

2 The companies concerned in the merger

Grand Metropolitan plc

2.1. Grand Met is a major food, drinks and retailing company, with interests in North America and elsewhere, as well as in the United Kingdom. In the year to 30 September 1988 it had a turnover of £6,029 million (£3,835 in the United Kingdom and Ireland), and its profit before tax was £575 million. Average capital employed was £4,023 million.

2.2. The company originated with a hotel business called MRMA Ltd which was incorporated in England in 1934, and became Grand Metropolitan Hotels Ltd in 1962. In the later 1960s it moved into the industrial catering business, and acquired Express Dairy Ltd and Berni Inns Ltd in 1969 and 1970 respectively.

2.3. Grand Met made further large acquisitions in the early 1970s, entering the entertainment and drinks businesses through purchase of Mecca (see paragraph 2.7), and the brewery companies Truman, Hanbury and Buxton Ltd and Watney Mann Ltd. At that time it changed its name to Grand Metropolitan Ltd.

2.4. The 1980s brought further growth, notably by the acquisition of Liggett Group Inc (for its wines and spirits), Warner Holidays Ltd, a group of three hotels in Paris, InterContinental Hotels Corporation, Heublein Inc (wines and spirits), and several other United States retailing and service companies.

2.5. In the last two years Grand Met has become a less diversified company, focusing more particularly on its food, drinks, and retailing businesses, especially branded goods and services, and has disposed of a number of the businesses acquired in the previous two decades, most notably InterContinental Hotels.

2.6. Acquisitions in the selected areas of activity have continued, in the United Kingdom, the United States, and the continent of Europe. Towards the end of 1988, it acquired the William Hill Organisation Ltd (see paragraph 2.14) and The Pillsbury Company, a leading United States food processing company which owns the fast-food operation Burger King among other interests.

Mecca Bookmakers Ltd

2.7. Before its acquisition by Grand Met in 1970, Mecca Ltd had begun to develop a bookmaking business through the take-over of two independent betting office chains, City Tote and Ron Nagle. The process of acquiring small and individual betting office companies continued after the take-over by Grand Met, and in 1972 Mecca Bookmakers Ltd (Mecca) was formed. By December 1988 Mecca operated 793 betting offices in Great Britain and 54 in the Republic of Ireland. Its presence is strongest in the Greater London area (see Appendix 3.2). Grand Met also has a joint venture off-track betting interest in Malaysia and a minority stake in a racetrack currently under construction in the United States, and has plans to establish a greyhound track and off-course betting in Botswana.

2.8. Mecca has played a leading role in the development of communications technology for the off-course betting trademost recently through the establishment of SIS in partnership with the other major off-course betting groups (see paragraphs 3.10 to 3.15). It has engaged extensively in sponsorship of horse and greyhound racing events, as has William Hill.

2.9. Mecca has expanded its credit betting operation in the past decade, moving in 1985 from offices in Central London to its Finsbury Park premises. It has some 10,000 registered credit clients. Before the merger it had no on-course representation (see paragraph 2.13). It is moving its racing headquarters, including the credit betting operation, to merge with those of William Hill in Leeds. The merged company's corporate headquarters will be in London. At the date of the merger Mecca had 4,620 employees, 2,245 of them being part-time (less than 35 hours per week).

William Hill Organisation Ltd

2.10. William Hill had a lengthy history in bookmaking before off-course cash betting offices were legalised in 1960. It was the eponymous creation of Mr William Hill, whose telephone credit account business grew rapidly in London in the ten years before the outbreak of the Second World War. In the 1940s the business branched into football, in which coupon betting became popular.

2.11. Between 1955 and 1961 Mr Hill's various companies were bought by a publicly-quoted company, Holdings Investment Trust Ltd, in which he and a partner had a majority shareholding. The company at this time gained a reputation, through its advertisements in the sporting press, for its ante-post prices for the main future racing events.

2.12. After the legalisation of off-course betting in 1960, the company did not immediately enter the field of licensed betting offices, since Mr Hill doubted their profitability. However, his scepticism was soon belied, and between 1966 and his death in 1971 a number of individual betting offices and larger groups were acquired. The company was taken over by Sears plc in December 1971, when it owned some 500 betting offices.

2.13. William Hill moved its headquarters from Blackfriars, London, to Leeds in 1981, and its credit betting operation in 1987. At the end of 1988 the credit business had about 25,000 registered clients. Apart from the off-course telephone betting facility, William Hill had on- course personal representation at most racecourses in Great Britain. At the same date it had 908 licensed betting offices spread throughout the country. There were also 370 small betting agencies in Belgium. William Hill had at that date 5,426 employees in Great Britain, 2,949 of them being part-time (less than 31 hours per week). Mecca expects that rationalisation of the two businesses will effect a net reduction in staff of around 250 overall.

The merger

2.14. Since 1986 Grand Met had been interested in building up the Mecca chain of betting offices to a point where it could effectively challenge Ladbrokes (see Chapter 3 for the relevant figures). The opportunity arose in 1988, following the publication of William Hill's disappointing results for the preceding year. Discussions with Sears led to the completion of the purchase of William Hill by Grand Met on 16 December 1988 for £331 million. This agreement, which includes the Belgian interests, was unconditional.

FINANCIAL INFORMATION

Grand Met

2.15. During the financial year to 30 September 1988 Grand Met changed its accounting policy to enable significant brands acquired after 1 January 1985 to be recorded in the balance sheet as fixed intangible assets instead of being written off against reserves. Appendix 2.1 shows the effects of this on gearing ratios for 1987 and 1988, if borrowings are compared with equity before and after deduction of the capitalised brands (the net equity basis normally adopted by the Commission). By including capitalised brands in the balance sheet, gearing is reduced from 78 to 58 per cent and from 27 to 22 per cent respectively.

