

DRAFT FOR CONSULTATION

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Primary Market Technical Note

Pro forma financial information

The information in this note is designed to help issuers and practitioners interpret our UK Listing Rules (UKLR), Prospectus Rules: Admission to Trading on a Regulated Market (PRM), Prospectus Regulation Rules, Disclosure Guidance and Transparency Rules (DTR), 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

PRM Appendix 2 Annex 1.18R, Item 18.4.1, PRM Appendix 2 Annex 15
PRR 2.1.4UK, PRR 2.1.5UK, FCA Guidelines on prospectus disclosure TN 619.2, UKLR 7 Annex 2 Part 4

Appendix 2 Annex 1.18R item 18.4.1 of the PR Regulation requires, in the case of a significant gross change, a description of how the transaction might have affected the assets, liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date

reported¹. The requirement will normally be satisfied by the inclusion of **pro forma financial information**, the presentation and content of which is set out in ~~Annex 20 of the PR Regulation~~Appendix 2 Annex 15 of the PRM.

What is a 'significant gross change'?

~~Article 1(e) of the PR Regulation defines~~ A significant gross change means as a variation of more than 25% to one or more indicators of the size of the issuer's business. Accordingly, if a prospectus is prepared in connection with a significant transaction or reverse takeover (as defined in the UKLRs) by an issuer listed in the equity shares (commercial companies) or the closed-ended investment funds category, there is a significant gross change. Similarly, a prospectus for an issuer in other listing categories (or unlisted) to raise funds for an acquisition that would have been classified as a significant transaction or reverse takeover if the issuer had been listed in the categories above would need to address the significant gross change. For an issuer listed in the equity shares (shell companies) category an initial transaction will be a significant gross change.

While a significant gross change could be directly related to the production of the prospectus, this is not necessarily the case.

A significant gross change may result from a transaction which is not, in itself, the subject of the prospectus.

A significant gross change transaction also covers situations where the transaction has not yet taken place but where the issuer has made a significant financial commitment within the meaning of ~~Article 18(4) of the PR Regulation~~PRM 4.4.4R.

We would consider that a pure fundraising transaction (eg a large rights issue or an open offer) would not constitute a significant gross change transaction for the purposes of Appendix 2 Annex 1.18R Annex 1-item 18.4. However, if a fundraising is undertaken in connection with an acquisition, the related acquisition might, depending on its size, constitute a significant gross change.

¹ Such requirement is also triggered by ~~Annex 24 item 5.7 of the PR Regulation~~Appendix 2 Annex 3.11R Item 11.5 of the PRM. For ease of reference, only Appendix 2 Annex 1.18R item 18.4.1 of the PRM ~~Annex 1-item 18.4~~ will be mentioned for the purpose of discussion in this note

What information does ~~Annex 20~~Appendix 2 Annex 15 apply to?

For the purposes of identifying information in a prospectus to which the requirements of ~~Annex 20~~Appendix 2 Annex 15 must apply, put simply, it is any information which includes a figure c which has been calculated by way of the formula "**a+b=c**", where

- a is the historical financial information
- b is the hypothetical adjustment (typically a transaction or change, for balance sheet purposes, that had not happened as at the date of **a** or, for income statement purposes, during the full period covered by a) and
- c is the resultant pro forma financial information.

Financial information where no hypothetical adjustment has been made (e.g. where it has simply been prepared on a different basis from the audited financial information) is not considered as being pro forma financial information for the purposes of ~~Annex 20~~Appendix 2 Annex 15.

The requirement for a pro forma profit and loss account and balance sheet

Once a significant gross change has been identified, Appendix 2 Annex 1.18R ~~Annex 1~~ item 18.4 states that the prospectus must include:

'... a description of how the transaction might have affected the assets, liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported.

This requirement will normally be satisfied by the inclusion of pro forma financial information.'

~~Annex 20~~ item 1.1Appendix 2 Annex 15.1R item 1.1 states that:

"The pro forma financial information ~~shall~~ must consist of: ... (2b) a profit and loss account, a balance sheet or both, depending on the circumstances..."

