

May 2018

Improving financial information in an equity PDS

- Response to submissions

This document summarises the key matters and changes we've made to our Guidance Note: Improving financial information in an equity PDS following consultation.

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Introduction

In May 2017 we issued our *Consultation paper: Improving financial information in an Equity PDS* (**the Consultation Paper**). We issued this Consultation Paper in response to 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 Financial Markets Conduct Regulations 2014 (**the Regulations**) (**the Rules**).

Therefore, the Consultation Paper was set-out in two parts:

- **Background:** This part provided a high level background to the financial information section and our interpretation of the Rules; and
- **Guidance:** on how issuers should disclose and improve their financial information.

We would like to thank all those who provided feedback whether formally or informally. They have resulted in improvements to the final Guidance Note: *Improving Information in an Equity PDS* (**the Guidance Note**). We received six formal written submissions and these are available on our website. We also received informal feedback and have considered the findings of our research into investors' views on product disclosure statements.¹

¹ The report on our research *Product disclosure statements: understanding investors' information needs* is available on our [website](#).

Key matters and our response

We have amended the Guidance Note on three key matters:

- pro-forma financial information;
- substituting EBITDA appropriately; and
- quantifying adjustments in an equity PDS.

Pro-forma financial information

We received detailed comments on our interpretation of Clause 39(l) of Schedule 3 of the Regulations regarding the use of pro-forma financial information. These can be divided into:

- when pro-forma financial information can be used; and
- how pro-forma financial information can be provided.

When can pro-forma financial information be provided

Clause 39(l) provides that:

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:

In the Consultation Paper we stated that:

If an issuer wants to use pro-forma financial information there must be factors that “materially affect the comparability or usefulness of the information.” We consider this wording is a high threshold aimed at fundamental changes to the issuer’s business or how that is accounted for, eg a PDS for a proposal to merge two businesses where the issuer intends to present the merger as if it had taken place at the start of the financial year. In this case, the threshold is high because it permits an issuer to add pro-forma information to a table or to substitute the GAAP information and present a potentially significantly different picture.

Two submitters agreed there was a higher threshold on the use of pro-forma financial information relative to Clause 39(e) and (f) of Schedule 3. However, other submitters considered that our use of the phrase ‘fundamental changes’ was not appropriate when Clause 39(l) uses the concept ‘material’. That is, there could be circumstances where the financial information in a table may have been materially affected by certain factors without there being a fundamental change in the issuer’s business or how it has been accounted for.

We agree that Clause 39(l) may not only apply to circumstances where there have been fundamental changes to the issuer’s business and we have removed this phrasing from the Guidance Note. However, to address our concerns that pro-forma adjustments can be over-used, the Guidance Note reminds issuers that pro-forma financial information:

- can only be used when they have identified factors that materially affect the comparability or usefulness of the information. That is, it can’t be used for immaterial factors.
- should not be used to exclude inconvenient truths, hide bad news, or mask important risks.

How can pro-forma financial information be provided

In the Consultation Paper we noted that if an issuer intends to use pro-forma financial information, that information needed to be provided ‘for a period’ (see Clause 39(l)(i)). We stated that this means that *all* measures for the impacted period need to be provided on a pro-forma basis. That is, Clause 39(l) does not permit the selective use of pro-forma financial measures.

Several submitters noted that our interpretation could result in issuers having to make complex and difficult assumptions about the capital structure and cash flows of the issuer which could potentially confuse and/or mislead investors. In addition, one submitter provided an alternative interpretation they considered available on the face of the Regulations. This interpretation permits issuers to add or substitute pro forma financial information for *selected* financial measures *within one or more periods*.

We have concluded that the phrase ‘for a period’ in Clause 39(l) is not conclusive. Therefore, in the Guidance Note we’ve stated that issuers should focus on what we consider to be the policy intent of Clause 39(l). That is, permitting pro-forma adjustments to be made to financial information in certain situations in order to provide investors with the most useful or comparable information. Practically, we’ve noted that issuers should consider the impact of the factors on all the measures presented in the table, and where reasonable and supportable assumptions can be made, adjustments should be made. We consider that this is likely to result in the most comparable or useful information to investors to understand the full effect of the factor on the financial information presented in the table.

We are happy to engage on a case-by-case basis on how this approach may impact your offer. For example, an issuer may not be able to formulate reasonable and supportable assumptions for certain measures. In these types of cases we encourage issuers to approach us as soon as possible with their proposal for what they consider would result in the most useful or comparable information for investors.

Substituting EBITDA appropriately

Most submitters agreed with the principles set out in the guidance section of the Consultation Paper. This included our views on making adjustments to financial measures that have been substituted for EBTIDA. However, some submissions outlined concerns that in some circumstances our proposed guidance was too broad about specific items, such as restructuring costs and the performance of closed stores.

