NEW RISK ALERT: (WH)

Wyndham's New Accounting Policy May Understate Goodwill Impairment

Latest 10-K reveals hotel chain's pandemic related impairment is below the lodging industry average.

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This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Wyndham Changes its Accounting Policy

Wyndham Hotel & Resorts, a global hotel franchisor with more than twenty brands, experienced a 37% decline in revenue in 2020. It lost $158 million after turning a $207 million profit in 2019. The travel industry was one of the hardest hit by the global pandemic. It's also one of the last to rebound.

Wyndham purchased La Quinta for $1.95 billion just weeks before the global pandemic prompted travel restrictions and lockdowns that torpedoed the lodging industry. The plunge in occupancy triggered impairment testing throughout the industry. Coincidentally, public companies were required to adopt an amended accounting rule related to how goodwill is tested for impairment in 2020.

It was no surprise then to see Wyndham adopt the new policy in its latest annual report. In its 2019 10-K, Wyndham disclosed it used a two-step process to test for goodwill impairment:

> *"This is done either by performing a qualitative assessment or **utilizing the two-step process**, with an impairment being recognized only where the fair value is less than carrying value."*

In its 2020 10-K, Wyndham notes that it now uses a one-step test:

> *"This is done either by performing a qualitative assessment or **utilizing the one-step impairment test**, with an impairment being recognized only where the fair value is less than carrying value."*

The new standard eliminates step two of the goodwill impairment test which companies say is costly and complex to comply with. Impairment is still the difference between a reporting unit's carrying value and its fair value— capped by the reporting unit's total goodwill— but no longer measures the fair value of each asset and liability of the reporting unit to quantify the impairment.

While some argue the change will increase the amount of impairment reported, others suggest that impairment resulting from the new test does not consider the true economic value of an entity's assets and liabilities since changes in those values are ignored.

Wyndham's Goodwill Impairment is Below the Industry Average

In the second quarter of 2020, Wyndham announced a $206 million impairment charge related to La Quinta. This contrasts slightly with Wyndham's 2020 annual report, which states the impairment was $205 million. Either way, Wyndham attributes much of the impairment to the use of a higher discount rate in its DCF analysis.

Industry data suggests Wyndham's discount rate may not have been high enough. The $206 million impairment is 14.8% of the $1.38 billion in goodwill Wyndham recorded in the La Quinta transaction. The average pandemic related hotel impairment is 20.2%, or 5.4% more than Wyndham calculates.

On October 1, 2020, Wyndham finished its annual impairment test and determined no additional impairment was necessary. The following month, data revealed that U.S. hotel occupancy had declined 304% from the prior year.