Part II

Background and evidence

3 Background to the proposed transfers

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Introduction

3.1. This chapter deals with the events leading up to the referral of the proposed transfer of the newspaper titles and related assets of PSN to any one of three potential bidders, namely Johnston, Newsquest and Newscom. It also describes the parties involved, their financial performance, details of the respective bid approaches, their contract printing activities, new media income sources and benefits of the proposed transfers.

3.2. An acquisition of PSN's titles would involve the transfer of 4 daily newspapers, 10 paid-for weekly newspapers and 21 free weekly newspapers.[1]

Events leading up to the referral of the proposed transfers

3.3. Johnston approached PSN in November 1998 with a view to seeking a board recommendation for an offer for its entire issued share capital. Following discussions between the two companies' financial advisers, Johnston was informed on 15 December that the PSN board did not wish to pursue Johnston's offer and accordingly considered discussions to be terminated.

3.4. However, on 22 January 1999 Johnston acquired 14.99 per cent of PSN's issued share capital from three institutional investors at a price of £16 a share and announced a tender offer to acquire up to a further 10 per cent of PSN's issued share capital at the same price. This offer valued the whole of

[1]This is in accordance with the summary shown in Appendix 3.1 and includes the *Guardian Home Finder*, which is not in our terms of reference and is probably not a newspaper within the meaning of the Act. The lists of titles which were referred to the Commission are shown in Appendix 1.1, which is consistent with Appendix 3.1 (see Appendix 1.1, paragraph 5).

PSN at around £192 million which, with acquisition costs, would amount to a total cost of some £200 million.

3.5. The PSN board advised shareholders not to accept the Johnston tender offer of £16 a share and made it clear that they would consider any bid that reflected the true value of the company. On 1 February Johnston announced that the tender offer had failed and was therefore void. Johnston applied for the consent of the Secretary of State to the transfer of PSN's newspapers and related assets as required by the Act and the matter was referred to the Commission on 5 February 1999. Subsequently a further reference was made relating to Johnston's application in respect of five more titles.

3.6. Newsquest and Newscom also expressed their interest in PSN and each subsequently applied for consent to the transfer of PSN's newspapers and related assets to them. Accordingly references were made to the Commission, on 9 February 1999 in respect of Newsquest and on 11 February 1999 in respect of Newscom.

3.7. On 13 April 1999 Johnston issued a press release stating that it had acquired further shares in PSN at £17.50 a share, taking its holding to 17.35 per cent. It also stated that any offer for shares in PSN would be at a price no less than £17.50 per share, unless otherwise agreed with the City Panel on Takeovers and Mergers. Such a price would value PSN at around £210 million, compared with Johnston's original offer of £192 million.

The companies

3.8. PSN, Johnston, Newsquest and Newscom are all public companies listed on the London Stock Exchange. At 23 April 1999 their market capitalizations were respectively £225 million, £580 million, £869 million and £196 million. In the following paragraphs we consider the history, development and financial position of each company in turn.

3.9. In our financial analysis, in order to make valid comparisons between the companies, we have adjusted 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.

PSN

3.10. PSN traces its origins to 1873 when Samuel Storey, great-grandfather of Sir Richard Storey, Bt (who was until 1998 Chairman of PSN), founded the *Sunderland Daily Echo*. Samuel Storey went on to form a newspaper syndicate with the US millionaire Andrew Carnegie and together they started up new titles and acquired existing ones.

3.11. The syndicate broke up in 1885 but Samuel Storey retained interests in (*inter alia*) the *Sunderland Echo*, the *Portsmouth Evening News* and the *Northern Daily Mail*. In 1934 these titles were brought together under the control of Portsmouth & Sunderland Newspapers Limited (which later became PSN), which was then floated on the Stock Exchange.

3.12. Further significant newspaper acquisitions were made in 1950, when the *Chichester Observer* Series in West Sussex was acquired, in 1983 when the Croydon Advertiser Group was acquired (subsequently sold in December 1995) and in 1991 when the Northern Press Group was acquired.

3.13. In 1970 the company's first newsagent's shop was opened. This initiative was undertaken with a view to enhancing the distribution of the group's newspapers. However, the emphasis subsequently shifted as the number of shops increased and led to the development of a chain of community stores under the brand name 'One Stop'.

3.14. In 1987 the group was reorganized with the formation of a northern and a southern subsidiary: Northeast Press Limited (NP) based in Sunderland, and Portsmouth Publishing and Printing Limited (PPP) based in Portsmouth.

3.15. Successive generations of the Storey family have been actively involved in the management of the company and the family still controls approximately 36 per cent of the company's share capital, although no members of the family have any executive role now. PSN informed us that as at 31 March 1999, in addition to Johnston, the holders of shares in excess of 3 per cent of its issued share capital were Prudential Corporation (3.73 per cent), Legal & General Investment Management (3.43 per cent), and Phillips & Drew Fund Managers (5.2 per cent on behalf of clients).

3.16. PSN currently publishes 35 local newspaper titles from its bases in Portsmouth and Sunderland. It is the twelfth largest publisher of local newspapers in the UK. An analysis of the circulation and distribution of titles owned by PSN by company, type and frequency is set out in Appendix 3.1. PSN also carries out contract printing for other publishers (including publishers of national newspapers). The retailing division had approximately 220 convenience stores at March 1999.

3.17. PSN's head office is in Portsmouth. The average number of employees in 1998 was 2,785 (full-time equivalent). PPP currently has around 653 employees and NP 656. The remaining employees (around 1,500) are mainly employed in the retailing business.

Financial information on PSN

3.18. Profit and loss accounts for PSN for each of the five years ended 31 March 1998 are set out in Table 3.1. PSN is involved in two separate businesses with very different financial profiles. It makes sense, therefore, to look at their operating margins separately.

TABLE 3.1 **PSN: group profit and loss accounts, 1994 to 1998**

£ million

	Years ended 31 March				
	*1994**	*1995*	*1996*	*1997*	*1998*
Turnover					
Newspapers	64.4	64.3	60.5	59.2	62.7
Retail (excluding inter-segment turnover)	47.7	55.4	77.7	91.8	113.8
	112.1	119.7	138.2	151.0	176.5
Cost of sales	(81.3)	(86.4)	(103.2)	(112.4)	(128.8)
Gross profit	30.8	33.3	35.0	38.6	47.7
Distribution costs	(4.1)	(4.3)	(4.0)	(3.3)	(3.5)
Administrative expenses	(17.9)	(20.1)	(22.6)	(27.8)	(33.9)
Other operating income	0.1	0.2	0.3	1.9	2.3
Other income	0.3	0.2	0.1	0.0	0.0
Operating profit	9.2	9.3	8.8	9.4	12.6
Exceptional items	(1.7)	(1.1)	9.6†	(1.8)	(0.8)
Profit before interest and tax	7.5	8.2	18.4	7.6	11.8
Net interest receivable/(payable)	(0.2)	0.0	0.2	(0.1)	(0.8)
Profit before tax	7.3	8.2	18.6	7.5	11.0
Taxation	(2.2)	(2.9)	(2.8)	(2.3)	(3.1)
Profit after tax	5.1	5.3	15.8	5.2	7.9
Dividends	(1.5)	(1.6)	(1.7)	(1.9)	(2.3)
Retained profit	3.6	3.7	14.1	3.3	5.6
					number
Average number of employees	2,119	2,151	2,172	2,523	2,785
					pence
Basic earnings per share	41	43	49†	42	65
Performance indicators					*per cent*
Increase/(decrease) in earnings per share	13	5	14†	(14)	55
Operating profit as a percentage of turnover	8.2	7.8	6.4	6.2	7.1
Operating profit as a percentage of turnover (publishing and printing)	11.2	10.7	10.6	11.4	14.5
Operating profit as a percentage of turnover (retailing)	3.7	3.8	2.9	3.0	3.2

Source: PSN.

