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The Secretary to the Code Committee
The Takeover Panel
10 Paternoster Square
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Our ref mb/kh

1 October 2012

Dear Sir

PCP 2012/1 – Profit Forecasts, quantified financial benefits statements, material changes in information and other amendments to the Takeover Code.

We welcome the opportunity to comment on the Consultation Paper issued by the Code Committee of the Panel PCP 2012/1.

We are generally supportive of the changes proposed in relation to profit forecasts, with a few exceptions as noted in our detailed response.

In relation to quantified benefits statements, we welcome the re-examination of the existing requirements. We do, however, believe that the proposals go too far in seeking to harmonise the guidance and requirements for profit forecasts with those for quantified benefits statements, and consider that the differences between the two are such that greater clarity and consistency will be achieved if the differences are recognised through separation of the guidance and requirements. Additionally, where the proposals introduce changes to the reporting requirements, it would seem sensible to coordinate the timing of the introduction of the changes with the work of the reporting accountant standard setters.

Our detailed comments in respect of the consultation questions are set out in the appendix to this letter.

If you have any queries in relation to the comments contained in this letter, please contact me (maggie.brereton@kpmg.co.uk).

Yours faithfully

Maggie Brereton
Partner

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"?

We agree that it is helpful to formalise the definition of 'profit forecast' and to include a definition of 'profit estimate' which is consistent with that in the Prospectus Directive.

We are, however, sceptical about the introduction of the new note relating to the term 'target'. Whilst we agree that a party should not be able to avoid the requirements of Rule 28, the emphasis in the note on the use of the term 'target' does not seem to provide much clarity as to the principle involved. In the first place, such a term is only one of many terms that could be used with a similar meaning and effect (eg aim, objective, goal); secondly, it is separately established in the Code (including under the proposals by virtue of the definition of a profit forecast) that a statement can be deemed a profit forecast even if the term profit is not used; and thirdly, in paragraph 2.7, it is acknowledged by the Code Committee that there are counter-examples, such as the use of the term 'target' within the context of a long term incentive plan, where 'target' does not designate a profit forecast. A core element of the definition of a profit forecast, both within the Code and within the Prospectus Directive, is the concept of the 'likely' level of profits. Whether a statement described as a target is a statement of a likely level of profits will depend on the facts of the case, and we consider that the introduction of a rebuttable presumption in this regard is unnecessary.

We do note, however, that a key element of the discussion in paragraph 2.6 is the inclusion of an accompanying statement that the 'target does not constitute a forecast of future profits'. We would agree that the inclusion of such a statement is not of itself conclusive proof of what it purports to assert, and could see a case for introducing guidance that statements of this sort will not be sufficient to prevent a statement which would otherwise have been deemed to be a profit forecast, from being so treated for the purposes of the Code.

In relation to the definition of a quantified benefit statement, although it is reasonably clear in part (b) what is likely to be covered under the heading of 'cost savings measures', the reference to an 'alternative transaction' is somewhat obscure, particularly given that in the Code the term 'transaction' usually refers to a takeover offer.

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 note that the concept of 'assumptions' is to be applied to quantified benefits statements in addition to profit forecasts, to which they have traditionally been related. Although it is true that assumptions may need to be made by parties making synergy

statements, we consider that the existing concept of 'the bases of belief' is likely to provide a sufficient and more pertinent disclosure in the case of quantified benefits statements. Accordingly, we would recommend that the requirement to disclose assumptions should be imposed as at present in relation to profit forecasts only. In making this recommendation, we have no objection (as noted in our response to question 12 below) to imposing specific requirements in cases where those making quantified financial benefits statements voluntarily refer to assumptions made.

In relation to third party reports, we agree that there remain cases where the added constraint imposed by such a requirement can serve to prevent the publication of unsuitable information.

