Improving financial information in an Equity PDS

The Financial Markets Conduct Regulations 2014 (**FMC Regulations**) contains rules that allow issuers to make changes to the information presented in the financial tables contained in a product disclosure statement for a regulated offer of equity securities (**Equity PDS**). These rules, and their interpretation, can have a significant impact on the information presented to investors.

This guidance is designed to help issuers:

- understand the Financial Markets Authority's (**FMA**) views on three particular rules set out in Clause 39 of Schedule 3 of the FMC Regulations; and
- present their financial information section in a clear, concise and effective manner.

This guidance forms part of the FMA's ongoing commitment to improving the quality of information for investors and providing clarity for issuers. This guidance will be reviewed and updated as necessary.

Contacting the FMA

If you have questions on how this guide applies to your Equity PDS, we encourage you to engage with us as soon as possible as this guide is an important reference point for any review we undertake.

We also offer a pre-registration review service to help issuers, and their directors, feel more confident their offer documents are likely to satisfy our expectations. More details about this service can be found here.

This guidance note is for issuers, their advisors, investors and other interested parties.

It sets out our guidance and interpretations of certain rules on the financial tables required for an Equity PDS.

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About this guidance

Clear, concise and effective information helps investors make more informed investment decisions.

We have issued this guidance in response to our concerns that:

- the financial information presented in an Equity PDS was unnecessarily complicated. In particular, we had seen issuers overuse financial measures which were not in accordance with generally accepted accounting practice (**non-GAAP financial measures**), resulting in crowded financial tables and complex footnotes that are difficult for investors to understand.
- issuers and their professional advisers had different interpretations than the FMA on the application of certain rules set out in Schedule 3 of the Regulations.

This guidance is to assist issuers and their professional advisers in understanding the FMA's expectations on certain aspects of the financial information section. In summary this guidance sets out:

- A high level background to the financial information section (**Part A**).
- How to apply specific rules (**Part B**).
- Principles on presenting the financial information section (**Part C**).

This document complements other guidance, about disclosing non-GAAP financial information and pro-forma financial information. On our website you can:

- read our guidance note
- read our frequently asked questions.

An issuer that does not follow our guidance runs the risk of their Equity PDS failing to be clear, concise and effective. If we consider an Equity PDS is not clear concise and effective, we can extend the waiting period and/or issue stop orders. However, we prefer issuers to engage with us early through our pre-registration review service.

Part A: Background to the financial information section

Under the Financial Markets Conduct Act 2013 (**FMCA**), disclosure for regulated offers of financial products has two key components; a PDS and an entry on the Disclose Register.

The structure and content of an Equity PDS is set out in Schedule 3 of the FMC Regulations.

The financial information section of the Equity PDS is designed for issuers to communicate key financial information to investors. That is, to disclose financial information that is likely to be the most useful to investors and enable them to compare the issuer's performance, position and cash flows over time, and with other issuers.

One of the key financial tables is Table 1: *Selected financial information*. Table 1 must be provided for all equity offers, but continuous issuers can include this information on the Disclose Register.[1] If an issuer intends to have their equity securities quoted or approved for trading on a financial product market (e.g. NZX) and does not currently have equity securities quoted, or approved for trading on that market they will often be required to present Table 2*: Capitalisation* and Table 3*: Investment metrics*.[2] The measures and metrics in Table 3 are impacted by the measures disclosed in Table 1.[3] Full financial statements are lodged on the Disclose Register.

The prescribed measures for Table 1 must be determined or calculated using generally accepted accounting practice (**GAAP**) and are presented over a period of up to five years (**the relevant periods**). They are:

- revenues
- EBITDA
- net profit after tax
- dividends
- total assets
- cash and cash equivalents
- total liabilities
- total debt and
- net cash flow from operating activities.