*1994 was a 53-week year.

†An exceptional profit of £10 million was made in 1996 following the disposal of the Croydon Advertiser Group. This gave rise to reported earnings per share of 131p. PSN also reported the earnings per share excluding the exceptional profit at 49p.

3.19. PSN's margins from publishing and printing were relatively static from 1994 to 1997, while the company was investing heavily in new printing presses at the same time as trying to rebuild profits after the expiry of major printing contracts with the *Daily Mail* at Sunderland and with *The Independent* at Portsmouth. The restructuring and investment programme was largely completed in 1997 and there was a significant improvement in profitability of publishing and printing in 1998.

3.20. PSN's retailing margins had grown to 3.8 per cent in 1995 before the decision was taken to accelerate the rate of store openings. Over the last three years (1996 to 1998) the number of stores has doubled and, as it takes at least three years for a store to reach its full potential, this had the effect of reducing the operating margin.

3.21. PSN's Chairman's statement in the 1998 Annual Report (dated 16 June 1998) emphasized that the group remained confident of the prospects for both businesses and would continue to seek opportunities for expansion in both. The Chairman's statement also said that:

(a) while local publishing is a cyclical business, local retailing is relatively resilient to economic changes and so helps balance the group's profits; and

(b) while local publishing requires substantial periodic capital expenditure (in particular on printing presses), it generates a strong money flow in the intervening period. This earns a good return by being invested in local retailing where, moreover, expansion can be regulated to the level of funds available.

3.22. A breakdown of the different sources of turnover within newspaper publishing and printing for the three years ended 31 March 1996, 1997 and 1998 is given in Table 3.2. Advertising income increased from £32 million to £36 million over the period, in contrast with circulation revenues, which fluctuated between £12 million and £13 million. Contract printing revenues increased from around £9 million in 1996 to £11 million in 1998.

TABLE 3.2 **PSN: analysis of turnover from newspaper publishing and printing, 1996 to 1998**

	Years ended 31 March			
	1996	*1997*	*1998*	*1998*
	£m	*£m*	*£m*	*%*
Advertising sales				
Display	12.6	13.1	13.4	21.4
Situations vacant	3.7	4.6	6.1	9.7
Motors	5.6	5.8	6.1	9.7
Property	4.1	4.3	4.5	7.2
Other	6.1	6.3	6.4	10.2
Total advertising	32.1	34.1	36.5	58.2
Circulation	12.3	12.7	12.6	20.1
Other sales, mainly leaflets	2.2	2.4	2.6	4.2
Contract printing	8.8	10.0	11.0	17.5
	55.4	59.2	62.7	100.0
Discontinued operations	5.1	0.0	0.0	
	60.5	59.2	62.7	

Source: PSN.

3.23. As Table 3.2 shows, circulation revenue actually fell slightly in 1998, although advertising revenue increased by 7.0 per cent in 1998 and by 6.2 per cent in 1997.

3.24. The balance sheets of PSN for each of the five years ended 31 March 1998, together with performance indicators, are set out in Table 3.3.

TABLE 3.3 **PSN: group balance sheets, 1994 to 1998**

					£ million
			As at 31 March		
	1994	*1995*	*1996*	*1997*	*1998*
Tangible assets	34.5	36.8	47.7	59.3	65.1
Working capital excluding net borrowings	(4.6)	(5.9)	(2.5)	(6.6)	(3.5)
Net operating assets	29.9	30.9	45.2	52.7	61.6
Investments	5.7	7.3	1.4	2.2	2.5
(Borrowings) less cash	6.2	6.7	9.0	1.1	(7.6)
Creditors less debtors due after one year	0.1	(0.2)	(0.5)	0.2	0.7
Provisions for liabilities and charges	(2.0)	(1.5)	(1.9)	(2.4)	(3.5)
Net assets	39.9	43.2	53.2	53.8	53.7*
Financed by					
Share capital	4.7	4.7	4.7	4.7	4.7
Reserves	35.2	38.5	48.5	49.1	49.0
Shareholders' funds	39.9	43.2	53.2	53.8	53.7
Goodwill written off	16.6	18.5	23.7	27.3	33.2
Revaluation reserve	(6.6)	(7.9)	(5.1)	(5.8)	(6.0)
Capital invested†	49.9	53.8	71.8	75.3	80.9
Performance ratios					*per cent*
Operating profit as a percentage of average net operating assets	28	31	23	19	22
Operating profit as a percentage of average capital invested	19	18	14	13	16
Debt to debt plus capital invested ratio	0	0	0	0	9

Source: The Commission, based on PSN's published accounts.

*Net assets in 1998 are analysed as £38.1 million to newspaper publishing, £20.7 million to retailing and (£5.1) million to net debt less investments.

†See paragraph 3.9.

3.25. Considerable capital investment in new printing equipment has occurred in PSN in the last three years, providing the group with modern colour presses and inserting machines. As discussed in paragraph 3.20, there has also been a steady expansion in the number of the group's retail outlets. In 1998 the results of that investment produced substantially improved profitability of the group causing a significant increase in returns on net operating assets and capital invested. PSN's overall borrowings are at a relatively low level of £8 million at 1998, compared with net assets of £54 million.

3.26. We noted PSN's capital expenditure projections in its business plan for the six years to 2003/04. Some 84 per cent of total capital expenditure of £163 million is concentrated on expansion of the retail business. PSN told us that the company has unused facilities of up to £40 million for a publishing acquisition and further funds could be made available by slowing down the expansion of the retail expansion.

3.27. PSN told us that it expects to release its preliminary results for the year ended 31 March 1999 in the first week of June. No financial information on the company has been published since the interim statement for the half year ended 30 September 1998, which was issued on 17 November 1998. This showed half-year turnover of £101 million (1997—£87 million), up 16 per cent, and operating profit of £8.9 million (1997—£6.7 million), up 33 per cent.

3.28. PSN told us that Newscom and Newsquest have both been provided with estimates of the company's results for the year ended 31 March 1999 and budgeted figures for the year ending 31 March 2000. These figures have not been released to Johnston, in accordance with Johnston's wishes not to become an insider. PSN informed us that, as at 23 April 1999, no formal bid for the company's publishing business has been received from any of the parties. On 30 April 1999, PSN announced that it had conditionally agreed to sell its retail stores business for £66 million (after deducting £2 million of cash balances) to another retail group.

