Part II

Background and evidence

3 The companies and the merger

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Introduction

3.1. In this chapter we present the financial performance of the companies involved in the merger, the merger offer and the reasons for the bid by BSkyB for Manchester United. We then go on to look at the impact of the acquisition on BSkyB and the justification for the offer price of £623 million. Finally we consider the contribution to Manchester United's financial position from participation in the Premier League.

BSkyB

History and activities

3.2. BSkyB was formed in November 1990 following the merger of the satellite TV businesses, Sky Television plc (Sky TV), a company in which News International had majority ownership, and British Satellite Broadcasting Holdings Limited (BSB), owned by a consortium which included Pearson plc, Granada and Chargeurs.

3.3. In December 1994 BSkyB was floated on the London and New York Stock Exchanges via an initial global offering that represented 20 per cent of the enlarged share capital base. This valued the company at £4.5 billion. The market capitalization of BSkyB now is approximately £8.7 billion[1] and it is ranked 37th on the FTSE Top 100[1] by market capitalization.

3.4. The activities of BSkyB, all of which are carried out within the UK and the Republic of Ireland, are the distribution of TV programming via satellite and the creation of programming content for distribution via satellite, cable and digital terrestrial TV. BSkyB is also one equity partner in a joint venture that is endeavouring to bring digital interactive services to the customer.

3.5. In this section we refer to both the digital and analogue services of BSkyB. Chapter 4 includes further information on the differences between the transmission formats.

Distribution

3.6. The distribution activities of BSkyB involve the packaging and marketing to DTH customers of subscription TV channels and channel packages delivered via satellite, and the ancillary services to support this activity which include:

(a) operation of call centres to provide ongoing customer service and retention;

(b) arranging manufacture and supply of satellite DTH receiving equipment; and

(c) retail network and installation arrangements.

3.7. In analogue, BSkyB offers one package of basic channels. In digital, it offers a range of packages that include various combinations of 'basic' channels. These include six wholly-owned basic channels provided by BSkyB, nine channels in which BSkyB has an equity interest and 28 channels provided by third parties for which BSkyB has been appointed the DTH satellite retailer.

3.8. In addition to a basic package, the customer can purchase one or more 'premium' channels. BSkyB offers four premium channels (two sports and two movie channels), two bonus premium channels and certain other premium channels provided by third parties.[2]

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[1]At the close of trading on 19 February 1999.
[2]This includes two premium channels in which BSkyB has an equity interest. This makes a total of 11 joint venture channels (basic and premium) in which BSkyB has an ownership interest.

3.9. All customers who take a Sky/DTH package are also able to access individual pay-per-view TV films and events from Sky Box Office.

3.10. To send the satellite signal of its channels to its subscribers, BSkyB leases transponder capacity on the Astra satellite system, operated by the Luxembourg company, Société Européenne des Satellites SA (SES). Other broadcasters, including the third party channel providers whose channels are distributed by BSkyB, also lease transponder capacity from SES or from another broadcaster with spare capacity. Further information on the transmission of a satellite signal is contained in Chapter 4.

Subscribing to BSkyB

3.11. A network of some 5,000 independent retailers (including large retailers such as Currys and Dixons) sells the necessary equipment to receive the satellite signal to approximately 92 per cent of BSkyB's new subscribers. Retailers stock the requisite equipment, which they buy from the manufacturers and on-sell to the customer. This equipment consists of a satellite dish to receive the satellite signal and a set-top box which, when used together with a smartcard (see paragraph 3.15), will decode the signal into a format that can be displayed on a standard TV screen.

3.12. Once the equipment has been purchased by the customer, the retailer makes arrangements for the installation of the equipment at the customer's premises. Retailers are paid a commission from BSkyB for each new subscriber that they add to BSkyB's DTH satellite service.

3.13. The other 8 per cent of new subscribers purchase the satellite dish and set-top box directly from BSkyB. Orders for these sales are taken by BSkyB's customer management centres.

Installation of the direct-to-home equipment

3.14. The installation service is performed by a BSkyB subsidiary, Sky In Home Services Limited (SIHS), and by a number of installation contractors. SIHS's engineers are responsible for the installation and maintenance of the customer's satellite DTH reception equipment. As part of the strategy to promote its digital DTH service, standard installation is free of charge to all new BSkyB digital DTH subscribers. BSkyB currently plans to offer this incentive for a further [✄].

Customer management and conditional access

3.15. The customer management function is carried out by another BSkyB subsidiary, Sky Subscribers Services Limited (SSSL). This company operates the subscriber management centres at Livingston and Dunfermline. The functions performed by the centres include:

(a) handling orders from subscribers;

(b) administration and distribution of smartcards that enable decoding of encrypted broadcasts;

(c) establishing and maintaining accounts;

(d) telemarketing;

(e) collection of revenues; and

(f) administration of subscriptions.

3.16. SSSL also operates the analogue and digital conditional access systems. Further information on conditional access is in paragraphs 4.39, 4.45 and 4.46.

Programming

3.17. BSkyB provides programming for distribution on all pay TV platforms. The programming covers the genres of sport, movies, news and entertainment. BSkyB programming is also provided through its pay-per-view TV service—Sky Box Office.

Sports channels

3.18. BSkyB provides three sports channels and a sports news channel (only available in digital), each broadcasting for up to 24 hours a day. Since 1992 BSkyB has featured more than 100 sports including Premier League football.

3.19. Programming resources go not only into coverage of the live sporting events, but also into support programming providing background information on the major sports that are covered, discussion and debate, preview programmes, highlights programmes and analysis.

3.20. The quality of BSkyB's coverage of live sporting events has been recognized by the TV industry by way of 15 awards, three of which (two for football coverage) were from the Royal Television Society. Also in 1998 BSkyB's coverage of the England–New Zealand rugby union match at Twickenham in December 1997 was voted the best live event coverage for the year by the British Academy of Film and Television Arts.

3.21. The rights to cover live sporting events are purchased under contracts, generally for a period of up to five years, and are normally exclusive to the purchaser of those rights. The present Premier League rights contract provides for BSkyB to show 60 live Premier League matches per season for four years. The rights to this package cost BSkyB £670 million and it is by far the most expensive package of rights that BSkyB has acquired.

Movie channels

3.22. The three movie channels provided by BSkyB show recent-release movies[1] from the major Hollywood studios, older library movies and, like sports, a range of support programming that includes material produced by BSkyB.

3.23. Recent release movies are paid for on a per-subscriber basis subject to a minimum guarantee. For library films, which may have been shown many times on pay and terrestrial TV, only a flat fee is incurred.

3.24. To reduce its reliance on the major Hollywood studios for programming content, BSkyB has announced plans to begin production of original and exclusive content for its movie channels. Around [✂] per cent of the movie programming budget will be spent on developing original British-made feature length movies. These movies will not be released in the cinema or on video, but will appear only on BSkyB's movie channels.

News and general entertainment channels

3.25. News and general entertainment channels make up the core of the channels included in the basic packages offered by BSkyB to its DTH subscribers. The major basic channels owned by BSkyB are Sky News, a 24-hour live news service, and Sky One, the most watched satellite and cable channel in the UK.

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[1]Pay TV movie release follows the release of the movie in the cinema, on video and for pay-per-view TV, but before terrestrial TV. Release on pay TV occurs approximately 12 months following the first release in the cinemas.

3.26. As with movies, BSkyB has increased its budget for spending on commissioned series for general entertainment channels, also to reduce its reliance on major programming sources. Around [✂] per cent of the programming budget for Sky One is committed to British-originated commissioned programming.

