Part II

Background and evidence

3 The background to the proposed transfers and the companies involved

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Introduction

3.1. This chapter deals with the events leading up to the references of the proposals to transfer the newspaper titles and related assets of Newscom to one of three potential bidders, namely Newsquest, Johnston and Trinity Mirror. It also describes the parties involved, their financial performance and details of the respective approaches to Newscom made by the potential bidders.

3.2. An acquisition of Newscom's titles would involve the transfer of 4 daily newspapers, 41 paid-for weekly newspapers and 52 free weekly newspapers. A list of all Newscom's titles as at 10 December 1999 and their circulation/distribution is set out in Appendix 3.1.

Events leading up to the references

3.3. Over recent years there has been considerable consolidation of the regional and local press in the UK. This process has also witnessed a greater degree of focus by the participants and the pursuit of cost reductions and efficiency gains.

3.4. The current three-way potential bid situation was instigated by Newsquest, which declared in December 1999 that it was interested in bidding for Newscom. This provoked Johnston Press and Trinity Mirror into declaring that they would also like to be considered as potential acquirers of Newscom.

3.5. Around February 1999 Newsquest had had informal discussions with Newscom about the possibility of a merger. However, these talks had come to nothing and as far as Newscom was concerned the matter was considered closed.

3.6. Then in March 1999, as part of a strategy for delivering shareholder value, Newsquest, prompted by its major shareholders, engaged financial advisers to explore the possibility of arranging a trade sale of itself. This culminated in the acceptance of an offer from Gannett, owner of *USA Today*, which was declared unconditional in July 1999.

3.7. In October 1999 the management of Newsquest (with the agreement and support of Gannett) approached Newscom in order to explore the possibility of a merger but were told by Newscom that the matter was considered closed. However, on 24 November Gannett made a further approach to Newscom, indicating that Gannett would be willing to make a recommended offer of £[✂] a share for Newscom. This would have valued Newscom at £[✂] million. Newscom responded that this proposal was not an adequate basis on which to enter into further discussions as the suggested price significantly undervalued the company.

3.8. On 10 December 1999 Gannett publicly announced that it had approached Newscom and expressed its interest in making an offer to acquire the company and that, since any offer would be conditional upon the consent of the Secretary of State, it had decided to seek such consent.

3.9. Following this announcement, Johnston and Trinity Mirror both independently contacted Newscom and then announced that they were also seeking consent from the Secretary of State to a transfer of the assets and titles of Newscom. The proposed transfer in respect of Newsquest was referred to the Commission on 16 December 1999 and those in respect of Johnston and Trinity Mirror on 21 December 1999.

The companies

3.10. Newscom, Johnston and Trinity Mirror are all public companies listed on the London Stock Exchange. As at 28 January 2000 their market capitalizations were £352 million, £641 million, and £2.2 billion respectively. As explained in paragraph 3.6, Newsquest has been owned by Gannett since July 1999. Gannett is a quoted US corporation. Its market capitalization as at 28 January 2000 was $19 billion (£12 billion). In the following paragraphs we consider the history, development and financial position of each of these companies in turn.

3.11. In our financial analysis, in order to present financial data on Newscom, Newsquest, Johnston and Trinity Mirror on a consistent basis, we have restated shareholders' funds as reported by adding back goodwill written off and deducting revaluations of fixed assets (where applicable) in order to arrive at a figure for capital invested for each company. This is in order to eliminate the effect of different accounting treatments adopted by each company. We have used the resulting figure for the purpose of calculating returns on capital invested and gearing ratios.

Newscom

3.12. Newscom was originally incorporated as The Hampshire Advertiser County Newspaper and Printing and Publishing Company Limited in 1864. The name was subsequently changed to Southern Newspapers PLC and in 1998 to News Communications & Media PLC. However, the origins of the company's business go back even further than 1864 to the first publication of the *Southampton Herald and Isle of Wight Gazette* in 1823.

3.13. The company acquired the *Evening Echo* (now the *Southern Daily Echo*) in 1890. The *Bournemouth Evening Echo* (now the *Daily Echo*) was launched in Bournemouth in 1900 and the *Dorset Daily Echo and Weymouth Despatch* (now the *Dorset Echo*) was launched in 1921. The company has grown considerably through a mixture of organic growth and acquisitions but these three newspapers are still at the core of the company's newspaper publishing business, which operates in central, southern and south-western England and South Wales.

3.14. Newscom's activities comprise newspaper and magazine publishing and printing.

3.15. As at 10 December 1999 Newscom published a total of 97 daily and weekly local newspaper titles, making it the seventh largest publisher of local newspapers in the UK. An analysis of all

Newscom's titles by area, frequency and type, including circulation and distribution figures, is set out in Appendix 3.1.

3.16. Newscom's newspaper printing operation, which has been the subject of substantial investment in the last two years, has centres at Redbridge (Southampton), Weymouth and Newport. In addition to printing the group's titles it carries out printing work for third parties. In particular Newscom has a contract from Associated Newspapers to print southern editions of the *Daily Mail* and *Mail on Sunday* until 2004. It also prints copies of the London *Metro* for Associated Newspapers.

3.17. The magazine printing division is based in Poole, Dorset, and at nearby Ferndown and produces high-quality bound magazines and catalogues. This division contributes around a fifth of group turnover and operating profit.

3.18. Newscom's magazine publishing division owns three publications acquired in 1998 and 1999, *Insurance Times*, *Global Reinsurance* and *Portfolio International*.

3.19. Newscom publishes electronic versions of a number of its newspapers on the Internet, with the objective of strengthening and enhancing its printed product. At present these web sites only generate small amounts of revenue, mainly from packaged advertising sales. Newscom also runs a corporate web site and has sites related to its magazine printing and publishing businesses. The latter generates a significant proportion of the group's total revenue attributed to the Internet. Newscom subscribes to a number of independent Internet initiatives—for example Fish4, which is a national database of jobs, motors and property advertisements.

3.20. Newscom floated on the Alternative Investment Market of the London Stock Exchange in 1995 and transferred to the Official List in 1998. The following institutional investors had declared shareholdings above 3 per cent as at 1 January 2000: Rathbone Brothers plc (5.8 per cent), Caledonia Leisure & Media Ltd (5.7 per cent), M&G Investment Management Ltd (4.6 per cent) and Lloyds TSB Group plc (3.2 per cent). Newscom's directors have an interest in approximately 4 per cent of the shares in the company. In addition there are still a large number of historical family interests in the company.

3.21. Newscom's head office is at Redbridge, Southampton, and it has around 2,400 employees in total, of whom some 2,100 full- and part-time staff are employed in the newspaper division.

