Milbank

Acquired Business Financials

When should financial statements for a business acquired or to be acquired be included in a Rule 144A offering memorandum? General Rule: when an acquisition of a significant business has occurred or is probable.

Exception: Financial statements for a business below the 50% significance level that was acquired less than 75 days before the offering or that is probable may be excluded. Marketing and disclosure considerations for a significant acquisition below the 50% significance level may lead to the inclusion of its financial statements (and related pro forma financial information) in the case of a recently completed acquisition or a probable acquisition.

IS THE TRANSACTION "PROBABLE"?

Probability should be evaluated in light of the facts and circumstances. An acquisition is considered probable when it is more likely than not to be completed. This may be the case upon the signing of a definitive purchase agreement or possibly a letter of intent.

IS THE TARGET A "BUSINESS"?

The term “business” should be evaluated in light of whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. A product line may also be considered a business. Alternatively, acquisitions of assets alone may not trigger financial statement or other disclosure obligations.

IS THE ACQUISITION SIGNIFICANT?

The SEC employs three different tests to determine the significance of an acquisition to the acquiring company. The significance tests are defined by the fractions below, expressed as a percentage. Significant means above 20% on any of the three tests described below.

THE SEC'S THREE SIGNIFICANCE TESTS*

INVESTMENT TEST	ASSET TEST	INCOME TEST
Purchase Price / Total Assets of Acquiring Company	Total Assets of Target / Total Assets of Acquiring Company	Pre-tax Income of Target / Pre-tax Income of Acquiring Company

FOR PURPOSES OF CALCULATIONS*

1. Never include the target in any denominator.
2. Use most recent annual financial statements.
3. Pre-tax income is defined as income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle exclusive of amounts attributable to any non-controlling interests.
4. Use five-year average if most recent year income is negative outlier by 10% or more.

SIGNIFICANCE LEVELS	FINANCIAL STATEMENTS
Individual acquisition (or multiple acquisitions of related businesses) 20% significance or less	No separate financial statements required.
Individual acquisition (or multiple acquisitions of related businesses) greater than 20% significance but less than 40% significance	Audited financial statements for the most recent fiscal year of the target should be included. Unaudited interim financial statements for any stub period may also be needed, depending on timing.
Individual acquisition (or multiple acquisitions of related businesses) greater than 40% significance but less than 50% significance	Audited financial statements for the two most recent fiscal years of the target should be included. Unaudited interim financial statements for any stub period may also be needed, depending on timing.
Individual acquisition (or multiple acquisitions of related businesses) greater than 50% significance	Audited financial statements for the three most recent fiscal years of the target should be considered. Unaudited interim financial statements for any stub period may also be needed, depending on timing.
Multiple acquisitions of unrelated businesses that are less than 20% significant individually, aggregating more than 50% significance on a combined basis	Audited financial statements for the most recent fiscal year should be considered for a majority of the acquisitions even if they are individually insignificant (i.e. below the 20% significance level). Unaudited interim financial statements for any stub period may also be needed, depending on timing.

When do you need pro forma financial information? General Rule: In every case where financial statements for the target are included, pro forma financial information showing the effects of the acquisition should also be included.

A condensed pro forma income statement	For the acquiring company's most recently completed fiscal year and the most recent stub period of the acquiring company, unless the historical income statement reflects the transaction for the entire period.
A condensed pro forma balance sheet	As of the end of the most recent period for which a consolidated balance sheet of the acquiring company is included, unless the transaction is already reflected in that balance sheet

FOR PURPOSES OF CALCULATIONS*

1. Only most recent audited year and any interim period.
2. Must be as current as most recent financial statement statements of the acquiring company.
3. Unaudited rather than audited.
4. No projections or synergies.

Note: The above answers are by reference to U.S. public offering requirements. Since the public offering requirements are only applicable to Rule 144A offerings by analogy, exceptions may be appropriate in some circumstances.