

ACCT-GB 3149 Entertainment Accounting

**News Corp's Acquisition of Dow Jones & Company
A Case Study**

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Company Summaries

Before being acquired by News Corp, Dow Jones & Company was a publishing and financial information firm with a variety of products. It owned products such as *The Wall Street Journal*, *Barron's Magazine*, *Factiva*, *Smart Money*, *Marketwatch.com*, and many more. In the last full operating year before the acquisition, 2006, the company generated revenues of \$1.78 billion and a net income of \$153 million.

News Corp is a multinational mass media conglomerate involved in cable network programming, filmed entertainment, television, satellite television, publishing, and more. In 2006, the company generated revenues of \$25.33 billion with a net income of \$2.31 billion. At the time of the acquisition, late 2007, News Corp had \$62.34 billion worth of assets on its balance sheet, with \$25.52 billion (40.9% of the total) representing intangibles. The same numbers for Dow Jones & Company were \$2.02 billion and \$903 million (44.7% of the total), respectively.

2007 Acquisition

News Corp completed the acquisition of Dow Jones on December 13, 2007. As per the merger agreement, each share of Dow Jones common stock was converted into a right to the holder to exchange it for either \$60 in cash or 2.86 Class B common units of Ruby Newco, which is a wholly owned subsidiary for News Corp. The agreed-upon price of \$60 represents a 65% premium over the stock's closing price of \$36.33 on April 30, 2007, the day the offer was made.

For financial reporting purpose, Newco is to be considered as the acquirer as it shall control Dow Jones' Board of Directors and management maintaining sole ownership of Dow Jones.

Some of the purchases accounting issues related to goodwill and intangible assets were addressed as follows at the time of the merger. Dow Jones' intangible assets primarily consisted of Subscriber Relationships. Approximately \$800 million was allocated towards amortizable intangible assets. The economic benefits for most of the intangible assets were estimated to be more during the initial period of ownership, thus they were amortized on an accelerated basis over the weighted average of the useful life, which was considered 25 years. Trade Names were valued at \$1600 million and were considered as indefinite intangibles based on the acquiring company's indefinite use of the same; thus, no amortization. Goodwill, the excess of purchase price over the fair value of net tangible and intangible assets acquired, was calculated as \$4,605 million. In accordance with the SFAS No. 142, goodwill was not subject to amortization.

At the time of acquisition, the amount of goodwill was expected to change due to the change in the fair values of the net assets. The provisional treatment was that if additional value is to be assigned to identifiable finite-lived tangible and intangible assets, the Goodwill shall be reduced; and for every \$25 million reduction in Goodwill, Depreciation & Amortization would increase by approx. \$1 million per fiscal year (representing amortization expense assuming an average useful life of 25 years).

After the acquisition of Dow Jones, the 2008 Balance Sheet of News Corp showed significant amounts of intangible assets including Goodwill. The intangible assets, which included Film & TV Libraries, FCC Licenses, Newspaper Mastheads, Distribution Networks, Publishing Rights and other etc., were valued at \$14,460 million. Goodwill for the year was reported at a massive \$18,620 million. Thus the total intangible assets including Goodwill amounted to \$33,080 million, which is approx. 53% of the Total Assets.

Write Down in February 2009

Just one year and three months from the announcement of the acquisition, in February 2009 News Corp announced an \$8.4 billion of impairment charges including a \$2.8 billion write-down of



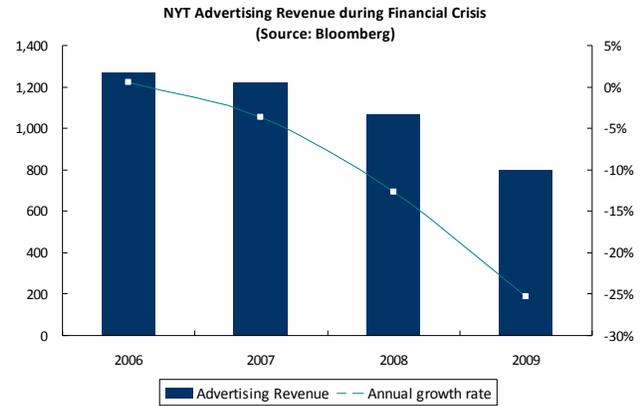
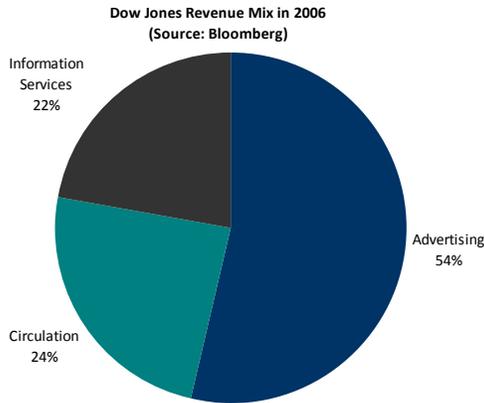
assets related to Dow Jones (\$2.4 billion for goodwill and \$400 million for intangible newspaper mastheads). As discussed above, News Corp gave \$1 billion valuation to masthead and \$4.6 billion valuation to goodwill at the time of acquisition. As a result of the impairment charges, News Corp wiped out 40% of the masthead valuation and 43% of the goodwill valuation. In addition, the total impairment charges of \$2.8 billion are equivalent to 55% of the \$5.16 billion acquisition price. I believe that there are two issues in relation to this write-down in such a short

period of time from the acquisition.

First issue is the timing and the valuation. As shown in the left chart above, the acquisition was announced in the peak of financial boom and the write-down was announced in the bottom during the financial crisis. However, Dow Jones stock price had underperformed S&P 500 index until April 30, 2007 when it became publicly known that News Corp was bidding for Dow Jones. The underperformance can be explained by the fact that market participants had anxiety towards the structural issue around the newspaper industry whether migration towards cheap digital might not be able to offset declining expensive paper circulation revenues. However, I still can say that there was euphoria around that time which made people overly optimistic and overconfident. I believe that this over-optimism and overconfidence led to the 21x EV/EBITDA acquisition valuation, while the median valuations were 11.7x for the newspaper industry and 14.9x for the information service industry. In addition, this extraordinarily high valuation was to some extent attributable to the following fact:

(1) News Corp had to pay a controlling premium to take full control of Dow Jones; and

(2) High valuation was necessary to persuade all the Bancroft family members to accept the offer.



The second issue is Dow Jones’ high exposure to advertising. In 2006 Dow Jones earned more than half of its revenues from advertising and advertising is the severely impacted business during the financial crisis. News Corp no more discloses revenue details at Dow Jones but I can still use New York Times as a proxy to Dow Jones’ advertising business trend since the acquisition. NYT experienced a 35% decline of advertising revenue in only 2 years from 2007. Even though DJ’s and NYT’s reader segmentation is different, but it is reasonable to estimate that Dow Jones also experienced a severe decline of advertising revenue during the downturn.

According to the 10-Q filed on February 6, 2009, News Corp admits by saying “the impairments at the Television and Newspapers and Information Services segments were due to a decline in the advertising-based businesses and lower projected growth. The Other segment impairment was due to higher valuations assigned to recent acquisitions, principally IGN, Photobucket and Jamba, that can no longer be sustained due to the decline in advertising-based businesses and the expected decline in future revenues.”