

The managing and supervisory directors

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Subject: Eumedion Focus Letter 2016

Dear managing and supervisory directors,

This is the 11th annual 'Focus Letter' sent to all Dutch listed companies by Eumedion, the corporate governance and sustainability platform for institutional investors. The purpose of this letter is to highlight priorities that Eumedion members have identified as important governance issues that deserve your attention. We plan to discuss the topics raised in this letter in the dialogues that Eumedion facilitates between listed companies and participating investors in the run-up to the 2016 general meetings, and possibly also at the general meeting itself. Our three priorities for 2016 relate to the subjects 'acquisitions', 'tax transparency', and 'integrated reporting'.

The priorities will be explained in more detail below.

Focus point 1: Acquisitions: improved transparency and meaningful shareholder involvement

Eumedion members request companies to provide a clear explanation of their growth strategy in the annual report. Acquisitions, which can be an important part of such growth strategy, can have a profound impact on the future prospects and risk profile of a company. Unfortunately, numerous studies show that many acquisitions destroy value for shareholders of the acquirer and that the losses for investors can be significant.¹ Therefore, the members of Eumedion ask for improved transparency and meaningful shareholder involvement with regard to acquisitions.

Future acquisitions

Eumedion members request all listed companies to take great care in outlining their acquisition strategy to investors. This would include the willingness to pursue acquisitions and any criteria, both strategic² and financial³, to which acquisition proposals will be judged.

¹ For an overview of these studies: M. Becht, M. Polo and S. Rossi, 'Does Mandatory Shareholder Voting Prevent Bad Acquisitions?', *European Corporate Governance Institute Finance Working Paper No. 422/2014*.

² E.g. BE Semiconductor Industries NV (http://www.besi.com/uploads/tx_news/Annual_Report_2014_01.pdf).

³ E.g. Randstad Holding NV (http://www.ir.randstad.com/-/media/Files/R/Randstad-IR/annual-reports/annual_report_randstad_2014.pdf).

Present acquisitions

On the announcement of a significant acquisition, investors have immediate information needs. Investors need to understand the strategic and financial rationale, for example:

- how does the acquisition fit into the company's strategy?
- how does the acquisition affect the risk profile of the company?
- what projections formed the basis for the valuation?
- to what extent will the acquisition be integrated in the company?

Investors need *pro forma* financial information as it forms the basis for any projections for the future of the combined entity. *Pro forma* financial information is information that presents a combined entity as if all mergers and acquisitions (M&A) activity was consummated on the first day of a financial report. On announcement of a significant acquisition, investors would like to receive:

- a summary *pro forma* income statement per most recent completed reporting year;
- a summary *pro forma* financial position per date of the latest financial figures report.

The annual report covering a year of significant M&A activity would benefit from a *pro forma* income statement as well.

Past acquisitions

The annual report would also benefit from both an evaluation of individual acquisitions and a longer term historic perspective on the acquisition strategy as a whole. Balanced post acquisition reviews help investors with monitoring the progress of significant individual acquisitions in the first years. This would include the comparison of any originally anticipated synergies with synergies realised, and the progress towards integrating the acquisition and identifying the remaining challenges towards the aspired level of integration. The evaluation of the longer term historic perspective on the acquisition strategy as a whole would assess, amongst others, the effects of the actual M&A activity on the company's strategic position and risk profile and the effects of dilution in shares outstanding related to acquisitions.

Meaningful shareholder involvement

Given the fact that especially large acquisitions generate many operational and strategic risks and are potentially value-destroying, Eumedion requests all listed companies to consider the incorporation of qualified voting majorities and a quorum requirement for those major transactions that require a shareholders' vote in accordance with Article 2:107a of the Dutch Civil Code. During the upcoming dialogues, Eumedion participants will refer in that respect to the legal requirements for approval of legal and cross-border mergers⁴ and to the recognised best practices in the Dutch market⁵.

⁴ These transactions need approval of $\frac{2}{3}$ of the votes cast in a general meeting if less than 50% of the issued capital is present or represented at that general meeting.

⁵ The Articles of Association of the new listed company ABN AMRO Group NV will determine that the transactions described in Article 2:107a Dutch Civil Code need a $\frac{2}{3}$ vote majority that represents at least 50% of the issued capital (see the NLFI Exit Advice ABN AMRO dated 22 May 2015). The Articles of Association of the Dutch listed companies Envipco Holding NV and ASTARTA Holding NV prescribe a $\frac{3}{4}$ respectively a $\frac{2}{3}$ vote majority for such transactions, while the Articles of Association of arGEN-X NV prescribe a $\frac{2}{3}$ vote majority if less than 50% of the issued capital is present or represented at that general meeting.

Focus point 2: Improved transparency on tax policy and associated risks

Eumedion members believe that it is the responsibility of the board to strike an appropriate balance between the financial benefits of reducing tax expense and any heightened reputational and regulatory risks that accompany specific tax practices. We generally support the actions currently taken by governments and regulators, for example the Action Plan to address Base Erosion and Profit Shifting ('BEPS') presented by the Organisation for Economic Co-operation and Development in October 2015.

Eumedion expects all listed companies to disclose a tax policy in their annual report and to demonstrate a responsible approach regarding the management of tax related issues. During dialogues, we will discuss this with the management board of companies. Where appropriate, Eumedion members will also ask supervisory directors to report on how these issues are supervised. The possible short-term financial benefits of engaging in aggressive tax planning may be out-weighted in the long term by the negative outcomes to brand value, stakeholder relations and the societal license to operate. These factors are critical for a company's long-term success and should therefore be addressed in a tax policy. Investors need insightful information on identified tax risks and an overview of where taxes are paid ('country-by-country reporting')⁶. Promoting greater disclosure of taxes paid per country increases overall transparency and allows for a more detailed analysis by investors.

To better understand and model a company's tax position, investors would like to have forward looking information on taxes, preferably in the annual report, on how the future effective corporate tax expense rate and the effective corporate taxes paid rate are expected to develop.⁷

Focus point 3: Continued support for integrated reporting

Our previous Focus Letter already explained the importance of 'integrated reporting' for investors.⁸ An integrated report provides investors with a concise view of the company's strategy to create sustainable value. An encouraging number of companies both in the Netherlands and internationally issued an integrated report in 2015. The dialogues between the Eumedion members and Dutch listed companies further indicated that more than one-third of Dutch listed companies consider issuing an integrated report.⁹ We would therefore encourage all companies to continue on, or start with, their integrated reporting journey in 2016 and on.

We are available should you require further clarification regarding this letter. Responses to this letter are much appreciated, rients.abma@eumedion.nl or +31 (0)70 2040 303.

Yours faithfully,

Rients Abma
Executive Director

⁶ E.g. Unilever: <https://www.unilever.com/sustainable-living/what-matters-to-you/tax.html>.

⁷ Best practice: Presentation to investors by ASML CFO, 24 November 2014, slide 15: http://www.asml.com/doclib/investor/asml_8_Investor_Day-Financial_Model_WNickl.pdf.

⁸ The Eumedion focus letter 2015: <http://www.eumedion.nl/nl/public/kennisbank/speerpuntenbrief/speerpuntenbrief-2015.pdf>.

⁹ The Eumedion evaluation of the 2015 proxy season: <http://www.eumedion.nl/en/public/knowledgenetwork/publications/2015-proxy-season-evaluation.pdf>.