In the Guidance Note we've clarified that what is considered an appropriate adjustment will vary from case to case, and that our views on adjustments are our general positions. In the Guidance Note, this commentary is now contained under the heading *Adjustments to non-GAAP financial measures*.

Quantifying adjustments in an equity PDS

We received mixed feedback about our proposal to include a summary reconciliation of non-GAAP financial measures to GAAP financial measures in an equity PDS. For example, some submissions supported our proposal to include a *summary* reconciliation in the equity PDS. One noted it was an important source of information for investors and analysts. However, one submitter objected to having a reconciliation in the equity PDS. Instead they consider that there should be one single cross reference to the additional information included on the Register. The submitter also said that including the reconciliation would likely result in a proliferation of additional explanatory footnotes and repetition of information on the Register, with no practical benefit to investors.

We recognise there is merit in both arguments:

- Where non-GAAP information is used, we recognise these reconciliations are an important source of information for investors and analysts.
- Reconciliations are often accompanied by detailed technical notes. Our research² indicates this detail is deterring investors from effectively engaging with the financial section. By having a single reference to a reconciliation on the register, issuers will have more space to provide plain English commentary on their financial information, while still providing interested investors and analysts with access to the information on the Register.

Therefore, in the Guidance Note we've provided an outline of more general factors for issuers to consider when considering how much detail to provide on their non-GAAP financial measures - including whether or not to include a reconciliation.

As an overarching point, if issuers keep their use of non-GAAP financial information and adjustments to a minimum, then the need for explanations is reduced.

² Refer to footnote 1.

Other changes

In the Guidance Note, we have also made a number of structural changes. Notably, we have combined relevant parts in the Consultation Paper's guidance section, with the commentary on the corresponding rules.

Submissions

- [CFA Society of New Zealand](#)
- [Chapman Tripp](#)
- [Ernst & Young](#)
- [First NZ Capital](#)
- [PwC](#)
- [Russell McVeagh](#)



21 August 2017

By Email: jeromy.meerman@fma.govt.nz

Jeromy Meerman
Principal Adviser
Markets Disclosure
Financial Markets Authority

Dear Jeromy

FMA consultation paper: Improving financial information in an equity PDS

- 1 Thank you for seeking input from CFA Society on the above FMA consultation paper. As you may be aware, the CFA Institute regularly researches issues such as these and issues guidance notes for the benefit of its members and market participants. In relation to the specific issue concerning the nature of adjustments and the use of pro-forma information the CFA Institute has recently issued two reports on the use of non-GAAP financial measures following studies that show more than 80 per cent of firms in the FTSE 100 and S&P 500 are using non-GAAP financial measures.

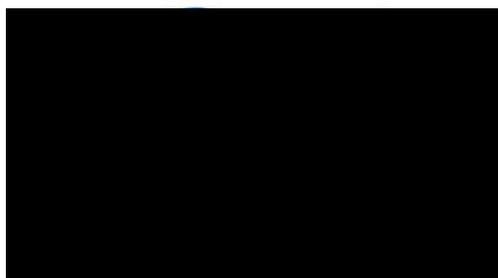
Two recent CFA Institute Reports on Disclosure Issues

- 2 The CFA Institute conducted a survey of 550 members to provide investor perspectives on the issue presented them in two reports: *Investor Uses, Expectations, and Concerns on Non-GAAP Financial Measures* and *Bridging the GAAP: Ensuring Effective Non-GAAP and Performance Reporting* (both of which are **attached**).
- 3 The key findings from the survey were as follows:
 - (a) Investors use non-financial measures extensively (64 per cent of respondents always often used these measures), albeit it to a lesser degree than GAAP/IFRS-based measures (72 per cent always or often used these measures).
 - (b) Investors do not just apply company-reported non-financial measures but rather many make adjustments to these measures by reversing line-item adjustments made by companies when calculating non-GAAP financial measures. The CFA Institute survey results showed that 60 per cent of respondents make further adjustments to reported non-GAAP financial measures.
 - (c) Investors and analysts apply these measures for many reasons, including as performance analysis, evaluation inputs, or an accounting-quality indicator, as well as to conform to such industry norms as consensus earnings reporting requirements.

- 4 The other conclusion from the surveys was that the quality of communication and transparency in non-GAAP financial measure reporting is an area in which there is scope for ongoing improvement:
- (a) Comparing non-GAAP financial measures across firms is difficult because of the lack of standardised definitions for these measures. It is challenging and often misleading to compare these adjusted measures across companies, even among those that employ a similar business model. The comparability challenge is compounded by the tendency of some companies to vary the line-item adjustments made when calculating non-GAAP financial measures across different time periods.
 - (b) Securities regulators' guidance requires companies that report non-GAAP financial measures to present reconciliations to the most directly comparable GAAP/IFRS line items as well as to provide contextualising disclosures that explain the line-item adjustments. The CFA Institute found that the reporting of these reconciliations and disclosures could be improved.
- 5 The CFA Institute survey indicates that non-GAAP financial measures are most likely to remain because many investors find them useful. The survey results show that investors are mostly supportive of different regulatory guidelines, and that they expect more effective oversight on non-GAAP financial reporting. The CFA Institute also considers current and potentially strengthened regulatory restraints imposed on misleading non-GAAP financial measures to be necessary but not sufficient for ensuring that companies communicate only the highest-quality performance, liquidity, and financial condition measures.

