rendez-vous
INVESTORS & CAPITAL

Business acquisition: the next day...

By Nicolas Barsalou, Associate, and Henri Philippe, Vice-President. Accuracy

Company leaders do not hesitate to enlist consulting services to carry out acquisition processes. During the following integration phase, management's attention naturally focuses on the operational aspects. Yet, the mastery of financial and accounting issues is essential for legal and fiscal security as well as for the sustainability of the new organisation.

Business acquisition is a complex issue that requires the full attention of management. Management rarely hesitates to surround itself with multiple consultants in order to successfully complete these relatively long processes full of multiple obstacles: consulting banks or independent experts for valuation of the target, specialised firms in charge of financial, tax, legal, environmental, social, etc. due diligence. Once the acquisition is completed, it naturally goes into the hands of the operational staff in charge of successful integration within the group. As reorganisations generally focus on legal or tax aspects, accounting and financial issues fall into the background.

“Reorganisation activities as complex as acquisitions”

From some concrete examples, we will see that, more than ever, it is necessary for management to organise the post-acquisition operations that they foresee as soon as possible. These complex operations require mobilising at least as many types of know-how as required during the acquisition phase.

Legal reorganisation of a group

Imagine a group specialising in food processing (biscuits, ice cream, fruit juices) that acquires a target in the same business segments. Upon completion of the transaction, management intends to consolidate the operational entities of the target with its own entities. On the legal and tax level, it has multiple possibilities for performing this legal restructuring: contributions of assets, a complete branch of activity, sale of securities, lease management of business, etc. From a financial perspective, the stakes are huge: first and foremost, these operations must be carried out based on market values. Thus, it is the market value of the assets that will determine the compensation of the contributions, the sale price, or the leasing management fees. The use of an independent expert will then make it possible to secure the operation from a legal and tax standpoint.

In addition to this valuation work, it is also important to conduct a detailed financial analysis of past, but also and especially future, cash flow of the various entities involved in the transfer. The tax optimisation schemes should be analysed in light of the operational constraints of the entities involved. This detailed analysis of the financial forecasts involves a better understanding of:

- The risks attached to these forecasts: for example, is this a mature company or a blooming shoot? The reliability of forecasts is clearly not the same from one case to another…
- Legal and operational constraints influencing these forecasts: Are there any local constraints that prevent the rise in dividends? Are there specific contract provisions with customers preventing this same rise in dividends? Are there any minority shareholders in the

different entities? These are all constraints that must be reflected in financial forecasts and must be understood so that the forecasts are analysed appropriately.

This post-acquisition due diligence work can be avoided, particularly since, like a chess player, the legal reorganisation and the allocation of the flows and related values must be done by thinking ahead: Are new mergers within this scope foreseen? Do we wish to be able to sell certain entities? These are questions that are crucial to answer before favouring this or that reorganisation plan.

From an accounting perspective, an acquisition can also have important consequences, particularly on the group's financial communications. This is the case, for example, for all groups that prepare their accounts according to IFRS. Thus, IFRS 8 (related to sector information) precisely dictates the level and detail of the financial information to be provided on the various activities of a group.

In general, the sector communication must be aligned with the group's internal organisation. We therefore cannot operate with lasting hiatuses between (i) optimised legal, tax, and accounting schemes on paper and (ii) the operational organisation of the group.

Finally, an acquisition could result in the operational reorganisation of a group and therefore lead to the complete overhaul of its CGUs[1]. However, these constitute the basic unit of goodwill impairment tests. Adopting two different organisation structures can lead to radically different tests, even though the consolidated flows from activity are the same.

Debt reorganisation

Now imagine that our food group, which took on debt to complete the acquisition, decides to project this debt closer to the entity that generates the cash flows that will be used to repay it. Once again, there are numerous possible legal mechanisms: transfer of activities, payment of outstanding dividends, etc. These debt push down operations require the same considerations as those mentioned above as part of legal reorganisations (on future cash flows, on likely future operations, on the value of assets).

In addition to these issues, there is the matter of the interest rate to be used to compensate this debt transferred to the operational entities. This involves securing the transaction by documenting the reasoning that led to the setting of the acceptable level of compensation. In this respect, an analysis of interest rates observed on the market in relation with the characteristics and financial capacity of the borrowing entity is a crucial step.

Reorganisation of intra-group flows

The latest traditional operation for integration of an acquisition within a group, the overhaul of the transfer price system. Once again, this operation can be undertaken without a prior sound financial and accounting analysis: it is essential to prepare a comprehensive, reliable table of the flows involved (accounting flows, costs, margin levels throughout the value chain, etc.). This analysis is sometimes made particularly difficult because of difficulties related to obtaining information on each operational entity: the quality of the information system and the complexity of the intra-group flows are then two important issues to be able to perform a reliable analysis.

Among these operations, it is necessary to mention, in particular, those concerning intellectual property in the broadest sense (patents, R&D, brands, etc.). Even if they involve very specific assets, these operations are not exempt from the various steps mentioned above. The additional difficulty lies in the crucial step of bringing the planned royalty system in line with the internal accounting work performed particularly during the acquisition (allocation of goodwill) as well as with the annual account closing work (asset impairment tests).

In conclusion…

Business acquisition is exceptional enough of a topic for company leaders to surround themselves with multiple skills to complete their plans. The next day... the myriad legal and fiscal operations that enable the integration of the acquired business within the group still require the use of know-how, particularly accounting and financial. This is even a prerequisite for both the legal and fiscal security and the sustainability of the project.

[1] **Cash Generating Units (CGU) are the smallest entities of the group independently generating cash flow. It is at the CGU level that acquisition goodwill must be allocated. It is also at this level that the value of goodwill must be tested each year for possible impairment.**

KEY POINTS

Post-acquisition reorganisation operations require careful management from an accounting and financial standpoint involving the following steps:

analysis of forecast financial flows;

anticipation of future operations;

estimation of the market value of the transferred assets by an independent expert.

ABOUT THE AUTHORS

Nicolas Barsalou and Henri Philippe are, respectively, Associate and Vice-President of Accuracy, a corporate finance consulting firm. Accuracy has 21 associates and 140 consultants in Paris, Madrid, Amsterdam, Milan, Frankfurt, and Brussels.