THE TAKEOVER PANEL

Profit Forecasts and Quantified Financial Benefits Statements

September 2013

Objectives

- Reduce the burden of the profit forecasts regime where forecasts are less contentious:
  - forecasts published before an approach
  - “ordinary course” forecasts
  - long term forecasts

- Extend the “merger benefits statements” regime to statements by an offeree company, i.e. “quantified financial benefits statements” (or “QFBSs”), bring the QFBS regime into Rule 28 and make it more consistent with the profit forecasts regime

- Update Rule 28 and make it more consistent with other standards, e.g. Prospectus Directive, ESMA recommendations and FCA Handbook

Scope of the new Rule 28

"One-off" profit forecasts	➢ Forecasts not published in the "ordinary course" ➢ Short term – for periods ending up to 15 months from date of publication ➢ Long term – for periods ending more than 15 months from date of publication
"Ordinary course" profit forecasts	➢ Guidance given to the market in accordance with an established practice and as part of the ordinary course of communications ➢ Still uncommon in the UK market, but the Code should not restrict the development of a communication practice welcomed by investors and companies
Quantified financial benefits statements	➢ Benefits accruing to the enlarged group as a result of a combination ➢ Also now includes statements of cost savings by the offeree company, e.g. as part of a defence
Not applicable to cash offerors	➢ Requirements of Rule 28 apply to offeree companies and securities exchange offerors but do not apply to cash offerors
Not applicable to "aspirational" targets	➢ Typically 3-5 year look-forward; may cover sales and margins rather than precise profit numbers ➢ Potentially fine dividing line between an "aspirational" target and a profit forecast ➢ "Aspirational" targets are not subject to Rule 28

Some terminology

- The new Rule 28 sets out essentially two regimes for profit forecasts:

  1. The “reporting regime”: requires reports from reporting accountants and financial advisers

  2. The “directors’ confirmations regime”:
     - less onerous than the “reporting regime”, no third party reports
     - requires directors to confirm that:
       - (i) the forecast has been properly compiled on the basis of the assumptions; and
       - (ii) a consistent basis of accounting has been used

- The applicable regime is driven by:
  - the type of forecast (“one-off” or “ordinary course”)
  - the financial period to which the forecast applies (short term, i.e. ≤ 15 months, or long term, i.e. > 15 months)
  - when the forecast is published (before approach, after approach or after commencement of the offer period) and hence whether the forecast is new or repeated

Short term profit forecasts (not ordinary course)

- Short term profit forecast (i.e. for period ending within 15 months from when it was published) during an offer period:
  - subject to the "reporting regime"
  - profit forecast and reports to be included in the document/announcement in which the forecast is published
  - see **Rule 28.1(a)**

- Short term profit forecast which was published following a bid approach but prior to the offer period commencing:
  - forecast must be repeated and is subject to the "reporting regime"
  - profit forecast and reports to be included in offer document/offeree board circular, or in any earlier announcement or document which refers to the forecast
  - see **Rule 28.1(b)**

- Short term profit forecast published prior to a bid approach being made:
  - three options:
    - (i) repeat the profit forecast, confirm it remains valid and give the "directors' confirmations"; **or**
    - (ii) explain why the profit forecast is no longer valid; **or**
    - (iii) include a new forecast, to which the "reporting regime" will apply
  - see **Rule 28.1(c)**

Long term profit forecasts – requirement to publish profit forecasts for all intervening periods

Long term profit forecasts

- New profit forecasts for a period ending > 15 months away will be subject to the "directors' confirmations regime", <u>not</u> the "reporting regime" (whether "one-off" or "ordinary course"). See **Rule 28.2(a)**
- Where a long term profit forecast has already been published, the company must (i) repeat it and give the "directors' confirmations"; or (ii) explain why the profit forecast is no longer valid; or (iii) publish a new forecast and give the "directors' confirmations"

Profit forecasts for intervening periods

- Whenever a company publishes or repeats a long term forecast, it will be required to produce a full sequence of profit forecasts for <u>all intervening financial periods</u>. See **Rule 28.2(b)**
- One (or occasionally two) of these forecasts will therefore relate to a period that ends within 15 months (i.e. a short term forecast):
  - if an intervening, short term forecast is published as a new forecast, the "reporting regime" applies
  - if an intervening, short term forecast has already been published, it must be repeated (and either the "reporting regime" or the "directors' confirmations regime" will apply in accordance with **Rule 28.1**), or a new forecast must be published
  - the option to "explain why the profit forecast is no longer valid" is only available if the same option is applied to all forecasts for subsequent periods

