

# Complex financial histories\*

A PricewaterhouseCoopers Capital Markets Group  
European Prospectus Disclosure guide



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## Preface

This PwC European Prospectus Disclosure Guide has been prepared in order to assist companies and their advisers in their consideration of the historical financial information that needs to be included in a prospectus under the EU Prospectus Directive. In particular, this Guide explores the recent amendment to the EU's Prospectus Directive regime that made it clear that a prospectus should provide additional historical financial information whenever a company's accounts do not accurately portray the financial record of its entire business undertaking or it has entered into a significant financial commitment.

We particularly welcome the fact that the new legislation takes a principles based approach to solving the financial information question. This Guide seeks to explain the principles and provides illustrations as to how they might be applied to a number of common scenarios drawing on our extensive experience of working with clients producing prospectuses.

Companies' financial histories are often complex and early consideration of the likely prospectus requirements, in consultation with auditors and other advisers, is vitally important if a smooth passage to a successful offering, or admission to trading, of its shares is to be achieved.

We would like to thank Kevin Desmond, and our network of capital market experts across Europe, for their assistance in producing this Guide.

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## Introduction

One important issue that remained unresolved throughout the drafting of the Prospectus Regulation<sup>1</sup> was the question as to how the financial record of an entity that had been through significant change in its business in the three financial years before drawing up a share issue prospectus should be presented.

Conscious of some disparity in historical practice, commentators sought clarity from the European Commission as to how the Prospectus Regulation's provisions requiring the presentation of historical financial information in a prospectus should be applied.<sup>2</sup> The European Commission's initial response was that the provisions only applied to the issuer of the shares in question.

Recognising that this was not necessarily the most appropriate outcome in that, for example, where the issuer was a new company it could result in the omission of relevant information, the European Commission sought advice from the Committee of European Securities Regulators ('CESR') as to whether the Regulation needed to be changed. In providing that advice<sup>3</sup>, CESR concluded that 'the [Prospectus] Regulation should be amended to include an additional provision to deal with situations of issuers having a complex financial history'.

The purpose of this brochure is to consider the amendment to the Prospectus Regulation arising from the European Commission's acceptance of CESR's advice, issued in February 2007 (the 'Amending Regulation').<sup>4</sup>

It should be remembered that whilst these rules specifically apply to share issue prospectuses, the principles set out may well be relevant when considering the historical financial information in other prospectuses such as for a depositary receipt or high-yield bond offering.

Getting the historical financial information disclosures properly identified has important consequences for the drafting of the financial commentary in a prospectus in the operating and financial review.

## Historical financial information requirements

The basic requirement is that a prospectus must include historical financial information for each of the last three completed financial years.

The disclosure of historical financial information can be met by including in the prospectus:

- The issuer's statutory accounts for each of the last three years together with the audit reports thereon; or
- Special purpose financial statements containing the same information as would be in a set of statutory accounts accompanied by an auditor's report; or
- A combination of both of the above ensuring that all three years are presented.

The Prospectus Regulation also addresses the question as to which accounting policies should be applied in the historical financial information. Importantly, it

<sup>1</sup> Commission Regulation (EC) no 809/2004 implementing Directive 2003/71/EC (the Prospectus Directive) as regards the information contained in the prospectus

<sup>2</sup> Prospectus Regulation, Annex I, item 20.1

<sup>3</sup> CESR/05-582

<sup>4</sup> Commission Regulation (EC) No 211/2007

requires that at least the last two year's financial history should be presented on the basis of the policies to be applied to an issuer's next annual financial statements. Most notably, the effect of this is felt on the first time admission to trading on an EU regulated market when issuers may be required to prepare, for the first time, consolidated accounts under EU endorsed IFRS.

The consequence of this provision is to add a further layer of complexity, and choice, when considering what historical financial information should be presented in a prospectus. Guidance on this is contained in CESR's recommendations on the consistent implementation of the Prospectus Regulation.<sup>5</sup>

## What is meant by a complex financial history?

A 'complex financial history' arises whenever the existing statutory accounts of an issuer needing to prepare a prospectus do not provide a comprehensive picture to investors of the financial history of the operations that it controls, or will control.

