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The Secretary to the Code Committee
The Takeover Panel
10 Paternoster Square
London
EC4M 7DY

28 September 2012

Dear Sir / Madam

Response to the Code Committee of the Takeover Panel consultation paper regarding profit forecasts, quantified financial benefits statements, material changes in information and other amendments to the Takeover Code.

We are pleased to have the opportunity to respond to your request for comments on the above consultation paper dated 5 July 2012.

We recognise that the Code Committee is seeking to codify the existing practice of the Executive but we question whether in some cases the detailed proposals achieve the Code Committee's objectives. We note that, in our view, the proposed changes result in more complicated rules for companies and advisors to interpret. We believe that the outcome will be the Panel always or almost always being consulted to clarify the requirements and that reports from reporting accountants on profit forecasts and estimates may continue to be commissioned even if a waiver may be granted by the Panel due to the desire to meet transaction timetables.

Our detailed responses to questions are set out in the attached appendix.

Should you wish to discuss our response, please contact Ursula Newton at ursula.newton@uk.pwc.com, Kevin Desmond at kevin.desmond@uk.pwc.com or Michael Wisson at michael.a.wisson@uk.pwc.com.

Yours faithfully

PricewaterhouseCoopers LLP

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APPENDIX

<u>Profit forecasts and quantified financial benefits statements</u>

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"?

The proposed definitions of "profit forecast" and "profit estimate" are similar, but not identical to, the definitions of those terms included in the PD Regulation and FSA Handbook.

The proposed definition of "*profit forecast*" in the consultation refers to "*.... a particular period,*" as opposed to "*...the current financial period and / or financial periods subsequent to that period,*" as per the definition in the PD Regulation. In addition the proposed definition of "*profit estimate*" includes reference to "*audited results*" rather than just "*results*".

We believe that it is helpful to companies and advisors if definitions are consistent between different legislation and would therefore recommend that the definitions of profit forecast and profit estimate be aligned to those in the PD Regulation and FSA Handbook.

As per our response to PCP 2010/1 we also believe that it would be helpful to companies if the Code cross refers to existing guidance for preparers of profit forecasts issued by the ICAEW entitled "Prospective Financial Information – Guidance for UK directors" and issued in CESR's recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses no 809/2004 regarding profit forecasts (paragraphs 38 to 50). This should guide preparers to consistent behaviours in the preparation of their forecasts.

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)?

Yes, we 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.

However, we do not believe that requiring a report on a quantified financial benefits statement to refer to accounting policies of the party to the offer is the most appropriate form of reporting on such statements. Typically such statements are focused on cash cost savings and accounting policies are less relevant than they are when reporting on a profit forecast. We therefore believe that the reporting should only state "*...properly compiled on the basis stated*" or could retain the current form of reporting under the Code and refer to "*...with due care and consideration*".

We also believe that Rule 28.1(a) should only require "*principal*" assumptions underlying the forecast or estimate or quantified financial benefits statements to be stated. This would be consistent with the requirements set out in the PD Regulation.

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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?

Yes, we agree with these requirements.

We would comment on Note 1 on Rule 28.1 that it would be helpful if it included the guidance in Practice Statement No.20 (originally in relation to Rule 2.2) listing the factors to be taken into account by the Panel in determining when an offer has been "first actively considered".

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)?

Yes, we agree with the new requirements with regard to an outstanding profit forecast.

We note that proposed 28.1(c)(i) by cross referring to Rule 28.3 may introduce practical challenges and have unintended consequences. In particular forecasts published by companies outside of an offer period may not meet all of the requirements set out in proposed Rule 28.3. For example, our experience is that forecasts made outside of regulatory documents are rarely accompanied by disclosure of assumptions.

Notwithstanding the intended reporting relaxation it may well be that companies opt to issue a new forecast for the relevant period and hence fall into 28.1(c)(iii).

A solution to this might be to mirror the language in Listing Rule LR13.5.32R(2).

We note that the proposed 28.1(c)(i) currently states "*include a confirmations*". We presume this should just be singular, i.e. "*confirmation*".

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?