It is clear from the drafting of Appendix 2 Annex 20-15 that where pro forma financial information is required, this should consist of a profit or loss account, a balance sheet or both (as well as the other items detailed in Appendix 2 Annex 15.1R Annex 20-item 1.1), depending on the circumstances. Whether one or both are required will depend on whether, and to what extent, the significant gross change has already been reflected in the issuer's published financial statements (as discussed further in FCA Guideline 22).

However, FCA Guideline 23 states that in exceptional circumstances the effect of the transaction may be described by alternative methods, such as:

- a. by providing only one of a pro forma profit and loss account or pro forma balance sheet in situations where both normally be required;
- b. by including a partial pro forma profit and loss account, containing elements which are relevant. It is noted in the Guideline that the elements presented should still be covered by an auditor's report and should be unbiased (that is show pro forma losses as well as gains); or
- c. by providing only narrative information.

These exceptional circumstances may arise, but are not limited to, where:

- the issuer will acquire another entity and it is not reasonably possible to obtain the relevant financial information relating to that entity;
- the issuer has acquired an asset and insufficient financial information is available;
- pro forma financial information would not accurately describe the effect of the transaction.

'Voluntary' pro forma financial information – i.e. where there is no significant gross change or where

Appendix 2 Annex 1.18R ~~Annex 1~~ item 18.4 does not apply

When an issuer includes a pro forma balance sheet in a prospectus but there has not been a significant gross change for the purposes of Annex 1.18R ~~Annex 1~~ item 18.4 (for example, to illustrate the proceeds of an offer to be received by the issuer), we consider that this is not subject to Annex 1.18R ~~item 18.4~~ ~~Annex 1~~ ~~item 18.4~~ because we consider this to be voluntary pro forma financial information. Similarly, if Annex 1.18R ~~item 18.4~~ ~~Annex 1~~ ~~item 18.4~~ does not apply to an issue (for example, in the case of an issue of debt securities) then we would also consider any pro forma balance sheet included in the prospectus as being voluntary pro forma financial information.

We consider that this voluntary pro forma financial information would be subject only to the requirements of Appendix 2 Annex 15 ~~Annex 20~~ (as discussed in FCA Guideline 26). Annex 1.18R dictates when an issuer must prepare pro forma financial information. Appendix 2 Annex 15 ~~Annex 20~~ explains how pro forma financial information should be presented and the information which must be included, whether as a consequence of being required by Annex 1.18R or due to being included voluntarily.

We consider that there is no requirement to include a pro forma P&L in circumstances where there is no significant gross change or where Annex 1.18R ~~item 18.4~~ ~~Annex 1~~ ~~item 18.4~~ does not apply to the issuer, subject to the prospectus containing all the necessary information under PRM 2.1.1R ~~Article 6 of the Prospectus Regulation~~.

However, for voluntary pro forma information presented by the issuer (regardless of whether it is a balance sheet or P&L), FCA Guideline 26 requires such information to be prepared with the same level of care as when it is mandatory, and for it to be prepared and included in the prospectus following the requirements set out in Appendix 2 Annex 15 ~~Annex 20~~.

Pro formas in significant transaction and reverse takeover announcements and in reverse takeover circulars under the UKLR

UKLR 7 Annex 2 Part 1 requires issuers to include in a significant transaction announcement required by UKLR 7.3.1R a statement of the

effect of the transaction on the group's earnings and assets and liabilities. The same requirement applies in the case of a reverse takeover (UKLR 7.5.1R), which in addition to an announcement requires shareholder approval and the publication of a circular. The rule does not prescribe in which form this statement has to be presented. However, issuers may want to include pro forma information in the announcement or, for reverse takeovers, also in the circular. UKLR 7 Annex 2 Part 4 sets out the requirements for pro forma financial information in these situations (and in relation to announcements required by UKLR 7.3.2R and UKLR 7.3.3R), which are distinct from the ~~PRM Prospectus Regulation~~ requirements. However, we highlight that if a prospectus is being produced in connection with the same transaction then Annex 1.18R item 18.4 ~~Annex 1 item 18.4~~ will apply in full to the prospectus disclosure.

