

Is Goodwill getting too big?

There is often the challenge in accounting circles in explaining the concept of goodwill. It is such an abstract concept, that a buyer would pay a premium over the value of assets just because the company is functioning well, or possesses some 'secret sauce' that will propel it to higher values in the future. But can this premium overwhelm other assets and even overwhelm equity?

The companies in the S&P 500 have a combined total of \$3.4 trillion in goodwill on the books, and \$7.8 trillion in stock holder's equity, or over 44%. While some large companies have no goodwill on the books (including Apple), 421 of the 500 do have some, ranging as high as \$145 billion with AT&T, which represents 74.5% of its equity.

For AT&T, other forms of intangibles, such as capitalized television production costs, licence agreements and other unspecified intangibles will bring the total of intangible assets to \$279 billion, compared to a 'mere' \$195 billion in equity.

Goodwill appears during a takeover or a merger, and while there are annual tests to see if it still "exists", it rarely goes away. So goodwill tends to grow in industries and companies that grow by acquisition. A great example of this would be Disney, having grown their goodwill to \$80 billion in 2019 from a mere \$31 billion. So how did they grow goodwill by \$49 billion? They bought Twentieth Century Fox. By paying \$69.5 billion for a company with \$20 billion net assets, mostly intangible items, goodwill was created. The management and shareholders of Disney deemed this a fair price, so the accountants needed to put the difference somewhere. And so goodwill grew.

By sector, the industrials come in the highest in terms of a percentage of equity compared to goodwill, at 88.7%. It is one of the bigger sectors overall, composed of 72 companies. Of these, 29 companies have more goodwill than equity.

On the other side, real estate comes away as the sector with the lowest amount of goodwill, both on an absolute and percentage basis. Of the 32 companies in the index, 22 have no goodwill at all. The highest in the real estate sector, at \$10.1 billion (or 99.6% of equity) is Crown Castle International (CCI). It owns cellphone towers across the United States. During the 2017 year, it made a number of acquisitions, the largest came with \$2.2 billion in intangible assets, and \$3.1 billion in goodwill. The intangibles were comprised of rental contracts and customer relationships, so the goodwill must be comprised of other items that make up the secret sauce.

129 of the 500 companies have goodwill greater than equity. While for 36 of these companies it is due to possessing negative equity, but for the rest it means that any write-down in goodwill could have a devastating effect on the company. But I suspect that many will take write-downs this year, as the current crisis drives down earnings and forces companies to remove goodwill.