In some specific cases, these prescribed measures may not provide the best selection of information for investors. The FMC Regulations therefore set out various rules that, subject to certain tests, allow the issuer to make changes to the financial tables. We discuss three of these rules in **Part B.**

Issuers are reminded that the information in the Equity PDS is subject to the overarching requirements that the information must be worded and presented in a clear, concise and effective manner.[4]

[1] See clause 40.
[2] See Clauses 36-37 for further details of when an issuer must present Table 2 and Table 3.
[3] Clauses 33-39.
[4] See FMCA, sections 49, 61 and 82

Part B: How to apply specific rules

Clause 39 of Schedule 3 of the FMC Regulations includes rules for when issuers can make changes to the information presented in the financial tables. Issuers should pay careful attention to the differences in the tests as to when information can be added or substituted, and consider whether applying the rules results in information that is consistent with the purpose of the offer.

1. Adding information (Clause 39(e))

> Other financial measures and non-financial information may be added to a table if the issuer reasonably considers that the added information is likely to be useful for investors

Under this rule an issuer can add information to a table that they reasonably consider to be likely to be useful to an investor. For example, the issuer could reasonably consider the following types of measures likely to be useful:

- measures commonly used to compare the relative valuation of companies in the issuer's industry; or
- measures for how the issuer assesses its performance internally or determines its dividends.

Where an issuer wishes to include a number of measures under Clause 39(e) we expect them to be selective and focus on the most useful measures or information for investors. We consider that including too many other financial measures or non-financial information will result in crowded tables and potentially complex footnotes that are difficult for investors to understand and can deter them from engaging with the financial information.

2. Substituting EBITDA or debt (Clause 39(f))

> Another GAAP financial measure or non-GAAP financial measure may be substituted for EBITDA or debt if the issuer reasonably considers that the other financial measure is likely to be more useful to investors than EBITDA or debt

If an issuer wants to substitute EBITDA or debt under Clause 39(f), they must reasonably consider that the substituted measure is likely to be more useful to investors than EBITDA or debt (as applicable). If the issuer is substituting EBITDA, the same substituted measure must be used when calculating the enterprise value multiple for Table 3. Therefore, they should consider common investment metrics for companies in the same industry. For example, for some capital intensive industries it may be more useful to use EBIT, which takes capital expenditure into account, rather than EBITDA.[5]

[5] See Clause 39(h) and MBIE commentary (page 8) here:

3. Adjustments to non-GAAP financial measures

In practice we've seen issuers:

- add a non-GAAP financial measure under Clause 39(e), or
- substitute EBITDA with a non-GAAP financial measure under Clause 39(f), and

that non-GAAP financial measure has been adjusted for certain items that impacted the relevant periods unevenly.

Whether adjustments are appropriate will vary from case to case. However, generally exclusions of ongoing business items are inappropriate as opposed to adjustments for truly isolated events. At a principles level when making adjustments we expect issuers to adopt an approach to making adjustments that:

- focus on material adjustments;
- are balanced, considering both revenue and expenses; and
- are in line with the FMA's guidance note (*Disclosing non-GAAP Financial Information).*

We've set out our view on more frequently proposed adjustments below.

a. Operating items

Generally, we consider operating items, for example, impairments of inventory or bad debts, should not be adjusted for when presenting operating profit measures. These items reflect the risks of the business and should be explained to investors in a clear, concise and effective way. Where relevant, this can be cross-referenced to the risk section of the Equity PDS.

Issuers that attempt to normalise, or remove, these types of items can present investors with an oversimplified trend that misleads them about the risks these matters pose to the issuer's earnings. Even worse, it can present a simple upward trend that could mislead investors about the growth prospects of the issuer.

b. Explaining other adjustments

Issuers need to clearly and concisely explain other adjustments. This could include adjustments for non-operating items. For example, some issuers exclude impairments of goodwill or long-term investments where the issuer's core business is not that of an investment business. However, these adjustments often provide valuable information about the quality of management's decision-making and/or risks to the company's future earnings and therefore need to be explained to investors.

c. Specific examples

Restructuring costs:

For some issuers, restructuring is an on-going part of their business and should *not* be adjusted for in earnings measures or referred to as a non-recurring cost.

Closed stores/operations:

When an issuer has a material discontinued operation, such as one defined by GAAP[6], it may be appropriate to adjust the financial information for that discontinued operation (also see page 8). However, for businesses that are consistently opening and closing stores, these adjustments will generally be inappropriate. For example, the closures of stores within an ongoing retail chain.

[6] See *NZ IFRS 5 Non-current Assets Held for Sale and Discontinued Operations* paragraph 32.