As regards the reporting accountant's report proposed in new Rule 28.1(a), whilst the basis of accounting is clearly important for a profit forecast, as the profit figure needs to derive from a comprehensive basis of accounting, the nature of quantified benefits statements is such that accounting policies, to the extent relevant, apply to specific transaction captions, and the result is not a comprehensive 'accounting' result but rather the arithmetical result of adding together certain calculations specifically made having regard to the unique circumstances of the business or businesses concerned. Furthermore, whilst a 'proper compilation' opinion has the merit of familiarity from other contexts, it has been developed for reporting on profit forecasts. In the absence of a professional standard for applying the opinion in the context of quantified financial benefits statements, the merit of moving from one formulation ('due care and consideration') to another seems questionable. We encourage the Panel to liaise with the standard setters for reporting accounts in the development of a standard for reporting. This process will also need to be accompanied by guidance on what constitutes 'proper compilation'.

We note that as drafted, new rule 28.1(a) would remove the exemption from the requirements of Note 9 on Rule 19.1 that currently applies to merger benefits statements where the offer has been recommended by the board of the offeree, and that this is discussed in paragraph 13.6 of the PCP. The PCP argues that there is no obvious basis for not applying new Rule 28.1(a) to a quantified effects statement. We find such a basis for imposing onerous new requirements (notably in relation to the reporting obligations) on an offeror questionable, particularly in the absence of clear evidence that there is a problem that needs to be remedied. We note that whilst reference is made to the FSA's CP12/2 and the discussion of synergy statements in the context of Class 1 transactions, the paper does not include that observation that whilst proposing enhanced disclosure, the FSA did not favour the introduction of a reporting requirement. We believe that Note 9 on Rule 19.1 continues to reflect the regulatory concern that existed when it was originally drafted – namely that a hostile bidder might make claims about the benefits of accepting its share offer, without investors having any reassurance that there was any substance to the claims. If there is a need to extend the requirements for reporting to the circumstances of recommended bids, it would be preferable to reserve the requirement for cases where the claimed synergies are very significant in the context of the proposed transaction having regard to the combined profits of the parties to the transaction.

- 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 to apply the requirements of new Rule 28.1(a) to forecasts published following an approach by an offeror to the offeree company. We can understand the argument for extending the rule to the period prior to approach but following 'active consideration', but we have questions about the wording of the Rule and the Note. The interaction between Rule 28.1(b) and Note 1 on Rule 28.1 is a little unclear in cases where the forecast is made after active consideration and after the approach but before commencement of the offer period. Under Rule 28.1(b), it would be expected that, except with the consent of the Panel, Rule 28.1(a) would apply. However, Note 1 suggests that as the forecast follows first active consideration, the application of the Rule is subject to the Panel's discretion (the "Panel may apply rule 28.1(b)"). We assume that the intention of the Note is to give the Panel discretion to extend Rule 28.1(b) to cover forecasts made after first active consideration but before the approach or before the commencement of the offer period, whichever is earlier. On a purely technical level, considering the relationship between Rules and Notes in the Code, we query whether it is consistent with the normal position for a Note to a Rule to extend the application of the Rule (as opposed to clarifying the interpretation and operation of the Rule itself). The question is, in other words, whether the Rule itself should provide for the possibility of its extension, with the Note explaining when the Panel might consider it appropriate to do so.

- 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 that the proposals strike a sensible balance.

In relation to the drafting of proposed new Rule 28.1(c) we note that because some punctuation has been omitted, the wording of (c)(i) is somewhat less clear than the language contained in 4.5(a) of the discussion paper. We would also observe that it omits the reference to details of the basis on which the profit forecast has been compiled. As drafted in the proposed Rule, there is ambiguity over whether the clause beginning 'and the assumptions' is governed by 'include' in the first line, or whether it forms part of the confirmation by the directors about the basis of accounting, and we consider that there is scope for misinterpretation. We recommend that consideration is given to redrafting the disclosure requirements in the Rule in the form set out in paragraph 4.5 of the PCP.

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?