Illustrative examples of pro forma P&L

We illustrate below with two example cases. In both cases an issuer prepares a prospectus subject to Annex 1.18R ~~Annex 1 item 18.4~~ in the year 20x2 and one significant gross change has occurred which is not the trigger for the document (eg, the prospectus relates to a fundraising which is not, in itself, a significant gross change). The issuer's financial year-end is 31 December and only annual financial statements have been included in the prospectus.

Case A

In case A, the transaction resulting in the significant gross change takes place in the same financial year in which the prospectus is being prepared, that is in the year 20x2. In this case,

- a **pro forma P&L** should be prepared, covering the full financial year ended 31 December 20x1, as if the transaction had taken place on 1 January 20x1, that is the commencement of the period being reported, to reflect its impact on the earnings for the full financial year; and
- a **pro forma balance sheet** should be prepared as if the transaction had taken place on 31 December 20x1, to reflect the impact on assets and liabilities from the transaction at that date.

Case B

In case B, the transaction resulting in the significant gross change takes place in the financial year prior to that in which the prospectus is being prepared, that is, in the year 20x1. In this case,

- a **pro forma P&L** should be prepared, covering the full financial year ended 31 December 20x1, as if the transaction had taken place on 1 January 20x1, as its impact on earnings has not been reflected for the full period of the 20x1 financial year; but
- a **pro forma balance sheet** is not required as the impact on assets and liabilities from the transaction would have already been reflected in the balance sheet of the most recent annual financial statements as at 31 December 20x1.

The preparation of a pro forma P&L

As income statement information spans a period of time, a pro forma P&L needs to demonstrate the impact on earnings since the beginning of the financial period, whereas a pro forma balance sheet only needs to demonstrate the impact on assets and liabilities at the end of the financial period. Therefore, the preparation of a pro forma P&L can often be more complicated than that of a pro forma balance sheet. In a Q&A format below, we address a number of issues that might be encountered in the preparation of a pro forma P&L.

1. Should source financial information always appear in the prospectus?

Annex ~~15.1R20~~ item 1.1 (4d) states: 'Where applicable, the financial information and interim financial information of the (or to be) acquired businesses or entities used in the preparation of the pro forma financial information must be included in the prospectus.'

Therefore, if the acquired business has published financial statements then they will be required to be included in the document. In many cases the financial statements of the acquired business will already be part of the prospectus, having been included as a result of the complex financial history requirements as set out in PRM 4.4 Article 18 of the PR Regulation (reproduced in in ~~PRR 2.3.1UK~~) or will otherwise be available, for example as part of the circular disclosures made by a listed company.

Where there are no such financial statements that could be included in the prospectus then the “if applicable” test within Annex 20-15.1R item 1.1 (4d) would not be satisfied. This test should not be regarded as imposing a further requirement for the production of financial statements.

2. Does the source financial information need to be audited?

There is no requirement resulting from Annex 20-15 itself for the source financial information to be audited.

However, as noted above, it may be that, in certain situations where there has been a significant gross change, an issuer will have to produce audited financial information, in order to meet the complex financial history requirements as set out in Article 18 of the PR Regulation (reproduced in PRR 2.3.1UK) PRM 4.4.

For example, in Case A above, where the ‘significant gross change’ transaction takes place in the same year in which the prospectus is being prepared, that is in 20x2, the complex financial history requirements could result in the inclusion of audited financial statements of the target(s) for the 20x1 financial year in the prospectus.

3. If the target has no financial statements, would they need to be prepared specifically for the document?

If financial statements are not available, we would accept the pro forma adjustments being sourced from unaudited financial information on the target(s), such as management accounts. We do not envisage requiring the production of financial statements purely for the purposes of the pro forma financial information.

It should be noted that, depending on the size of the transaction, audited financial information may still need to be included in the prospectus for this period under the complex financial history provisions as discussed in 2, above.

4. What approach may be taken in presenting a pro forma P&L for an acquisition that took place in the financial year prior to that in which the prospectus is being prepared?