“Ordinary course” profit forecasts

- Ordinary course profit forecast published <u>prior to the offer period commencing</u> (whether before or after an approach):
  - subject to the three options set out in Rule 28.1(c) (i.e. the “directors’ confirmations regime” if repeated)
  - see **Note 2(a) on Rule 28.1**

- Ordinary course profit forecast published <u>during the offer period</u>
  - subject to the “reporting regime”, <u>unless</u> all other parties agree to a dispensation, in which case the “directors’ confirmations regime” applies
  - see **Note 2(b) on Rule 28.1**

Note: It is assumed that ordinary course profit forecasts will generally be short term. But Rule 28.2 will apply to long term profit forecasts irrespective of whether they are “one-off” or “ordinary course”.

Summary table of profit forecast provisions

<table>
<tr><th>Profit forecast published</th><th>“One-off”
≤ 15 months</th><th>“Ordinary course”
≤ 15 months</th><th>Long term
> 15 months*</th></tr>
<tr><td>During offer period</td><td>Rule 28.1(a)
Reports when published</td><td>Note 2(b) on Rule 28.1
Directors’ confirmations if other parties agree, otherwise reports when published</td><td>Rule 28.2(a)
Directors’ confirmations when published</td></tr>
<tr><td>Following approach but before offer period</td><td>Rule 28.1(b)
Reports in first document</td><td>Note 2(a) on Rule 28.1
First document must:
repeat and give directors’ confirmations; or
explain why not valid; or
publish new forecast and report</td><td rowspan="2">Rule 28.2(a)/Rule 28.1(c)
First document must:
repeat and give directors’ confirmations; or
explain why not valid; or
publish new forecast and give directors’ confirmations</td></tr>
<tr><td>Before approach</td><td colspan="2">Rule 28.1(c)
First document must: repeat and give directors’ confirmations; or explain why not valid; or publish new forecast and report</td></tr>
</table>

***Where a profit forecast > 15 months is published or repeated, forecasts must be published for all intervening periods and Rule 28 will apply to each such forecast**

This is an abbreviated version of the summary table included at Appendix C to RS 2012/1

Management buy-outs and offers by controllers

Rationale

- Profit forecasts should be subject to enhanced scrutiny where a management team or a controlling shareholder might have an incentive to depress a profit forecast so as to be able to acquire the company more cheaply

Provisions

- No dispensation from the "reporting regime" on forecasts ≤ 15 months, including
  - forecasts published before an approach to the offeree company
  - ordinary course forecasts
  - forecasts for periods ≤ 15 months required by Rule 28.2(b) by virtue of a long term forecast being published
- See **Note 3 on Rule 28.1**
- For long term forecasts for periods > 15 months, the three options (repeat and give "directors' confirmations"; explain why no longer valid; or make a new forecast and give "directors' confirmations") still apply, per **Rule 28.2(a)**

Profit forecasts for part of a business

Rationale

- Profit forecasts for <u>part</u> of a business, where made in the context of an offer, are likely to have been made to influence the debate on the offer
- No intention to apply the "reporting regime" or the "directors' confirmations regime" to profit forecasts for "parts" of a business which are building blocks in a profit forecast published for the whole group – reporting or directors' confirmations would be required for the whole only
- Numerical guidelines for "materiality" thresholds for requiring reports are not practical:
  - e.g. a part that is forecast to move from a loss to a small profit, but that profit is still *de minimis* in relation to the whole?
  - e.g. a part that is valued on a profit multiple basis, where the rest of the business is valued on an asset value basis?
  - general presumption that where a party chooses to publish a separate forecast for a part of a group, that forecast is likely to be material

Provisions

- Rule 28 applies to a forecast made in respect of part of a business in the same way as to a forecast for the whole
- Panel may grant dispensation in cases of genuine non-materiality
- See **Note 5 on Rule 28.1**

Dispensations where the application of Rule 28 would be disproportionate

Rationale

- Dispensation may be appropriate where the forecast sets a <u>ceiling</u>, rather than a floor, to profits since, in the context of an offer, it is not normally in the interests of the party making the forecast to set a ceiling. But therefore dispensation will <u>not</u> be granted for a profit ceiling forecast made:
  - by an MBO team or controlling shareholder
  - with the effect of increasing expectations (e.g. market "consensus" EPS forecast is 10p per share; company forecasts that EPS will not exceed 12p per share, with the effect of increasing expectations to 11-12p)