We agree that the proposal is reasonable. In relation to the drafting of new Note 2, we believe that, as noted in our response to Question 4, consideration should be given to re-punctuating the sentence beginning 'Where a dispensation is granted, ...' so as to avoid the ambiguity over whether the clause 'and the assumptions ...' forms part of the directors' confirmation. Consideration should also be given to adding a requirement for the disclosure of details of the basis on which the profit forecast has been compiled.

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 that the proposed Note provides useful clarification of an important issue. Whilst, as noted in the discussion paper, there is scope for quibbling about the 15 month time period, we agree that it is preferable to introduce a presumption of a specific time period. We reiterate our comments in our response to question 5 and 6, in the context of the new Note also, with regard to the wording of the required disclosures.

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 would be wary of overregulation in this area. We are not convinced that the prevalence of publication of future period forecasts is very substantial; furthermore, where such statements are published, we have some doubt as to whether they would actually be a device for enabling "shareholders, analysts and other market participants to interpolate a profit forecast for the current year". For example, if a company has been loss making in 2011, is silent about its 2012 position, and forecasts a profit for 2013, deriving a figure for 2012 would be fraught with difficulty. And the difficulties would be even greater if the statement relates to a more distant future period. If it were possible to 'interpolate' a forecast for the current period reliably from the future information given, then under the existing definition of a 'profit forecast' a forecast of the current period has been made and would need to be dealt with accordingly. If, however, as is likely, deriving a current year forecast would be hazardous and speculative, the mischief identified by the Code Committee would not be present, and the proposed requirements unnecessary.

We believe that the proposals would be particularly disproportionate in the case of a previously published future forecast which has been published without a current year forecast. In this situation, under the new rules, if a profit forecast could actually be interpolated from the numbers, it could be disclosed in accordance with new Rule 28.1(c)(i) (and not be reported on), but if such a forecast could not actually be interpolated, the entity would be required to publish for the first time a forecast which

could not by definition have been arrived at by shareholders, and then, because it had not previously been published, have it reported on.

Overall, we consider that the existing (and other proposed) requirements of the Code are adequate to prevent the future forecast being used as a device to avoid the reporting requirement (where it would otherwise be subject to such a requirement) and that the proposed new rule should therefore be omitted.

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?

Although we would expect rules on market manipulation to serve as the principal deterrent to the issuance of profit warnings or loss forecasts designed to make a subsequent offer appear more attractive, and the advice of the independent adviser to the offeree to be the major source of guidance if a management offer undervalues the business, we accept that there may be a perception that forecasts made by a management team who then become bidders for the company are influenced by their conflicting interests in the transaction. We have some reservations about introducing regulations as a result of perceptions, but if the Code Committee is content that the additional requirement for reports is a necessary measure, we accept its judgement in this matter.

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

We agree with the general principle of dispensing with reporting obligations in the context of statements amounting to profit ceilings.

In relation to the carve out for management buy-outs and offers by controllers, we accept the Code Committee's judgment that the perception that the statement may serve the interests of the bidders merits a different approach.

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 that the Panel should have the ability to apply the rules with flexibility in this area.

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 support the proposal to include material in the Code relating to the compilation of profit forecasts and quantified benefits statements. However, we believe that the guidance should deal with each of these statements separately, as forecasts and quantified benefits statements are quite distinctly different in terms of how they are prepared and presented.

Although the material derived from the ESMA recommendations is generally sound and its inclusion welcome, in its original context it focuses quite specifically on profit forecasts, and accordingly is less suited to clarifying the position relation to quantified financial benefits statements, which are developed in a different way, and give rise to different issues. The material in the ESMA recommendations is itself based on the ICAEW's "Prospective Financial Information: Guidance for UK Directors September 2003" which expresses rather more clearly the concept of 'reliability', as 'it should be supported by analysis of the entity's business and should faithfully represent factually based strategies, plans and risk analysis'. We consider this better indicates what needs to be factual, and avoids the somewhat confusing contrast with what is 'hypothetical' (bearing in mind that any information based on assumptions about the future is to some degree hypothetical).