4. Presenting non-GAAP financial measures

Non-GAAP financial measures can vary between issuers and what is appropriate for one issuer may not be appropriate for another.[7]

There are specific rules around the presentation of non-GAAP information in an Equity PDS. For example, under Clause 2 of Schedule 3 of the FMC Regulations where an Equity PDS includes a non-GAAP profit measure issuers must state that measure is not in accordance with GAAP and also refer investors to where they can find reconciliations to the corresponding GAAP information on the Disclose Register.

In addition to these rules, we expect issuers to consider the key principles in the FMA's Guidance Note: *Disclosing non-GAAP Financial Information*.[8]

How much detail should an issuer provide in the Equity PDS?

The level of detail issuers should provide regarding a non-GAAP financial measure requires judgement. Factors that would likely lead issuers to provide more detail include:

- if the measure is unique to the issuer, or generally not well understood by investors;
- if the measure is material in the context of the offer and ongoing performance of the issuer; and
- where there are significant differences between the non-GAAP financial measure and the corresponding GAAP financial measure.

Should an issuer include a reconciliation in the Equity PDS?

Clause 53(1)(f) of Schedule 3 of the FMC Regulations requires issuers to include a reconciliation of any non-GAAP profit measure to the corresponding GAAP measure on the Disclose Register. However, if the measure is materially different from the corresponding GAAP measure, we also recommend issuer considers including a reconciliation that summarises the key differences in the Equity PDS. Including this will enable investors to easily understand the difference between the non-GAAP and GAAP financial measure.

Should an issuer disclose its non-GAAP policy?

We recommend issuers make available a copy of their non-GAAP financial measures policy on their website.

For more comprehensive information on non-GAAP financial information please refer to the frequently asked questions on our website.

[7] For a regulated offer of equity clause 2 of Schedule 3 of the FMC Regulations 2014 defines GAAP and non-GAAP financial information/measures.
[8] This guidance was most recently revised in 2017 and is available here.

5. Pro-forma financial information (Clause 39(l))

If there are any factors that would materially affect the comparability or usefulness of the information reflected in a table (for example, changes to accounting policies, business combinations, or dispositions),—

(i) pro-forma financial information may be **added** to a table or **substituted** for financial information for a period; or

(ii) the PDS must include explanatory notes about those factors if those notes are necessary or desirable to explain the effect of the factors on that comparability or usefulness

When can pro-forma financial information be provided?

Pro-forma financial information, as referred to in Clause 39(l), is a type of non-GAAP financial information that has been adjusted for factors that materially affect the usefulness or comparability of the financial information in a table. Pro-forma financial information is provided in an Equity PDS for illustrative purposes and can assist investors in evaluating the merits of an offer.

For example, pro-forma financial information can be useful where the structure of the issuing group going forward is significantly different. If the historical financial information required by the FMC Regulations includes information about a material discontinued business, then this information would not be directly comparable to any prospective financial information. In this case, using pro-forma financial information to reflect the historical performance of the continuing business is likely to be more useful to investors. Similarly, if an issuer changed one of its significant accounting policies in its most recent accounting period, adjusting the remaining historical information for consistency will make the information more comparable or useful for investors.

If an issuer chooses not to provide pro-forma financial information where there are factors that affect the comparability or usefulness of the information, then the Equity PDS must include explanatory notes about those factors if those notes are necessary or desirable to explain the effect of the factors on the comparability or usefulness.

When shouldn't pro-forma financial information be provided?

Pro-forma financial information shouldn't be provided when:

- there are no factors that materially affected the comparability or usefulness of the information in a table. For example, an insignificant change in accounting policy or for factors that result in immaterial adjustments; and/or
- it could mislead investors:
    - Issuers should not use pro-forma financial information to exclude inconvenient truths, hide bad news or mask important risks (see our earlier discussion at *3. Adjustments to Non-GAAP financial measures*); or
    - When the issuer cannot formulate reasonable and supportable assumptions as the basis for their pro-forma financial information.

How can pro-forma financial information be provided?

Pro-forma financial information can either be:

- added to a financial table (as a row or column); *or*
- used as a substitute for one (or all) of the default financial measures required for a period.

In preparing pro-forma financial information, issuers should focus on producing the most comparable or useful information for investors.

