

The Talbots, Inc., and Subsidiaries: Accounting for Goodwill

Thecasesolutions.com

Goodwill Creation

Thecasesolutions.com

- Goodwill is the established reputation of a business regarded as a quantifiable asset
- Goodwill is the excess of the purchase price over the fair market value of the purchased company
- Companies often pay more to acquire another company than the fair value of tangible assets purchased because trademarks, existing leases, customer loyalty, or other intangible assets such as reputation have value

Background Information

- On May 3, 2006, Talbots will acquire JJI for \$518 million in cash
- This amount exceeds the fair market value of the net physical assets Talbots will acquire from JJI
- Talbots will need to recognize the excess paid over fair market value as goodwill, trademarks, and other intangible assets

Thecasesolutions.com

Agenda

Thecasesolutions.com

- Background Information
- Goodwill Creation
- Purchase Details
- Journal Entries to Record
- Goodwill Amortization Calculations
- Conclusion
- Questions & Answers

Thecasesolutions.com

| | | | | | | | | | | | | | |
|--|-------------------|-------------|---------------------------|---------------|----------|-------------|--|---------------------|-------------|----------|-------------|-------|-------------|
| <table border="1"> <tr><td>Acquisition Price</td><td>518,000,000</td></tr> <tr><td>Less: Net Physical Assets</td><td>(248,500,000)</td></tr> <tr><td>Goodwill</td><td>269,500,000</td></tr> </table> | Acquisition Price | 518,000,000 | Less: Net Physical Assets | (248,500,000) | Goodwill | 269,500,000 | <table border="1"> <tr><td>Net Physical Assets</td><td>248,500,000</td></tr> <tr><td>Goodwill</td><td>269,500,000</td></tr> <tr><td>Total</td><td>518,000,000</td></tr> </table> | Net Physical Assets | 248,500,000 | Goodwill | 269,500,000 | Total | 518,000,000 |
| Acquisition Price | 518,000,000 | | | | | | | | | | | | |
| Less: Net Physical Assets | (248,500,000) | | | | | | | | | | | | |
| Goodwill | 269,500,000 | | | | | | | | | | | | |
| Net Physical Assets | 248,500,000 | | | | | | | | | | | | |
| Goodwill | 269,500,000 | | | | | | | | | | | | |
| Total | 518,000,000 | | | | | | | | | | | | |

Thecasesolutions.com

| | | | | | | | | | | | | | | | | | | | |
|--|---------------------|-------------|-------------|-------|---------------------|-------------|--------|------|-------------|---|--------|----------|-------------|--------|---------------------|-------------|-------|------|-------------|
| <table border="1"> <tr><td>Debit</td><td>Goodwill</td><td>269,500,000</td></tr> <tr><td>Debit</td><td>Net Physical Assets</td><td>248,500,000</td></tr> <tr><td>Credit</td><td>Cash</td><td>518,000,000</td></tr> </table> | Debit | Goodwill | 269,500,000 | Debit | Net Physical Assets | 248,500,000 | Credit | Cash | 518,000,000 | <table border="1"> <tr><td>Credit</td><td>Goodwill</td><td>269,500,000</td></tr> <tr><td>Credit</td><td>Net Physical Assets</td><td>248,500,000</td></tr> <tr><td>Debit</td><td>Cash</td><td>518,000,000</td></tr> </table> | Credit | Goodwill | 269,500,000 | Credit | Net Physical Assets | 248,500,000 | Debit | Cash | 518,000,000 |
| Debit | Goodwill | 269,500,000 | | | | | | | | | | | | | | | | | |
| Debit | Net Physical Assets | 248,500,000 | | | | | | | | | | | | | | | | | |
| Credit | Cash | 518,000,000 | | | | | | | | | | | | | | | | | |
| Credit | Goodwill | 269,500,000 | | | | | | | | | | | | | | | | | |
| Credit | Net Physical Assets | 248,500,000 | | | | | | | | | | | | | | | | | |
| Debit | Cash | 518,000,000 | | | | | | | | | | | | | | | | | |

