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VALUATION observations

Good Bye, Goodwill: 2009 Promises to be Full of Impairment Charges

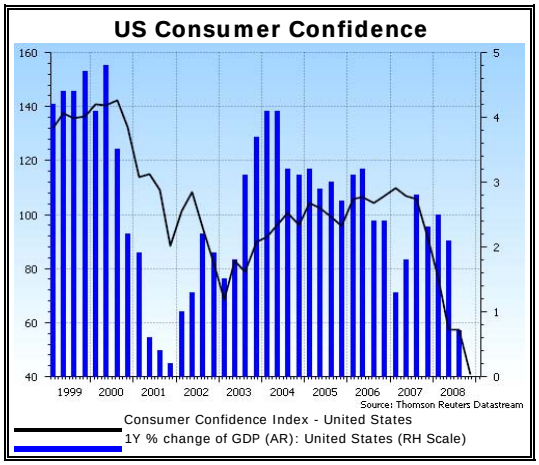
By Brian D. Bornino and Kelly N. Curtin

Several studies estimate that less than 10% of goodwill-carrying companies record goodwill impairment charges during a given year. We expect this percentage to more than double in 2009, as the current environment reflects a "perfect storm" for goodwill impairment. Specifically, poor company performance, an economic recession, low valuation multiples, increased emphasis on fair value measurements by auditors in light of the issuance of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS 157"), and heightened scrutiny by financial statement users such as shareholders and banks, are expected to lead to a historic level of goodwill write-downs.

The Perfect Storm

Not in recent memory has the economic climate for businesses changed so quickly and been so difficult. In our view, the current environment represents a "perfect storm" that will result in goodwill impairment charges for many companies, with the key contributing factors being the following:

- ***Economic Recession.*** There are few companies that are immune to the challenging economic climate that we face. As highlighted below, leading economic indicators such as GDP growth, Consumer Confidence, Manufacturing Inventories, and Personal Consumption Expenditures all experienced sharp declines in 2008. As the economy struggles, companies struggle as well (i.e., a sinking tide lowers all boats).



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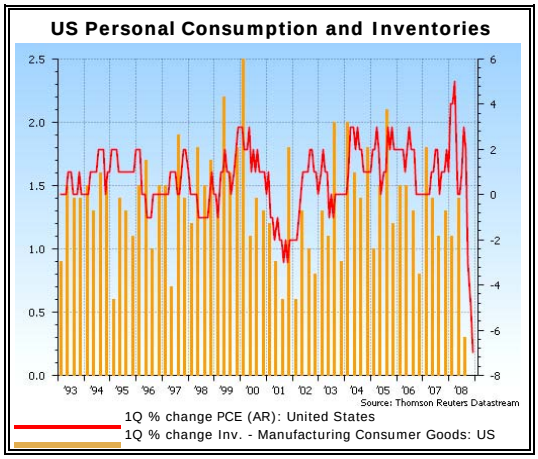
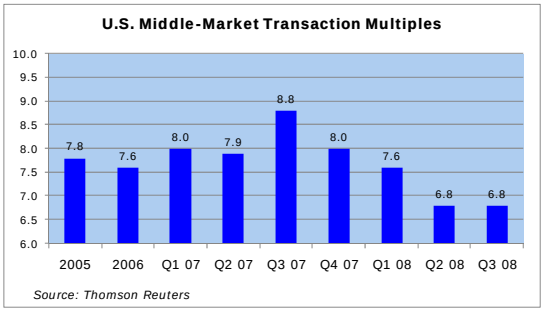


- ***Poor Company Performance.*** Many companies reported lackluster performance in 2008, and prospects for 2009 and 2010 are difficult. Since discounted future cash flow analyses are often at the heart of valuation impairment testing, it stands to reason that lower projected cash flows will lead to lower fair values (and thus, greater levels of impairment). Importantly, auditors who have in the past "signed off" on management-prepared calculations supporting an opinion that goodwill is not impaired will be hard-pressed to do so in 2009, as poor company performance will lead auditors to scrutinize these calculations much more rigorously.

The days of auditors accepting management-prepared, "back-of-the-envelope" valuation calculations are probably over.

- ***Low Valuation Multiples.*** One only needs to review their most recent 401 (k) statement to recognize the massive stock market decline of the past year. Valuation multiples in virtually every industry are down, with overall middle-market transaction multiples declining from a high of 8.8 to a low of 6.8, which means that company valuations and fair value measurements will also suffer.



- ***Heightened Scrutiny by Financial Statement Users.*** Company stakeholders are paying more and more attention to valuation issues. Banks have incurred losses on many investments and are closely monitoring others. Investors in private equity firms are requiring far more transparent reporting on how fair value estimates are determined. Shareholders and boards of directors are increasingly evaluating management in these diffi-

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Good Bye, Goodwill: 2009 Promises to be Full of Impairment Charges (continued)

cult times. More people are watching more closely than ever, and most expect to see impairment charges or good reasons why they have not been taken.

Batten Down the Hatches

Given the factors above, there is not much we or our clients can do about the prospects of facing a goodwill impairment charge. Perhaps the best advice we can provide is to communicate with our clients about these issues and set the expectation that goodwill impairment may be a real possibility and that an outside valuation study from a qualified valuation practice may be required to quantify the level of impairment. As we stated earlier, we expect that auditors will be extra rigorous with their audits in 2009 and beyond, and goodwill impairment testing will often take "center stage" during these audits.

ABOUT US

GBQ Consulting specializes in Business Valuation, Mergers and Acquisitions, and Dispute Advisory and Forensic Services. Our Business Valuation group is one of the largest and most experienced in the Midwest. Professionals at our offices in Columbus (OH) and Indianapolis (IN) provide the following services:

- Transaction Support & Opinions
- ESOP & ERISA Advisory
- Succession & Wealth Planning
- Financial Reporting Services
- Corporate Planning & Assistance
- Expert Opinion Valuations

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