Specific CFA feedback on Consultation Paper

- 6 CFA New Zealand strongly supports the guidance on non-GAAP as articulated in section C. It covers key concerns including a need for explaining reasons for using these measures, transparency on calculation, avoiding misleading calculation and consistency across reporting platforms. We would also recommend crafting a principle of consistency in the period to period calculation.
- 7 Although EBITDA is one of the most popular performance metrics for investors (as shown by the Institute's surveys), it is not defined under IFRS and it can create comparability challenges. In many markets EBITDA is a non-GAAP measure and it is more appropriate for some business models than others. Accordingly, it might be questioned why it made the cut for one of the default measures.
- 8 Also it is unclear in what circumstances the substitution of a debt measure would be encouraged, so it may be useful to have some discussion of when it would be appropriate to have a replacement measure.
- 9 For completeness we also **enclose** a further CFA Institute publication entitled *Designing a European Summary Prospectus Using Behavioural Insights*, which contains related research regarding using behavioural insights in drafting a condensed summary of an IPO prospectus.



SUBMISSION ON IMPROVING FINANCIAL INFORMATION IN AN EQUITY PDS

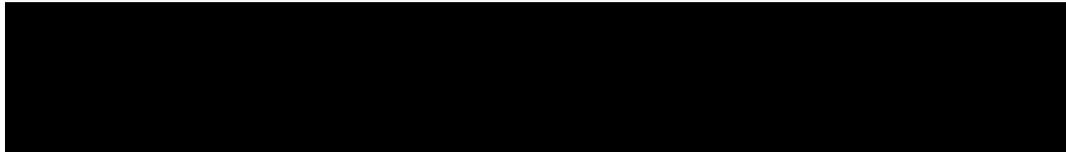
31 MAY 2017





CHAPMAN TRIPP SUBMISSION ON IMPROVING FINANCIAL INFORMATION IN AN EQUITY PDS

- 1 The Financial Markets Authority (*FMA*) proposes to publish a guidance note regarding disclosing financial information in equity PDSs in a clear, concise and effective manner.
- 2 We have set out our submission as a response to the questions asked in the consultation paper. In summary, we think the guidance could go further to ensure unnecessary footnotes are removed.
- 3 Please contact us should you wish to discuss our submissions and the reasoning behind them.





Question	Response
<p>Where do you agree with our guidance?</p>	<p>We agree that the financial information section has been unnecessarily complicated in a number of PDS, but we suspect that we have a different view on the reasons why this is the case. We've outlined this in more detail below.</p> <p>We agree that the focus of the PDS needs to be on providing user-friendly information for the prudent, but non-expert, investor and this underpins a number of our comments below.</p>
<p>Where do you disagree with our guidance?</p>	<p>We disagree that the FMA's proposed guidance will remove crowded financial tables and complex footnotes. A number of these footnotes have been included to reflect current FMA guidance around the use of non-GAAP financial information, and including statements about which measures are non-GAAP and where reconciliations can be found and so on.</p> <p>Going back to the purpose of the PDS, we query whether these footnotes actually add anything to the prudent, but non-expert, investor. As we submitted on the non-GAAP guidance consultation, we think a far better approach is to include a single cross reference to a document on the Disclose Register that includes full non-GAAP and/or pro forma reconciliations. This would make the financial information section of the PDS more clear and concise, while still providing an easy way for investors to access more detailed financial information if this is of interest to them (and is something that they are able to make their own assessment of).</p> <p>Including reconciliations on the Disclose Register also avoids cutting across the FMC Regulations. In particular, clause 39(i)(ii) and (m)(iv) explicitly require the PDS to refer to where GAAP reconciliations can be found on the offer register. If this information is also included in the PDS, there is a duplication of information, which may make investors less likely to read the full financial information on the offer register and is also inconsistent with the FMC Regulations.</p> <p>The FMA's proposed guidance would therefore have the effect of changing regulatory decisions made in enacting the FMC Regulations. We think the regulations get the position right.</p> <p>For example, the regulatory impact statement at the time the regulations were approved noted that "Given the limited capacity of most retail investors to process financial information, we do not consider that adding more detailed financial information to the PDS means that retail investors are likely to be better informed about the financial condition of the issuer".</p>
<p>Do you think our guidance will result in high quality information for investors?</p>	<p>No. For the reasons we have outlined above, we think that the likely result of the FMA's guidance is to be a proliferation of additional explanatory footnotes, the repetition of non-GAAP reconciliations in both the PDS and the Disclose Register and limited changes that will provide any practical benefit to the target audience for a PDS.</p>