A common example would be where a new company is formed specifically for the purpose of the offering of the securities and that company will have either acquired or agreed to acquire a business in which investors are, in substance, being invited to invest.

In such circumstances, investors would reasonably expect to see the financial history of the underlying business in order to make an informed assessment of the assets, liabilities, profits and losses, and prospects of the issuer.

However, as noted above the legal interpretation was that requirements of the Prospectus Regulation strictly only applied to the issuer itself and, accordingly, competent authorities could not require that information on the underlying business be presented.

Not infrequently issuers have a more complex history than this. As a result, the European Commission decided, consistent with many commentators' views and CESR's advice, that it should adopt a principles based solution that is broad enough to be applied to specific circumstances as they arise.

The definition of a complex financial history included in the Amending Regulation is:

'An issuer shall be treated as having a complex financial history if all of the following conditions apply:

- its entire business undertaking at the time that the prospectus is drawn up is not accurately represented in the historical financial information which it is required to provide under item 20.1 of Annex I;
- that inaccuracy will affect the ability of the investor to make an informed assessment as mentioned in Article 5(1) of directive 2003/71/EC<sup>6</sup>; and
- information relating to its business undertaking that is necessary for an investor to make such an assessment is included in financial information relating to another entity.'

<sup>5</sup> CESR/05-054b section 5

<sup>6</sup> The test set by the Prospectus Directive requirement, Article 5(1), is for a prospectus to include all information necessary to enable the investor to make an informed assessment of the issuer's financial position and prospects

The first point to consider is what is intended by the reference to an issuer's 'entire business undertaking'.

Our view is that this does not necessarily mean that the financial information in the prospectus needs to provide financial information in respect of one hundred per cent of the issuer's business undertaking as it may be the case that an issuer has made one very small acquisition where separate disclosure of a financial history would not be material to an investor's assessment. Whilst some sense of materiality should be applied, prospective issuers need to assess their corporate history in order to identify whether events have occurred that would give rise to their financial history not encompassing all of their business undertakings in the last three financial years.

Once it has been determined that the entire business undertaking is not addressed in the issuer's own three year financial record, it is necessary to determine which acquired businesses are caught by the requirement to disclose historical financial information.

In answering this question, we believe that there are two aspects that should be taken into account; namely, the relative sizes of the businesses and the point in time in the three year track record period when an acquisition of a business arose.

Clearly the larger an acquired business undertaking is, the more likely it is that separate financial information will be required. An example would be the case in many private equity backed situations, where the issuer was incorporated during the relevant period. As it will not have any history prior to the date of its acquisition of its underlying business, it would be necessary to present separately the financial record of the acquired business prior to the date of its acquisition by the issuer.

On the contrary, and as noted above, if an acquisition was very small, it would not be required to be separately presented.

As a guide to determining materiality, our view is that issuers should look to see whether it would have been necessary to consider providing pro forma financial information had the prospectus been prepared in the year in question. This is consistent with the approach adopted in the Amending Regulation when addressing significant financial commitments, discussed below.

Such an analysis should in our view be tempered by looking at when in the three year period the acquisition occurred. Our view is that the materiality threshold would be lower the closer to the date of the prospectus an acquisition occurred.

To illustrate, where an acquisition of another business undertaking occurs in the first financial year it may be that the financial statements for that year provide sufficient information on the effect of that acquisition such that no additional financial information is needed. At the other extreme, an acquisition of a business undertaking immediately after the issuer's last financial year end would not have been covered by the issuer's financial statements and separate financial information on the acquired business undertaking would almost certainly be required.

It should be noted that the analysis is not limited to situations where a company has made acquisitions but also captures situations where the company has made a disposal or disposals of business undertakings.

## A significant financial commitment

In addition to addressing circumstances where transactions have been completed by an issuer prior to the drawing up of a prospectus, the Amending Regulation also covers the circumstance where an issuer has agreed to acquire another business undertaking at the point at which a prospectus is prepared. Generally, market practice has been to treat committed acquisitions in the same way as completed acquisitions and the Amending Regulation follows this approach.