As per our response to PCP 2010/1, we agree with the principle of the provision of exemptions from the obligation to report on a profit forecast published in the normal course of a company's business. However we would note the following regarding the proposed new Note 2 on Rule 28.1:

- "*Ordinary course*" and "*established market practice*" – Notwithstanding the fact that a definition of "*ordinary course*" has been included in the proposed new Note 2 on Rule 28.1, there remains a considerable amount of judgement with respect to what constitutes "*ordinary course*" and "*established market practice*" and how this can be demonstrated by an offeror or offeree. For example, how many years would an offeror or offeree need to have issued forecast profit guidance as part of its regular communications with its investors for this to be considered "*established*" by the Panel? We would note that there could be potentially difficult consequences of providing an exemption in relation to "*ordinary course*" business forecasts, where, for example the information is subsequently altered in some way whilst the offer is open. For example, during the Kraft offer for Cadbury, Kraft regularly issued profit guidance with its quarterly reporting which presumably would have been considered "ordinary course"

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and hence would have been subject to a waiver request. Kraft subsequently refined this guidance further during the offer period. It was only possible for the reporting accountant to complete its work and issue its report on the refined forecast within the transaction timetable by virtue of the fact that a significant amount of work had been done on the original forecast that had been issued as part of the quarterly reporting. Under the proposed new Note 2 on Rule 28.1, it would appear that whilst the original profit guidance would have received a reporting waiver, the refinement would not have met the proposed definition of "*ordinary course"* and hence would have required reporting on. As no procedures will have been performed on the original waiver, this would present practical challenges for the reporting accountant and Rule 3 advisor in completing work on the refined forecast within the transaction timetable.

- Other parties consent to the disapplication of Rule 28.1(a) or (b) – we are unclear as to why the Code Committee is seeking to permit disapplication of Rule 28.1 (a) or (b) "*provided that the other parties consent to the disapplication of those requirements*" rather than just referring to recommended offer scenarios. We believe that in hostile or competitive bid scenarios it would be unlikely and inappropriate that other parties would consent to dispensing with the requirements of Rule 28.1(a) or (b).

We also believe it would be helpful to companies and advisors if the table in Appendix A were included as an appendix in the Rules (subject to comment in response to question 7 below).

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?

Yes, we agree with the proposal to provide a dispensation.

We note that the implication of the new Note 3 is that in the situation where a party to an offer has previously issued profit guidance (which is not "ordinary course") for a period ending 15 months or more from the date on which it was first published, no reports will be required from a reporting accountant even if that date is within 15 months by the time the offer period commences.

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 in principle with the proposals. As per our response to question 5 we believe it would be helpful to companies and advisors if the table in Appendix A were included as an appendix in the Rules. However, we note that the final sentence in footnote 2 to the table in Appendix A states "*Such a profit forecast for the current financial year that has not previously been published will be required to be reported on, unless it is an ordinary course profit forecast and the other parties consent to a dispensation from the reporting requirements."* We do not see how such a forecast can be "*ordinary course*" as it is being issued for the first time as a result of the requirements imposed by the Rules.

We believe that 28.2(c) should reference Rule 28.1 rather than "Rule 28" as per the proposed drafting.

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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?

Yes, we 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. We have no comments on the proposed new Note 4.

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

As per our response to PCP 2010/1 we continue to believe that a form of words that puts a ceiling on likely profits may be in the interests of more than just management or controlling shareholders since a statement such as "Profits for the year will be less than last year" puts a ceiling on the likely profits and may guide investors' expectations down. Additionally loss statements such as "We will make a loss for the year" technically puts a ceiling on the profits as these will be no higher than zero. Therefore we believe that no change should be made to the existing Rule 28.6(a).

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 note that if the offer consideration is wholly or partially in shares of the offeror then a public profit forecast is likely to be material to the offeree shareholder even if the consideration shares are less than 10% of the enlarged equity share capital of the offeror. Therefore we believe such a provision should not be included in the rules.

An alternative approach might be to measure materiality by reference to the proportion of the offer consideration in shares. However, the benefit of this relaxation for companies will often be negated by the requirement for the offeror to produce a document equivalent to a prospectus.