For acquisitions such as Case B above, where the target’s historical financial information was partially consolidated in the issuer’s latest

annual accounts, we consider that two alternative approaches could be used to demonstrate the impact on earnings.

Both approaches assume that the issuer's historical consolidated financial information (including the partially consolidated target information) is presented as the unadjusted information in the first column of the pro forma P&L.

We consider that the pro forma P&L could be prepared by:

- i. subtracting the partially consolidated target financial information and then adding the target's latest full year financial information to those of the issuer through separate adjustment columns of the pro forma P&L or
- ii. (ii) presenting the target financial information only for the pre-acquisition period in the adjustment column.

We would accept both approaches.

5. Can the accounting exercise of purchase price allocations (PPAs) be viewed as 'factually supportable' and included as pro forma adjustments?

The accounting exercise of purchase price allocation to fixed assets at fair value and the subsequent amortisation or impairment of those assets very often requires a degree of judgement and the use of assumptions.

We consider that PPAs are 'factually supportable' as required by Annex 20-15.2R item 2.3(3e) and would expect to allow these as pro forma adjustments if the issuer:

- sets out in the explanatory notes the basis adopted in making the PPAs;
- specifies any assumptions used; and
- where relevant, quotes any relevant supporting evidence.

Where a PPA is preliminary, we expect issuers to disclose this fact together with what events are expected to occur to complete the exercise and the potential impact of any re-allocation.

6. Can synergy benefits be included as pro forma adjustments?

Adjustments in pro forma information that relate to future effects which are very uncertain should not be included in pro forma information, as they could give a misleading picture of the transaction, as explained in FCA Guideline 24. The Guideline further states that pro forma financial information should generally not include adjustments which are dependent on actions to be taken once the transaction has been completed, even where such actions are central to the issuer's purpose in entering into the transaction, e.g. synergies. Accordingly, synergy benefits should not be considered to be directly attributable to the transaction, as required by ~~Annex 20 item 2.3(c)~~Annex 15.2R item 2.3(3), and should not be included as pro forma adjustments.

7. What is the time period that needs to be covered by pro forma financial information, in particular, would a six-month pro forma P&L be acceptable?

FCA Guideline 21 states that where the prospectus contains interim financial information in addition to annual financial statements, the persons responsible for the prospectus may decide to cover only the interim period, only the full year, or both the interim period and full year in the pro forma P&L. However, where only the interim pro forma P&L is included, the persons responsible for the prospectus should ensure that this will sufficiently describe how the transaction might have affected the earnings of the issuer. For example, the issuer's business may be affected by seasonality, and in that case the pro forma P&L may need to cover the full year. Therefore, the decision about the time period should always include consideration of the circumstances on a case-by-case basis.

For example, if the prospectus in Case B above is being prepared in the second half of year 20x1 (rather than in the first half of year 20x1) and the issuer has published its interim financial statements, no pro forma P&L would be necessary as the earnings impact of the transaction is already reflected in the interim financial statements for year 20x1, unless the interim pro forma P&L does not sufficiently describe the effect of the transaction. In the latter case, a longer time period would be required.

The report prepared by independent accountants

Any pro forma financial information included in a prospectus (whether or not there has been a significant gross change) must be prepared in accordance with Annex 2015, including section 3, which sets out the requirement for an accountant's report.

Accountant's reports on pro forma financial information often also refer to the report being required by e.g. Appendix 2 Annex 1.18R item 18.4 ~~Annex 1 item 18.4~~ (or corresponding items in other Appendix 2 Annexes). However, this should only be included in the case where there has been a significant gross change and we consider that such references are not appropriate in the case of voluntary pro formas. Instead, we consider that reference should be made to Appendix 2 Annex 20-15 section 3 (the section which refers to an accountant's report).

Where historical financial information (annual or interim financial information) included in a prospectus itself includes pro forma financial information in order to comply with the applicable accounting framework (usually IFRS), we would not expect additional disclosure to be included to address Annex 2015. However, if the pro forma financial information relates to a significant gross change, and Annex 1.18R applies to the issuer, then Annex 1.18R item 18.4 ~~of Annex 1~~ will need to be addressed.