<u>PCP 2012/1 Consultation Response: Alex Money, Partner, Temple Bar Advisory</u>

Q17. Do you have any comments on the proposed new Rules 28.7(b) and (c), and the proposed new Notes 2 to 4 on Rule 28.7, with regard to a party to an offer referring to consensus profit forecasts with respect to the profits of another party to the offer?

<u>Rule 28.7 (b)</u>

The requirement to refer to consensus profit forecasts is welcomed. Subject to the appropriate process and procedures being applied in collating consensus forecasts, it offers a potentially more comprehensive, correct and complete representation of market expectations.

<u>Note 2</u>

While Rule 19.1 acknowledges the importance of care and accuracy in the compilation of consensus forecasts, Paragraph 15.8 of the consultation document appears to enshrine two vendors as the de facto independent providers of third party consensus forecasts. However many companies believe that the data from such providers is often inaccurate, largely due to inadequate process. Indeed, an estimated 20-30% of FTSE 100 companies now compile consensus estimates independently (http://bit.ly/PvaIIV). As a result, there is often more than one 'consensus' forecast in the market. The potential for confusion is obvious, and an amendment to Note 2 is proposed as follows:

For the purposes of Rules 28.7(b) and (c), a consensus profit forecast should normally be calculated as the arithmetical mean of ~~any~~ the most representative consensus figures for the relevant profit forecasts which have been published by independent financial data providers.

It may ultimately fall to the Panel to arbitrate on which figures the most representative, but this should be straightforward with the application of some basic criteria, e.g. maximum age of oldest forecast; proportion of analyst universe included; like-for-like basis of inclusion, etc. It is important that an incentive exists for high quality consensus forecasts to be produced and published. This is at least as important as merely demonstrating the independence of the data.

<u>28.7 (c)</u>

The proposed Rule change again emphasises the importance of high quality consensus forecasts, a point well understood by listed companies (e.g. http://bit.ly/tU4Vyt).

<u>Note 4</u>

This note makes a distinction between an 'average' profit forecast and a 'consensus' profit forecast due to the proposed structure of Rule 28, but this is not necessary here. Irrespective of whether the data is sourced by a third party or not, any consensus forecast should state which analyst firms' submissions have been included, and the date of submission (which may be different from the date of publication).

With regard to stating the individual analysts' estimates, this may not always be possible. Legally, analysts own their forecast data, and as a condition of providing submissions to companies or third parties, may not be willing or able to relinquish ownership rights. As such while they may have no objection in submitting forecasts that are included in a public consensus, they may be unwilling for their underlying estimates to be published. As Note 4 currently stands, they would potentially need to be excluded from the consensus.

However the publication of range (mean, high, low) numbers should be sufficient to meet the requirements of Rule 28.

The requirement that companies state which analysts are excluded from forecasts still leaves open the risk of selective disclosure, given the many vague reasons that can be proffered for not including 'undesirable' numbers. Instead, where consensus forecasts are being used in the context of Rule 28, there should be an explicit requirement that the numbers are compiled using a process which is – and can be seen to be - transparent. There are various models for delivering against this process requirement, including web-based digital forecast collation.

An amendment to Note 4 is proposed as follows:

Where any document or announcement published by a party to the offer refers to any third-party profit forecast, including a consensus forecast ~~an average profit forecast, as referred to in Rule 28.7(a), or a consensus profit forecast, as referred to in Rule 28.7(b),~~ the sources and basis of compilation must be stated, including:

~~(a) in the case of an average profit forecast:~~

(i) the names of the firms whose analysts' ~~whose~~ forecasts have been included in the calculation of the average profit forecast, the median, high and low numbers from the sample, ~~including the individual figures~~ the dates on which they were published; and

~~(ii) the analysts whose forecasts have been excluded from the calculation of the consensus figure, including the reason(s) for their exclusion; and~~

~~(b) in the case of a consensus profit forecast, the independent financial data providers upon whose figures the consensus profit forecast has been calculated.".~~

(ii) the source of the data; and

(iii) a generic statement, approved by the Panel and issued by the publishing party, warranting the transparency and freedom from interference of the process used to compile the forecasts

Comment

- The value of consensus forecasts is directly proportional to the comprehensiveness, correctness and completeness of the underlying numbers, which in turn is a function of the transparency of the process used in compilation. Under the current (and indeed proposed) Rules, there is the risk of more than one 'consensus' forecast being in the market during an Offer Period, which is potentially confusing and unhelpful.

- The Panel might consider requiring that a single consensus forecast is used during an Offer Period, which must be compiled *after* the commencement of the Offer Period, by an approved third party provider of consensus forecasts, of which the Panel would maintain a list. Membership of the list would be contingent on the provider meeting and maintaining a standard of best practice (below).

- The most effective way to ensure integrity of process amongst providers in the collection and publication of consensus forecasts might be for the Panel to set out a standard of best practice. This standard could be incorporated within Rule 19.1, and would cover *inter alia* how old any forecast is allowed to be, how to ensure it is a like-for-like comparator with other forecasts, what processes and safeguards exist to ensure the integrity of the data and objectivity of the recorded numbers etc.

- The cost of compiling the consensus would be met by the offeree company, and the information would be disseminated both on their website and more widely, including directly to the offeror. Data compiled by a third party on the Panel's approved list would be deemed to meet the required standards of objectivity, albeit with appropriate mechanisms to review and challenge.

- Adoption of this approach, which would clearly require some limited re-drafting, has the potential to simplify and strengthen the provisions of Rule 28, and remove some of the ambiguities that are inherent in both the current and proposed approaches. It is also worth noting that this approach could potentially be applied to a wider set of financial metrics than just profit forecasts.

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