A 'significant financial commitment' is defined as follows:

'An issuer shall be treated as having made a significant financial commitment if it has entered into a binding agreement to undertake a transaction which, on completion, is likely to give rise to a significant gross change.'

The Amending Regulation goes on to explain what it means by a financial commitment by stating that:

'the fact that an agreement makes completion of the transaction subject to conditions, including regulatory approval, shall not prevent that agreement from being treated as binding if it is reasonably certain that those conditions will be fulfilled.'

and

'In particular, an agreement shall be treated as binding where it makes the completion of the transaction conditional on the outcome of the offer of the securities that are the subject matter of the prospectus or, in the case of a proposed takeover, if the offer of securities that are the subject matter of the prospectus has the objective of funding that takeover.'

## The test of significance

Once an issuer has identified that it has committed to undertake a transaction, or transactions, during the relevant period it is necessary to consider whether it gave rise to or would give rise to a 'significant gross change'.

The European Commission has used the definition of a 'significant gross change' in the Prospectus Regulation that gives rise to the need to consider presenting 'pro forma financial information' in a prospectus in defining significance. The Amending Regulation states that:

'a significant gross change means a variation of more than 25%, relative to one or more indicators of the size of the issuer's business'.

In considering how an issuer should make the assessment for the purposes of pro forma financial information, CESR suggests a non-exhaustive list of

indicators that should be considered by an issuer, being total assets, revenue and profit or loss. CESR goes on to acknowledge that, with the agreement of the competent authority, other indicators of size can be applied especially where the stated indicators of size produce an anomalous result or are inappropriate to the specific industry of the issuer.<sup>7</sup>

Accordingly, it is to be expected that competent authorities would expect issuers to apply these, or other relevant, indicators when considering whether any transaction is of such significance as to give rise to a complex financial history or a significant financial commitment.

## Deciding what to disclose

The consequence of concluding that a complex financial history, or significant financial commitment, exists is that the competent authority can require that certain financial information in respect of businesses other than that of the issuer be included in the prospectus.

The Amending Regulation emphasises that such financial information would be incremental to any pro forma financial information that was already expected to be included under the existing requirements. The role of pro forma financial information is considered below.

The additional financial information should be based on the normal Prospectus Regulation requirements for historical financial information. Effectively this means that the additional business's historical financial information should cover that part of the issuer's three year period where the business is not consolidated by the issuer.

Whilst the initial position would be to present historical financial information in the form of full audited financial statements of acquired businesses, competent authorities are allowed to modify this position in the light of any of the following factors:

- 'The nature of the securities;
- The nature and range of information already included in the prospectus, and the existence of financial information relating to an entity other than the issuer is in a form that might be included in a prospectus without modification;
- The facts of the case, including the economic substance of the transactions by which the issuer has acquired or disposed of its business undertaking or any part of it, and the specific nature of that undertaking; and/or
- The ability of the issuer to obtain financial information relating to another entity with reasonable effort.'

The first factor requires some thought as the Amending Regulation only applies to those securities to which Annex I of the Prospectus Regulation applies, that is shares or securities convertible or exchangeable into shares. Our view is that the new provisions should only apply if it is a share issue prospectus.

The recitals to Amending Regulation indicate that the European Commission is conscious that competent authorities should not impose disclosure

<sup>7</sup> CESR/05-054b paragraphs 91, 92 and 93

requirements where the cost is disproportionate to the benefit to investors in the shares in question by including language such as:

- ‘When making that determination, competent authorities should have regard to the principle of proportionality.’
- ‘Where there are alternative ways of satisfying the obligation ... through the disclosure of different kinds of supplementary financial information, or the presentation of that information in different formats, the competent authority should not require the issuer to satisfy that obligation in a way that is more costly or onerous than an adequate alternative.’
- ‘It would not be proportionate to require the inclusion of such information where the issuer cannot obtain that information with reasonable effort.’
- ‘It may not be proportionate to require the inclusion of financial information which does not exist at the time when the prospectus is drawn up, or to require the auditing or restatement of supplementary financial information if the costs to the issuer of complying with that requirement outweigh any potential benefit to the investor.’