In doing so we expect issuers to assess the effect of each factor on the usefulness and comparability of each of the measures contained in the table - including the effect on the balance sheet and cash flow measures. Where the issuer has decided the impact is material the issuer should make appropriate adjustments. We consider that this is likely to result in the most useful or comparable information for investors to understand the full effect of the factor(s) on the financial information presented in the table.

However, we are happy to engage on a case by case basis on how this approach may impact your offer. For example, due to changes in the capital structure an issuer may be able to formulate reasonable and supportable assumptions for certain measures (such as revenue and EBIT), but *not* for other measures (such as debt, interest, NPAT, dividends and cash-flows). In these types of cases issuers should consider what will provide the best information for investors, for example:

- providing an explanatory note under clause 39(l)(ii) rather than using pro-forma financial information under clause 39(l)(i); or
- providing selected pro-forma financial information, in combination with the prescribed measures, with notes to explain their approach; or
- applying for an exemption in order to exclude certain measures from a table. Applications for exemptions should be made as early as possible.

Once the issuer has come up with its proposal, we recommend you contact the FMA for feedback.

Required disclosures

Where an issuer includes pro-forma information in their Equity PDS they must provide the information set out in Clause 39(m) of Schedule 3. This includes briefly describing the basis on which the pro-forma information has been prepared and where more information about the principal assumptions can be obtained on the Disclose register.

Part C: Presenting the financial information section

Provide an outline

If issuers make substantial changes to the financial tables, for example using pro-forma information, or if their financial table contains a number of measures compiled on different bases, then they should consider having an explanatory note in the Equity PDS that explains the reasons for the changes or different measures.

Provide plain English commentary

Providing commentary on the financial tables helps investors to understand the issuer's past and projected financial performance, position and cash flows. Where possible, issuers should provide commentary in plain English and move complex material to the Disclose Register.

Clear the clutter

Consider whether footnotes explaining certain calculations need to be in the Equity PDS or whether you can simply provide one overall reference to where the calculations are on the Disclosure Register. Avoid repeating footnotes where possible.

Be consistent throughout the Equity PDS

It is important that the financial information and other parts of the Equity PDS are consistent and link together. This will make it easier for investors to assess the merits of the offer. For example:

- If the purpose of the offer is to repay long term debt or recapitalise the business, then the financial information section should show or explain the impact of this on the forecast financial position and performance of the business (as applicable).
- Where the financial information has been impacted by key risks set out in the risk section, these can be highlighted and cross referenced to the relevant risks.
- Where the issuer has significantly different business units, then the financial information section can include information on the performance of each unit.

Ensure information between the Equity PDS and the Disclose Register is consistent

Key financial themes should be captured in the financial section of an Equity PDS and reflect more detailed information on the Disclose Register. The financial section of an Equity PDS should cover the issues in a balanced way that is consistent with the financial information on the Disclose Register.

Glossary of terms

GAAP	Generally Accepted Accounting Practice, which has the meaning given to it by section 8 of the Financial Reporting Act 2013. For most issuers, complying with GAAP means preparing financial statements that comply with the New Zealand equivalents of the International Financial Reporting Standards (NZ IFRS).
EBITDA	As defined by the FMC Regulations is net profit after tax plus interest, tax, depreciation and amortisation
Enterprise value multiple	The key investment metric calculated under Clause 38(2)(d) of Schedule 3 of the FMC Regulations by the following formula: implied enterprise value/EBITDA
GAAP financial measure	A numerical measure of an issuer's or issuing group's historical or future financial performance, financial position, or cash flows, determined in accordance with GAAP.
Issuer	For equity securities (shares) it is the company, Industrial and Provident Society, Building Society, or other entity which the security is for.
Non-GAAP financial measure	A numerical measure of an issuer's or issuing group's historical or future financial performance, financial position, or cash flows used as an alternative to, or to supplement, a GAAP financial measure.
Non-GAAP profit measure	A non-GAAP financial measure used as an alternative to, or to supplement, net profit after tax.
Pro-forma financial information	Non-GAAP financial information intended to show the effects of proposed, completed or hypothetical events or transactions on the financial position of a business, its performance, cash flows and/or prospects.