Financial information on Newscom

3.22. Profit and loss accounts for Newscom for each of the five years ended 30 June 1999 are set out in Table 3.1.

TABLE 3.1 **Newscom: group profit and loss accounts, 1995 to 1999**

£ million

	Years ended 30 June				
	1995	*1996*	*1997*	*1998*	*1999*
Turnover	84.8	88.9	105.4	127.9	139.1
Cost of sales	(56.2)	(59.9)	(69.9)	(80.7)	(85.4)
Gross profit	28.6	29.0	35.5	47.2	53.7
Distribution costs	(7.6)	(7.6)	(9.4)	(10.6)	(12.7)
Administrative expenses	(10.5)	(10.6)	(11.8)	(15.6)	(17.3)
Other operating income	0.9	0.8	0.9	0.8	0.4
Operating profit	11.4	11.6	15.2	21.8	24.1
Other income	0.0	0.7	0.3	1.6	0.2
Exceptional items	0.0	6.7	0.8	4.3	0.7
Profit before interest and tax	11.4	19.0	16.3	27.7	25.0
Net interest receivable/(payable)	0.1	(0.2)	(2.2)	(3.7)	(4.4)
Profit before tax	11.5	18.8	14.1	24.0	20.6
Taxation	(3.0)	(2.9)	(1.5)	(5.5)	(5.8)
Profit after tax	8.5	15.9	12.6	18.5	14.8
Dividends	(3.7)	(4.2)	(4.9)	(5.7)	(6.4)
Retained profit	4.8	11.7	7.7	12.8	8.4
					number
Average number of employees	1,617	1,639	1,899	2,207	2,409
					pence
Underlying earnings per share	35.8	38.0	48.1	53.4	58.0
					per cent
Performance indicators					
Change in earnings per share	22.6	6.1	26.6	11.0	8.6
Return on sales*	13.4	13.0	14.4	17.0	17.3

Source: Newscom statutory accounts.

*Based on operating profit.

3.23. Between 1995 and 1999 turnover increased by £54 million, or 64 per cent, from £85 million to £139 million. Around £30 million of this increase in turnover can be attributed to the acquisitions of South Wales Argus Ltd in November 1996 and Bailey Newspaper Group Ltd in December 1997.

3.24. Underlying earnings per share, which excludes exceptional items, has risen from 1995 to 1999 by between 6 and 27 per cent each year. Return on sales rose from around 13 per cent in 1995 and 1996 to 17.3 per cent in 1999.

3.25. A breakdown of the different sources of turnover within Newscom's newspaper publishing and printing business for the years ended 30 June 1998 and 1999 is given in Table 3.2.

TABLE 3.2 **Newscom: analysis of turnover**

	Years ended 30 June		
	1998 £m	*1999 £m*	*1999 %*
Newspaper publishing			
Advertising	72.6	78.4	56.3
Newspaper sales	13.7	14.5	10.4
Leaflet distribution	3.2	3.7	2.7
Other	4.3	4.8	3.5
	93.8	101.4	72.9
Contract printing	3.7	4.3	3.1
Magazine printing	29.4	30.2	21.7
Magazine publishing	-	2.7	1.9
Other	1.0	0.5	0.4
	127.9	139.1	100.0

Source: Newscom management accounts.

3.26. Newscom's newspaper publishing division accounts for almost three-quarters of group turnover, the remainder being mainly attributable to contract printing (newspapers and magazines). In 1999 some 77 per cent of revenue from newspaper publishing was attributable to advertising compared with 14 per cent from newspaper sales. The remaining 9 per cent arose from leaflet distribution and other sources (for example readers' offers).

3.27. Balance sheets for Newscom for each of the five years ended 30 June 1999 are set out in Table 3.3.

TABLE 3.3 **Newscom: group balance sheets, 1995 to 1999**

£ million

	As at 30 June				
	1995	*1996*	*1997*	*1998*	*1999*
Intangible assets*	-	-	-	-	9.8
Tangible assets	53.9	75.2	87.0	85.5	88.3
Working capital excluding net borrowings	(1.5)	(0.8)	(0.1)	(2.3)	3.9
Net operating assets	52.4	74.4	86.9	83.2	102.0
Investments	0.3	0.3	0.4	0.3	0.7
(Borrowings) less cash	(0.8)	(10.0)	(38.8)	(57.0)	(65.5)
Creditors less debtors due after one year	1.7	1.6	1.8	1.7	1.8
Provisions for liabilities and charges	(0.4)	(0.8)	(0.1)	0.0	(1.7)
Net assets	53.2	65.5	50.2	28.2	37.3
Financed by					
Share capital	23.9	24.1	24.2	24.3	24.4
Reserves	29.3	41.4	26.0	3.9	12.9
Shareholders' funds	53.2	65.5	50.2	28.2	37.3
Goodwill written off	15.7	15.7	39.3	73.8	73.9
Revaluation reserve	(7.6)	(6.9)	(6.8)	(4.9)	(2.8)
Capital invested†	61.3	74.3	82.7	97.1	108.4
					per cent
Performance ratios					
Return on average net operating assets‡	23.1	18.3	18.8	25.6	26.0
Return on average capital invested§	19.7	27.7	18.0	26.7	20.0
Gearing¶	1.3	11.9	31.9	37.0	37.7

Source: Newscom statutory accounts.

*Intangible assets represent publishing titles acquired. Before 1999 they were written off directly to reserves.
†See paragraph 3.11.
‡Based on operating profit.
§Based on profit before tax.
¶Debt divided by debt plus capital invested.

3.28. Return on average net operating assets fell from 23.1 per cent in 1995 to 18.3 per cent in 1996, before increasing to 26.0 per cent in 1999. Return on average capital invested has fluctuated between 18.0 per cent in 1997 and 27.7 per cent in 1996. Gearing has increased each year from 1.3 per cent in 1995 to 37.7 per cent in 1999. This reflects the cost of a succession of acquisitions in the last five years and capital expenditure on new printing presses.

Gannett

3.29. Gannett is a US corporation, which primarily publishes newspapers and operates television channels. It operates in 45 states in the USA, where it publishes around 75 daily newspapers with a combined circulation of more than 6.7 million. Gannett owns *USA Today*, which has a circulation of around 2.2 million, making it the USA's largest selling daily newspaper. *USA Today* is also available in 60 countries around the world.

3.30. In 1998 Gannett had a turnover of $5.1 billion and net income after tax of $1 billion. It is a public company quoted on the New York Stock Exchange. As at 18 December 1999 the following share-holders held more than 3 per cent of the issued share capital of Gannett: Regents of the University of California (3.79 per cent), Wellington Management Company (3.66 per cent), Tukman Capital Management Inc (3.2 per cent) and Barclays Global Investors NA (3.13 per cent). As stated in paragraph

3.10, at 28 January 2000 Gannett had a market capitalization of $19 billion. Gannett's headquarters are in Arlington, Virginia and it employs 39,400 people worldwide.

3.31. As explained in paragraph 3.6, in July 1999 Gannett acquired Newsquest for a consideration of £904 million ($1.4 billion) funded out of borrowings. This acquisition was Gannett's first significant investment outside the USA. Gannett told us that it had been approached by the major shareholders of Newsquest and that the acquisition was only undertaken once Gannett had been satisfied regarding the competence of Newsquest's management and the willingness of particular individuals to remain with the company following the proposed acquisition.

Financial performance of Gannett

3.32. Summarized financial highlights showing the profitability of Gannett over the five years ended 31 December 1998 are set out in Table 3.4 and considered briefly in the following paragraphs.

TABLE 3.4 **Gannett: profitability, 1994 to 1998**

$ billion

	Years ended 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover	3.6	3.7	4.4	4.7	5.1
Operating income	0.8	0.8	1.1	1.3	1.4
Income before income taxes (recurring)	0.8	0.8	0.9	1.2	1.4
Net income	0.5	0.5	0.9	0.7	1.0
Average shareholders' equity*	1.9	2.0	2.5	3.2	3.7
					per cent
Performance indicators					
Return on sales†	22.2	22.0	24.1	27.8	28.2
Return on average shareholders' equity‡	41.0	39.0	36.7	37.7	36.6

Source: Gannett published accounts.

