# THOMSON REUTERS INDICES

## CORPORATE ACTIONS METHODOLOGY

February 2013

THOMSON REUTERS

## Table of Contents

# THOMSON REUTERS INDICES
## CORPORATE ACTIONS METHODOLOGY

### Introduction

This methodology document details the guiding principles laid down by our index research experts for the treatment of corporate actions that affect Thomson Reuters Indices[1].

Thomson Reuters recognizes the importance of understanding how adjustments are made in order to maximize the benefits of using Thomson Reuters Indices for benchmarking, investment analysis and portfolio construction.

We hope readers find this document useful. In case of any questions or queries please contact index team by using the following email: Index_Queries@thomsonreuters.com

#### About Thomson Reuters Indices

Thomson Reuters provides innovative indices and index-related services to the global financial community to help investors make better decisions. Our index clients and partners rely upon the unparalleled breath, depth, global network and vast data and content sets that only Thomson Reuters can provide. Backed by the content, data, independence and global information network of Thomson Reuters, our indices and index services are designed to suit any need. For more information, go to www.financial.thomsonreuters.com/indices

#### About Thomson Reuters

Thomson Reuters is the world's leading source of intelligent information for businesses and professionals. We combine industry expertise with innovative technology to deliver critical information to leading decision makers in the financial and risk, legal, tax and accounting, intellectual property and science and media markets, powered by the world's most trusted news organization. With headquarters in New York and major operations in London and Eagan, Minnesota, Thomson Reuters employs approximately 60,000 people and operates in over 100 countries. Thomson Reuters shares are listed on the Toronto and New York Stock Exchanges. For more information, go to www.thomsonreuters.com.

[1] The Index Committee reserves the right to make exceptions in the treatment if the need arise. Announcements will made with sufficient notice should the Committe decide to make an exception to the general rules stated in this document.

## 1. Cash Dividend

A cash dividend is a distribution of wealth to the shareholders of a company, made out of the earnings during a period (year, half year or quarter). For index calculation purposes, regular dividends will affect Total Return indices only and not the Price Return indices.

The dividend's impact is significant on total return indices. "Total Return" is the result of reinvesting all dividends back into the index or portfolio. In the short term, the contribution of dividends to the total return performance may not be visible. Over time, however, the difference in accumulated wealth is significant due to reinvestment of income.

The price of the total return index is adjusted according to the amount of dividends paid in by index constituent companies. When a company issues a dividend, the price of the equity drops in the exact amount of the per share dividend amount. Leaving aside subsequent market movements of the equity price, the direct impact of a dividend upon an index is a drop in the price of the index. However, the total return index is adjusted for the issuance of dividends by reinvesting them. For the purposes of the Total Return index calculations and dividend reinvestment, Thomson Reuters will use the gross dividend amount. Further information about the index formulas that are used in the total return calculations can be found in Thomson Reuters Index Methodology document, publicaly available on our website: http://financial.thomsonreuters.com/indices

## 2. Special Dividend

A special dividend is a non-recurring distribution of profit to shareholders, usually in the form of cash. A special dividend is usualy larger when compared to normal dividends paid out by the company.

Typically, special dividends are distributed if a company has exceptionally strong earnings that it wishes to distribute to shareholders or if it is making changes to its financial structure, such as spin-off or changes in debt ratio.

For these larger 'special dividends', the ex-dividend date is normaly one trading day after the dividend date (the date on which dividend payment is made, typically after the record date).

The stock will trade on an ex-distribution basis (adjusted for the amount of the dividend paid) on the trading day after the dividend date.

For index calculation purposes, a special dividend results in a stock's price being adjusted (reduced) by the payment amount. Special dividends are adjusted on the ex-date and if greater than a certain percentage of the underlying security price, may be treated as corporate actions with price and divisor adjustments (thresholds vary from market to market depending on local conventions). All special dividends are analysed by Thomson Reuters to determine if they exceed a pre-set country specific threshold. If the dividend amount is below the threshold, it is processed as a common dividend. If the dividend amount exceeds the threshold then it is treated as a "capital return" event and the underlying security will be adjusted in all Thomson Reuters Indices through an index divisor adjustment on the ex-date.

**Example:** The special dividend threshold for Hong Kong is 25%. Let's suppose that a constituent of Thomson Reuters Hong Kong index announces a special dividend of 75HKD and on the day of announcement the price of the stock is 250HKD. The special dividend threshold is calculated as 75/250 and because it exceeds 25% it will be treated as a capital return event.

## 3. Stock Split

A Stock Split takes place when a company decides to increase the amount of its outstanding shares while decreasing the nominal share price proportionally. Stock splits cause an increase in the number of shares while reducing its share price in the same proportion, thus keeping the market capitalization of the company constant. A company with 10,000 shares trading at $100 can split into 20,000 shares of $50. The objectives of a company opting to perform a stock split include increasing the liquidity and increasing the perceived attractiveness for small investors (small investors can more easily afford shares if the cost is lower).

