M&A; EXECUTION PROGRAM

PART 09 OF 12 · PART 3: POST-MERGER INTEGRATION & ACCOUNTING

PART 9

PURCHASE PRICE ALLOCATION & ASC 805

The deal has closed. Now the real accounting work begins. This session covers the acquisition method under ASC 805, the Purchase Price Allocation process, valuing identifiable intangibles, and the treatment of goodwill — including impairment testing.

IN THIS PART

- ASC 805 acquisition method overview
- Identifying all assets and liabilities at fair value
- Valuing identifiable intangible assets
- In-process R&D; treatment
- Goodwill calculation and testing
- Deferred tax implications of PPA

THREE CASE STUDIES

Each session includes one fully worked case study with detailed calculations, negotiating dynamics, and CFO-level decision frameworks.

SESSION 9: PURCHASE PRICE ALLOCATION

The Opening Balance Sheet: The CFO's First Post-Close Deliverable

The day after a transaction closes, the acquirer's CFO faces one of the most technically complex accounting tasks in corporate finance: the Purchase Price Allocation (PPA). Under ASC 805 (Business Combinations), the acquirer must record the acquisition using the **acquisition method**, which requires recognizing and measuring every identifiable asset acquired and liability assumed at **fair value** on the acquisition date — regardless of the seller's historical book values.

The excess of the total consideration paid over the fair value of net identifiable assets acquired is recorded as **goodwill**. In technology acquisitions, goodwill often represents 60-80% of the total consideration — the 'blue sky' value of an assembled workforce, market position, and expected synergies that cannot be separately identified and measured.

The PPA Framework: Four Steps

Step 1	**Measure Total Consideration**	Sum of cash paid, fair value of stock issued, fair value of contingent consideration (earnout), assumed debt at fair value. This is the 'purchase price' to be allocated.
Step 2	**Identify All Assets and Liabilities**	Physical assets (PP&E;), financial assets (AR, investments), identifiable intangible assets (customer relationships, technology, trade names, backlog), and all liabilities — at fair value.
Step 3	**Measure Fair Values**	Engage a qualified valuation firm. Use income approach (DCF), market approach (comparables), or cost approach depending on the asset type. Document all assumptions.
Step 4	**Calculate Goodwill**	Goodwill = Total Consideration minus Fair Value of Net Identifiable Assets (identifiable assets minus liabilities assumed). Goodwill is not amortized but tested for impairment annually.

Identifiable Intangible Assets: The Valuation Challenge

The most challenging and consequential part of any technology acquisition PPA is identifying and valuing intangible assets that are not on the seller's balance sheet. These must be separately recognized if they meet either the contractual-legal criterion or the separability criterion under ASC 805.

Intangible Asset	Valuation Method	Typical Life (Amortization)	Complexity
Customer Relationships	Multi-Period Excess Earnings Method (MPEEM)	5-15 years (straight-line)	High — requires attrition rate, revenue attribution
Developed Technology / IP	Relief from Royalty Method	3-10 years	Medium — requires royalty rate benchmarks
Trade Names / Brands	Relief from Royalty Method	Indefinite (if strong) or 5-20 years	Medium — royalty rate selection critical
Order Backlog	MPEEM or Direct Method	0.5-2 years (rapid amortization)	Medium — contracted backlog is more certain
Non-Compete Agreements	With/Without Method	Term of agreement	Low — typically smaller amounts
In-Process R&D; (IPR&D;)	Income Approach — probability-weighted	Indefinite until complete; then amortized	Very High — probability and timing assumptions
Favorable Contracts / Leases	Income Approach — above-market excess	Remaining contract term	Medium

◆ FULL PPA — TECH ACQUISITION

PURCHASE PRICE ALLOCATION — COMPLETE EXAMPLE

TOTAL CONSIDERATION:

Cash paid at closing: $85,000,000

Fair value of earnout (probability-weighted): $8,200,000

TOTAL CONSIDERATION: $93,200,000

IDENTIFIABLE ASSETS AT FAIR VALUE:

Cash: $2,100,000

Accounts Receivable (net): $4,800,000

Inventory (at NRV): $3,200,000

PP&E; (appraised FMV): $6,400,000

Customer Relationships (MPEEM, 10yr): $18,500,000

Developed Technology (Relief from Royalty, 7yr):$12,300,000

Trade Name (Relief from Royalty, indefinite): $5,800,000

Order Backlog (Direct Method, 18 months): $2,100,000

IPR&D; (in-process; probability-weighted): $4,600,000

Other assets: $850,000

TOTAL IDENTIFIABLE ASSETS: $60,650,000

LIABILITIES ASSUMED AT FAIR VALUE:

Accounts Payable: ($2,400,000)

Deferred Revenue (debt-like in PPA): ($1,800,000)

Other Accrued Liabilities: ($1,600,000)

Deferred Tax Liability (on intangibles): ($10,120,000)

TOTAL LIABILITIES: ($15,920,000)

NET IDENTIFIABLE ASSETS: $60,650,000 - $15,920,000 = $44,730,000

GOODWILL: $93,200,000 - $44,730,000 = $48,470,000

Goodwill as % of consideration: 52.0%

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CASE STUDY 1

QuantumPath Technology Inc.