*Shareholders' equity includes goodwill arising on acquisitions, which is amortized over 40 years.
†Based on operating income.
‡Based on income before income taxes (recurring).

3.33. Between 1994 and 1998 Gannett's turnover increased by 42 per cent from $3.6 billion to $5.1 billion. Over the same period its operating income increased by 75 per cent from $0.8 billion to $1.4 billion. Return on sales increased from around 22 per cent in 1995 and 1996 to 28.2 per cent in 1998. Return on average shareholders' equity fell from 41.0 per cent in 1994 to around 37 per cent in 1996, 1997 and 1998.

3.34. Table 3.5 analyses the turnover of Gannett in the year ended 31 December 1998 between various sources and shows the proportion of revenue attributable to each source.

TABLE 3.5 **Gannett: analysis of turnover by source, year ended 31 December 1998**

	Turnover	
	$bn	*%*
Newspaper advertising	2.9	56.9
Newspaper sales	1.0	19.6
Broadcasting	0.7	13.7
Cable and security	0.3	5.9
Other	0.2	3.9
	5.1	100.0

Source: Gannett published accounts.

3.35. In 1998 over three-quarters of Gannett's turnover was attributable to newspaper publishing and of that some three-quarters arose from advertising and one-quarter from newspaper sales. Gannett has recently disposed of its cable and security interests.

Newsquest

3.36. Newsquest was formed in January 1996 in order to effect a management buyout of Reed Regional Newspapers Ltd (RRN). RRN was a subsidiary of Reed Elsevier plc (Reed Elsevier), which had first established its regional newspaper business by acquiring the Worcester-based Berrows Organisation from News International in 1981.

3.37. Reed Elsevier subsequently made a series of acquisitions and disposals of local newspapers but for strategic reasons decided to sell RRN, which led to a successful bid by RRN's management, with the backing of Kohlberg Kravis Roberts & Co (KKR), a US private equity partnership.

3.38. Newsquest subsequently acquired Westminster Press in December 1996, which transaction virtually doubled its size. In October 1997 Newsquest floated on the London Stock Exchange, thereby raising £100 million, which was used to reduce borrowings. In October 1997 Newsquest also sold its Wessex newspaper publishing business for £35 million (including indebtedness) to Bristol United Press plc.

3.39. Some further small acquisitions were made in 1998 and in July 1999, as explained in paragraphs 3.6 and 3.31, Newsquest was acquired by Gannett for a consideration of £904 million. As a consequence Newsquest became a subsidiary of a much larger and financially more powerful group.

3.40. Newsquest publishes 186 local newspaper titles in England, including 11 paid-for daily newspapers, making it the third largest publisher of local newspapers in the UK. An analysis of the circulation and distribution of titles owned by Newsquest by area, type and frequency is set out in Appendix 3.2. Newsquest also publishes electronic versions of all its newspapers on the Internet. Newsquest said that at present this activity is primarily aimed at supporting and protecting the company's local franchises supplying news, information and classified advertising and developing this new market, rather than generating significant revenues. Newsquest also has interests in a classified advertising web site, a dating web site and an e-commerce web site.

3.41. Newsquest's head office is in Morden, Surrey. It operates eight newspaper printing plants and it employs approximately 5,800 staff.

Financial information on Newsquest

3.42. Profit and loss accounts for Newsquest for each of the five years ended 31 December 1999 are set out in Table 3.6.

TABLE 3.6 **Newsquest: group profit and loss accounts, 1995 to 1999**

£ million

	Years ended 31 December				
	1995	*1996*	*1997*	*1998**	*1999*
Turnover	136.4	144.6	285.6	305.8	316.7
Net operating costs	(115.1)	(120.9)	(214.1)	(224.4)	(224.6)
Operating profit	21.3	23.7	71.5	81.4	92.1
Exceptional items	(2.8)	(9.6)	(7.5)	(4.8)	(29.3)
Net profit before interest and tax	18.5	14.1	64.0	76.6	62.8
Net interest receivable/(payable)	0.3	(17.1)	(32.5)	(15.6)	(29.6)
Profit/(loss) before tax	18.8	(3.0)	31.5	61.0	33.2
Taxation	(5.7)	0.6	(11.9)	(19.2)	(15.3)
Profit/(loss) after tax	13.1	(2.4)	19.6	41.8	17.9
Dividends	(195.0)	0.0	0.0	(11.8)	0.0
Retained profit/(loss)	(181.9)	(2.4)	19.6	30.0	17.9
					number
Average number of employees	†	3,265	5,828	5,743	5,890
					pence
Adjusted diluted earnings per share‡	§	§	17.7	22.5	§
					per cent
Performance indicators					
Return on sales¶	15.6	16.4	25.0	26.6	29.1

Source: Newsquest statutory accounts (1999 figures per unaudited management accounts).

*1998 was a 53-week accounting period.
†Not available.
‡Adjusted for exceptional items to give an indication of underlying performance.
§Not applicable. Newsquest floated in 1997 and was acquired by Gannett in 1999.
¶Based on operating profit.

3.43. Between 1995 and 1999 turnover increased by £180.3 million, or 132 per cent, from £136.4 million to £316.7 million. The significant increase in turnover and profits in 1997 was largely due to the acquisition of Westminster Press.

3.44. Return on sales has risen each year from 15.6 per cent in 1995 to 29.1 per cent in 1999.

3.45. A breakdown of the different sources of turnover within Newsquest for the years ended 31 December 1998 and 1999 is given in Table 3.7.

TABLE 3.7 **Newsquest: analysis of turnover**

	Years ended 31 December		
	1998 £m	*1999 £m*	*1999 %*
Newspaper publishing			
Advertising	249.4	253.7	80.1
Newspaper sales	37.7	36.7	11.6
Leaflets	11.5	13.0	4.1
Other (including contract printing)	7.2	13.3	4.2
	305.8	316.7	100.0

Source: Newsquest management accounts.

3.46. In 1999 some 80 per cent of turnover was attributable to advertising compared with just under 12 per cent from newspaper sales.

3.47. Balance sheets for Newsquest for each of the five years ended 31 December 1999 are set out in Table 3.8.

TABLE 3.8 **Newsquest: group balance sheets, 1995 to 1999**

£ million

	As at 31 December				
	1995	*1996*	*1997*	*1998*	*1999*
Intangible assets*	31.4	332.4	319.9	329.6	330.5
Tangible assets	39.1	72.1	66.6	67.4	81.4
	70.5	404.5	386.5	397.0	411.9
Working capital excluding net borrowings	5.8	11.7	(6.8)	(33.7)	(35.1)
Net operating assets	76.3	416.2	379.7	363.3	376.8
(Borrowings) less cash	3.1	(325.7)	(174.0)	(133.6)	8.6
Long-term debtors after one year	0.0	4.9	3.0	1.9	0.0
Provisions for liabilities and charges	(2.6)	(5.5)	(4.5)	(5.2)	(10.2)
Net assets	76.8	89.9	204.2	226.4	375.2
Financed by					
Share capital and reserves	(73.4)	89.9	204.2	226.4	256.0
Inter-company balances	150.2	0.0	0.0	0.0	119.2
Shareholders' funds	76.8	89.9	204.2	226.4	375.2
Goodwill written off	0.0	63.5	65.4	65.4	65.4
Capital invested†	76.8	153.4	269.6	291.8	440.6
					per cent
Performance ratios					
Return on average net operating assets‡	28.4	9.6	18.0	21.9	24.9
Return on average capital invested§	25.5	(2.6)	14.9	21.7	9.1
Gearing ratio¶	N/A¤	68.9	39.7	31.6	N/A¤

Source: Newsquest statutory accounts (1999 figures per unaudited management accounts).