Fiscal Year 2007

| | | | | | | | | | | | | | |
|---|--------------|-------------|--------------------------------|--------------|--------------|-------------|---|--------------|-------------|------------------|--------------|--------------|-------------|
| <table border="1"> <tr><td>Goodwill</td><td>269,500,000</td></tr> <tr><td>Less: Accumulated Amortization</td><td>(10,000,000)</td></tr> <tr><td>Net Goodwill</td><td>259,500,000</td></tr> </table> | Goodwill | 269,500,000 | Less: Accumulated Amortization | (10,000,000) | Net Goodwill | 259,500,000 | <table border="1"> <tr><td>Net Goodwill</td><td>259,500,000</td></tr> <tr><td>Less: Impairment</td><td>(10,000,000)</td></tr> <tr><td>Net Goodwill</td><td>249,500,000</td></tr> </table> | Net Goodwill | 259,500,000 | Less: Impairment | (10,000,000) | Net Goodwill | 249,500,000 |
| Goodwill | 269,500,000 | | | | | | | | | | | | |
| Less: Accumulated Amortization | (10,000,000) | | | | | | | | | | | | |
| Net Goodwill | 259,500,000 | | | | | | | | | | | | |
| Net Goodwill | 259,500,000 | | | | | | | | | | | | |
| Less: Impairment | (10,000,000) | | | | | | | | | | | | |
| Net Goodwill | 249,500,000 | | | | | | | | | | | | |

Thecasesolutions.com

Questions & Answers

Conclusion

Thecasesolutions.com

- A company creates goodwill when it acquires another company for more than the fair market value of the assets received
- To record the purchase entry of an acquisition, Talbots will debit the assets received, credit the assets given up, and credit the liabilities received
- Talbots will amortize the intangible assets, except trademarks and goodwill, over their estimated life and will write-off the assets upon impairment
- Talbots will reverse trademarks and goodwill for impairment annually and write them off upon impairment

By: Michelle German

The Talbots, Inc., and Subsidiaries: Accounting for Goodwill

Thecasesolutions.com

Goodwill Creation

Thecasesolutions.com

- Goodwill is the established reputation of a business regarded as a quantifiable asset
- Goodwill is the excess of the purchase price over the fair market value of the purchased company
- Companies often pay more to acquire another company than the fair value of tangible assets purchased because trademarks, existing leases, customer loyalty, or other tangible assets such as reputation have value

Background Information

- On May 3, 2006, Talbots will acquire J. Jill for \$518 million in cash
- This amount exceeds the fair market value of the net physical assets Talbots will acquire from J. Jill
- Talbots will need to recognize the excess paid over fair market value as goodwill, trademarks, and other intangible assets

Thecasesolutions.com

Agenda

Thecasesolutions.com

- Background Information
- Goodwill Creation
- Purchase Details
- Journal Entries to Record
- Goodwill Amortization Calculations
- Conclusion
- Questions & Answers

Thecasesolutions.com

| | | |
|--|---|---|
| <p>Cash Paid to Shareholders:</p> <p>\$518,120,000</p> | <p>Fair Market Value of Acquired J. Jill Assets:</p> <p>\$687,572,000</p> | <p>Liabilities Assumed by Acquirer (J. Jill):</p> <p>21,551,767</p> |
|--|---|---|

Journal Entries to Record

Thecasesolutions.com

| ASSETS RECEIVED (DEBIT) | DEBIT | CREDIT |
|--------------------------------------|-------------|-------------|
| Cash | 518,120,000 | |
| Deferred Income Taxes | 15,475,000 | |
| Other Current Assets | 92,487,000 | |
| Property and Equipment | 254,153,000 | |
| Goodwill | 211,897,000 | |
| Trademarks | 79,188,000 | |
| Other Intangible Assets | 208,188,000 | |
| LIABILITIES ASSUMED (CREDIT) | | |
| Debt on Hand | | 128,128,000 |
| ACQUISITION COSTS | | 4,870,000 |
| Cash Received Through Debt Financing | | 490,000,000 |
| LIABILITIES RECEIVED (CREDIT) | | |
| Current Liabilities | | 50,000,000 |
| Deferred Income Taxes | | 30,000,000 |
| Other Long-Term Liabilities | | 11,820,000 |

Questions & Answers

Conclusion

Thecasesolutions.com

- A company creates goodwill when it acquires another company for more than the fair market value of the assets received
- To record the journal entry of an acquisition, Talbots will debit the assets received, credit the assets given up, and credit the liabilities received
- Talbots will amortize intangible assets, except trademarks and goodwill, over their estimated life and will write-off the assets upon impairment
- Talbots will review trademarks and goodwill for impairment annually and write them off upon impairment

