Investor view

Insight from the investment community

Merger and acquisition disclosures

Given their economic significance, it is not surprising that the investment community tells us of their intense interest in the disclosures relating to acquisitions. However, we continually hear concerns about the quality of disclosures for these transactions. This ‘Investor view’ examines some of the areas commonly cited by investment professionals as offering opportunities to improve the effectiveness of disclosure in this critical area of reporting.

When talking to investors about reporting, two themes come through time and again; firstly, the desire to understand if management are spending capital wisely; secondly the need to have the base of data to forecast with confidence. These themes dominate our discussions with investors when talking about both M&A and disposals disclosures.

What did the acquirer pay?

Financial reporting standards do require management to report on the cash cost of an acquisition, but important detail about total cost can get lost. For example:

- Investors want to know the enterprise value of an acquisition – that is, the effective net value of the transaction.
- Investors typically cannot see the debts acquired or detailed information on pension liabilities assumed unless the scheme is material to the acquirer.
- Some of this information is might be provided elsewhere in the annual report or in analyst presentations; however, the investors we spoke to expressed concern because it is unaudited.
- Investors are increasingly concerned about the income statement effects that might arise from implementing the revised business combinations standard – for example, remeasurement of contingent consideration and consideration linked to future service of the selling-shareholders.

Are the intangibles really goodwill?

Having to capitalise acquired intangible assets separately from goodwill and then amortise these can be a source of frustration for investors. Some of the acquired assets will have a finite life (such as a patent), so an investor is happy for there to be an associated amortisation charge. However, other intangibles may be considered by investors to be goodwill, notwithstanding management’s
classification as separate assets with limited lives. In such cases, investors may wish to reverse amortisation charges.

In order to decide whether an amortisation charge makes ‘economic sense’ or not, investors would like to see greater detail about the nature of the identified intangible assets.

How has the acquired business performed since the transaction took place?

Investors tell us that they want to know more about the strategy underpinning an entity’s acquisition.

- They would like to know the rationale behind any acquisition and whether or not it was a success as measured against this strategy.
- Investors quickly lose visibility of previous acquisitions; this is because, unless an acquisition is a reportable segment in its own right, it is absorbed into the acquirer’s business, with no detailed information provided. If management thinks it important enough to monitor the acquisition separately, that information is also important to investors, even if separate disclosure is not required by the standards.
- It would be helpful for acquirers to give the exact date of acquisition (or disposal) rather than a vague indication – a date to the nearest quarter is not sufficiently precise for many investors. Modelling future cash flows is challenging without the exact dates.
- Investors appreciate clear disclosure of the non-cash deferred consideration.

What did management make for selling a business?

It is not just the disclosures associated with acquisitions that have drawn the attention of investment professionals. The reporting of disposals is also a source of frustration.

As with acquisitions, investors want to know the enterprise value realised on disposals, in addition to cash received. Similarly, they wish to be able to assess management’s stewardship of the assets with which they have been entrusted and to have sufficient historical data in order to be able to forecast the future.

- Stewardship: Investors wish to hold management to account for its running of the entire business. Financial reporting standards distinguish between continuing and discontinued operations; management’s narrative often concentrates only on the continuing operations. Management could better meet user needs by presenting additional narrative and financial information about the combined results, including the disposed business.
- Forecasting the future: Current accounting standards require management to present quarterly comparative data only as each subsequent quarter is reported. This is not deemed sufficiently timely by investment professionals, who wish to update their forecasts for the residual entity immediately. They have told us that they would like to see, at the date of disposal, historic quarterly/interim data that would allow them to do so.

You can watch our short webcast featuring investors talking about these issues here.