*Intangible assets represent publishing rights and titles acquired.
†See paragraph 3.11.
‡Based on operating profit.
§Based on profit/(loss) before tax.
¶Debt divided by debt plus capital invested.
¤Business was a division of a larger entity, hence funded by group.

3.48. The large increase in intangible assets and in borrowings in 1996 was attributable to the acquisition of RRN and Westminster Press. The decrease in borrowings and increase in share capital in 1997 was as a result of Newsquest's flotation on the stock market, raising new equity, and the disposal of its Wessex business.

3.49. Return on average net operating assets fell from 28.4 per cent in 1995 to 9.6 per cent in 1996 and then increased each year to 24.9 per cent in 1999. Return on average capital invested has fluctuated between a low of –2.6 per cent in 1996 and a high of 25.5 per cent in 1995. Gearing was initially quite high following the management buyout in 1996 at 68.9 per cent but subsequently fell significantly, helped by the flotation in 1997 as described in paragraph 3.48.

Johnston

3.50. Johnston traces its origins to a printing business founded in 1765, which acquired *The Falkirk Herald* in 1846. Johnston concentrated on newspaper publishing and printing in Scotland until 1978 when the company made its first acquisition in England. Further acquisitions followed, including most significantly the acquisition of the newspaper business of EMAP in July 1996. This transaction, comprising 65 newspaper titles, virtually doubled the size of the company. Most recently, in July 1999, Johnston acquired PSN for £266 million. This acquisition added a further 35 titles (£71 million of turnover) to Johnston.

3.51. Johnston floated on the London Stock Exchange in 1988. Over the years the relative size of the Johnston family shareholding in the company has decreased. However, the family still holds approximately 28 per cent of the shares in issue. The only other declared shareholdings of 3 per cent or more as at 30 September 1999 were Baillie Gifford & Co (4.6 per cent), Standard Life Assurance Co (3.5 per cent), Legal and General Investment Management Ltd (3.4 per cent) and Threadneedle Investment Managers Ltd (3.1 per cent).

3.52. Johnston is the fourth largest local newspaper publisher in the UK. It currently publishes 179 daily and weekly titles in Scotland and England, including nine daily titles. An analysis of the circulation and distribution of titles owned by Johnston by area, company, type and frequency is set out in Appendix 3.3.

3.53. Johnston's activities are now mainly confined to newspaper publishing and printing. It also publishes electronic versions of many of its newspapers and sells advertising packages combining the printed and electronic version of a title. Johnston has nine printing plants in the UK, some of which carry out contract printing of newspapers for third parties, in addition to printing Johnston's own titles. Johnston's head office is in Edinburgh. The total number of people employed by Johnston is currently around 4,420.

Financial information on Johnston

3.54. Profit and loss accounts for Johnston for each of the five years ended 31 December 1999 are set out in Table 3.9.

TABLE 3.9 **Johnston: group profit and loss accounts, 1995 to 1999**

£ million

	Years ended 31 December				
	1995	*1996*	*1997*	*1998*	*1999*
Turnover	102.4	165.0	212.0	201.7	
Cost of sales	(60.7)	(99.4)	(121.0)	(107.7)	
Gross profit	41.7	65.6	91.0	94.0	
Distribution costs	(6.2)	(12.4)	(16.2)	(16.2)	
Administrative expenses	(18.0)	(24.5)	(29.2)	(26.3)	
Operating profit	17.5	28.7	45.6	51.5	
Exceptional items	(0.9)	0.5	(3.5)	0.5	✄
Profit before interest and tax	16.6	29.2	42.1	52.0	
Net interest receivable/(payable)	0.2	(5.1)	(7.5)	(6.1)	
Profit before tax	16.8	24.1	34.6	45.9	
Taxation	(5.4)	(7.3)	(10.4)	(14.3)	
Profit after tax	11.4	16.8	24.2	31.6	
Dividends	(3.2)	(5.1)	(6.2)	(7.2)	
Retained profit	8.2	11.7	18.0	24.4	
					number
Average number of employees	2,238	3,746	4,573	4,078	5,000
					pence
Headline earnings per share*	8.42	9.76	13.09	15.73	[✄]
					per cent
Performance indicators					
Increase in earnings per share	11.2	15.9	34.1	20.2	✄
Return on sales†	17.1	17.4	21.5	25.5	

Source: Johnston statutory accounts (1999 figures per unaudited management accounts).

*Adjusted to exclude exceptional items and abortive acquisition costs.
†Based on operating profit.

3.55. The acquisition of EMAP's newspaper business in July 1996 resulted in a substantial increase in turnover and profits in 1996 and 1997. The fall in turnover (and employees) in 1998 was largely attributable to the disposal of Johnston's bookbinding and bookselling operations in September 1997.

3.56. Headline earnings per share has increased each year from 8.42p in 1995 to [✄]p in 1999. Similarly return on sales has increased each year from 17.1 per cent in 1995 to [✄] per cent in 1999.

3.57. A breakdown of the different sources of turnover within Johnston's business for the years ended 31 December 1998 and 1999 is given in Table 3.10.

TABLE 3.10 **Johnston: analysis of turnover from newspaper publishing and printing, and other activities**

	Years ended 31 December		
	1998	*1999*	*1999*
	£m	*£m*	*%*
Newspaper publishing			
Advertising	154.5		
Newspaper sales	18.5		
Leaflets/other	7.1		
	180.1	✂	✂
Contract printing	7.9		
Wholesale stationery	9.8		
Other	3.9		
	201.7		

Source: Johnston management accounts.

3.58. Newspaper publishing accounts for [✂] per cent of group turnover, the remainder mainly being attributable to contract printing and the sale of wholesale stationery (business now sold). In 1999 some [✂] per cent of revenue from newspaper publishing was attributable to advertising compared with [✂] per cent from newspaper sales. The remaining [✂] per cent arose from leaflet distribution and other sources (for example readers' offers).