Examples where it is considered that cost benefit analysis might cause some debate are:

- The ability of an auditor to provide a true and fair view on the acquired business’s historical financial information;
- The issuer and the other business do not have the same accounting reference date;
- The business was acquired on a date other than its normal financial reporting date;
- The issuer and the other business have not historically applied the same accounting framework;
- The issuer or the other entity may not have access to an entity that they had disposed of prior to determining that they may need to prepare historical financial information;
- The acquired business may legitimately not have drawn up consolidated accounts; and/or
- The business may not have constituted a legal group.

Clearly, individual circumstances need to be considered by issuers and should be dealt with on a case by case basis. One particular aspect that in our view, should be brought into account when considering a cost benefit analysis, is the purpose for which the prospectus is being prepared. By way of example, we believe that in the case of an IPO investors are very likely to know much less about the issuer than where an issuer has been traded on a market for many years. The benefit of providing additional historical financial information disclosure in the former case would be considered to be much greater.

Taking such a position on the relative benefits by having regard to the purpose of the prospectus would be consistent with CESR’s recommendations regarding historical financial information in prospectuses.<sup>8</sup>

<sup>8</sup> CESR/05-054b paragraph 52

## Interaction with other requirements

Whilst the above commentary and analysis describes our view as to the intended operation of the Amending Regulation, issuers would need to consider whether any other requirements might impact on the historical financial information to be presented.

Notably, where issuers are considering an offering of their shares into the United States of America requiring registration with the Securities and Exchange Commission they should note that whilst similar rules exist in that jurisdiction they are more prescriptive as to what financial information needs to be presented. Even where securities are being offered to United States based investors without a registration with the Securities and Exchange Commission, securities counsel invariably advise that the same disclosure standards should be applied.

Issuers should also note that some European stock exchanges have specific conditions that apply when shares are to be admitted to listing.

## A role for pro forma financial information

It should be noted that the purpose of the pro forma financial information disclosures anticipated by Prospectus Regulation<sup>9</sup> is quite narrow in that it is only there to illustrate the impact of transactions on the issuer's latest financial information.

Accordingly, pro forma financial information should be seen as a complement to the historical financial information of the issuer and its businesses acting as a bridge to guide investors to an indication of the totality of what it is they are investing in. As a result, pro forma financial information should not be seen as a substitute for presenting the full historical financial records of the components of the issuer's business.

## When is a year not a year?

One other complexity, on which commentators had sought guidance, that has been addressed in the Amending Regulation, is the question of whether it mattered if an issuer had short financial years as a result of having changed its financial year end.

The European Commission has answered this in the Amending Regulation by making it clear that the historical financial information should cover a period of at least 36 months or the period of the issuer's existence, if shorter. Similar changes have been made to the other registration documents annexes although substituting 24 months where the requirement is for two financial years.

It would be expected that the 36 month rule would apply not only to the issuer itself, but also to any entities that fall within the complex financial history net as requiring a financial record to be presented.

<sup>9</sup> Prospectus Regulation Annex I item 20.2 and Annex II

## What issuers need to do

The most important thing is for issuers to be conscious of the need to consider whether they have, or are likely to have, a complex financial history as early as possible in the timeline towards an admission to trading or public offer of their shares. The sooner that the issue is identified the sooner that solutions and alternatives can be determined and costed.

It would also be appropriate to engage the investment bank(s) likely to be involved in the selling of the shares to ascertain their view as to the impact of any solution on the offering. Only then will it be possible to secure the agreement of the competent authority to the preferred solution. The earlier such agreement is reached the smoother will be the prospectus preparation and approval process.

## Some illustrations

The specific nature of the individual circumstances of an individual case means that it is not possible to prescribe a solution that would be expected to be followed. Nor is it possible to explore every possible permutation of circumstances in defining solutions that should be applied.

Sensibly, the authors of the amendment to the Prospectus Regulation acknowledged that this was the case and, instead of seeking to provide prescriptive solutions, have set out the principles we have explored in this Guide.

However, in order to assist in the application of these principles we have sought to identify a number of the more common situations that we have come across when advising on the financial information to be included in a prospectus. We have used these as examples to illustrate the possible solutions that could be applied in each case and expressed our view as to the most appropriate.