The ICAEW guidance on Prospective Financial Information also contains some useful material on merger benefits statements, and provides a more tailored interpretation of the concepts of understandability and reliability in the context of consideration of merger benefits statements. We believe that the ICAEW material would provide more comprehensible and relevant guidance in relation to quantified benefits statements than the ESMA material on profit forecasts, and we would therefore recommend that this should be used as a basis for separate guidance within the Code dealing with the compilation of quantified financial benefits statements.

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?

Whilst, as noted above, we do not consider that assumptions are a principal element of quantified financial benefits statements (in the manner that they are for profit forecasts), we consider that where they are included the guidance proposed in new Rule 28.3 would be applicable.

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 proposals contained in new Rule 28.4.

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

In general we welcome the increased level of detail on the disclosure requirements for quantified benefits statements. We have commented above on the application of Rule 28.1(a) to quantified financial benefits statements and the need to differentiate such statements and related disclosures from profit forecasts.

Proposed Rule 28.5 (d), requires the offeror to 'include details of all the material financial effects of the proposed transaction or other measures, and not only the financial benefits or other selected effects'. It is not clear to us precisely how this requirement is to be understood. The concept of 'all the material financial effects' seems to be potentially significantly wider than the (generally) limited disclosures made in relation to synergy benefits. It is typical for such statements to be limited to statements of cost savings, rather than a statement of all possible synergies, let alone all possible 'financial effects'. The proposed wording may be seen to be requiring disclosure of matters which would currently be omitted as being too speculative or uncertain. Given that the general intention of the regulation is to restrict disclosure to matters which are well supported by evidence, there may be a risk of conflicting messages being conveyed. We recognise that the wording may be attempting to convey the notion that there should not be 'cherry picking' of quantified financial benefits, such that there would be an unbalanced impression given of the overall benefits that could be achieved. This might happen either because obvious dis-synergies had been overlooked, or because the costs of delivering the synergies, whether one-off or recurring, had been omitted. New Rule 28.5(h), addresses this to the extent that non-recurring costs are involved. To the extent that the offeror was choosing to disclose a 'gross' benefit rather than a 'net' benefit, it might be necessary to indicate that such an approach was not acceptable. A requirement to take into account dis-synergies should also be considered for cases where the transaction can be expected to give rise to such effects and the amounts involved are such that disclosure would be necessary in order for there to be a proper understanding of the stated synergy benefits.

More commonly though the suggestion is that the quantified financial benefits disclosed are an understatement, because of potential synergy benefits that are not quantified, such as revenue synergies. Overall, therefore, we consider that proposed Rule 28.5(d) should be deleted, and replaced by guidance relating to the disclosure of net benefits and dis-synergies.

In relation to proposed Rule 28.5(e), the inclusion of the words 'and exclude any financial benefits which could be achieved independently' would seem to create problems in the case of a 'Type (b)' quantified financial benefits statement, where the offeree company's purpose in making the statement is to highlight the cost savings which it is proposing to achieve if it remains independent. It may be preferable to limit the application of proposed Rule 28.5(e) to 'Type (a)' quantified financial benefits statements and to delete the rather obscure reference to 'or other measures'.

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 welcome the recognition (in the inclusion in the proposed rule that the Panel should have the ability to grant an exemption) that there is a need for flexibility in determining whether or not a forecast relating to part of a business is significant for the purposes of the Code. We consider that the proposed new rule strikes a reasonable balance.

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 that the availability and use of third party and consensus forecasts gives rise to complex issues under the Code. We agree with the proposals in new Rule 28.7(a). We agree that removal of consensus forecasts from the company's website is marginally preferable to the inclusion of Rule 28 'health warnings', although given that the information is otherwise available in the public domain, removal is rather more a symbolic gesture than a matter of practical significance.

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 proposals.

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 have no comments on the proposals.

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?



We have no comments on the proposals.

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

We have no further comments on the proposals.

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

We agree with the reformulation of the reference to consent, so as to bring the wording into line with that prevailing in the context of Listing Rules documents and prospectuses.

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

We have no comments on the proposals.