3.59. Balance sheets for Johnston for each of the five years ended 31 December 1999 are set out in Table 3.11.

TABLE 3.11 **Johnston: group balance sheets, 1995 to 1999**

£ million

	As at 31 December				
	1995	*1996*	*1997*	*1998*	*1999*
Intangible assets	14.9	206.4*	206.4	217.3	
Tangible assets	28.6	44.5	46.9	48.0	
	43.5	250.9	253.3	265.3	
Working capital excluding net borrowings	6.4	9.7	(6.0)	(9.9)	
Net operating assets	49.9	260.6	247.3	255.4	
Investments	0.6	0.6	0.8	0.4	
(Borrowings) less cash	(15.7)	(116.2)	(86.4)	(69.0)	
Creditors less debtors due after one year	2.0	2.1	1.2	1.5	
Provisions for liabilities and charges	(2.8)	(3.9)	(2.4)	(3.4)	
Net assets	34.0	143.2	160.5	184.9	✂
Financed by					
Share capital	14.5	21.1	21.2	21.2	
Reserves	19.5	122.1	139.3	163.7	
Shareholders' funds	34.0	143.2	160.5	184.9	
Goodwill written off	47.1	58.9	62.3	62.3	
Revaluation reserve	(2.4)	(2.3)	(3.9)	(3.8)	
Capital invested†	78.7	199.8	218.9	243.4	
					per cent
Performance ratios					
Return on average net operating assets‡	41.9	18.5	18.0	20.5	
Return on average capital invested§	22.6	17.3	16.5	19.9	✂
Gearing¶	16.6	36.8	28.3	22.1	

Source: Johnston statutory accounts (1999 figures per unaudited management accounts).

*The large increase in intangible assets (representing publishing titles acquired) in 1996 was due to the acquisition of the newspaper interests of EMAP. Intangible assets arising from the value of titles created by the group are not capitalized.

†See paragraph 3.11.

‡Based on operating profit.

§Based on profit before tax.

¶Debt divided by debt plus capital invested.

3.60. Return on average net operating assets fell from 41.9 per cent in 1995 to 18.0 per cent in 1997, before rising to 20.5 per cent in 1998 and falling to [✂] per cent in 1999. Return on average capital invested fell from 22.6 per cent in 1995 to 16.5 per cent in 1997, before rising to 19.9 per cent in 1998 and falling to [✂] per cent in 1999. Gearing increased significantly from 16.6 per cent in 1995 to 36.8 per cent in 1996, as a result of the acquisition of EMAP. Thereafter it fell in 1997 and 1998 to 22.1 per cent but increased in 1999 to [✂] per cent following the acquisition of PSN.

Trinity Mirror

3.61. Trinity Mirror was formed by a merger between Trinity plc (Trinity) and Mirror Group plc (Mirror Group) in September 1999. Trinity Mirror is the largest publisher of local newspapers in the UK. It has a portfolio of 177 daily and weekly newspaper titles having an audited circulation/distribution and 24 weekly titles with no certified circulation/distribution (making 201 daily and weekly titles in total). Of these 4 are national titles and 197 are local and regional titles. In addition Trinity Mirror publishes 14 monthly or fortnightly titles, 3 specialist racing publications and 34 specialist magazines. The group publishes several major national and regional daily and Sunday titles, most notably *The Mirror*. An analysis showing these and the number, location and circulation/distribution of Trinity Mirror's audited weekly newspaper titles is set out in Appendix 3.4.

3.62. Trinity Mirror's head office is in London. It operates 15 newspaper printing plants and employs around 12,000 staff, of whom around 8,000 are involved in local and regional newspapers. The following institutions held more than 3 per cent of the share capital of Trinity Mirror as at 31 December 1999: Phillips & Drew (8.3 per cent), Sanford C Bernstein & Co (5.3 per cent), Capital Group (3.6 per cent), Standard Life Group (3.6 per cent) and Halifax Group (3.1 per cent).

3.63. Although technically Trinity acquired Mirror Group and changed its name to Trinity Mirror, the two companies were of similar size and significance and indeed following the merger Mirror Group shareholders held the majority of shares in the combined group by a small margin. For this reason and because the merger only happened relatively recently, we have chosen to deal with each company as if it were still a separate entity, and then to consider the financial position of the merged group.

Trinity

3.64. Trinity was incorporated as The Liverpool Daily Post and Echo Ltd in 1904. It published the *Daily Post* and the *Liverpool Echo*, respectively a morning and an evening newspaper serving the people of Liverpool and Merseyside. These newspapers had been founded in 1855 and 1879 respectively.

3.65. From 1950 onwards Trinity expanded by acquiring other newspaper publishers in the UK and also in the USA and Canada. In addition it diversified into papermaking and corrugated board and case manufacturing. Trinity sold this business in 1992 and disposed of its Canadian publishing business in 1996 and its US publishing interests in 1998. Meanwhile in 1996 it had made a large and significant UK regional newspaper publishing acquisition, when it acquired part of the business of Thomson Regional Newspapers Ltd (TRN).

3.66. Trinity published approximately 120 local and regional newspapers. Its main daily newspapers were centred in Belfast, Cardiff, Huddersfield, Liverpool, Newcastle and Teesside. Its major paid-for titles included the *Belfast Telegraph*, *The Western Mail* (Cardiff), the *Daily Post* (Liverpool) and *The Journal* (Newcastle). The *Belfast Telegraph* and associated titles in Northern Ireland are currently being sold by Trinity Mirror in order to comply with conditions imposed by the Secretary of State in relation to his consent to the merger between Trinity and Mirror Group.

3.67. Trinity had Internet sites associated with (but not exclusive to) many of its regional newspapers. Following the merger with Mirror Group, Trinity Mirror also has access to an Internet portal (see paragraph 3.77). It hopes that the portal will harness traffic visiting the group's newspaper sites, which can be used to generate revenue streams from advertisers and e-commerce.

Financial information on Trinity

3.68. Profit and loss accounts for Trinity for each of the five years ended 31 December 1998 are set out in Table 3.12.

TABLE 3.12 **Trinity: group profit and loss accounts, 1994 to 1998**

£ million

	Years ended 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover					
UK publishing	109.2	113.4	275.6	299.7	321.3
Discontinued operations (USA and Canada)	55.3	54.5	56.9	25.1	21.1
	164.5	167.9	332.5	324.8	342.4
Cost of sales	(87.8)	(91.7)	(174.7)	(159.3)	(165.7)
Gross profit	76.7	76.2	157.8	165.5	176.7
Trading profit					
UK publishing	20.5	22.4	57.2	70.1	77.9
Discontinued operations (USA and Canada)	5.0	5.1	5.7	4.0	3.2
	25.5	27.5	62.9	74.1	81.1
Exceptional items	-	-	5.7	0.4	13.0
Operating profit	25.5	27.5	68.6	74.5	94.1
Other income	-	-	0.6	-	0.2
Profit before interest and tax	25.5	27.5	69.2	74.5	94.3
Net interest receivable/(payable)	(2.6)	-	(13.0)	(10.4)	(10.6)
Profit before tax	22.9	27.5	56.2	64.1	83.7
Taxation	(6.4)	(9.0)	(17.2)	(20.2)	(20.8)
Profit after tax	16.5	18.5	39.0	43.9	62.9
Minority interests	-	-	-	0.2	0.1
Dividends	(7.4)	(14.8)	(16.3)	(18.3)	(20.2)
Retained profit	9.1	3.7	22.7	25.8	42.8
					number
Average number of employees	3,958	3,903	6,935	6,477	6,519
					pence
Basic earnings per share	21.8	21.5	28.3	31.9	45.4
					per cent
Performance indicators					
Change in earnings per share	19.1	(1.4)	31.6	12.7	42.3
Return on sales*	15.5	16.4	18.9	22.8	23.7

Source: Trinity statutory accounts.

*Based on trading profit.

3.69. Trinity's turnover increased by 108 per cent from £164.5 million in 1994 to £342.4 million in 1998. The large increase in 1996 was attributable to the acquisition of TRN. Over the same period its trading profit grew by 218 per cent from £25.5 million to £81.1 million.