Pay-per-view TV

3.27. BSkyB's pay-per-view TV service, Sky Box Office, has four analogue and 48 digital channels. The service mainly carries movies that are available for viewing around six months before screening on BSkyB's movie channels.

3.28. The digital pay-per-view TV service offers DTH subscribers access to up to 15 movies at any one time starting every 15 minutes and can be purchased using the remote control instead of making a phone call as required in analogue.

3.29. Other pay-per-view TV offerings from BSkyB have in general been one-off events, such as music concerts and boxing matches.

Advertising

3.30. The programming activity carried out by BSkyB includes the sale of advertising on the BSkyB-owned channels. Advertising revenue is an important source of income to the company but is not as critical to the viability of BSkyB's operation as it is for commercial terrestrial TV companies.

Subscriber interactive services

3.31. British Interactive Broadcasting Limited, now known as Open…., is a joint venture consisting of BSkyB (32.5 per cent), British Telecommunications Holdings Limited (32.5 per cent), Midland Bank plc (20 per cent) and Matsushita Electric Europe (Headquarters) Limited (15 per cent). The consortium is aiming to provide interactive TV services broadcast to the population of digital satellite set-top boxes.

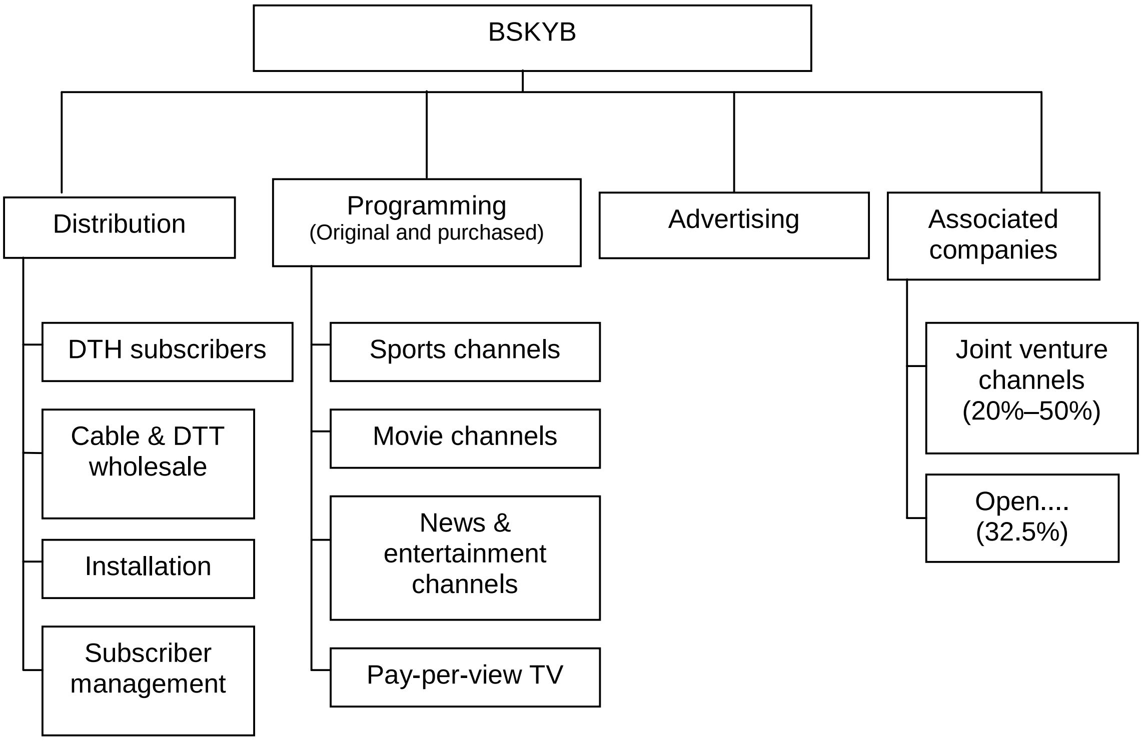
3.32. Through the addition of a phone connection and a modem in the digital satellite set-top box, the customer will be able to order services and products directly from the TV screen using the remote control. The consortium partners have committed to invest £275 million to subsidize the retail price of digital satellite set-top boxes. A new customer will have to pay under £200 for the set-top box (and the satellite dish and other receiving equipment) while existing analogue BSkyB subscribers will pay around £160.

3.33. Services to be offered by Open…. include home shopping, banking, travel services, interactive games and informational and educational services. The service will be available to owners of digital satellite equipment and is expected to be fully operational by spring 1999.

3.34. Figure 3.1 summarizes BSkyB's activities.

FIGURE 3.1

Activities of BSkyB



Source: MMC, based on information from BSkyB.

Ownership of BSkyB

3.35. The major shareholders in BSkyB are News International (40 per cent), BSB Holdings Limited (12 per cent) and Pathé (13 per cent).[1]

3.36. News International is a wholly-owned subsidiary of News Corporation. Based in the UK, News International has other media assets including the newspapers *The Times*, *The Sun*, *News of the World* and *The Sunday Times*. The company also owns News Datacom Limited, an electronic data compression and encryption company, which supplies conditional access technology to BSkyB.

3.37. News Corporation is 30 per cent owned by the Murdoch family. Mr Rupert Murdoch is a director on each of the boards of News Corporation, News International and BSkyB.

Profitability of BSkyB

3.38. Over the period 1994 to 1998, BSkyB produced consistent increases in profits each year until 1997. Operating profit increased from £170 million in 1994, peaking at £374 million in 1997 before falling to £341 million in 1998. Similarly, profits after tax increased from £93 million in 1994, to £288 million in 1997 and then fell to £249 million in 1998. The fall in operating profits between 1997 and 1998 (£33 million) was much more than accounted for by the increase in advertising and marketing costs between those two years (£93 million—see paragraph 3.55).

3.39. Table 3.1 shows a summary of BSkyB's consolidated profit and loss accounts from 1994 to 1998.

[1]Pathé has a 33 per cent interest in BSB Holdings Limited. The sum of its direct and indirect interests is 17 per cent.

TABLE 3.1 **BSkyB's consolidated profit and loss accounts, 1994 to 1998**

£ million

	Years ended 30 June				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover	550	776	1,001	1,249	1,434
Net operating costs	(380)	(531)	(686)	(875)	(1,093)
Operating profits on ordinary activities	170	245	315	374	341
Share of associated companies' losses	(4)	(3)	(4)	(10)	(17)
Exceptional items	20	(9)	-	-	-
Profit before interest	186	233	311	364	324
Net interest payable	(93)	(78)	(54)	(50)	(53)
Profit on ordinary activities before taxation	93	155	257	314	271
Taxation charge	-	(19)	(23)	(26)	(22)
Profit after taxation	93	136	234	288	249
Dividends	-	(249)*	(95)	(103)	(103)
Retained earnings	93	(113)	139	185	146
Performance indicator summary					
Turnover growth (%)	45	41	29	25	15
Operating profit as a percentage of turnover (%)	31	31	31	30	24
Profit before interest as percentage of turnover (%)	34	30	31	29	23
Profit after tax growth (%)	-†*	46	72	23	(14)
Average employee numbers (full-time equivalent)	2,403	3,054	4, 205	4,580	4,634
Change in employee numbers (%)	36	27	38	9	1
Turnover per employee (£'000)	229	254	238	273	309

Source: BSkyB's published accounts and MMC calculations.

*This dividend includes £206 million that was paid to shareholders prior to the flotation of the company.
†BSkyB made a loss after tax in 1993 of £76 million.