Question	Response
<p>Are there situations where you think our guidance would lead to information that was not appropriate for investors?</p>	<p>Yes – see our earlier comments.</p>
<p>Do you agree with our interpretation of when to add and/or substitute information?</p>	<p>No – see below.</p>
<p>If you disagree, please outline what you would consider the appropriate interpretation to be?</p>	<p>The main issue we have the FMA’s interpretation is that it does not address the interaction between cl 39(f) and (l) of schedule 3. In particular, cl 39(l) allows pro forma financial information to be substituted for financial information for a period (without placing any limit on what financial information can be substituted). On the other hand, cl 39(f) only allows EBITDA or debt to be substituted. We are aware that the FMA has previously taken the view that cl 39(f) means that an issuer cannot rely upon cl 39(l) to, for example, replace GAAP net profit with pro forma net profit.</p> <p>This interpretation is not readily apparent from the face of the regulations, nor from the FMA’s proposed guidance, so if this is still the FMA’s position it should be expressly spelled out that, notwithstanding the wording of cl 39(l), the FMA’s view is that pro forma financial information cannot be substituted for GAAP net profit or total debt. We note that restricting issuers from substituting GAAP net profit or total debt would have the effect of increasing the length of the financial information section, as any issuer that wished to use pro forma financial information would also have to include GAAP financial information (in circumstances where the issuer has already formed the view that there are factors that materially affect the comparability or usefulness of the information).</p> <p>We also disagree with the FMA’s interpretation of factors that would “materially affect the comparability or usefulness of the information”. We think that the word “usefulness” does not necessarily require a “fundamental change” to the issuer’s business. Financial information may well be materially more useful to investors if it has appropriate pro forma adjustments made to it, even if there is not a “fundamental change” to the issuer’s business.</p> <p>Finally, we note that the sentence “However, if an issuer wants to substitute EBITDA or debt, they must reasonably consider that the replacement measure is more useful than EBITDA or debt (as applicable)” is missing the words “likely to be” that appear in the FMC Regulations. The FMA’s guidance appears to impose a higher standard than is required under the wording of the FMC Regulations.</p> <p>Again, we note that the FMA should not be purporting to contradict or supersede the FMC Regulations through guidance notes.</p>



Question	Response
<p>Are there additional areas or specific examples where you think we should provide guidance?</p>	<p>We think the FMA could provide guidance around the manner in which issuers designate pro forma financial information, prospective financial information and actual financial information.</p> <p>In this respect, we noted that a recent PDS included a defined term of "PF", which noted that the inclusion of "PF" after a reference to a financial period is an indication that it is a "Pro forma" period.</p> <p>We think this is likely to lead to confusion – for example, the recent PDS that we saw had at least one table which did not have any "PF" headings listed in the heading (but included pro forma financial information and referred to "PF" in footnotes), and equally had at least table which included "statutory NPAT per security" for a "PF" period. It is impossible for a reader to determine whether they should be taking the "PF" or the "statutory" as being the determining factor.</p> <p>After reading the FMA's guidance, we suspect that this may have been an attempt to comply with the FMA's comments about including pro-forma information "for a period". However, we do not think this is the most helpful way of presenting this to investors – instead, it makes sense to make the necessary pro forma adjustments consistently and appropriately across all of the financial information for a period, and then label those measures that have been adjusted as "pro forma". If adjustments are not necessary to a specific measure, then it should not be labelled as "pro forma".</p> <p>Any confusion is only heightened where an issuer has separately defined "F" as indicating a forecast period, as it becomes very unclear whether information is forecast, pro forma or both. It makes more sense to include "F" after a year, as this relates to the timing of the information, whereas pro forma financial information can be historic or prospective, so it is confusing to put an identifier as to whether it is pro forma immediately following the year.</p> <p>As such, we think that the FMA should put out guidance that issuers should not use "PF" after a financial year to signal pro forma financial information, as this has the potential to be easily confused with the more commonly used "F".</p>

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Mr Jeromy Meerman
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29 June 2017

Improving financial information in an equity PDS

Dear Jeromy

Thank you for the opportunity to comment on the FMA consultation paper *Improving financial information in an equity PDS* (the consultation paper). This letter outlines EY Limited's feedback on that consultation paper.

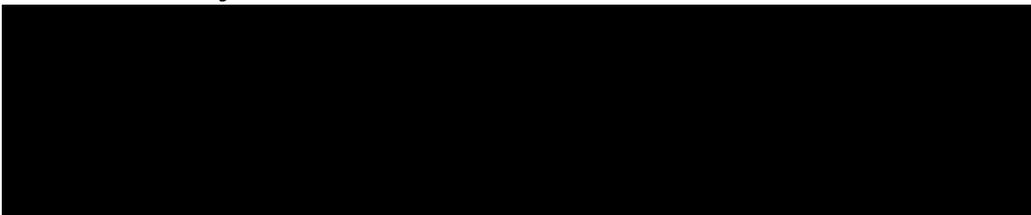
Overall we support the broad principles outlined in the consultation paper. In supporting these principles we acknowledge the difficulty in providing more detailed guidance which clearly and concisely articulates how the thresholds for the addition and/or substitution of information to the statutory tables should be applied in all circumstances.