Johnston

3.29. Johnston traces its origins to a printing business founded in 1765 and from 1846 concentrated on newspaper publishing and printing in Scotland until 1978 when the company made its first acquisition in England. Further acquisitions followed, including the acquisition of the newspaper business of EMAP in July 1996. This transaction, comprising 65 newspaper titles, virtually doubled the size of the company.

3.30. In 1988 Johnston floated on the stock market. 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 31 March 1999 were Fidelity International Ltd/FMR Corp (4 per cent) and Legal and General Investment Management Ltd (3 per cent).

3.31. Johnston is the fifth largest local newspaper publisher in the UK. It currently publishes 155 newspaper titles in Scotland and England. With the exception of five daily evening titles they are all weekly publications (roughly half are free and half paid-for). An analysis of the circulation and distribution of titles owned by Johnston by area, company, type and frequency is set out in Appendix 3.2.

3.32. Johnston's activities are now confined to newspaper publishing and printing and wholesale stationery supply. The latter accounts for around 7 per cent of group turnover. Johnston has ten 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.

Financial information on Johnston

3.33. Profit and loss accounts for Johnston for each of the five years ended 31 December 1998 are set out in Table 3.4. Between 1994 and 1998 its operating profit as a percentage of turnover increased from some 16 per cent to 25 per cent. In 1998, its returns from individual business units ranged from a low of around 13 per cent to a high of 41 per cent.

TABLE 3.4 **Johnston: group profit and loss accounts, 1994 to 1998**

£ million

	Years ended 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover	95.3	102.4	165.0	212.0	201.7
Cost of sales	(57.8)	(60.7)	(99.4)	(121.0)	(107.7)
Gross profit	37.5	41.7	65.6	91.0	94.0
Distribution costs	(5.9)	(6.2)	(12.4)	(16.2)	(16.2)
Administrative expenses	(16.5)	(18.0)	(24.5)	(29.2)	(26.3)
Operating profit	15.1	17.5	28.7	45.6	51.5
Exceptional items	(0.6)	(0.9)	0.5	(3.5)	0.5
Profit before interest and tax	14.5	16.6	29.2	42.1	52.0
Net interest receivable/(payable)	0.2	0.2	(5.1)	(7.5)	(6.1)
Profit before tax	14.7	16.8	24.1	34.6	45.9
Taxation	(5.0)	(5.4)	(7.3)	(10.4)	(14.3)
Profit after tax	9.7	11.4	16.8	24.2	31.6
Dividends	(2.8)	(3.2)	(5.1)	(6.2)	(7.2)
Retained profit	6.9	8.2	11.7	18.0	24.4
					number
Average number of employees	2,429	2,238	3,746	4,573	4,078
					pence
Basic earnings per share	7.0	8.0	10.2	12.0	15.7
					per cent
Performance indicators					
Increase in earnings per share	10	14	27	17	31
Operating profit as a percentage of turnover	16	17	17	22	25

Source: Johnston.

3.34. 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 its bookbinding and bookselling operations in September 1997.

3.35. A breakdown of the different sources of turnover within Johnston's business for the years ended 31 December 1997 and 1998 is given in Table 3.5.

TABLE 3.5 **Johnston: analysis of turnover from newspaper publishing and printing, and other activities**

	Years ended 31 December		
	1997 *£m*	*1998* *£m*	*1998* *%*
Advertising sales			
Display	49.0	49.7	24.4
Situations vacant	28.4	34.2	16.8
Motors	23.1	23.8	11.7
Property	19.1	20.9	10.3
Other	23.5	24.4	12.0
Total advertising	143.1	153.0	75.2
Circulation	18.5	18.5	9.1
Leaflets	6.8	7.2	3.5
Contract printing*	25.2	24.7	12.2
Total for newspapers and publishing	193.6	203.4	100.0
Wholesale, other activities and acquisitions	14.3	15.1	
Elimination of inter-company turnover*	(14.1)	(16.8)	
Discontinued activities	18.2	0.0	
Turnover	212.0	201.7	

Source: Johnston.

*Johnston's printing activity is carried out either through its separate printing division (see paragraph 3.94) or through its seven centres which are integral to its newspaper activities (see paragraph 3.93). The printing activities of the latter are not accounted for separately and the contract printing figures disclosed above relate only to the printing division. The inter-company turnover mainly relates to internal printing. In 1998, external printing turnover amounted to £7.5 million.

3.36. Whereas revenue from advertising increased by 6.9 per cent between 1997 and 1998, circulation revenues were static, representing 9.1 per cent of the total turnover from newspaper publishing and printing in 1998.

3.37. Balance sheets for Johnston for each of the five years ended 31 December 1998 are set out in Table 3.6.

TABLE 3.6 **Johnston: group balance sheets, 1994 to 1998**

					£ million
			As at 31 December		
	1994	*1995*	*1996*	*1997*	*1998*
Intangible assets	0.9	14.9	206.4*	206.4	217.3
Tangible assets	27.4	28.6	44.5	46.9	48.0
	28.3	43.5	250.9	253.3	265.3
Working capital excluding net borrowings	5.3	6.4	9.7	(6.0)	(9.9)
Net operating assets	33.6	49.9	260.6	247.3	255.4
Investments	0.3	0.6	0.6	0.8	0.4
(Borrowings) less cash	(1.2)	(15.7)	(116.2)	(86.4)	(69.0)
Creditors less debtors due after one year	2.0	2.0	2.1	1.2	1.5
Provisions for liabilities and charges	(2.5)	(2.8)	(3.9)	(2.4)	(3.4)
Net assets	32.2	34.0	143.2	160.5	184.9
Financed by					
Share capital	14.4	14.5	21.1	21.2	21.2
Reserves	17.8	19.5	122.1	139.3	163.7
Shareholders' funds	32.2	34.0	143.2	160.5	184.9
Goodwill written off	40.5	47.1	58.9	62.3	62.3
Revaluation reserve	(2.5)	(2.4)	(2.3)	(3.9)	(3.8)
Capital invested†	70.2	78.7	199.8	218.9	243.4
Performance ratios					*per cent*
Operating profit as a percentage of average net operating assets	49	42	19	18	21
Operating profit as a percentage of average capital invested	26	24	21	22	22
Debt to debt plus capital invested ratio	1.7	17	37	28	22

Source: The Commission based on Johnston's published 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 3.9.

3.38. Operating profit as a percentage of average capital invested fell from 26 per cent in 1994 to 21 per cent in 1996 and then increased to 22 per cent in 1997 and 1998. Gearing (measured as debt divided by debt plus capital invested) increased significantly as a result of the EMAP acquisition in 1996 but has since fallen slightly to 22 per cent in 1998.

Newsquest

3.39. 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.

3.40. A series of acquisitions and disposals followed but for strategic reasons Reed Elsevier decided to sell RRN, which led to the successful bid by RRN's management, with the backing of Kohlberg Kravis Roberts & Co (KKR), a private equity partnership, which currently controls 37 per cent of the issued share capital.[1]

3.41. Other declarable shareholdings in Newsquest (ie those with 3 per cent or more) are funds controlled by Cinven Limited, a UK venture capital organization (13 per cent), Sanford C Bernstein & Co (a US fund manager with 4 per cent) and Global Asset Management (3 per cent).