3.40. Set out below is an outline of how this level of profitability has been achieved, as well as recent emerging trends that are likely to impact BSkyB's future profitability.

Turnover

3.41. Turnover growth has averaged 27 per cent a year during the period 1994 to 1998. This level of growth reflects the combined effect of growth in subscriber numbers and increases in prices.

Growth in subscriber numbers

3.42. BSkyB's total subscriber numbers in the UK and the Republic of Ireland (including cable and DTT) have increased from 3.9 million in 1994 to 6.9 million in 1998. The greatest growth has been in cable subscribers such that this category now makes up approximately 49 per cent of total subscribers for one or more channels broadcast by BSkyB in 1998 against 35 per cent in 1994.

3.43. Cable subscriber growth rates continue to be strong with a 20 per cent increase in 1998. However, DTH subscribers showed a net increase of only 0.4 per cent in that year. This may in part reflect the recent introduction of a digital service, which may have led consumers to adopt a wait-and-see approach to the new technology, thereby slowing the growth of new subscribers to DTH.

Increases in price

3.44. Each year from 1993 up until 1997 BSkyB increased the price per month of every DTH subscription package (with one exception) by at least £1, and by as much as £5. There was no increase in prices in 1998 although the price per month for the packages that included either of the premium movie channels changed by £1 or £2 (Sky Premier up by £1 or £2, Sky MovieMax down by £1 or £2) as part of a rebranding strategy. Wholesale prices are directly linked to BSkyB’s retail price and have therefore been broadly subject to the same increases.

3.45. Prices are discussed further in Chapter 4.

Operating margins

3.46. After a number of years of operating losses, before and after the merger of Sky TV and BSB, BSkyB achieved operational break-even during 1992 and its first operating profit in 1993. The operating margin in that year was 16 per cent.

3.47. During the period 1994 to 1998, operating margins have been consistently around 30 per cent except for 1998 when they fell to 24 per cent. This period has been the most profitable period of BSkyB’s history. Gross margins were 49 per cent in 1995 and 46.5 per cent in 1998.

3.48. A major factor in the achievement of those results has been the price increases introduced by BSkyB and the growth in subscriber numbers during the period. These are outlined in paragraphs 3.44 and 3.42 respectively.

3.49. BSkyB told us that there were two reasons for the price increases:

(a) initial prices were set low to attract subscribers at a time when the product was new and customers were uncertain about the value for money that BSkyB offered; and

(b) the quality of the programming offered to subscribers had increased, with BSkyB adding significantly to the packages of channels offered.

3.50. BSkyB’s largest operating cost is the cost of programming. Table 3.2 shows BSkyB’s programming costs since 1994, and these costs as a proportion of turnover in this period.

TABLE 3.2 **BSkyB’s programming cost and programming cost to turnover, 1994 to 1997**

	Years ended 30 June				
	1994	*1995*	*1996*	*1997*	*1998*
Programming cost (£ million)	231	329	420	574	688
Programming cost to turnover (%)	42	42	42	46	48

Source: BSkyB published accounts and MMC calculations.

3.51. This rise in costs is likely to reflect the increased demand for TV rights in the period as pay TV emerged as a major purchaser of rights; the extent to which free-to-air TV broadcasters have sought to compete for rights and the extent to which holders of rights have now been able to obtain higher revenues as a result.

3.52. In 1998 this trend continued with programming costs increasing by 20 per cent (due to an increase in sports programming costs) and turnover increasing by 15 per cent. However, unlike previous years, the operating margin fell to 24 per cent. The other major cost category contributing to this fall in margin was marketing costs. We looked at sports programming costs and marketing costs in more detail.

Sports programming costs

3.53. Sports programming costs increased from £164 million in 1997 to £286 million in 1998. Of the £122 million increase, £92 million related to the new Premier League rights contract that came into effect in the 1997/98 season.

3.54. In 1997 the Premier League rights cost £39 million for the 1996/97 season. This represented 24 per cent of the sports programming cost for that year. In comparison, the Premier League rights cost £135 million for the 1997/98 season and represented 47 per cent of the sports programming cost. The Premier League rights make up 53 per cent of the annualized cost of all sports rights held by BSkyB—see Table 4.17. This demonstrates the significance of Premier League rights to BSkyB.

Marketing costs

3.55. Advertising and marketing costs increased from £59 million in 1997 to £152 million in 1998. The reasons for the increase were a 67 per cent increase in advertising spending to £25 million and a 97 per cent increase in customer acquisition costs to £91 million. However, the latter included a write-off of £49 million relating to the previous two Christmas promotions.

3.56. BSkyB is planning a further increase in marketing and promotion activities over the next five years. Table 3.3 shows the forecast breakdown of marketing and promotion costs as taken from BSkyB's five-year business plan.

TABLE 3.3 **BSkyB's forecast marketing costs**

£ million

	Years ended 30 June				
	1999	*2000*	*2001*	*2002*	*2003*
Acquisition marketing costs	*Figures omitted. See note on page iv.*				
Subscriber retention costs					
Publicity					
Customer marketing					
Cost of free installations*					
Other					
Total					
Total less free installations					

Source: BSkyB Financial Plan—1 July 1998 to 30 June 2003.

*Free installations are offered as an incentive for customers to take up BSkyB's digital service. The costs of providing the installation service are normally recovered from an installation charge to the customer. New digital DTH subscribers subscribing within [✄] will not be required to pay for the installation of their digital DTH equipment.

3.57. Table 3.3 shows total marketing costs continuing to increase. BSkyB told us that this was due in part to the introduction of the DTH digital service but also as a result of the increasing competition for retail customers between DTH, cable and DTT.

Balance sheet and cash flow of BSkyB

3.58. Table 3.4 shows the summary balance sheets of BSkyB for the five years between 1994 and 1998.

TABLE 3.4 **BSkyB: consolidated balance sheet, 1994 to 1998**

£ million

	1994	*1995*	*1996*	*1997*	*30 June 1998*
Tangible fixed assets	32	46	73	110	175
Investments	-	1	24	38	44
Stock and debtors less creditors	222	26	45	150	134
Net operating assets	254	73	142	298	353
Borrowings less cash	(1,712)	(768)	(659)	(627)	(518)
Dividend payable	-	(43)	(52)	(56)	(56)
Provisions	(28)	(30)	(39)	(37)	(79)
Deficit of shareholders' funds	(1,486)	(768)	(608)	(422)	(300)

Source: BSkyB published accounts and MMC calculations.

3.59. The net liability position of BSkyB is the dominant feature of the balance sheet. Large losses were incurred during the early stages of the company's development. It was not until 1992 that BSkyB achieved operational break-even, and in 1994 it achieved its first profit after tax.

3.60. Also in 1994, BSkyB undertook a capital restructure to enable it to pay future profits as dividends. This preceded the stock market listing in November of that year, the funds from which provided an injection of equity to strengthen the balance sheet and repay the shareholder loans that had provided much of the necessary finance up until that stage.

3.61. Between 1996 and 1998, the strong cash flows generated by BSkyB allowed the company to further strengthen the balance sheet through capital expenditure and repayment of debt while still providing a dividend income stream to shareholders. Table 3.5 provides a summary of the BSkyB cash flows for the five years between 1994 and 1998.

