FINANCIAL CONDUCT AUTHORITY

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Primary Market Technical Note

Profit forecasts and estimates

The information in this note is designed to help issuers and practitioners interpret our UK Listing Rules, Prospectus Regulation Rules, Disclosure Guidance and Transparency Rules, and related legislation. The guidance notes provide answers to the most common queries we receive and represent FCA guidance as defined in section 139A FSMA

Rules and Guidance

Guidelines 10-13 of the FCA Guidelines on prospectus disclosure; ESMA Questions and Answers on the Prospectus Regulation (ESMA/2020/ESMA31-62-1258) (ESMA Q&A); PR Regulation Annex 1 item 11.2

Definition of a profit forecast

The requirements on profit forecasts and estimates are set out in PR Regulation Annex I section 11 (and similar Annex items), Guidelines 10 – 13 of the FCA Guidelines on prospectus disclosure. In the PR Regulation a profit forecast means a statement that expressly or by implication indicates a figure or a minimum or maximum figure for the likely level of profits or losses for current or future financial periods, or contains data from which a calculation of such a figure for future profits or losses can be made, even if no particular figure is mentioned and the word "profit" is not used. In addition, the ESMA Q&A provide issuers with some broad guidance on how they could determine

whether or not they have made a profit forecast for the purposes of a prospectus.

Profit estimate is defined as a profit forecast for a financial period which has expired and for which results have not yet been published. Publication of results for an annual financial period means publication of both the final figures, which have been approved by the person responsible within the issuer, and the auditor's report. Preliminary results released prior to the publication of the full annual audited financial statements therefore constitute a profit estimate.

Quarter four reports which contain unaudited results for an annual financial period should be considered as interim financial information rather than a profit estimate.

Companies should bear in mind the requirements referred to above when making any public announcement that contains statements about their future performance. PR Regulation Annex 1 11.1 (and similar Annex items) requires the issuer to include a profit forecast or estimate in a registration document if it is outstanding and still valid. If the profit forecast or estimate is outstanding but no longer valid, then the issuer should provide a statement to that effect and explanation of why such forecast or estimate is no longer valid. Issuers should make sure that any statement they publish about their future performance is not a forecast if it is not intended to be one. Often, statements made by companies in previous announcements are caught by the profit forecast requirements when the companies come to prepare prospectuses.

In practice, this covers a broad range of statements of future performance. In particular it should be noted that the definition covers statements about 'losses' as well as about 'profits', and that neither word needs to be used at all. For example, where the words 'results' or 'earnings' are used, the FCA may still take the view that there is a forecast or estimate if it is apparent that the market interprets this as profit. It is also possible, depending on the context, that a forecast of earnings per share will be viewed as a profit forecast. Revenue figures may also be a profit forecast if that allows a calculation of profit. This is most likely to be the case where an issuer has previously published details of its profit margins.

Statements of performance against market expectations may also be forecasts if there is a clear market consensus of expectation that allows a calculation of a floor or ceiling on forecast profits. A public

reference to market expectations may also be a profit forecast if the issuer is endorsing the view of analysts.

It should also be noted that the definition refers to a 'financial period', and not to a reporting period or other defined length of time. So it is possible that a comment limited to a quarter/half year may be still construed as a forecast.

Basis on which profit forecasts are prepared

Guideline 11 of the FCA Guidelines on prospectus disclosure set out principles for preparing profit forecasts and estimates. Among other things, issuers should ensure that profit forecasts or estimates are understandable for investors and comparable. With regard to the latter, profit forecasts or estimates should be drawn up in a way which makes it easy for investors to compare them with the historical and interim financial information which is included in the prospectus. Issuers should also consider whether there have been post balance sheet events that that may impact the profit forecast or estimate and any such impact should be explained.

Invalid profit forecasts and estimates

The regulatory requirements in relation to outstanding profit forecasts or estimates in connection with prospectuses are referred to above. In some cases, issuers and their advisers may state that previously made profit forecasts and estimates are no longer valid, and hence avoid the requirement to state assumptions.

However, this approach is only appropriate when the previously made forecast is rendered invalid or inaccurate due to matters not contemplated in the original forecast, and should not be used by issuers as a way to avoid this requirement.

To make the assertion that a previously made profit forecast is invalid, an issuer needs to demonstrate that changes have occurred since the date the forecast was made, which were not taken into account in the forecast and mean that the actual profits or losses will likely be materially different from those forecast. Frequently these changes relate to an acquisition (or occasionally a disposal) in contemplation (usually the subject of the documents), and the reasons for invalidity relate to differences in circumstances between when the forecasts

were made, and the likely position of the issuer or target following the transaction.

In determining whether the reasons for invalidity are credible, we will take into account the following:

- **When was the forecast made:** We will take into account when the profit forecast was made, and whether the transaction was in contemplation at that time. A profit forecast made several months before an acquisition is announced is more likely to be no longer valid than one published post-announcement.
- **Materiality:** Reasons for the forecast's invalidity should be expected to have a material impact, either individually or in aggregate. Immaterial reasons should be avoided so investors understand the key reasons for invalidity. An issuer should not present generic factors that are not materially relevant to the forecast. Also, it is important that the stated reasons have a material impact during the remaining part of the forecast period – e.g. synergies are less likely to be seen as a valid reason if the acquisition is only going to complete close to the end of the period.
- **Factors considered as a whole:** We are likely to consider all of the reasons presented as a whole, taking into account the specific circumstances of the issuer and the profit forecast in question.

