainly to the failure of the standard to clarify the meaning of “recoverable amount” in net present value terms. It is hoped that such clarification is not far away.

Further tightening by the Accounting Standards Board of the rules relating to the carrying values (and amortisation) of intangible assets will have major implications for public companies which are tempted to carry identifiable intangible assets in their accounts at excessive values. This should avoid a recurrence of the situation where mastheads are carried at artificially high values in balance sheets and then largely disappear in times of financial crisis. This phenomenon occurred in many sectors of the media industry (particularly in respect of TV and radio licences) in the 1980s.

A simple solution to the problem of overvalued mastheads and other identifiable intangible assets would be for the Accounting Standards Board to impose the same amortisation/depreciation requirements to all intangible assets, regardless of whether they are identifiable or unidentifiable.

Conclusion

The valuation of a masthead, if conducted properly, should in my view ensure that:

- those persons involved in the preparation of prospectuses (and accounts)

are in a better position to discharge their duties under the Corporations Law;
- investors are fully informed (especially if the valuation is made public);
- share issues are priced correctly; and
- ASC (and other) concern is avoided.

To ensure that investors are fully informed, prospectuses which include masthead valuations should include a copy of the supporting valuation. Alternatively, the prospectus should disclose the valuation methodology, the major assumptions adopted and a sensitivity analysis of the major assumptions underlying the valuation.

Both the NCSC and ED49 concur that an identifiable intangible asset should only be brought to account where:
- it is probable that the future benefits or service potential embodied in the asset will eventuate; and
- the asset possesses a cost or other value that can be measured reliably.

In the event that an identifiable intangible asset (such as a masthead) fails to meet one or both of these fundamental asset recognition criteria, the NCSC, quite correctly, concluded that it should not be recognised in the accounts (emphasis added).

The correct principles which should be applied to the valuation of identifiable intangible assets are understood by only a handful of people in the marketplace. Directors, lenders, auditors, underwriters, investors and analysts should therefore treat values attributed to mastheads (and other identifiable intangible assets) with extreme caution.

SUPER-REALITY

Continued from page 13

basic issues. Daryl Dixon recently gave the present structure a comprehensive pasting when he said:

“Present superannuation policies are inequitable, inefficient, resource allocation distorting and poorly designed and conceived. The proposed 12 per cent of salary projected to the year 2000 will make them worse.”

(Tax Matters, Australian Tax Research Foundation, Newsletter No. 30, February 1992.)

It is not for me to say that Australia has got it wrong, or that recently suggested changes may make things better or worse, however those concepts may be defined. However, there seem to be some fundamental questions which Australians need to identify before they can be asked and then answered. Based on the New Zealand experience, I think that creating political debate out of the superannuation issue is a sure way to avoid identifying those questions.

A lasting solution to this multi-faceted problem is unlikely to emerge from our adversarial political systems. While one party’s view may be technically superior to the other’s, without some objectives which have been agreed to by the community as a whole, I fear that change will be constant and that superannuation, as an issue, will tend to remain directionless.

In any issue of public concern, the “government” is really no more than a synonym for “us all”. The central authority is in no better position to resolve this issue than are we all, individually; and able to do no more than we are prepared to allow. What about finding out what the public thinks?

JASSA JUNE 1992 19