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The Secretary to the Code Committee
The Takeover Panel
10 Paternoster Square
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24 September 2012

Consultation Paper PCP 2012/1 'Profit Forecasts, Quantified Financial Benefits Statements, Material Changes in Information and Other Amendments to the Takeover Code'

Dear Sir:

We welcome the opportunity of commenting on the Consultation Paper PCP 2012/1 'Profit Forecasts, Quantified Financial Benefits Statements, Material Changes in Information and Other Amendments to the Takeover Code' (the PCP) issued by the Code Committee of the Panel. We are supportive of the proposed Rule changes although we believe that in some areas further refinement would be beneficial.

We have included as an appendix to this letter our non-confidential response to each question.

If the Panel would like further clarification on the points raised by Ernst & Young, please contact me on 020 7951 4636.

Yours faithfully

Steve Hextall
Executive Director
For and on behalf of
Ernst & Young LLP

Appendix

Q1 Do you have any comments on the proposed new definitions of "profit forecast", "profit estimate" and "quantified financial benefits statement" and the proposed amendments of the definitions of "cash offeror" and "offer period"?

Quantified financial benefits statement

We suggest the following changes to (a) make it clear that the statement is referring to benefits that will accrue to the offeror as opposed to shareholders of the offeror, for example through enhanced dividends; and (b) deal with the situation where cost savings measures have already been implemented but the financial effect has not yet been reported. Additionally it is not clear what is meant in (b) by "an alternative transaction". If this means an offer by an alternative bidder it would appear to conflict with Note 2 on Rule 28.5 and therefore it might be appropriate to delete this reference.

"A quantified financial benefits statement is either:

(a) a statement by an offeror or the offeree company quantifying any financial benefits expected to accrue to the offeror ~~arise~~ from the proposed transaction if the offer or possible offer is successful; or

(b) a statement by the offeree company quantifying any financial benefits expected to arise from cost saving measures and/or an alternative transaction which have either been implemented or are proposed to be implemented if the offer or possible offer is withdrawn or lapses."

Q2 Do you agree that the requirements for assumptions to be stated and for third party reports to be obtained should be retained for profit forecasts and quantified financial benefits statements which are first published during an offer period? Do you have any comments on the proposed new Rule 28.1(a)?

We agree with the proposal in principle but it would be helpful to explain the difference between an assumption and a basis of belief in respect of quantified financial benefits statements. As the Rules are currently proposed it is necessary to disclose both but we believe that an assumption is a basis of belief and there may be other bases of belief based on fact. It is therefore unclear when Rule 28.5(a) requires bases of belief to be disclosed in addition to assumptions. This could be resolved by amending Rule 28.1(a)(i) to say:

(i) The basis for the profit forecast, including assumptions (see Rule 28.3) on which it is based, and the basis of belief for the quantified financial benefits statement (see Rule 28.5(a)).

Rule 28.5(a) would then be amended to:

(a) Include the bases of belief (identifying assumptions (see Rule 28.3) and sources of information)

Rule 28.1(a)(ii) should be amended because a quantified financial benefits statement would not be dependent upon accounting policies. We suggest that it is reworded as:

"(ii) a report from reporting accountants stating that, in their opinion, the profit forecast or the quantified financial benefits statement has been properly compiled on the basis stated and that, in the case of a profit forecast, the basis of accounting used is consistent with the accounting policies of the party to the offer;"

Appendix

Whilst we note that Rule 28.5(h) has introduced the concept of accounting policies into quantified financial benefits statement, it does not require the profit and loss charge to be stated.

Q3 Do you agree that the requirements for assumptions to be stated and for third party reports to be obtained should be retained for profit forecasts which have been published following the making of an approach or, in appropriate circumstances, the first active consideration of a possible offer? Do you have any comments on the proposed new Rule 28.1(b) and Note 1 on Rule 28.1?

We agree with the proposal and have no further comment.

Q4 Do you agree with the proposed new requirements with regard to an outstanding profit forecast? Do you have any comments on the proposed new Rule 28.1(c)?

We agree with the principle underpinning the proposal but have two comments on its practical application;

(i) 28.1(c) requires that the forecast is repeated. The repeated forecast will presumably have to comply with note 7(b) to Rule 28.1 in that it will need to be "understandable" (please see the comments on how this is defined in our response to Q11 below). In our experience forecasts made prior to an offer may not be "understandable". In these circumstances new forecasts have been made (often based on the same expected profit number but with further explanation). Consideration could be given to making it clear that in repeating the forecast note 7(b) applies which may lead to a debate as to whether including additional disclosure constitutes a new forecast.

(ii) It seems unlikely that a company could comply with 28.1(c)(ii) without triggering 28.1(c)(iii) as an explanation of why a forecast is no longer valid is likely to involve a statement that would fall within the definition of a profit forecast.