In our view, success of the guidance will be determined by the extent to which equity PDS documents entering the market make amendments to the statutory tables. For example, if the threshold for pro-forma adjustments is intended to be high, expectation would be that such adjustments will be made only in exceptional circumstances; and that the rationale for making such adjustments will be fully explained. Ultimately market precedent, rather than guidance, will send the strongest signal for future equity PDS documents on the types of amendment that might be made.

We have provided more detailed comments on the questions outlined in the consultation paper below and included in the Appendix accompanying this submission.

Please feel free to contact either of us should you wish to discuss any aspect of this submission in greater detail.

Yours sincerely



APPENDIX

Consultation Question	EY Comment
1. Where do you agree with our guidance?	We agree with the board principles outlined in the consultation paper. We believe it will provide a useful reference point for future equity PDS documents when considering the extent of any amendments to the statutory tables.
2. Where do you disagree with our guidance?	<p>When introducing the guidance the FMA make reference to “the over-use of non-GAAP financial information resulting in crowded financial tables and complex footnotes”.</p> <p>We note that this in part can be attributed to other currently in force FMA guidance related to the use and disclosure of non-GAAP financial information. That guidance requires that non-GAAP financial information to be fully reconciled to GAAP financial information.</p> <p>It is hoped that the recently published FMA consultation paper on the use of non-GAAP financial information will go some way to addressing the issue of crowded financial tables and complex footnotes.</p>
3. Do you think our guidance will result in high quality information for investors?	As noted previously, this will be determined by how the guidance is applied in practice i.e. the extent to which additions and/or substitutions are made to future equity-PDS documents and the rationale for making such adjustments.
4. Are there situations where you think our guidance would lead to information that is not appropriate for investors?	Please see our response to Question 2 above.
5. Do you agree with our interpretation of when to add and/or substitute information?	Yes, in principle we agree with the FMA interpretation of when to add and/or substitute information.
6. If you disagree, please outline what you consider the appropriate interpretation to be.	N/A
7. Are there any additional areas or specific examples where you think we should provide additional guidance?	We are not currently aware of areas where further guidance is required.

29 June 2017

Financial Market Authority
Level 5, Ernst & Young Building
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Re: Consultation Paper: Improving financial information in an equity PDS

Thank you for the opportunity to provide feedback on the draft consultation paper. We note that we share the FMA's goals of facilitating the disclosure of financial information that is clear, concise and effective, and appreciate the ability to provide comment.

We set out below our views on the guidance note, which reflect our equity issuance experience and our perspectives on the market.

Q1. Where do you agree with our guidance?

We are in strong agreement with the FMA's intention to produce a guidance note clarifying expectations around disclosure of financial information. We also agree that there have been instances where the disclosure has become overly complex and somewhat immaterial adjustments have been made to statutory information. We agree that adjustments should only reflect those that are most useful, keeping adjustments to a minimum.

We agree that the required disclosures for Table 1 may not always be the best selection of information for investors and that they may not reflect:

- Measures commonly used to compare the relative valuation of companies in the issuer's industry;
- The way the issuer measures its own performance or determines its dividends; and
- The current business structure of the issuer.

We also agree with the need to be able to add or substitute information provided certain tests are met, and that the test for additional information is lower than that of substituted information. We further agree to a higher threshold for the use of pro-forma measures.

Q2. Where do you disagree with our guidance?

To provide context to our comments below, we view the purpose of adjustments to statutory information to be required in certain circumstances to aid comparability of historical and forecast information thereby allowing potential investors to better identify underlying trends of the current business which they are investing in.

In our view, making explicit adjustments (i.e. showing the reconciliation) to statutory information, makes information more clear to investors by removing non-recurring impacts not expected to occur in future periods.

We note however, that we agree that the actual statutory numbers remain of significant relevance as they reflect the actual historical performance of the business achieved, but note that this is still available to investors through the statutory information disclosed. We also note that whilst analysts generally calculate investment metrics based on normalised profit measures based on the forward looking periods (which by their nature should not contain significant adjustments) they also look at historical information to guide them in forming their own views on the achievability of the forecasts. Having such a high threshold for adjustments, could limit the usefulness of historical information.

In light of this, we note that in our view:

- Large operating costs should be adjusted for. For example, IPO offer costs, (a portion of which would generally be expensed) would require an adjustment and are forward looking.
- Restructuring costs should be adjusted for if they are non-recurring in nature. For example, a large one-off cost could occur in the forecast period if say material redundancy costs are expected in the second forecast period due to plans in place at the time of IPO.;
- Closed stores / operations should be adjusted for. Investors need to understand the historical trends of the current business which they are investing in (and not what it previously was). For example, if a company has sold or closed down part of its operations which generated 50% of the revenue in the year prior to listing, investors may incorrectly interpret that the forecast revenue is conservative and that based on previous years it has the potential to double its revenue.