TABLE 3.5 **BSkyB: consolidated cash flow statement, 1994 to 1998**

£ million

	Years ended 30 June				
	1994	*1995*	*1996*	*1997*	*1998*
Operating profit	170	237	315	374	341
Depreciation	6	6	6	5	17
Tax paid	-	(8)	(11)	(24)	(26)
Net interest paid	(184)	(123)	(58)	(47)	(48)
Changes in provisions and other non-cash items	(17)	(6)	(5)	(13)	(3)
Gross cash flow	(25)	106	247	295	281
Changes in working capital	(14)	16	(15)	(107)	50
Dividend paid	-	-	(86)	(99)	(103)
Net capital expenditure	10	(21)	(28)	(39)	(81)
Investment in associated companies	(4)	(4)	(5)	(18)	(45)
Net cash flow	(33)	97	113	32	102
Equity raised	-	831	-	-	8
Debt drawn down/(repaid)	133	(1,027)	(124)	(2)	(104)
Net movement in cash	100	(99)	(11)	30	6
Opening cash balance	39	139	40	29	59
Closing cash balance	139	40	29	59	65

Source: BSkyB published accounts and MMC calculations.

Manchester United

History and activities

3.62. Manchester United is the parent company of Manchester United Football Club (the football club) which is one of 20 teams in the top English football competition, the Premier League.

3.63. The football club was established in 1878, under the name of Newton Heath LYR Football Club, and joined the First Division of the Football League in 1892. In 1902 the name of Manchester United was adopted and in 1910 the football club relocated to Old Trafford where it has played its home matches ever since.

3.64. Table 3.6 shows the record of major trophies won by the club to date. We were told that the success of the club is second only to Liverpool Football Club.

TABLE 3.6 **Manchester United Football Club honours**

Premier League (or equivalent)	1908, 1911, 1952, 1956, 1957, 1965, 1967, 1993, 1994, 1996, 1997
FA Cup	1909, 1948, 1963, 1977, 1983, 1985, 1990, 1994, 1996
League Cup	1992
European Cup	1968
European Cup Winners Cup	1991

Source: *Rothmans Football Year Book*.

3.65. Since the establishment of the Premier League in 1992, the football club has won the championship on four occasions and was runner-up on the other two.

3.66. The activities of Manchester United are primarily the operation of the football club. Revenue is generated through competing in various football competitions and hosting matches at their 55,000-capacity stadium at Old Trafford. In the 1998 season, Manchester United attracted a total of 1.4 million spectators to its home matches; gate receipt income was £30 million, representing 34 per cent of total turnover. Table 3.7 shows the contribution of each revenue category to total turnover.

TABLE 3.7 **Manchester United contribution by revenue category to total turnover, 1994 to 1998**

per cent

	Years ended 31 July				
	1994	*1995*	*1996*	*1997*	*1998*
Gate receipts	41	32	35	34	34
TV	9	11	11	14	18
Sponsorship and advertising	11	12	12	13	13
Conference and catering	7	6	7	6	7
Merchandising and other	32	39	35	33	28
	100	100	100	100	100
Total turnover (£m)	44	61	53	88	88

Source: Manchester United published accounts and MMC calculations.

3.67. The football operations also generate income through sponsorship and advertising, such as the right for the sponsor's name to appear on the players' strip, and through TV rights and appearances. In 1998 total TV-based income was £16 million of which £9 million related to the Premier League contract held by BSkyB and £5.5 million to European matches.

3.68. The other major activities of Manchester United are merchandising and catering.

3.69. Manchester United sells, and licenses the right to sell, replica player strip and a broad range of other items that carry the Manchester United emblem or name. There are plans to expand merchandising operations overseas with a recent announcement of an intention to establish 150 Manchester United shops abroad, either under direct ownership or in joint venture with third parties.

3.70. The catering activities involve the provision of hospitality services at the ground for match-day fixtures and other events, such as conferences, that use the Old Trafford facilities.

3.71. In 1998 MUTV was launched. This is a joint venture between Manchester United, Granada and BSkyB that provides a subscription TV channel dedicated to Manchester United. The channel shows six hours daily of magazine-type programmes about Manchester United, archive material and live reserves and youth team matches (but not live Premier League matches). Since its launch, approximately [✄] subscribers have taken up the channel. The target is for [✄] subscribers in the UK [*Details omitted. See note on page iv*].

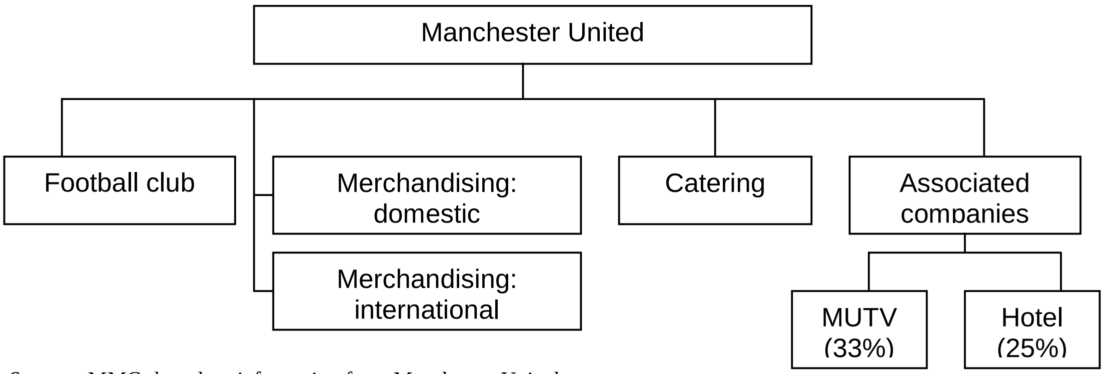
3.72. Under the MUTV joint venture agreement, all significant transactions must be agreed by all shareholders, effectively giving each shareholder a right of veto on all major decisions.

3.73. Other projects recently completed or planned include the newly-opened hotel near the stadium, in which Manchester United has a 25 per cent interest, the £14 million development of new training facilities and the £30 million expansion of the east and west stands at Old Trafford. This will increase capacity to 67,400 spectators. As at February 1999 £9 million of the capital expenditure for the stadium expansion has been committed.

3.74. Figure 3.2 summarizes Manchester United's corporate structure and activities.

FIGURE 3.2

Activities and corporate structure of Manchester United



Source: MMC, based on information from Manchester United.

Ownership of Manchester United

3.75. Manchester United's shares were listed on the London Stock Exchange in 1991 with an initial market capitalization of £47 million. The BSkyB offer values Manchester United at £623 million, and as at 30 September 1998 the company was ranked 210th by market capitalization in the FTSE Top 500.

3.76. As at 31 July 1998 Manchester United had 27,737 small shareholders who together held 23 per cent of the issued shares, with the remainder held by institutions (60 per cent) and Manchester United directors (17 per cent).

3.77. As reported in Manchester United's 1998 annual report, the largest shareholders of the company are Manchester United Chief Executive Martin Edwards (14 per cent), BSkyB[1] (9 per cent) and Royal and Sun Alliance Insurance Group (3 per cent).

[1]On 20 October 1998 BSkyB acquired a further 2 per cent of Manchester United at 230p per share giving BSkyB a total holding of 11 per cent. This occurred subsequent to the issue of the annual report.

3.78. 95 per cent of Manchester United's shareholders, holding 99 per cent of the issued shares, are located in the UK.

Profitability of Manchester United

3.79. The profitability of Manchester United has resulted from a sustained period of on-field success. As a result, Manchester United has become, in financial terms, the largest English club by a substantial margin. In 1998 Manchester United's turnover was 78 per cent more than the next English club, Newcastle United. Further, according to accounting firm Deloitte and Touche (Deloitte), Manchester United is the largest[1] football club in the world. Manchester United told us that its financial position has been reached through the company's management capitalizing on the benefits that the success of the football club has brought.