3.70. A breakdown of the different sources of turnover within Trinity's business for the years ended 31 December 1997 and 1998 is given in Table 3.13.

TABLE 3.13 **Trinity: analysis of turnover**

	Years ended 31 December		
	1997 £m	*1998 £m*	*1998 %*
UK newspaper business			
Advertising	204	217	70
Newspaper sales	64	64	21
Contract printing	12	12	4
Other	13	15	5
	293	308	100
Other revenue	32	34	
	325	342	

Source: Trinity.

3.71. In 1998 70 per cent of Trinity's turnover from newspapers came from advertising compared with 21 per cent from newspaper sales.

3.72. Balance sheets for Trinity for each of the five years ended 31 December 1998 are set out in Table 3.14.

TABLE 3.14 **Trinity: group balance sheets, 1994 to 1998**

£ million

	As at 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Intangible assets	79.0	83.8	349.0	354.0	348.5
Tangible assets	52.0	56.7	115.3	117.7	122.7
Working capital excluding net borrowings	6.6	8.4	22.2	(8.7)	(9.5)
Net operating assets	137.6	148.9	486.5	463.0	461.7
Investments	3.0	4.4	6.3	4.7	4.9
(Borrowings) less cash	(38.5)	139.5	(159.2)	(117.6)	(65.8)
Creditors less debtors due after one year	(0.2)	(0.1)	(8.0)	(9.8)	(8.6)
Provisions for liabilities and charges	(5.7)	(3.6)	(10.1)	(10.3)	(12.2)
Net assets	96.2	289.1	315.5	330.0	380.0
Financed by					
Share capital	6.9	13.8	13.8	13.9	13.9
Reserves	89.3	275.3	301.7	316.1	366.1
Shareholders' funds	96.2	289.1	315.5	330.0	380.0
Goodwill written off	23.5	23.5	18.9	31.6	25.9
Revaluation reserve	(6.8)	(6.7)	(5.7)	(5.6)	(5.6)
Capital invested*	112.9	305.9	328.7	356.0	400.3
					per cent
Performance ratios					
Return on average net operating assets†	18.5	19.2	19.8	15.6	17.5
Return on average capital invested‡	21.1	N/A§	17.7	18.7	22.1
Gearing¶	25.4	N/A§	32.6	24.8	14.1

Source: Trinity statutory accounts.

*See paragraph 3.11.
†Based on trading profit.
‡Based on profit before tax.
§The balance sheet was distorted at the year end by a rights issue in advance of the acquisition of TRN (see paragraph 3.65).
¶Debt divided by debt plus capital invested.

3.73. Return on average net operating assets has fluctuated between 15.6 and 19.8 per cent. Return on average capital invested fell from 21.1 per cent in 1994 to 17.7 per cent in 1996, before increasing to 22.1 per cent in 1998. Gearing fell from 32.6 per cent in 1996, following the acquisition of TRN, to 14.1 per cent in 1998.

Mirror Group

3.74. The origin of the newspaper business of Mirror Group goes back more than 100 years. Its main national titles were either established or acquired by the Harmsworth family and eventually formed part of IPC. In 1970 IPC was sold to Reed International plc, which owned it until 1984. In that year Mirror Group was sold to companies controlled by the late Robert Maxwell, who subsequently floated 49 per cent of Mirror Group on the stock market in May 1991. Following the death of Robert Maxwell in November 1991 and the discovery of financial irregularities, administrators were appointed to a number of Maxwell companies, including those that controlled Mirror Group.

3.75. Trading in the shares of the company on the London Stock Exchange, which had been suspended, recommenced in July 1992. In late 1992 the senior management team at Mirror Group was restructured and in September 1993 the administrators sold their controlling shareholding in the company. As a result the company gained a wide range of mainly institutional shareholders.

3.76. Mirror Group subsequently adopted a policy of expansion and diversification, in order to reduce its dependence on *The Mirror* and its other national titles. In November 1997 it acquired Midland Independent Newspapers plc (MIN), which owned 38 regional and local newspaper titles published in the Midlands. MIN also had a specialist magazine publishing business and an exhibitions business. Other investments in television production and broadcasting have subsequently been disposed of.

3.77. Mirror Group had also made substantial investments in the Internet, both on its own and in partnership. It had set up an Internet service provider and Internet portal and had web sites related to the group's major titles and providing on-line betting services and shopping facilities.

3.78. Mirror Group's main national newspaper titles were *The Mirror*, the *Sunday Mirror* and the *Sunday People*. It also owned *Racing Post*, which is a daily newspaper devoted largely to horse racing. In Scotland, Mirror Group owned the *Daily Record*, the *Sunday Mail* and *The Glaswegian*; and in Northern Ireland it owned the *News Letter*, the *North Down News*, the *East Belfast News*, the *Derry Journal* and the *Journal Extra*.

Financial information on Mirror Group

3.79. Profit and loss accounts for Mirror Group for each of the five years ended 31 December 1998 are set out in Table 3.15.

TABLE 3.15 **Mirror Group: group profit and loss accounts, 1994 to 1998**

					£ million
	Years ended 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover	463	512	538	559	697
Cost of sales	(266)	(319)	(336)	(340)	(401)
Gross profit	197	193	202	219	296
Distribution costs	(15)	(17)	(18)	(22)	(36)
Administrative costs	(66)	(69)	(85)	(86)	(130)
Trading profit	116	107	99	111	130
Exceptional items	111	28	13	(7)	13
Operating profit	227	135	112	104	143
Other income/(expense)	(10)	(1)	7	2	(5)
Profit before interest and tax	217	134	119	106	138
Net interest payable	(28)	(27)	(17)	(26)	(38)
Profit before tax	189	107	102	80	100
Taxation	(44)	(24)	(19)	(23)	(33)
Profit after tax	145	83	83	57	67
Dividends	(15)	(17)	(19)	(22)	(24)
Retained profit	130	66	64	35	43
					number
Average number of employees	2,785	2,868	3,290	3,765	5,680
					pence
Earnings per share before exceptional items	16.4	13.4	14.3	15.6	15.6
					per cent
Performance indicators					
Change in earnings per share	16.3	(18.3)	6.7	9.1	0.0
Return on sales*	25.1	20.9	18.4	19.9	18.7

Source: Mirror Group statutory accounts.

*Based on trading profit.

3.80. Mirror Group's turnover had increased by 50 per cent from £463 million in 1994 to £697 million in 1998. Over the same period trading profit had initially fallen from £116 million in 1994 to £99 million in 1996 and had only increased to £130 million by 1998. Return on sales had fallen from 25.1 per cent in 1994 to 18.4 per cent in 1996 and fluctuated around 19 per cent in 1997 and 1998.

3.81. A breakdown of the different sources of turnover within Mirror Group's business for the years ended 31 December 1997 and 1998 is given in Table 3.16.

TABLE 3.16 **Mirror Group: analysis of turnover**

	Years ended 31 December		
	1997	*1998*	*1998*
	£m	*£m*	*%*
Newspaper revenue			
Advertising	213	297	45
Newspaper sales	300	334	50
Other	6	31	5
	519	662	100
Non-newspaper revenue	40	35	
	559	697	

Source: Mirror Group management accounts.

