

10. Profit forecasts and other financial information

Profit forecasts

10.1 Standards of care

There are obvious hazards attached to the forecasting of profits; ~~†~~ This should in no way detract from the necessity of maintaining the highest standards of accuracy and fair presentation in all communications to shareholders in an offer. A profit forecast must be compiled with due care and consideration by the directors, whose sole responsibility it is; the financial advisers must satisfy themselves that the forecast has been prepared in this manner by the directors.

Note to Rule 10.1:

Existing forecasts

At the outset, an adviser should invariably check whether or not his client has a forecast on the public record so that the procedures required by Rule 10.3(d) can be set in train with a minimum of delay.

10.2 The assumptions

- (a) When a profit forecast appears in any document addressed to shareholders in connection with an offer, the assumptions, including the commercial assumptions, upon which the directors have based their profit forecast, must be stated in the document.
- (b) When a profit forecast is given in a press announcement made at the commencement of or during an offer period, any assumptions on which the forecast is based should be included in the announcement.

Notes to Rule 10.2:

1. Requirement to state the assumptions

- (a) *It is important that by listing the assumptions on which the forecast is based useful information should be given to shareholders to help them in forming a view as to the reasonableness and reliability of the forecast. This should draw the shareholders' attention to, and where possible quantify, those uncertain factors which could materially disturb the ultimate achievement of the forecast.*
- (b) *There are inevitable limitations on the accuracy of some forecasts and these should be indicated to assist shareholders in their review. A description of the general nature of the business or businesses with an indication of any major hazards in forecasting in these particular businesses should normally be included.*

- (c) *The forecast and the assumptions on which it is based are the sole responsibility of the directors. However, a duty is placed on the financial advisers to discuss the assumptions with their client and to satisfy themselves that the forecast has been made with due care and consideration. Auditors or consultant accountants must satisfy themselves that the forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the basis of the assumptions made.*

Although the accountants have no responsibility for the assumptions, they will as a result of their review be in a position to advise the company on what assumptions should be listed in the circular and the way in which they should be described. The financial advisers and accountants obviously have substantial influence on the information about assumptions to be given in a circular; neither should allow an assumption to be published which appears to be unrealistic, or one to be omitted which appears to be important, without commenting appropriately in its report.

2. *General rules*

- (a) *The following general rules apply to the selection and drafting of assumptions.*

(i) *The shareholder should be able to understand their implications and so be helped in forming a judgement as to the reasonableness of the forecast and the main uncertainties attaching to it.*

(ii) *The assumptions should be specific rather than general, definite rather than vague.*

(iii) *Assumptions about factors which the directors can influence may be included, provided they are clearly identified as such. However, assumptions relating to the general accuracy of estimates should be avoided. The following would not be acceptable:-*

“Sales and profits for the year will not differ materially from those budgeted for.”

“There will be no increases in costs other than those anticipated and provided for.”

Every forecast involves estimates of income and of costs and must obviously be dependent on these estimates. Assumptions of the type illustrated above do not help the shareholder in considering the forecast.

(iv) *The assumptions should not relate to the accuracy of the accounting systems. If the systems of accounting and forecasting are such that full reliance cannot be placed on them, this should be the subject of some qualification, in the forecast itself. It is not satisfactory for this type of deficiency to be covered by the assumptions. The following would not be acceptable:-*

“The book record of stock and work-in-progress will be confirmed at the end of the financial year.”

(v) *The assumptions should relate only to matters which may have a material bearing on the forecast.*

(b) *Even the more specific type of assumption may still leave shareholders in doubt as to its implications, for instance:-*

“No abnormal liabilities will arise under guarantees.”

“Provisions for outstanding legal claims will prove adequate.”

Such phrases might be dismissed on the grounds that the first relates to the unforeseen and the second to the adequacy of the estimating system. In both these examples information would be necessary about the extent or basis of the provision already made and/or about the circumstances in which unprovided for liabilities might arise.

(c) *There may be occasions, particularly when ~~the~~an estimate relates to a period already ended, when no assumptions are required.*

10.3 Reports required in connection with profit forecasts

- (a) A forecast made by an offeror offering solely cash need not be reported on. With the consent of the Executive, this exemption may be extended to an offeror offering a non-convertible debt instrument.
- (b) In all other cases, the accounting policies and calculations for the forecasts must be examined and reported on by the auditors or consultant accountants. Any financial adviser mentioned in the document must also report on the forecasts.
- (c) When income from land and buildings is a material element in a forecast, that part of the forecast should normally be examined and reported on by an independent valuer: this requirement does not apply where the income is virtually certain, e.g. known rents receivable under existing leases.

- (d) Except with the consent of the Executive, any profit forecast which has been made before the commencement of the offer period must be examined, repeated and reported on in the document sent to shareholders.
- (e) Exceptionally, the Executive may accept that, because of the uncertainties involved, it is not possible for a forecast previously made to be reported on in accordance with the Takeovers Code nor for a revised forecast to be made. In these circumstances, the Executive would insist on shareholders being given a full explanation as to why the requirements of the Takeovers Code were not capable of being met.

10.4 Publication of reports and consent letters

Whenever a profit forecast is made during an offer period, the reports must be included in the document addressed to shareholders containing the forecast. When the forecast is made in a press announcement, that announcement must contain a statement that the forecast has been reported on in accordance with the Takeovers Code and the reports have been lodged with the Executive. If a company's forecast is published first in a press announcement, it must be repeated in full, together with the reports, in the next document sent to shareholders by that company. The reports must be accompanied by a statement that those making them have given and not withdrawn their consent to publication.