Tech Acquisition PPA — Valuing IPR&D; vs. Customer Relationships

Background

QuantumPath Technology was acquired for $100M. The company had $12M ARR but its primary value was in two assets: a 500+ customer base with 118% NRR, and a pre-commercial AI/ML engine still in development (expected commercialization in 18 months). The PPA debate centered on how to split the $80M of 'blue sky' between customer relationships, developed technology, and IPR&D.;

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◆ QUANTUMPATH PPA DETAIL

QUANTUMPATH — IPR&D; vs. CUSTOMER RELATIONSHIP VALUATION
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CUSTOMER RELATIONSHIPS (MPEEM):
ARR: $12,000,000; Gross Margin: 72%; Customer Attrition: 8%
Revenue from existing customers (10-yr decay):
Year 1: $12M × (1-0.08)^0 = $12,000,000
Year 5: $12M × (1-0.08)^4 = $8,600,000
Year 10: $12M × (1-0.08)^9 = $5,400,000
MPEEM contribution margin (72% GM less charges): 45%
Discount rate: 18% (higher risk premium for intangibles)
Indicated Fair Value — Customer Relationships: $22,400,000
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IPR&D; (AI/ML Engine — Pre-Commercial):
Expected revenue at commercialization: $8M ARR
Probability of successful completion: 65%
Expected commercialization: 18 months
Discount rate: 30% (pre-revenue tech risk premium)
PV of probability-weighted cash flows:
Indicated Fair Value — IPR&D;: $9,800,000
(Classified as indefinite-lived until completed)
(Annual impairment testing required)
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GOODWILL RESIDUAL AFTER PPA:
Total consideration: $100,000,000
Net tangible assets (book value): $8,200,000
Customer Relationships: $22,400,000
Developed Technology (existing product): $14,200,000
IPR&D;: $9,800,000
Trade Name: $3,600,000
DTL on intangibles (21%): ($10,500,000)
GOODWILL: $100M - $47,700,000 = $52,300,000
52.3% of total consideration is goodwill
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CASE STUDY 2

Coastal Brands Group

Trade Name Valuation — Indefinite vs. Finite Life Decision

Background

Coastal Brands Group owns three consumer brands acquired in a $75M transaction. The PPA debate: should the flagship brand (30 years old, strong consumer recognition) be classified as an indefinite-lived intangible (no amortization, annual impairment test) or a finite-lived intangible (amortized, with no impairment unless indicator exists)? The P&L; impact of this decision is substantial.

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◆ TRADE NAME LIFE DECISION — P&L; IMPACT

COASTAL BRANDS — TRADE NAME LIFE DECISION
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Flagship brand fair value (Relief from Royalty): $18,000,000
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OPTION A: INDEFINITE-LIVED (no amortization):
Annual amortization charge: $0
P&L; impact: None (until impairment, if ever)
Annual impairment testing required
Argument: 30-year brand with no foreseeable end
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OPTION B: FINITE-LIVED (20-year life):
Annual amortization: $18M / 20 = $900,000/year
Tax benefit (21%): $189,000/year
P&L; hit each year: ($900,000)
Argument: Consumer preferences evolve; brand relevance
has finite useful life
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10-YEAR CUMULATIVE IMPACT:
Amortization (Option B): $9,000,000 expense
Tax shield: $1,890,000
Net EPS impact (10yr): ($7,110,000)
ACQUIRER CHOSE: Indefinite-lived (Option A)
Reasoning: Brand has 30-year track record; dominant
category position; no contractual limitation on life
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CASE STUDY 3

DataStream Analytics

Goodwill Impairment — When the Blue Sky Evaporates

Background

DataStream Analytics was acquired for $120M in Year 1 with goodwill of $72M. By Year 3, the business had deteriorated significantly — customer churn accelerated, a key competitor introduced a superior product, and ARR dropped 35%. The annual goodwill impairment test indicated a need for a $38M write-down.

◆ GOODWILL IMPAIRMENT TEST

DATASTREAM — GOODWILL IMPAIRMENT TEST

STEP 1: QUALITATIVE ASSESSMENT (ASC 350)

Triggering events identified: ✓

ARR decline 35% YoY

Key product manager departures (3 of 5)

Competitor market share increase from 12% to 28%

→ Proceed to quantitative test

STEP 2: QUANTITATIVE IMPAIRMENT TEST

Carrying value of reporting unit:

Net assets (book): $48,200,000

Goodwill: $72,000,000

Total carrying value: $120,200,000

FAIR VALUE OF REPORTING UNIT (revised DCF):

Revised EBITDA (Year 3 actual): $3,200,000

Revised forward growth: 5% (vs. 18% at acquisition)

Revised WACC: 16% (vs. 12% at acquisition)

Revised EV (DCF): $82,200,000

IMPAIRMENT CHARGE:

Carrying value: $120,200,000

Fair value: $82,200,000

GOODWILL IMPAIRMENT: ($38,000,000)

After-tax impact (non-deductible goodwill): ($38,000,000)

EPS impact (40M shares): ($0.95) per share