3.82. In 1998 some 45 per cent of Mirror Group's newspaper revenue was derived from advertising and 50 per cent from newspaper sales. This reflected the predominance of national daily newspapers in Mirror Group's portfolio.

3.83. Balance sheets for Mirror Group for each of the five years ended 31 December 1998 are set out in Table 3.17.

TABLE 3.17 **Mirror Group: group balance sheets, 1994 to 1998**

£ million

	As at 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Intangible assets	-	-	-	185	205
Tangible assets	364	361	353	371	360
	364	361	353	556	565
Working capital excluding net borrowings	(52)	(61)	(42)	(59)	(80)
Net operating assets	312	300	311	497	485
Investments	91	45	58	51	69
(Borrowings) less cash	(382)	(309)	(291)	(522)	(489)
Creditors less debtors due after one year	10	(2)	(1)	0	(3)
Provisions for liabilities and charges	(62)	(51)	(39)	(66)	(34)
Net assets/(liabilities)	(31)	(17)	38	(40)	28
Financed by					
Share capital	104	105	105	114	114
Reserves	(135)	(122)	(67)	(154)	(86)
Shareholders' funds	(31)	(17)	38	(40)	28
Goodwill written off	652	703	714	893	244
Revaluation reserve	(637)	(635)	(635)	(635)	(10)
Capital invested*	(16)	51	117	218	262
					per cent
Performance ratios					
Return on average net operating assets†	36.9	35.0	32.4	27.5	26.5
Return on average capital invested‡	N/A§	611.4	121.4	47.8	41.7
Gearing¶	104.4	85.8	71.3	70.5	65.1

Source: Mirror statutory accounts.

*See paragraph 3.11.
†Based on trading profit.
‡Based on profit before tax.
§Capital invested negative.
¶Debt divided by debt plus capital invested.

3.84. Return on average net operating assets had fallen each year from 36.9 per cent in 1994 to 26.5 per cent in 1998. Return on average capital invested had fallen from 611.4 per cent in 1995 to 41.7 per cent in 1998 (see paragraph 3.85).

3.85. Gearing had fallen each year from 104 per cent in 1994 to 65 per cent in 1998. This decline (and the fall in return on average capital invested from very high levels) reflected the rebuilding of

Mirror Group's capital base from nothing following its obligation to make large provisions in respect of unfunded pensions as a result of the financial irregularities associated with Robert Maxwell.

Financial information on Trinity Mirror

3.86. As explained in paragraph 3.61, the merged Trinity Mirror only came into existence in September 1999. There are therefore no published statutory accounts relating to the merged group and there is only a short period during which the two companies have traded as one.

3.87. Trinity Mirror told us that the merged group would have a pro forma turnover of £1.0 billion and a pro forma operating profit of £217 million, based on 1998's results. It also gave us an analysis of pro forma turnover by division on that basis. This is set out in Table 3.18.

TABLE 3.18 **Trinity Mirror: analysis of pro forma turnover, year ended 31 December 1998**

£ million

	Trinity	*Mirror Group*	*Trinity Mirror*
National newspapers	-	397	397
Scottish newspapers	-	110	110
Regional newspapers	311	132	443
Magazines and exhibitions	10	20	30
Sports	-	23	23
	321	682	1,003

Source: Trinity Mirror.

3.88. Table 3.19 sets out the pro forma balance sheet of Trinity Mirror as at 27 June 1999. This was prepared for shareholders in the two companies in connection with their proposed merger.

TABLE 3.19 **Trinity Mirror: pro forma balance sheet, as at 27 June 1999**

£ million

	Trinity	*Mirror Group*	*Adjustments**	*Trinity Mirror*
Fixed assets				
Intangible assets	349	209	1,075	1,633
Tangible assets	130	353	-	483
Investments	4	14	-	14
	483	572	1,075	2,130
Current assets				
Stocks	3	9	-	12
Debtors	66	114	-	180
Cash at bank and in hand	7	34	-	41
	76	157	-	233
Creditors: amounts falling due within one year	(84)	(244)	(30)	(358)
Net current liabilities	(8)	(87)	(30)	(125)
Total assets less current liabilities	475	485	1,045	2,005
Creditors: amounts falling due in more than one year	(59)	(294)	(381)	(734)
Provisions for liabilities and charges	(12)	(33)	-	(45)
Net assets	404	158	664	1,226
Share capital	14	114	(99)	29
Reserves	390	44	763	1,197
Shareholders' funds	404	158	664	1,226

Source: Trinity offer document.

*Adjustments relating to the merger and the funding of it, excluding any fair value adjustments.

3.89. Table 3.19 indicates that the merged Trinity Mirror group has net assets in excess of £1.2 billion, largely accounted for by goodwill arising from the merger. The current and prospective gearing and interest cover of Trinity Mirror is dealt with further in paragraphs 3.110 to 3.113.

The respective approaches to Newscom

3.90. In the following paragraphs we consider various aspects of the respective approaches to Newscom, namely the price that each of the potential bidders might have to pay for Newscom; the synergies that each expects to arise from a transfer of titles arising out of a merger; the way in which each potential bid would be funded; and the effect on the financial position of the potential bidders.

Prospective bid prices

3.91. As explained in paragraph 3.7, Gannett indicated privately to Newscom on 24 November 1999 that it would be willing to make an offer for Newscom at £[✂] a share, valuing Newscom at £[✂]. The board of Newscom dismissed this proposal of an offer as inadequate. Although each of the potential bidders indicated that they would be interested in making an offer they all decided to seek clearance for the transfers first. None of the potential bidders indicated to us what price or what maximum price they would be willing to pay.

3.92. However, as at 28 January 2000 the share price of Newscom was £14.375, suggesting that (in the absence of unforeseen circumstances) a price per share [✂] would have to be paid by any party wishing to gain control of Newscom. At a share price of £14.375 Newscom's stock market value is £352 million. However, taking into account existing share options and Newscom's borrowings (estimated by the parties at between £50 million and £60 million) this implies an enterprise value of around £410 million and a total cost including stamp duty and fees to advisers somewhat higher than that.

3.93. The actual price for Newscom would depend primarily on the level of synergies identified by the bidding parties and the amount of competition in the bidding process. All the potential bidders had carried out analyses to show the impact of an acquisition on their earnings given various assumptions about synergies and financing structures. We consider these matters in the following paragraphs.

Synergies

3.94. We asked each of the potential bidders for their estimate of the amount and source of any synergies and cost savings that they would expect to arise from a merger. We were told that none of them had had access to unpublished information on Newscom. Accordingly their estimates are based on published information and, as such, subject to revision in the light of further and more detailed information. A summary of the total synergies eventually available in a full year identified by each company is set out in Table 3.20 and commented on in the following paragraphs.

TABLE 3.20 **Analysis of synergies**

£ million

	Newsquest	*Johnston*	*Trinity Mirror*
Revenue increases			
Leaflet distribution			
Cost savings			
Elimination of head office			
Eliminations at publishing centres			
Employment costs			
Integration of accounting function			
Purchasing benefits on newsprint		*Figures omitted.*	
Other purchasing benefits		*See note*	
Integration of national advertising sales		*on page iv.*	
Newspaper printing synergies			
Magazine printing synergies			
Representation commission			
Integration of training and personnel functions			
Arising in acquiring company			
Increase in sales (leaflets and national display)			†

Source: Submissions from the companies.

