

TS insights

Market turmoil and goodwill implications – a study of the market response to goodwill impairment announcements

Impairment announcements – Why all the anxiety

From chemicals to financials, from technology to media, the number of goodwill impairments has increased dramatically. That is not surprising, given the plunge in stock prices in 2008. With further stock price declines in the beginning of 2009 and continued uncertainty in the markets, more goodwill impairment announcements might be around the corner. However, management teams that are anxious about announcing a goodwill impairment in today's market often overlook one key item – recent goodwill impairment announcements typically have had a muted effect on stock prices by the time of the announcement.

Much of the recent debate on financial reporting has focused on financial instruments; however, with the current credit crisis spreading to the general economy, impairment testing of nonfinancial assets has become more prevalent. The past few months have seen numerous goodwill impairment charges by companies across the industry spectrum. This is in stark contrast to the general experience for most industries through 2007 as equity markets generally trended upward since the adoption of Financial Accounting Standard 142: *Goodwill and Other Intangible Assets (FAS 142)* in 2001.

Under FAS 142, goodwill is subject to periodic impairment testing. Until the market recovers, companies will need to continually monitor their situation quarterly, in particular companies that are trading below book value. Of course, trading below book value does not determine whether there is

impairment; rather, it is one factor that can potentially increase the risk for impairment and may be an indication that an interim impairment test should be considered.

Goodwill impairment study highlights

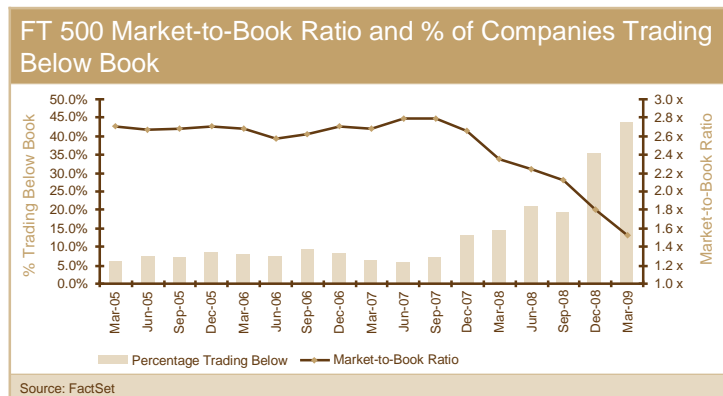
Impairment announcements have become more prevalent

The downward trend for equity markets began at the end of 2007, continued throughout 2008, and accelerated during the fourth quarter. Since third quarter 2008 (through March 20, 2009), Fortune 500 companies have announced approximately \$230 billion of impairments. This is more than twice the total of impairments recorded by Fortune 500 companies during the three years leading up to third quarter 2008.

Market cushion has decreased significantly

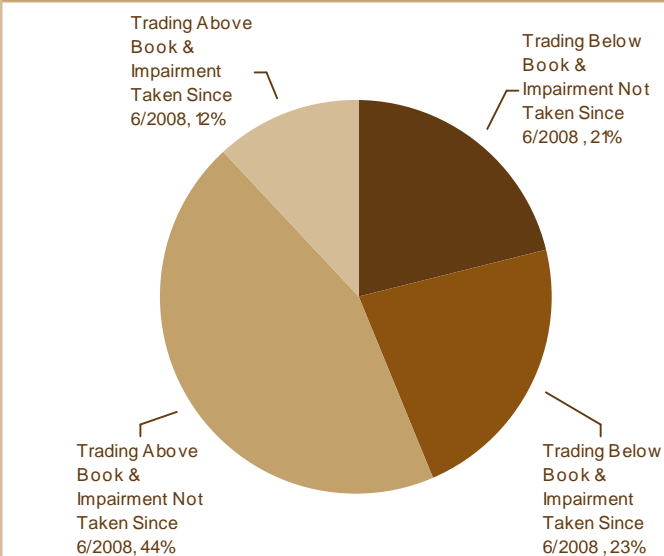
As stock prices have fallen, the gap between the market value of equity and the book value of equity (referred to herein as cushion) has decreased significantly.

- Since September 2007, the cushion within publicly traded Fortune 500 companies has dropped 74 percent, going from more than \$8 trillion to approximately \$2 trillion as of March 20, 2009.
- The overall market-to-book ratio for that same group of companies has dropped from an average of 2.7x over the past 3 years to approximately 1.5x as of March 20, 2009.



- As of March 20, 2009, 44 percent of publicly traded Fortune 500 companies were trading below book value, and of these, 48 percent have not taken or announced any impairment charges since June 2008.
- Companies trading below book value are not the only companies exposed to potential impairment. Based on our research, 12 percent of the Fortune 500 companies have recently recognized goodwill impairments despite trading above book value.