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 note that the principles of profit forecasts and profit estimates being "understandable" and "reliable" as outlined in the ESMA guidance have been included in note 7. However, the principles of "comparable" and "relevant" have not been included. We believe all the principles set out in the ESMA guidance should be included in Note 7.

Further, we note that these are the principles which are considered to be suitable criteria for reporting accountants to evaluate profit forecasts under SIR 3000 (Investment Reporting Standards applicable to Public Reporting Engagements on Profit Forecasts).

The reference to "cash offeror" in Note 7c) should be removed as we consider that the form of consideration is not relevant to the requirements of the preparation of the forecast or estimate.

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?

As set out in our response to Q2, we believe that as per the PD Rules, new Rule 28.3 should refer to "principal" assumptions underlying the profit forecast or estimate or quantified financial benefits statement.

We do not believe that individual assumptions that affect a profit forecast or quantified financial benefits statements should be quantified because of the manner in which such statements are prepared:

i) Profit forecasts
Profit forecasts are the result of the interaction of a number of different individual assumptions. Therefore, disclosing the impact of an individual assumption on the forecast in isolation would potentially provide a misleading view to investors. Further, profit forecasts and estimates are typically prepared with sufficient contingency (headroom) for adverse changes in the principal assumptions i.e. effectively setting a floor.

ii) Quantified financial benefits statements
Quantified financial benefits statements are typically evaluated on the basis of existing cost and operating structures, macroeconomic factors, e.g. foreign exchange rates and regulatory environment (see example below). We would therefore question whether the inclusion of sensitivities is necessary if the basis of the statement is clearly disclosed. Below are extracts from two quantified financial benefits statements included in offer documents to illustrate this point.

Taylor Nelson Sofres plc proposed merger with GfK AG (25 June 2008)
"The Merger benefits and related non-recurring costs to achieve the Merger benefits referred to in this document have been calculated on the basis of the existing cost and operating structures of the companies and by reference to current prices and the current regulatory environment."

Acquisition of Cadburys by Kraft (2009)
"When evaluating the cost savings the Kraft Foods Directors have assumed the following:

> *(i) that Kraft Foods will acquire 100% of the shares in Cadbury following completion of the Offer, without undue delay;*
> *(ii) that there will be no material unanticipated impact on the Combined Group arising from any decisions made by competition authorities;*
> *(iii) that there will be no material change to the market dynamics affecting Kraft Foods and/or Cadbury following completion of the Offer; and*
> *(iv) that there will be no material change to exchange rates following completion of the Offer."*

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 believe that the exemptions from the requirements of Rule 28 for certain profit estimates should be extended but we do not agree with the current drafting of new Rule 28.4.

Under the Disclosure and Transparency Rules, periodic financial reporting for companies listed on the UK Main Market involves the issuance of Interim Management Statements (IMS). We note that whilst the actual content of IMS varies in practice between issuers and may or may not include any numbers or financial analysis it is subject to regulatory oversight. We therefore believe that if an IMS contains a profit number for a completed period, this should be included in the exemptions from the requirements of Rule 28.1 set out in Rule 28.4. We would also note that profit numbers disclosed in an IMS could be considered to fall within the definition of "*ordinary course*" under new Note 2 to Rule 28.1. For the avoidance of doubt, if an IMS were to include a forecast of future profits we believe this should be reported on (save to the extent this meets the definition of "*ordinary course*") and such guidance should be included in a note to Rule 28.4 (see below).

We believe that a definition of "*interim financial information*" should be included in "*Definitions*" within the Code so as to avoid any potential confusion of what type of financial information is being referred to in the Code. We note that many market users and commentators refer to an issuer's half-yearly report as "interims".
We also note that the exemption in 28.4(a)(iii) currently only applies to IFRS reporters as it requires the information to be prepared in accordance with IAS 34 and hence would exclude any issuers which prepare financial statements in accordance with another permitted GAAP e.g. US GAAP.

A proposed definition of "*interim financial information*" might be:

Interim financial information
Financial information for a historical period (other than in respect of a full financial year or half-year) published in accordance with a regulatory requirement and prepared in accordance with International Accounting Standard 34 (or equivalent standard).