[1]The Commission reported on the historical structure of Newsquest in paragraphs 3.28 to 3.50 of *Newsquest Media Group Limited and Westminster Press Limited: a report on the proposed transfer to Newsquest Media Group Limited of the newspapers of Westminster Press Limited,* The Stationery Office, Cm 3485, November 1996.

3.42. Newsquest subsequently acquired Westminster Press in December 1996, which transaction virtually doubled its size. In October 1997 Newsquest floated on the London stock market, thereby raising £100 million, which was used to reduce borrowings by repurchase of loan notes and bank debt. In October 1997 Newsquest sold its Wessex newspaper publishing business for £35 million (including indebtedness) to Bristol United Press plc.

3.43. As a result of its acquisitions, Newsquest publishes some of the oldest and most respected titles in the country, including the *Berrows Worcester Journal*, which was first published in 1690.

3.44. Newsquest publishes 179 local newspaper titles, 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 3.3.

Financial information on Newsquest

3.45. Profit and loss accounts for Newsquest for each of the five years ended 31 December 1998 are set out in Table 3.7. Between 1994 and 1998 operating profit as a percentage of turnover has increased from around 14 per cent to 27 per cent. However, in 1998 the profitability of different business units within Newsquest varied from a low of 21 per cent to a high of 36 per cent.

TABLE 3.7 **Newsquest: group profit and loss accounts, 1994 to 1998**

£ million

	Years ended 31 December				
	1994	*1995*	*1996*	*1997*	*1998**
Turnover					
Advertising	110.9	114.0	118.7	230.2	249.4
Circulation	12.1	12.1	13.5	37.8	37.7
Direct marketing (leaflets)	6.5	7.3	7.9	10.3	11.5
Other, including contract printing	2.8	3.0	4.5	7.3	7.2
	132.3	136.4	144.6	285.6	305.8
Net operating costs	(113.2)	(115.1)	(120.9)	(214.1)	(224.4)
Operating profit	19.1	21.3	23.7	71.5	81.4
Exceptional items	(2.8)	(2.8)	(9.6)	(7.5)	(4.8)
Net profit before interest and tax	16.3	18.5	14.1	64.0	76.6
Net interest receivable/(payable)	0.0	0.3	(17.1)	(32.5)	(15.6)
Profit/(loss) before tax	16.3	18.8	(3.0)	31.5	61.0
Taxation	(1.8)	(5.7)	0.6	(11.9)	(19.2)
Profit/(loss) after tax	14.5	13.1	(2.4)	19.6	41.8
Dividends	(10.0)	(195.0)	0.0	0.0	(11.8)
Retained profit/(loss)	4.5	(181.9)	(2.4)	19.6	30.0
					number
Average number of employees	†	†	3,265	5,828	5,743
					pence
Basic earnings per share	‡	‡	‡	12	21
Performance indicators					*per cent*
Operating profit as a percentage of turnover	14	16	16	25	27

Source: Newsquest.

*1998 was a 53-week accounting period.
†Not available.
‡Not applicable. Newsquest floated in 1997.

3.46. The significant increase in turnover and profits in 1997 was largely due to the acquisition of Westminster Press. Whereas advertising revenues went up 8.3 per cent in 1998, circulation revenues declined marginally, because of the impact of the divestment of the Wessex business in 1997. On a like-for-like basis circulation revenues were up by 1.4 per cent.

3.47. Balance sheets for Newsquest for each of the five years ended 31 December 1998 are set out in Table 3.8.

TABLE 3.8 **Newsquest: group balance sheets, 1994 to 1998**

£ million

	As at 31 December				
	1994	*1995*	*1996*	*1997*	*1998*
Intangible assets*	39.1	31.4	332.4	319.9	329.6
Tangible assets	31.0	39.1	72.1	66.6	67.4
	70.1	70.5	404.5	386.5	397.0
Working capital excluding net borrowings	3.5	5.8	11.7	(6.8)	(33.7)
Net operating assets	73.6	76.3	416.2	379.7	363.3
(Borrowings) less cash†	(0.1)	3.1	(325.7)	(174.0)	(133.6)
Long-term debtors after one year	0.0	0.0	4.9	3.0	1.9
Provisions for liabilities and charges	(2.6)	(2.6)	(5.5)	(4.5)	(5.2)
Net assets	70.9	76.8	89.9	204.2	226.4
Financed by					
Share capital and reserves	30.5	(73.4)	89.9	204.2	226.4
Inter-company balances	40.4	150.2	0.0	0.0	0.0
Shareholders' funds	70.9	76.8	89.9	204.2	226.4
Goodwill written off	0.0	0.0	63.5	65.4	65.4
Capital invested‡	70.9	76.8	153.4	269.6	291.8
Performance ratios					*per cent*
Operating profit as a percentage of average net operating assets	N/A§	28	10	18	22
Operating profit as a percentage of average capital invested	N/A§	29	21	34	29
Debt to debt plus capital invested ratio	N/A¶	N/A¶	69	40	32

Source: The Commission, based on information from Newsquest.

*Intangible assets represent publishing rights and titles acquired. Intangible assets arising from the value of titles created by the group are not capitalized.

†Net of deferred fees.

‡See paragraph 3.9.

§Figures not available.

¶Business was a division of a larger entity, hence funded by group.

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

3.49. Gearing (measured as debt divided by debt plus capital invested) was initially quite high following the management buyout in 1996 but has since fallen significantly, helped by the flotation in 1997.

Newscom

3.50. 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 the *Isle of Wight Gazette* in 1823.

3.51. 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 Evening 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.

3.52. During the period under review, Newscom's newspaper business was divided into four geographical regions—namely, northern, southern, south-western and Wales and western. However, the northern and south-western regions have now been amalgamated to form central region. Newscom publishes a total of 107 local newspaper titles, including four daily titles, making it the ninth largest publisher of local newspapers in the UK. An analysis of titles by area, frequency and type, including circulation and distribution figures, is set out in Appendix 3.4.

3.53. Newscom also has a magazine publishing division that was formed in 1997, which publishes two financial publications—*Insurance Times* and *Portfolio International*. These titles are not relevant to our inquiry. In addition, Newscom has a newspaper printing division and a magazine printing division.

3.54. The newspaper printing division prints copies of the southern editions of the *Daily Mail* and *The Mail on Sunday* under contract from Associated Newspapers. Roughly 35 per cent of the printing work undertaken by Newscom's newspaper printing division is for third parties.

3.55. The magazine printing division is based in Poole, Dorset, and at nearby Ferndown and produces high-quality bound magazines and catalogues.

3.56. Newscom floated on the Alternative Investment Market of the London Stock Exchange in 1995 and transferred to the Official List in 1998. Declared shareholdings above 3 per cent as at 27 April 1999 were in respect of the following institutional investors: Rathbone Investment Management (7.0 per cent), Caledonia Leisure & Media Ltd (5.7 per cent), Hill Samuel Asset Management (5.6 per cent), M&G Investment Management Ltd (4.6 per cent) and British Empire Securities & General Trust Plc (3.8 per cent).