The treatment of a stock split is the following:

Adjusted Price = Closing Price * A / B

New Number of Shares = Old Number of Shares * (B/A)

Note: It is assumed that shareholders receive B(i), new shares for equity i (denoted B above) for every A(i) shares held (denoted A above).

## 4. Right Offerings (or "Rights Issues")

Through Rights Offerings, companies seeks to increase their capital by issuing new securities. This offer is extended to existing shareholders and gives them an opportunity to buy a proportional number of additional shares at a specific price (rights or subscription price, usually at a discount) within a fixed period (subscription period). The existing shareholders are given a chance to maintain their stake in the company to prevent dilution.

The rights are securities just like shares and can be listed on a stock exchange. Rights are often tradable during a predetermined trading period. They can be exercised to subscribe to new securities during the exercise period. On the payment date of the event, the shareholder who exercised the rights will receive the resulting securities and will pay the company the exercise price per share. Unexercised rights lapse.

Rights can be transferable or non-transferable. Transferable rights, also known as renounceable rights, are issued to existing shareholders and can be traded in the open market. Non-transferable or non-renounceable rights cannot be bought or sold due to being non-transferable. The existing shareholders can buy the new issued stocks at a discount so as to be compensated for the dilution caused due to rights offering. However, shareholders who do not exercise the rights by buying the discounted stock will lose money as their existing holdings will suffer from the dilution.

Rights issue results in capital inflow, and increases the number of shares as well as the free float-adjusted market capitalization of a security. For the purpose of index calculation, Thomson Reuters assumes that the rights will be fully subscribed at the time of the event and will adjust both the price and the share counts of the impacted securities by the ex-date of the event. Subsequent share count changes will only be captured at the next rebalance bi-annual date.

The treatment of a Rights Issue is the following:

| |
|---|
| Adjusted Price = (Closing Price * A + Subscription Price * B) / (A + B) |
| New Number of Shares = Old Number of Shares * (A + B) / A |
| Where shareholders receive B(i) new shares for equity i (denoted B above) for every A(i) shares held (denoted A above). |

**Example:** 2:25 rights offering (i.e., the right to buy two new shares for every twenty five shares owned) at a subscription price $2.50 and the market value of the stock on previous day's close is $3.45; Total No. of old shares is 100.

Adjusted Price = (3.45 * 25 + 2.50 * 2) / (25+2) = $3.38

New No. of Shares = 100 * (25+2) / 25 = 108

## 5. Stock Dividend

A stock dividend is an event in which a corporation distributes a payment to shareholders in the form of shares of stock, as opposed to money, while increasing the number of shares. The treatment of stock dividends is similar to stock splits, except that stock dividends are quoted in terms of the percentage of shares received to those held. Shareholders receive B(i) new shares for equity i (denoted B below) for every A(i) shares held (denoted A below). A 10% stock dividend is the same as a 1.10 for 1 stock split with an adjustment factor of 1.10.

The treatment of a Stock Dividend is the following:

| |
|---|
| Adjusted Price = Closing Price * A / (A+B) |
| New Number of Shares = Old Number of Share * (A+B) / A |

Companies can also offer "optional" stock dividends where shareholders can opt for new stocks or cash. When stock dividends are offered in alternative to cash, Thomson Reuters will assume that all shareholders will opt for cash and treat the event as a "common" dividend.

## 6. Bonus Issue

In a Bonus Issue, shareholders are awarded additional securities free of any payment. It is sometimes referred to as "Scrip Issue" or "Capitalization Issue" and is effectively a free issue of shares paid for by the company issuing the shares out of capital reserves.

The treatment of Bonus Issues is similar to the Stock Split or the Stock dividends.

**Example:** Company ABC calls a 1 for 4 Bonus Issue, for every four shares that shareholders own in ABC they will receive one additional free share, i.e. shareholders will own 5 shares of ABC plc after the issue. The number of shares issued increases by 25%. The issued share capital increases by 25%, although this is offset by the reduction in the capital reserves. The share price adjusts proportionately; if the market price was $100 before the issue, it will adjust to $80 as the number of shares has increased.

## 7. Consolidation

This event may also be referred to as a "Reverse Stock Split", as it is the exact opposite of a stock split. In a reverse split the company decides to decrease the amount of its outstanding shares while at the same time increasing the share price proportionally, keeping the market capitalization unchanged.

A reverse split will result in all shareholders holding fewer shares in the company. However, the stake of each shareholder in the company will remain the same and the nominal value per share will increase. Each new consolidated share will carry the same rights as the pre-reverse-split shares including voting rights and dividend entitlements.

The adjustment factor is calculated just like in the stock split.

