

THE TAKEOVER PANEL

MERGER BENEFITS AND EARNINGS ENHANCEMENT STATEMENTS

The Code is being amended in order to ensure that specific requirements are satisfied when certain statements are made in takeover documents about the expected benefits of a proposed takeover or merger.

During the course of the takeover of Forte plc ("Forte") by Granada Group plc ("Granada"), Granada published a circular setting out its belief that the ongoing profits of Forte could be improved by over £100 million per annum from Granada's first full financial year following acquisition. Granada also stated that, on that basis, the acquisition was expected to be significantly earnings enhancing.

The claimed £100 million improvement, taken together with other published financial information, did not constitute a profit forecast within the meaning of Rule 28 because, as there was no forecast on record for either Granada or Forte to the conclusion of the financial year of Granada in question (namely for the first full financial year following acquisition), it was impossible, despite the earnings enhancement statement, to treat the information in Granada's circular and other published financial information as creating either a floor or a ceiling for the profits of Forte or Granada in that period.

As Rule 28 was therefore not relevant and as no Rule in the Code explicitly governed such a statement, it was only the general Code standards of information which applied. Following an appeal by Forte, the Panel agreed with the ruling of the Executive that, in the circumstances of the case, those general standards had been satisfied. The Panel nevertheless asked the Executive to examine whether there might be any need for new specific requirements in respect of any statements made about the expected benefits of a proposed merger where such benefits were quantified.

The matter was subsequently considered by the Executive which concluded that there was a need for specific requirements in respect of statements made about the expected financial benefits of a proposed merger, largely similar to the information which Granada ultimately included in relation to such benefits, whether or not such benefits were quantified. The Panel agreed with the Executive's conclusion that an additional Note should be inserted in the Code to draw this to parties' attention.

Rule 19.1 has therefore been amended by the insertion of a new Note 8 as follows:

"8. Merger benefits statements

In order to satisfy the existing standards of information set out in the Code, certain additional requirements will normally need to be complied with if statements are made by a party about the expected financial benefits of a proposed takeover or merger (for example, a statement by the offeror that it would expect the offeree company to contribute an additional £x million of profit post acquisition). These requirements may also need to be complied with even if such benefits are not quantified.

These additional requirements include publication of:

- (a) the bases of the belief (including sources of information) supporting the statement;
- (b) reports by financial advisers and accountants that the statement has been made with due care and consideration;
- (c) an analysis and explanation of the constituent elements sufficient to enable shareholders to understand the relative importance of these elements; and

(d) a base figure for any comparison drawn.

These requirements may also be applicable to statements to the effect that an acquisition will enhance an offeror's earnings per share where such enhancement depends in whole or in part on material merger benefits.

Parties wishing to make merger benefits statements should consult the Panel in advance.

See also Rule 28.6(h)."

The Executive was also concerned that earnings enhancement statements might be interpreted in different ways by shareholders. They could be regarded by some as meaning that an acquisition would result in the offeror's earnings per share following an acquisition being greater than those published in its latest financial statements, i.e. a forecast. Alternatively, they could be regarded as meaning that the offeror's earnings per share following an acquisition would be greater than they would have been had the acquisition not taken place (even though earnings per share following the acquisition might be less than those set out in the offeror's latest financial statements). Since the Executive understands that offerors and their advisers normally intend such statements to have the second meaning, an amendment has been made to the Code requiring offerors which make any earnings enhancement statements which are not intended to be profit forecasts to include an explicit and prominent disclaimer to the effect that they should not be interpreted to mean that earnings per share will necessarily be greater than those for the relevant preceding financial period.

It is also possible that earnings enhancement statements, when combined with merger benefits statements and/or other published financial information, could result in the market being provided with information from which the prospective profits for the offeror or the enlarged offeror group or at least a floor or ceiling for such profits can be inferred.

Accordingly, an amendment has been made to the Code to warn parties that they should be alert to this possibility in order to avoid reporting obligations under Rule 28 with which they may be unable to comply.

Rule 28.6 of the Code has therefore been amended by the inclusion of a new paragraph (h) stating as follows:

"(h) Earnings enhancement and merger benefits statements

Parties wishing to make earnings enhancement statements which are not intended to be profit forecasts must include an explicit and prominent disclaimer to the effect that such statements should not be interpreted to mean that earnings per share will necessarily be greater than those for the relevant preceding financial period.

Parties should also be aware that the inclusion of earnings enhancement statements, if combined with merger benefits statements and/or other published financial information, may result in the market being provided with information from which the prospective profits for the offeror or the enlarged offeror group or at least a floor or ceiling for such profits can be inferred. Such statements would then be subject to this Rule. If parties are in any doubt as to the implications of the inclusion of such statements, they should consult the Panel in advance.

See also Note 8 on Rule 19.1."

These amendments should, where practicable, be applied with effect from today; where, however, this would produce major difficulties, for example where an offer document has

already been posted, the Panel should be consulted and will endeavour to agree a solution which is fair to all parties.

Amended pages of the Code will be issued in due course.

3 April 1997