3.57. Newscom's directors have an interest of 3.8 per cent in the company. Its head office is at Redbridge, Southampton, and it has around 2,200 employees (full-time equivalent), as disclosed in the Annual Report and Accounts 1998.

Financial information on Newscom

3.58. Profit and loss accounts for Newscom for each of the five years ended 30 June 1998 are set out in Table 3.9. Between 1994 and 1998 operating profit as a percentage of turnover increased each year from 12 to 17 per cent. In 1998, the percentage return on turnover varied between the four geographical regions from a high of 27 per cent to a low of 16 per cent.

TABLE 3.9 **Newscom: group profit and loss accounts, 1994 to 1998**

£ million

	Years ended 30 June				
	1994	*1995*	*1996*	*1997*	*1998*
Turnover	76.9	84.8	88.9	105.4	127.9
Cost of sales	(52.8)	(56.2)	(59.9)	(69.9)	(80.7)
Gross profit	24.1	28.6	29.0	35.5	47.2
Distribution costs	(6.3)	(7.6)	(7.6)	(9.4)	(10.6)
Administrative expenses	(9.6)	(10.5)	(10.6)	(11.8)	(15.6)
Other operating income	0.8	0.9	0.8	0.9	0.8
Operating profit	9.0	11.4	11.6	15.2	21.8
Other income	3.7	0.0	0.7	0.3	1.6
Exceptional items	(1.2)	0.0	6.7	0.8	4.3
Profit before interest and tax	11.5	11.4	19.0	16.3	27.7
Net interest receivable/(payable)	0.0	0.1	(0.2)	(2.2)	(3.7)
Profit before tax	11.5	11.5	18.8	14.1	24.0
Taxation	(2.2)	(3.0)	(2.9)	(1.5)	(5.5)
Profit after tax	9.3	8.5	15.9	12.6	18.5
Dividends	(3.2)	(3.7)	(4.2)	(4.9)	(5.7)
Retained profit	6.1	4.8	11.7	7.7	12.8
					number
Average number of employees	1,573	1,617	1,639	1,899	2,207
					pence
Basic earnings per share	39	36	66	52	76
					per cent
Performance indicators					
Change in earnings per share	73	(9)	85	(22)	47
Operating profit as a percentage of turnover	12	13	13	14	17

Source: Newscom.

3.59. In December 1997 Newscom acquired Bailey, which accounted for £8.3 million of the increase in turnover in 1998. The underlying increase in turnover was 13.5 per cent.

3.60. A breakdown of the different sources of turnover within Newscom's newspaper publishing and printing business for the years ended June 1997 and 1998 is given in Table 3.10.

TABLE 3.10 **Newscom: analysis of turnover from newspaper publishing and printing***

	Years ended 30 June		
	1997 *£m*	*1998* *£m*	*1998* *%*
Advertising	58.0	72.6	68.6
Circulation	12.1	13.7	12.9
Leaflets	2.7	3.2	3.0
Contract printing	6.7	11.1	10.5
Other	4.2	5.3	5.0
	83.7	105.9	100.0

Source: Newscom.

*Excluding magazine printing contracts, hence lower than turnover on Table 3.9.

3.61. Advertising revenues increased by 25 per cent in 1998 compared with an increase of 13 per cent in circulation revenues. These increases were in part attributable to the Bailey acquisition.

3.62. Balance sheets for Newscom for each of the five years ended June 1998 are set out in Table 3.11.

TABLE 3.11 **Newscom: group balance sheets, 1994 to 1998**

£ million

	As at 30 June				
	1994	*1995*	*1996*	*1997*	*1998*
Tangible assets	47.3	53.9	75.2	87.0	85.5
Working capital excluding net borrowings	(0.9)	(1.5)	(0.8)	(0.1)	(2.3)
Net operating assets	46.4	52.4	74.4	86.9	83.2
Investments	0.3	0.3	0.3	0.4	0.3
(Borrowings) less cash	3.9	(0.8)	(10.0)	(38.8)	(57.0)
Creditors less debtors due after one year	1.8	1.7	1.6	1.8	1.7
Provisions for liabilities and charges	(0.4)	(0.4)	(0.8)	(0.1)	0.0
Net assets	52.0	53.2	65.5	50.2	28.2
Financed by					
Share capital	23.6	23.9	24.1	24.2	24.3
Reserves	28.4	29.3	41.4	26.0	3.9
Shareholders' funds	52.0	53.2	65.5	50.2	28.2
Goodwill written off	11.4	15.7	15.7	39.3	73.8
Revaluation reserve	(7.8)	(7.6)	(6.9)	(6.8)	(4.9)
Capital invested*	55.6	61.3	74.3	82.7	97.1
Performance ratios					*per cent*
Operating profit as a percentage of average net operating assets	20	23	18	19	26
Operating profit as a percentage of average capital invested	17	20	17	19	24
Debt to debt plus capital invested ratio	0	1	12	32	37

Source: The Commission, based on Newscom's published accounts.

*See paragraph 3.9.

3.63. Newscom's gearing (as measured by debt divided by debt plus capital invested) has increased each year to 37 per cent in 1998. This reflects the cost of a succession of acquisitions in the last five years.

The respective bid approaches

3.64. In the following paragraphs we consider various aspects of the bid approaches, in particular the prices that the parties say they are willing to pay for PSN; the effect on the companies' gearing; the relative efficiency of the parties; their external printing activities; the potential for new revenue sources, such as from the Internet and new media; and the intended benefits of the merger.

Bid prices

3.65. The market price of PSN's shares already reflects in part the premium that would have to be paid by any party in order to gain control of PSN. This is as a result of Johnston's tender offer and Johnston's subsequent announcement that it had made further share purchases at £17.50.

3.66. Table 3.12 summarizes the share prices and price earnings ratios (PERs) of the bidders and of other companies involved in publishing local newspapers at four dates over the last year. PSN's share price was around £10 in May 1998 and increased to £11 in September and has since risen with the bid expectations. We also looked at PERs for food retail businesses at March 1999 and many had PERs in the range from 13 to 16 times.

TABLE 3.12 **Summary of share prices and PERs for regional newspaper companies***

	22 May 1998		*17 September 1998*		*12 March 1999*		*27 April 1999*	
	Price (£)	*PER*	*Price (£)*	*PER*	*Price (£)*	*PER*	*Price (£)*	*PER*
Parties to the merger								
PSN	9.50	19.5	11.10	17.3	16.25†	18.4	19.25	21.8
Johnston	2.28	17.8	1.80	12.6	2.69‡	19.0	2.90	19.0
Newsquest	3.24	18.2	2.32	11.2	3.46§	13.8	4.39	19.4
Newscom	8.30	16.2	7.30	14.3	7.62¶	12.4	8.15	13.3
Others								
Trinity	5.58	17.7	4.39	14.0	5.26	15.5	5.87	17.3
Mirror Group	2.11	15.7	1.54	10.8	1.99	11.1	2.19	12.5
Southnews	5.45	¤	3.37	11.5	5.25	15.0	5.40	15.4

Source: The Commission, based on the *Financial Times*.

