

## Case 3: Analysis of Competitors

### Facts

You are an analyst, following NatureWear and you are currently preparing your forecast for NatureWear. During your analysis, you find an interesting competitor of NatureWear, namely LeafGroup. You are provided with the following information about LeafGroup.

### Company History and Operations

LeafGroup was founded in Frankfurt in 2010. It produces plant-based lunchboxes for camping. LeafGroup mainly distributes their lunchboxes via LeafGroup's own online shop but also has some local stores. The online shop operates globally, while the stores are mainly focused on the German-speaking region.

LeafGroup mainly uses advertisements via social media channels such as Instagram or X.

LeafGroup went public on the Frankfurter Wertpapierbörse in 2015.

### Company Growth Strategy

LeafGroup's growth strategy has mainly one element: Three years ago, LeafGroup acquired BrownBag. Since LeafGroup expected large synergies from the acquisition (BrownBag produces recycled bread wrapping paper – a perfect match with LeafGroup's plant-based lunchboxes!), they recorded a large goodwill from the transaction.

LeafGroup provides you with the following information about their goodwill acquisition. LeafGroup has allocated the goodwill across three cash-generating units.

LeafGroup defined CGUs based on product families and allocates the goodwill to the respective CGUs. The following table provides you with the carrying amounts (in TEUR) of the CGUs before any goodwill impairment testing.

	<b>CGU 1 [Kids lunchboxes]</b>	<b>CGU 2 [Fancy Instagram lunchboxes]</b>	<b>CGU 3 [Snackbox]</b>
Goodwill	80,000	70,000	50,000
Machinery	100,000	90,000	80,000
PPE	210,000	100,000	90,000
Current Assets	90,000	80,000	50,000
<i>Sum</i>	<i>480,000</i>	<i>340,000</i>	<i>270,000</i>

### Product Development

Currently, LeafGroup is highly dependent on their suppliers and the goods are produced by independent manufacturers. In the future, LeafGroup plans to build own factory buildings to become independent.

## **Financial Reporting**

The consolidated financial statements are reported in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as applicable within in European Union. You are provided with LeafGroup's balance sheet and income statement (s. Excel).

## Tasks

1. Please describe LeafGroup's business model. Further, compare the competitor to NatureWear regarding the different strategies and its implications.
2. Please explain how to account for goodwill impairment under IFRS. In your explanation, please also explain the concept of a cash-generating unit. Please also explain potential incentives managers might have when exercising their discretion in allocation goodwill to cash-generating units with a view to avoiding future impairments.
3. Please decompose LeafGroup's ROE. Please use the excel to prepare your solutions.
4. The management of LeafGroup is worried! During their annual impairment tests, it turned out there might be a need for impairment. Help the management and
  - a) conduct a step-by-step impairment test. Assume the following recoverable amounts for the respective CGUs (in TEUR).

CGU 1	CGU 2	CGU 3
400,000	270,000	200,000

- b) explain how the impairment loss will affect the results of the company's ROE decomposition (Advanced DuPont) in the current and future periods.
- c) Suppose that CGU 2 has high hidden reserves in its non-goodwill assets and could therefore absorb impairments more easily. Discuss the management implications.