**Example:** 1 for 4 reverse stock split for company XYZ. Before the reverse split XYZ had 1,000,000 outstanding shares with a nominal value per share of EUR 0.50. After the Reverse Split the company will have 250,000 outstanding shares, with a nominal value per share of EUR 2.00. The total market cap of the company remained contant, EUR 500,000.

## 8. Share Repurchase/Buy-Back

A Share Repurchase or Buyback is an offer by the issuing company to existing shareholders to repurchase the company's own shares or other securities convertible into shares. This results in a reduction in the number of outstanding shares.

Companies buy a portion of their outstanding shares to reduce the number of shares on the market. These repurchased shares could either be retired by the company or retained as treasury stock, to be reissued at a later date. In the first scenario, an adjustment factor is normally used to reflect the price offered in the buy-back. When companies retain securities as treasury stock, Thomson Reuters will not process an adjustment factor and the free float number of shares will be updated at the next scheduled rebalance event.

## 9. Spin-offs

Spin-off or demerger is the creation of an independent company through the sale or distribution of new shares of an existing business/division of a parent company. Shares of the new organization or spun-off entity are distributed to the equity shareholders of the parent organization, at a ratio established by the parent (for example, each shareholder in parent company A will receive 5 shares in the spun off company B). Both company's shareholders and stakes are identical at the moment when the spin off is initiated. Each shareholder holds shares in company A as well as in B at the moment of the spinoff.

The impact of Spinoffs on Thomson Reuters Indices is the following:

Adjusted Price = ((Closing Price * Shares Before Spin-off) – (Price of Spun Off Shares * New Shares)) / Shares Before Spin-off.

The price adjustment of the parent company is performed together with an index divisor adjustment. Thomson Reuters does not add Spun companies inbetween rebalances. Spun entities will require a minimum of 6 months of history in order to qualify for becoming an index constituent (other requirements also apply, including liquidity, minimum free float, etc, as per Thomson Reuters Index Methodology).

## 10. Mergers and Acquisitions

A merger is a strategic transaction, which involves combining two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock. The great majority of these event are acquisitions and typically there is no name change or price adjustment made to the acquiring company. However in some cases a merger two firms often but not always of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. For example, both Thomson and Reuters ceased to exist when the two firms merged, and a new company, Thomson Reuters, was created.

Mergers may be pure cash deals or a stock exchanges or a combination of both. A merger results in the deletion of the target company, normaly with a name change and price adjustment made to the acquirer.

The Impact of M&A’s on Thomson Reuters Indices is the following:

| |
|---|
| Shares Adjustment Factor = (New Shares + Old Shares) / Old Shares |

For the purpose of processing M&A activity, Thomson Reuters will use the prices provided by the exchange. In the event of a delisting, Thomson Reuters will use the last available price to process the removal of the security from the indices, with a divisor adjustment. Share count adjustments to the parent company may be perfomed if deemed appropriate by the Index Committee.

Float adjustments that result from M&As are applied at the next scheduled rebalance date.

## 11. Capital Repayments

Capital repayments are characterized by the distribution of a portion of a company’s reserves or capital to its shareholders. They are similar to special dividends. The price of the security is adjusted on the ex-date of the event.

| |
|---|
| Adjusted Price Factor = [P(t) + Cash] / P(t)<br>Impact on Shares = No change.<br>Where P(t) = Price on Ex-date. |

## 12. Additions and Deletions

Thomson Reuters Indices may be affected by addition and deletions of constituents due to a number of different reasons.

- Initial Public Offerings: IPO additions to the index take place on the index scheduled rebalancing dates.
- Spin-offs: Spin-offs from current index constituents are eligible for index inclusion at the next scheduled rebalancing date if the spun-off issue has met the eligibility requirements for the index under consideration.
- Mergers & Acquisitions: M&A’s usually result in the deletion of the target company and a possible weight change for the acquirer (in an all-stock offer or a combination of a cash-and-stock offer, assuming the purchase was funded with the acquirer’s shares). In an all-cash takeover, the target will be dropped from our indices. All-cash takeovers generally become effective on the date of the takeover. Thomosn Reuters Indices may not necessarily wait until the delisting date of the target for its deletion from the index. The change in weight of the acquirer and the deletion of the target company are effective the same day.
- Bankruptcy: The removal of a bankrupt stock is done at the same time with the same closing price in all Thomson Reuters indices. If the stock is trading on its usual or primary exchange at the close of the day it is removed, that price is used. If the security is suspended from trading, the last available price will be used. Delisting: Thomson Reuters Indices will generally drop a stock from all our indices on or around its expected delisting date. Where the delisting is due to an M&A event, the target company might be dropped once an offer to acquire the stock has been deemed unconditional. We may not wait until the delisting date to drop the company from Thomson Reuters Indices.

## 13. Contact Us

For any additional clarification required or for any topics not covered in this document please do not hesitate to contact our Thomson Reuters Index team via the following email: Index_Queries@thomsonreuters.com