3.80. Table 3.8 shows Manchester United's summary consolidated profit and loss accounts from 1994 to 1998.

TABLE 3.8 **Manchester United's consolidated profit and loss accounts, 1994 to 1998**

£ million

	Years ended 31 July				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover	44	61	53	88	88
Net operating costs	(33)	(45)	(39)	(62)	(61)
Operating profits on ordinary activities	11	16	14	26	27
Exceptional items	-	-	2	-	-
Profit before interest and transfer fees	11	16	16	26	27
Net interest receivable	1	1	-	1	3
Profit before transfer fees	12	17	16	27	30
Net transfer fees receivable/(payable)	(1)	4	(1)	-	(16)
Profit on ordinary activities before taxation	11	21	15	27	14
Taxation charge	(3)	(6)	(4)	(8)	(4)
Profit after taxation	8	15	11	19	10
Dividends	(3)	(3)	(3)	(4)	(4)
Retained earnings	5	12	8	15	6
Performance indicator summary					
Turnover growth (%)	76	38	(13)	66	-
Operating profit as percentage of turnover (%)	25	26	26	30	31
Profit before transfer fees as percentage of turnover (%)	27	28	30	31	34
Profit after tax growth (%)	167	88	(27)	73	(47)
Average employee numbers (full-time equivalent)*	248	299	338	412	463
Change in employee numbers (%)	25	21	13	22	12

Source: Manchester United published accounts and MMC calculations.

*Excludes temporary match-day staff.

3.81. The turnover growth has been achieved while maintaining operating margins of between 25 and 30 per cent.

3.82. An important element of Manchester United's sustained on-field success has been its ability to develop players of the necessary quality. Manchester United has a reputation for having one of the best junior development programmes of all clubs. This has seen a number of players progressing through the system to become high-quality players and even international representatives at a young age. Manchester United has paid players wages in excess of the league average (though not necessarily the highest in the Premier League) and has been able to do so on the back of a strong revenue base. Player wage inflation is a major risk to the football club's profits. The youth development programme,

[1]Based on turnover for the 1996/97 financial year.

and a policy of securing players on contracts of five years or more, have been adopted by Manchester United's management to control this risk.

3.83. Another important benefit of a successful youth development programme is to reduce the need to acquire playing talent through the transfer market. Until 1998, Manchester United's net transfer fees ranged between plus or minus £4 million. In the 1998 calendar year, though, Manchester United spent £28 million on players, the reasons given being its failure to win any trophies in the previous year and a desire to increase the likelihood of achieving greater success in European competitions.

3.84. Manchester United told us that the recent transfer expenditure did not reflect an abandonment of the youth development programme. It has invested £14 million towards new training facilities as an ongoing commitment to developing home-grown talent.

3.85. With on-field success comes increased popularity which Manchester United appears to have been successful in turning into long-term profitability. Capacity at Old Trafford was increased by 11,000 seats in 1996 and plans have been approved to increase seating capacity to accommodate another 12,400 spectators.

3.86. Manchester United told us that it sets ticket prices at an overall optimum level rather than at prices to capitalize on the high level of demand that exists to see Manchester United home matches.[1]

3.87. The capacity of 55,000 is fulfilled as follows: 40,000 season/executive seats, 3,000 visitors, 2,000 sponsors/complimentary/other and 10,000 individual match-day tickets. The 10,000 match-day tickets are available to Manchester United club members only. There are 100,000 Manchester United club members; this figure is restricted because of the limited number of tickets available. A club member wishing to purchase a match-day ticket must apply for the ticket usually five weeks in advance of the match, then entering a lottery with other club members applying for tickets to the same match. The chance of obtaining a ticket is one in ten assuming all club members apply.

3.88. Table 3.9 shows the increases in match-day and season ticket prices for Manchester United between 1994 and 1998. Included in Chapter 4 is a comparison of ticket prices between Premier League football clubs.

TABLE 3.9 **Manchester United's match-day and season ticket prices, 1994 to 1998**

	Years ended 31 July				
	1994	*1995*	*1996*	*1997*	*1998*
Match-day tickets *(including VAT)*					
Lowest-priced ticket (£)	10.00	11.00	12.00	12.00	13.00
Increase year-on-year (%)		*10*	*9*	-	*8*
Median of mid-range-priced ticket (£)	12.00	14.00	16.00	16.00	17.00
Increase year-on-year (%)		*17*	*14*	-	*6*
Highest-priced ticket (£)	14.00	16.00	18.00	18.00	19.00
Increase year-on-year (%)		*14*	*12*	-	*6*
Season tickets *(including VAT)*					
Lowest-priced ticket (£)	190.00	209.00	228.00	228.00	247.00
Increase year-on-year (%)		*10*	*9*	-	*8*
Median of mid-range-priced ticket (£)	228.00	280.00	304.00	304.00	323.00
Increase year-on-year (%)		*23*	*9*	-	*6*
Highest-priced ticket (£)	280.00	320.00	342.00	342.00	361.00
Increase year-on-year (%)		*14*	*7*	-	*6*

Source: Manchester United.

3.89. Catering and merchandising have also grown due to the high popularity of the club and to management strategies designed to take advantage of this popularity. In particular, merchandising has

[1]The ticket pricing policy is supported by the Premier League National Fan Survey 1996/97 that showed that Manchester United supporters were the highest spenders in overall terms of all Premier League clubs.

built a solid operating base and Manchester United is now planning to develop an international network of outlets.

3.90. Manchester United's recent period of success has enabled it to benefit more than any other club in any other era from the developments in the pay TV market and the money that has come into the game from this. As was mentioned in paragraph 3.85, with success comes popularity, with popularity comes viewers and therefore more coverage. The consistent on-field success has resulted in Manchester United being shown 10 to 14 times per season by BSkyB over the past five years by comparison with 7 to 10 times per season for the next football club, Liverpool. Also, greater TV exposure is one factor that increases the sponsorship value of Manchester United.

3.91. Manchester United told us that because of its financial success it is used as a benchmark by other clubs who now adopt similar strategies pioneered by Manchester United both in England and particularly overseas. An example is the development, by a number of clubs, of the sale and distribution of club merchandise.

Balance sheet and cash flow of Manchester United

3.92. Table 3.10 shows the summary balance sheets of Manchester United for the five years 1994 to 1998.

TABLE 3.10 **Manchester United: consolidated balance sheet, 1994 to 1998**

					£ million
	1994	*1995*	*1996*	*1997*	*31 July 1998*
Tangible fixed assets	26	43	61	71	83
Stock and debtors	7	13	13	14	15
Cash	14	16	20	46	42
Gross assets	47	72	94	131	140
Creditors	(7)	(11)	(14)	(15)	(18)
Borrowings	-	(6)	(14)	(7)	(5)
Dividend payable	(2)	(2)	(2)	(3)	(3)
Provisions	(18)	(21)	(23)	(34)	(36)
Shareholders' funds	20	32	41	72	78
Calculation of net operating assets					
Tangible fixed assets	26	43	61	71	83
Stock and debtors less creditors	-	2	(1)	(1)	(3)
Net operating assets	26	45	60	70	80
					per cent
Performance indicator summary					
Operating profit as percentage of average net operating assets	48	45	27	40	36
Operating profit as percentage of average shareholders' funds	63	62	38	46	36
Profit after tax as percentage of average shareholders' funds	46	58	30	34	13

Source: Manchester United published accounts and MMC calculations.