Whilst we note that commentary can be used to explain some of these non-recurring items, the onus is then put on the investor to undertake any adjustments required for comparability. This creates a danger that they may:

- Be performed incorrectly by less informed investors; or
- Not be performed at all leading to a misinterpretation of the financial information.

We note however that we agree that such adjustments should only be made if material.

Q3. Do you think our guidance will result in high quality information for investors?

In its current form, in our view, whilst the guidance may result in more concise disclosures, there is a danger of preventing adjustments which would make the financials clearer and more effective.

Q4. Are there situations where you think our guidance would lead to information that was not appropriate for investors?

See examples provided for 2 above.

Q5. Do you agree with our interpretation of when to add and / or substitute information?

We agree with your interpretation of the relative hurdles for the addition or substitution of information, but disagree with when those thresholds are met, as outlined above.

Q6. If you disagree, please outline what you would consider the appropriate interpretation to be?

See above

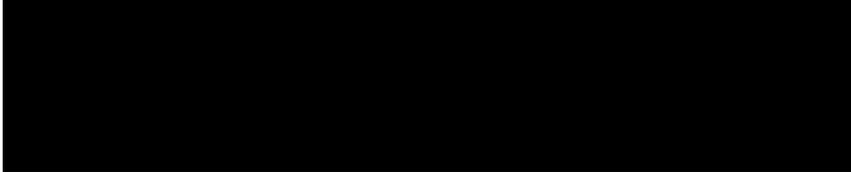
Q7. Are there additional areas or specific examples where you think we should provide guidance?

It would be useful to provide specific guidance with regard to:

- Additional non-statutory information, for example Underlying measures in addition to pro-forma measures. In this regard we reference a recent IPO PDS which disclosed pro-forma as well as Underlying metrics given Underlying metrics are commonly used by both companies and research analysts in that sector; and
- Disclosure of NPAT, tax and interest for historical periods when there is a material change in capital structure as a direct result of the offer. For example, when a highly levered private equity owned business raises primary capital to repay debt. In such a situation, the change in capital structure materially distorts the comparability of historical and forecast NPAT. We also note that previous offers have generally not disclosed historical NPAT, tax and interest in these cases, and that adjusting backwards for the new capital structure is practically difficult and in many cases not possible.

Thank you again for the opportunity to provide comment. Set out below are our contact details if you would like to discuss further:

Date: 29 June 2017



Feedback form: Consultation paper: Improving financial information in an equity PDS

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Improving financial information in an equity PDS: [your organisation's name]' in the subject line. Thank you.

Submissions close on Wednesday 31 May 2017.

Date: 31 May 31, 2017 Number of pages: 2

Name of submitter: [REDACTED]

Email: [REDACTED]

Phone: [REDACTED]

Company or entity: PricewaterhouseCoopers

Organisation type: Chartered Accountants

Contact name (if different): [REDACTED]

Contact email and phone: [REDACTED]

Phone: [REDACTED]

Question number	Response
Q1	<p><i>Guidance 4 Quantifying adjustments in the PDS – We agree that summarised reconciliations between statutory and pro forma information should be included in the PDS and should directly follow Table 1.</i></p> <p><i>Guidance 5 Ensuring information between the PDS and Disclose Register is consistent – We agree that movements in statutory numbers need to be discussed in the PDS where they are materially different to movements in adjusted /pro forma numbers.</i></p>
Q2	<p><i>Guidance 3 (a) and Guidance 3 (c) – while we agree these types of items should in general not be adjusted, allowance needs to be made where these may have a significant impact on the business and are potentially outside of management's control. For example, natural disasters, large customers going into receivership etc. can adversely impact the business and result in history not being comparable with the future on a like for like basis. We believe that these need to be adjusted where they are separately identified and a rationale needs to be disclosed as to the reason why. The same rationale would also apply to significant discontinued operations.</i></p> <p><i>Not adjusting for these types of significant events can result in repetition when explaining historical trends and can also result in an offer document which is not clear and concise.</i></p> <p><i>The impact from any adjustments will be shown in the statutory GAAP financial statements and their impact would also be apparent in the reconciliation between pro forma and GAAP financial statements, especially if a reconciliation follows Table 1.</i></p>