*Identified by the companies as areas where synergies would arise, but the extent of them was not quantified.
†See paragraph 3.95.

3.95. To a certain extent comparability is hampered by the different ways in which each of the potential bidders analysed the synergies that they would expect to arise and the varying depths of their investigations. Trinity Mirror said that in the light of the lack of information it had taken a broad view of the likely synergies and the areas in which it believed they could be achieved. Trinity Mirror believed that synergies might be in the region of £[✂].

3.96. The potential bidders all agreed that savings would arise from the elimination of head office costs, listed company status and duplicated accounting and other back-office functions (at a central and local level). Neither Johnston nor Trinity Mirror saw any significant scope for increasing sales as a consequence of the merger.

3.97. A large element of Newsquest's cost savings are attributed to lower employment costs (£[✂]). However, this figure was based on a very broad comparison of levels of turnover per employee for the publishing businesses of Newscom and Newsquest. This indicated that Newscom might have around 220 more employees than it needed. However, following a review of costs, Newscom had already reduced staff levels by over 200 by 31 December 1999. It therefore appears unlikely that any significant further reduction in headcount would be possible on this basis.

3.98. Newsquest's synergy figures also include a large decrease in newsprint costs. It told us that Gannett was the largest single consumer of newsprint in the world and that consequently there were real prospects of large savings on newsprint prices. Newsquest also emphasized to us its need for extra printing capacity so that it could reduce its reliance on contract printers. Newscom had spare capacity and hence this was an area where savings should arise. Likewise Johnston said that Newscom's modern colour presses in Southampton would enable it to bring more printing in-house and to enhance its existing titles, in cases where location of presses was not a key factor in newspaper production (primarily on weekly titles).

3.99. [*Details omitted. See note on page iv.*] Trinity Mirror identified Newscom's magazine printing division as an area where it would derive synergies. It also said that it would derive synergies from integrating the national advertising sales function at Newscom with its in-house national sales operation, AMRA. [*Details omitted. See note on page iv.*]

Funding of the proposed acquisitions

3.100. We asked each of the companies how they would fund any acquisition of Newscom and to provide us with financial models showing the impact of the acquisition of Newscom on their businesses.

3.101. Newsquest said that it would fund the acquisition out of borrowings by Gannett in the USA. This would not present any problems at all since Gannett already had low gearing (see Table 3.21) and its cable and security division had just been sold, leaving Gannett totally debt-free.

3.102. Newsquest's financial model for the acquisition was based on a price per share for Newscom of £[✂] and £[✂] million of synergies. The cost of borrowing was assumed to be [✂] per cent. Under this scenario the acquisition would add £[✂] to Gannett's net income in year [✂] and £[✂] in year [✂].

3.103. Johnston's financial analysis was based on funding the acquisition [*Details omitted. See note on page iv.*]. It assumed £[✂] of synergies and considered three different share prices for Newscom (£[✂], £[✂] and £[✂]) and two different share prices for Johnston (£[✂] and £[✂]). Johnston's share price at 28 January was £3.195. The cost of borrowing was assumed to be [✂] per cent.

3.104. The financial structure adopted had been chosen so as to ensure that Johnston did not breach its interest rate cover covenant of [*Details omitted. See note on page iv.*]. The model showed that the acquisition enhanced earnings [✂] under the worst case scenario (Newscom share price of £[✂] and Johnston share price of £[✂]).

3.105. Johnston told us that it did not think there would be any problem renegotiating its interest cover covenant if necessary and cited Regional Independent Media Holdings Ltd (RIM) as an example of a much more highly leveraged regional newspaper company. However, in this case there would inevitably be a higher interest rate to pay. Johnston also emphasized that it was accountable to its shareholders and was a conservative company. Hence it would not chase Newscom's assets at any price.

3.106. Trinity Mirror told us that the financial structure of its acquisition would depend in part upon the desires of Newscom's shareholders to receive cash, loan notes or shares in Trinity Mirror. Their financial advisers had produced a model which considered two basic structures, [*Details omitted. See note on page iv.*] This was based on a share price for Trinity Mirror of £[✂], compared with £7.215 on 28 January. The cost of debt was assumed to be [✂].

3.107. The model showed the share prices associated with a range of synergy levels and different extents to which the synergy benefits were paid away to Newscom's shareholders. Assuming £[✂] of synergies with an all-cash offer, Trinity Mirror could afford to pay up to £[✂] per Newscom share without diluting earnings, whereas under the cash and shares alternative it could [*Details omitted. See note on page iv.*].

3.108. Trinity Mirror also produced its own assessment of the impact of the acquisition on gearing and interest cover at different prices for Newscom between £[✂] and £[✂]. This was based on £[✂] of synergies and an all-cash offer and also assumed a disposal of the *Belfast Telegraph* and associated titles (see paragraph 3.66). Under the worst case scenario (a Newscom price of £[✂]) Trinity Mirror's gearing would [✂] per cent and interest cover [✂] times.

3.109. Trinity Mirror told us that this was comfortably within its borrowing covenants. In view of its size and the marketability of its shares Trinity Mirror did not foresee that there would be any problem funding a purchase of Newscom. If necessary it would be able to arrange a placing of shares to supplement the amount borrowed.

Gearing and interest cover

3.110. In order to illustrate the effect of each of the proposed mergers on the financial position of Gannett, Johnston and Trinity Mirror respectively, we have produced our own figures for gearing and interest cover for each company before and after a merger. In order to be consistent we have adopted our own definitions of gearing (debt divided by debt plus capital invested) and interest cover (operating profit before exceptional items divided by net interest payable).

3.111. We have also adopted a standard set of assumptions about Newscom and the terms of a merger. These are that a merger is achieved at £15 a share, valuing Newscom's equity at £375 million (based on 25 million shares in issue), and that Newscom has outstanding £77 million of its own debt (actual published figure at 31 December 1999), giving an enterprise value of £452 million. Newscom's operating profit is assumed to be £29 million and synergies accruing to the acquirer £4 million. For all the companies we have used an interest rate on borrowings of 7 per cent. For Gannett we have assumed an exchange rate of £1=$1.60.

3.112. With the exception of Johnston we have assumed that the acquisition would be financed out of borrowings. We have assumed that Johnston would finance the acquisition using [*Details omitted. See note on page iv.*]. Details of the position before a merger have been taken from current information given to us by each of the companies. The financial position of Gannett does not include the proceeds of sale of its cable and security division, which has already occurred. The financial position of Trinity Mirror before and after the merger does not take account of assumed proceeds of £[✂] from the sale of the *Belfast Telegraph* and associated titles, which has not yet occurred.

3.113. The impact of a merger under these conditions on the financial position of each of the potential bidders is summarized in Table 3.21.

TABLE 3.21 **Comparison of the effect of the acquisition of Newscom on each company's gearing* and interest cover**

			per cent
	Gannett	*Johnston*	*Trinity Mirror*
Gearing pre-acquisition	[	✂	]
Gearing post-acquisition			
			times
Interest cover pre-acquisition	[	✂	]
Interest cover post-acquisition			

Source: Commission, based on submissions from the companies.

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*Gearing is calculated as debt divided by debt plus capital invested. Capital invested is shareholders' funds as reported plus goodwill written off less any revaluation of fixed assets.