3.93. The balance sheet of Manchester United shows the strength of the company's financial base. The increase in tangible fixed assets is primarily due to the significant improvements to the Old Trafford stadium that have been undertaken over recent years.

3.94. Cash reflects the season ticket and sponsorship income from Sharp, all of which is received prior to the commencement of the football season. This prepaid income is generally held in liquid securities which are realized when cash is required throughout the year.

3.95. Table 3.11 shows the summary cash flows of Manchester United for the five years 1994 to 1998.

TABLE 3.11 **Manchester United: consolidated cash flow statement, 1994 to 1998**

£ million

	Years ended 31 July				
	1994	*1995*	*1996*	*1997*	*1998*
Operating profit	11	16	14	26	27
Depreciation	1	1	2	3	3
Tax paid	(1)	(3)	(6)	(3)	(8)
Net interest receivable	-	1	-	1	3
Changes in provisions and other non-cash items	-	-	2	-	-
Gross cash flow	11	15	12	27	25
Changes in working capital	3	-	7	5	7
Dividend paid	(2)	(3)	(3)	(3)	(4)
Net capital expenditure	(5)	(19)	(20)	(13)	(15)
Transfer fees	(1)	4	(1)	-	(15)
Net cash flow	6	(3)	(5)	16	(2)
Equity raised	-	-	1	17	-
Debt drawn down/(repaid)	-	5	8	(7)	(2)
Net movement in cash	6	2	4	26	(4)
Opening cash balance	8	14	16	20	46
Closing cash balance	14	16	20	46	42

Source: Manchester United published accounts and MMC calculations.

3.96. Table 3.11 shows the capital expenditure incurred which reflects the growth in tangible assets on the balance sheet. The strength of the cash flows also shows that in 1998 capital expenditure did not inhibit the ability of the company to spend a large amount of money on new players and still maintain a healthy net cash position.

The merger

Background to the offer

3.97. On 9 September 1998 the boards of BSkyB and Manchester United announced the terms of a recommended offer for all the issued shares in Manchester United. The offer was 120p per share and 0.2537 BSkyB shares for every Manchester United share. BSkyB also offered a full cash alternative of 240p per share or a full share election of 0.5074 BSkyB shares per Manchester United share. Based on the cash offer, Manchester United was valued at £623 million.

3.98. On 10 September 1998 BSkyB acquired 9 per cent of the issued shares in Manchester United at 230p per share through on-market transactions.

3.99. On 29 October 1998 the Secretary of State for Trade and Industry referred the proposed acquisition of Manchester United by BSkyB to the MMC. This caused the offer to lapse except for shares held by Martin Edwards, the Chief Executive of Manchester United, which are subject to an irrevocable undertaking during the period of the MMC's review.

3.100. The offer of 240p per share represented a premium of 51 per cent on the closing middle market price of 159p per Manchester United share on 4 September 1998.[1]

[1]This was the last business day prior to the announcement that the boards of BSkyB and Manchester United were in discussions on the potential acquisition.

3.101. The offer values Manchester United at 21 times earnings pre-transfer fees and tax, 62 times earnings post-transfer fees and tax and 8 times net asset value.

Reasons for the bid

3.102. The reasons for the bid are covered in paragraphs 5.35 and 5.128.

3.103. BSkyB and Manchester United also told us that investing in sporting clubs is a common brand-building strategy of media groups. Supporting BSkyB's strategy of acquiring Manchester United is the evidence of other US and European media interests with ownership stakes in major sporting organizations. Table 3.12 shows examples of this.

TABLE 3.12 **Media interests with ownership stakes in major sporting organizations**

Media interest	*Sporting clubs*	
Canal+	Paris St Germain	(France—football)
	Sevette Geneva	(Switzerland—football)
Mediaset	AC Milan	(Italy—football)
	Monza	(Italy—football)
International Management Group	Racing Club Strasbourg	(France—football)
Cecchi Gori Communications	Fiorentina	(Italy—football)
News Corporation*	LA Dodgers	(US—baseball)
	New York Knicks	(US—basketball)
	New York Rangers	(US—ice hockey)
Time Warner	Atlanta Braves	(US—baseball)
	Atlanta Hawks	(US—basketball)
	Thrashers	(US—ice hockey)
Disney	Anaheim Angels	(US—baseball)
	Chicago Cubs	(US—baseball)
	Mighty Ducks	(US—ice hockey)
Cablevision	New York Yankees	(US—baseball)

Source: Manchester United submissions, Italian competition authorities and various newspaper reports.

*News Corporation also has options over interests in the LA Lakers (US—basketball) and the LA Kings (US—ice hockey).

Impact of the acquisition for BSkyB

3.104. The acquisition represents 7.5 per cent of BSkyB's market capitalization of £8.3 billion at the time the offer was made.[1] This means that the earnings impact is likely to be small. BSkyB stated in the offer document that the acquisition will be modestly earnings dilutive (pre-amortization of intangible assets) for the 1999 and 2000 financial years and earnings neutral thereafter. BSkyB provided us with an analysis of its estimated financial performance with and without the acquisition of Manchester United. This showed that the acquisition was estimated to be [*Details omitted. See note on page iv.*], but because the new shares that would be issued as part of the offer make up only 3 per cent of the enlarged capital base, the incremental effect on all BSkyB shareholders is only very small. In Table 3.13 we set out the estimated incremental revenues and costs of the acquisition.

[1]Based on the closing middle market price of BSkyB of 480p per share on 2 October 1998 (the last practicable business day prior to the issue of the offer document).

TABLE 3.13 **Incremental impact of the Manchester United acquisition on BSkyB**

				£ million
	1999	*2000*	*2001*	*2002*
Manchester United operating profit before transfer fees	[✄]			
Interest on acquisition debt*	(25.9)	(25.9)	(25.9)	(25.9)
Tax @ 31%	*Figures omitted. See note on page iv.*			
New shares issued (m)†	60.3	60.3	60.3	60.3
Incremental earnings per share based on new shares issued	*Figures omitted. See note on page iv.*			
BSkyB pre-acquisition earnings per share forecast				
Incremental earning effect for all BSkyB shareholders				

Source: BSkyB forecasts, MMC calculations.

*Total debt of £345 million has been calculated based on the debt required if BSkyB issues the maximum number of BSkyB shares as stated in the Offer Document (60.3 million BSkyB shares) as the shares component of the acquisition consideration, the acquisition of 23.5 million Manchester United shares on-market at 230p per share, and transaction costs of £9 million.

†As stated in the Offer Document, the maximum number of BSkyB shares to be issued in the offer is 60.3 million.

3.105. BSkyB explained that it assessed the impact of the acquisition on a pre-amortization of intangibles basis because of the size of the intangible assets arising on consolidation of the entities. At 31 July 1998 Manchester United had net assets of £78 million. Independent assessment of the land and buildings indicated a value £[✄] than that carried on the balance sheet. Intangible assets therefore make up £[✄] million of the £623 million acquisition price.

3.106. BSkyB identified two major intangible assets that it thought might be included separately from goodwill on the balance sheet. These were the value of players and the value of the Manchester United brand name.

3.107. Due to the complexity involved in valuing these intangible assets, it is likely that, except for the value of players' contracts required to be brought to account and amortized under accounting standard FRS10–Goodwill and Intangible Assets, the majority of the purchase cost will remain classified as goodwill. This will then be either amortized or subject to an annual impairment of value test. If the latter is the case, and the inherent value of Manchester United is realized for the reasons stated by BSkyB as the rationale for the acquisition, there will be no impairment of value and therefore no profit and loss effect will result.