Q3	<i>We agree that further guidance around the matters discussed in the consultation document should improve the quality of information provided to investors.</i>
Q4	<i>If the items discussed in Q2 above are not allowed to be adjusted then this could lead to information being provided to investors which distorts the true underlying performance of the business. For example including the results of a discontinued operation in a particular year could distort a decline in sales for that year from the existing business.</i>
Q5	<p><i>It is not clear if pro forma information is substituted or added to Table 1 then all other financial information included in Table 1 also needs be added or substituted on a pro forma basis. The regulations are not explicit that this is the intent.</i></p> <p><i>We do not think it would not be appropriate to provide pro forma information for items below EBITDA as acquisitions, capital structure, changes to debt, goodwill etc. are generally too difficult and hypothetical in nature.</i></p> <p><i>It is not clear which prescribed items included in Table 1 (clause 35 (1)) can be substituted (apart from EBITDA and Debt).</i></p>
Q6	<i>Further clarification needs to be provided as to what information can and cannot be substituted in Table 1.</i>
Q7	<i>The FMCA regulations require interim period financial information for the current year and comparatives to be provided if the most recent period ended more than 9 months before the date of the PDS. We question the usefulness of including this information in Table 1 as it is not comparable to full year information and its inclusion can result in Table 1 not being clear and concise.</i>
<p>Feedback summary – <i>We agree and encourage this paper since clarification is important to facilitate a more efficient processes; however, we do not believe the current drafting adequately deals with all the situations we encounter on the majority of IPOs that we work on.</i></p>	
<p>Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.</p>	
<p>Thank you for your feedback – we appreciate your time and input.</p>	

31 May 2017

Financial Markets Authority

Email: consultation@fma.govt.nz

**SUBMISSIONS ON THE FMA CONSULTATION PAPER "IMPROVING
FINANCIAL INFORMATION IN AN EQUITY PDS"**

Introduction

In this document we set out our submissions in response to the Financial Markets Authority's ("**FMA**") consultation paper on "improving financial information in an equity PDS", dated 11 April 2017 ("**Consultation Paper**").

The submissions have been prepared based on our own review of the Consultation Paper and do not represent any client views or instructions.

We have structured our submissions to respond to the questions set out in the Consultation Paper. Unless otherwise defined in this document, capitalised terms have the meanings given to them in the Financial Markets Conduct Act 2013 ("**FMC Act**").

We would be happy to meet with the FMA to discuss the submissions contained in this letter and have no objection to the submissions being made publicly available.

Consultation questions

1. Where do you agree with our guidance?

In the interests of brevity, we have limited our comments to those areas in which we disagree with the FMA's guidance.

2. Where do you disagree with our guidance?

In its discussion regarding substituting EBITDA appropriately on page 7 of the Consultation Paper, the FMA provides guidance regarding the appropriateness of certain specific adjustments. We consider that the guidance around closed stores or operations may be overly broad, and risks discouraging adjustments that would be helpful for investors.

For example, where an issuer has closed a number of underperforming stores or operations, we consider that it may well be appropriate to make adjustments to remove those stores or operations from profit measures. The fundamental question is whether the inclusion of those stores or operations would materially affect the comparability of

the relevant period(s) with other historical or future periods presented. This determination will come down to whether the closure of the stores or operations is (a) likely to be an ongoing or recurring event or a one-off event and (b) whether the earnings (or losses) attributable to those operations or stores for the period is material.

There are various instances in which the closure of a number of underperforming stores or operations would clearly be a one-off event for which it is appropriate to make adjustments. For example, where an issuer has divested some sites/self-contained operations, whether or not they are profitable, it may be appropriate to exclude the earnings for those sites or operations as a pro forma item. If the earnings from the divested sites are not removed, then the three year historical period and two year forecast period will not be comparable as the EBITDA and NPAT will be shown on a different basis. This adjustment ensures investors' views of the year-on-year performance of the issuer's business are not distorted. The financial information should reflect the business into which the public is being asked to invest and should be comparable across the periods in all material respects – any impediment to this diminishes the ability of investors to adequately assess the investment.

Furthermore, by isolating the adjustments made in a reconciliation between the GAAP and non-GAAP information, investors are provided with very clear information should they wish to understand how much of the statutory earnings/losses relates to those divested operations, and therefore the historical impact of the non-performance is clearly explained to investors.

3. Do you think our guidance will result in high quality information for investors?

Please see our comments above regarding certain aspects of the guidance that we consider may detrimentally affect the quality of the information for investors.

4. Are there situations where you think our guidance would lead to information that was not appropriate for investors?

Please see our comments above.

5. Do you agree with our interpretation of when to add and/or substitute information?

We disagree with the FMA's interpretation in two respects, and set out below a description of each.

A. The conflation of "material" with "fundamental"

Clause 39(l) of the Financial Market Conduct Regulations ("**FMC Regulations**") enables an issuer to either substitute financial information for pro forma financial information for a period or add pro forma financial information for a period where there are any factors that would "materially affect the comparability or usefulness of the information reflected in a table".

On page 5 of the Consultation Paper, the FMA states that it considers this wording to create a high threshold aimed at "fundamental changes" to the issuer's business or how that is accounted for. We do not consider it appropriate for the FMA to imply a threshold of "fundamental" where the legislature has used the term "material", which has a well understood meaning that applies across the FMC Act and previous legislation.