- Dispensation may be appropriate where the burden of applying Rule 28 is disproportionate, e.g.:
  - the securities offered are *de minimis* in relation to the offeror's enlarged share capital (the "whale and minnow" argument)
  - the securities component is a *de minimis* component of the value of the offer

- Panel will take into account the context of the profit forecast (e.g. why it was made; how specific the forecast was; whether the offer was hostile or competitive) in deciding whether to grant a dispensation

Provisions

- Panel may grant a dispensation from the requirements of Rule 28 where it considers the application of the Rule would be disproportionate – see **Note 4 on Rule 28.1**

Profit estimates

- Definition: "A profit forecast for a financial period which has expired and for which <u>audited</u> results have not yet been published.":
  - consistent with ESMA Prospectuses Q&As

- Exemption from Rule 28.1: in respect of profit estimates where, although audited results not published, the profit numbers should be sufficiently reliable for Rule 28 reports or confirmations not to be required:

  - preliminary statements of annual results complying with UKLA Rules – see **Rule 28.5(a)** *(per existing rules)*

  - AIM or ISDX Growth Market companies' preliminary results complying with the substance of UKLA Rules for preliminary results – see **Note 1 on Rule 28.5** *(codification of existing Panel Executive practice – confirmation by accountants or financial advisers will still be required*)

  - half-yearly financial reports complying with UKLA, AIM or ISDX Growth Market Rules – see **Rule 28.5(b)** *(previously available only in recommended offers)*

  - interim management statements that are (i) a regulatory requirement and (ii) in accordance with IAS 34 – see **Rule 28.5(c)** *(new exemption)*

  - other cases where an estimate is published in accordance with a regulatory requirement and under a framework equivalent to the UKLA Rules/IAS 34 accounting treatment, e.g. overseas-listed offerors – see **Note 2 on Rule 28.5(c)** *(codification of existing Panel Executive practice – confirmation by accountants or financial advisers will still be required)*

Investment analysts' forecasts

- Quoting investment analyst or other third party forecasts is "endorsement" and Rule 28 will apply:
  - Formerly (implicitly) provided for under Note 5 on Rule 19, now explicitly provided for in **Note 6 on Rule 28.1**

- **Rule 28.7:** Parties may maintain "consensus" forecasts on their websites during an offer period, provided:
  - source analysts' forecasts were published since latest preliminary or interim results
  - connected analysts' forecasts are removed
  - high, low and arithmetic mean (= "consensus") is stated
  - other disclosure requirements are met – see **Rule 28.7(c)**
  - prominent disclaimer that the "consensus" is not endorsed by the company

- **Rule 28.8:** If party A refers to analysts' forecasts for party B, it must use either party B's "consensus" from its website (per Rule 28.7 above) or, if not available, compile its own "consensus" in accordance with Rule 28.7:
  - if party B <u>has not</u> consented to party A referring to the "consensus" forecast, party B may then itself refer to the "consensus" used by party A (but may not elaborate on it) without being subject to Rule 28.1 (the "right of reply") – see **Rule 28.8(b)**
  - if party B <u>has</u> consented to party A referring to the "consensus" forecast, party B has endorsed the forecast and Rule 28.1 will apply – see **Rule 28.8(c)**

Quantified financial benefits statements

- "Merger benefits statements" provisions of the old Note 9 on Rule 19.1 (now defined in a new definition of "quantified financial benefits statements") extended to:
  - include statements made by the offeree company about cost savings or other financial benefits it will achieve if the offer does not succeed
  - capture statements by securities exchange offerors at all times, not just when the offer is hostile or competitive
  - make the reporting treatment consistent with that for profit forecasts

- A QFBS must be reported on in accordance with **Rule 28.1(a)** and must include the disclosures required by **Rule 28.6**

- Offeree company will not have to obtain reports if it simply <u>repeats</u> cost saving measures published prior to the offer period

- If <u>revised</u> cost saving measures are published:
  - after an approach but prior to the commencement of the offer period: consult the Panel – reporting may be required in the offeree board circular
  - during the offer period: report when published
  - see **Note 1 on Rule 28.6**

Contact details and disclaimer

This presentation has been prepared by the Panel Executive (the “Executive”) to provide informal summary guidance on the new regime applicable to profit forecasts and quantified financial benefits statements. The new regime, which is effective as of 30 September 2013, was adopted by the Code Committee of the Takeover Panel (the “Panel”) in Response Statement 2012/1, dated 24 July 2013. The presentation does not form part of the Takeover Code (the “Code”) and its contents are not binding on the Executive or the Panel. It is not a substitute for reading the Code or RS 2012/1 or for consulting the Executive to establish how the Code applies in a particular case.

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