- 1 Significant acquisition made in the financial history period
- 2 Acquisition to be made by newly incorporated holding company
- 3 Significant disposal made in the financial history period
- 4 A de-merger or division from an existing group
- 5 A private equity backed acquisition in the three year history

Clearly this list is not exhaustive but it should provide some indication of the analysis that would need to be undertaken when faced with a particular fact pattern.

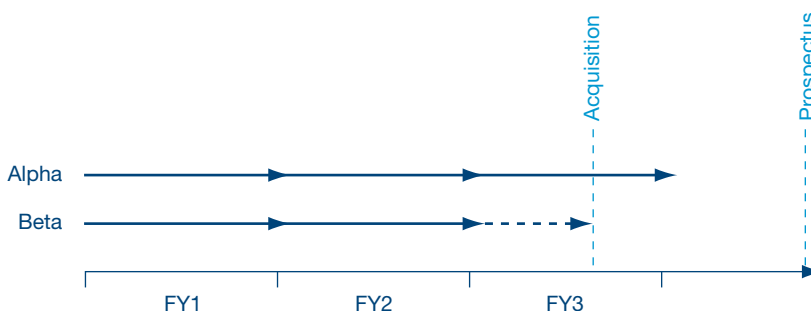
In due course issuers will be able to have regard to prospectuses issued by other companies that may provide some indication as to the approach they might wish to adopt. However, such precedents may need to be treated with caution as it will be appreciated that all of the facts and circumstances leading to a particular form of disclosure in another prospectus may not be readily apparent.

## 1 Significant acquisition made in the financial history period

### Fact pattern

Alpha has been in existence for many years and has prepared consolidated accounts in accordance with IFRS. Alpha acquired Beta during its latest financial year. Beta was approximately half the size of Alpha when measured relevant to indicators of size such as turnover and profitability. We will assume that Beta also used IFRS when preparing its consolidated financial statements.

Alpha is seeking admission to trading on an EU regulated exchange for the first time.



Alpha has a complex financial history having made an acquisition of a business undertaking in its three year track record period and, as the acquired business undertaking is significant, some additional financial information disclosure might well be expected. As Alpha's prospectus is being prepared in connection with an initial admission to trading the benefit threshold would be set quite high.

### What financial information should be presented in the prospectus?

As a starter, it will be necessary to include Alpha's financial information for its last three financial years.

As regards Beta, the following options are available:

- Rely on the disclosures made by Alpha in its latest financial statements about the acquisition of Beta. (Option 1A)
- Include separate financial information on Beta for its latest financial years, FY1 and FY2, prior to its acquisition by Alpha. (Option 1B)
- Include separate financial information on Beta not only for its latest financial years prior to its acquisition by Alpha but also through to the date of its acquisition that is FY1, FY2 and part of FY3. (Option 1C)
- Include separate financial information on Beta for its last three financial years ending immediately after the date of its acquisition by Alpha, ie all of FY1, FY2 and FY3. (Option 1D)

It might also be appropriate to include a pro forma income statement for FY3 illustrating the effect of bringing together Alpha and Beta as if they had been together at the beginning of that year.

### PwC view

Option 1C would provide the most complete set of financial information tying in Beta's record through to its date of acquisition and consolidation by Alpha and providing the components necessary to construct a pro forma income statement. However, drawing up and auditing a financial record of Beta through to its date of acquisition by Alpha could be difficult to deliver. In such circumstances, we would support Option 1D over Option 1B, as this would avoid a gap in the financial record being presented.

Option 1A would be most appropriate where the issuer is already publicly traded in that the information in Alpha's accounts would be the basis on which the market is trading in Alpha's shares.