We believe it would be simpler to set out the items that are not caught by Rule 28 rather than refer to them as profit estimates and then say they are exempt which would be more similar to the current drafting of rule 28.6(c). In addition we believe proposed 28.4(b) should be in a guidance note rather than a rule. We would propose drafting along the lines of the following:

"28.4 Interim and preliminary figures
The provisions of Rules 28.1 and 28.3 do not apply to the following:
(i) preliminary statements of annual results which comply with the relevant provisions of the UKLA Rules
(ii) a half-yearly report which complies with the relevant provisions of the UKLA Rules, the AIM Rules for Companies or the PLUS Rules for Issuers;
(iii) financial information for a completed period included within an Interim Management Statement which complies with the relevant provisions of the UKLA Rules; and
(iii) interim financial information.

Notes on Rule 28.4

1. For the avoidance of doubt, a forecast of profit for a future financial period included in an announcement associated with any of above is not exempt (unless Note 2 on Rule 28.1 applies).

2. Where a party to an offer which is not admitted to trading on a UK regulated market or on AIM or PLUS includes, or has included, a profit estimate in a preliminary statement of annual results, a half-yearly financial report or interim financial information published in accordance with a regulatory requirement, the Panel may, in appropriate circumstances, grant a dispensation from the requirements of Rule 28.1. The Panel should be consulted in such cases."

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

In respect of 28.5(d) we would seek clarification on what the Code Committee expects to be stated under this requirement. Does the Code Committee expect offerors and / or offerees to include balance sheet and cash flow information?

In respect of 28.5(e) we would seek clarification on what the Code Committee expects under this requirement otherwise different interpretations of the rule may arise in practice. Typically, when quantifying cost synergies from an acquisition an offeror would expect to include cost reductions arising from, for example procurement savings due to the increased buying power of the combined group. The offeree might be capable of achieving a degree of cost savings independently so is it the Code Committee's expectation that only incremental savings from the combined group would be included in the financial benefits statement?

In order to address questions such as these we would suggest that the Code Committee works with the ICAEW or the FRC, as issuers of SIR 3000, to provide guidance for preparers.

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 have no further comments on the proposed new Rule 28.6. However, we do not think it should be necessary to report on a part of a business when a profit forecast has also been made and reported on for the whole business and so would propose a note is added to this effect.

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?

Proposed 28.7(a) states that Rule 28.1(a) will apply to third party or average forecasts. We understand the intention of the Code Committee in proposing new Rule 28.7(a) but believe that in practice this new rule will essentially force companies to issue a new forecast as it is unlikely that a company's internal forecasts for the relevant period will be exactly in line with third party profit consensus and capable of supporting the diligence required for the forecast to be reported on by a reporting accountant.

We also note that similar to our point raised in Question 4 we note that forecasts published by third parties are unlikely to meet all of the requirements in proposed Rule 28.3 (which is referred to in Rule 28.1(a)).

In respect of note 1 on Rule 28.7 we do not agree with the revised proposal. We believe the principle outlined in 15.6 of PCP 2010/1 should apply on the basis that this is more logical given information technology today would allow an investor or potential investor to find the information.

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 have no comments on new Rule 28.7(b) or new Notes 2 to 4 on Rule 28.7.

In respect of new Rule 28.7(c) we note that it only appears to provide a right of reply. If a hostile offeror does not refer to third party forecasts in its offer document (for example where the price offered is below that of analyst consensus), an offeree that wishes to challenge this offer by reference to third party forecasts will be caught by new Rule 28.7(a) and therefore be potentially disadvantaged.

Material changes in information

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?

It is our opinion that it is more helpful for companies and advisors if there is a definitive outcome rather than matters always being subject to review by the Panel so would suggest either 27.1(b) is deleted or guidance provided as to when a circular will be required.

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?

No.

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

No.

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Other amendments in relation to documents published by an offeror and the offeree company

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

No.

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

No.

<u>Other comments</u>

(1) Notes on Rule 20.1

We agree in principle with the amendments but would question whether guidance should be included as to which situations would typically require issuance of a circular.

(2) Amendments to Rule 24.3 and rule 25.3

As per our comments on question 13, we believe that could be confusion as to what information is envisaged under "*interim financial information*" and a definition should be included.