Specific examples of reasons given for invalidity

We present below a selection of typical factors that we have seen, together with some considerations on when they are more or less likely to be credible reasons for invalidity. The list is not necessarily exhaustive, nor should it be taken that these reasons will always be accepted, as we will assess each case on its own merits. It should not be assumed that just because a reason for invalidity is accepted in a particular case that it will apply in all circumstances.

- **Synergy benefits** anticipated in an acquisition that were not included in issuer or target profit forecasts. This reason is more credible when synergies/quantified financial benefits are extensively discussed in the transaction documents.
- **Restructuring/integration costs** expected for an acquisition that were not included in the issuer or target profit forecast.
- **Divestments** expected for an acquisition that have not been considered within the issuer or target profit forecast. This is more likely to be accepted when these are due to enforced disposals

following reviews by competition authorities. Expected voluntary divestments by the enlarged group for strategic reasons are less likely to be sufficiently evidenced at the point of publication of the document to justify invalidity of the profit forecast.

- **Purchase price allocation adjustments** expected to be made to a target not considered in target's profit forecast. For example, the PPA exercise may lead to an increase in intangible assets subject to amortisation, and this would potentially lead to lower profits in the target than previously forecast.
- **Transaction costs** that have not been considered in the issuer's (or target's) profit forecast. Care should be taken if these transaction costs are clearly quantifiable, e.g. from the prospectus.
- **Foreign exchange** movements since the forecast was made might be significant enough reasons for invalidity if for example the issuer has overseas subsidiaries or material revenues/costs in foreign currencies.
- **Events in the period between the date** the profit forecast was originally made and the date of the document. Specific events in this period that were unanticipated in the profit forecast may be sufficiently material to be a reason for invalidity. Such events should be explained in the narrative. A general reference to changes in 'assumptions and estimates' is less likely to be sufficient to justify, on its own, that a profit forecast is invalid. Events that have led to announcements/disclosure in interims are more likely to be seen as sufficiently material.
- **Change in accounting framework** ('GAAP') or accounting policies to align financial reporting basis of target and issuer. It may be that material GAAP differences could be cited as a reason for invalidity. However, any references to changes in GAAP or changes in accounting policies should explain what specific impact of the changes is likely to be on the operating performance and profit forecast of the target or issuer, as applicable. Noting that there is going to be a change in GAAP, or that there is a risk that there may be differences in accounting policies, without explaining the specific differences, is unlikely to be sufficient to justify invalidity of a profit forecast.
- **Change in presentational currency** by a target to align with issuer's presentational currency that was not addressed in the issuer or target profit forecast. An expected change in the presentational currency of a profit forecast is unlikely to be

sufficient to justify invalidity of the profit forecast, as the conversion of the profit forecast in the original presentational currency into the new presentational currency does not impact the expected underlying performance projected in the profit forecast.

- **Issuer may take different strategic/operating decisions** compared to those assumed by target when preparing target's standalone profit forecast. Expected changes in the strategic direction or operating decisions made in relation to the target by the new management team are less likely to be sufficient to justify invalidity of target's existing profit forecast on their own without other reasons supporting the invalidity. It may be the case that these changes can be factually supported through details of the change in strategic direction being disclosed elsewhere in the document.
- **Period covered by profit forecast is longer than 12 months.** Long-term profit projections, such as annual projections across a five-year period, can be caught by the definition of a profit forecast in Article 1(d) of the PR Regulation; therefore all years in such a profit forecast should be addressed in accordance with Annex I section 11. We are aware that this differs from the Takeover Panel's approach, in which Rule 28.2 of the Takeover Code explains that the Panel will normally dispense with the requirement for reports from accountants and financial advisers for periods ending more than 15 months from when the forecast was first published. However, the longer-term nature of forecasts for periods of longer than 12 months may mean that other reasons for invalidity (such as those mentioned here) are more credible. There may be situations where the first year of a profit forecast is treated in accordance with Annex I, section 11, but later years (e.g. years 2–5) are viewed as invalid and an explanatory statement in accordance with Annex I, item 11.1 is disclosed.
- **Change in tax and capital structure** following the transaction might be credible reasons for invalidity, provided that the profit forecast relates to a profit metric that takes tax and interest into account. EBITDA is unlikely to be affected by changes to future tax and interest payments.
- On occasion, the **profit forecasts have been made due to the requirements of another regulator.** The most common situation is where forecasts have been included in an offer document at the request of an overseas takeover regulator. These forecasts may be included to support a valuation or a fair and reasonable

opinion/recommendation. We have been presented with arguments that these forecasts have not been made by the issuer, or that the issuer has had no involvement in their preparation. We would consider these types of arguments to be less credible, however, because these offer documents are often presented as joint documents of the issuer and target, and the inclusion of a forecast in a document with the issuer’s name on the front cover leads to a presumption that the forecast has been implicitly endorsed by the issuer. In these cases, issuers may still present other arguments to support the invalidity of the forecast, if applicable.