### Extra thoughts

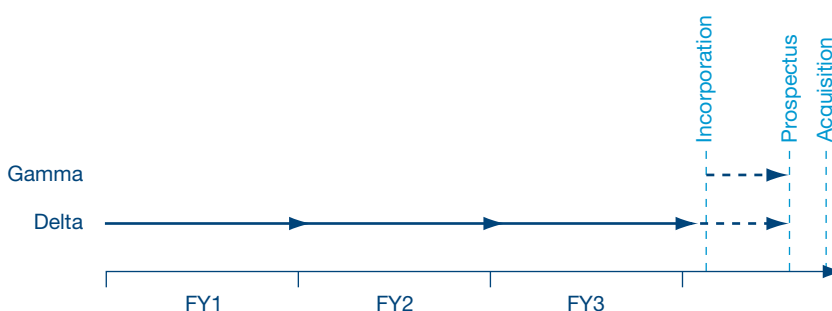
The above example is quite simple and can easily be complicated in a number of different directions:

- Would the answer differ if the acquisition of Beta had occurred in the middle or first year of the three year financial history period?
- If Beta has not been an IFRS reporter?
- If Alpha elects to only present FY2 and FY3 on an IFRS basis, presenting FY1 and, following CESR's Recommendations, FY2 on its previous EU national GAAP basis?
- If there was more than one acquisition in the track record period?

## 2 Acquisition to be made by newly incorporated holding company

### Fact pattern

Gamma is a recently incorporated company formed for the purposes of making an offer and admission to trading of its shares to finance the acquisition of Delta. Delta has existed for a number of years as the parent of a business undertaking that it had acquired with private equity finance.



### Analysis

This represents a straightforward example of a significant financial commitment, in that Delta is quite obviously significant in relation to an entity that has only recently been formed.

### What financial information should be presented in the prospectus?

Applying the principles of the new rules and deeming Delta to be the issuer would lead to the inclusion of historical financial information on Delta for each of its last three financial years.

In addition, it may also be necessary to present separate financial information on Gamma itself. As statutory financial statements would not have been prepared for Gamma, it would be necessary to draw up, and have audited, special purpose financial statements to a convenient period end date if it has not reached its first financial year end.

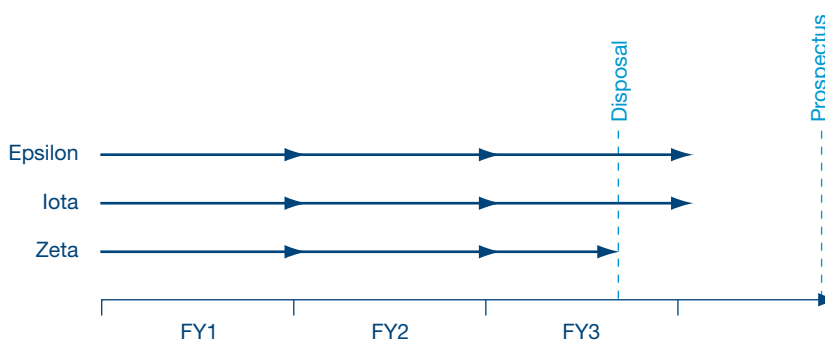
### PwC view

The solution that requires Delta's three year history to be presented is that which should be followed in such cases.

## 3 Significant disposal made in the financial history period

### Fact pattern

An entity Epsilon has been the holding company for two substantive business undertakings over the past three financial years: Zeta and Iota. Apart from some shared overheads, Zeta had no trading relationship with Iota. In its latest financial year Epsilon disposed of Zeta. Zeta accounted for approximately one-third of Epsilon's assets and profits. Again, assume that Epsilon has prepared consolidated IFRS financial statements for each of its past three financial years. Epsilon is preparing a prospectus in connection with an initial offer and admission to trading of its shares.



## Analysis

Clearly Epsilon's consolidated accounts do reflect the entire business undertaking that it has owned in the track record period. However, they do not reflect the entire business undertaking at the date the prospectus has been drawn up as by then Zeta has been disposed of. Accordingly, the question of a complex financial history needs to be considered.

