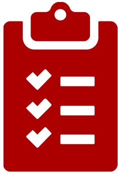
KPMG LATHAM & WATKINS LLP

WHEN DO YOU NEED ACQUIRED BUSINESS FINANCIAL DISCLOSURES IN A PROSPECTUS UNDER THE SEC'S RULES?



GENERAL RULE: Your prospectus must include (or incorporate by reference) financial statements for a **significant** acquisition of a **business** that has **closed 75 days** or more before the offering. Significant means **above 20%** on **any** of the three tests described below. The 75-day grace period **does not apply** for recently closed acquisitions above the 50% significance level, so financial statements will generally be required. For **probable** (not yet closed) acquisitions below the 50% significance level, financial statements will not be needed; by contrast, above 50% they will generally be needed. In every case where target financial statements are required, you will also need pro forma financial information.

Note: in the case of a probable or recently closed acquisition that is above the 20% significance level but less than the 50% significance level, marketing and/or disclosure considerations may lead to the inclusion of acquired company financial statements (and related pro formas) even before the expiration of the 75-day grace period. This is a case-by-case analysis.

If the answer to both of the questions below is "yes":

Is the target a ***"business"***?

- Is the target a separate product line, operating unit, division, subsidiary, or business entity?
- Will there be significant continuity of the target's operations compared to before the transaction?

Is the transaction either ***completed*** or ***"probable"***?

- Is there a binding purchase agreement or signed LOI?
- The "probable" inquiry is fact-specific. Bear in mind industry and issuer-specific considerations.

You will need the answers to these questions:

- What is the acquiror's ***investment***, which equals consideration transferred (*i.e.*, GAAP purchase price)?
- What is the ***aggregate worldwide market value*** of the acquiror's voting and non-voting common equity, or ***book value of total assets***, if the acquirer does not have publicly traded securities?
- What are the ***total revenues*** and the ***pre-tax income*** of the target and the acquiror for the most recent fiscal year?

To test whether the acquisition is "significant" under the SEC definition (S-X Rules 3-05 and 1-02(w)):

An acquisition is ***significant*** if ***any*** of the following three tests **> 20%**:

Test	Description
Investment Test	The amount of the acquiror's investment in the target compared to the aggregate worldwide market value of the acquiror's common equity; if worldwide market value is not available, the amount of the acquiror's investment in the target compared to the acquiror's total assets.
Asset Test	The consolidated total assets of the target compared to the acquiror's consolidated total assets.
Income Test ○ Must test both components where applicable ○ **Both** components must exceed 20% to trip significance threshold ○ The ***lower*** of these amounts determines which financials are required below	*Net income component*: The target's income from continuing operations before income taxes and cumulative effect of a change in accounting principles (after intercompany eliminations) ("**pre-tax income**") compared to the pre-tax income of the acquiror for the most recent full fiscal year. Absolute values should be used to calculate net income. *Revenue component (where acquiror and target have recurring annual revenue)*: The acquiror's share of the target's consolidated total revenues (after intercompany eliminations) compared to acquiror's consolidated total revenues for the most recent full fiscal year.

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If significant, you will need to include the following financial disclosures in your prospectus:

Basic Scenarios	Historical Financial Statements Required
Individual acquisition (or multiple acquisitions of related businesses) of **20% significance or less**	**No separate financial statements needed**.
Individual acquisition (or multiple acquisitions of **related** businesses) of greater than **20%** significance but less than **40%** significance	**Audited financial statements for the most recent fiscal year** of the target must be included. Unaudited interim financial statements for the most recent stub period may also be needed, subject to staleness rules. No comparative period is required at this significance level. An acquiror may omit separate financial statements of a target that has been included in its post-acquisition results for **nine months**.
Individual acquisition (or multiple acquisitions of related businesses) of greater than **40%** significance	**Audited financial statements for the two most recent fiscal years** of the target must be included. Unaudited interim financial statements for any stub period (together with the comparative period from the prior year) may also be needed, subject to staleness rules. An acquiror may omit separate financial statements of a target that has been included in its post-acquisition results for **one year**.
Multiple acquisitions of unrelated businesses that are < 20% significant individually or for which financial statements are not yet required because of the 75-day filing period, aggregating more than **50%** significance on a combined basis	**Audited financial statements for the most recent fiscal year** will be required for businesses whose individual significance exceeds 20% but for which historical financials are otherwise not yet required because of the 75-day grace period. Unaudited interim financial statements for any stub period (together with the comparative period from the prior year) may also be needed, subject to staleness rules.
Acquisitions of related businesses	Related businesses are treated as a single business when measuring significance. If significance under S-X Rule 3-05 is met, separate financial statements for each of the related businesses (or combined financial statements, if appropriate under GAAP) will be required.

Pro Forma Financial Information Required:

Where historical financial statements of the target are required, pro forma financial information complying with S-X Article 11 must also be included. The pro forma information **must** include adjustments that are required by GAAP to account for the transaction and also to show the acquiror as an autonomous entity when it was previously part of another entity. The pro forma information **may** include management adjustments to include forward-looking information (*e.g.*, synergies and dis-synergies that would, in management's opinion, enhance an understanding of the pro forma effects of the transaction). Article 11 requires:

A condensed pro forma **balance sheet**	As of the end of the most recent period for which a consolidated balance sheet of the acquiror is required, unless the transaction is already reflected in that balance sheet.
A condensed pro forma **income statement**	For the acquiror's most recently completed fiscal year and the most recent stub period of the acquiror, unless the historical income statement reflects the transaction for the entire period.
Multiple acquisitions of unrelated businesses (defined above)	Pro forma financial information for individually insignificant businesses aggregating more than 50% significance on a combined basis depicting the aggregate effects of all such businesses in all material respects (even where separate historical financial statements of the individual businesses are not required).

Certain Situations and Industry Considerations:

Using pro forma financials to test significance	An IPO issuer may use pro forma financials to measure significance for acquisitions consummated in the most recent fiscal year. It will need to continue to use pro forma financials until the next Form 10-K. A serial acquiror may be able to use pro forma financials that are more recent than its most recent audited financials for purposes of calculating significance in certain circumstances. In both cases, this can be useful where the pro forma information produces a larger "denominator" for testing significance.
Shelf takedowns	The rules for shelf takedowns are generally the same as those for new registration statements. However, in certain circumstances, such as a purely secondary offering or in the absence of a "fundamental change," it may be possible to conduct an offering using an existing shelf without providing historical financial statements for probable or completed acquisitions that exceed the 50% significance level.
Acquisitions of Oil and Gas Properties	Producing oil and natural gas properties are considered to be a business under S-X Rule 11-01(d). Abbreviated audited financial statements may be provided in the form of a statement of revenues and direct operating expenses if substantially all of the revenues of the business are from oil-and-gas producing activities **and** the total assets and revenues of the acquired business are 20% or less of the corresponding amounts for the seller for the most recently completed fiscal year.
Real estate operations	Significance tests and disclosure requirements for real estate operations acquired or to be acquired under S-X Rule 3-14 have largely been harmonized with Rule 3-05. In particular, the threshold at which audited and unaudited abbreviated income statements (*i.e.*, statements of revenue and certain expenses) must be provided for any "significant" acquisition has been raised from 10% of the acquiror's total assets to 20% of the aggregate worldwide market value of the acquiror's common equity or more.
Rule 144A offerings	Since the public offering requirements are only applicable to Rule 144A offerings by analogy, exceptions may be appropriate in some circumstances. This will be a case-by-case analysis.