*The PERs take account of a company's earnings as reported in interim statements.
†PSN's price had fallen back from a high of £17.50 following Johnston's tender offer at £16.00 per share in January.
‡Johnston's price ranged between £1.47 and £2.69 over last year.
§Newsquest's price ranged between £2.09 and £3.53 over last year.
¶Newscom's price ranged between £6.56 and £8.47 over last year.
¤Not available.

3.67. At £17.50 per share PSN would be worth around £210 million. However, in order to determine the residual value of PSN's publishing and printing business it is necessary to deduct a value for PSN's retailing business since none of the acquirers wishes to retain that operation.

3.68. Johnston told us that it had not requested confidential financial information from PSN so that it would be permitted to purchase more shares beyond the 14.99 per cent it held at the time of its tender offer to PSN's shareholders. Johnston said that, based on analysts' expectations and its own estimates, it had placed a value of around £[✂] million on the retail business, implying that its estimate for the value of PSN's publishing and printing business was around £[✂] million, based on its recent purchase of PSN's shares at £17.50 a share.

3.69. Newsquest indicated to PSN that it would be prepared to make an offer for PSN's publishing and printing business alone (ie excluding the retail business) of between £[✂] million and £[✂] million, whereas Newscom suggested a value, on the same basis, in the range £[✂] million to £[✂] million.

3.70. PSN has also indicated that there may be other possible means of realizing the best value for its businesses, including a management buyout or a separate sale of the retailing business (see paragraph 3.28).

Effect on gearing

3.71. We asked each of the potential acquirers about the effect of the acquisition of PSN's newspaper publishing business on their gearing. Both Johnston and Newsquest have said that they could finance the acquisition in whole by increasing borrowings. [*Details omitted. See note on page iv.*].

3.72. All the parties told us that generally lenders require covenants based on earnings before interest, tax and depreciation and that balance sheet gearing measures are not used for the purpose of covenants. Lenders would generally expect a minimum interest cover of three times and the closer that expected performance approaches this level, the more expensive would be the cost of borrowings.

3.73. We have ourselves calculated the effect that the acquisition of PSN's newspaper publishing business would have on each company's balance sheet gearing (calculated as debt divided by debt plus capital invested). The companies have also advised us what the effect on their interest cover would be. The calculations are based on an acquisition cost for the business of £[✂] million for Johnston, £[✂] million for Newsquest and £[✂] million for Newscom. In the case of Johnston and Newsquest the calculations assume that the acquisition would be funded entirely by borrowings. In the case of

Newscom they assume funding of *[Details omitted. See note on page iv]*. The results are summarized in Table 3.13.

TABLE 3.13 **Comparison of the effect of the acquisition of PSN on each company's gearing* and interest cover**

			per cent
	Johnston	*Newsquest*	*Newscom*
Gearing pre-acquisition	22	32	37
Gearing post-acquisition	[	✄	]
			times
Interest cover pre-acquisition	9	7	6
Interest cover post-acquisition	[	✄	]

Source: The Commission, based on submissions from the companies.

*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. The value of PSN's retail business has no effect on these calculations.

Efficiency

3.74. In order to compare the recent performance of each of the four companies we have extracted their operating profit and average capital invested from the earlier tables so as to show each company's operating profit divided by average capital invested for 1998 in one table. This information is set out in Table 3.14.

TABLE 3.14 **Comparison of each company's performance for 1998**

				£ million
	PSN *31 March*	*Johnston* *31 December*	*Newsquest* *31 December*	*Newscom* *30 June*
Operating profit	12.6	51.5	81.4	21.8
Average capital invested*	78.1	231.2	280.7	89.9
				per cent
Operating profit as a percentage of average capital invested	16	22	29	24

Source: The Commission, based on published accounts.

*See paragraph 3.9.

3.75. We also compared the efficiency of each of the parties to the proposed mergers in terms of sales and operating profit per employee for the last two financial years, based on information in published accounts. Johnston did warn us, however, that such a comparison could be misleading where different production methods were used (for example, if one company outsourced services, such as printing and typesetting). The results are set out in Table 3.15.

TABLE 3.15 **Comparative efficiency of the parties to the proposed mergers**

	*PSN** *31 March*	*Johnston* *31 December*	*Newsquest* *31 December*	*Newscom* *30 June*
1998				
Sales *(£m)*	62.7	201.7	305.8	127.9
Operating profit *(£m)*	9.1	51.5	81.4	21.8
Number of employees	1,269	4,078†	5,743	2,207
Sales per employee *(£'000)*	49.4	49.5	53.2	58.0
Operating profit per employee *(£'000)*	7.2	12.6	14.2	9.9
1997				
Sales *(£m)*	59.2	212.0	285.6	105.4
Operating profit *(£m)*	6.7	45.6	71.5	15.2
Number of employees	1,298	4,573†	5,828	1,899
Sales per employee *(£'000)*	45.6	46.4	49.0	55.5
Operating profit per employee *(£'000)*	5.2	10.0	12.2	8.0

Source: The Commission, based on published accounts.

*Newspaper business only (including inter-segment turnover).

†The reduction in employee numbers is mainly due to the disposal of the bookbinding and library book selling operations.

3.76. Some allowance needs to be made for the different incidence of the companies' year-ends. However, Tables 3.13 and 3.14 would appear to indicate that in terms of performance PSN has not achieved the same level of operational efficiencies as the other three companies. For instance, although it had almost identical sales per employee to Johnston, it achieved a lower level of operating profit per employee in both 1997 and 1998.

Analysis of advertising revenues

3.77. Table 3.16 compares the turnover analysis of the four companies between advertising, circulation and other headings for 1997/98. Advertising revenues are extremely important to the newspaper groups and range between 58 and 82 per cent of total revenues.

TABLE 3.16 **Analysis of sources of revenue of the companies for 1997/98**

	PSN *31 March*	*Johnston* *31 December*	*Newsquest* *31 December*	*Newscom* *30 June*
				£ million
Advertising	36.5	153.0	249.4	72.6
Circulation	12.6	18.5	37.7	13.7
Leaflets	2.6	7.2	11.5	3.2
Contract printing and other	11.0	24.7*	7.2	16.4
Turnover for newspaper activities	62.7	203.4†	305.8	105.9‡
				per cent
Advertising	58	75	82	69
Circulation	20	9	12	13
Leaflets	4	4	4	3
Contract printing and other	18	12	2	15
Total	100	100	100	100

Source: The Commission, based on company submissions.

*This includes in-house and external printing as noted in Table 3.5.

†This excludes other activities as shown in Table 3.5.

‡This excludes magazine printing as noted in Table 3.10.

3.78. For each of the four companies we considered the extent to which advertising was split between display (local and national) and classified for the last two financial years and looked at the relative growth in each of these sectors. The results are set out in Table 3.17.