Fiscal Year 2007 Intangible Asset Amortization Calculations

| | | |
|-------------------------------------|------------------------------------|---|
| <p>Trademark</p> <p>211,897,000</p> | <p>Goodwill</p> <p>211,897,000</p> | <p>Other Intangible Assets</p> <p>208,188,000</p> |
|-------------------------------------|------------------------------------|---|

Thecasesolutions.com

By: Michelle German

Agenda

Thecasesolutions.com

- **Background Information**
- **Goodwill Creation**
- **Purchase Details**
- **Journal Entries to Record**
- **Goodwill Amortization Calculations**
- **Conclusion**
- **Questions & Answers**

Background Information

- On May 3, 2006, Talbots will acquire J. Jill for \$518 million in cash
 - This amount exceeds the fair market value of the net physical assets Talbots will acquire from J. Jill
 - Talbots will need to recognize the excess paid over fair market value as goodwill, trademarks, and other intangible assets

Thecasesolutions.com

Goodwill Creation

Thecasesolutions.com

- Goodwill is the established reputation of a business regarded as a quantifiable asset
- Goodwill is the excess of the purchase price over the fair market value of the purchased company
- Companies often pay more to acquire another company than the fair value of tangible assets purchased because trademarks, existing leases, customer loyalty, or other tangible assets such as reputation have value

Thecasesolutions.com

Cash Paid to Shareholders

\$518,320,000

*Fair Market Value of Acquired
J. Jill Assets*

\$687,572,000

*Liabilities Assumed in
Acquisition of J. Jill*

| LIABILITIES RECEIVED | |
|-----------------------------------|--------------------|
| Current Liabilities | 55,662,000 |
| Deferred Income Taxes | 95,699,000 |
| Other Long-Term Liabilities | 11,820,000 |
| Debt Acquisition Loan | 400,000,000 |
| Total Liabilities Received | 563,181,000 |

Shares Purchased

21,551,767

Journal Entries to Record

Thecasesolutions.com

| ASSETS RECEIVED (DEBIT) | DEBIT | CREDIT |
|--------------------------------------|--------------|---------------|
| Cash | 30,445,000 | |
| Deferred Income Taxes | 19,475,000 | |
| Other Current Assets | 91,837,000 | |
| Property and Equipment | 154,553,000 | |
| Goodwill | 211,977,000 | |
| Trademarks | 79,100,000 | |
| Other Intangible Assets | 100,185,000 | |
| ASSETS GIVEN-UP (CREDIT) | | |
| Cash on Hand | | 118,320,000 |
| Acquisition Costs | | 6,071,000 |
| Cash Obtained Through Debt Financing | | 400,000,000 |
| LIABILITIES RECEIVED (CREDIT) | | |
| Current Liabilities | | 55,662,000 |
| Deferred Income Taxes | | 95,699,000 |
| Other Long-Term Liabilities | | 11,820,000 |

Fiscal Year 2007

Intangible Asset Amortization Calculations

Customer Relationships

Fair Market Value \$84,200,000
Estimated Life 12 Years

Fiscal Year 2007 Amortization = $\frac{\$84,200,000}{12 \text{ Years}} \times \frac{9}{12} = \$5,262,500$

Favorable Leasehold Interests

Fair Market Value \$11,085,000
Estimated Life 8 Years

Fiscal Year 2007 Amortization = $\frac{\$11,085,000}{8 \text{ Years}} \times \frac{9}{12} = \$1,039,219$

Trademarks and Goodwill

Trademarks Fair Market Value \$79,100,000
Goodwill Fair Market Value \$211,977,000
Estimated Life Indeterminable

- Not amortized
- Reviewed for impairment on an annual basis

Non-Compete Agreements

Fair Market Value \$4,900,000
Estimated Life 20 months

Fiscal Year 2007 Amortization = $\frac{\$4,900,000}{20 \text{ months}} \times 9 = \$2,205,000$

Thecasesolutions.com

Conclusion

Thecasesolutions.com

- A company creates goodwill when it acquires another company for more than the fair market value of the assets received
- To record the journal entry of an acquisition, Talbots will debit the assets received, credit the assets given up, and credit the liabilities received
- Talbots will amortize intangible assets, except trademarks and goodwill, over their estimated life and will write-off the assets upon impairment
- Talbots will review trademarks and goodwill for impairment annually and write them off upon impairment