In practice, the concept of **materiality** is, and should be, the analysis that is applied in determining whether a pro forma adjustment is made to financial information for a period. The issuer, together with the due diligence committee and the issuer's accounting advisers, will have determined quantitative materiality thresholds for an offering, and these will be the primary guide as to whether a particular factor materially affects the comparability or usefulness of financial information, such that pro forma information adjusting for this factor should be included.

It is not clear to us how the FMA has determined that the use of the term "material" by the legislature in the context of clause 39(l) is intended to imply a threshold applying only to "fundamental changes". Certainly elsewhere in the FMC Act this is not the understood interpretation of the concept of materiality. By way of example, we do not expect the FMA to be advocating for the concept of "materially adverse" in section 82 of the FMC Act to be interpreted in a manner limited only to events that are "fundamental" to the issuer.

We therefore submit that the concept of "material" in clause 39(l) of the FMC Regulations should be applied consistently with the remainder of the FMC Act, and not conflated with the concept of a "fundamental change" for the purposes of this provision only.

B. Adding or substituting pro forma financial information "for a period"

Under clause 39(l) of the FMC Regulations, if there are factors that would materially affect the comparability or usefulness of the information reflected in a financial table, an issuer has the option to either substitute financial information for pro forma financial information "for a period" **or** add pro forma financial information "for a period".

In its draft guidance, the FMA suggested that this clause should be interpreted such that if pro forma information is to be substituted for some measures then it needs to be substituted for **all** measures within that period. We consider that this interpretation of the legislation should be reconsidered, as it is likely to result in financial information being presented in a manner that is less helpful for investors. In our view, the preferable interpretation (and one that is open on the face of the legislation) is that clause 39(l) enables an issuer to add or substitute pro forma financial information for **selected** statutory measures within one or more periods.

As an overarching comment, we do not consider that adding full columns of pro forma financial information for multiple periods, and therefore presenting up to thirteen full columns in the Selected Financial Information Table, is the most effective disclosure for investors (this hardly seems to fit the requirements of "clear, concise and effective" and would create a crowded table). Where it is appropriate to include pro forma financial information, i.e. because it provides materially better comparability or usefulness, this information should be permitted to be added as a separate line item to the financial

information or substituted for the financial information, depending on which approach the issuer considers will provide investors with more useful information.

Furthermore, where adding or substituting pro forma financial information, it is not always appropriate for an issuer to pro forma every line item within a table. For example, pro forma adjustments may only affect some expense line items but not other line items (e.g. Revenue) or, more importantly, it may be that certain line items cannot be presented accurately on a pro forma historical basis (e.g. NPAT).

By way of example, while it can be practical and helpful to pro forma EBITDA historically, given the uncertainty around historical interest, it is not always appropriate to pro forma NPAT historically, as this would involve an issuer making significant assumptions about debt balances and cash flows dating back three years which would not provide useful information to investors and may be misleading.

On the other hand, if, as a result of its IPO, an issuer will have a different capital structure than for historical periods, then it is appropriate to show pro forma interest expense in the current financial year under the new capital structure. This enables investors to accurately compare the current financial year to the next forecast year, and likewise the resultant NPAT.

In requiring the issuer to also pro forma the historical interest expense and NPAT, the FMA would be asking the directors to make assumptions around how much debt the company would have had three years previously and how much cash flow was used to pay down this debt etc. These assumptions are artificial and would be difficult to gain comfort on. Similarly, the operating cash flow, total debt and total assets numbers could be completely different to the statutory accounts as they would have to be adjusted for potentially lower interest charges, but this would be based on artificial assumptions. These assumptions sit outside the traditional bounds of assumptions for IPO forecasts and may risk misleading investors if there are not sufficient grounds to make them accurately.

Similarly, in some cases, the use of a statutory financial measure (without a corresponding pro forma number for that measure) will provide more useful and accurate financial information for investors i.e. as mentioned above, operating cash flow and total assets.

We therefore consider that clause 39(l) should be interpreted as follows:

- (a) where an issuer considers that an adjustment is required for a factor that "materially effects the comparability" of the information, the issuer has the discretion to select whether to add pro forma financial information **or** substitute statutory information with pro forma information, depending on which is more useful to investors;
- (b) where an issuer elects to add pro forma financial information to a financial table, this does not require a new column of pro forma financial information to be added for a period. Rather, an issuer can add pro forma lines to the already existing column for a period within the table; and
- (c) similarly, where an issuer elects to substitute statutory financial information for pro forma financial information with a table column for a period, this does not require pro forma financial information to be substituted for all measures within

that period. Rather, an issuer can elect which specific financial measures/line items it considers it is appropriate to substitute with pro forma financial information.

6. If you disagree, please outline what you would consider the appropriate interpretation to be.

Please see our comments above.

7. Are there additional areas or specific examples where you think we should provide guidance?

We have no further comments.