TABLE 3.17 **Comparison of sources of advertising revenues* for 1997 and 1998 accounting periods**

	1997		*1998*	
	£m	*%*	*£m*	*%*
PSN (31 March)				
Display advertising (national)	3.2	9.4	3.3	9.0
Display advertising (local)	9.9	29.0	10.1	27.7
	13.1	38.4	13.4	36.7
Classified advertising†	21.0	61.6	23.1	63.3
	34.1	100.0	36.5	100.0
Johnston (31 December)				
Display advertising (national)	10.5	7.3	10.3	6.7
Display advertising (local)	38.5	26.9	39.4	25.8
	49.0	34.2	49.7	32.5
Classified advertising†	94.1	65.8	103.3	67.5
	143.1	100.0	153.0	100.0
Newsquest (31 December)				
Display advertising (national)	18.6	8.3	19.9	8.1
Display advertising (local)	52.4	23.3	55.4	22.7
	71.0	31.6	75.3	30.8
Classified advertising†	153.8	68.4	169.2	69.2
	224.8	100.0	244.5	100.0
Newscom (30 June)				
Display advertising (national)	5.9	13.8	6.3	12.2
Display advertising (local)	9.2	21.5	10.1	19.5
	15.1	35.3	16.4	31.7
Classified advertising†	27.7	64.7	35.3	68.3
	42.8	100.0	51.7	100.0

per cent

	PSN	*Johnston*	*Newsquest‡*	*Newscom*
Growth rates:				
Display advertising (national)	3	(2)	4	7
Display advertising (local)	2	2	4	10
Total advertising	7	7	7	21

Source: The Commission, based on company submissions.

*Excluding acquisitions and disposals. Local advertising represents the sale of advertising at publishing centres. It can therefore include that from regional advertisers, who are not likely to use advertising agencies that would place business via the national advertising offices of the newspaper groups. It can also include a small amount of local advertising by national advertisers, where they give their local managers some discretion (or a small budget) to place advertisements in local papers.

†Classified advertising revenue includes that from situations vacant, motor and property.

‡1998 was a 53-week accounting period. Growth rates have been adjusted accordingly.

3.79. The companies estimated that less than 5 per cent of the local advertising carried in their titles could be classified as county-wide or regional. The position for such regional advertisers is that they are able to deal with individual local newspaper offices though there are cases where their requirements can be handled by a single point of contact.

3.80. Both PSN and Johnston use the same external sales agency (Mediaforce) to act as their representative when selling advertising space to national advertising agencies working on behalf of large clients.

3.81. Newscom told us that it handles its own sales of national advertising, which it said was the reason why it achieved a higher proportion of such advertising—in the range 12 to 15 per cent of total advertising revenues. Newsquest also carries out national sales in-house.

3.82. We asked the companies how much space they devote to free advertisements as a service for readers, or in order to compete with advertising-only publications that also offer this service for low-value advertisements.

3.83. PSN told us that the range varies between around 6 and 10 per cent of advertising space and it is rationed according to space that is paid-for. It is likely to be greater in daily newspapers than in weekly publications and is insignificant in free newspapers. PSN expects this free space to increase as it expands the categories offering it in order to attract private classified advertising from free advertising publications. By increasing the appeal of its advertising section to readers PSN hopes to attract more paid-for advertising from trade advertisers.

3.84. Johnston said that free classified advertising was introduced several years ago on low-value items (between £50 and £500), in response to the competitive threat from free advertising publications. The volume of free advertising had grown in recent years and this trend was expected to continue.

3.85. All Johnston's subsidiaries carried a measure of such advertising, although local management determined the extent in response to local market conditions. In most cases it appeared in paid-for publications, although in those few instances where they are market-leading titles, it could also be carried in free newspapers. The volume would depend on local market conditions but would typically run to one or two pages in a classified lineage section of ten pages.

3.86. Newsquest told us that the majority of its paid titles and many of its free newspapers offer free classified advertisements for private 'for sale' items, up to £1,000. This is in response to the free advertisement publications, which offer this popular service to readers. The extent of free advertisements' space in newspapers is determined by local managements and is variable with market conditions, but was not likely to exceed 5 per cent of total advertising space.

3.87. Newscom told us that it was unable to provide us with meaningful data on the allocation of 'free' classified space because this is left to individual local managements and such advertising is used as a filler when there is insufficient paid advertising. Generally, it informed us that free advertisements for articles for sale would be held without promise of when they would be published, and mainly would go into paid-for titles, where there was a requirement to produce newspapers of a particular size and quality.

External print activities

3.88. We asked each of the companies about the activities of, and their plans in relation to, their contract printing operations.

PSN

3.89. PSN has three printing sites at Sunderland, Hartlepool and Portsmouth. It regards itself as a leading contract printer in the UK. For 1997/98 its contract printing turnover totalled £11 million, of which £9.3 million was in the Portsmouth division. Overall operating profit was £3.2 million of which Portsmouth contributed £2.6 million (28 per cent margin).

3.90. PSN's Portsmouth site contract prints for the Isle of Wight County Press and for three of HCG's four titles. These contracts expire in 2000 and their continuation or extension will be a matter for negotiation with the relevant owner or controlling party. HCG expressed its concern that it might, in any event, need to find alternative printers for its titles if PSN is acquired by Newscom (see also paragraph 6.13). In this context we noted that there are a substantial number of contract printers around the country.

3.91. PSN's two sites at Hartlepool and Sunderland contract print for 18 titles including 400,000 copies of *The Sun* and the *News of the World* and 120,000 copies of the *Aberdeen Independent*.

3.92. At April 1998 PSN said that it had spare capacity at PPP of 6 per cent on its two cold-set double-width presses, and 21 per cent on its heat-set single-width press; at Sunderland it had spare capacity of 54 per cent, and some 65 per cent in Hartlepool. These two presses were only commissioned in 1997 and PSN is gradually building up contract work for them and adding appropriate shifts.

Johnston

3.93. Johnston has seven printing centres in Falkirk, Kirkcaldy, Halifax, Wakefield, Scarborough, Chesterfield and Eastbourne. These centres are used largely for printing Johnston's titles and are treated as integral to its newspaper activities.

3.94. Johnston also has three centres constituting its printing division, at Peterborough, Northampton and Burgess Hill, which arise from its EMAP acquisition in 1996. For 1998, about 30 per cent of the printing division's turnover related to external contracts, amounting to £7.5 million (£10.6 million for 1997).

3.95. Johnston said that its preference was for in-house printing, but if the economics made it viable or if its own presses could not accommodate a required print slot or a particular colour or pagination requirement, it would consider external printing.

Newsquest

3.96. Newsquest has eight printing plants at Worcester, Lostock (Lancashire), Colchester, Bradford, York, Brighton, Swindon and Oxford. For 1998, total turnover from these sites was £59.2 million of which £58.0 million was for in-house titles, leaving £1.2 million turnover for external contract printing. The overall operating profit from printing was £[✂] million ([✂] per cent). Newsquest estimated that the margin on external printing was about [✂] per cent.

3.97. Newsquest prefers in-house printing because of the control it gives it for the publication of daily newspapers, where printing is time-critical. Weekly newspapers offer greater flexibility for shifting print requirements and can be timetabled around daily newspapers. However, Newsquest still has about 15 per cent of its overall printing done by third parties under contract, and contracts are mostly short-term for a 13-week period.