Q5 Do you agree with the proposed ability for the Panel to grant a dispensation from the proposed new Rules 28.1(a) and (b) in relation to ordinary course profit forecasts? Do you have any comments on the proposed new Note 2 on Rule 28.1?

Yes, but see point (i) in response to Q4 as this would apply equally to an ordinary course profit forecast.

The inclusion in the definition of an "ordinary course profit forecast" of the phrase "in a forward looking statement" means that a profit estimate in the form of a preliminary announcement can never be an "ordinary course profit forecast". Whilst Rule 28.4(a)(i) does provide some relief if the company is traded on one of the identified UK markets, Rule 28.4 (b) would only apply when a preliminary announcement was made in accordance with a regulatory requirement. This seems anomalous in that a company that regularly made a profit forecast just before the year end might be exempt from requiring a report, but the same company that regularly issued a preliminary announcement would still need to have it reported on.

Q6 Do you agree with the proposal for the Panel to be able to grant a dispensation from the proposed new Rules 28.1(a) and (b) in relation to profit forecasts for certain future financial periods? Do you have any comments on the proposed new Note 3 on Rule 28.1?

We agree with the proposal and have no further comment.

Appendix

Q7 Do you agree with the proposed requirement to publish corresponding profit forecasts for the current and intervening financial periods where a profit forecast for a future financial period is published? Do you have any comments on the proposed new Rule 28.2?

We agree with the proposal and have no further comment.

Q8 Do you agree that reports should always be required to be obtained on a profit forecast where the offer is a management buy-out or is made by the existing controller of the offeree company? Do you have any comments on the proposed new Note 4 on Rule 28.1?

We agree with the proposal and have no further comment.

Q9 Do you have any comments on the proposed new Note 5 on Rule 28.1 with regard to profit ceilings?

We do not understand the presumption that a profit ceiling is different from any other profit forecast and therefore would not need to be reported on save in circumstances of a management buy-out/controller transaction. The argument that a profit forecast has "no benefit to the company or the management announcing the profit ceiling" could apply to other forms of forecast as well, for example a range which contains both a ceiling and a floor.

Q10 Do you agree that the Code should expressly provide the Panel with the ability to grant a dispensation from the requirements of Rule 28 where the offer would not result in a material increase in the equity share capital of the offeror? Do you have any comments on the proposed new Note 6 on Rule 28.1?

We agree with the proposal and have no further comment.

Q11 Do you have any comments on the proposed new Note 7 on Rule 28.1 in relation to the compilation of profit forecasts and quantified financial benefits statements?

We are supportive of the Code endorsing the principles contained in the ESMA guidance. However, our experience shows that one of the greatest challenges in reporting on profit forecasts is persuading companies to make forecasts that are "understandable". We often have cause to refer to the ICAEW 2003 guidance which says:

"2.21 One practical technique is to consider expressing financial outcomes or financial statement highlights in terms of a range (between x and y), a floor (not less than, or at least, x) or a ceiling (not more than, or at most, y). This can reduce the uncertainty attaching to PFI and its sensitivity to deviations occurring in respect of individual assumptions. This in turn can have the positive effect of reducing the extent of disclosures that investors might otherwise find difficult to understand. For this reason, ranges, floors and ceilings are accepted and acceptable methods of presenting PFI. However, a range suggests a breadth of outcomes within the given limits**: it would be misleading for directors to present a range if they did not believe that all the outcomes within the range were possible**. Floors and ceilings are not generally interpreted literally but rather viewed in a wider context. So, for example, **a floor that is excessively cautious, even though literally true, will be misleading because it is likely to be far below actual performance**."

The issue is that whilst a company may make a statement that is literally true e.g. "profits will be more than 100" there is a market expectation, which is reflected in the ICAEW guidance above, that profits will not significantly exceed 100. If management believe that the actual profit will be

200 we do not believe that the statement that profits will be more than 100 is "understandable". Assuming that the Panel agree with this view, it would be helpful if the Code made this point clear. It is most commonly an issue in the context of forecasts made inadvertently prior to the offer period, hence the need to consider this point in the context of our response to Q4 above. This could be achieved through adding wording such as:

"It is important that a profit forecast conveys a clear understanding of the directors' expectation of the results of the company and therefore if a profit floor is used it should not be excessively cautious nor should a range extend to amounts that have little realistic possibility of being achieved."

Additionally the wording in 7(c) could be amended to:

"(c) Any profit forecast published by a party to an offer (other than a cash offeror) must be compiled on a basis comparable with its historical financial information *that will be prepared for the period covered by the forecast*.*"*

in order to make it clear that it is a forward-looking requirement.

Q12 Do you have any comments on the proposed new Rule 28.3 with regard to assumptions in relation to profit forecasts and quantified financial benefits statements?

Rule 28.3 (b) says:

".........draw attention to any assumptions about factors which could have a material effect on the achievement of the profit forecast or the quantified financial benefits statement and, where possible, those factors should be quantified."