FT 500 Breakdown of Trading & Impairments

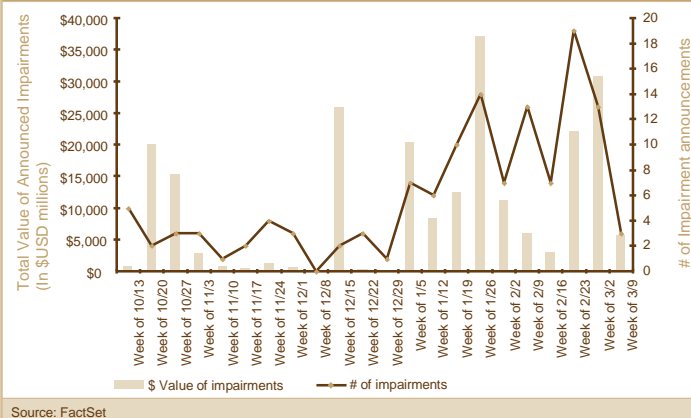


Source: FactSet

More goodwill impairments are likely

Many of the recent slate of impairments were announced during the last week of January 2009 and had a testing date of October 1, 2008, or December 31, 2008.

Weekly Summary of Fortune 500 Impairments



With the equity markets dropping further for many companies since these testing dates, the likelihood of additional impairment announcements has increased.

The announcement typically had a muted effect on stock price

A look at daily and monthly historical trading prices for the S&P 1500 companies announcing recent impairment compared with performance of the S&P 500 has shown there has been little impact to

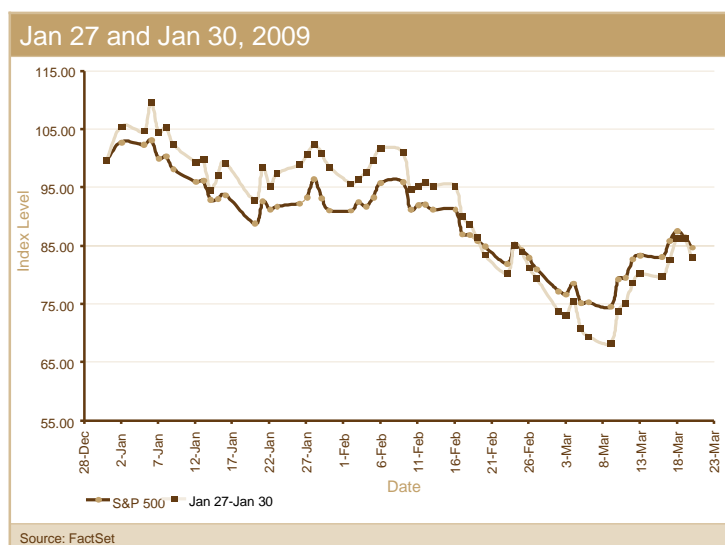
share price for companies as of the goodwill impairment announcement date.

We found that for many of the S&P 1500 companies announcing recent impairments, most of the decrease in stock price occurred on or before the October/November 2008 timeframe, and not necessarily when the impairment was announced.

- We created an index of the relative stock performance of the S&P 1500 companies that announced goodwill impairments during each week since the start of 2009, as compared with the S&P 500 over the following durations:
 - Daily performance from December 30, 2008 through March 20, 2009
 - Monthly performance from January 1, 2008 through March 20, 2009

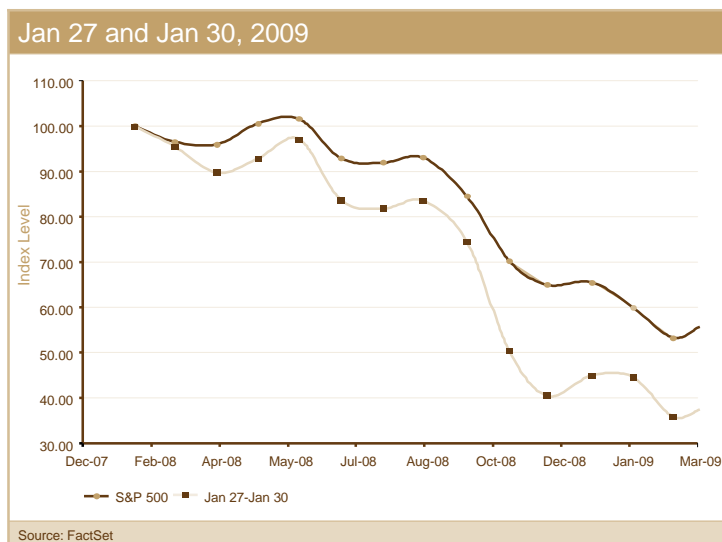
Index versus S&P 500 – Daily

To illustrate using the week ended January 30, 2009, 30 companies in the S&P 1500 announced impairments representing approximately \$25 billion in charges. The stock price performance of these 30 companies has effectively mirrored the S&P 500 since the beginning of 2009 through March 20, 2009 (see chart below).



Index versus S&P 500 – Monthly

Continuing with the same 30 S&P 1500 companies announcing impairment during the week ended January 30, 2009, most of the decrease in stock price occurred on or before October/November 2008, and not when the impairment was actually announced.



On the horizon

The recent market turmoil, coupled with the complexities of goodwill impairment testing, will require companies to continually monitor potential triggering events and begin the impairment process as early as possible when warranted. Even for companies that do not recognize an impairment, management should consider early warning disclosures and their plans to further evaluate the business for impairment in future periods.

Although recent goodwill impairment announcements typically have produced only muted effects on stock prices, reviewing public information regarding impairment charges can help management consider the impact an impairment charge would have on its company. This, in turn, can enable management to articulate a broader perspective of their business – both internally and to the public markets.