2.16. If (to be consistent) the net equity basis were to be applied for the five years to 30 September 1988, it can be seen that Grand Met's gearing levels would have declined substantially from 55 to 27 per cent (see Appendix 2.1), although there would have been a sharp rise in 1987 to 78 per cent due largely to the goodwill arising on acquisitions and the increased borrowing needed to pay for this.

2.17. Grand Met's agreed acquisition of Pillsbury for \$5.8 billion (£3.1 billion) was completed on 4 January 1989, and its sale of InterContinental Hotels for approximately \$2.0 billion (£1.1 billion) net of tax to the Japanese Seibu Saison group on 15 December 1988 will be reflected in its accounts for the financial year to 30 September 1989.

2.18. The returns on average capital employed and net tangible assets over the period 1984 to 1988 are given in Table 2.1. These are consistent with the method normally used by the Commission to evaluate returns.

TABLE 2.1 **Grand Met: returns on average capital employed and net tangible assets, 1984/85 to 1987/88 (historical cost modified by the revaluation of certain land and buildings)**

		1984/85	1985/86	1986/87	1987/88
Average capital employed	£ million	2,965	3,079	3,121	3,425
Profit before interest and tax	£ million	417	469	576	668
Return	%	14.06	15.23	18.46	19.50
Average net assets	£ million	1,975	2,103	1,975	2,370
Profit before taxation	£ million	311	368	456	575
Return	%	15.75	17.50	23.09	24.26

Source: MMC from Grand Met's published figures.

2.19. These figures show that Grand Met's returns on average capital employed and on average net assets have improved over the period 1984/85 to 1987/88.

2.20. Grand Met's calculations of earnings per share for each of the five years to 1987/88 are set out in Table 2.2; they are taken from the five-year record included in its 1987/88 accounts. (Grand Met's summarised consolidated profit and loss accounts for the same five years are shown in Appendix 2.2.)

TABLE 2.2 **Grand Met: earnings per share, 1983/84 to 1987/88 (ordinary shares of 50 pence each)**

	1983/84	1984/85	1985/86	1986/87	1987/88
Earnings per share (pence)	28.9	29.0	32.1	38.9	48.0

Source: Grand Met.

The returns on average capital employed and net assets for the two years 1986/87 and 1987/88 (including brand valuations) are given in Table 2.3.

TABLE 2.3 **Grand Met: returns on average capital employed and net assets, 1986/87 and 1987/88 (historical cost modified by the revaluation of certain land and buildings)**

		1986/87	1987/88
Average capital employed*	£ million	3,485	4,023
Profit before interest and tax	£ million	576	668
Return	%	16.53	16.60
Average net assets*	£ million	2,339	2,968
Profit before taxation	£ million	456	575
Return	%	19.50	19.37

Source: MMC from Grand Met's published figures.

*Including brand values acquired and treated as intangible assets in the group accounts from 1986/87 onwards.

2.21. The effect on returns of including the brand valuations as part of capital employed and net assets for 1986/87 and 1987/88 is illustrated in Table 2.4.

TABLE 2.4 **Grand Met: returns on capital compared, excluding and including brand valuations**

	1986/87	1987/88
Return on average capital employed:		
excluding brand valuations (Table 2.1)	18.46	19.50
including brand valuations (Table 2.3)	16.53	16.60
Return on average net assets:		
excluding brand valuations (Table 2.1)	23.09	24.26
including brand valuations (Table 2.3)	19.50	19.37

Source: MMC from Grand Met's published figures.

Mecca

2.22. Mecca's balance sheets and profit and loss accounts are summarised in Appendices 2.3 and 2.4 respectively. Its principal activity is as an operator of betting offices, a business which generates cash surpluses. The company values betting licences in its balance sheet as at the cost of acquiring licensed premises or shares at a premium. In a note to Appendix 2.3 we explain that these amounts are written off to reserves by Grand Met in its consolidated accounts, in the year of acquisition.

2.23. Appendix 2.4 shows that in the five years 1984 to 1988 turnover increased by 61 per cent from £307.6 million to £495.2 million and trading profits by 140 per cent from £6.5 million to £15.6 million.

William Hill

2.24. William Hill's balance sheets and profit and loss accounts are summarised in Appendices 2.5 and 2.6 respectively. Payments made for licences and goodwill are either amortised over a period not exceeding 20 years or are written off directly against reserves.

2.25. We have examined William Hill's published balance sheet at 28 January 1988, and have also examined its management accounts prepared as at 15 December 1988, the day before acquisition. Both show that gross assets are significantly in excess of £30 million.

2.26. Appendix 2.6 shows that in the five years 1984 to 1988 turnover increased by 42 per cent from £427.8 million to £608.9 million and trading profits by 53 per cent from £11.0 million to £16.8 million. This is a less favourable trend than Mecca's (Appendix 2.4) and is reflected in the trading margin trends shown in Table 2.5.

TABLE 2.5 Trading profit as a percentage of sales

	<i>1984</i>	<i>1985</i>	<i>1986</i>	<i>1987</i>	<i>1988</i>
Mecca	2.11	2.93	3.49	2.86	3.15
William Hill	2.57	2.39	3.03	4.07*	2.76

Source: MMC from Mecca Annual Reports and William Hill Annual Accounts.

*Gross margins were higher than average, partly reflecting the business of a number of special clients during the year.