3.98. At the Bradford plant, Newsquest has contracted from the second quarter of 1999 to print for the *Daily Mail* and *The Mail on Sunday*, using night-time capacity. This will increase contract printing revenue by about £[✂] million a year and the agreement is for [✂] years.

3.99. For 1999, Newsquest has budgeted £[✂] million for printing works improvements. It is also considering replacing a press (Lostock) with a refurbished press (from abroad) at a cost of £[✂] million.

Newscom

3.100. Newscom has printing plants at Redbridge, Weymouth, Plymouth, Newport, and Dursley (Gloucestershire) which handle all its internal printing needs. Its contract printing for third parties totals some £11 million a year and is aimed at using its spare capacity at weekends and overnight, which periods are invariably underutilized by local newspaper publishers.

3.101. In 1998 Newscom announced a £13 million investment in its Weymouth publishing and printing centre and a £3 million upgrade to printing plant at Redbridge. Redbridge prints copies of the *Daily Mail* and *The Mail on Sunday*, contributing around £[✂] million a year towards reducing group printing costs. It is expected that the new Weymouth facility will print the group's Gloucestershire titles (currently printed at Dursley on outdated presses) and that further external contracts will be sought to fill spare capacity.

3.102. A merger with PSN would give some scope for reorganizing the printing of the enlarged group's newspapers. Newscom sees no reason why PSN's existing external print contracts, including those with HCG, should not continue, although possibly with a wider choice of press in future.

Internet and new revenue sources

3.103. We asked each of the companies about the extent to which they were exploiting new technology such as the Internet, in order to utilize their assets and skills in new ways and generate new sources of revenue.

PSN

3.104. PSN is forecasting revenue from new media sources of £727,000 in 1998/99 and £937,000 in 1999/2000. About 45 per cent of this revenue is from leveraged advertising (ie publishing advertisements in newspapers and on the Internet), 25 per cent is from premium calls, 9 per cent is from third party advertising on PSN's website, 12 per cent from website design for customers and the balance of 9 per cent is attributable to commission from Cable & Wireless Communications plc (CWC) and from advertising on teletext.

3.105. These revenues compare with total advertising sales of some £37 million in 1997/98. Although small, these activities are costed to make a contribution to PSN's profits, and are growing.

Johnston

3.106. Johnston spent about £200,000 in 1998 to put some of its newspapers on the Internet. It plans to spend a similar amount in 1999. A number of Johnston's publishing centres now have their own web sites and there are plans for all centres to be on-line well before the end of 1999. Johnston's longer-established web sites are already generating useful revenues from a variety of on-line services, including business directories, classified advertising sites and banner advertising. Much of Johnston's classified advertising is now on-line, both locally and nationally, and more electronic services are under development to extend the breadth of services on offer. Since April 1999, Johnston has been introducing a locally branded free Internet access service, which is available via its local newspapers.

Newsquest

3.107. Newsquest had Internet revenues in the year ended 31 December 1998 of £522,000, mainly made up of [✂] per cent from advertising, [✂] per cent from site construction for advertisers and [✂] per cent from third party advertising on its web site. It hopes to increase this revenue to around £2 million to £3 million in 1999. At present Newsquest does not specifically itemize Internet investment costs as staff are involved in a mix of activities.

3.108. The main source of revenue (accounting for around [✂] per cent in 1999) and growth is from premium rates paid by advertisers for in-paper advertisements to appear in local Internet classified advertisements or nationwide 'Hunter' advertisements (for example, AutoHunter, JobHunter and BargainHunter). London and Cheshire are the two regions within the company that have developed this source of revenue the most—accounting for about [✂] per cent of group revenue from this source.

3.109. A second major initiative is 'Quartet'. This is a nationwide directory for businesses on the Internet set up as a joint venture with Trinity, Northcliffe and Associated Newspapers and incorporating features such as price lists and map directions.

Newscom

3.110. Newscom currently earns modest income from Internet activities. This business is small, employing [✂] people and around £[✂] of start-up capital. [

Details omitted. See note on page iv.

]

3.111. Newscom also provides an audiotext service. This is provided by a third party telecommunications company called TPI Ltd and involves dating services, horoscopes and reader polling. This activity generates about £300,000 a year at present.

3.112. Newscom also sees potential for other revenue sources (for example, licensing its photographic library via the Internet) and has set up a team to explore such possibilities.

Benefits of the proposed transfers

3.113. We asked each of the parties what they saw as the benefits of the proposed transfers. Generally most of the bidding parties suggested that the following were areas where benefits could be achieved:

(a) elimination of duplicate head office functions. According to PSN, head office costs total £1.7 million a year. PSN considered that a new owner in the industry could virtually eliminate all these costs;

(b) savings in newsprint and other materials through greater purchasing power;

(c) increases in advertising yields; and

(d) savings through better use of printing resources.

3.114. The parties generally did not expect savings to come through large reductions in PSN's workforce (see also sections dealing with employment effects in Chapter 5). Overall, the bidders suggested that a range of savings, up to several million pounds a year, could be achieved, as we note in the following paragraphs.

Johnston

3.115. Johnston told us that its estimates were based on information in the public domain, as it had not requested confidential PSN information. It foresaw savings in head office costs of £[✂], £[✂] from savings from not running a plc, £[✂] from consolidation of accounting and related administrative functions, £[✂] from newsprint savings, £[✂] in materials and £[✂] from savings in cars, phones, and payroll. These total £[✂] million. Johnston could not estimate improvements in advertising yields but had no plans for rate increases as a consequence of the merger. It also hoped for printing synergies but could not place a value on this.

3.116. Johnston estimated that PSN's requirement for newsprint was around 20,000 tonnes a year compared with its own usage of 50,000 tonnes a year, on which savings in prices of up to £[✂] a tonne might be possible. Johnston also considered that there would be savings on the purchase of inks and benefits from reorganizing printing activities around the enlarged group.

Newsquest

3.117. Newsquest provisionally estimated savings of about £[✂] million a year, attributable primarily to £[✂] million off newsprint costs, £[✂] million off head office costs and £[✂] million off back-office costs in each of PSN's two centres. Further benefits could derive from better use of printing capacity, adding more colour titles, bringing national sales representation in-house and from higher leaflet sales.

3.118. Newsquest also considered that it could improve on PSN's current profit margins and estimated that around [✂] per cent would be achievable (taking Newsquest's own current margins as a guide). It noted, however, that contract printing has a much lower margin at about [✂] per cent and it would aim to use PSN's facilities to bring in-house some of its external printing, where possible.

3.119. Newsquest has also allowed for a one-off provision of £[✂] million relating to post-acquisition reorganization costs. It had not done detailed due diligence and therefore could not provide detailed support for this provision, which could include costs to terminate onerous contracts, lease termination costs and some redundancies at head office.

Newscom

3.120. Newscom had not done extensive due diligence, but its preliminary view was that it could achieve improvements in PSN's performance of around £[✂] million a year by the second year following acquisition. This would be achieved from improved advertising revenue (£[✂] million), reduced newsprint costs (£[✂] million), realignment of retail terms to Newscom levels (£[✂] million), reduced overheads (£[✂] million), and the elimination of employment duplication at group administrative levels (£[✂] million).