Funding of the acquisition

3.108. The offer is a cash and shares bid. Alternatively, Manchester United shareholders may elect to receive either all cash and no BSkyB shares, or vice versa. BSkyB stated that if all Manchester United shareholders elect the cash alternative, it will refinance approximately half the payment through an issue of BSkyB shares into the equity market. Notwithstanding this, BSkyB told us that it expects the acquisition to be funded 50:50 cash and BSkyB shares.

3.109. As at 30 June 1998 BSkyB had £583 million of debt outstanding. Gearing ratios for BSkyB are not meaningful because of the net liability position of the company. Banking covenants are based on cash flow of the company. At 30 June 1998 senior debt to earnings before interest, tax, depreciation and amortization (EBITDA) was 1.6 times and EBITDA to interest was 6.3 times. BSkyB forecast that, following the acquisition, these ratios will worsen slightly to be [✄] times and [✄] times respectively. These ratios though are comfortably within the covenant limits of a maximum of [✄] times senior debt to EBITDA, and a minimum of [✄] times EBITDA to interest.

3.110. BSkyB's 1998 annual accounts show unused credit facilities of £615 million and at the time of the offer had in place bridging facilities sufficient to complete the transaction. BSkyB considered the funding of the acquisition to be well within its financial capabilities.

The offer price

3.111. Included in the information provided by BSkyB on the proposed merger was the cash flow model that was the basis for the evaluation of Manchester United. The model valued Manchester United at £[✄] million (or £[✄] per share). The valuation was prepared on the basis of Manchester United continuing as a separate entity and covered the period 1998 to 2007. We considered carefully the forecasts that were used in the model.

3.112. For the purpose of evaluating Manchester United’s share of TV rights revenue and matches played in the European Champions’ League, BSkyB forecast that Manchester United’s recent record of on-field success (specifically finishing either first, second or third in the Premier League and participating in the European Champions’ League) would continue indefinitely (with the exception of the 1999/2000 season).

3.113. This forecast is important because it has a pervasive effect on other cash flows, such as sponsorship and merchandising revenues. It should not, however, be assessed in isolation. To achieve the results that have been forecast requires a squad of high-quality players and such a squad commands high salaries. Manchester United’s current success in the Premier League has been achieved in the context of 18 per cent of turnover going in players’ wages. [

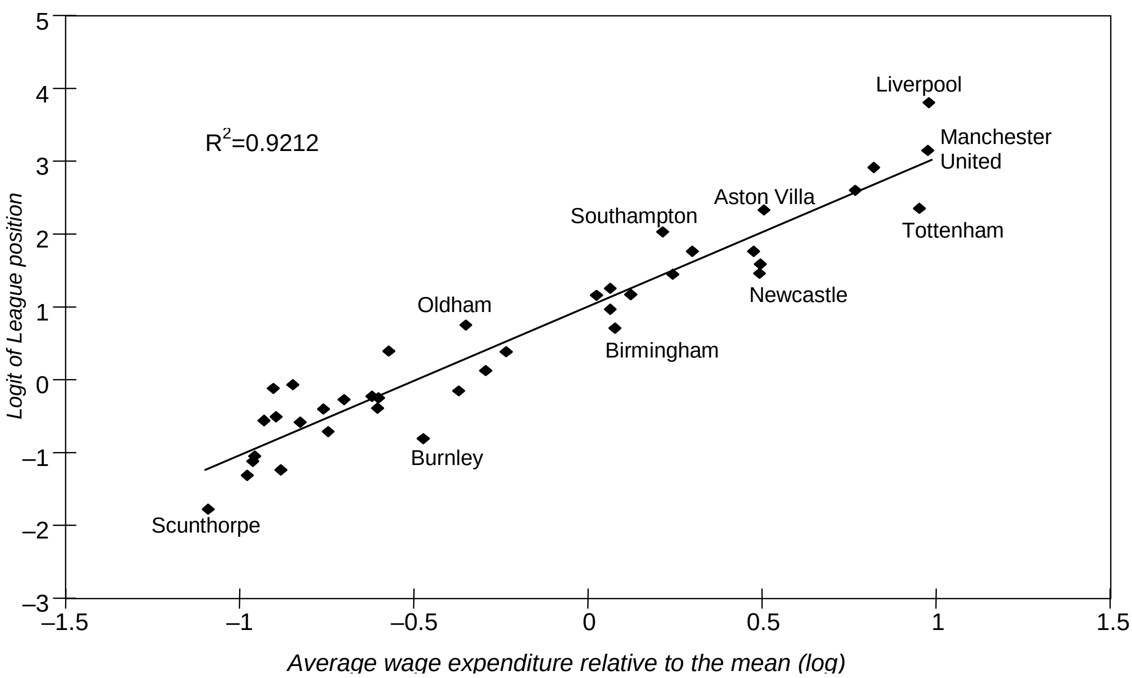
Details omitted. See note on page iv.

]

3.114. The reasonableness of this element of the forecast is illustrated by Figure 3.3, which shows a strong correlation between the level of wages paid by a football club relative to the average level of wages paid in the competition and the relative on-field success achieved by the respective football club, indicated by final league positions, ie the more successful clubs consistently have to pay more in wages than the competition to achieve lasting success in the league.

FIGURE 3.3

Wage expenditure and league position, 39 clubs 1978 to 1996



Source: Szymanski and Kuypers, *Winners and Losers: The Business Strategy of Football*.

3.115. Individual examples can be given of teams that have paid high wages without achieving equivalent success. This indicates that the competence of a club's management is also important in ensuring that the money is spent on the right resources.

3.116. BSkyB told us that Manchester United and BSkyB share a common competence in being able to identify the resources required to manage creative talent. BSkyB suggested that the pool of management skill that it could offer Manchester United means that the merged group will have the appropriate resources to maintain the level of management capability that has been so important in achieving Manchester United's overall success.

3.117. There are two other revenue streams that are important in valuing Manchester United and in part reflect BSkyB's knowledge of the pay TV industry.

3.118. The domestic TV rights are assumed to be sold collectively as in the past. [

Details omitted. See note on page iv.

]

3.119. In respect of revenue from pay-per-view TV, BSkyB also has an advantage in assessing the value of this income stream to Manchester United. As the current holder of the Premier League rights, BSkyB has a special insight into the prospects for pay-per-view TV and indeed has the opportunity, with the agreement of the Premier League, to introduce a pay-per-view TV service itself.

3.120. The pay-per-view TV scenario included in the model adopts a structure for revenue sharing between clubs similar to the revenue-sharing arrangements for TV rights. Beginning in 2000, BSkyB forecast that Manchester United will earn £[✂] million from pay-per-view TV increasing to £[✂] million at the end of the forecast period. This represents around [✂] per cent of the overall valuation.

HSBC Investment Bank valuation paper

3.121. HSBC Investment Bank plc (HSBC) was commissioned by the Manchester United board to produce a valuation paper to assist the directors in their consideration of an offer from BSkyB. This involved an extensive discounted cash flow modelling exercise, plus consideration of comparable companies and transactions in both football clubs, media and leisure companies, bid premia analysis and an assessment of the impact of projections for pay-per-view TV and TV rights.

3.122. The operational assumptions used were based initially on the Manchester United three-year plan (approved by the Manchester United board) which was discussed in detail with Manchester United management. HSBC then extrapolated the projections beyond the forecast period, again discussing and agreeing the assumptions with Manchester United.