### What financial information should be presented in the prospectus?

The following options are available:

- Rely on the statutory financial statements of Epsilon, which, in FY 3, would have shown Zeta as a discontinued operation on one line in the income statement for FY3 and the comparatives for FY2. In FY2 and FY1's statutory financial statements it should be possible to see the results of Zeta and Iota in the segment reporting note. (Option 3A)
- As well as the Epsilon financial statements and the pro forma FY3 income statement present Zeta's financial statements. This would enable investors to see the full performance of the business undertaking disposed of. (Option 3B)
- As well as the Epsilon financial statements and the pro forma FY3 income statement present Iota's financial statements. This would enable investors to see the financial performance of the business undertaking that in essence is to be the subject in which investors are to invest. (Option 3C)
- Present special purpose financial information that excludes the results and assets of Zeta by treating them as part of the previous shareholders' equity. (Option 3D)
- Present special purpose consolidated financial information for Epsilon showing Zeta as a discontinued operation throughout the track record period. (Option 3E)

It might also be appropriate to include a pro forma income statement for FY3 illustrating the effect of the disposal of together Zeta from Epsilon as if it had happened at the beginning of that year.

### PwC view

The cleanest presentation may well be presenting special purpose financial information that excludes Zeta, Option 3D. Indeed, this may be the only practicable solution where Epsilon does not have access to the historic records of Zeta following its disposal. However, this approach is predicated on the financial information of Zeta being complete, discrete and separate from Iota such that it can be argued that Epsilon acts more as investment holding entity.

Option 3E might be more attractive on a cost benefit basis than Option 3D although the use of a discontinued operations approach would only give the effect of the disposal on the income statement as Zeta would be fully consolidated in the balance sheet.

Options 3A, or 3B or 3C, if the impact of Zeta's disposal was quite significant, would be more appropriate where Epsilon is already traded on a regulated market.

### Extra thoughts

- Would the answer differ if the disposal of Zeta had occurred in the middle or first year of the three year financial history period?
- What if Iota and/or Zeta had not been IFRS reporters, as would be permitted under EU law?
- What if Epsilon elects to only present FY2 and FY3 on an IFRS basis, presenting FY1 and, following CESR's Recommendations, FY2 on its previous EU national GAAP basis?
- What if there was more than one disposal in the track record period?
- Would the answer differ if the prospectus were being issued in connection with a further issue of securities by a company already traded on an EU regulated market and would the proportion of new shares being issued matter?
- What if Zeta and Iota had been under common operational management?

## 4 A de-merger or division from an existing group

### Fact pattern

Lambda is currently traded on an EU regulated market. It has a distinct business undertaking Tau, Lambda intends to separate out Tau and secure a separate listing for Tau under a new holding company on an EU regulated market. Tau was shown in Lambda's financial statements as a separate segment in each of Lambda's last three year's financial statements.

Whilst the companies that comprised Tau were all owned and controlled by Lambda, directly or indirectly throughout the last three financial years they were not constituted as a legal sub-group. Prior to the separation, or de-merger, Lambda will undergo an internal re-organisation that will enable the new holding company to acquire the Tau business undertaking prior to its admission to trading.

### What financial information should be presented in the prospectus?

Does a complex financial history or significant financial commitment exist?

Irrespective of when the new Tau holding company acquires the Tau business undertaking, whether prior to the date of the prospectus, or after the drawing up of the prospectus, the new Tau holding company self-evidently would have either a complex financial history or entered into a significant financial commitment.

The key issue is therefore determining a financial history for the Tau business undertaking.

- One option would be to consider the existing financial information available for the business undertaking of Tau or entities within it. This might comprise one or more sets of financial information which could be presented in the prospectus of the new holding company. These could then be supplemented by pro forma financial information for FY3 combining the new holding company with the separate information for the Tau business undertaking entities. (Option 4A)

- An alternative option is to present a single financial record for the Tau business undertaking as if it had been separately constituted throughout the last three financial years. Such financial information is often described as ‘carve-out’ financial statements. It would also be appropriate to consider including pro forma financial information to illustrate the impact on the new holding company’s balance sheet of acquiring the Tau business undertaking. (Option 4B)

## Analysis

Option 4A has the attraction of delivering a financial record at the least cost to the issuer as it uses previously published financial statements.

