ENTERPRISE APPRAISAL COMPANY

Financial Focus Newsletter

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MERGERS AND ACQUISITIONS IN THE
CHEMICAL INDUSTRY
FINANCIAL REPORTING OF AQUISTIONS AND DIVESITITURES

The closing of a merger or acquisition is always a noteworthy and newsworthy event. However, it is after the closing that much of the work is accomplished. After the closing, the acquisition is booked for financial reporting purposes and the buyer's auditors sign off on the purchase price allocation to fully integrate the acquisition into the new owner's organization.

Why is this important to the buyer of a chemical business?
The purchase price allocation becomes the basis for the initial balance sheet of the integrated company, which will determine depreciation and amortization charges for financial reporting.

Why is this important to the seller of a chemical business?
The purchase price allocation can have a significant effect on the taxes the seller will have to pay as a result of the sale.

How does this affect M&A activity in the chemical industry?
Most chemical facilities can be rightfully classified as special purpose facilities, and it is not uncommon to see the acquisition of a single product line within a large manufacturing complex. In these situations, several unique considerations come into play. Favorable ground leases may be present. Buildings may be very special, complying with special NFPA fire codes and containing special personnel safety provisions. Some structures are considered to be equipment enclosures. The manufacturing process may include tanks, piping, towers, pumps, compressors, and other major structures situated on the site. This process equipment must be properly segregated from any land improvements or fixtures to the real estate. Finally, there may be some unique intangible assets to be investigated, beyond the typical customer relationships, patents, trademarks, trade names and technology, such as in-process R&D (IPR&D) which requires special treatment by the acquiring company. In 2001, the rules relating to financial reporting were refined (and redefined) by the Financial Accounting Standards Board (FASB) with the issuance of Statement 141, Business Combinations.

This accounting pronouncement superseded prior financial reporting requirements, and brought significant changes to the accounting for business combinations:

- ✓ Required that all business combinations be accounted for by the purchase method
- ✓ Required separate recognition of intangible assets apart from goodwill.
- ✓ Required disclosure of the primary reasons for a business combination and the allocation of the purchase price.
- ✓ Established Fair Value as the appropriate standard of value.

The concept of Fair Value was clarified expanded upon, but that is another topic for another time.
New rules, which are effective for business combinations with an acquisition date in an annual reporting period beginning on or after December 15, 2008, can be summarized as follows:

- ✓ Defines the acquirer as the entity that obtains control of one or more businesses.
- ✓ Establishes the acquisition date as the date that the acquirer achieves control.
- ✓ Retains guidance for identifying and recognizing intangible assets separate from goodwill.
- ✓ Requires recognition of the assets acquired and liabilities assumed, measured at fair value as of the acquisition date.
- ✓ Requires recognition of the acquisition of a non controlling interest.
- ✓ Requires the recognition of acquisition costs separately from the acquisition.
- ✓ Requires recognition of expected restructuring costs separate from the acquisition.
- ✓ Requires recognition of expected restructuring costs separate from the acquisition.
- ✓ Requires an acquirer in a step acquisition to recognize assets and liabilities as well as the non-controlling interest at full amounts of their fair value.

To present an accurate and clear representation of what is acquired and to present that accurately in financial statements requires the professional expertise of a valuation team working in concert with the seller's or buyers audit team.

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