3.123. In its report to the Manchester United board, HSBC calculated a valuation of the existing operations of Manchester United and added a risk-adjusted valuation for the upside potential that Manchester United offered from pay-per-view TV [*Details omitted. See note on page iv.*]. These elements together formed HSBC's 'base case' valuation. HSBC provided an additional incremental valuation which incorporated work performed by consultants that estimated the potential additional revenues receivable by Manchester United if they controlled their own TV rights (domestic, international and pay-per-view TV) rather than these rights being sold by the Premier League. We discuss this issue in paragraph 3.134.

3.124. The valuation of the existing operations ('the base value') was the most comparable to the valuation prepared by BSkyB. We considered carefully the reason for the difference between the valuations (being [✂]p per share by BSkyB and [✂]p per share by HSBC).

3.125. Using the information from BSkyB and HSBC we arranged, where necessary, the cash flows into common categories and discounted the cash flows at the same discount rate used by the companies. Table 3.14 shows the cash flow items side by side on a pence-per-share basis, to facilitate comparison.

TABLE 3.14 **Comparison of the component values of the Manchester United valuation**

	pence per share		
	BSkyB	*HSBC*	*Difference*
Gate receipts:			
Existing capacity			
Expanded capacity			
TV rights:			
Premier League			
European competitions			
Other			
Share of MUTV			
Pay-per-view TV			
Merchandising			
Catering			
Sponsorship			
Other revenue			
Players' wages and bonuses			
Cost of sale—merchandising and catering			
Other costs			
Player transfers			
Tax			
Planned and ongoing capital expenditure			
Stadium expansion capital expenditure			
Change in working capital			
Terminal value			
Cash on hand			
Value per share			

Figures omitted. See note on page iv.

Source: MMC calculations based on information from BSkyB and HSBC.

3.126. We identified the major cause of the differences in the valuations to be the different forecasts of on-field success and players' wages.

Details omitted. See note on page iv.

] HSBC forecast that [*Details omitted. See note on page iv.*]; the club will on average finish fourth in the Premier League championship, and in the UEFA Cup competition progress through to the semi-final stage.

3.127. The effect of this difference compounds through the other cash flows. For example, the financial rewards of competing in the European Champions' League (as forecast by BSkyB to be every year except 2000) are much greater than those available from the UEFA Cup.

3.128. Similarly, looking at the sponsorship income estimates, HSBC forecast [✄] nominal terms ([✄] per cent a year average over the forecast period). BSkyB's model forecasts sponsorship growth of [✄] per cent a year. This is consistent with the value of consistent success and the increased exposure through pay-per-view TV. Historical growth rates in sponsorship income have been in excess of 20 per cent per annum over the last five years.

3.129. On pay-per-view TV, BSkyB's model included the value of income from this source under a collective Premier League scenario, as discussed in paragraph 3.120. Pay-per-view TV was not part of the base value in the HSBC model but was included in the HSBC 'base case' valuation by way of an incremental valuation (not included in Table 3.14) of potential pay-per-view TV revenues which, prior to any adjustment for risk, was quite similar to that in BSkyB's model.

3.130. Finally, in calculating a terminal value in the model, BSkyB forecast a perpetual cash flow growth rate of [✄] per cent whereas HSBC used [✄] per cent. This forecast in isolation accounts for a difference of [✄]p per share in the valuation. The actual average growth rate of cash flows over the last five years of the forecast periods in the BSkyB model was [✄] per cent a year, and [✄] per cent a year in the HSBC model.

3.131. Other financial forecasts that we received from Manchester United were generally, in our view, reasonable and conservative. HSBC's base valuation therefore seems to adopt the conservative approach that the Manchester United management prefer when estimating future financial performance.

3.132. The HSBC model provided a valuable reference point on which to assess the BSkyB valuation. As we have explained above, there are clear reasons for the difference in valuations by each party.

3.133. Other reference work that we carried out compared the major profit and loss items in the BSkyB model with recent forecasts made by analysts that covered Manchester United. Again we found reasonable explanations for the differences in the forecasts made by each party.

Potential value to Manchester United from control over TV rights

3.134. As mentioned in paragraph 3.123, the HSBC valuation paper included an additional incremental valuation of additional revenues if Manchester United controlled TV rights individually. This valuation was based on work by Spectrum that was commissioned by Manchester United. Manchester United provided us with a copy of Spectrum's report.

3.135. In order to evaluate the potential bid, Manchester United asked Spectrum to assess the effect on Manchester United's revenues were they, rather than the Premier League, to control Manchester United's TV rights (however, Manchester United did not inform Spectrum about the potential bid). Manchester United was looking for a balance between maximizing potential revenue and an understanding of the practical options and risk of pursuing different strategies. This analysis showed that Manchester United would be considerably better off financially selling its rights individually rather than collectively, particularly if Premier League matches were broadcast on pay-per-view TV.

3.136. HSBC took this analysis and calculated the incremental value of Manchester United from individual control of each category of TV rights. This value was between [✄]p and [✄]p per share in aggregate. The significance of this analysis is that there is other potential value of Manchester United that has not been included by BSkyB in its cash flow model. The Spectrum and HSBC work on upside potential show that there are other aspects of Manchester United that may provide future value to the acquisition. [*Details omitted. See note on page iv.*]

Other issues

The contribution to Manchester United's financial position from participation in the Premier League

3.137. Manchester United provided a breakdown of financial information that showed that 74 per cent of the operating profit in 1998 was derived from competing in the Premier League and associated activities. Table 3.15 shows a breakdown of the 1998 operating profit between domestic and European earnings. In essence the Premier League is its core activity with European competition income providing a high-margin addition to the core operating profits.

TABLE 3.15 **Breakdown of Manchester United's operating profit for 1998**

£ million

	Domestic	*European*	*Total*
Gate receipts	27	3	30
TV	10	6	16
Sponsorship and advertising	12	-	12
Conference and catering	6	-	6
Merchandise and other	24	-	24
Turnover	79	9	88
Cost of sales	(21)	(1)	(22)
Operating expenses	(38)	(1)	(39)
Operating profit	20	7	27
Operating profit as a percentage of total operating profit (%)	74	26	100

Source: Manchester United, MMC calculations.

3.138. Manchester United commissioned Deloitte to compare the impact on existing profits if Manchester United were to play in an alternative European League. This scenario was based on proposals being put forward by Media Partners during 1998 and used information available in the public domain and from the Premier League commissioned report 'Super Leagues & Super Clubs' prepared by sports media consultants Oliver and Ohlbaum.

3.139. The result of the analysis was that had Manchester United played in an alternative European League, its profit would have been equivalent to [✄] per cent of the actual 1998 result.

3.140. Deloitte also calculated an alternative base case that incorporated the draft revised UEFA proposals for the European Champions' League that had been published shortly before the date of the report. In this case, Deloitte assumed that Manchester United would compete in both the European Champions' League and the Premier League as presently organized. Using the same success outcomes as Manchester United achieved in 1998, Deloitte estimated that operating profits would be [✄] per cent higher than the actual 1998 results. This would increase the gap between what Manchester United could derive from participating in the Premier League (and qualifying for the European Champions' League) and withdrawing from the Premier League and participating solely in an alternative European competition of high quality.

3.141. Deloitte concluded in the report that, notwithstanding the uncertainty as to whether there would be an appropriate alternative competition in which Manchester United could compete, the net negative financial impact on Manchester United that would result from its leaving the Premier League leads to serious doubt as to whether such a course of action would be seriously considered. Manchester United also added that, in the event of their leaving the Premier League, it believed that Manchester United's supporter base would erode over time and also that there would be difficulty in recruiting and retaining top-class players.