As the purpose of the assumptions is to quantify the effect of the "factors" it is not clear what is intended by the words "*and, where possible, those factors should be quantified*." Where a factor is binary e.g. outstanding litigation, and there is an alternative outcome to that assumed, it would be possible to specify, and potentially quantify, the alternative outcome. However, in most circumstances an assumption identifies a point in range. It may be possible to quantify the effect of alternative assumptions (through some form of sensitivity analysis) and it would be helpful to clarify if this is the intention.

Q13 Do you agree that the exemption from the requirements of Rule 28 for certain profit estimates should be extended as proposed? Do you have any comments on the proposed new Rule 28.4?

We agree with the proposal except there is a possible gap in that if an overseas company not using IFRS (but using another acceptable GAAP such as US GAAP) that is traded on one of the markets referred to in this Rule issues both interim and quarterly financial statements the exemption would only apply to the former and there is no basis (as there is under Rule 28.4(b)) for the Panel to grant a dispensation.

Also see response to Q5 above.

There has been a recent (June 2012) amendment to the Prospectus Directive Regulation to clarify the circumstances in which an unaudited preliminary announcement would not be required to be reported on in a prospectus as a profit estimate. Whilst we do not suggest that the same approach is adopted for the purpose of the Code (because we have reservations as to the practical application of the revised rules) we wish to bring this to your attention given that the PCP has identified consistency with EU prospectus regulation as being a relevant consideration in developing the proposals. The amendment says;

"A report prepared by independent accountants or auditors stating that in the opinion of the independent accountants or auditors the forecast or estimate has been properly compiled on the basis stated, and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer.

Where financial information relates to the previous financial year and only contains non misleading figures substantially consistent with the final figures to be published in the next annual audited financial statements for the previous financial year, and the explanatory information necessary to assess the figures, a report shall not be required provided that the prospectus includes all of the following statements:

(a) the person responsible for this financial information, if different from the one which is responsible for the prospectus in general, approves that information;
(b) independent accountants or auditors have agreed that this information is substantially consistent with the final figures to be published in the next annual audited financial statements;
(c) this financial information has not been audited."

Q14 Do you have any comments on the proposed new Rule 28.5 in relation to quantified financial benefits statements?

The inclusion in 28.5(e) of "other measures" is presumably intended to only apply to statements made by an offeree and it would be helpful to make this clearer.

The following phrase in 28.5(e) needs to be disapplied for statements made by offerees as clearly the statement is not relevant if the offer does not proceed:

"....and exclude any financial benefits which could be achieved independently "

Note 1 does not deal with the point regarding what happens if a statement made by the offeree prior to any approach is referred to by either party subsequently. It would be helpful to clarify the consequences of this.

Q15 Do you have any comments on the proposed new Rule 28.6 with regard to a profit forecast for part of a business?

We agree with the proposal and have no further comment.

Q16 Do you have any comments on the proposed new Rule 28.7(a), the proposed amendments to Note 5 on Rule 19.1, or the proposed Note 1 on Rule 28.7, with regard to references by a party to an offer to third party or average forecasts with respect to its own profits?

We agree with the principle behind the Rule but in practice it is unlikely that Rule 28.1(a) could be complied with because when the forecast was originally made it is unlikely that it would have complied with that Rule e.g. disclosure of assumptions. The effect of Rule 28.7(a) would therefore appear to be that a party cannot refer to an existing third party forecast unless they are prepared to make a new forecast (which may be of the same number). It might therefore be simpler not to allow reference to third party forecasts except where it has issued its own forecast or other than as envisaged by Rule 28 (b) and (c).

Appendix

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?

We agree with the proposal and have no further comment.

Q18 Do you have any comments on the proposed new Rules 27.1 and 27.2(a)(i) with regard to material changes in information?

We would suggest that in order to make clear that materiality is determined by reference to the context in which the information is presented, rather than referring to "*....any material changes in information disclosed in any document or announcement...*" Rule 27.1 refers to "*.........any changes in information disclosed in any document or announcement that are material to such document or announcement....*"

We suggest that it would be simpler to amend Rule 27.2(a)(i) to say;

"(i) any item announced pursuant to Rule 27.1(a) that has not been included in a document pursuant to Rule 27.1(b)"

Q19 Do you have any comments on the proposed new Rules 27.2(a)(ii), 27.2(b) and 27.2(c) in relation to the requirement to update certain matters in any subsequent document?

It is not clear why profit forecasts are included in Rule 27.2 (b)/(c) and also in Rule 27.2(d). If there is a reason for this then Rule 27.2 (b)/(c) should also refer to quantified financial benefits statements.

Q20 Do you have any further comments on the proposed new Rule 27 and the related Code amendments?

We have no further comment.

Q21 Do you have any comments on the proposed amendments relating to the current Rule 28.4?

We agree with the proposal and have no further comment.

Q22 Do you have any comments on the proposed amendments to Rule 26 in relation to documents on display?

We agree with the proposal and have no further comment.