10.5 Subsequent documents - continuing validity of forecast

When a company includes a forecast in a document, any document subsequently sent out by that company in connection with that offer must, except with the consent of the Executive, contain a statement by the directors that the forecast remains valid for the purpose of the offer and that the financial advisers and accountants who reported on the forecast have indicated that they have no objection to their reports continuing to apply.

10.6 Statements which will be treated as profit forecasts

- (a) When no figure is mentioned

Even when no particular figure is mentioned or even if the word "profit" is not used, certain forms of words may constitute a profit forecast, particularly when considered in context. Examples are "profits will be somewhat higher than last year" and "performance in the second half-year is expected to be similar to our performance and results in the first half-year" (when interim figures have already been published). Whenever a form of words puts a floor under, or a ceiling on, the likely profits of a particular period or contains the data necessary to calculate an appropriate approximate figure for future profits, it will be treated by the Executive as a profit forecast which must be reported on. In cases of doubt, professional advisers should consult the Executive in advance.

- (b) Estimates of profit for a completed period

An estimate of profit for a period which has already expired should be treated as a profit forecast.

- (c) Forecasts for a limited period

A profit forecast for a limited period (e.g. the following quarter) is subject to this Rule 10.

- (d) Dividend forecasts

A dividend forecast is not normally considered to be a profit forecast unless, for example, it is accompanied by an estimate as to dividend cover.

- (e) Profit warranties

The Executive must be consulted in advance if a profit warranty is to be published in connection with an offer as it may is likely to be regarded as a profit forecast.

10.7 Taxation, extraordinary items, exceptional items and minority interests

When a forecast of profit before taxation appears in a document addressed to shareholders, there must be included forecasts of taxation ~~(where the figure is expected to be significantly abnormal)~~, extraordinary items, ~~and~~ exceptional items and minority interests. ~~(where either of these amounts is expected to be material)~~.

10.8 When a forecast relates to a period which has commenced

Whenever a profit forecast is made in relation to a period in which trading has already commenced, any previously published profit figures in respect of any expired part of that trading period, together with comparable figures for the same part of the preceding year, must be stated.

Other **F**inancial **I**nformation

10.9 Interim and preliminary figures

Except with the consent of the Executive, any unaudited profit figures published during an offer period must be reported on. This provision does not, however, apply to:-

- (i) unaudited statements of annual or interim results which have already been published;

- (ii) unaudited statements of annual results which comply with the requirements for preliminary profits statements as set out in the Listing Rules;
- (iii) unaudited statements of interim results which comply with the requirements for half-yearly reports as set out in the Listing Rules in cases where the ~~offer has been publicly recommended by the~~ board of the offeree company has not publicly advised its shareholders not to accept an offer; or
- (iv) unaudited statements of interim results by offerors which comply with the requirements for half-yearly reports as set out in the Listing Rules, whether or not the offer has been publicly recommended by the board of the offeree company but provided the offer could not result in the issue of securities which would represent 10% or more of the enlarged voting share capital of the offeror.

The Executive should be consulted in advance if the company is not listed on the Stock Exchange but wishes to take advantage of the exemptions under (ii), (iii) or (iv) above.

Note to Rule 10.9:

Growth Enterprise Market companies

References to interim results include quarterly results for companies listed on the Growth Enterprise Market of the Stock Exchange.

10.10 ~~Working capital statements~~

~~Where a working capital statement is required under the Listing Rules to be included in a document to shareholders the Executive must be consulted to determine whether such a statement should be reported on and disclosed in accordance with this Rule. This would normally apply when the financial condition of the company is a material issue for shareholders in considering the offer.~~

Merger benefits statements in securities exchange offers

In a securities exchange offer, a quantified statement about the expected financial benefits of a proposed takeover or merger is deemed to be a profit forecast statement for the purpose of this Rule 10. In addition to satisfying the existing standards of information and requirements under Rules 9 and 10 of the Takeovers Code, a person issuing such a statement must provide:-

- (a) the bases of the belief (including sources of information) supporting the statement;

(b) an analysis and explanation of the constituent elements sufficient to enable shareholders to understand the relative importance of these elements; and

(c) 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 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 unquantified 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 10. If parties are in any doubt as to the implications of the inclusion of such statements, they should consult the Executive in advance.

Note to Rule 10.10:

Statements that will be treated as profit forecasts

Quantified statements of merger benefits or earnings enhancements, such as a statement by an offeror that it would expect the offeree company to contribute \$x million of profit post acquisition, will be treated as profit forecasts. The Executive will also apply tests similar to those in Rule 10.6 to determine whether statements that do not mention any particular figure constitute profit forecasts. General statements that do not provide a floor or ceiling for profits, such as a statement by an offeror that it expects to achieve synergies through the rationalisation of head office costs, would not be regarded as forecasts.

10.11 Material changes in financial or trading position

Where a document to shareholders includes information about material changes in the financial or trading position of the offeror or offeree company subsequent to the last published audited accounts, in accordance with Schedules I and II or, in the case of a share repurchase by general offer or off-market share repurchase, Schedule III respectively, such information must be reported on in accordance with this Rule 10. The directors of the company must provide the Executive with evidence of the steps taken by them to support the statement included in such a document that there have been no such material changes (or none save as disclosed in the document).

Note to Rule 10.11:

Evidence of steps taken

The evidence required under this Rule 10.11 normally includes a confirmation in writing by the board of the offeror or offeree company to the Executive that the board has reviewed, among other things, the financial position of the company (including the latest consolidated management accounts, financial condition, capital and other commitments, contingent liabilities and future cash flow and financing requirements) and the trading position with respect to the company's suppliers and customers. The confirmation should also state that the board has discussed all these aspects with the financial advisers of the company before it makes the confirmation.