Option 4B has the benefit of providing a single clean record of the Tau business undertaking on the basis of which investors can make an informed assessment. However, the benefit of this might be the most expensive to achieve. This option also requires the auditor to be able to report that such combined, or what is often termed ‘carve-out’, financial information shows a true and fair view. This can create some challenges where the required accounting framework, such as IFRS, does not explicitly address such questions although presenting such financial information is common market practice. Combined, or ‘carve-out’, financial statements are sometimes described as ‘pro forma’. This should not be confused with the definition of pro forma financial information within the Prospectus Regulation.

## PwC view

The best presentation of Tau’s business would be for combined financial information to be presented in the prospectus (Option 4B). Whilst the preparation of combined financial information can present practical challenges, the likelihood of a relatively simple alternative solution set as suggested in Options 4A is unlikely to occur in practice.

## Extra thoughts

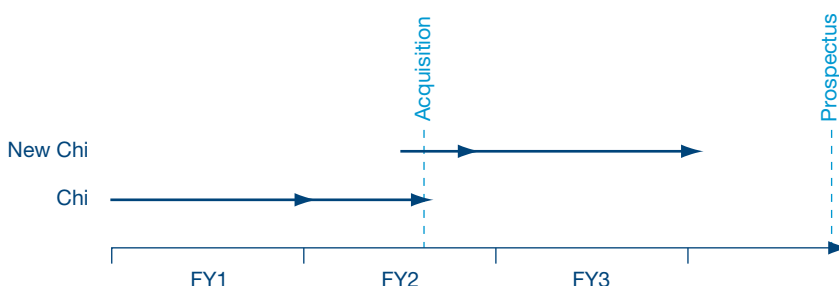
Challenges might arise if:

- The businesses forming Tau were not constituted in separate legal entities or sub-groups but were part of entities or sub-groups that also carried out business being retained by Lambda;
- There are a large number of entities on which separate financial information is available to be included;
- Lambda had undergone internal re-organisations through the past the years affecting the legal sub-groups that are to be transferred to the Tau holding company:
  - the legal sub-groups have included entities that have been disposed of in the three year period;
  - consolidated financial statements at the legal sub-group level have not been prepared; or
- The financial statements of the entities within the Tau business undertaking might have been prepared in their domestic GAAP.

## 5 A private equity backed acquisition in the three year history

### Fact pattern

In the second year of the last three financial years Chi was the subject of an acquisition financed by a private equity house through a new holding company New Chi. The underlying business undertaking of Chi has continued unchanged throughout those three years. New Chi is to be the subject of an initial public offer and admission to trading of its shares on a regulated market.



### Analysis

As the issuer, New Chi has entered into a transaction in FY2 that means that its entire business undertaking is not accurately presented for the three financial years. Consequently, New Chi has a complex financial history.

### What financial information should be presented in the prospectus?

- One route is to present separately the consolidated statutory accounts of New Chi for the part of FY2 and for FY3 and special purpose financial information for Chi for FY1 and FY2 through to the date of its acquisition by New Chi. (Option 5A)
- If it is not possible to prepare special purpose financial information for Chi as at the date of its acquisition by New Chi, the statutory accounts of Chi for both FY1 and FY2 could be presented, if they exist. (Option 5B)
- Special purpose financial information combining the results of Chi and New Chi in one single set of financial information could be prepared. This is consistent with historic practice in a number of international markets including the United States, the United Kingdom and Italy. (Option 5C)

### PwC view

Our view is that the most beneficial presentation is that of a combined predecessor and successor record, Option 5C, as this reflects the fact that the underlying trading of the Chi business undertaking has continued throughout the three financial years and that the acquisition was effectively a financial transaction.

### Extra thoughts

The impact of any fair value adjustments made on the acquisition of Chi on the post-acquisition income statement needs to be considered as regards the disclosure in any combined financial information – it may be that a ‘black line’ approach distinguishing between the pre- and post-acquisition periods is desirable.

## PricewaterhouseCoopers Capital Markets Groups

Our network of Capital Market Groups across Europe comprise specialists who provide a broad range of services to companies and investment banks in connection with the capital market transactions, including:

- Preparation for becoming a public company;
- Selecting the right market and advisory team;
- Advising on regulatory issues;
- Undertaking financial and business due diligence investigations; and
- Assisting with GAAP conversion projects.

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