

Case 11-7

Food for Thought

Allfoods Corp. (Allfoods) is a calendar year-end company. On February 1, 2009, Allfoods announced that it was acquiring 80 percent of the outstanding common stock of Baked Beans Corp. (Baked Beans) in a business combination. On the acquisition date, Allfoods paid \$40 million in cash and issued two million shares of Allfoods common stock to the selling shareholders of Baked Beans. All of the outstanding stock options granted to employees of Baked Beans will be replaced with Allfoods stock options as required by the merger agreement. Allfoods is accounting for the transaction in accordance with ASC 805, *Business Combinations*.

1. Determining Consideration Transferred

On August 1, 2009, Allfoods acquired Baked Beans. The Allfoods share price was \$30 on the announcement date and \$35 on the acquisition date. The parties agreed that Allfoods would issue the selling shareholders an additional one million shares if Baked Beans revenues for the 12-month period after the acquisition were at least \$150 million. The fair value of the contingent consideration was determined to be \$20 million as of the acquisition date. The value of the replacement stock option awards attributable to precombination services is \$5 million, and the portion that relates to postcombination services is \$7 million. Allfoods incurred \$4 million of acquisition related costs.

2. Fair Value of Assets Acquired and Liabilities Assumed

Baked Beans owns a manufacturing facility in Chino, California. The facility is comprised of land, two buildings, and machinery. There are no other significant assets located at this facility. The land could be rezoned into a residential subdivision for a nominal fee and management has determined that the fair value of the underlying land as residential property would be \$30 million, after considering costs necessary to prepare it for use as residential lots (i.e., demolition costs of the building, net of the fair value of scrap from the building and nonmovable equipment). The movable equipment (i.e., equipment that could be sold separately) could be sold at auction for \$2 million. The Chino manufacturing facility (as acquired) is estimated to be worth \$36 million. Management determined that the individual fair value of the land being used for industrial purposes is \$21 million and that the fair value of the buildings and machinery as currently being used (for industrial purposes) is \$7 million.

3. Valuation of Intangible Assets

The in-process research and development (IPR&D), which is proprietary food freezing technology submitted for Food and Drug Administration (FDA) approval, has a fair value of \$15 million. The company considers its R&D to be in-process because it has not yet obtained FDA approval and additional R&D may be required. Allfoods management has determined that the fair value of the Baked Beans trademark is \$3 million, using a market participants' viewpoint. Management has also determined that it will not use the trademark because it intends to distribute the Baked Beans products under the Allfoods trademark. Management has also determined that it will not sell the trademark because it

believes that this could potentially result in new participants entering the market, thus reducing its market share. No amounts were recorded in the balance sheet of Baked Beans for the research and development costs related to their proprietary freezing technology. The trademark has a carrying value of \$2 million in Baked Beans financial statements related to costs that it incurred in purchasing the trademark.

Required:

- What is the total consideration transferred by Allfoods in the acquisition of Baked Beans?
- On what premise should management record the land and buildings, i.e., the “in-use” or “in-exchange” premise?
- What fair values should be recorded for the intangible assets as part of the acquisition accounting?